Revised Monetary Programme of the NBS for 2002

INTRODUCTION

The Revised Monetary Programme (RMP) is a standard material that follows up the Monetary Programme approved in December 2001. Compared with the Monetary Programme, the values in the RMP have been adjusted and updated as per definitive figures for 2001 and it takes into account the development of macroeconomic indicators since the beginning of 2002.

The end-year figures of inflation in 2001 were below the bottom level of the programme interval, while average inflation was in line with the Programme values. There were no changes in the development trend of the price level in the course of last year, but only minor fluctuations in the last months of the year, primarily resulting from changes of oil prices. Thus, despite positive development of headline and core inflation, with regard to risks in the fiscal area, the NBS is not changing its Programme intervals for development of inflation (headline and core inflation) for the year 2002.

Development of the current account of the balance of payments in 2001 exceeded the programme level, which was influenced by higher than expected dynamics of domestic demand. In the RMP compared with the Monetary Programme, the NBS revises the level of the trade balance deficit and the deficit of the whole current account, which is associated with the development in the first quarter of 2002, in particular with an anticipated increase of the fiscal deficit. Within the RMP the level and the structure of the capital and financial account was modified, which already takes into account the current development in the first months of 2002, as well as specification of the volume and use of privatization proceeds.

The fiscal deficit in 2001 was in line with the programme level, while in 2002 the level will not be kept, as enacted in the State Budget Act at 3.5 percent of the GDP (without costs of restructuring of banks). The Revised Monetary Programme assumes an increase of the fiscal deficit to 4.5 percent of GDP, i.e., SKK 46.8 billion (without costs of restructuring of banks). This increase is associated with expected influence of privatization proceeds on domestic demand.

Based on a decision of the government about the use of privatization proceeds in 2002, the volume of resources to influence domestic demand (by settlement of obligations toward the national railway company ZSR, health insurance companies, resolving price differences for heat deliveries, compensation to municipalities for gas distribution networks development, etc.) is estimated to be approximately SKK 10 billion.

The RMP also includes a medium-term outlook that was influenced by a change of the starting point, i.e., the year 2002, as well as by the change of privatization activities of the government of the Slovak Republic (sale of power distribution companies already in 2002 instead of 2003). Values of individual macroeconomic indicators however have not changed significantly compared with values in the Monetary Programme of the NBS.

1. Year 2001

1.1 Inflation

Rate of inflation, measured by growth of consumer prices, in December 2001 compared with December of the previous year reached 6.5 percent, while core inflation was 3.2 percent. Compared with forecasts of the Revised Programme of the NBS for 2001, the end-year headline as well as core inflation were lower.

Consumer prices (in %)

		MP 2001	**RMP 2001**	**Estimate for 2001** /1	**Revised estimate for 2001** /2	**Result December 2001**
Core inflation	**year-on-year rate**	3.6 - 5.3	3.6 - 5.3	4.2 - 4.6	2.9 - 3.2	3.2
Inflation	**year-on-year rate**	6.7 - 8.2	6.7 - 8.2	7.3 - 7.7	6.3 – 6.5	6.5
	average year-on-year rate	7.1 - 8.3	7.1 - 8.3	7.5 - 7.6	7.3 – 7.4	7.3

/1 estimate published in October 2001 (based on development until August)
/2 estimate based on current development until November 2001

A greater slowdown of consumer price growth in the second half of 2001 was caused by a major drop of the crude oil price on the world markets (its price was below the reference interval of the Organization of Petroleum Exporting Countries – OPEC) with a subsequent drop of motor fuel prices. The National Bank of Slovakia in its Revised Monetary Programme for 2001 (RMP) anticipated the price of this strategic commodity within the reference interval. Abstracted from the development of fuel prices, core inflation would have been 0.7 percentage points higher (3.9 percent) which would be a level within the programme interval in the RMP 2001. The price development in individual basic segments of the consumer basket (prices of food, tradable goods – without motor fuel prices, market services, and regulated prices) was in line with expectations of the NBS.

1.2 Producer prices

Prices of industrial producers increased in 2001 on average by 6.6 percent, which compared with the estimated development as a basis for the Monetary Programme 2002 (7 percent) represents a slowdown of growth rate by 0.4 percentage point.

Slower growth of industrial producer prices in 2001 compared with expectations was caused by external cost factors the influence of which became visible mainly in the second half of the year. A significant impulse was the major drop of oil price on the world markets at the end of the 3rd quarter as a consequence of slower economic growth in the world and subsequent drop of demand for this strategic commodity. This was reflected in a deepening year-on-year decline of refinery products prices and prices of products of the chemical industry. Other factors included falling prices of raw materials on the world markets that were reflected in prices of the pulp and paper industry (their year-on-year growth decelerated on average during the year) and prices of base metals and metal products (in this branch the effect of price decline on world markets was reflected at the end of the year).

Among producer prices, the fastest growth achieved agricultural products prices that increased year-on-year on average by 7.8 percent (NBS estimate 7.5 percent). Prices of plant products, including fruit and vegetable prices grew significantly (by 11.2 percent year-on-year) which was associated with higher prices of all types of grain imported to the Slovak Republic as a result of both, insufficient crop and drought in the year 2000. Average year-on-year price growth of animal products was 6.6 percent. Above all the price of beef grew slower because of a shift of demand for other types of meat (BSE infection). Higher price growth of agricultural products compared with expectations of the NBS was primarily influenced by the situation in animal farming, where interventions of the State Market Regulation Fund prevented a more significant decline of beef prices in the last months of the year.

Development of producer prices (year average, index: the same period of the previous year=100)

	1999	2000	Estimate 2001*	Result 2001
Industrial producer prices	103.8	109.8	107.0	106.6
Construction works prices	111.0	109.0	106.8	106.8
Construction materials prices	101.8	106.0	107.0	106.8
Agricultural prices	98.2	107.2	107.5	107.8

* mid values

1.3 Balance of payments

The trade balance deficit in 2001 reached SKK 103 billion. Although during the year the NBS gradually increased its estimate of the deficit, (from originally SKK 50.7 billion to SKK 64.1 billion in the RMP, and from SKK 91 billion to SKK 100 billion in the end-year estimate in November) the real level of the trade deficit exceeded all expectations of the NBS.

Reasons for the deficit can be sought both on the side of demand as well as offer, which reflected in other than expected development of both imports and exports. The National Bank of Slovakia overestimated the development on the offer side and underestimated factors that in 2001 influenced the development of domestic demand and subsequently also the level of imports.

On the side of domestic demand the factors where the NBS underestimated their influence or did not take them into consideration at all include:

- higher growth of domestic demand, which exceeded estimated values
- higher than expected share of imports to satisfy higher growth of demand, and in case of fixed capital (because domestic offer could not satisfy demand for higher technological level), as well as goods for final consumption (where a relatively low share of domestically produced durable goods became apparent). Higher share of imports from GDP was visible also in the case of raw materials and semi finished products, where despite lower crude oil prices import intensity increased by more than 2 percentage points.

Rising share of foreign offer in covering aggregate demand that appeared in 2001 documents a growing import intensity of the entire domestic production and can mean a risk for the development of imports in the upcoming years, whereby it is difficult to estimate the relationship between GDP growth and growth of individual components of imports.

The higher trade deficit was not determined only on part of imports but also by lower export ability of the Slovak economy during slower economic growth of our main trading partners. Although Slovak exports reached double digit growth, lower dynamics of growth compared with expectations of the NBS (on average by 2 percent) was to a great extent a consequence of overestimating the structure of Slovak production and its sensitivity on cyclical development, as well as the time factor of restructuring, above all in the automotive industry.

In comparison with some countries of central and eastern Europe, the deficit on the current account worsened in the Slovak Republic in 2001, which was linked to a combination of several factors. On the one hand, it was the commodity structure of exports, which is more sensitive to development of economies of our largest trading partners. On the other hand, the revival and acceleration of domestic demand contributed to the current account deficit.

	Domestic demand growth in fixed prices		Share of current account deficit on GDP	
	2000	2001	2000	2001
Hungary	4.7	3.3	-2.9	-2.2
Poland	2.6	-1.3	-6.3	-4.0
Czech Republic	2.2	4.2	-5.6	-4.7
Slovenia	1.1	1.1	-3.4	0.0

Compared with the NBS estimate that was included in the Monetary Programme for 2002, development of the current account of the balance of payments differed from preliminary data in 2001 apart from the trade balance also in the balance of services item.

Balance of payments

	2001 – MP	2001 – RMP	2001– estimate	2001
Trade balance	-50.7	-64.1	-91.0	-103.2
Balance of services	18.5	18.8	18.5	23.2
Balance of incomes	-11.7	-14.7	-16.1	-15.1
Current transfers	5.5	5.5	10.5	10.2
Current account	**-38.4**	**-54.5**	**-78.1**	**-84.9**

Unlike the trade balance, the balance of services recorded an improvement compared with the estimated value by SKK 4.7 billion. This improvement ensued from a combination of a differing development compared with the prediction in two items. While net revenues from foreign trade were substantially higher than estimated values (higher revenues from tourism of SKK 9.5 billion, which apart from rising revenues from foreign tourism in 2001 were also influenced by rising deposits in foreign exchange accounts of the population, presumably associated with gained revenues or deferred expenses from previous years. A more significant growth of deposits in foreign currencies was registered in particular in the last three months of the year and was presumably associated with conversion of foreign currencies of member countries of the European Union to the euro), estimated deficit of “miscellaneous services total” was undervalued compared with the real development (by approximately SKK 5 billion).

Current transfers in the MP and the RMP were estimated based on the development in the year 2000. Their difference compared with the real value in 2001 (by SKK 4.7 billion) was associated with the fact that the development in the past years was very volatile and did not follow trends or predictable influences. With regard to the fact that the surplus of current transfers in the course of 2001 has been increasing, the estimate made in November was already close to the real figure.

The current account in 2001 ended in a deficit of SKK 84.9 billion (8.8 percent of GDP), which represents a significant worsening compared with Programme values. Significantly overstepped trade balance deficit compared with predictions also influenced the difference in the prediction of the current account.

The capital and financial account of the balance of payments in 2001 reached SKK 83.2 billion surplus, and slightly overstepped the estimated levels from the RMP and the estimate that was a part of the MP for 2002 (the MP for the year 2001 included other values of privatization revenues, including the privatization of SPP).

Balance of payments 2002 SKK billions

	2001 – MP	2001 – RMP	2001– estimate	2001
Capital transfers	5.4	5.4	0.5	3.8
Direct investments	122.0	54.8	52.0	55.0
Portfolio investments	17.3	28.5	12.5	-10.5
Loans received from abroad	5.9	-10.8	15.5	-4.8
Loans provided abroad	0.5	0.5	-1.0	-0.7
Net short-term financial account	-20.8	-4.6	0.2	40.4
Capital financial account	**130.3**	**73.8**	**79.7**	**83.2**
Change of reserves (-, growth)	**-92.0**	**-19.1**	**-1.5**	**-6.9**

Predicted values and real development of the capital and financial account of the balance of payments in their structure differ primarily in items of portfolio investments and short-term financial account.

In portfolio investments, despite the anticipated inflow in reality there was an outflow. This was caused by differing development of assets as well as liabilities. On the side of assets, commercial banks bought into their portfolio a large volume of foreign securities. On the side of liabilities, a lower inflow of resources was associated with a change of financing of corporate entities (in predicted values that were based on development in previous years, it was expected that corporate entities will continue using long-term resources in the form of fiduciary loans that are a component of portfolio investments).

Short-term financial account in 2001 reached SKK 40.4 billion. Higher inflow of short-term capital compared with estimated values was associated with higher demand of corporate entities (companies and commercial banks) for borrowing in the form of short-term resources. In commercial banks the difference was caused also by tied depositing of a part of foreign exchange privatization revenues. Commercial banks allocated the inflow of these resources on the side of assets in the form of securities, which reflected in the aforementioned increased outflow of capital in the form of portfolio investments.

Preference of short-term resources by corporate entities caused that in 2001 instead of an expected inflow of long-term capital, there was an outflow of SKK 5.4 billion. The banking sector also played an important role in the structure of long-term capital, where a subordinated debt was repaid in two commercial banks in December.

Foreign exchange reserves of the NBS on December 31, 2001, were USD 4.2 billion. Their level was sufficient to cover 3.0 times the average monthly import of goods and services in the year 2001.

Financing of the current account in 2001 was not problematic despite the significant growth of its deficit. The capital and financial account cleared of activities of the government and the NBS, the result of which had an influence on a change of the balance of reserves of the NBS, ended with a surplus of SKK 78.9 billion.

Balance of payments adjusted by activities of the government and the NBS SKK million

	January -December 2001	
	Real*	Adjusted**
Current account	-84 891.5	-78 386.4
Capital and financial account (without NBS transactions)	84 360.7	78 918.7
Unassigned items	8 585.4	8 585.4
NBS transactions including interventions	-1 187.7	-1 187.7
Change of net foreign activities of commercial banks (-growth)		-7 930.0
Change of reserves of the NBS (-growth)	-6 866.9	

* original structure of the balance of payments, i.e., influence of collection and payments on reserves of the NBS

** cleared of influences of the government and the NBS that do not have an effect on the position of commercial banks toward nonresidents and to not represent real financing of the current account

To finance the adjusted current account, resources were used that came into the banking and corporate sectors primarily in the form of direct investments (44 percent without privatization activities and including other capital within FDI) and portfolio investments (23.5 percent). Net foreign assets of commercial banks increased by SKK 7.9 billion.

	2000			2001		
	SKK bln.	Share of FDI in %	Share of c/a in %	SKK bln.	Share of FDI in %	Share of c/a in %
Foreign direct investments (FDI) in the Slovak Republic	97.8	100	301.9	71.3	100	84.0
thereof: capital interest	93.4	95.5	288.3	57.0	79.9	67.1
thereof: privatization FDI	42.1	43.0	130.0	33.9	47.5	39.9
Other capital interest	51.3	52.5	158.3	23.1	32.4	27.2
Other capital	4.4	4.5	X	14.3	20.1	X

Capital and financial account (adjusted) was sufficient to finance the current account and therefore during the year 2001 there was no pressure toward depreciation of the exchange rate. In a year-on-year comparison, the exchange rate in 2001 toward the EUR strengthened by 2.8 percent and toward the USD it weakened by 2.3 percent. Expressed as average figures, the exchange rate weakened toward the EUR (1.7 percent) as well as the USD (4.6 percent). The NBS influenced the exchange rate by direct and indirect interventions. It intervened directly on the foreign exchange market at the beginning of the year with insignificant volume (on aggregate sale of EUR 44 million), while during the year it sterilized incoming foreign exchange proceeds from privatization, which represents an indirect form of intervention (against appreciation of the exchange rate).

1.4 Gross domestic product

According to preliminary data, gross domestic product in 2001 grew in a year-on-year comparison by 3.3 percent[1] at constant prices, and exceeded the upper limit of the Programme and estimated interval of the NBS. Accelerated economic growth was recorded in particular in the last quarter. While year-on-year growth of real GDP in the first three quarters was 3.1 percent, in the last quarter it reached 3.9 percent. On the usage side, GDP development was influenced by rising domestic demand (including statistical discrepancy) that grew by 7.3 percent. The difference compared to an estimated rise by 4.8 percent resulted from faster than expected growth of the main components of domestic demand – gross investments and consumption.

(year-on-year change in %)

	MP 2001	RMP 2001	Estimate 2001	Result 2001
GDP at constant prices of 1995	2.8-3.2	2.8-3.0	2.8-3.0	3.3
Domestic demand*	3.9	4.3	4.8	7.3
thereof				
Final consumption total	2.0	1.6	2.8	4.3
Final consumption of households	2.1	2.5	3.0	4.0
Final consumption of nonprofit institutions serving households	-	-	-	2.9
Final consumption of government	1.7**	-0.8**	2.3**	5.2
Gross capital formation *	8.3	10.2	9.1	13.7
Gross capital formation	3.5	9.4	11.5	11.6
Net export	x	x	x	X
Export of goods and services	5.5	3.0	6.8	6.5
Import of goods and services	6.8	5.0	9.4	11.7

* including a statistical discrepancy, which since the first quarter of 2001 the Statistics Office of the Slovak Republic reports separately and does not include it in domestic demand

** including nonprofit institutions serving households. It is not possible to separate consumption of the public sector, since in the MP, RMP, and the estimate for 2001 the development of both components was given jointly as one value.

Reasons for the difference between the estimate and real development can be found at several levels. The starting point for the estimate was data for the first half of 2001 that still did not document such a dynamic growth of components of domestic demand as those achieved during the year. In the first half of the year, real GDP grew by 2.9 percent with consumption growing by 3.1 percent (within which household consumption grew by 2.8 percent) and gross fixed capital formation grew by 12.2 percent. Export of goods and services in this period grew by 10 percent at constant prices and import by 15.4 percent, the results of which was that the deficit of net export exceeded SKK 10 billion. It was assumed that these tendencies will continue in the second half of the year, however, with faster growth of the deficit of net export, and the consequence of this was that the programme interval of real GDP growth was left unchanged in the interval 2.8 to 3.0 percent. With regard to the expected higher deficit of foreign trade compared with the RMP, it was expected that GDP growth would be at the lower border of this interval. This assumption was further underlined by relatively pessimistic expectations after

[1]When GDP is created using ESA 95 methodology, the effect of hidden economy is also partly reflected

September events in the United States, when several institutions corrected their prognoses and lowered their growth estimates of world's and local economies.

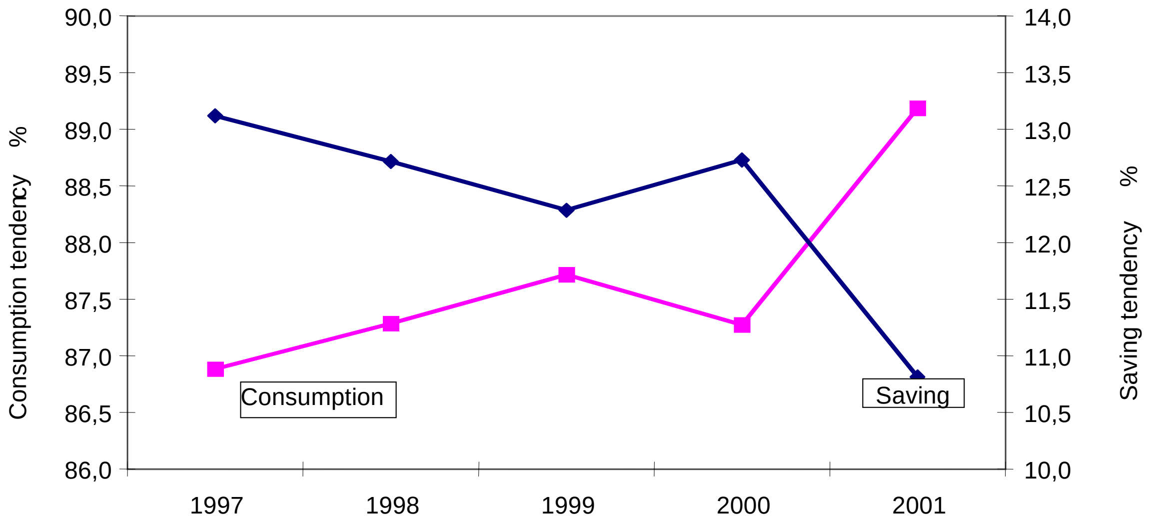
However, data published by the Statistical Office of the Slovak Republic for the third quarter did not confirm these prognoses. Apparently, the slowdown of the world economy did not influence the economy of the Slovak Republic to an extent as was expected, and this did not happen in the fourth quarter either. On the contrary, growth rate of the real GDP in the third quarter accelerated to 3.5 percent and in the fourth quarter to 3.9 percent.

Development in the fourth quarter was specific in that GDP growth was supported exclusively by domestic demand accompanied by an unforeseen drop of export of goods and services. Within domestic demand, in particular the growth rate of private consumption accelerated. Influence of the external environment reflected in a combination with domestic factors (restructuring of production of motor vehicles, etc.) in a decrease of real export of goods and service and subsequently in a deepening deficit of net export, which in the fourth quarter reached SKK 16 billion. This was the highest level since the end of 1998.

Gross capital formation grew by 13.7 percent on aggregate during the year (instead of estimated 9.1 percent). Fixed investments increased in line with estimates by 11.6 percent year-on-year (the estimate was 11.5 percent). The difference between the real and estimated development of gross capital was in accumulation of inventory. The change in inventories, including statistical discrepancy, exceeded the estimated value by almost SKK 10 billion (result SKK 31.1 billion, estimate SKK 21.5 billion) and reached the highest share of the GDP since 1993. Buildup of inventory was associated primarily with development of foreign trade, where import of goods was in part directed into inventory, primarily of tradable goods. A simultaneous decrease of exports caused that a surplus was achieved of the stock of finished products for a prevailing part of tradable sector.

Within consumer demand, final consumption of households increased by 4 percent (instead of estimated 3 percent) as a result of other than wage influences, when real wages grew by 0.8 percent (which was in line with expectations). Growth of private consumption was a result of a sharp increase of the tendency of the population toward consumption at the expense of savings (in the year 2000 the savings rate was 12.7 percent, in 2001 it dropped to 10.8 percent), whereby the importance of this influence was underestimated. Rising tendency toward consumption appears as a relatively unambiguous result of long lasting income and consumption deficiency in the household sector. Apart of these lasting factors, the tendency toward consumption was enhanced by the redemption of bonds of the National Property Fund to the population (however, its use for consumption was higher than estimated; almost 100 percent was spent compared while the estimated level of 70 percent), and a widespread system of consumer credits from retailers, instalment sales, and other sale benefits. A drop of interest rates on the one hand could have had a certain influence on decreased motivation of households toward saving, while on the other hand it supported a rise of consumer loans.

Use of gross disposable income



Final consumption of the government grew by 5.2 percent (instead of estimated 2.3 percent). The difference in growth rates were caused by methodological problems with reporting consumption of nonprofit institutions, which the Statistical Office of the Slovak Republic reports separately, however, with regard to its small volume in prognoses it is usually included under miscellaneous components of consumption (with regard to anticipated transformation of organizations from the public sector to nonprofit organizations, the NBS includes them in final consumption of the government). The volume of final consumption of nonprofit institutions in 2001 in fixed prices was SKK 3.6 billion, however, the estimate counted with a substantially lower value. This was the main reason why the volume of final consumption of the government came close to the estimate (result SKK 135 billion, estimate SKK 134.8 billion), however, growth rates differed when consumption of nonprofit institutions was added. According to a statement from the Statistical Office of the Slovak Republic, public consumption was in particular a reflection of higher creation of added value in the sub-sector social security funds. The selected methodological approach in this period caused that settlements made by health insurance companies to hospitals were recorded in accounts at the time a payment was made and not at the time when the title to payment originated, as in other sectors of the economy.

The use of revenues from privatization transactions carried out by the NPF had a substantial influence on growth of final consumption of households as well as the government, whereby this effect was difficult to quantify in advance. Total volume of revenues the NPF used was SKK 42 billion. Thereof more than 35 percent was used for redemption of privatization bonds for the household sector, which triggered an increased tendency toward consumption (the NBS estimate did not count with full use of these resources for consumption). Another part was transferred to accounts of health insurance companies, which had a direct impact on final consumption of the government.

Rising investment demand, build-up of inventory, and renewed growth of consumer demand, with an insufficient reaction of domestic offer, caused an acceleration of imports. In fixed prices import of goods and services grew 11.7 percent (estimate was 9.4 percent). On the other hand, growth of foreign demand after being ahead of domestic demand for four years now slightly lagged behind and reached 6.5 percent (estimate was 6.8 percent). As a result of this development, the deficit of net import has almost doubled over the estimated value (real deficit was - SKK 28.7 billion, estimate was - SKK 15 billion). This had a significant negative contribution of net export to GDP growth. From the viewpoint of GDP, domestic demand has fully compensated this and moved the growth rate of GDP to the upper limit of the estimated interval. Real GDP in fixed prices was SKK 3.2 billion higher than the estimated value.

Contributions to GDP growth (fixed prices of 1995)

	MP 2002	RMP 2001	Estimate 2001	Result 2001
GDP growth in percent*	3.0	2.8	2.8	3.3
Contribution of domestic demand in percentage points	3.8	4.3	4.8	7.3
Contribution of net exports in percentage points	-0.8	-1.5	-2.0	-4.0

* calculation according to table supplements to the MP without taking into account the range of GDP growth

In nominal terms, gross domestic product grew by 8.7 percent and reached SKK 964.6 billion (compared with the estimate it was SKK 2.4 billion lower). Real development at current prices differed from the estimate as a result of slower growth of consumer and producer prices than was their anticipated development when the estimate was prepared (September 2001).

	MP 2002	RMP 2001	Estimate 2001	Result 2001
GDP at current prices				
SKK billions	960.0	962.0	967.0	964.6
year-on-year growth in percent	8.4	8.4	9.0	8.7
Year-on-year growth of GDP deflator in percent	5.2	5.5	6.0	5.3

In line with expectations, value added in particular in market services had a growing influence on the creation of GDP. In industry, its creation was close to the level of the year 2000, whereby in industrial production it increased. Value added in nonmarket services, agriculture, and building sector had a moderate pro-growth influence on the GDP development.

1.5 Wages and employment

Revised estimate of nominal and real wages for 2001 included in the MP for 2002 assumed growth of nominal wages by 8.6 percent and real wages by 1.1 to 1.2 percent, with average inflation of 7.3 to 7.4 percent.

According to data of the Statistical Office of the Slovak Republic, the average nominal monthly wage in 2001 grew year-on-year by 8.2 percent to SKK 12,365. Growth rate was 1.7 percentage points faster than on a year ago. Nominal wage growth was influenced in particular by acceleration of its tempo in the third quarter (to 8.3 percent) and in the fourth quarter (to 9.3 percent), which was to a certain degree linked with the fact that in the second half of the year the downward effect ceased of low wages paid to workers employed in public works projects (the programme of public works projects was started in August 2000 and was projected into the comparison basis of the second half of the year 2000).

Real wages grew 0.8 percent year-on-year (in the year 2000 they dropped 4.9 percent), supported by faster growth of nominal wages and slower growth of consumer prices. Most marked effect of higher growth of nominal wages and lower growth of inflation appeared in the 4th quarter, when at 9.3 percent nominal wages and 6.7 percent of inflation real wages grew 2.4 percent.

Actually achieved growth of average nominal wages of employees in the national economy (8.2 percent) in 2001 was in line with expectations of the NBS, growth of real wages (0.8 percent) was slightly below the lower level of the interval, which was caused by the fact that the scope of real wage growth was calculated from the interval of inflation and not from the possible lower limit of growth of nominal wages.

In its Monetary Programme, the NBS expected year-on-year growth of employment by 0.5 to 1 percent, and subsequently growth of labour productivity from GDP in fixed prices by 1.8 to 2.3 percent.

According to statistical reports, employment in 2001 grew by 1.5 percent.

The more notable growth than anticipated in the MP 2002 was influenced by higher dynamics of employment growth in the sector of real estate, leasing, and market services, and in the sector of transport, as well as lower dynamics of decline in other public social services and personal services.

Higher growth of employment compared with the estimate influenced the development of labor productivity, which despite positive GDP development at constant prices grew by 1.8 percent, which was at the lower limit of the interval estimated by the NBS. The relationship between real wages and labor productivity developed in line with expectations of the NBS when growth of labor productivity was 1.0 percentage points higher than growth of real wages (NBS estimate was 0.7 to 1.2 percentage points).

1.6 Public sector

Revised Monetary Programme for 2001 assumed a deficit of the state budget of SKK 37.2 billion, and a deficit of the public sector (in line with the Staff Monitored Programme) of SKK 37.8 billion, i.e., 3.94 percent of GDP (without costs of bank restructuring).

Total revenues of the state budget (without grants and transfers) in 2001 were SKK 191.6 billion, which means they were overstepped by SKK 11.0 billion, and expenditures (including costs of bank restructuring) were SKK 236.0 billion, and the budget deficit was SKK 44.4 billion. This deficit comprised a deficit of current operations of the state budget (SKK 36.4 billion) and a deficit ensuing from bank restructuring (SKK 8.0 billion), which is evaluated separately in line with the state budget law. It can thus be said that although the planned deficit was maintained, revenues that exceeded the planned level were used to increase expenditures and not to reduce the state budget deficit.

According to the Final State Account of the Slovak Republic for 2001 the aggregate deficit of public finances was SKK 37.4 billion, i.e., 3.87 percent of GDP, which means expectations of the Monetary Programme of the NBS were fulfilled.

2. Revised Monetary Programme for 2002

2.1 Inflation

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

Current development from January to April 2002

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

Development of consumer prices until April was in line with expectations of the MP 2002, when it was characterized in particular by an absence of cost factors. From the viewpoint of the external environment, low cost pressures were determined by gradual appreciation of the Slovak currency to its reference currency and favorable development of energy prices on the world markets. In the first three months of the year 2002, the price of crude oil remained below the reference interval of the organization of petroleum exporting countries OPEC. At the end of March and the beginning of April the price of crude oil increased again to about 26 USD/barrel.

From domestic factors, as expected in the MP 2002 price development was influenced in particular by a slowdown of the deregulation process compared with the year 2001. In line with expectations of the Monetary Programme, at the beginning of the year within regulated prices an administrative upward adjustment of heat prices by 7 percent came into effect, which at the same time significantly lowered the contribution of the sector of regulated prices to headline inflation. A deceleration of deregulation caused a slowdown of year-on-year inflation by 2.8 percentage points. In an environment of a significant reduction of cost pressures and at the same time weak demand pressure however, so far in 2002 there has been a gradual and general year-on-year price growth deceleration.

Consumer prices in April 2002				
Consumer basket structure	Calculated weight as of March 2002/2	Change over		
		March 2002	April 2001	December 2001
Total	100.0	0.4	3.6	2.3
Regulated prices in percent	23.6	0.1	5.3	1.7
Share of total in percentage points	*0.0*	*0.02*	*1.22*	*0.41*
Influence of a change of indirect taxes in unregulated prices – share of total in percentage points		0.00	0.35	0.41
Core inflation in percent	76.1	0.5	2.6	1.9
Share of total in percentage points		*0.40*	*1.99*	*1.47*
thereof: Food prices in percent	21.1	0.2	3.6	2.9
Share of total in percentage points		*0.04*	*0.75*	*0.60*
Tradable goods in percent/1	36.9	0.9	1.6	1.7
Share of total in percentage points/1		*0.33*	*0.62*	*0.62*
Market services in percent /1	18.1	0.2	3.5	1.4
Share of total in percentage points		*0.04*	*0.63*	*0.25*
Net inflation (without influence of a change of indirect taxes) in percent	55.0	0.7	2.2	1.6
Share of total in percentage points		*0.36*	*1.25*	*0.87*

Source: Statistics Office of the Slovak Republic
/1 calculation of the NBS from data of the Statistics Office of the Slovak Republic
/2 because of methodology of adjusting changes of indirect taxes, the sum of weights does not equal zero

Assumptions of the Monetary Programme and expected development until the end of the year

The level of uncertainty in the estimate of inflation when the Monetary Programme of the NBS was compiled for 2002 was aggravated by the fact that from 2002, inflation should be reported on the basis of a new consumer basket. At the time when the Monetary Programme was prepared, its definitive structure was not known yet so estimates were used based on the old consumer basket.

Recalculation of expected price growth in 2002 on the new consumer basket basis however, is comparable with the expectations in the MP 2002. The revisions of the consumer basket should result in differing price growth in the sector of regulated prices only. According to the MP 2002, growth in this sector was expected in the interval 4.7 to 5.5 percent, however, on the basis of the new consumer basket, growth of regulated prices should be 3.4 to 4.3 percent. In year-on-year inflation, this means a lower contribution by about 0.4 percentage points. The reason for these differences is the fact that weight of some regulated prices in the new consumer basket decreased. For the year 2002 this means that an increase of the price of heating by 7 percent represented a contribution to headline inflation in January of 0.3 percentage points, while according to the old consumer basket it would have been 0.6 percentage points.

When inflation was estimated in the MP 2002, changes of indirect taxes were not expected. An increase of the excise tax on cigarettes and tobacco in January 2002 represented a contribution to inflation by 0.4 percentage points, which in the estimate of headline inflation in the basis of the new consumer basket compensates for the lower contribution of the sector of regulated prices. When this effect is included in the calculation, the influence of administrative measures on inflation in 2002 should be approximately the same as expected in the MP 2002.

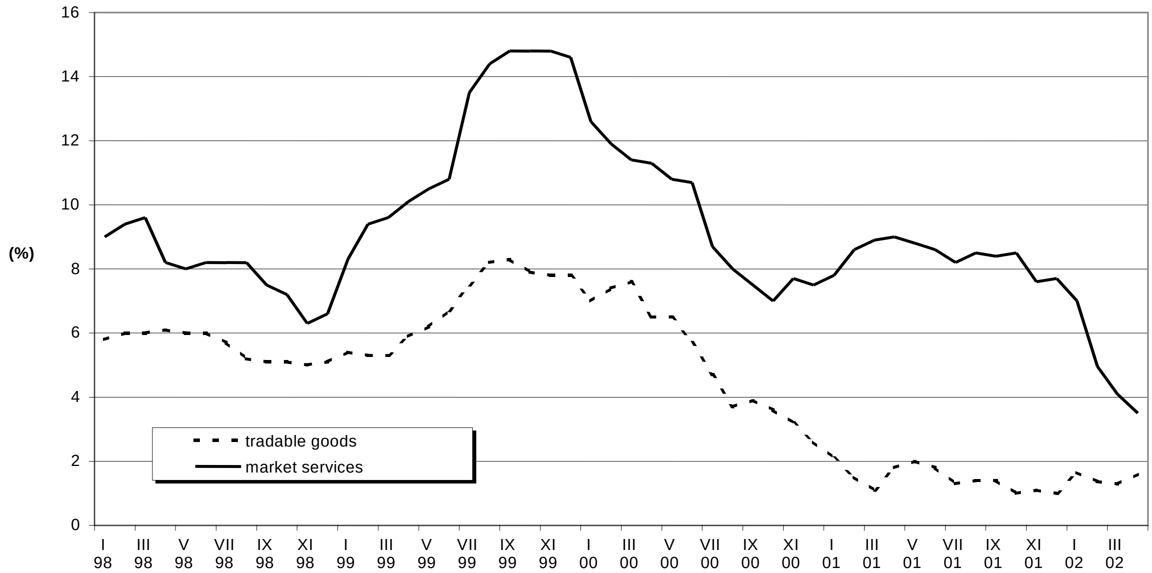
Within the structure of core inflation, price development until April 2002 indicated some differences compared with expectations in the MP 2002. An absence of inflation pressures causes to a greater extent on a general decline of the dynamics of consumer price growth.

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

One of the reasons can be continuing to satisfy unrealized consumption from 1999 and 2000. Increasing final consumption of households is concentrating on the tradable sector, which reflects in rising imports. In the sector of tradable goods, increased demand is mitigated by low imported inflation, an exchange rate that has been stabilized over a long period, but above all a strong competitive environment. Nevertheless, growth rate is increasing slightly.

Decelerated price growth of market services significantly reduced also the so-called dual inflation (the difference of the price growth rate of market services and tradable goods without food). In April, dual inflation was 1.9 percentage points while in 2001 it represented around 7 percentage points. This indicates that a major part of dual inflation from 1999 to 2001 was not caused by Balassa-Samuelson effect, but by transmission of secondary effects of increased input costs (not wages) into consumer prices of market services. Existence of Balassa-Samuelson effect is confirmed by differing development of unit labor costs and price growth between tradable and non tradable sector at the level of the economy. A transmission of this effect into consumer prices however is not very visible at present.

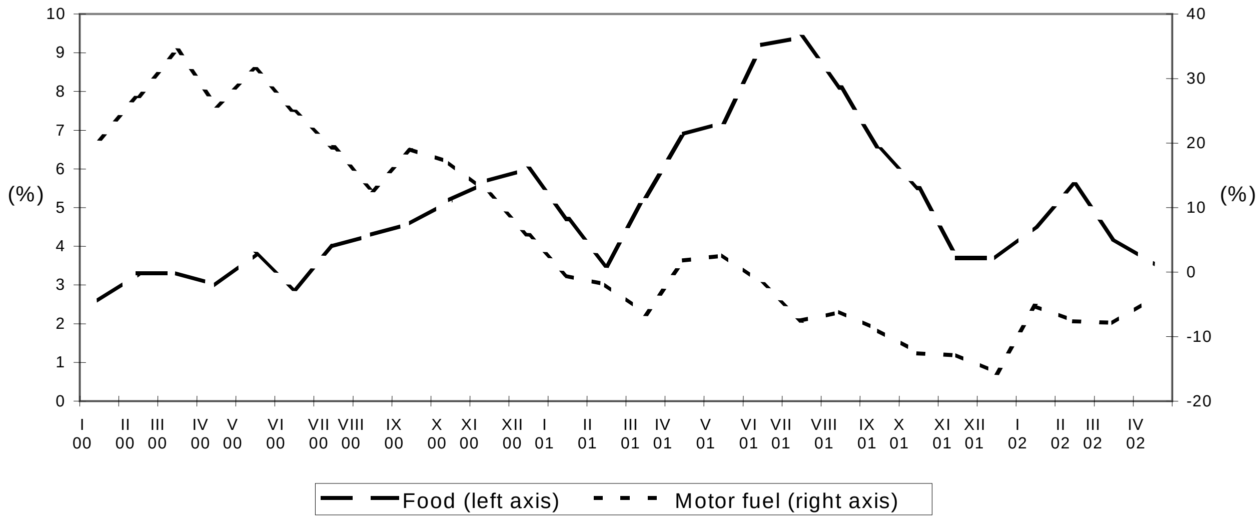
Development of tradable and non tradable sector prices
(year-on-year growth in %)



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

Apart from the influence of differing price levels of 2001, a change of trend of the inflation rate in the second half of 2002 could be slightly pro-inflationary influenced by an anticipated recovery of external demand accompanied by price rises of industrial commodities.

Sub-aggregates of core inflation
(year-on-year growth)



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

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

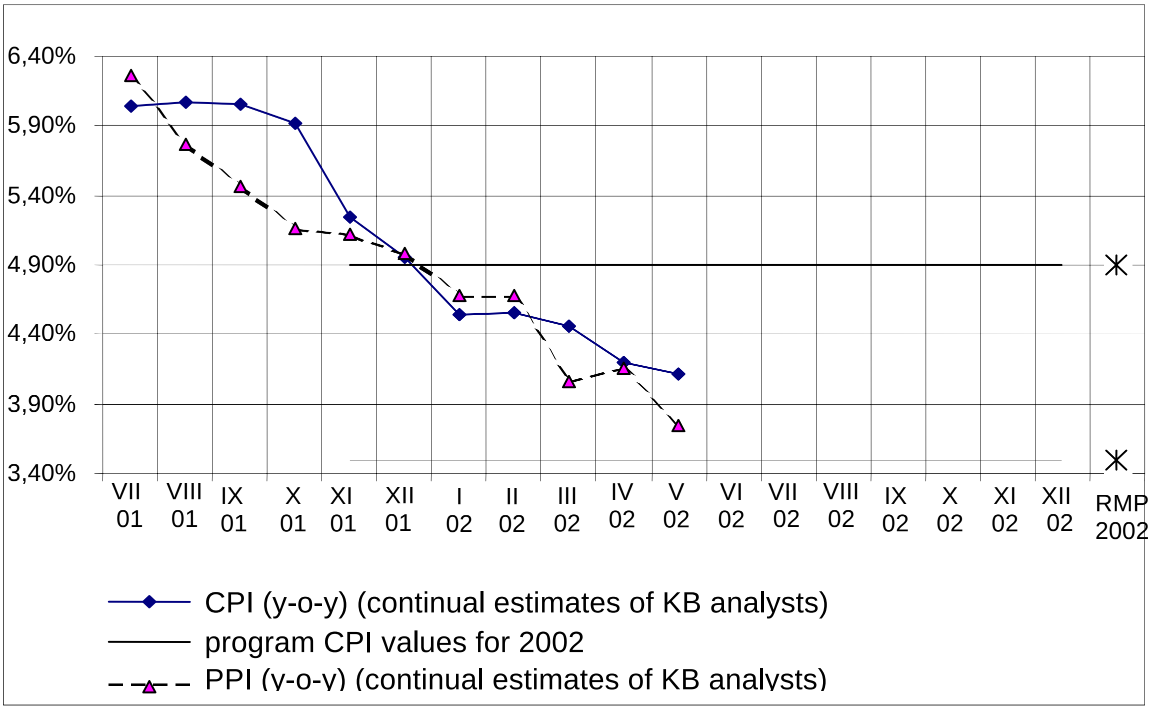
32 USD/barrel or below 18 USD/barrel maintained over a longer period. However, this is not expected to happen this year.

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

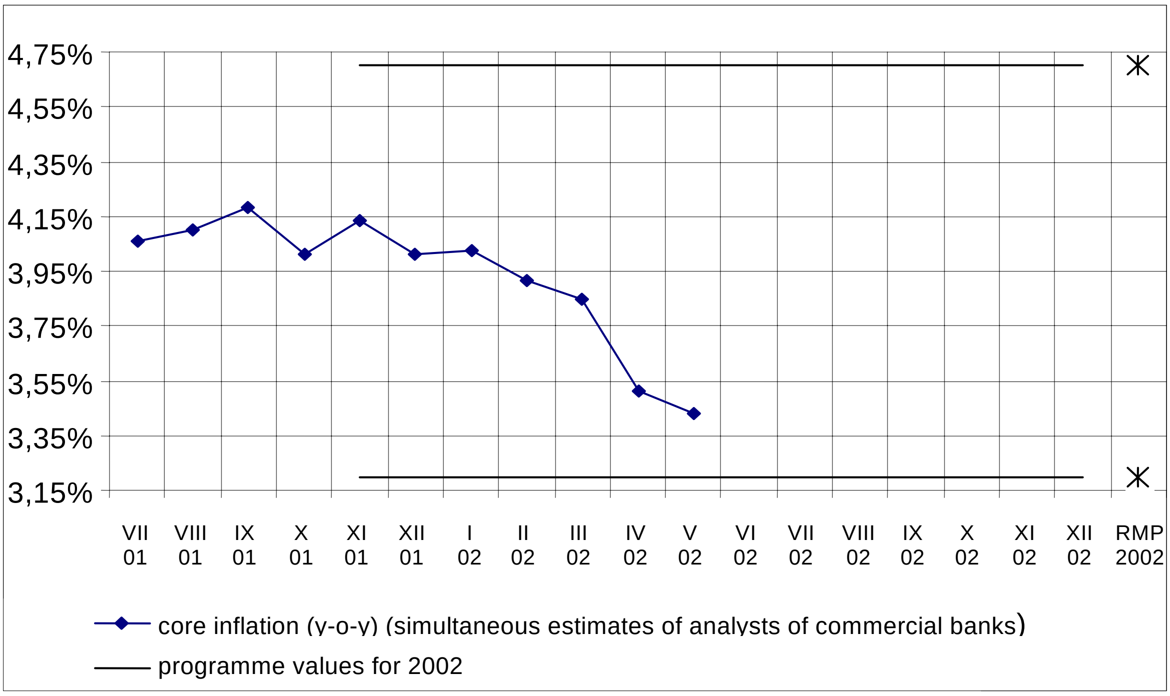
Inflation estimate for the year 2002

	Price growth in percent Dec02/Dec01 (share in percentage points of total growth)			
	MP 2002		*RMP 002*	
	min	*max*	*min*	*max*
Total	*3.5*	*4.9*	*3.5*	*4.9*
Regulated prices	*4.7 (1.24)*	*5.5 (1.44)*	*3.4 (0.80)*	*4.3 (1.02)*
Influence of changes of indirect taxes in non-regulated prices	*0.00*	*0.00*	*(0.41)*	*(0.41)*
Core inflation	*3.2 (2.28)*	*4.7 (3.42)*	*3.2 (2.33)*	*4.7 (3.52)*
thereof: Food	*1.8 (0.41)*	*4.0 (0.92)*	*2.4 (0.50)*	*4.4 (0.92)*
Tradable goods (without food)	*2.4 (0.85)*	*3.2 (1.10)*	*3.2 (1.15)*	*4.3 (1.58)*
Market services	*6.5 (1.03)*	*8.8 (1.40)*	*3.7 (0.67)*	*5.6 (1.02)*

Prediction of inflation (measured by consumer price index and producer price index) for the year 2002 according to analysts of commercial banks[2]



Prediction of core inflation for the year 2002 according to analysts of commercial banks



[2]These charts depict development of predictions of individual macroeconomic indicators at the end of 2002 made by analysts of commercial banks continually since 7/2001 until the present time and these are compared with their values in the MP and the RMP.

Risks associated with the inflation forecast for the year 2002

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

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

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

2.2 Producer prices

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

Current development since the beginning of the year

Since January 2002, the development of prices in the production sphere has been monitored in revised schemes of individual indices of producer prices on the basis of the year 2000. Revised and updated were also weight schemes, selections of price representatives and reporting units. The year 2001 has been recalculated according to the new schemes as well. The value of the average year-on-year producer price index, recalculated according to the new weight structure for 2001, decreased by 0.1 percentage points, the value of average year-on-year construction works price index and agricultural producer prices remained unchanged according to a preliminary recalculation of the Statistics Office of the Slovak Republic.

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

Assumptions of the Monetary Programme and expected development until the end of the year

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

Development of producer prices, mainly the prices dependant on the development of crude oil price on the world markets in the first three months of 2002 corresponds with assumptions of the Monetary Programme. The trend so far of the crude oil price movement on the world markets indicates that despite certain volatility it should settle within the OPEC reference interval.

As far as non-market factors are concerned, average year-on-year growth of producer prices in industry in 2002, in comparison with the MP 2002, should be influenced by changed circumstances:
- a more favorable development of prices of industrial producers in 2001, when their year-on-year growth in December was 3.4 percent, while the Monetary Programme expected growth of 4.5 percent.
- update of the weight system, as well as choice of price representatives within a revised scheme of the industrial producer price index, which should have come into force in 2002, and which at the time when the Monetary Programme was being prepared had not been known yet. The year 2001 was recalculated according to the new scheme, which caused that the growth of industrial producer prices at the end of 2001 decreased from 3.4 percent to 2.2 percent.

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

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

Industrial producer prices

	result 2001*	MP 2002	RMP 2002
average annual index	106.5	105.0	103.5

*according to the revised scheme

2.3 Foreign Trade

2.3.1 Balance of payments

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

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

Together with low price of crude oil, which influenced imports to even a greater extent than exports, a decline of imports unavoidably reflected also in a decline of exports and lower demand for imports of machinery from abroad. This, together with moderate appreciation of the exchange rate of the Slovak currency reflects in the Revised Monetary Programme in lower growth rates of imports and exports in year-on-year terms (in the MP we counted with a stable exchange rate and crude oil price of USD 26 on average. Low crude oil price in the first quarter that moved around the level of USD 21 lowered the estimate of its average price to 24.5 USD/barrel).

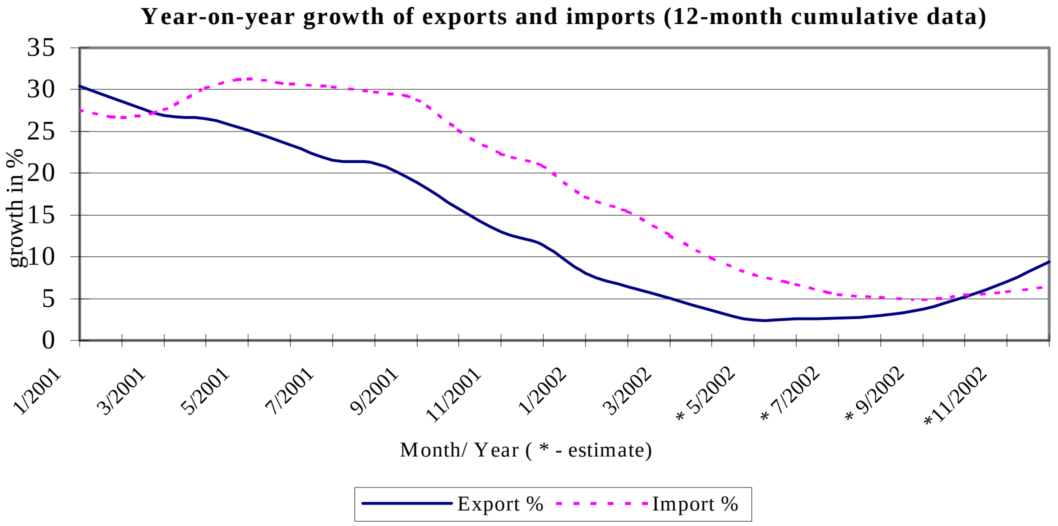
Development of foreign trade in the first quarter of 2002 along with updated estimates of the volume of exports and imports for the full year led to a slight increase of the current account deficit and its share of GDP compared with the MP. In the RMP, the capital and financial account involves in particular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

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

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

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

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



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

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

Growth rate of other export (80 percent of total export), the volume of which is calculated based on growth of import in partner countries, price growth on world markets, and the influence of appreciation of the Slovak currency on the competitive potential of Slovak production could reach 11 percent. A downward revision of the prognosis of growth of the German economy from

1 percent to 0.6 percent and associated impacts on exports of Slovak semifinished products led to a reduction of estimated dynamics of exports in this group of goods.

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

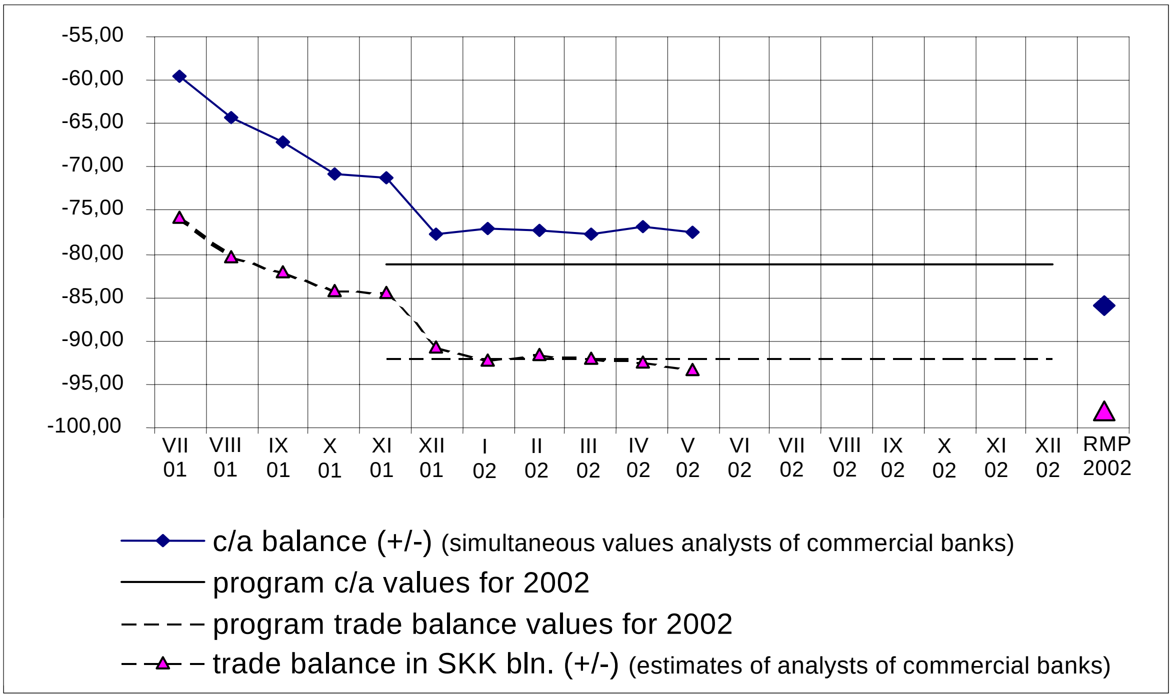
Expected more noteworthy demand stimuli on part of public finances will presumably cause a higher trade balance deficit compared with what the Monetary Programme assumed. A negative trade balance should reach SKK 98 billion, and its share GDP 9.5 percent (the MP counted with a deficit of SKK 92 billion).

With regard to results of 2001, the balance of services should increase in value to SKK 20 billion (the MP counted with SKK 18.6 billion). In its structure, compared with original estimates net revenues from tourism were increased and total deficit in other services was revised upward. In the revenues part of tourism, growth is not expected in foreign exchange accounts, and therefore its value is lower than in 2001 (in the year 2001, the increase of revenues without deposits in foreign exchange accounts compared with 2000 represented SKK 5 billion. The RMP bases its assumption on equal growth also in the year 2002).

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

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

Prediction of the trade balance and the current account of the balance of payments for 2002 according to analysts of commercial banks



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

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

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

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

Total net inflow of foreign direct investments increased from originally SKK 149.0 billion to SKK 198.4 billion as a result of several rather significant changes on the side of privatization activities (higher price for the sale of SPP, where instead of expected SKK 100 billion the transaction was worth SKK 130 billion, and a shift of privatization of power distribution networks from 2003 to 2002). On the other hand, the RMP does not expect revenues for RIF, Banka Slovakia, and Slovenske pristavy (a total of SKK 6 billion).

The inflow of FDI into the commercial sector (apart from privatization resources) should be sufficient to cover about one-third of the current account deficit.

In the original MP portfolio investments (POI) were estimated at SKK 20.1 billion. Their assumed value in the RMP is SKK 35.4 billion, and is based on development in the first months of the year 2002, when commercial banks were selling foreign securities that they bought mainly in 2001. This change of the estimate ensues from current trading in foreign securities in particular in one commercial bank and under condition of continuation of these activities during the whole year (purchase or sale of securities on part of commercial banks brings on the other hand a decline or growth of short-term deposits abroad, and means only a change of the structure of their total assets).

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

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

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

SKK billions	MP 2002		RMP 2002	
	real	*adjusted*	*real*	*adjusted*
Current account	-81.2	-76.1	-85.9	-80.3
Capital and financial account total	178.3	72.5	244.4	74.1
Foreign direct investments (FDI)	147.1	46.0	197.4	27.5
Official sector	120.5	17.5	169.9	0.0
Commercial sector	28.5	28.5	28.5	28.5
Unassigned items	0.0	0.0	0.0	0.0
NBS interventions	0.0	0.0	0.0	0.0
Change of net foreign assets of commercial banks (-growth)		3.6		6.2
Change of foreign exchange reserves of the NBS (-growth)	-97.1		-158.5	
Coverage of current account by FDI	181.2%	60.4%	229.8%	35.5%

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

2.3.2 Foreign debt

Considering the prediction of the development of foreign debt in 2002 the estimation of government sector was based on exact installment schedules as well as available information about intentions of the borrowing strategy of the government of the Slovak Republic for 2002. A method of a qualified estimate based on trends of previous years was applied for entrepreneurial sector.

The prediction is consistent with predicted development of the balance of payments for 2002.

Within the prediction of the development of foreign debt and debt service payments in 2002, we expect an increase of total gross foreign debt by USD 988 million to USD 12,030 billion. When installments of principal of foreign liabilities (USD 102 million) are taken into account and in the absence of new bond issues on foreign capital markets, and only partial drawing of the EFSAL-WB loan (USD 126 million), foreign debt of the government of the Slovak Republic should reach the level of USD 2,538 billion. This prediction does not take into account foreign liabilities of the government of the Slovak Republic ensuing from ownership of nonresidents of government bonds denominated in the Slovak currency.

As a result of new methodology effective from January 1, 2002, the short-term official debt was increased by including REPO transactions of the NBS (USD 164.5 million) to this item.

Overview of the development of foreign debt and debt service
in 2001 and prediction for 2002 (in USD millions)

	2001	1.1.2002*	2002
Total foreign debt of the Slovak Republic	11 042.5	11 380.5	12 030.0
Total medium and long-term foreign debt	7 969.4	8 143.0	8 287.1
– thereof			
Official debt of the government of the Slovak Republic and the NBS	2 780.5	3 305.9	3 281.4
Government agencies	574.1	222.3	0
Municipalities	96.9	96.9	96.9
Foreign debt of the commercial sector	4 517.9	4 517.9	4 908.8
– thereof			
Commercial banks	95.2	95.2	150.6
Non-bank entrepreneurial entities	4 422.7	4 422.7	4 758.2
Total short-term foreign debt	3 073.0	3 237.5	3 742.9
– thereof			
Government of the Slovak Republic and the NBS	4.1	168.6	168.6
Commercial banks	779.6	779.6	927.1
Non-bank entrepreneurial entities	2 289.3	2 289.3	2 647.2

* new methodology valid as of January 1, 2002

Net foreign debt at the end of 2002 will reach a level of USD -679.3 million, which compared with the level of January 1, 2001 (USD 1,979.7 million) represents a decrease of USD 2,659.0 million. The significant decrease of net foreign debt will be caused by faster growth of foreign assets by USD 3,308.3 million (thereof growth of foreign exchange reserves of the NBS, in particular resulting from revenues from privatization represents USD 3,336.2 million) over gross foreign debt by USD 649.4 million.

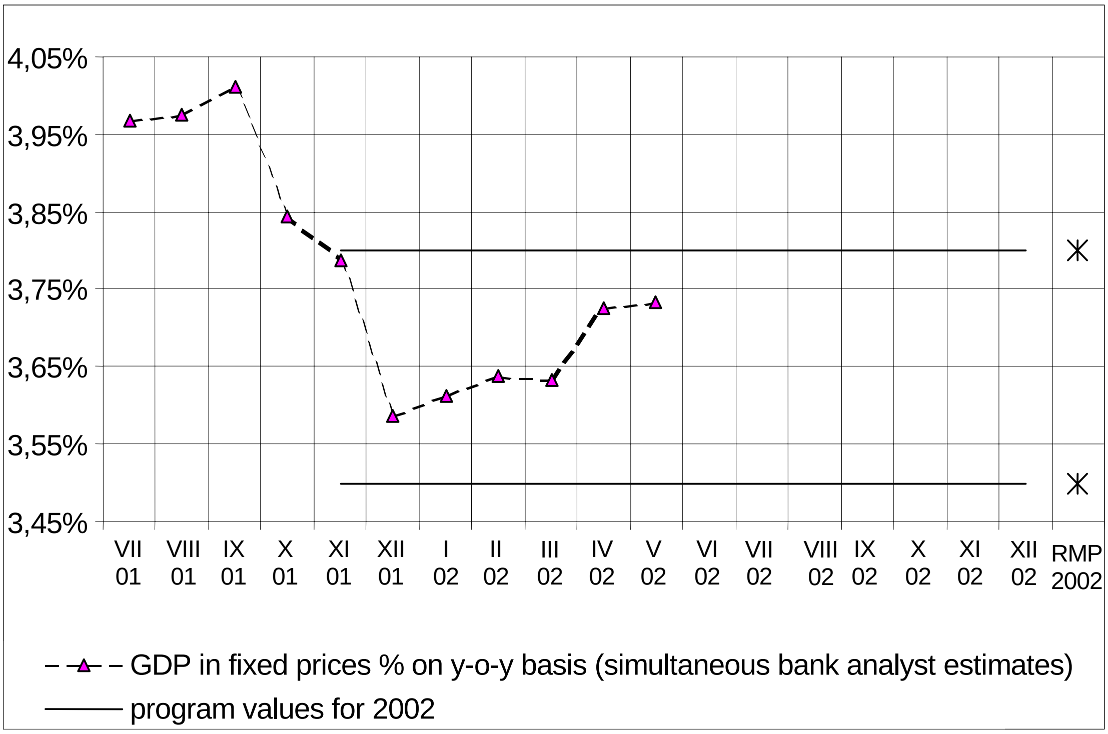
2.4 Gross domestic product

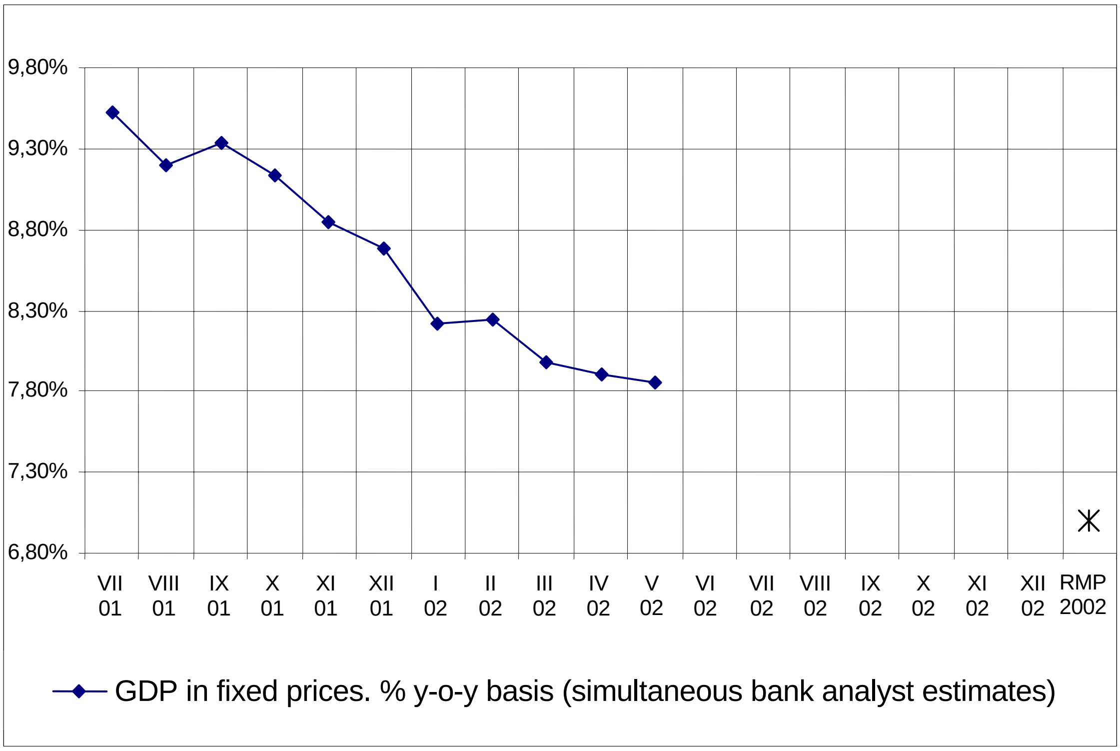
The Monetary Programme of the NBS for 2002 assumed GDP growth at constant prices in the interval from 3.5 to 3.8 percent (middle value 3.6 percent), under the influence of pro-growth effect of foreign as well as domestic demand.

Higher initial base of 2001 (GDP growth by 3.3 percent) and current development of selected indicators of the real economy since the beginning of the year indicated that **real GDP growth will be maintained in the interval from 3.5 to 3.8 percent.** We assume that GDP growth rate will approach the upper limit of the Programme interval and reach **3.7 percent**[3] at constant prices.

[3] An estimate of potential product shows that since the second half of 1999 the Slovak economy has been producing below its potential (negative production gap). Narrowing of the negative production gap in the second half of 2001 indicated that the Slovak economy began growing faster than its potential. The trend of narrowing of the negative production gap should continue in this instance also in 2002, whereby in the second half it should achieve positive values. On an annual basis the volume of GDP in 2002 should represent a value of approximately the level of its potential. Hodrick-Prescott filter was used to estimate the potential product of the Slovak Republic that was applied to real volume of GDP in fixed prices (seasonally adjusted on a quarterly basis) over a time horizon Q1 1993 -Q4 2002. For 2002 the GDP growth estimate was used according to the RMP 2002 and its quarterly breakdown.

Prediction of real GDP for the year 2002 according to analysts of commercial banks





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

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

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

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

Year-on-year growth of final consumption of households could grow by 3.8 percent. Expected development of final consumption of the government takes into account consumption of nonprofit institutions serving households, whereby its growth rate should reach 2.5 percent.

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

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

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

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

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

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

2.5 Wages and employment

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

Current development since the beginning of the year

According to statistical surveys in selected branches of the national economy in the first quarter of this year, compared with the same period of last year, average nominal wages grew slower in the construction sector, wholesale, hotels and restaurants, sale and maintenance of motor vehicles, post and telecommunications, and faster in the branches of real estate, leasing and other public services, transport, and retail. In industry, the growth rate was approximately the same. Employment in the first quarter was characterized by growth only in the sector of real estate, leasing and other public services, sale and maintenance of motor vehicles and construction, while in all other branches employment decreased.

Development of wages and labour productivity in the first quarter of 2002
(index, the same period of the previous year = 100)

	Industry	Construction	Wholesale	Sale and maintenance of motor vehicles	Retail	Real estate, leasing and other public services	Transport	Post and telecom.
nominal wage	110.1	102.3	108.5	104.1	104.6	112.8	108.5	111.2
real wage	105.2	97.7	103.6	99.4	99.9	107.7	103.6	106.2
labor productivity real*	105.4	95.3	.	108.6	107.2	100.3	.	.

Source: Statistics Office of the Slovak Republic, monthly data for selected branches

Average real monthly wages in the first quarter exceeded in most surveyed branches the level of the same period of last year. Wages were lower in the branch of sale and maintenance of motor vehicles and retail, although these sectors achieved relatively high growth of real labour productivity. Highest year-on-year decline of real wages was registered in construction, which approximately corresponded with a decline of labour productivity. Development of real wages in industry according to preliminary data was covered by growth of real labour productivity, however, labour productivity in this branch only slightly exceeded wage growth. Wage growth exceeded labour productivity growth most significantly in real estate, leasing and other public services (approximately 6 percent of the total number of employees).

Assumptions of the Monetary Programme and expected development until the end of the year

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

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

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

(year-on-year change in percent)

	Estimate 2002	Result 2001	MP 2002	RMP 2002 (middle of interval)
Average nominal monthly wage	up to 8.6	8.2	7.0 – 8.0	7.5
Average real monthly wage	1.1 – 1.2	0.8	2.4 -3.3	3.5
Average inflation rate	7.3 – 7.4	7.3	4.5	3.9
Employment	0.5 – 1.0	1.5	0.9	0.7
Labour productivity from GDP in fixed prices	1.8 – 2.3	1.8	2.6 – 2.9	3.0

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

Subsequently to prognosticated economic growth and development of employment, real labor productivity from GDP per employee should grow by about 3 percent (middle of interval). This would mean that real wages would grow faster than labour productivity by 0.6 percentage points. Growth of real wages and labour productivity would be equal only at the lower border of the interval of wage growth assumed in the MP 2002. Growth of nominal wages exceeding the level of 7 percent, which represents real wage growth of 3 percent when the effect of average consumer price growth is taken into account, whereby this wage growth would not be covered by growth of productivity, can constitute a potential demand impulse causing inflation pressures. It would be desirable in order to maintain productivity growth rate over real wage growth rate, to keep nominal wage growth below the level of 7 percent.

Risks in wage development in 2002

With regard to development of the trade balance and possible risks in the fiscal area, as well as possible influence of use of privatization revenues for consumption, decisions in the wage area should be oriented in a direction to avoid creating additional support of domestic demand. Growth of domestic demand could additionally be enhanced by adopted measures reducing the tax burden of natural persons effective from January of this year. According to calculations of the Ministry of Finance of the Slovak Republic, a reduction of the tax rate for taxpayers in the lowest bracket from 12 to 10 percent and in the highest bracket from 42 to 38 percent, together with increasing the level of maximum income from which a fixed rate tax can be paid, represents a reduction of revenues of the state budget by SKK 1.8 billion in 2002. Theoretically, the volume of available liquidity usable for private consumption could grow by this sum. Therefore, in the present situation we consider as acceptable growth of nominal wages by a maximum of 6 percent, i.e., up to the level ensuring that productivity growth rate is at least slightly faster than real wage growth, hence not heightening pressure on private consumption.

2.6 Public sector

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

Fulfillment of the state budget in the first quarter of 2002

Performance of the state budget of the Slovak Republic as of March 31, 2002 ended with a deficit of SKK 15.2 billion, of which the volume of bonds issued to restructure banks (Article 11, Subsection 5, of Act 586/2001 Z.z.) was SKK 9.3 billion.

State budget revenues reached SKK 47.9 billion (21.8 percent of annual budget revenues) which means a shortfall of budget revenues of SKK 7.1 billion in comparison with their time design. State budget revenues involved primarily taxes (their volume was SKK 42.8 billion, i.e., 23.7 percent of budgeted volume), of which the highest share was of the value-added tax (SKK 18.1 billion, i.e., 22.0 percent), excise taxes (SKK 6.5 billion, i.e., 21 percent of plan), personal income tax (SKK 7.6 billion, i.e., 26.7 percent fulfillment), and corporate income tax (SKK 5.6 billion, i.e., 24.7 percent of budgeted volume). Non-tax revenues with their volume of SKK 4.8 billion reached only 17 percent of budgeted volume, and in particular this category poses the greatest risks of a shortfall in the upcoming period.

Total expenditures of the state budget were SKK 63.1 billion, which is 24.5 percent of the planned annual expenditures. Without bank restructuring costs, total expenditures were SKK 53.8 billion (20.9 percent of planned annual expenditures).

Assumptions of the Revised Monetary Programme

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

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

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

fiscal deficit approved in the state budget law	SKK billion	36.8
	% of GDP	***3.57***
risks stemming from use of privatization revenues	SKK billion	10.0
fiscal deficit	SKK billion	46.8
	% of GDP	***4.53***
use of state budget revenues with one-off character – IMF methodology	SKK billion	10.0
fiscal deficit	SKK billion	56.8
	% of GDP	***5.5***

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

Providing state guarantees to bank loans is a specific problem, which influences performance of the public sector. Our opinion is that guarantees are provided very benevolently and they often have the character of indirect subsidies.

SKK billions

	1998	1999	2000	2001
newly provided guarantees	13.8	23.7	34.6	37.8
exercised guarantees*	2.1	4.2	15.5	8.0

*/ these are guarantees that, as a result of insolvency of the debtor have to be settled by the government, primarily from privatization revenues (since the year 2000)

Conclusions from an evaluation report of a Consultative Mission of the International Monetary Fund to Article 4

In its report, the IMF states that expansive fiscal policy of the government was one of the causes that stimulated of domestic demand and rising deficit on the current account of the balance of payments. Simultaneously it warns that with regard to growing external imbalance, a continuation of such expansive fiscal policy is not sustainable. Although the approved deficit of public finances for 2002 (3.5 percent of GDP) is lower compared with the previous year (3.9 percent of GDP), performance of fiscal policy this year is more expansive. If corrective measures are not adopted, the deficit of public finances in 2002 could reach SKK 55.5 billion (compared with SKK 36.8 billion approved in the state budget law), which represents 5.3 percent of GDP. The reason for an increase of the deficit could above all be overstepping expenditures in the social area and a shortfall of non-tax revenues. With regard to intentions of the government, in particular wage rises and social welfare payments enacted by law, the fiscal deficit in 2003 could reach SKK 66 billion, i.e., 5.7 percent of GDP compared with 3 percent that the Slovak Republic pledged not to overstep in its Pre-accession Economic Programme.

With regard to the low level of restructuring of the economy and ensuing limitations on the offer side of the economy, stimulating aggregate demand through fiscal expansion has a negative effect of a climbing deficit on the current account of the balance of payments.

The mission therefore considers as necessary adopting measures leading toward consolidation of public finances. Most of these measures should be implemented on the side of expenditures. In line with recommendations of the technical mission of the IMF, state authorities should pursue a resolute implementation of tax administration reform and adopt measures to reduce tax arrears.

If measures are not adopted to resolve the tense situation in public finances, the economic imbalance will further deepen. Economic costs ensuing from such development would be depreciation of the currency, rising interest rates, declining confidence of foreign investors, and last but not least, integration ambitions of Slovakia could be threatened in relationship to accession to the European Union.

With regard to privatization revenues, it is necessary to use these exclusively to repay the government debt and to launch a reform of the social security system. The government at present assumes the use of privatization revenues for repayment of domestic debt. The IMF mission however repeatedly recommends preferring a repayment of foreign government debt. This use of privatization revenues would enable reducing costs of sterilizing excess liquidity by the National Bank of Slovakia, and at the same time would improve indicators of foreign indebtedness.

Simultaneously it is necessary to adopt resolute measures in the area of providing state guarantees, the volume of which reached 15 percent of GDP. Under the existing practice, guarantees are provided too liberally, and in some instances they replace transfers from the state budget to cover operating losses of some state owned companies. The mission in its report expresses concerns that providing guarantees may reflect an absence of strict budgetary controls in state owned companies. The mission recommends the adoption of measures directed toward an improvement in the area of debt servicing of beneficiaries of state guarantees, enforcement of strict budgetary limitations in the economy, and a reduction of the volume of guarantees.

2.7 National Property Fund

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

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

On April 25, the government of the Slovak Republic approved a document on the use of privatization revenues “Proposal of an Amendment to Use of Assets of the National Property Fund of the Slovak Republic in 2002, pursuant to Article 28, Subsection 3, Letter b) of Act 92/1991 Zb. on conditions for transfer of assets of the state to other entities in the wording of subsequent regulations." This document specifies assumed revenues of the NPF and their use.

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

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

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

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

Compensation in favor of KBB from the title of division of federal assets – agreement 01/2002	1.1
Health Ministry of the Slovak Republic	3.7
Railway passenger transport – originally approved SKK 4 400 million	4.2
Exercising government guarantees for 2001 and 2002	5.1
Resolving price difference of delivered heat and hot water for 1997-1998	0.7
(Compensation to municipalities for their costs to built gas distribution networks)	4.1
Other purposes based on decision of the government of the Slovak Republic	0.4
Liabilities of the NPF	**25.4**
TOTAL	**44.6**

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

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

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

Almost SKK 3.7 billion is allocated to settle liabilities of health care facilities and health insurance companies. Their use will very probably have an effect on growth of domestic demand and liquidity of the banking sector, since the money will be paid to suppliers (energy, medicaments, etc.).

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

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

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

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

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

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

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

The NPF should further use privatization revenues for payments to persons eligible to restitution, to cover NPF costs, costs associated with withdrawal from contracts, share capital increase, purchase of equity shares to which it has an option (SKK 2.9 billion). These payments should increase the liquidity of the banking sector (and sterilization position of the NBS) and potentially can also have an effect of an additional demand stimulus. Simultaneously the NPF will be paying a share from privatization revenues of companies under the responsibility of the Ministry of Health and the Ministry of Agriculture (originally designated for the State Health Fund and the State Support Fund for Agriculture and Food Industry, which were already cancelled). Commitments with aggregate volume of SKK 1.3 billion will gradually be paid to legal successors of the cancelled funds, i.e., the Ministry of Health of the Slovak Republic and the Ministry of Agriculture of the Slovak Republic. The NBS has no information about their planned use by these ministries. These resources however can represent an increase of liquidity as well as stimulate domestic demand.

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

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

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

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

2.8 Monetary aggregates

Development of monetary aggregates in 2002 will primarily be influenced by revenues from privatization of state property and their use.

In total the inflow of privatization revenues should increase net foreign assets by 115.4 percent, i.e., by SKK 158.1 billion.

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

- SKK 66.3 billion for the social insurance reform
- SKK 36.3 billion to settle the deficit from 2001
- SKK 10.4 billion to repay domestic state debt in 2002
- SKK 3.3 billion to repay foreign government debt in 2002
- SKK 9.1 billion a premature redemption of restructuring bonds possessed by VUB

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

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

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

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

Year-on-year changes of selected items of monetary survey in SKK billion

	2001 Result	2002 Monetary Programme	2002 Revised Monetary Programme
Net foreign assets	**14.0**	**98.6**	**158.1**
Net domestic assets	**58.4**	**-27.0**	**-80.9**
Domestic credits	76.6	-25.8	-68.5
Net position of the public sector	53.2	-48.0	-89.5
Credits to households and enterprises	23.4	22.2	21.1
M2	**72.4**	**71.6**	**77.2**

Conclusions of an Evaluation Report of the Consultative Mission of the International Monetary Fund to Article 4

The IMF mission expressed its support to the NBS policy that continuously implements the floating exchange rate regime of the Slovak koruna and performs a monetary policy toward lowering inflation and protecting foreign exchange reserves. The mission expects the NBS to be successful in 2002 in achieving its goals in the area of inflation despite the notable growth of wages. Dynamics of M2 money supply projected in the Monetary Programme that assumes a slower velocity of circulation of money is consistent with these goals. The mission recommends to the NBS to inform social partners in tripartite wage negotiations of available analyses so that during negotiations the effect of wage growth on price development is taken into account.

The IMF mission considers the recent increase of interest rates by 50 basis points a suitable signal reacting to rising external imbalance and to insufficient measures in the fiscal area. In the next few months, the main question for the monetary policy will be how to respond if a fiscal policy adjustment does not happen and external pressures will continue. According to the view of the mission there is no need to react to recent depreciation of the currency by interventions on the foreign exchange market or by increasing interest rates because it is unlikely that this depreciation could threaten the goals of the NBS in the area of inflation. Apart from that, if wage and price pressures can be contained, this weakening of the currency can help to improve external competitiveness and support a solution to the external imbalance. If however, uncontrolled depreciation of the Slovak currency continued that would threaten the fulfillment of inflation targets, it would be necessary for the NBS to increase interest rates in order to achieve these targets.

The IMF mission does not consider measures of monetary policy as the most suitable instrument to solve the deficit on the current account of the balance of payments. Although a further rise of interest rates would reduce domestic demand, this could at the same time cause excessive strengthening of the Slovak koruna and thus weaken the competitiveness of the economy at the time when export is stagnating. Nevertheless, sensitivity of the exchange rate to changes of interest rates is weak with regard to low interest sensitive capital flows. However, in a situation of an absence of measures in the fiscal area, a major increase of interest rates would be necessary to influence domestic demand. This would certainly have an effect on the exchange rate of the Slovak currency as well as interest cost of the business sector. These reasons further underline the urgency of adopting additional measures in the fiscal area to eliminate pressures on the balance of payments.

2.9 Liquidity – monetary basis

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

1) A different starting level of exchange rates in 2001 and 2002 influenced the starting level of the Revised Monetary Programme compared with the Monetary Programme.
2) The largest difference is represented by privatization revenues the projection of which in the Monetary Programme was SKK 120 billion, while in the Revised Monetary Programme it was revised to SKK 170 billion.

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

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

2.10 Implementation of monetary policy

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

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

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

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

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

3. *Conclusions*

Objective of the Monetary Programme

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

Assumptions of the Monetary Programme

- relatively stable development of the exchange rate of the Slovak currency toward the EUR, corresponding with the efficiency of the economy,
- GDP growth in fixed prices by 3.5-3.8 percent,
- fiscal deficit without costs of restructuring of banks should reach SKK 46.8 billion, i.e., 4.5 percent of GDP (5.5 percent when use of some non-tax revenues of the state budget is abstracted, according to IMF methodology)
- share of deficit of the current account of the balance of payments to GDP should reach 8.3 percent

Indicative growth rates of monetary aggregates

- growth of money supply should not exceed 11.4 percent
- with regard to development of the balance of payments, net foreign assets should grow by 115.4 percent,
- net credit to the government and the National Property Fund should decrease by 24.1 percent, which is consistent with assumed development of the fiscal deficit, expected development of revenues and expenditures of the NPF, as well as assumed use of privatization revenues to repay government debt,
- with regard to the development of preceding aggregate indicators, there will be created room for a year-on-year growth of credits to enterprises and households by a maximum of 6.9 percent. With regard to the higher dynamics of M2 aggregate it would be desirable to achieve a lower growth of credits, in particular with regard to excess liquidity from the public sector. Hence in practice, excessive expansion of public finances can crowd out credits to enterprises.

Risks of the Monetary Programme

- PUBLIC SECTOR: Part of the risk in the area of public finances has already been incorporated in assumptions of the Revised Monetary Programme (increased estimate of the fiscal deficit from 3.5 to 4.5 percent of GDP as a result of the use of a part of privatization revenues; or from 4.5 to 5.5 percent of GDP in IMF methodology). Other risks stem from the full impact of the use of privatization revenues
- WAGES: Faster growth of nominal wages than recommended 6 percent together with changed behavior of the households (growth of consumption at the expense of a lower saving rate) could cause worsening of the trade balance.
- PRICES OF RAW MATERIALS: Under influence of political factors as well as revival of demand can cause a major increase of prices of strategic raw materials and subsequently higher growth of consumer prices and imports.
- DEVELOPMENT OF WORLD ECONOMY: Lower than expected growth of German economy can have a negative impact on the development of Slovak exports.

4. Outlook until 2005 – Revised

Outlook until 2005 is based on an assumption that adopted and implemented policies will create an environment for: economic growth, reducing and sustaining a budget deficit and a deficit on the current account of the balance of payments; and the convergence of price level to the European Union countries on the one hand, and on the other hand for lowering inflation to a level ensuring that Maastricht criteria are fulfilled. This means necessary measures must be adopted not later than at the beginning of 2003. During that year, subsequently inflation should rise and fiscal deficit decrease (although real decrease under influence of corrective measures would probably come only in 2004) and the share of the current account deficit to the GDP should improve. In the following years then monetary and fiscal policy will be aimed at development of the economy, implementation of necessary measures to achieve sustainable growth, as well as acceptable fiscal deficit and at the same time harmonization of legislation with the European Union. These years will be marked by preparations for European Union accession and improvement of macroeconomic indicators of the Slovak Republic.

Only development similar to that outlined in the RMP will enable accession of the Slovak Republic to the European Union. An opposite development, i.e., if necessary urgent and effective measures are not adopted to reform the health care system, education, social insurance, and the micro sphere, values of macroeconomic indicators would be significantly worse. That means that the Slovak Republic would be achieving a high fiscal deficit, depreciation of the exchange rate, decrease of domestic demand, and decline of the standard of living.

4.1 Inflation

Estimates of inflation in the medium-term outlook are comparable with medium-term assumptions in the MP 2002. Basic determinants of price development include continued adjustments of regulated prices, an approximation of laws, in particular concerning taxes with European Union standards, and gradual reduction of core inflation. The speed and extent of administrative measures should to a great extent be limited by the reference date of accession of the Slovak Republic into the European Union, which is January 1, 2004.

A slowdown of price deregulation in 2002 will create pressure on an adoption of a wider package of measures in upcoming years. The most significant extent of price deregulation can probably be expected in 2003, which will cause an increase of headline as well as core inflation. In the following years the effect of administrative measures should gradually decrease, and this will restore a slowdown of headline inflation.

The Slovak Republic managed to agree on some transitions periods within accession negotiations in the area of taxes. This means a reduction of pressure from administrative measures on price growth ahead of European Union accession. At the same time however, we can expect that the influence of administrative measures on the development of inflation will continue longer than the horizon of a medium-term outlook.

The degree of uncertainty concerning a forecast of inflation for the period from 2003 to 2005 is increased by the fact that a detailed timetable and extent of deregulation is not known. Therefore we based the forecast on available analyses of pertinent ministries so that at the end of the medium-term horizon the level of regulated prices reaches a level covering economically justified costs and a fair profit.

The update of a forecast of consumer price growth in the medium-term horizon was influenced by the revision of the consumer basket. In the structure of the consumer basket, on the basis of which inflation is reported from 2002, weight of some regulated prices has been reduced and thereby also the influence of deregulation on inflation in individual years. For this reason, inflation in 2003 should be about 0.5 percentage points lower compared with the estimate based on the old structure of the consumer basket.

Within harmonization of the excise tax on cigarettes and tobacco, a gradual increase of prices can be expected of tobacco products with an impact on headline inflation of about 0.4 percentage points annually (in the instance of a one-off increase in 2003, the contribution to inflation growth could be approximately 2.5 percentage points). The government of the Slovak Republic agreed on a formula for an increase of cigarette prices after accession to the European Union. During the transition period of taxing cigarettes with the excise tax, the excise tax on cigarettes will gradually increase from its present level of 32 percent and on January 1, 2009 will reach 57 percent of the retail price of the best selling cigarette brand.

Development of core inflation so far has indicated that its dynamics is to a greater extent influenced by domestic cost factors rather than demand. Therefore, the trend of core inflation until 2005 should be closely linked with intensity of cost pressures that will be determined by the extent of deregulation. A gradual lowering of administrative interventions in 2004-2005 should, under the condition of a stabilized exchange rate, determine a downward trend of core inflation.

Outlook for inflation development until 2005 (as of December of the pertinent year)

		MP 2002	RMP 2002	2003	2004	2005
Inflation (percent)	year-on-year inflation rate	3.5-4.9	3.5-4.9	6.5	5.2	4.2
	average year-on-year inflation rate	4.1-4.9	3.6-4.2	6.4	5.5	4.5
Core inflation (percent)	year-on-year inflation rate	3.2-4.7	3.2-4.7	4.0	3.6	3.0
	average year-on-year inflation rate	3.6-4.6	2.7-3.3	3.9	3.7	3.2

For the period from 2003 to 2005 only the middle value of the forecast is given.

4.2 Producer prices

Assumed development of prices of industrial producers from 2003 to 2005 is not being modified compared with the MP 2002. Their slower growth compared with the Monetary Programme is associated with a lower level of prices in the reference years 2001 and 2002, as well as a change of the weight structure of the index.

The prognosticated trend is based on an assumption of continued restructuring of the Slovak economy in association with implementation of policies of the European Union in the pre-accession period in Slovakia. A successful course of structural changes in the entrepreneurial environment and subsequently growing competitiveness of businesses will have a decisive influence on the development of prices of industrial producers. This means that despite possible cost pressures on price growth resulting from harmonization in tax, agricultural, and environmental policies of the European Union, continued (though to a lesser extent) process of energy price deregulation, as well as persisting growth of domestic demand, dynamics of growth of prices of industrial producers should slightly decrease in the medium-term horizon. An exception will be the year 2003, when as a result of delayed deregulation their year-on-year growth probably will accelerate. From the viewpoint of external cost factors, we can expect that a stabilization of world prices of strategic raw materials will contribute to a reduced volatility of prices of industrial producers in the medium-term horizon.

Outlook for development
of industrial producer prices until 2006 (index, the same period of previous year = 100)

	Result 2001*	MP 2002	RMP 2002	2003	2004	2005
average annual index	106.5	105.0	103.5	104.0	103.4	102.9

*according to the revised scheme

4.3 Balance of payments

We leave the basic assumptions for the period from 2003 to 2005 unchanged, which represents a consolidation of economic development. In this period in all likelihood the recession will end that influenced our most important trading partners in 2001 and the first half of 2002.

Assumption of a gradual reduction of the trade deficit should be upheld even when its level should increase by SKK 10 billion on average, whereby growth rate of both import and export would slightly decrease. Average annual growth dynamics of export will be in the range from 13.5 to 14.0 percent and import 10.7 to 11.9 percent.

Trade deficit in the period from 2003 to 2005 should be on a descending trajectory, from SKK 90.5 billion in 2003 to SKK 72 billion in 2004.

The balance of services will be moving in the range and structure of this category from 2001. Transport together with tourism will continue being its main components that will ensure the main income from services of the Slovak Republic. The aggregate balance of services will be positive in the range from SKK 21.5 billion to SKK 23.5 billion.

The balance of incomes will be determined in particular by development of loans to the corporate sector, which will be using them to partly finance the results of their economic activity. The balance of incomes will be relatively stable and its average annual volume will be from SKK 15.9 billion to SKK 16.7 billion.

Current transfers with regard to stabilized income from transfers of natural persons and legal entities (welfare, compensation, and insurance indemnity) will generate a surplus, which on annual average will be approximately SKK 9 billion.

As a result of a gradual decline of the trade deficit and growing surpluses of the balance of services, the negative balance on the current account in the prediction period will decline from SKK 71.4 billion (in 2003) to SKK 56.1 billion (in 2005) and its share of GDP in 2004 or 2005 will drop below 5 percent.

SKK billions

	MP 2002	RMP 2002	2003	2004	2005
Trade balance	- 92.0	- 98.0	-90.5	79.0	-72.0
Balance of services	18.6	20.0	21.5	22.0	23.6
Balance of incomes	- 16.8	- 16.9	-15.9	-17.1	-16.7
Current transfers	9.0	9.0	9.0	9.0	9.0
Current account	- 81.2	- 85.9	-76.0	-64.9	-56.1

Financing of the deficit on the current account will continue to be provided from direct and portfolio investments or long-term and short-term loans of the banking sector.

Foreign direct investments will be decreasing as a result of a gradual weakening of the privatization process. In 2003, we expect from privatization in the area of electricity generation an inflow of FDI into the government sector of SKK 15.0 billion. In 2004, we expect privatization revenues in railway transport of SKK 3.5 billion (half of the total sum). In 2005, the inflow of foreign investments associated with privatization will only represent SKK 3.5 billion (the second half – railway transport).

The commercial sector can expect to receive in 2003-2005 a sum of FDI of SKK 23.0-25.0 billion, whereby the current account deficit will be covered by FDI to 33 - 40 percent.

Portfolio investments will be influenced by transactions of the business sector and the government sector at aggregate volume of approximately SKK 12.0 billion.

In the prediction period, the government sector will have to ensure the repayment of bonds issued in 1998 of USD 900.0 million and in 1999 of USD 570.0 million. With regard to the fact that the government gave preference to repaying domestic debt from privatization revenues, we assume that to repay the government bonds maturing in 2003, debt instruments could be issued on the local market, that would be converted to foreign currency, which would reduce foreign exchange reserves. A similar form of repayment of bonds maturing in 2004 would cause a further decline of foreign exchange reserves, and therefore in 2004 these bonds could be rolled over, or a part of privatization revenues used to repay a part of maturing government's foreign debt.

In the sector structure, the corporate sector will remain the sector drawing the largest part of financial loans, which however will to a great extent serve to repay old loans drawn in previous years.

Short-term capital of the corporate sector will continue to participate in financing the current account deficit, though its development will have a downward tendency.

SKK billion

	MP 2002	RMP 2002	2003	2004	2005
Capital transfers	1.0	5.0	8.0	8.0	8.0
Direct investments	147.0	191.8	23.0	39.5	24.5
Portfolio investments	20.1	35.4	13.0	10.0	10.0
Other debt. fin. account	4.8	0.0	-40.9	6.3	0.3
Short-term financial account	5.3	6.6	11.6	7.4	2.5
Capital and financial account	178.2	232.8	14.6	71.2	45.3

During the entire prediction period foreign exchange reserves of the NBS will be declining up to the level of SKK 7,069.0 million. As a consequence of this as well as because of growing imports, average monthly coverage of imports of goods and services will decrease to 4.5 in 2003, to 3.9 in 2004, and to 3.4 in 2005.

4.4 Foreign debt and debt service of the Slovak Republic

Foreign debt outlook for the period from 2003 to 2005 is consistent with the balance of payments. In 2003 we do not expect the government to draw any foreign loans, which reflected in the outlook for 2004 and 2005 by a reduction of the estimated volume of foreign debt by USD 0.9 billion. From 2002, the government debt (official foreign debt of the Slovak Republic) includes liabilities of the former State Road Development Fund.

Foreign debt outlook (similarly as the balance of payments) assumes a relatively higher inflow of foreign direct investments in upcoming years (also in association with privatization). Foreign direct investments represent a substitute for potential new foreign loans. It is assumed that privatization in the Slovak Republic will be completed in 2005, and then the inflow of foreign direct investment will be aimed only toward the private sector.

Prediction of the development of foreign debt and debt service in 2003-2005 (in USD million)

End-year figure	2002	2003	2004	2005
Total gross foreign debt of the Slovak Republic	12 030.00	11 600.96	12 080.06	12 385.46
Total medium and long-term foreign debt	8 287.09	7 550.79	7 809.89	7 943.29
- thereof				
official debt of the government and the NBS	3 281.36	2 130.86	2 027.06	1 854.26
Thereof government of the Slovak Republic	2 889.98	1 938.78	1 887.58	1 766.38
drawing (new loans)	126.00	0.00	570.00	0.00
repayment of principal (debt service)	102.20	951.20	621.20	121.20
municipalities	96.93	96.93	96.93	96.93
Foreign debt of the commercial sector	4 908.80	5 323.00	5 685.90	5 992.10
- thereof				
Commercial banks	150.60	230.60	310.60	390.60
Non-bank business entities	4 758.20	5 092.40	5 375.30	5 601.50
total short-term foreign debt	3 742.87	4 050.17	4 270.17	4 442.17
- thereof				
Short-term foreign debt of the commercial sector	3 574.27	3 881.57	4 101.57	4 273.57
Commercial banks	927.06	1 025.46	1 121.76	1 194.86
Non-bank business entities	2 647.21	2 856.11	2 979.81	3 078.71
Official debt of the government and the NBS	168.6	168.6	168.6	168.6

Net foreign debt will gradually increase in the period from 2003 to 2005 from USD -195.6 million in 2003 to USD 816.0 million in 2005.

4.5 Gross domestic product

Prognosis of the development of GDP, similarly as in the MP 2002, takes into account in particular medium-term goals of the macroeconomic policy formulated in the Pre-accession Economic Programme. A priority is to increase the effectiveness of the economy to a level sustainable in a long-term horizon, growing competitive potential, as well as improvement of the situation on the labor market, which together with other factors would help integration of the Slovak Republic to the European Union. This requires continued structural reforms in the non-financial and financial entrepreneurial sector and a consolidation of public finances .

In the period until 2005 under these conditions, we can expect further improvement of the effectiveness of the Slovak economy. In 2003, real economic growth could achieve 4.1 percent, in the following year 4.4 percent, and at the end of the prognosticated period 4.6 percent. GDP growth in the period from 2003 to 2005 will be based on growing exports with a significant contribution of fixed investments and private consumption.

Continuing restructuring of companies along with expected slower growth of real wages compared with growth of labor productivity will generate a higher volume of resources usable for development. This circumstance together with higher offer of loan resources should have an influence on the development of fixed investments, where the main stimulus will be investment demand of nonfinancial organizations. We can expect the creation of gross fixed capital in fixed prices by approximately 5 percent each year.

In comparison with other components of domestic demand, private consumption will presumably be subject to greatest fluctuations, in particular in association with the development of wages and draining of a part of income as a result of greater extent of adjustments of regulated prices. Its year-on-year growth can reach 4.2 to 4.6 percent.

Relatively balanced economic growth as well as relatively fast growth of labour productivity in the business sector, together with moderate growth of employment and a gradual decrease of inflation will create conditions for growth of real wages. However, the rising tendency of growth of real wages will be interrupted in 2003, when under the influence of higher inflation, the year-on-year growth of real wages can slow down to 2 percent. In the following year, real wages could grow by 2.2 percent and in 2005 by 3 percent.

(index, the same period of the previous year =100)

	RMP 2002	2003	2004	2005
average monthly nominal wage	107.5	108.5	107.8	107.7
average monthly real wage	103.6	102.0	102.2	103.0
employment	100.7	101.0	101.1	101.3
labour productivity from GDP per employee in fixed prices	103.0	103.0	103.1	103.1
consumer prices – average	*103.8*	*106.4*	*105.5*	*104.6*

Prognosis of final consumption of the public administration takes into account plans of the medium-term financial outlook until 2004. With respect to quantification of development of current expenditures of the public sector and development of consumer prices this means that final consumption of the public administration (including nonprofit institutions serving households) will grow 1.8 to 2.7 percent year-on-year.

During the prognosticated period, the fastest growing component of the real GDP will presumably be export of goods and services. Growth of export should stem from expected economic growth in countries of our main trading partners, from future effects of present investments, and a more effective production aspect of the economy. Its year-on-year growth in fixed prices can reach approximately 7 to 8 percent, which will represent a significant factor of sustainability of economic productivity of the Slovak Republic in the long-term outlook.

Import of goods and services will be influenced by the development of domestic demand, where lower year-on-year growth compared with growth of real GDP should not generate significant pressure on imports. Maintaining higher growth of exports over imports, following adjustment of price influences, will reflect in a gradual reduction of the deficit of net export.

(year-on-year change in percent)

	RMP 2002	2003	2004	2005
GDP in fixed prices of 1995	**3.7**	**4.1**	**4.4**	**4.6**
Domestic demand	2.5	2.4	3.6	4.3
Thereof				
Final consumption of households	3.8	4.2	4.3	4.6
Creation of gross fixed capital	6.3	5.3	4.8	5.2

4.6 Wages and employment

Outlook for 2003-2005 is not being change significantly. Development of real wages has been specified in association with changes of consumer prices. Interval ranges of expected development have been replaced by middle values of the intervals.

RMP for 2002 and outlook until 2005

(index, the same period of the previous year =100)

	2002	2003	2004	2005
	RMP			
average wages nominal	107.5	108.5	107.8	107.7
average wages real	103.5	102.0	102.2	103.0
CPI average	103.9	106.4	105.5	104.5
employment	100.7	101.0	101.1	101.3
labour productivity/per employee from GDP in fixed prices	103.0	103.0	103.1	103.1

4.7 Public finance

In the medium-term outlook the NBS expects performance of the public sector in line with goals of the government presented in the Pre-accession Economic Programme that was released in 2001. Deficit of public finances should gradually decrease to 2.0 percent of GDP in 2005.

4.8 *Monetary policy*

Monetary policy in the period from 2003 to 2005 will be performed in an environment of temporary growth of consumer prices at the beginning of this period as a result of restoration of adjustments of regulated prices. In the following years the process of gradual disinflation should continue. Consolidation of public finances, improving the competitive potential of the Slovak economy associated with anticipated accession to the European Union and associated improvements of the development on the current account of the balance of payments should create conditions for moderate and balanced acceleration of economic growth.

From the viewpoint of monetary policy instruments, the NBS will concentrate on harmonization with instruments used by the ECB, which is at a high level at present. In the medium-term horizon, we expect to decrease the level of minimum required reserves and an adjustment of its base. We do not expect any major changes in the area of operations on the open market.

In the considered medium-term outlook, monetary policy will be implemented under conditions of membership of Slovakia in the European Union, with which the change of the exchange rate regime is associated. Since the date of accession of the Slovak Republic to the European Union, the Slovak koruna should join the ERM II. Within this exchange rate mechanism, a central parity of the Slovak koruna would be set toward the euro, whereby the market rate will be allowed to float within the band of ± 15 percent. Participation in the EMR II is one of the conditions for future membership of the country in the European Monetary Union.

With regard to the fact that Slovakia is a small and open economy, exchange rate development must be taken into account when monetary policy is implemented. Movements of the exchange rate influence the development of consumer prices, in particular of tradable goods. A continuation of a disinflation process and sustainable growth of the economy hence requires an elimination of excessive fluctuations of the exchange rate. In particular ERM II represents a suitable mechanism to anchor expectations of the exchange rate development. With regard to the possibility to adjust the central parity and the fluctuation band +/- 15 percent simultaneously, ERM II enables a country to use a certain degree of flexibility. This poses the advantage of this exchange rate mechanism for countries in the pre-accession process, among which Slovakia belongs. Flexibility of ERM II offers sufficient space for restructuring of the economy and a real convergence.

At present, the Slovak koruna is a freely floating currency, whereby the NBS enters the foreign exchange market only to eliminate excessive volatility caused primarily by non-economic factors. The participation of the Slovak koruna in ERM II should be a natural process, since over a longer period the currency is moving within the framework of ERM II. Under the present exchange rate regime compared with the exchange rate on January 1, 1999, the most significant movements of the exchange rate of the Slovak koruna toward the euro were +9.8 percent (depreciation) and -3.8 percent (appreciation).

Main Economic and Financial Indicators

	2 001	2 001	2 001	2 002	2 002	2 003	2 004	2 005
	Monetary Programme	Revised Monetary Programme	Actual	Monetary Programme	Revised Monetary Programme	Outlook		
(year-on-year change in %)								
Gross domestic product (fixed prices)	2.8-3.2	2.8-3.0	3.3	3.5-3.8	3.5-3.8	4.1	4.4	4.6
Consumer price index (end-year, core inflation)	3.6-5.3	3.6-5.3	3.2	3.2-4.7	3.2-4.7	4.0	3.6	3.0
Consumer price index (annual average)	7.1-8.3	7.1-8.3	7.3	4.1-4.9	3.6-4.2	6.4	5.5	4.5
Consumer price index (end-year)	6.7-8.2	6.7-8.2	6.5	3.5-4.9	3.5-4.9	6.5	5.2	4.2
Gross domestic product (nominal, in SKK bln.)	960.0	962.0	964.6	1 032.0	1 032.0	1 130.0	1 232.0	1 340.0
Deficit of the current account of the balance of payments to GDP	-4.0	-5.7	-8.8	-7.9	-8.3	-6.7	-5.3	-4.2
Official reserves of the NBS (USD millions)	5 843.0	4 489.0	4 346.4	6 575.9	8 455.3	7 479.0	7 294.9	7 069.0