THE ECONOMY FACING THE "FINAL BARRIER" [1]

(Velimir Bole)

Summary

Economic Achievements in 2004

Since the end of 2003, economic activity has strengthened. Major impulses for growth have come from export demand and, slightly less, from investment demand. Considerable expansion of credit to the population has enabled growth of private consumption expenditures, which, however, were only following the lively growth of GDP. Current government expenditures for goods and services lagged.

The active labour force continues to rise, with the quality of employment improving rapidly. Indeed, the share of the upper quintile in the quality distribution of employment is almost at the EU average.

Reduction of inflation has slowed. The consequences of oil prices fluctuations on inflationary expectations and on inflation were neutralized partly by the decrease of food prices and partly by fiscal policy. Relative prices of non-tradables increased. Producer prices, pushed by prices of raw materials and wages in the business sector, have enhanced cost pressures; they will affect economic activity (employment) in tradable sectors and prices in non-tradable sectors.

Interest rates decreased in real and, even more so, in nominal terms. Net financial outflow abroad through non-banking sectors (business and household) prevented even deeper reduction of interest rates, while increased net financial inflows through the banking sector added to pressure on lowering lending interest rates more than deposit interest rates.

Credits to households increased considerably; after a long period of stability, the indebtedness of households increased as well. Credits to the business sector also increased, with foreign exchange credits growing twice as fast as credits in tolars.

Considerable enhancement of the credit supply of money was neutralized by demonetizations on the retail foreign exchange market. As a result, broader money (M2) increased very slowly, which consequently prevented even stronger reduction of nominal deposit interest rates.

The development in the financial part of the balance of payments prevented the full increase in "interest weakness" of the central bank in 2004; such an increase in central bank strength had not been expected. The pressures on exchange rate fluctuations were thus relatively modest.

[1] The majority of the results presented in this paper have already been presented at the Business Conference in Portorož (24 November) and at the annual conference of Abanka (2 December).

In the months following EU entry, a considerable liquidity gap of domestic taxes on goods and services appeared, while effective tax rates have not yet been significantly changed.

Outlook for 2005

Economic activity in 2005 will be similar to activity in 2004. Impulses to growth will remain, coming from exports.

Inflation will, following a rather short interruption at the end of 2004, continue to fall only until the middle of 2005. At the end of next year, inflation will reach the upper limit of the criteria for entry into the EMU (around 2.5%).

Real interest rates will decrease only slightly and will start increasing in the second part of the year.

If caused by the shift in tax revenue cash flow upon entering the EU, the current liquidity gap in tax revenue is not very important for performance in 2005; indeed, it might even be favourable. However, if liquidity problems were a consequence of the already-falling efficiency of tax administration (towards the significantly lower EU level), this could endanger the fulfilment of the government deficit criteria for entering the EMU, particularly since troubles in the efficient implementation of the new tax system can be foreseen. Indeed, troubles with tax revenues could increase the deficit by over 2.3 percent of GDP. Thus, even only "structural" changes in the expenditure of the public sector in 2005 might be extremely dangerous.

The trouble with tax revenues could also increase volatility of inflation and worsen the ability to reach the inflation criterion.

Greater autonomous financial inflows would additionally lower interest rates; inflows of already-experienced levels could lower interest rates by more than 0.5 points. This would again enhance the weakness ("observer" role) of the central bank with regards to interest rates and therefore the opportunity costs of (likely) urgent anti-inflationary interventions in 2005.

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0. Introduction

In the functioning of certain segments of the economy, 2004 saw some notable changes. Some are more long-term or endogenous in nature, while others were triggered by the accession to the EU. Changes in economic performance have been all the more significant, since 2005 is the reference year for entry into the Euro Monetary Area. For this reason, an assessment of the current functioning of key parts of the economic mechanism, as well as an assessment of the possible effectiveness of economic policy interventions during the closing period of transition are very important.

This paper deals with the economic performance in 2004 that might constitute significant determinants of the working of the economy in 2005, and with the possible economic performance in the coming year. It is focused particularly on the key achievements for entry into the euro, that is, on inflation and the public finance deficit. Most of the paper is devoted to two segments of the economy which underwent the biggest changes in 2004, namely foreign financial flows through the non-government sectors and tax revenue. It will also probably be in these two segments that the "final" will be played in 2005.

This paper takes account of the actual data up to the end of the third quarter of 2004.

The paper is divided into two parts. The first describes the essential changes in the functioning of the economic mechanism in 2004, and the second provides an assessment of the possible economic achievements in 2005 under the assumed policy and external conditions. Given its scope, the first part is further divided into separate points regarding level of activity and employment, prices and costs, the balance of payments and tax revenue.

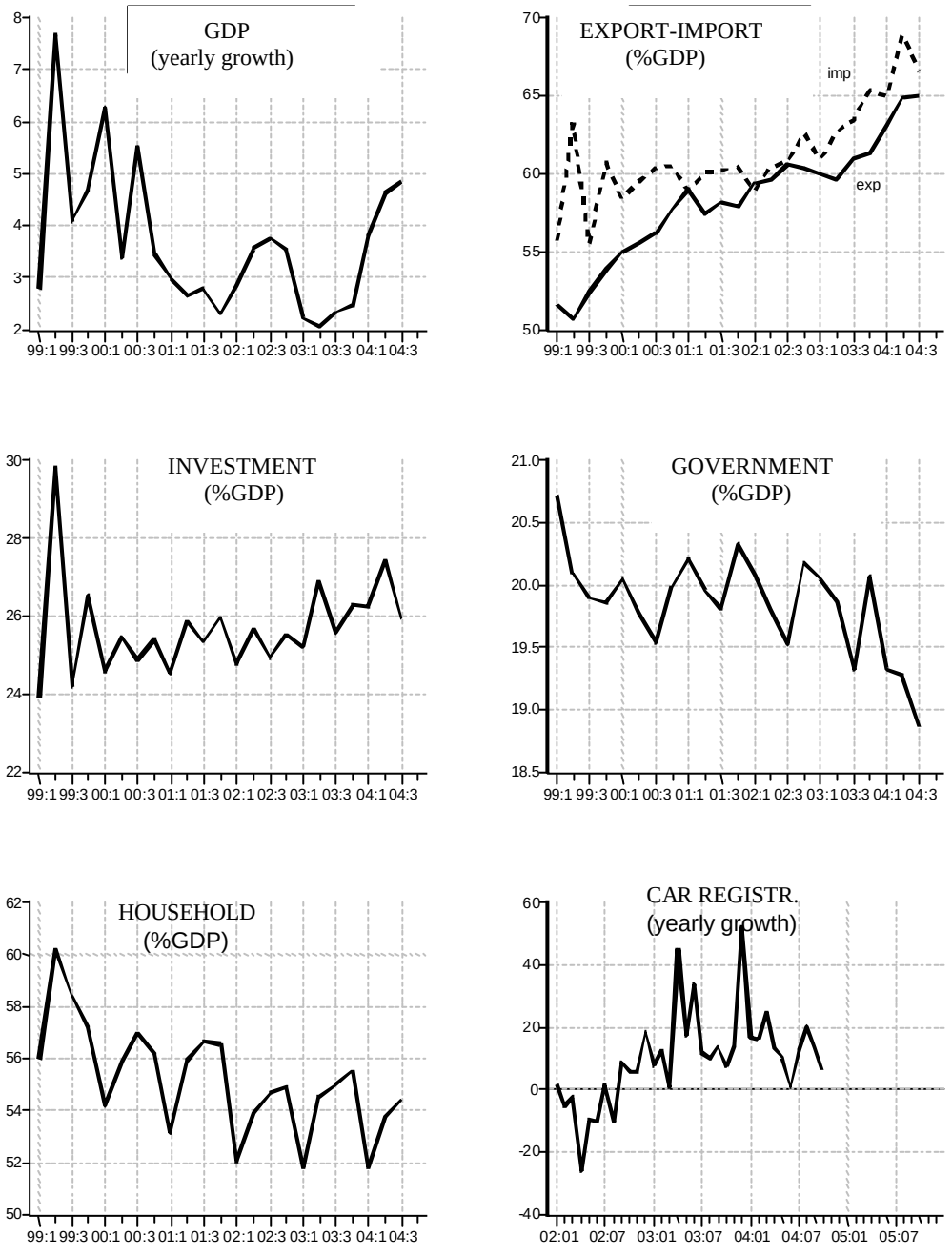
I. ECONOMIC PERFORMANCE IN 2004

1. Growth of economic activity; tempo dictated by exports

Economic activity. The dynamic and structure of what is driving economic activity is shown on Figure 1. It shows the yearly (quarter-over-quarter in the previous year) growth of GDP (gross domestic product) and changes in the structure of that product. Changes in the structure are shown in constant 2000 prices.

It is quite obvious that economic activity was stepped up markedly after the end of 2003, and that yearly rates were, by the middle of 2004, already twice those of the end of 2003. Despite this acceleration, the dynamic of domestic product has still not regained that of 1999 and 2000.

Figure 1
Aggregate demand



Although certain features of the changing structure of final demand are quite unusual (in 2004/II, for example, change in inventories contributed as much as 1.5 points to the growth of GDP; similarly, the growth of GDP received an additional boost in 2004/III, when the import dynamic fell), it is beyond dispute that the major contribution of exports to growth was essential, both for the sustainability of growth in real terms and for nominal convergence in the reference year for entry into the euro

(2005). While in the period from the beginning of 2001 to the middle of 2003, exports grew approximately as quickly as economic activity (GDP), in 2004 exports accelerated much more than GDP. The intensity with which exports drove domestic product is clearly illustrated by the relative increase in export demand vis-à-vis domestic product, since from the middle of 2003 to the middle of 2004, exports (in 2000 prices) grew by more than 4 points of GDP. Owing precisely to the key contribution of exports to the growth of GDP, the changing trajectory of economic activity in the last three years has been very similar to the changing trajectory in the growth of GDP in the EU, except that the growth rates in Slovenia were approximately 2 percentage points higher!

Domestic final demand has been almost stagnant relative to the GDP. Yearly growth of investments has been faster than product growth (by around 1-1.5 points), but primarily owing to the (temporarily) high capital spending by the state. The dynamic of two other components of domestic consumption (relative to GDP) is similar to how it has been since the beginning of 2001. Relative to GDP, the dynamic of current spending (for goods and services) of the state is gradually slowing down, while household spending is stagnating. As the aforementioned dynamics are given relative to GDP, it should be borne in mind that GDP is showing extremely lively growth in that period.

Household spending, as stated, is showing accelerating growth about as rapidly as domestic product. The nature of household demand, and especially the boost in the last year-and-a-half, can be nicely illustrated by the growth in registration of new cars, which generally very clearly indicates changes in household consumption – it is a good "leading indicator" for household consumption. Yearly growth in the number of new cars strengthened markedly following the first quarter of 2003. Two jumps in growth, the last at the beginning of 2004, were very strong (with yearly rates increasing over 40%), and despite some downward dips, growth is accelerating – in cumulative terms, yearly growth of new cars registrations has already exceeded 13%, in 2004! It is obviously an end of the stagnation or faltering in the growth of car purchasing, which had lasted from the major speculative purchasing of cars prior to the introduction of the VAT in the first half of 1999.

Employment. The marked acceleration in economic activity is also confirmed by the dynamic of employment. ILO-type (surveyed) data on employment (data from the Statistical Office of Slovenia/SURS) reveal a major jump after the middle of 2003. Figure 2 shows the yearly growth of employment, as well as the change in its structure.

Since the beginning of 2001, the dynamic of employment has been consistently falling from the yearly rate of 2.8% (in the first quarter of 2001) to an actually noticeable shrinking of employment of -3.7% annually in the first quarter of last year. After the middle of 2003, however, the yearly growth in employment showed an upturn and started increasing! In the middle of 2004 the number of employed had already exceeded the number of persons employed in the middle of 2003 by almost 6%. Such a dynamic represented the fastest yearly growth in the last four years. The acceleration in surveyed employment stands out even more than the attained dynamic itself. In a mere four quarters, the yearly rate grew from -3.7% to almost 6%! The timing of this quickening corresponded entirely to the acceleration in GDP growth.

Registered employment also grew markedly over the year (from 2003/III to 2004/III by around 0.7%), but registered employment as a rule reacts slowly to changes in demand on the labour market, owing to the rigidity of formally contracted employment. By definition, registered employment covers only contracted employment, while surveyed employment covers all those actively working who in the past week (before the survey) worked for payment or for the benefit of their families. The surveyed employment is far more responsive to changes in demand on the labour market, and thus is also more appropriate for monitoring the consequences of changing economic activity.

Figure 2
Employment

While the growth in employment in the middle of 2003 fell significantly (yearly rates fell to almost -4%), this did not affect the quality of employment, which has indeed been growing consistently for more than three years. Despite the low economic activity, the number of employees with university-level education grew, even in 2003, when economic activity was actually at its lowest level for the last four years. As the Figure shows, the proportion of graduate employees (by surveyed employment) in the middle of 2004 exceeded the corresponding value in 2003 by more than 8% (and the value in the middle of 2000 by almost 43%).

Owing to the rapid increase in employees with the highest qualifications, the proportion of unemployed high-level professionals or persons with university and specialist education is very low (only around 3%), which is, for example, less than the EU average, where around 4% of unemployed persons have tertiary education (ISCED 5-6).[2] Nor is the rapid growth in high-quality employment in Slovenia a a process of "closing" the gap behind the advanced countries, since the differences in the level of high-quality employment are already considerably less than the differences in development. On average, in the old EU member states around 24% of

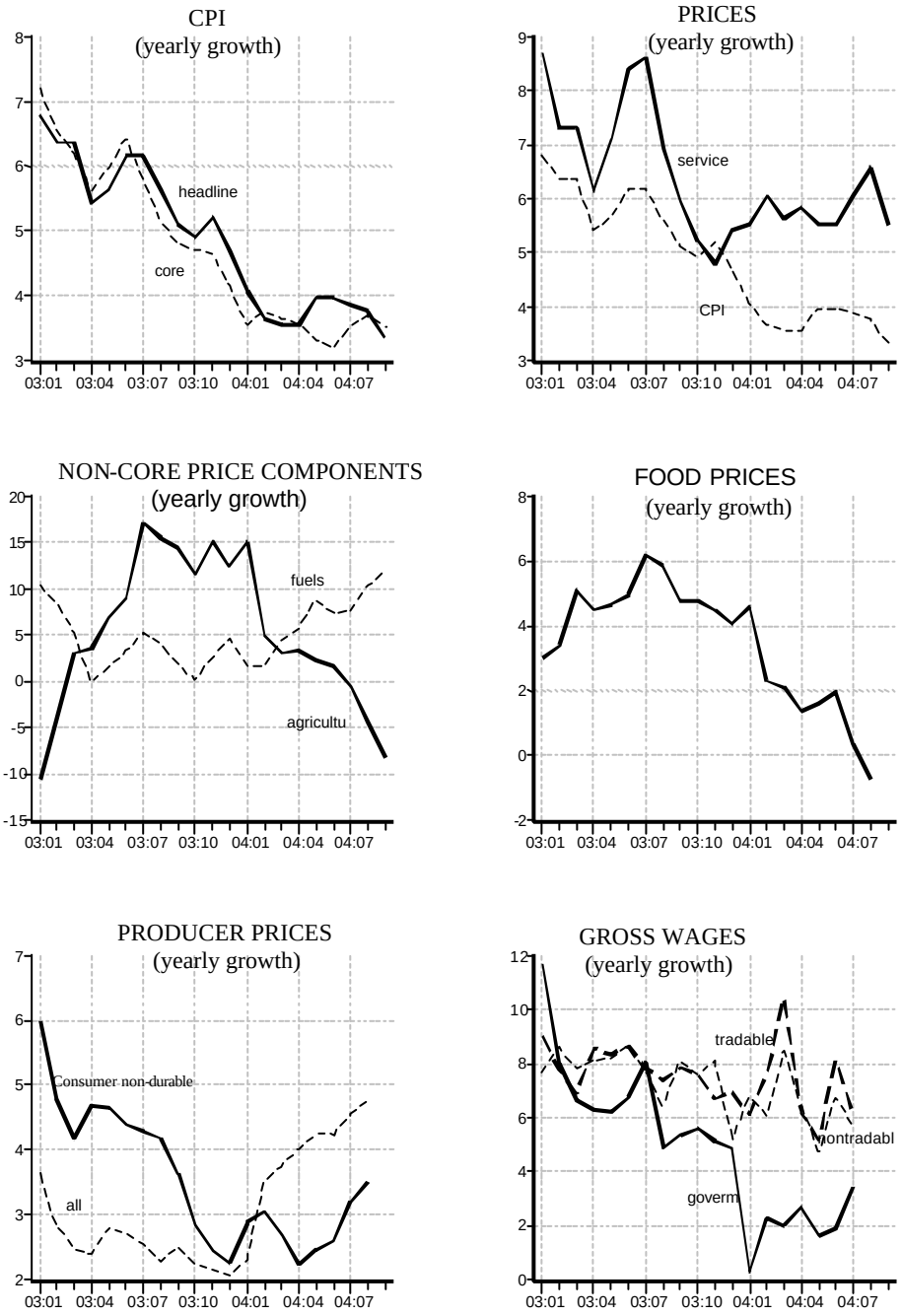
[2] This figure relates to 2002 (Eurostat, **Yearbook 2004**); see also **Manual for ISCED-97***;* **Implementation in OECD countries**, 1999 edition.

employees have tertiary education (ISCED 5-6), while in Slovenia the figure is 22.5%!

2. Gradual calming of inflation and increase of cost pressure

Prices. The yearly dynamic (more precisely, the twelve-months average of yearly growth rates) in the growth of the cost of living will be a key criterion for entry into

Figure 3
Prices and wages



the Euro Monetary Area, along with (annual) general government fiscal balance. At the end of 2004 Slovenia had not yet (for the moment) attained the inflation criterion,

but had done so (for the moment) in public finance criteria. The other two criteria, namely, the size of the debt as well as the level of interest rates will probably not represent any effective barrier to entry into the euro. For this reason, developments in the pricing and public finance segments in 2004 have been vital for the still-timely correction of economic policy in the first half of 2005.

Figure 3 shows the yearly (month-over-month in the previous year) rates of growth for headline and core inflation. While headline (measured) inflation represents the usual, directly quantified indicator of growth in prices of essential goods, core inflation is calculated for a basket of products that do not include fresh agricultural products ("green market" products) and energy products. Up until the beginning of this year, yearly growth rates for prices had consistently fallen, but this year the reduction in the yearly dynamic of prices practically came to a short halt.

The halt to the calming of (core) inflation in 2004 and the moderate increase following entry into ERMII were expected,[3] while the small differences between core and measured inflation are (apparently) a surprise. In the middle of the year (from May to July), when the difference was greatest, core inflation was only about 0.5 points (in yearly growth) behind headline (measured) inflation.

The question arises as to how is it possible that the difference between measured and core inflation remained so small, since prices of oil exceeded the expected value by over 50% (they even exceeded 50 dollars a barrel for Brent). The direct contribution of oil prices alone, if this were carried over entirely to the growth in the cost of living (via the housing and transport group of products), would exceed 3.6 points.

In 2004 at least three factors neutralised the greater increase in the growth of living costs owing to the growth of oil prices: the adjustment of the excise duty on oil products, the prices of fresh agricultural products and the prices of the entire group of food products.

Through lower excise duty, the Ministry of Finance neutralised to a significant extent the major temporary swings in the price of oil.[4] In this way, it reduced inflationary expectations, and especially the higher pressure of the prices of non-tradable products at a following (future) downturn in oil prices. In the non-tradable sectors, owing to the relatively much less competitive market structure, in Slovenia the price hysteresis on the downswing of oil prices was much greater than in the advanced economies of the EU. Owing to the increase in oil prices, the price increases in these sectors have been similar to those abroad, but there is no reduction as there is abroad (or it is far smaller than abroad) if oil prices fall again.

Since the ministry was restricted in reducing excise duty, the "residual" effect on prices of liquid fuels was not negligible, as indicated in Figure 3, which also shows the yearly rate of growth of prices for liquid fuels from a basket of retail prices – it clearly already exceeded the yearly growth rate of 5% in April.

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[3] See, for example, Bole(2004).

[4] The Ministry of Finance held to the established rule: finance temporary changes and adapt to permanent changes.

The Figure also reveals another factor that contributed to the "neutralisation" of the great impact of oil prices on the cost of living in 2004: the prices of fresh agricultural products ("green market" products). Indeed, in 2004 and 2003 they moved precisely the opposite way to fuel prices. Last year (2003), owing to the major drought, the prices of fresh farm products contributed strongly to the growth in living costs, especially in the middle of the year, when the relevant yearly rates even went beyond 15%. The opposite happened in 2004. Owing to favourable weather conditions, in 2004 prices of fresh agricultural products fell sharply below those of 2003 (in October the drop was even greater than 15%).

A beneficial influence on the growth of living costs was also exerted by the prices for the entire group of food. Yearly growth rates for food prices fell significantly, not just because of the prices of fresh agricultural products, but also because of abolishing customs duties at accession to the EU. From the end of 2003 to October 2004, food prices fell by more than 5 points, thereby reducing the yearly dynamic of living costs by more than 1 point (food and non-alcoholic beverages represent about 20% of the basket of living expenses)!

As expected, the dynamic of relative prices also changed.[5] These involve the prices of the non-tradable sector, on which the halting of the exchange rate, with unchanged domestic spending, had a stimulative effect. As Figure 3 shows, right from the beginning of 2004 the yearly dynamic of the prices of services even started to grow (in the middle of the third quarter it even exceeded 6%), so the growth of relative prices was given a strong boost, and there was therefore a marked internal appreciation of the exchange rate.

Alongside the renewed increase of relative prices, developments in producer prices were also significant for the growth of prices in 2005. From the start of 2004 higher commodity and oil prices have driven up the dynamic of producer prices, so that in the middle of the third quarter the yearly rates had already exceeded 5%. Towards the end of the year the acceleration of the producer prices dynamic did ease off, but yearly growth rates still reached 5%.

The renewed boost to producer prices of non-durable consumer goods was especially important for inflation of consumer prices in the following months; in the middle of the third quarter, yearly rates of the relevant producer prices had already climbed noticeably above 3%. This is a large segment of generally tradable products which are under the negligible influence of regulated prices. These producer prices are therefore a good indicator of the pressures on the dynamic of retail goods prices in the near future, and in addition to this, in comparison with the dynamic of relevant foreign prices, they are also a "leading indicator" of the squeeze on the performance (financial results) of a major portion of manufacturing.

Wages. The possible squeeze on performance of manufacturing is also highlighted by the high yearly dynamic of average wages in the economy (see Figure 3). The dynamic of average wage is especially strong in the tradable sector, since the average increase of corresponding wages in the first seven months of 2004 was higher than

[5] See, for example, Bole(2004).

7%.[6] Given such a dynamic of labour costs and the growth in raw material producer prices, the aforementioned upswing of producer prices for non-durable consumer goods is of course not as unexpected as it might seem. With an average share of labour costs at around 25%-30%, the growth in wages alone contributes approximately 1.7-2 points to the annual growth of producer prices. The consequences of a (further) rapid hike in tradable sector labour costs may be painful for financial performance, levels of activity and employment. At the same time, the high dynamic of wages in the non-tradable sector could have an impact primarily on the growth of relative prices, and therefore also on inflation.

The steps taken by the Ministry of Finance in 2003 squeezed the dynamic of labour costs in the public sector at least for a time into an acceptable framework (see lower graph in Figure 3) for securing an appropriate public finance balance. A dangerous deterioration of this portion of the wage segment can be expected at the renewed attempt for launching the already prepared new law on the systemic arrangement of wages in the public sector. No changes, even only structural, to the system of wages in the public sector can be implemented without a net rise in the volume of wages; even preliminary (conservative) estimates have exceeded 20 billion tolars!

3. Balance of payments catalysing lively developments on the money and capital markets

Interest rates. As expected, the fall in interest rates increased after the end of 2003. After accession to the EU, the central bank shifted forewardentry into ERMII for six months. Therefore, nominal convergence and the reduction in interest rates were further stepped up, as indicated by Figure 4, which shows the yearly (month-over-month in the previous year) interest rate increments in the money market and retail interest rates.

The accelerated drop in interest rates was (under otherwise unchanged conditions) expected, since after entry into ERMII the central bank had started to maintain unchanged central parity. For this reason it started to "lose" degrees of freedom in conducting monetary policy, while adjusting to this stepped up the nominal convergence of interest rates.

Owing to the stability of the exchange rate, since June the central bank has no longer had the possibility of autonomous (effective) changing of (nominal) interest rates, and can therefore no bnger target the necessary level of real interest rates as up until May 2004.[7] Namely, owing to the entirely open financial account of the balance of payments, financial inflows from abroad, which would be triggered (*ceteris paribus*) by the higher interest rates, would quickly erase the differences in the level of interest rates (through the "offset" effect).

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[6] Big pressure from labour costs has also been noticeable in some other new EU Member States; expectations for 2005 are even greater (see FT, 7 November 2004).

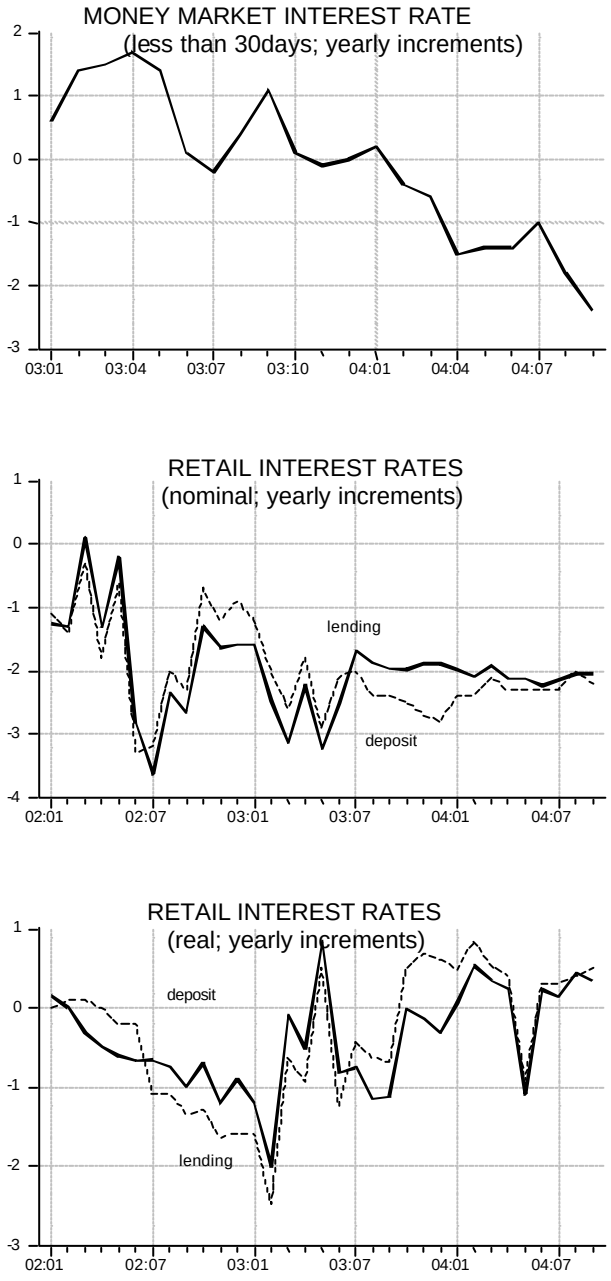
[7] Big pressure from labour costs has also been noticeable in some other new EU Member States; expectations for 2005 are even greater (see FT, 7 November 2004).

[7] See, for example, Bole(2003).

[8] See, for example, Bole(2003).

Only because of the (unexpected) significant changes in the financial account of the balance of payments[8] has the central bank at least partly been able to continue to influence the interest rates since May 2004. In the Figure we illustrate that despite the major drop in interest rates (by around 2.2 points), the interest rate reduction could have been even greater.

Figure 4
Interest rates



[8] Changes in the financial account of the balance of payments (to be described below) are entirely diffrerent from those in the other new EU Member States.

At least two facts point to this. Firstly, it makes sense to assume that Slovenia's risk could add a maximum of around 0.8 points to interest rates, and consequently the (converged) nominal level of domestic interest rates could also exceed those abroad by the same amount. And secondly, data for the first ten months of 2004 do not reveal any increase in financial repression (owing to central bank measures), since the reductions in lending and deposit interest rates from commercial banks, on the one hand, and in interest rates on the money market, on the other, were practically the same!

Figure 4 shows increments in the nominal lending interest rates for short-term credits to the economy and in the deposit interest rates for deposits of up to 90 days and, as stated, increments in interest rates on the money market.

If the changed position in the financial account of the balance of payments continued in 2005, the central bank could be a little better "armed" in 2005 to achieve the inflation criteria that were expected.

Interest rates in the retail market point to a marked reduction in nominal interest rates, which has lasted for more than three years. While up until the final quarter of 2003 the yearly drops in interest rates were, on average, much smaller and with greater swings, in the last year the yearly drops have been systematically greater than 2 points. The structure of the reduction is also noteworthy. Particularly outstanding is the systematically greater reduction in lending rates in comparison with deposit interest rates, which lasted from the middle of 2002 to the end of 2003. This was a period that saw the beginning of the latest intensive "battle" for market shares – for clients. It is clear that squeezing broader money, which came about this year despite the rapid growth in credits (!), reduces the possibility of increasing market shares with domestic sources, so the absolute values of deposit interest rate increments also fell after the first quarter of this year. In recent months, therefore, the downward pressure (for greater reductions) in lending interest rates has been greater than for deposit rates, but of course it can only be financed by foreign sources, via the financial part of the balance of payments.

Such a change in the structure of pressure on interest rates in the retail market has for the moment still not visibly affected the performance of banks. The "bills" will start to come in when interest rates move upwards, that is, when interest rates abroad start increasing.

Credits. The marked reduction in nominal interest rates gave, as expected, a considerable boost to the growth of credits.[9] Figure 5 shows the dynamic of credits to households and the business sector.

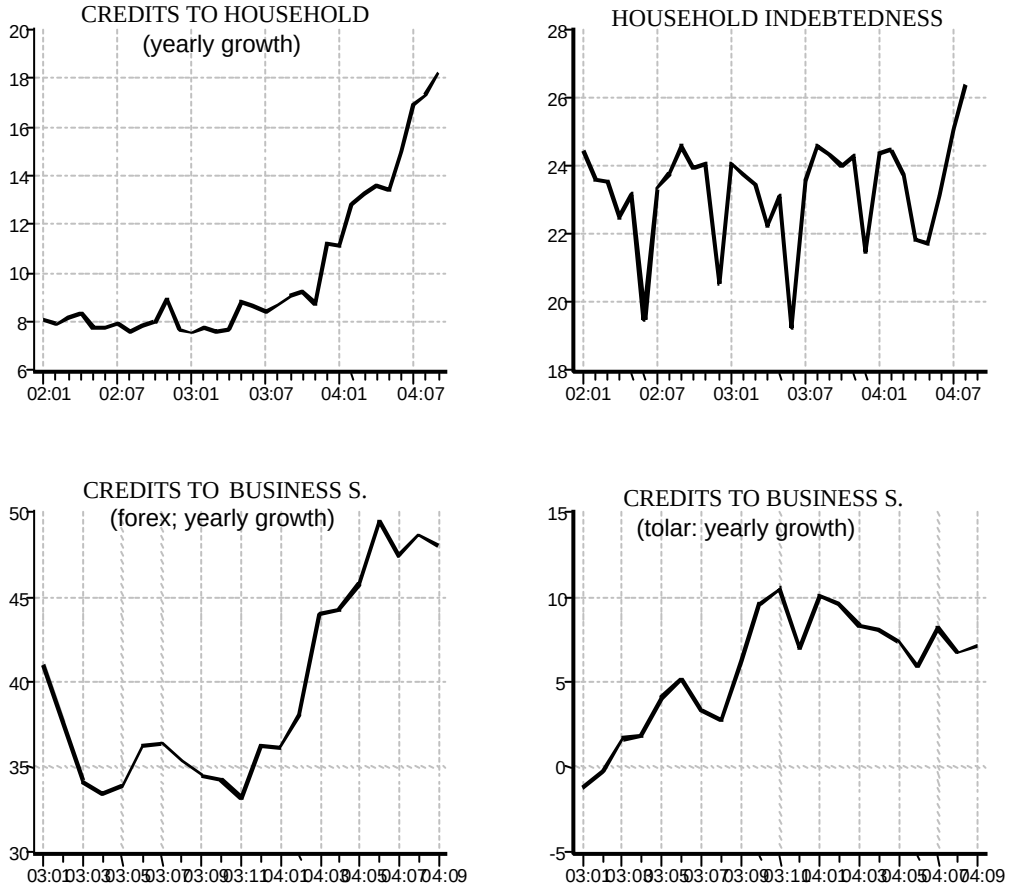
The wealth effect of the marked reduction in nominal interest rates boosted the growth of credits to households from approximately 8% annually to around 19% a year. The strength of this boost to credits is also confirmed by the dynamic of indebtedness of the household, which is also shown on Figure 5 (household indebtedness is given as a percentage of total annual income of households). The last time the indebtedness of households significantly changed was in the first half of

[9] See, for example, Bole(2004).

1999, when anticipating the introduction of the VAT, households considerably increased spending and borrowing. At that time the number of new cars, for example, grew by rates exceeding 45% (see Figure 1), while indebtedness of households increased by more than 40% in less than six months. From June 1999 to May 2004, indebtedness remained practically unchanged, while credits boosts in 2004 has again driven up the indebtedness of households, which had grown by 13% by August.

Up until the third quarter 2004, total credits to the business sector systematically accelerated growth (Figure 5). Foreign currency credits have grown at more than double the speed of those in tolars, and have already almost reached their level. Foreign currency credits to the business sector have been maintaining a rapid growth of around 35% annually for some time now, and after the third quarter of 2003 accelerated further, to over 40%. Tolar credits to the business sector in the middle of 2003 practically stagnated, and after that they increased their dynamic; in 2004 their growth attained a little under 10% annually. After fixing of the exchange rate, the difference in the growth of credits (in favour of foreign currency), and also the growth of total credits to the business sector, increased further.

Figure 5
Bank credits

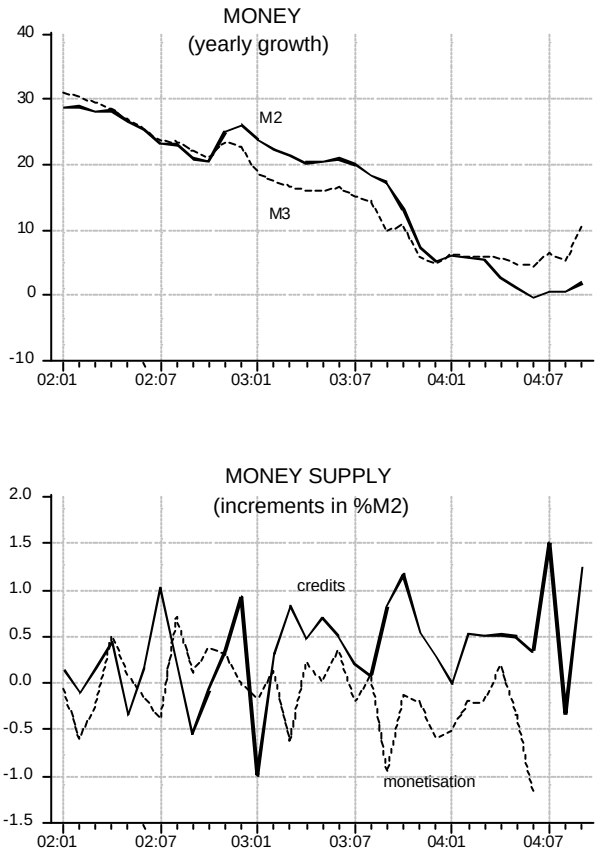


Money. The rapid growth in tolar credits (credits to households and tolar credits to enterprises) should push up the growth of tolar deposits, given other at least approximately unchanged business conditions. Despite this, the yearly dynamic of broader money (M2) has been falling since the middle of 2003.

Figure 6 shows yearly rates of growth for broader money (M2 according to the national definition), which covers tolar deposits and all liquid assets (M3 according to the national definition), which in addition also covers foreign currency deposits. The Figure reveals two important features of the money dynamic in the period after the beginning of 2003 till the middle of 2004.

Firstly, the yearly dynamic of both categories of money, after the jump owing to the purchase of Lek in 2002, has fallen consistently, and in the middle of 2004 the growth of both stabilised at a very low level. The growth in broader money practically even came to a halt in the middle of the third quarter of 2004 (the July yearly rate fell to just 0.6%)! And secondly, while from the purchase of Lek to the middle of 2003, foreign currency deposits in banks increased significantly more slowly than tolar deposits, after February 2004 the reverse process began, with a more rapid growth in foreign currency deposits.

Figure 6
Money



For the functioning of monetary policy, it is chiefly the first feature, namely the rapid calming (reduction) of the dynamic of both categories of money that is important. But first let us look briefly at the nature of restructuring of all liquid assets (M3).

The dynamic of all liquid assets (M3) fell up until the beginning of 2004, as did the dynamic of broader money (M2), while in 2004 the yearly growth of all liquid assets settled at around 6%-8% annually, and the growth in broader money (M2) came to a complete halt. All liquid assets contain broader money, so the difference in their dynamic in 2004 may be a consequence simply of restructuring all liquid assets in favour of foreign currency instruments. When broader money (national definition) practically stagnated or grew very slowly, foreign currency instruments increased by approximately 2% of GDP (120 billion tolars).

The relative dynamic of tolar vis-à-vis foreign currency interest rates is predictable. Also taking into account the size of foreign currency reserves (at commercial banks and the central bank) and the constant latent pressures towards appreciation of the tolar, it is not clear what reasons drove the aforementioned restructuring of the portfolio of non-bank economic agents in favour of foreign currency instruments. The drafting of new tax legislation (income tax), the "handiest scapegoat", cannot explain the restructuring, since restructuring had already started earlier, besides the taxation of interest does not depend on the currency of deposits. It seems most probable that in the background of these changes of portfolio structure was a depreciation expectation upon accession to the EU. The fact is, the dynamic of restructuring into foreign currency instruments came to a standstill upon entry into ERMII, that is, after fixing the central parity.

Retail foreign exchange market. The answer to the question of why the yearly dynamic of broader money (tolar deposits) is falling, despite the rapid growth of the money credit supply, is provided by the relative dynamic of the two most important channels of money supply, that is, the credit channel and monetisation in the retail foreign exchange market (net purchasing of foreign currency from the non-bank sector).

Figure 6 shows the increase in money supply via each of the two channels in percentages of broader money: in the credit channel, of course, only the increment of tolar credits from the previous period is taken into account. The Figure clearly shows the reasons for the reduction in the growth of broader money despite the boost to the growth of tolar credits. After the middle of last year, demonetisation (net sale of foreign currency to the non-bank sector) in the retail foreign exchange market, that is, the net withdrawal of money, grew rapidly (in individual months the monthly demonetisation reduced broader money by as much as 1%) and in this way to a large extent neutralised the supply of money via the credit channel.

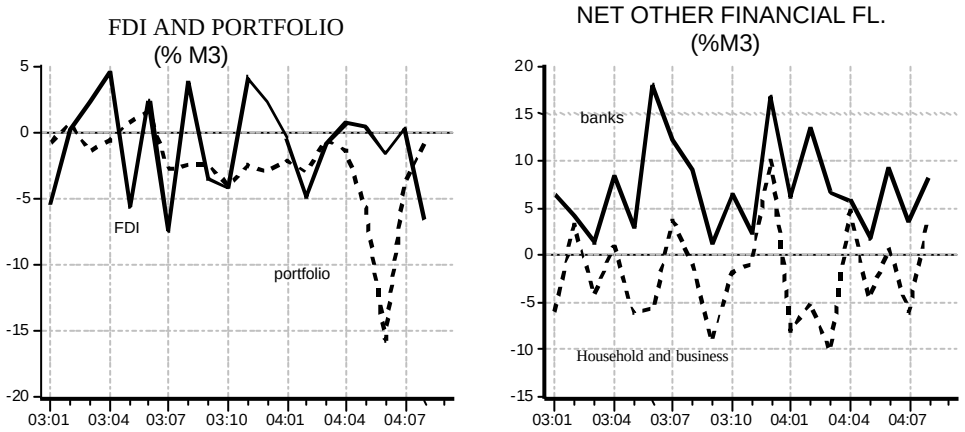
The major increase in demonetisation (net purchase of foreign currency in the retail foreign currency market) of course should not (with other conditions unchanged) have contributed to a decline in the dynamic of all liquid assets (M3), since this aggregate of money also contains foreign currency instruments. Given the credits dynamic, the opposite could be expected, in other words a marked boost to all liquid assets, especially since after the middle of 2003, foreign currency credits also

experienced a boost in growth. Nevertheless, the Figure shows that up to the beginning of 2004 the dynamic of all liquid assets fell rapidly, and this year it has settled at a low level of something over 6% annually. So only a part of the net demonetisation increased the foreign currency deposits in banks (and thus halted the decline in the yearly growth rates of M3 in comparison with M2), while a large part as a net outflow of loanable funds strongly altered the dynamic and structure of the financial part of the balance of payments.

Financial part of the balance of payments. Foreign financial flows provide the final part of the explanation behind the slow growth of all liquid assets (and of broader money) despite the notable boost to the growth of credits and with a relatively small deficit in current account transactions. The key segments of foreign financial flows are shown in Figure 7.

The first graph of the Figure shows net portfolio investments and net direct foreign investments (by private economic units). Both net flows are annualised and shown in percentages of all liquid assets (M3). It is obvious that after the middle of 2003 net portfolio investments have been negative, therefore there were more outward portfolio investments from Slovenia than inward portfolio investments into Slovenia. Clearly, at the same time as the bourse rocketed, after the middle of 2003, a notable portion of investments also went into foreign securities. On average, in the period after 2003/7, each month net outflow of loanable funds (raised to the annual level) attained around 3.5% of total liquid assets.

Figure 7
Foreign financial flows



Moreover, net foreign direct investments, which up until the end of 2003 had hovered around 0, also became markedly negative in 2004. Therefore, even direct investments abroad by residents (private economic units) went far beyond the net foreign direct investments in Slovenia. On average, net direct investments abroad (annualised) each month exceeded 1.6% of all liquid assets in 2004.

Thus, after 2003/7, via net portfolio investments as well as via net foreign direct investments, there was an outflow of a significant portion of loanable funds generated by the banking sector through high credit growth; the average monthly outflow in 2004 (annualised) was approximately 5.1% of total liquid assets (M3).

The second graph of Figure 7 shows other (net) financial flows of private economic units. The more important components of this part of financial flows are loans, cash and deposits, and trade credits. In the Figure, other net financial inflows are shown separately for the banking sector and separately for the segment of households and enterprises. Values are again recalculated to the annual level and shown in percentages of all liquid assets (M3).

It is obvious that after the beginning of 2003 and especially after 2004/1, in net terms loanable funds also flowed abroad via (net) other financial flows through the segment of households and enterprises. The major portion was contributed by net trade credits and cash and deposits items, while via (net) loans item financial assets flowed into the segment of households and enterprises. On average for 2004, net other financial outflows (on an annual level) amounted to approximately 2.7% of all liquid assets (M3).

Figure 7 also explains how banks financed the high growth of credits despite the major outflow of liquid assets via net portfolio investments, net direct investments abroad and other net financial flows of enterprises and households. Indeed, after the beginning of 2003, other net financial flows via banks were very high and positive, and therefore net inflows. The lion's share was provided by loans, and a lesser amount by net deposits and cash items of banks. Precisely for this reason, in the battle for market share, the reductions in lending interest rates notably exceeded the reductions in deposit interest rates. The banks could also, namely, provide abundant financing for the growth of credits through the inflow of loanable funds from abroad; the unfavourable movement (slow growth) of deposits by residents was therefore no obstacle. Moreover, prior to this period, lending interest rates had differed more from foreign rates than had deposit rates. At the same time, especially in 2004, the marked increase in the outflow of assets abroad via the three aforementioned channels began to curb further major downward corrections to deposit interest rates that would have been necessary in order "to rescue" the performance (results) of banks.

4. Tax revenue: liquidity or solvency problems?

Shift in cash flow of tax revenue. With accession to the EU, the timing of cash flow of VAT payments on goods imported from the EU shifted into the phase of the first tax accounting. For this reason it was expected that after accession to the EU there would be a significant liquidity deficit from domestic taxes on goods and services – it was expected that this deficit would have to be between 0.2% and 0.3% of GDP, depending on the level of imports just before EU accession.

The actual deficit was greater. There were several reasons for this additional deficit. The most important were bigger imports than expected, adjustment of enterprise behaviour to the anticipated consequences of EU accession, a large increase in inventories and changes of VAT law.

From the beginning of 2004, in anticipating accession to the EU, enterprises stepped up exports to those areas with which Slovenia had more favourable trade regimes (lower customs duties) than the EU (the most important were markets of former Yugoslavia and Russia). In addition to this, enterprises held off importing goods from the EU until accession to the European Union.[10] For this reason, after the accession to the EU, the shift of cashflow from VAT payments on imported goods was bigger.

The minor administrative changes (Article 40) to the law further increased the VAT cashflow shift. Adjustments to the law specifically enabled taxpayers to make refunds before physically receiving the corresponding invoice. VAT revenue was also reduced by large increase in inventories, which did not only significantly increase the growth of domestic product,[11] but also caused a liquidity shift of tax revenue, since refunds had already been made, but tax accounts had not.

All the above cases as a rule involved just a (forward) shift of cashflow, so in principle the solvency of tax revenue from domestic taxes on goods and services should not be endangered. Only inclusion of DARS (the state-owned firm for the maintenance and building of roads) in the VAT system could also change the tax basis – in other words, the solvency of VAT.

After the initial, expected reduction in revenue in 2004/6, yearly growth rates of domestic taxes on goods and services cashflow "relatively slowly" normalised. In the third quarter, for example, there was still a yearly increase in taxes on domestic goods and services of only 3.9%. The dynamic of tax revenue from direct taxes and non-tax revenues was as expected; in the first three quarters of 2004, it was approximately 8.2% higher than in the same period of 2003.

Owing to the slow normalisation of the yearly dynamic of tax revenue from domestic taxes on goods and services, the question arises as to whether EU accession caused any long-term changes in the efficiency of the tax administration.

The question could make sense, especially because the decline in the tax revenue over a longer period (in two to three years) was already expected.[12] Some substantive reasons point to the probable decline in the tax revenue in the longer period. To begin with, tax revenue could decline as a consequence of the changes in the tax system and especially owing to the increased complexity of tax legislation; the tax administration probably will not be able to implement it rapidly, with necessary technical effectiveness. Later, tax revenue could start to stagnate further owing to an increase in tax evasion. A more efficient capital market after accession to the EU, and the "lost" fiscal role of the customs duty at foreign trade transactions with the EU, will increase tax evasion. Even in theory, an increase in the efficiency of the capital market reduces the effectiveness of the tax administration in collecting taxes.[13] This is all the more valid where it involves complicated tax legislation with a large number of

[10] See Gospodarska Gibanja for July, September and October 2004.
[11] In the second quarter 2004, for example, GDP increased by 4.7% yearly, almost 1.7 points additional increase in inventories!
[12] See, for example, Bole (2002).
[13] See, for example, Stiglitz (1988).

tax incentives and exemptions, which automatically reduces the effectiveness of any tax administration. Precisely for this reason, (tax) incentives and exemptions are well known as being major types of "tax termites" in that they reduce the effectiveness of the tax administration and therefore erode tax revenue.[14] And finally, it is also worth mentioning the entirely "domestic" reason for the reduction in the effectiveness of the tax administration over a longer period. The tax administration has been functionally and institutionally squeezed for almost four years.

Changes in effective taxation. For the performance of the economy in 2005, the aforementioned liquidity shift in tax revenue cashflow is not important, or rather, it is even favourable. However, it would be an entirely different story if the effectiveness of the tax administration began to deteriorate faster than expected!

In order to answer the question of whether the effectiveness of the tax administration has already begun to diminish, Figure 8 shows the effective tax rates for indirect taxes (primarily domestic taxes on goods and services) and for direct taxes and non-tax revenues. Namely, in assessing the effectiveness of the tax administration, it is necessary to analyse the effective tax rates, not tax revenue only.

The first graph in Figure 8 shows direct taxes and non-tax revenues in percentages of final spending. Obviously, we assumed that the tax basis of direct taxes and non-tax revenues is "sufficiently well" correlated with overall final spending, that is, with the sum of domestic final consumption and exports. Judging by the graph, we may heuristically assert that, after the end of 2002, effective taxation by direct taxes has even modestly been improving. The graph shown does not indicate any "visible" signs of a decline in revenue (per unit of tax basis).

The second graph in Figure 8 shows the tax revenue from indirect taxes (primarily domestic taxes on goods and services) in percentages of spending by households and government spending on goods and services. Again, we assumed that the joint dynamic of household spending and government spending on goods and services approximates well the dynamic of the tax basis for indirect taxes. Such an assumption seems meaningful, since VAT charged on spending for intermediate and capital goods is refunded, and export is zero rated.

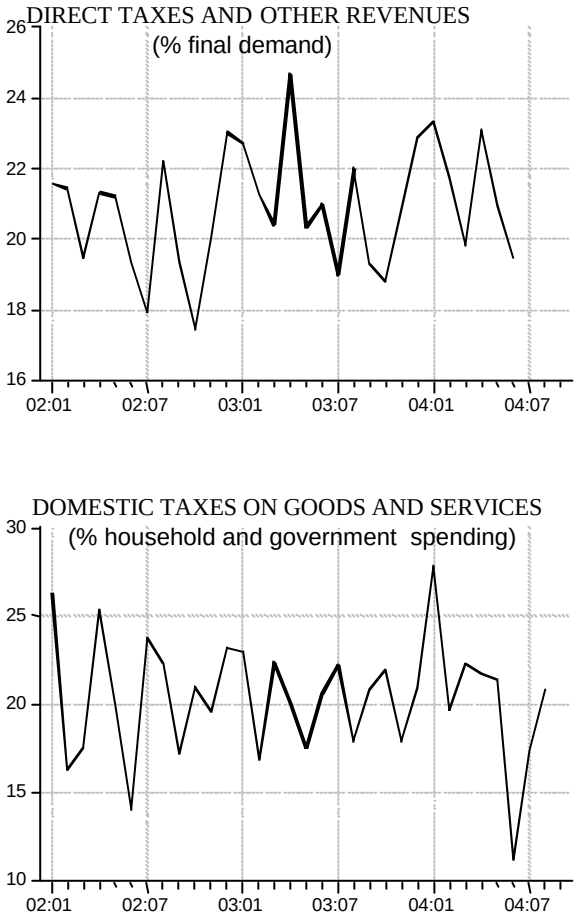
After the end of the third quarter of 2002, the most noticeable downswing in indirect taxes took place in June 2004. That is, a drop in tax revenue took place in the first month when EU accession could have an influence on tax revenue cashflow. Smaller changes in the effective tax rate can also be identified in the period 2004/1-2004/5, when the effectiveness of taxation increased, and in July, when effective taxation still lagged a little (approximately 7.5%) behind "normal". The increase prior to June 2004 could have been a consequence of the aforementioned behaviour of the enterprises owing to the anticipated accession to the EU, while the June and July deficit is a result (chiefly) of the aforementioned shift in timing for the first accounting of VAT on goods imported from the EU.

Judging by the graph, by August 2004 effective taxation through indirect taxes (domestic taxes on goods and services) was again of a "normal" size!

[14] See Tanzi and Schuknecht (2000).

If we take into account that government spending on goods and services and households spending together amount to around 63% of GDP, then the liquidity drop in June and July 2004 (8.6% or 2.1% of joint households and government spending), after accession to the EU, reached in total around 0.56% of GDP, that is 34 billion tolars. The deficit in tax revenues beyond that figure is a consequence of changes in the tax basis, in other words, in spending of households and government.

Figure 8
Taxes

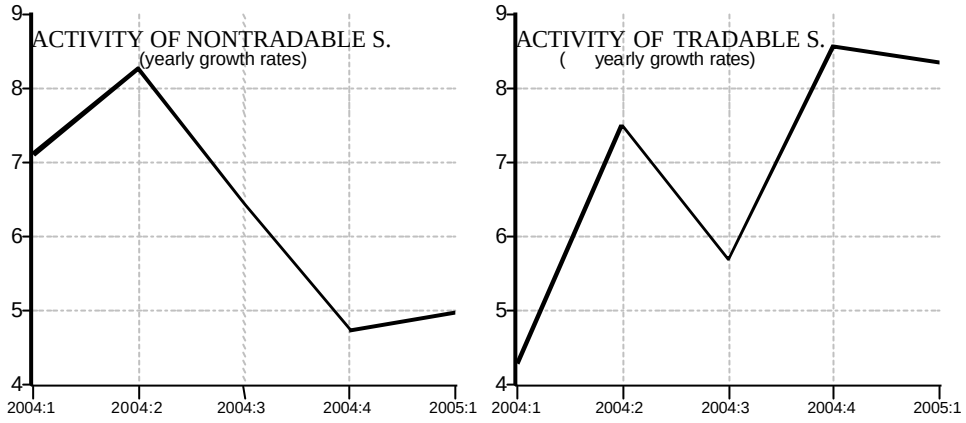


II. ECONOMIC PROSPECTS IN THE "REFERENCE" YEAR

"Predetermined" economic activity. Economic performance in 2004 notably determined the functioning of the economy in 2005, especially in the first half of the year as shown on Figure 9. The Figure shows estimates of yearly growth rates for economic activity in tradable and non-tradable sectors using only corresponding leading indicators. Activity of the tradable sector is measured by the index of industrial production, while activity of the non-tradable sector is defined by the

weighted average of activity of retail trade, catering (hotels and restaurants), construction, road and rail transport (corresponding weights are 0.42, 0.1, 0.21, 0.06 and 0.21).

Figure 9
Predetermined economic activity



Obviously, export and (much) less the investment-driven economic activity in the tradable sector will last at least until the beginning of the second quarter of 2005. After a modest decline in growth in the third quarter, economic activity will accelerate again in the final quarter of 2004, as well as in the first quarter of 2005; the growth rate will exceed that in the past eight quarters. Activity of the non-tradable sector attained its maximum value in the second quarter of 2004. In the last quarter of 2004 and in the first quarter of 2005, the dynamic of the non-tradable sector will probably decline further, so that at the beginning of 2005/II it will be considerably (around 35%) lower than in 2004/II, when it reached its peak!

Dynamic of exogenous variables - assumptions. Major changes in policy variables (government spending for goods and services, government wages, exchange rate, etc.) and variables of the external environment (import absorption of foreign markets, oil prices, commodity prices, etc.) may significantly alter the trajectories of key economic performance, especially in the second half of 2005. In the simulation of possible economic performance to the end of 2005, it is therefore necessary to assume values of economic policy variables and values of external variables.

Variables of the external environment are quantified using data given in the International Monetary Fund's World Economic Outlook of September 2004. IMF data used for evaluating external variables are presented in Table 1.1. The latest OECD forecasts (OECD Economic Outlook, No. 76) vary significantly from those of the IMF, especially in economic activity. In the OECD forecast, for example, economic activity in developed countries will accelerate from 2004 to 2005 without decline, while IMF projection of economic activity will decelerate in 2005. There is a similar situation with the ECB estimates (from the beginning of December) for import

absorption of the Euro Area. For this reason, values assumed in the simulation of economic performance vary somewhat from those shown in table 1.1. The import absorption of developed countries in 2004, for example, is lower, and in 2005 higher, than that assumed by the IMF; similarly, assumed import prices and oil prices increased in 2004 slightly less than the IMF figures would suggest.

Table 1.1
IMF projections (September 2004)

	2004	2005
Imports (developed economies)	7.6	5.6
Imports (developing economies)	12.8	11.9
Oil (USD)	28.9	0.0
Other commodities (USD)	16.8	-3.9
Prices (developed economies)	2.1	2.1
Prices (developing economies)	6.0	5.5
Libor (Euro deposits)	2.2	2.8

Note: Except for interest rates, yearly growth rates.

Table 1.2
Assumptions

	2004	2005
Absorption of export markets in OECD	6.6	6.5
Foreign interest rates (change in percentage points)	0.0	0.9
Oil	23.9	3.5
Import prices (US$)	8.0	1.0
Export prices (US$)	2.0	3.0
Dollar exchange rate (vis-à-vis euro)	-5.3	0.0
Euro exchange rate (vis-à-vis tolar)	1.7	0.5
Base money	5.5	6.5
Interest rate (change in percentage points)	-2.5	-0.3
Government current material spending (nominal)	5.5	18.0
Government investment spending (nominal)	17.5	3.5
Government wages (nominal)	5.0	2.5
Employment in government sector	2.0	1.0

Note: Except for interest rates, yearly growth rates; “government” denotes general government

Table 1.2 shows assumed values for economic policy variables and variables of the external environment in 2004 and 2005. For all variables except interest rates, annual growth rates are given (the average for the current year over the average for the previous year). For interest rates, yearly increments are shown in percentage

points. For all exogenous variables, except for variables of government spending, uniform growth is assumed within the year.

Table 1.3 illustrates levels of three key exogenous economic variables (dollar exchange rate, euro exchange rate and price of oil) calculated from assumed growth rates.

Table 1.3
Assumptions (levels)

	2004	2005
Dollar	195.9	195.9
Oil	35.8	37.1
Euro	237.7	238.8

Note: Variables are shown in levels.

Values assumed for government expenditures (current expenditures on goods and services, investments and wages) are taken from documents that were prepared for adoption of the budget. Two suppositions are crucial for the simulation: the major (nominal) increase in investments in 2004 and the large increase in current government expenditures for goods and services in 2005. Values for other economic policy variables were chosen so that the government commitment to nominal convergence by the end of 2005 would not be jeopardized.

The simulation also involves four implicit assumptions. Firstly, it is assumed that regulated prices would grow in step with free prices. Secondly, the Ministry of Finance would continue with the policy of adjusting excise duties to neutralise temporary swings in oil prices (at an unchanged exchange rate of the dollar). Thirdly, the effects of tax reform would be fiscally neutral. And lastly, in 2005 the effectiveness of VAT administering would start to decline; till the end of the year, effectiveness would fall by 20% (revenue per normal VAT rate would fall from 0.5% BDP at the end of 2004 to 0.4% GDP at the end of 2005).

After EU accession, a longer-term decline in the effectiveness of VAT administering could be expected.[15] In the simulation it is assumed that the effectiveness of VAT administering would already start to decline in 2005. It is assumed that revenue collection effectiveness would deteriorate steadily from 0.5% of GDP (per each point of standard rate) at the end of 2004 to 0.4% of GDP (per each point of the standard rate) at the end of 2005. The assumed scenario of accelerated decline in tax administration effectiveness is, of course, conservative. But, owing to the size of the (transitory) tax revenue decline in 2004, on the one hand, and the importance of fiscal balance in 2005 on the other, the consequences of the assumed (conservative) tax scenario in 2005 would be highly instructive!

[15] On the possible deterioration in tax administration see Bole (2002) and Bole (2004); a revenue of 0.4% of GDP (per point of standard rate) is collected by better tax administrations in the EU.

Projection of economic performance. Table 2.1 shows simulated annual growth rates for components of final demand, inflation and tax revenue. It shows annual increases (the average for the current year over the average for the previous year) in percentages. In order to make conclusions on changes of the dynamic in the period from 2004 to 2005, values for 2004 are also estimates (known values up to 2004/II are not taken into account).

Table 2.1

Simulated economic performance

	2004	2005
Investments	5.7	5.3
Households spending	3.7	3.6
Exports	8.6	8.8
Imports	11.1	7.1
Prices (CPI)	3.9	2.9
Indirect taxes	4.1	3.7
Direct taxes and non-tax revenues	8.2	6.7

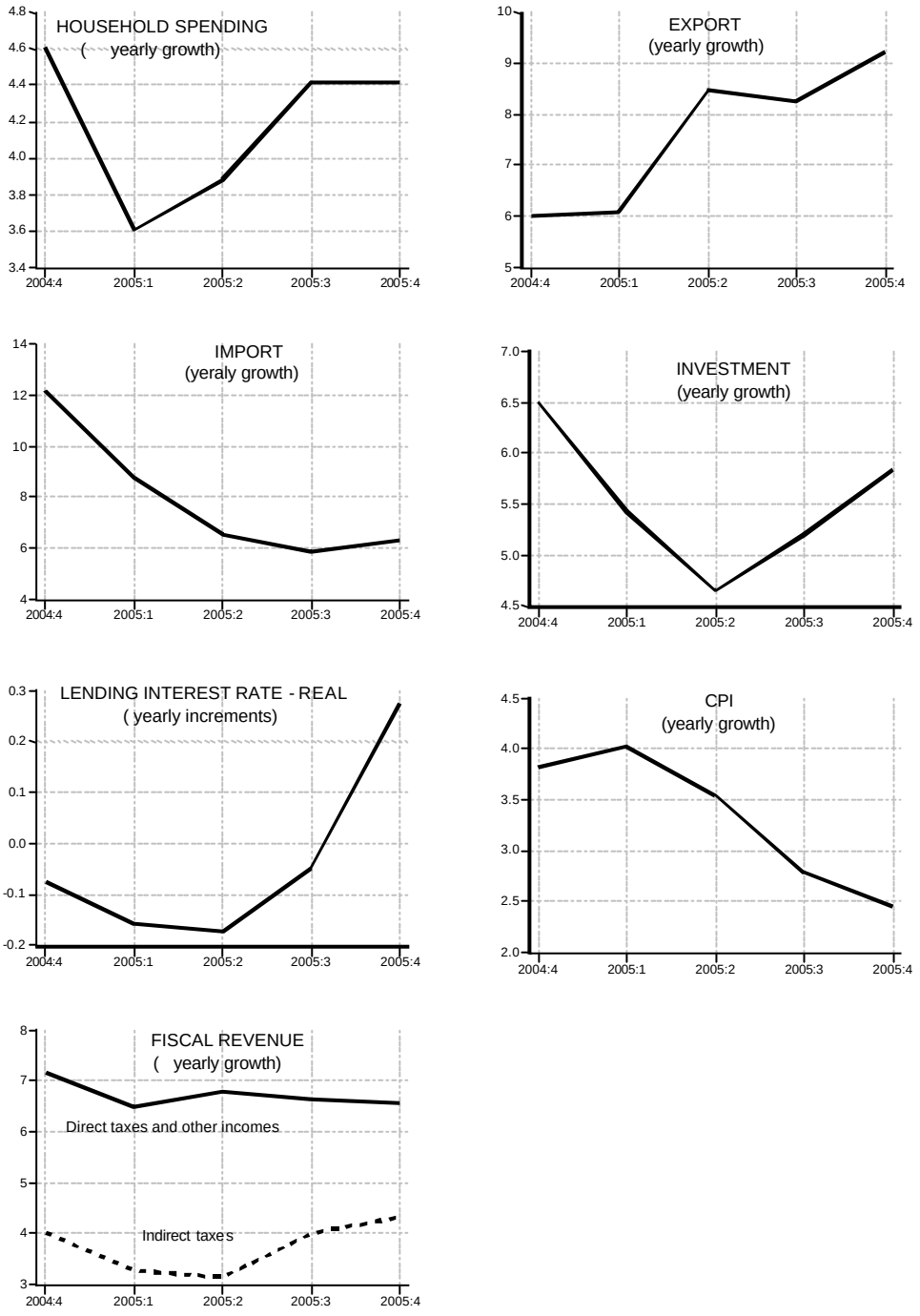
Note: Yearly growth rates

Figure 10 shows the quarterly dynamic for the components of final demand, inflation, lending interest rates and tax revenue. With the exception of interest rates, all other variables are given as yearly (quarter-over-quarter in the previous year) growth rates. For interest rates, changes (increments) from the same quarter of the previous year are given.

Spending. In 2005, the structure of the growth of the components of final demand would be similar to that in 2004. The tempo of economic activity would still be dictated by exports. Major changes may be expected only in current material expenditures of government. In 2005, government current material expenditures will grow faster than GDP, while in 2004 it lagged behind the dynamic of GDP. According to the assumption, in 2005 current material expenditures of the government would increase nominally by as much as 18% (primarily owing to requirements linked to EU accession).

The (real) dynamic of investments and households spending would fall slightly in the first half of 2005 and accelerate afterwards. The dynamic of exports would also slightly decline in 2004/IV and 2005/I; afterwards it will pick up again and on average attain in 2005 nominally similar growth as in 2004 (in euros). Nominal growth (in euros) of imports would be steadily falling in all quarters of 2005.

Figure 10
Forecasts



The reduction in the dynamic of real exports in 2005 would be noticeably bigger than in the dynamic of real imports. It should be pointed out, that the assumed movement of the dollar exchange rate is a crucial factor for such a result, especially because in 2005 the dynamic of the dollar exchange rate is probably the most questionable/uncertain of all exogenous variables. The assumed exchange rate for the

dollar, therefore, would have to remain, on average, unchanged in 2005 (see table 2.1) relative to 2004.[16]

Inflation. The estimated yearly dynamic of prices (the average for the year against the average for the previous year) for 2005 would be approximately one point lower than in 2004 (from 3.9% it would drop to 2.9%).

For entry into the Euro Area, the yearly growth rate of prices at the end of 2005 (quarter-over-quarter in the previous year) is more important than the growth of average prices, since the reference period will run from the middle of 2005 to the middle of 2006, and in the last quarter of 2005, yearly (quarter-over-quarter in the previous year) inflation will relate precisely to the middle of the reference period. The inflation dynamic within the year is shown in Figure 10. Judging by the graph, following a slight increase at the beginning of the year, the yearly dynamic would drop markedly up to the third quarter of 2005. In the last quarter, the yearly (quarter-over-quarter in the previous year) growth rate of prices would reach around 2.5%.

Whether the average yearly inflation in the reference period of around 2.5% would suffice for attaining the inflation reference criteria depends of course on the referential inflation. The latest ECB estimate for the growth of prices in the entire (!) Euro Area is 1.5%-2.5% for 2005 and 1%-2.2% for 2006. If we assume that the lower bound of the interval estimate corresponds to inflation in the reference economies with the lowest inflation, it is clear that only one or two tenths of a point could be crucial for attainment of the inflation criteria!

Fiscal revenues. The estimated (nominal) increase in fiscal revenues is shown in Table 2.1 and in Figure 10. It is obvious that the estimated indirect taxes (primarily domestic taxes on goods and services) would increase in 2005 only a little less than was assumed when the budget was prepared (end of 2003). The planned increase is 4.5%, while the simulated increase is 3.7% (Table 2.1). However, the level of collected indirect taxes in 2005 would also be less by the entire shortfall, from the planned level, in 2004 (i.e., 2.6 points), to which the yearly rate for 2005 relates. The revenue from domestic taxes on goods and services (with albeit conservative assumptions of a diminishing effectiveness of the tax administration) could, therefore, lag behind the revenue planned during the adoption of the budget by around 0.45% of GDP.

If we take into account the fact that direct taxes and other non-tax revenues represent approximately 66% of the total current revenues of the public sector (general government), and indirect taxes 34%, then the total current revenues would grow by approximately 5.7% in 2005, while the assumed increase in the adopted budget is 7.2% (figures from December 2003). If account is also taken of the lower level of estimated current revenues in 2004 than those planned (i.e., a lower level of basis for comparison), the estimated current revenues in 2005 could lag by up to around 0.7% of GDP.

[16] Recently several articles have been published in which authors expect even further marked declines in the dollar. See, for example, Obstfeld and Rogoff (2004), Wolf (2004), Special Report (2004).

The reduction in tax revenues, even with a conservative assumption of declining effectiveness of the tax administration, clearly could not seriously jeopardise the reference criterion for fiscal balance. With that kind of drop and with an unchanged (as envisaged in the budget) level of spending by the public sector (general government), the fiscal deficit would reach approximately 2.3% of GDP. Clearly those entrusted with conducting economic policy should adhere to no, even minor, "structural" corrections to public spending; just increasing pensions by approximately 2.7% and activating the public sector wages act, for example, would be enough to bring fiscal balance dangerously close to the fiscal reference criterion.

The shrinking of tax revenues (with an assumed reduction in the effectiveness of the tax administration) could also influence attainment of the reference inflation criteria. Indeed, the analysis does not assume renewed temporary upswings in oil prices (with an unchanged dollar rate) of 2004's dimensions. In the event of such repeated temporary jumps in oil prices, the Ministry of Finance would, given the estimated lower fiscal revenues, have to be much more cautious about using excise duties for neutralising the effects of oil price swings on inflationary expectations, and also, therefore, on the growth in the cost of living.

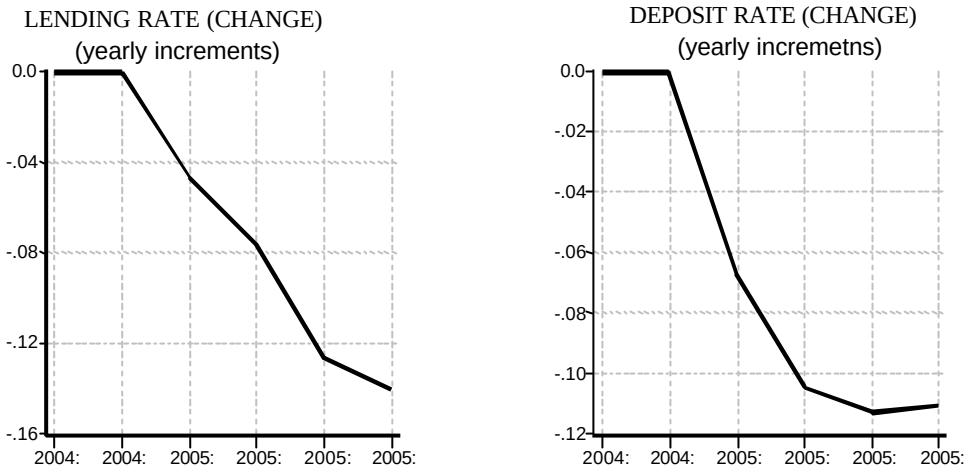
Interest rates. Yearly (quarter-over-quarter in the previous year) changes to real lending interest rates are shown in Figure 10. In 2005, lending (real) interest rates would fall until the third quarter by approximately 0.15 points relative to the same period of 2004, and then would start rising. The increase would be rather rapid, so that at the end of the year they would exceed the level by 0.3 points in the last quarter of 2004.

It is clear that with the assumed dynamic of exogenous variables, the direct effects of nominal convergence on the real sector would dwindle to nothing in the middle of the coming year (2005). At that time, the reduction in inflation would begin to ease off, and real interest rates would start to grow.

In 2004, net foreign financial flows, as stated, had a major influence on the dynamic of interest rates. The large net outflow via the non-bank private sector reduced the dynamic of all liquid assets (M3) and thus restrained the drop in interest rates.

The question then arises as to what kind of effect there could be in the coming year from major autonomous changes in net foreign financial flows on interest rates. This involves, of course, changes to financial inflows, which do not depend on short-term economic performance (interest rates). For example, what would be the effect of major acquisitions or a significant sale of state property. The described "strengthening" of the central bank in influencing interest rates, like that in 2004 caused by a large net financial outflow (via direct investments, portfolio investments, commercial credits and non-bank sector deposits), would indeed be welcome in 2005, too, since the central bank will in fact have almost no scope for curbing domestic spending through interest rates. For this reason the central bank will be able to keep reining in the inflation consequences (on attaining inflation criteria) of the short-term increase in (relative) prices for non-tradable products through appreciation of the exchange rate (appreciation of tradable products).

Figure 11
Autonomous financial inflows - effects



For this reason, the differential effects of autonomous inflow via the financial account of the balance of payments on interest rates are also estimated. Figure 11 shows the effects on lending and deposit interest rates. Only the differential effects are given; that is, only the differences that would be caused by (additional) autonomous financial inflow from abroad are shown. According to the assumption, the inflow in all quarters of 2005 would be equal to 0.25% of GDP, and over the whole year, therefore, 1% of GDP (which would correspond, for example, to the sale of 10% of the property of Kapitalska Družba). The values for other exogenous variables would, according to the assumption, be the same as in the basic simulation of economic performance in 2005.

The analysed autonomous financial inflow would markedly reduce the deposit interest rate in the first two quarters, since the yearly (quarter-over-quarter in the previous year) interest rate increment would fall by approximately 0.11 points. The drop in the lending interest rate would even be a little greater, but it would be spread out over the whole year. In the last quarter, given the assumed autonomous financial inflow, the yearly lending interest rate increment would be approximately 0.14 points lower. The slower reaction of lending rates could be a consequence, for example, of safeguarding the bank financial results, which, owing to the battle for market share (greater pressure on lending rates), would already be strongly squeezed in 2004.

The effect of autonomous financial inflow on interest rates can be illustrated by the range of the autonomous financial inflow, which would neutralise the net financial outflow via enterprises and households (direct investments abroad, portfolio investments and other investments), equal in intensity to the first eight months of 2004, that is, 7.8% of all liquid assets. Such a large autonomous financial inflow (approximately 5.5% of GDP) would additionally(!) reduce the deposit interest rate by approximately 0.6 percentage points, and the lending rate by almost 0.8 percentage points!

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