ICEG European Center

NEWS OF THE MONTH
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A Report by the ICEG European Center
ICEG European Center
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News of the Month 2002/October

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I. PROSPECTS OF ECONOMIC GROWTH IN THE CZECH REPUBLIC

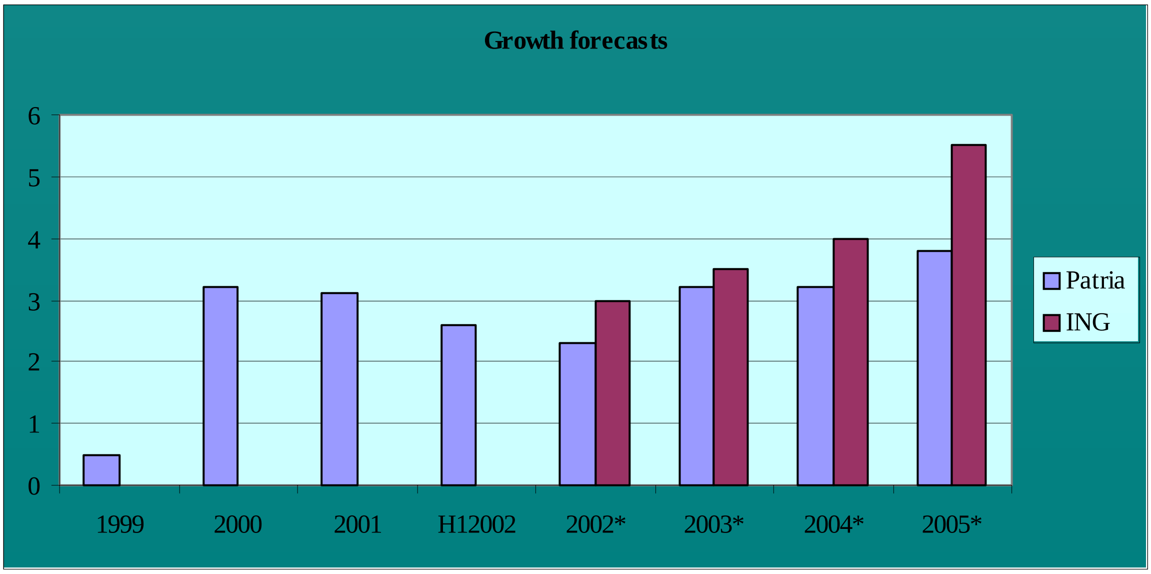
GDP-growth indicators in the Czech economy may be of some concern. The revised year-on-year growth figure for the first quarter of 2002 is 2.8%, and although this value is slightly higher than that of the previous quarter (2.7% in Q4 2001), it still remains well below the ambitious market expectations of 3-3.4%. Seeing this unfavourable trend, the Czech Statistical Office modified their forecast for the second quarter to 2.4%, which appears to be a better approximation. Growth in the second quarter is now estimated at 2.5% (y-o-y at 1995 constant prices), which reflects a steadily decelerating GDP-growth for the past one and a half year. Compared to the first quarter, the economy grew by 0.6% seasonally adjusted. This adds up to a 2.6% growth for the first half of 2002. Due to the enormous floods of August, however, also hitting the Czech Statistical Office, these estimations for the second quarter should be taken only as an orientation for the time being.

Chart 1

According to Patria's forecast (see chart), the Czech economy is expected to return to its previous growth path in 2003, and should go on producing better results in the long run (ING is even more optimistic). Mid-range forecasts are, however, rather pessimistic: the Czech National Bank forecasts 2-2.7% average growth for this year, (the same value for the Ministry of Finance is 2.7%; 2.8% was recorded at an OECD poll (market consensus) and 2.3% for Patria Finance).

Growth in the second quarter of 2002 was mainly driven by increased government consumption (an increase of 4.6%), as increases in household spending remained low (3.6%) and foreign trade continues to be sluggish due to persistent economic stagnation in the EU. (The Czech Republic's main trading partner, Germany is expected to grow at the rate of only 0.3% this year.) The impact of this was seen mainly in the declining exports of services (by 9.1%). This caused the current account deficit to widen from the Q1 figure of CZK 15.6 bn to 18.6 bn in Q2, as trade deficit increased and the services balance surplus unexpectedly shrank.

Chart 2



September trade balance unexpectedly fell to a deep deficit of CZK 12.6 bn in September after a revised gap of CZK 11.0 bn in August. In September 2001, the trade deficit reached a rare surplus of CZK 3.0 bn. This time imports rose by 13.2% on a monthly, while exports rose by 4.8% on a seasonally adjusted basis. While exports rose somewhat below expected seasonal trends, imports reflected several specific factors, removal of flooding costs and start up of new shopping centers. Exports declined an annual 1.8% and have fallen every month this year except February. The continued decline could signal that the country is losing its export markets due to the slowing global economy and possibly also the strengthening of the Koruna this year. Furthermore, despite the wide deficit for September, the country's nine month trade deficit narrowed to CZK 57.9 billion from CZK 79.1 billion a year earlier, so the current account gap is unlikely to widen beyond 5% of GDP. On the other hand, recent privatisation revenues (government sale of Transgas) comfortably cover the deficit.

Increased final consumption expenditure by the government in the past months was a great deal affected by inclusion of an additional military aircraft for the Ministry of Defence of the CR. If this were excluded, then government expenditures would have grown by only 2.9%, mostly as a result of growth in the subsector of health insurance companies. Higher budget spending in Q2 is also explained by both the political and the business cycle: elections held in May coincided with an undoubtedly unfavourable world business climate.

The August floods have come on top of that for the next quarter – the reconstruction of damaged infrastructure surely put pressure on the budget, especially as Prime Minister Spidla's "flood package" was defeated in Parliament by a single vote. The package was about an increase in tax revenues amounting to 1% of GDP by raising duties on tobacco and spirits, raise the 5% VAT rate to 7% and the introducing of an additional income tax bracket of 35% for annual incomes over CZK 1 million. The defeat of the package led to a crisis within the ruling coalition and raises doubts about the financing of the upcoming reconstruction efforts. The wealth destroyed by the greatest floods of the last century is estimated around CZK 100 bn (3.3 bn dollars), over 4% of GDP (the highest loss/GDP ratio among the Central European countries hit by the floods this summer).

The Czech government approved the 2003 state budget draft on October 21 with the country's highest-ever deficit, although it was still lower than planned by using accounting moves to lower the gap and put off a major rise in spending as EU entry nears. The new budget draft is a result of a hard-fought compromise: the headline gap was cut by delaying payment of over $1.25 billion in losses stemming from costly bank and corporate bailouts made in previous years. An additional 2.0 billion crowns were cut in general expenditure at individual ministries and a further 1.5 billion was shaved off the Ministry of Defence's budget, but the gap still amounts to about 4.5% of estimated 2003 GDP. The overall public sector deficit is even higher, running at 5.5% of GDP.

Patria expects a sharp drop in the year-on-year increase in industrial output, construction output and retail sales for August, mainly as a result of the floods. Although these figures are likely to recover by September, the overall performance this year is expected to be much worse than in 2001 (the expected average values for 2002 are 4.3% vs. 6.8%, 3.6% vs. 9.6% and 3.0% vs. 4.3% respectively). Nevertheless, this weakening of economic performance should not be attributed to the natural catastrophe for the most part; it is more of a result of the general economic downturn in the region. The loss of wealth itself does not directly influence the growth path of the Czech economy – the CNB, for example, had left its rates unchanged and did not modify its growth forecast, either – paradoxically, recovery work might even boost economic activity in the upcoming quarters. However, these macro trends are accompanied by more and more disorderly public finances, which may have a strong indirect effect on growth in the mid-range.

The Czech Koruna reached its all-time high against the Euro at 28.84 on July 11th. Since then the Czech National Bank (CNB) succeeded in fighting against the strength of the currency and pushed the exchange rate back to levels above 30 CZK/$ today. The Koruna survived the floods with remarkable resilience, too: having reached a low in mid-August, the Czech currency stabilized and gradually strengthened back. The reasons behind the surprisingly well-behaving foreign exchange markets are actually the speculation on flood-related inflows such as foreign aid and transfers from insurance companies outside the CR. On the other hand, the replacement of damaged equipment and machinery will raise import demand and prevent the currency’s further appreciation.

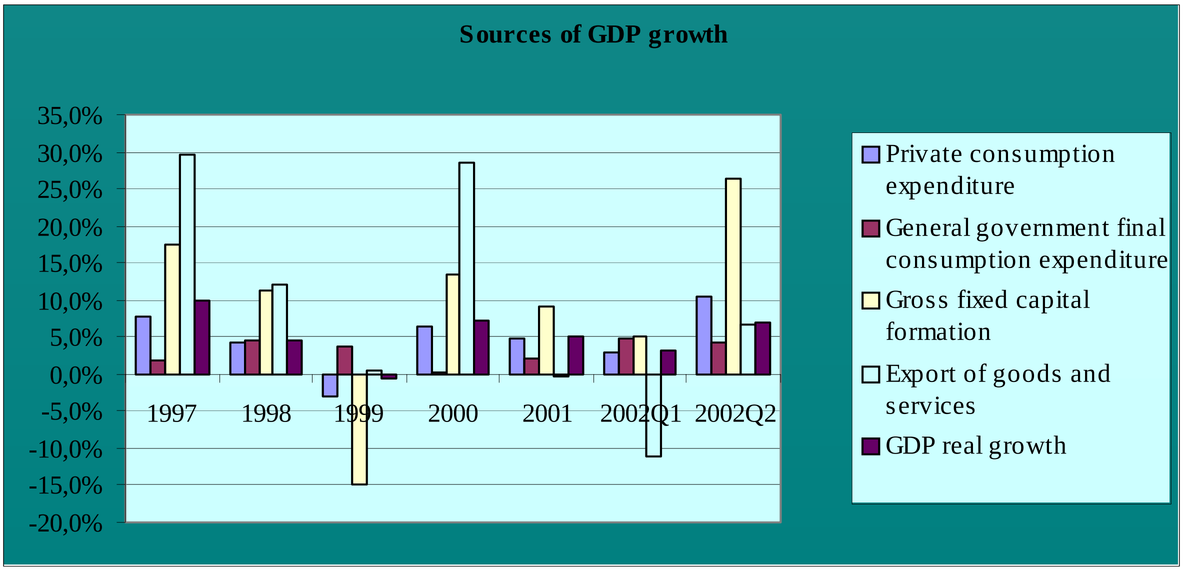
Having said that, and given that CNB interest rates are already lower than the ECB refinancing rate (following five cuts in the past twelve months, the two week CNB repo is now at 3%), there is very little scope for short term appreciation for the Koruna. In fact, the CZK may currently be the least attractive currency in the CEE region, portfolio investment is expected to dry up and so the long term trend of appreciation may be temporarily broken in the near future. Many analysts believe the central bank may cut interest rates by up to 50 basis points at the next policy meeting on October 31 as inflation remains low and because there is a need to boost the economy in the wake of the floods.

II. Remarkable but Fragile Growth in Estonia

In spite of expectations and the delay of its main trading partners' economic recovery Estonia showed up a solid economic growth of 5.2% in the first half of 2002. The upsurge was especially surprising in the second quarter, because it reached 7% y-o-y. Although it is parallel with some favorable process in the economy (e.g. decreasing unemployment rate and inflation) but the growth seems to be fragile due to the soaring current account deficit.

All the analysts forecasted a ca. 4.4% GDP growth for Estonia in 2002. Regarding the cool climate of the world economy and being a small and open economy which is heavily dependent on foreign trade, there was no hope that the country could achieve an outstanding GDP growth in this year. But Estonia did it. The growth rate bottomed out in 1Q02 at 3.2%, and in 2Q02 reached a sparkling 7% (the best rate since the third quarter of 2000). The main engine of the boom is **domestic demand**, which was up by 12.8% in 2Q02.

Chart 3



Compared to the second quarter of 2001 the private consumption expenditure increased by 10.5%, the general government final consumption expenditure was up by 4.3%, the gross fixed capital formation rocketed by 26.4%, and changes in inventories rose by 2.3%. Their shares in GDP are 53.6%, 20.4%, 27.2%, 3.6% respectively. The share of private consumption has increased from 51.8% since 2Q01, while capital formation has increased from 23.5%.

This pattern of economic growth is not characteristic of the way in which Estonia has developed in the last years. The internal market of Estonia is small and maybe this is the first (and only) quarter when it can provide prosperity to such an extent. What are the reasons for the high domestic demand?

Private consumption is supported by low interest rates (the margins are also decreasing), increasing wages and the nominal appreciation of the Euro (to which the Estonian Kroon is pegged) against the dollar. The interest rates have hit an all-time low in May 2002 because they were following the European rates. The 3 month interbank rate sank from 6.18% to

3.94% between November 2000 and May 2002. This has been boosting the consumption of private individuals and firms. In the first half of the year, lending increased 28 % y-o-y. Afraid of the vision of an overheated economy the government and the national bank want to restrain commercial banks' lending (and therefore the domestic demand). The government's first step is to reallocate its asset portfolio and shifts about one billion Kroons (€64 million) of its deposits with commercial banks to the central bank.

The *increasing wages* also encourage consumption. The real growth of wages has exceeded the real growth of productivity since the start of 2001. The gap was 6.3 percentage points in the first quarter of 2002, but it is rather due to the „whitening” of some sectors of the economy than to the growth of true (pay-to-pocket) wages. The change of real unit labour cost has been continuously negative since the end of 1999, thus the virtual productivity is increasing. Nonetheless, the growth of labour productivity has been declining since the second quarter of 2000.

The *nominal appreciation* of the Euro (and thus the Estonian Kroon) has strengthened the domestic demand for imported goods, but weakened the chances of export. The rate of appreciation against the dollar was 9% this year. Consequently the current account deficit is extremely high, 14.4% in the first and 10.6% in the second quarter of 2002.

The general government final consumption expenditure increased to a lesser extent than the GDP, which is according with the traditionally conservative Estonian fiscal policy. Nonetheless two supplementary budgets were accepted in the current year, because the revenues of the general government surpassed the expected figures. The surplus of the budget was 1.7% of GDP (according to GFS methodology) at the end of July. Although the balanced general government budget principle is one of the three solid principles of economic policy, the draft budget for 2003 contains a deficit of 0.3%. Prime Minister Siim Kallas explained the deficit with the launching costs of the second pillar of the pension system. He claimed that the fiscal policy remained trustworthy and reasonable. The general government expenditures account for the 40% of GDP and are planned to slightly decrease in the following years.

The gross fixed capital formation increased by 26.4% in the second quarter of 2002, therefore reached 27.2% of GDP. These surprising figures cannot be explained solely with expansive monetary policy (the mentioned low interest rates). Amendments in the taxation system have also contributed to the high investment rate since the beginning of 2000. The average effective tax rates on capital plunged considerably, from 35.1% in 1999 to 10.9% in 2002. The abolition of the income tax for reinvested profit (1. January 2000) has had the biggest impact. The increased corporate retained earnings also provided growth of investment. In spite of the attractiveness of the Estonian tax system the FDI inflows fell sharply in the second quarter of 2002. In 1Q02 the net FDI inflows were EEK 1 728.5 millions, but in 2Q02 only EEK 287.6 millions. It must be mentioned that half of the direct capital inflows in Q1 consisted of reinvested profits of foreign owned enterprises.

The change in inventories was up by 2.3% in 2Q02, which is a considerable decline compared to the 10.4% in 1Q02. The decrease is due to the booming private consumption expenditure, and therefore to the increasing wholesale and retail trade.

While the domestic demand was growing to such a surprising extent, the recession of the developed world hit the foreign trade of Estonia. The liberal trade policy (as one of the three main principles) is characteristic of the economic policy of Estonia. The Heritage Foundation gave the 4th position to Estonia among 155 countries in its economic freedom index.

Consequently the total foreign trade turnover accounted for the 185% of GDP in 2001. As a small and open economy Estonia is very sensitive to external shocks, first of all to the export demand of its main partners. The foreign trade of Estonia in 1H02 was mainly affected by the nominal appreciation of the Euro and by the slow growth of the EU-15 economies. The export of goods and services fell sharply in 1Q02 in a year-on-year comparison (-11%), and the import of goods and services also decreased by 4.2%. This generated a very low (3.2%) economic growth.

The external conditions for the Estonian economy improved in the second quarter. The export was up by 6.7% y-o-y (due to the 23.9% increase of services), and the import by 8.7% (with an 36.4% upsurge in services). The recovery of foreign trade gave a contribution to the sparkling performance of the second quarter in 2002. Although Finland, Sweden and Germany (who are responsible for a major part of the export and import of Estonia) are still struggling, an increasing volume of trade of goods characterised the summer months, July and August. The export was up by 13.7% in these two months in y-o-y comparison, and imports rose by 15.1% y-o-y. Small fluctuation of foreign trade does not affect the GDP growth of the small Baltic country significantly, because it mainly derives from the low value-added electronics subcontracting. The value of foreign trade was equally to the 173.3%% of GDP in 2Q02.

If someone investigates the gross domestic product by economic activity, he will see that the construction, the manufacturing and the financial intermediation were the engines of the economy in the first half of 2002. Growth characterised all economic sectors in 2Q02 except agriculture and electricity, gas and water supply. Value added at constant prices in construction was up by 12.5% y-o-y in the first and by 14% in the second quarter. Manufacturing grew by 12.6% in 2Q02 compared with the second quarter of 2001. Thus manufacturing is responsible for the 18.9% of GDP at current prices. The industrial firms sold more than they produced (in H1 2002) thus the stockpiles in warehouses are decreasing. The financial intermediation sector showed up a significant amount of growth (13.6%) thanks to (above all) the growing loan stock of commercial banks. Wholesale and retail trade went up by 10%, thus its share in GDP is 14%. The transport, storage and communication sector increased only by 5.8% in the second quarter, consequently its share in GDP slightly decreased to 16.4%.

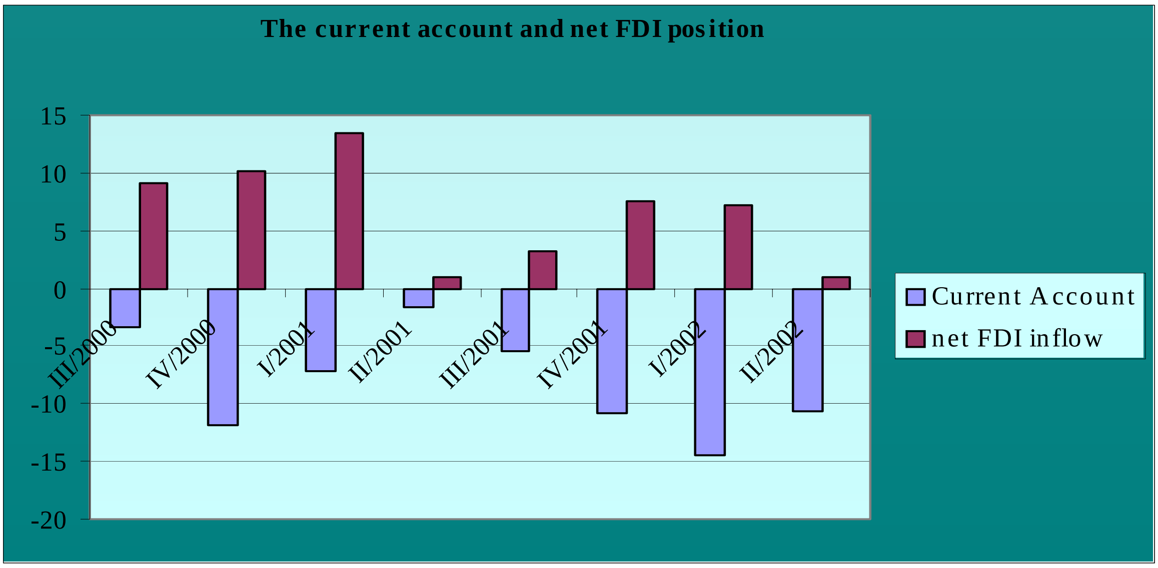
All analysts agree that the Estonia has showed some signs of an overheated economy. The 5.2% economic growth in the first half of 2002 exceeded even the best expectations, but it is accompanied by a 12.3% current account deficit. The average of forecasts for the economic growth in 2002 is about 4.3%. For the next year the expectations are more optimistic, they move between 5.5% and 6%. As the Pre-accession Economic Programme 2002 (PEP, it was endorsed on the 13. of August) stated, the long-term growth potential of Estonia is about 5-5.5%. However, “Estonia is able to achieve 6% average economic growth in the medium-term perspective, in first of all in connection with consistent inflow of EU structural funds and implementation of structural reforms”.

In order to achieve this object the government will retain the three main principles of economic policy: the Currency Board Arrangement, balanced general government budget, liberal trade policy and favourable investment climate. The most important indirect goal is “to increase flexibility of the supply side of the economy via consistent structural reforms and infrastructure development”. This means first of all the improvement of the quality (and supply) of the labour force and the reducing of corporate costs. The growth of total factor productivity (which derives from human capital accumulation and technology diffusion) could be the engine of economic growth in the medium-term according to PEP.

Many dangerous signs threaten the Estonian economy and they make the current growth fragile. The most important among them is the soaring current account deficit, which reached the 12.3% of GDP in the first half of 2002. The CA deficit is traditionally high in Estonia, 5.8% and 6.1% in 2000 and 2001 respectively, but it was fully covered by net FDI inflow in both of the previous years. Contrary to the tradition, the net FDI inflow was lagging behind the CA deficit in 1H02, and covered only 31%. The figure is even grimmer when only the second quarter is taken into consideration, because the net FDI flow in April-July accounted for only 9.4% of CA deficit. The CA deficit derives from the huge trade deficit, which is generated by the strong import demand (for investment and private consumption).

The decline in trade of goods was smaller in the 1Q02 than the decline of export, and in the second quarter import increased higher than export. The trade deficit was equally to 17% of GDP in the first half of the year. The perspectives for export are rather grim because of the slump in the global telecommunications and electronics sector. A considerable part of the Estonian export would stream to the above-mentioned sector of the Scandinavian economies. The surplus in balance of services (8% of GDP) was not to be able to overweight the trade deficit. The construction boom has contributed to the relative low surplus in services. The net income was negative (5.5% of GDP), and the net transfer was positive (2.1% of GDP) as usual.

Chart 4



The net FDI inflow was favourable in the first quarter, when it reached 7.1% of GDP. The same figure for 2000 and 2001 (whole years) was 6.4% and 6.1% respectively. The net FDI inflow was only 1% compared to the GDP at current prices. The terrible figure is owed to the low inflow volume (smaller than ever in the last two years) and to the jump in the volume of FDI outflow. Estonia is the biggest investor per capita among Central and Eastern European countries (131 dollars per capita). It is hard to explain why the value of FDI inflow has dropped when Estonia provides such an attractive environment for foreign investors. The explanation could be the weak economic performance of the EU and the Scandinavian countries, which are the largest investors in the Baltic states.

The next risk factor is the low value of official reserve assets of the Bank of Estonia. The reserves can not cover 3 months' import, which is a relatively low figure compared to international standards.

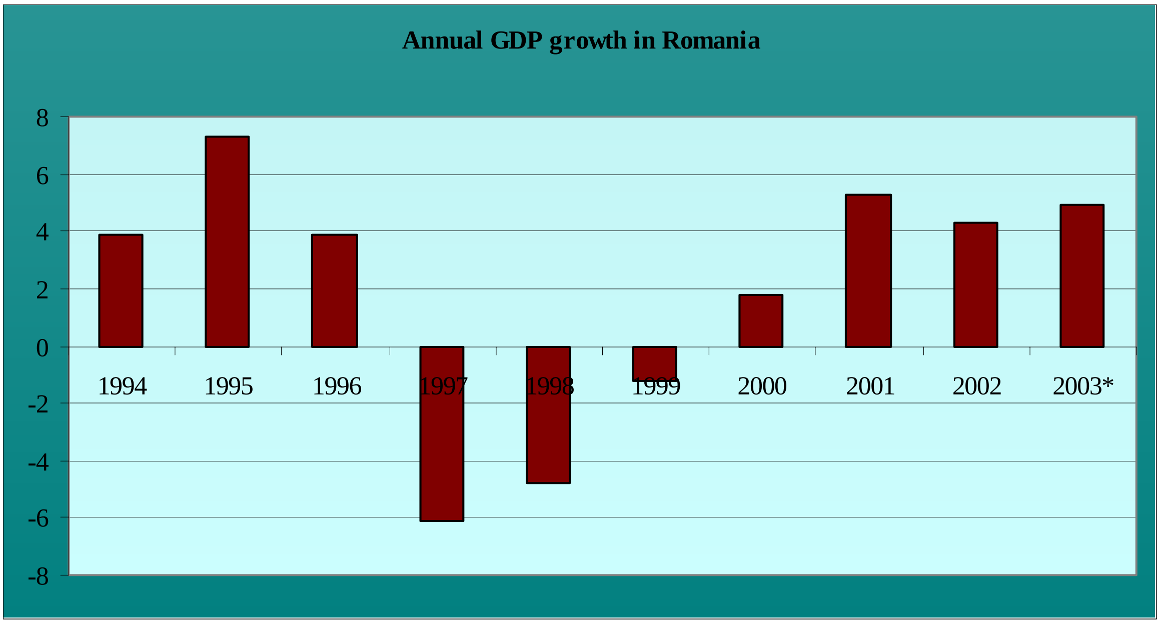
The parliament election is approaching, thus there is a pressure on the expenditure side of the central government budget. The increase of governmental consumption or investment would further heat the economy at the expense of external stability. By the way, the government seems to be committed to the balanced central government budget principle.

One of the biggest risks is the deterioration of competitiveness because of the rapidly rising real wages. As we have already mentioned the real unit labour cost has still decreased in 2002, but to a much smaller extent than in 2000. Estonia is the 27th among 75 countries in the World Economic Forum's global competitiveness list. IMD World Competitiveness Yearbook 2002 ranked Estonia the 21st place in the world (the most competitive among Central and Eastern European countries).

III. ROMANIA IS ON TRACK

After three years of recession in the end of 1990s, Romania seems to find the pathway to sustainable economic growth. In 2000, modest growth was produced and it accelerated in the next year. The 1,8 % GDP growth speeded up to 5,3 % which is really good data considering the slowing world economic trend. High economic growth rate sustains in 2002 and it will be resumed in 2003 too. The IMF's forecast is 4,3 % for this year and 4.9 % for the next.

Chart 5.



* GDP growth rates for 2002 and 2003 are forecasts.

In 1997 the economy in Romania decreased by 6,1 % that meant quite large recession. That was the second decline period after the transition in Romania. In 1999 the GDP hit again the level of GDP which was produced in 1994. In the following year Romania was able to stop the decline and produced modest increase that accelerated to 5,3 % in 2001. That growth accompanied with decreasing inflation rate and increasing current account deficits. The big GDP growth rate was based on high domestic demand that caused rising import and worsening current account balance. The current account deficit reached 5,9 % of GDP. Exports performed well but imports outpaced exports. Exports growth rate was about 10 % last year while imports growth rate nearly reached 20 %. The current account deficit was USD 2349 million last year. Notable details that the net services and current transfer accounts improved but these could not neutralize the impact of worsening trade balance.

However, the current account deficit is already high, the macroeconomic policies are on track. The fiscal policy has been tightened since late 2001 and monetary policy strikes an appropriate balance between achieving further disinflation and preventing an excessive appreciation of the currency.

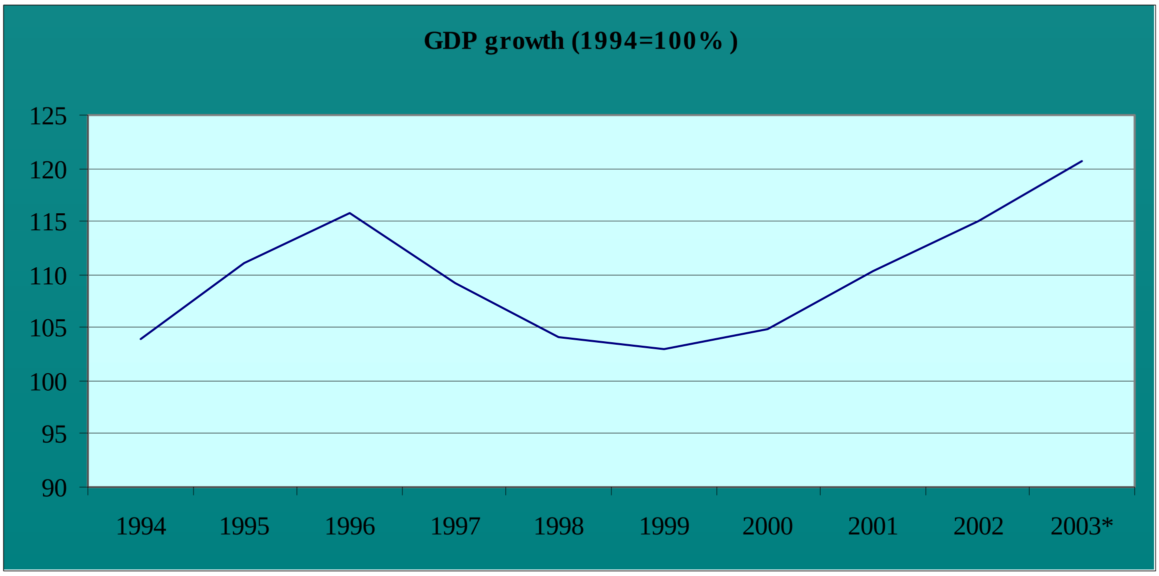
The inflation rate is decelerating, although it is still high. The reduction of this factor is helpful to reach a sustainable economic growth. The inflation rate at the end of this year will be 18% at most, considering the evolution in the early nine months of the year, expected the

Governor of the National Bank of Romania (BNR), Mugur Isarescu. Considering the current situation, inflation cannot go beyond 18% by the end of the year, he added. In his opinion, BNR could have an inflation target of 12% for next year. In September, the inflation rate was 0.6%, and in the previous month it had been 0.8%, while for all the first nine months of the year it was 11.4%. BNR Governor said that in an optimistic scenario for the last three months of the year, the inflation rate for the year 2002 could be close to 16%.

The Romanian economy is doing well. Industry appears to have become more competitive, exports are still rising and it was accompanied with the after-effects of last year's good agricultural performance to lift second quarter of 2002 GDP by 5.7%. So the robust GDP growth continued, it will be about 4.3 % and that is remarkable considering the unfavorable world economic conditions. Comparing that expected growth with those expected to other countries in the region, 4.3 % growth might be one of the highest increase in Central and Eastern Europe. In the region, only the Baltic countries can exceed this robust increase. In the end of this year, GDP may reach the GDP of 1996, the level of last year before recession.

In 2002 the relatively lower GDP growth rate is because of the economic slowdown of Romania's trading partners. The recovery of world economy is expected the next year. In that period, the growth rate of output in Romania can reach again the 5 % and it may continue in the next year.

Chart 6.



* GDP growth rates for 2002 and 2003 are forecasts.

The current account balance will slightly improve in 2002, it is expected to reach 5.1 % of GDP and that improving is expected to continue in the next year (4.9 % is forecasted). The decreasing seems to be approachable, the monthly current account deficit of first half year is equal to the projected data for the period. Trade deficit in August was USD 65.4 million, lower than the USD 108.1 million in August 2001. In the first seven months, the current account balance was better by USD 332 million than last year. It is an interesting fact that the IMF expects improving current account balance (4.9% deficit in 2003) while some analysts forecast worsening C/A balance (remarkable worsening is expected by Deutsche Bank

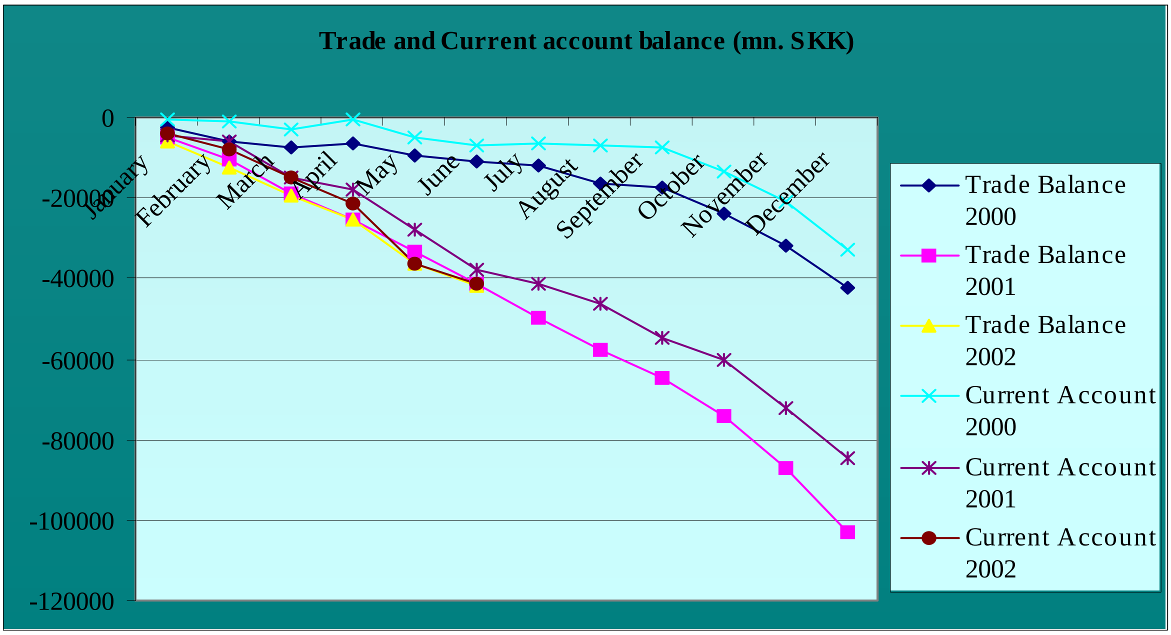
Research, C/A balance deficit is expected to be 5.5%, versus 5.2% this year). It may be connected with the different expectations of global economic recovery.

Romania seems to be on track. With further support coming from the projected recovery in Western Europe, the country is expected to continue growing by 4–5 percent in the next period. External deficits remain rather high, however, and Romania will need to maintain a firm fiscal stance coupled with ongoing efforts to restructure its economy and boost external competitiveness. High inflation remains a key concern in Romania, and needs to be tackled both through sound macroeconomic policies and by wage restraint (including the government sector and state-owned enterprises).

IV. Growth Prospects in Slovakia

During the first half of 2002, gross domestic product increased by 3.9% on year-on-year base (at constant prices). That growth was 1 percentage point higher than in the same period a year earlier. The real economic growth in the first half of the year was a result of relatively balanced development in the individual quarters, when GDP grew by 3.9% in the first quarter and 4.0% in the second. The consumer prices recorded the second highest month-on-month increase this year in August, which reversed the downward trend in the year-on-year rate of overall inflation. The 12-month rate of inflation rose by 0.7 of a percentage point in comparison with July, to 2.7%. The balance of payments on current account for the first half of 2002 resulted in a deficit of SKK 41.2 billion, which was SKK 2.2 billion more than in the same period a year earlier. The moderate increase in the year-on-year deficit in the trade and the income balance was accompanied by an increase in the positive balance of services. These macroeconomic factors are relevant to estimate the further pathway of Slovak economy.

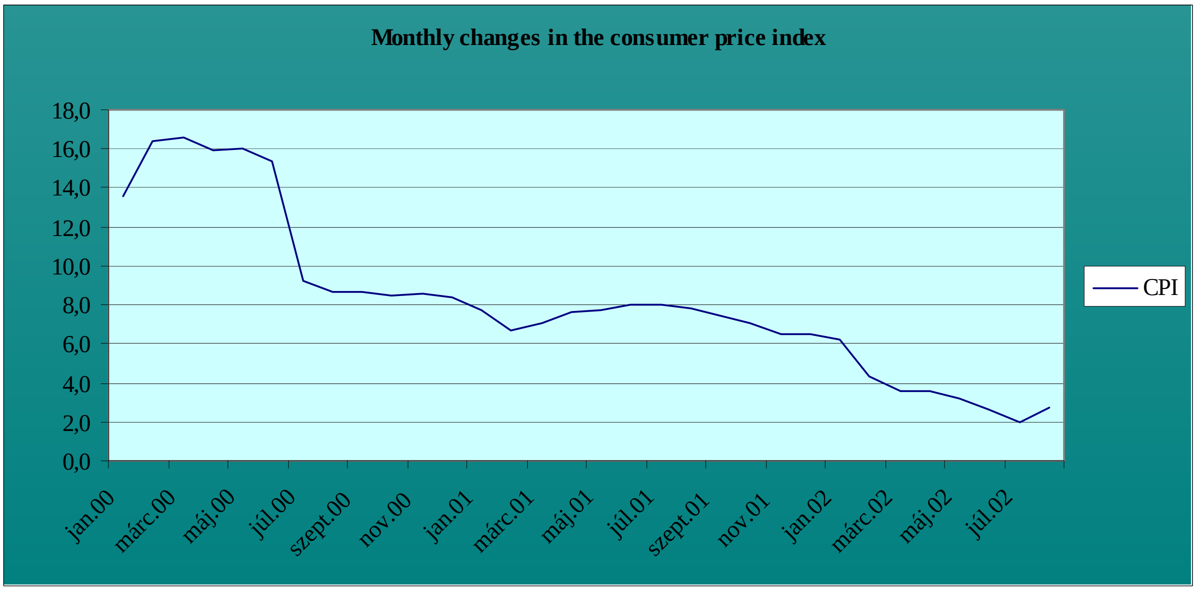
Chart 7



Slovak economic growth (3.9%) has recently outpaced the growth of the traditionally stronger countries of Central Europe (3.1% increase is the second best rate in Central Europe, Hungary produced it). The European Union average was 0.7 per cent. Experts are warning that the outstanding growth is not based on long-term health and the new government will have no choice but to choke off the rise. They mentioned that Slovakia's growth was largely artificial, driven by increased state spending and delays in deregulating prices for gas and electricity, which have in turn fuelled the growth in household spending. They added that government will have to impose austerity measures and cap growth stimuli after September election.

Analysts say that household consumption remains the biggest growth driver. This is no surprise considering the pre-election 'sweeteners'. Grown by 5.9 per cent year-on-year in the second quarter of 2002, household consumption was driven by the postponed major price deregulation in 2002 and an increase in public sector wages, increased by as much as 11 to 16 per cent year-on-year in real terms. In addition, public sector spending grew by 6.8 per cent in the second quarter of 2002, an increase which analysts attributed to an unexpected fall in inflation. Excessive growth in public sector spending resulted from original state budget estimates, which were based on expectations of 6.7 per cent inflation. However, inflation has reached record lows (of 2.7 per cent), so there is a discrepancy now. At the same time, domestic demand grew by 3.4 per cent and foreign demand by 0.6 per cent in the first half of the year, another factor driving Slovakia's GDP rise.

Chart 8.



Although real wage growth in Slovakia has reached its highest level for the last five years, analysts stress that the growth stems from government policy rather than greater labour productivity. The average nominal monthly wage increased by 10.5 per cent on year-on-year base, while in real values wages grew by 7.2 per cent compared to the same period in 2001. Experts cautioned that increases in public sector wages combined with record low inflation were behind the wage growth, not an increase in labour productivity. The new government will implement austerity measures in early 2003 and that will take real wage growth back to levels of 0 to 1%.

However, analysts emphasise that the high figures reflect a pace of growth which in not sustainable unless its driving force shifts from consumption to production. While household and public sector consumption grew, business sector investments, which provide sustainable economic growth, fell by 0.3 per cent year-on-year in the second quarter of 2002, according to the Slovak Statistics Office. This structure of strong consumption (either by households or government) and a drop in gross investments does not represent a long-term sustainable source of economic growth. After the election, the country's economic health will almost certainly become the focus of the next administration.

Experts forecast that public spending would be hit by the fiscal austerity package (to be) introduced in January 2003 by the new government. However, export growth to pick up further by the end of 2002, as well as consumption to stay strong throughout 2002. Exports should then re-take their leading growth support role. The growth rate will be approximately the same, only its structure will be more healthy.

According to Statistics Office, Slovakia's GDP in the second half of this year should be influenced by a post-election cut in public sector spending. The benefits of greater fiscal discipline could be mitigated by potentially higher foreign and domestic demand, fuelled by construction needs following the past summer's flooding. The Statistics Office expects annual GDP growth to reach 3.7 per cent for the full year 2002. Analyst predictions range from 3.5 per cent (DB) to 4 per cent (IMF).

Deutsche Bank predicts 3.5% GDP growth in 2002 and it speeds up to 4.0% in next year, forecasting the improving world economic conditions. The inflation rate will be 3.5% this year, and it jumps to 6.2% in 2003. The current account balance will be better than it was expected at the beginning of the year, they forecasts 7.4% deficit and it will improve next year (to 5,7% deficit).

The IMF’s prediction is a little different, they expect 4.0% economic growth this year and that level will remain in 2003 (3.7%). The consumer price index rise to 7.2% next year from this year’s 4.2%. IMF predicts higher current account deficit to both years, 8.5% to this year and 7.2% to 2003.