Slovak Republic

GDP growth is expected to continue in the 5½ to 6½ per cent range and employment growth is picking up. However, inflation risks are re-emerging and structural unemployment remains very high.

Both monetary and fiscal conditions will need to tighten over the projection horizon, in order to damp inflation risks, further reduce the fiscal deficit, and ensure that the plan to adopt the euro in January 2009 remains credible.

Strong domestic demand continues to underpin robust growth

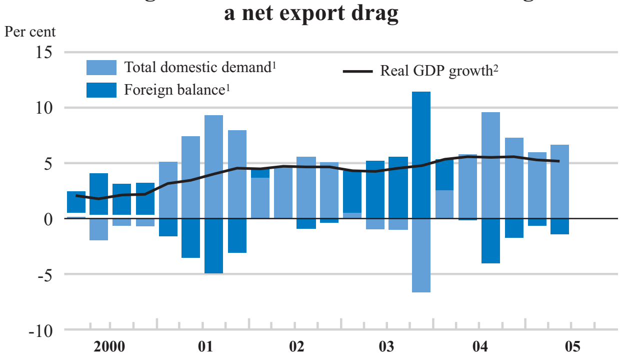
Private consumption growth has remained high, supported by strong real wage growth and a recovery in employment, while growth of gross fixed capital formation has further strengthened. Recent data on retail sales, industrial production and business and consumer confidence suggest that the strong output growth will continue. On the other hand, high imports realted to foreign direct investment (FDI), oil prices, and dividend payments caused the current account deficit to widen to 7.9% of GDP in the second quarter of 2005. Perhaps reflecting the tax and labour market reforms implemented over the past two to three years, employment growth has picked up and the unemployment rate fell to 16.2%, its lowest level since 1999. However, most unemployment is structural and the remaining excess capacity in the economy, as measured by the output gap, is limited.

Monetary and fiscal conditions will need to tighten

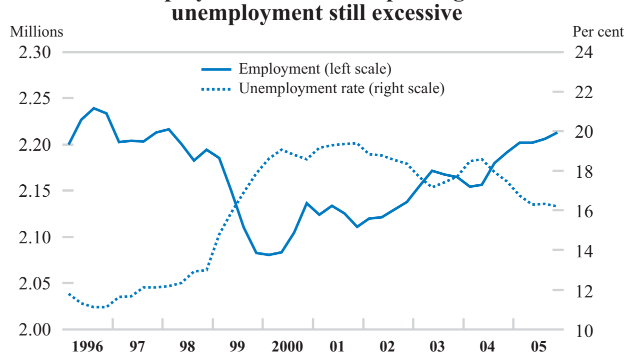
Both fiscal policy and monetary conditions have recently been stimulatory, given the impact of transfers from the European Union, continued low policy interest rates, and a stable exchange rate. At the same time, however, strong FDI inflows are increasing the production capacity of the economy, and this, together with relatively flexible labour and product markets, has helped to permit high growth without excessive inflation. Indeed, headline consumer price inflation recently reached an all-time low of 2.1%. However, a number of factors, including strong real wage growth, high oil prices, and a large increase in gas prices, are expected to push year-end inflation to around 4% – the top of the inflation target range. If renewed exchange rate appreciation does not occur, tighter monetary policy could be expected next year in order to meet the 2006 and 2007 inflation targets (below 2.5% and 2.0% respectively). Given the Government's clearly-signalled intention to adopt the euro in January 2009, a renewed tightening in fiscal policy will also be required to meet the Maastricht criterion on government finances by 2007, and this may also help to reduce excess demand in case of over-heating in the domestic economy.

Slovak Republic

Strong domestic demand has been offsetting a net export drag



Employment situation improving but unemployment still excessive



1. Percentage point, contributions to annual per cent change in real GDP.
2. Year-on-year percentage changes.
Source: OECD, *National Accounts*.

Slovak Republic: **Demand, output and prices**

	2002	2003	2004	2005	2006	2007
	Current prices SKK billion	Percentage changes, volume (1995 prices)				
Private consumption	633.6	-0.6	3.5	4.9	5.6	5.1
Government consumption	220.8	2.7	1.1	1.1	3.6	1.3
Gross fixed capital formation	303.5	-1.5	2.5	9.5	8.8	5.2
Final domestic demand	1 157.8	-0.2	2.8	5.3	6.1	4.4
Stockbuilding[1]	18.9	-1.9	3.6	0.6	0.0	0.1
Total domestic demand	1 176.7	-2.0	6.5	5.8	5.8	4.3
Exports of goods and services	788.2	22.5	11.4	7.5	10.6	12.6
Imports of goods and services	866.3	13.6	12.7	8.1	10.9	10.9
Net exports[1]	- 78.1	6.5	-0.8	-0.4	-0.2	1.9
GDP at market prices	1 098.7	4.5	5.5	5.3	5.6	6.2
GDP deflator	_	4.7	4.6	2.0	2.9	2.4
Memorandum items						
Consumer price index	_	8.6	7.5	2.8	4.3	2.8
Private consumption deflator	_	7.7	6.9	4.0	3.2	3.9
Unemployment rate	_	17.5	18.1	16.4	15.8	15.2
General government financial balance[2, 3]	_	-3.8	-3.2	-4.1	-4.2	-3.5
Current account balance[2]	_	-0.9	-3.6	-6.7	-6.6	-2.9

1. Contributions to changes in real GDP (percentage of real GDP in previous year), actual amount in the first column.
2. As a percentage of GDP.
3. Deficit definition includes the cost of transferring contributions to the second pillar of the pension system.
Source: OECD Economic Outlook 78 database.

Statlink: *http://dx.doi.org/10.1787/877883366485*

Strong GDP growth and high unemployment to continue…

With low interest rates, a stable exchange rate, and strong business confidence, GDP growth is expected to continue at around 5½ to 6½ per cent per annum, together with strong growth in potential GDP as additional production facilities open. However, the investment needs of the new automobile plants, together with higher oil prices, suggest that the current account deficit will remain large in the short term, before narrowing to around 2-3% of GDP by 2007-08 as new export capacity comes on stream. Since strong FDI flows are expected to continue, this high temporary deficit is not expected to pose any risks. While job creation is also expected to continue, the high unemployment rate will only gradually decrease in the absence of further structural reforms.

… but increasing up-side risks to inflation…

Despite strong growth in potential output, there is probably little remaining spare capacity, as reflected in a pick up in real wage growth, including in low-productivity sectors – perhaps also in response to the recent 6.2% increase in the minimum wage. Much of the increase in nominal wages was associated with high headline inflation in 2004. However, with headline inflation now being boosted by high energy prices, there remains a risk that backward-looking wage setting could jeopardize the achievement of the Maastricht inflation criteria.

… and uncertainty about how much fiscal tightening will be needed

Although the government is expected to continue to cut expenditures over 2006 and 2007, revenues may fall short of expectations if more people than projected by the Ministry of Finance transfer to the funded second pillar of the reformed pension system. Consequently, although the fiscal deficit adjusted for pension reform costs is expected to fall to around 2% of GDP by 2007, the headline deficit could still exceed the Maastricht ceiling of 3%, in which case successful entry to the eurozone would depend on the extent to which allowance is made, under the new Stability and Growth Pact rules, for the costs of the pension reform. Finally, uncertainty about the outcome of the 2007 elections poses risks to the continuity of recent policies.

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Conventional signs

$	US dollar	.	Decimal point
¥	Japanese yen	I, II	Calendar half-years
£	Pound sterling	Q1, Q4	Calendar quarters
€	Euro	Billion	Thousand million
mb/d	Million barrels per day	Trillion	Thousand billion
. .	Data not available	s.a.a.r.	Seasonally adjusted at annual rates
0	Nil or negligible	n.s.a.	Not seasonally adjusted
–	Irrelevant		

Summary of projections

	2005	2006	2007	2005	2006				2007		Fourth quarter		
				Q4	Q1	Q2	Q3	Q4	Q1	Q2	2005	2006	2007
							Per cent						
Real GDP growth													
United States	3.6	3.5	3.3	3.7	3.3	3.5	3.5	3.3	3.2	3.2	3.7	3.4	3.1
Japan	2.4	2.0	2.0	1.7	1.9	2.1	1.9	2.0	2.0	2.1	3.2	2.0	2.1
Euro area	1.4	2.1	2.2	2.2	1.9	2.0	2.2	2.1	2.2	2.2	1.8	2.1	2.2
Total OECD	2.7	2.9	2.9	3.1	3.0	2.8	2.6	2.9	3.2	2.9	3.0	2.8	2.9
Inflation													
United States	2.7	2.5	2.3	2.9	2.2	2.3	2.3	2.3	2.6	2.2	2.9	2.3	2.2
Japan	-1.1	-0.1	0.6	-0.2	0.0	0.1	0.3	0.5	0.6	0.7	-1.3	0.2	0.8
Euro area	1.8	1.7	1.9	1.9	1.5	1.5	1.5	1.8	2.0	2.1	1.9	1.6	2.0
Total OECD	2.1	1.9	1.9	1.5	1.4	2.1	2.4	2.0	1.7	1.8	1.9	2.0	1.9
Unemployment rate													
United States	5.1	4.8	4.7	5.0	4.9	4.9	4.8	4.8	4.7	4.7	5.0	4.8	4.7
Japan	4.4	3.9	3.5	4.3	4.1	4.0	3.9	3.8	3.7	3.5	4.3	3.8	3.3
Euro area	8.7	8.4	8.1	8.6	8.5	8.5	8.4	8.4	8.3	8.2	8.6	8.4	8.0
Total OECD	6.5	6.3	6.0	6.4	6.3	6.3	6.2	6.2	6.1	6.1	6.4	6.2	5.9
World trade growth	7.3	9.1	9.2	9.3	8.8	8.8	8.9	9.1	9.3	9.4	8.1	8.9	9.3
Current account balance													
United States	-6.5	-6.7	-7.0										
Japan	3.4	3.9	4.7										
Euro area	-0.2	-0.2	-0.1										
Total OECD	-1.8	-2.0	-2.0										
Cyclically-adjusted fiscal balance													
United States	-3.6	-4.2	-3.9										
Japan	-6.3	-6.1	-6.4										
Euro area	-2.2	-2.1	-2.0										
Total OECD	-3.1	-3.3	-3.2										
Short-term interest rate													
United States	3.5	4.8	4.9	4.2	4.6	4.9	4.9	4.9	4.9	4.9	4.2	4.9	4.9
Japan	0.0	0.0	0.7	0.0	0.0	0.0	0.0	0.0	0.3	0.6	0.0	0.0	1.0
Euro area	2.2	2.2	2.9	2.2	2.2	2.2	2.2	2.3	2.6	2.8	2.2	2.3	3.3

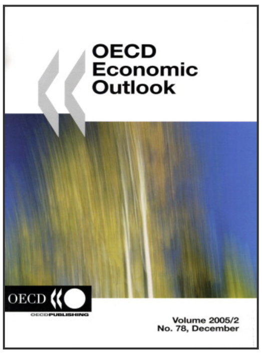
Note: Real GDP growth, inflation (measured by the increase in the GDP deflator) and world trade growth (the arithmetic average of world merchandise import and export volumes) are seasonally and working-day-adjusted annual rates. The "fourth quarter" columns are expressed in year-on-year growth rates where appropriate and in levels otherwise. The unemployment rate is in per cent of the labour force while the current account balance is in per cent of GDP. The cyclically-adjusted fiscal balance is in per cent of potential GDP. Interest rates are for the United States: 3-month eurodollar deposit; Japan: 3-month certificate of deposits; euro area: 3-month interbank rate.

Assumptions underlying the projections include:

- no change in actual and announced fiscal policies;
- unchanged exchange rates as from 11 November 2005; in particular 1$ = 118.00 yen and 0.85 euros;

The cut-off date for other information used in the compilation of the projections is 22 November 2005.

Source: OECD Economic Outlook 78 database.



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