INSTITUTE OF ECONOMIC RESEARCH
OF SLOVAK ACADEMY OF SCIENCES

Economic Development of Slovakia in 2006

(A study prepared on behalf of the United Nations Economic Commission for Europe)

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1. AN OVERALL ECONOMIC DEVELOPMENT

In June 2006 parliamentary elections were held in the Slovak Republic, which brought about changes in the political disposition of the individual political parties. After failure of the mid right-wing parties the new government was composed by the Social Democratic Party – Smer in coalition with the Slovak National Party and the People's Party – Movement for a Democratic Slovakia, which over the years of 1993 till 1998 pushed in Slovakia the „Slovak way" of transformation of the centrally directed economy to a market economy.

As things stand at the moment, it can hardly be estimated what consequences develops the mentioned political change on future development of the Slovak economy. In 2006 its course was running still within the economico-political and institutional rules set up in the previous period.

In contrast to the previous years when positive and negative trends were often differently combined, in 2006 the successful development of the Slovak economy acquired almost universal character. A robust economic growth was joined with a striking improvement of the situation on labour market and with maintaining a satisfactory macroeconomic stability. Combination of the mentioned macroeconomic trends had favourable impacts on living standard of the population of Slovakia.

The positive conformity of results with trends of the Slovak economy in 2006 may be seen on data in table 1 and in the chart 1.

The rate of GDP growth in 2006 achieved a record-breaking level mainly due to the fact that new capacities of foreign investors were launched. The 8.3 % GDP growth was shared probably in the same proportion by the work productivity growth and by the growth of labour force. The industrial output in 2006 grew by 9.9 % and it exceeded the 1989 level by 14.7 %.

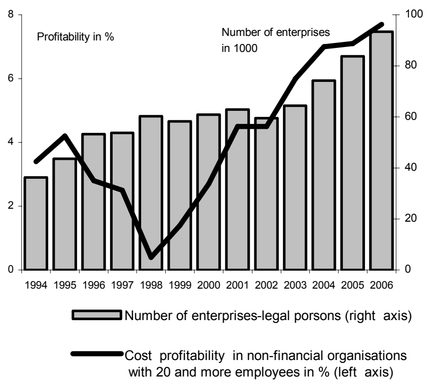
In 2006 things became explicitly better on the labour market. The average number of employees in 2006 (according to the labour force sample survey) increased in comparison with 2005 by 85 thousand and reached the highest level since the independent SR came to existence. In this connection the overall employment rate in the age group 15 – 64 years grew within the first 9 months from 57.4 % in 2005 to 59.1 % in 2006.

In equal age category and in equal periods it was with men 64.1 % and 66.7 % and with women 50.8 % and 51.6 %. Decrease in the unemployment rate accelerated not only because of employment growth, but also because of emigration which became stronger after the SR acceded the European Union[1]. Compared with the previous year it was 1.9 in 2005 and 2.9 percentage points (p. p.) in 2006.

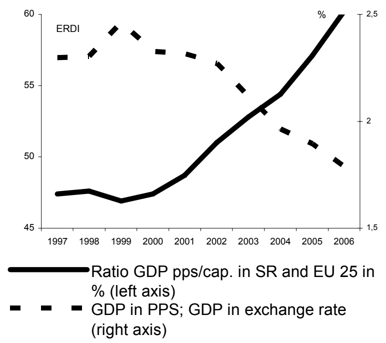
In 2006 the real wages increased and after 17 years they exceeded for the first time the 1989 level. The higher values of real consumption of households/capita than the values of real wages index are the result of a fast growth pace in real incomes of self-employers. Thus they are one of the marks of increasing income differentiation of the population. Downturn of the social benefits shares in the consumption of households considerably slowed down in 2006.

C h a r t 1

A. Number of enterprises



B. Characteristics of real convergence



[1] The difference between number of workers by Labour Force Sample Survey and the number arrived at by the method of European System of National Accounts – ESA95 (by means of quarterly national accounts) which indicates approximately the number of workers emigrated abroad, was 169 thousand in 2006.

T a b l e 1

Socio-economic development of SR over 1996 - 2006

	1996	1997	1998	1999	2000	2001	2002	2003	2004	2005	2006
	A. Development in performance of economy										
GDP Index[1] Previous year = 100	106.1	104.6	104.2	101.5	102.0	103.8	104.6	104.5	105.5	106.0	108.3
1989 = 100	94.7	99.0	103.2	104.7	106.8	110.9	116.0	121.2	127.9	135.6	146.9
Labour productivity index[2]											
Previous year = 100	102.4	105.5	104.5	104.6	103.5	102.7	104.5	102.6	105.2	103.8	104.3
1989 = 100	107.6	114.0	119.3	124.4	129.3	133.4	140.3	144.0	152.4	158.2	165.0
Cost profitability in non-fin. org. in %	2.8	2.5	0.4	1.4	2.7	4.5	4.5	6.0	7.0	7.1	7.7
	B. Indicators of stability										
Inflation rate in %[3]	5.8	6.1	6.7	10.6	12.0	71	3.3	8.5	7.5	2.7	4.5
Of which: Core inflation rate in %	.	.	6.1	6.0	5.7	4.3	2.1	2.6	2.6	1.1	2.5
ϕ interest rate on credits in %[4]	13.3	18.4	19.4	16.9	11.8	9.3	9.1	7.6	7.9	6.0	7.4
Balance of public finance/GDP in %	-7.4	-6.2	-3.7	-7.0	-12.3	-6.0	-5.7	-3.7	-3.3	-2.95	-3.4[6]
Annual Δ in productivity[2] –annual Δ in real wages in NE, in points	-4.7	-1.1	1.8	7.7	8.4	1.7	-1.3	4.6	2.7	-2.5	1.0
Net export of goods and services/GDP in % at current prices.	-8.6	-7.6	-10.7	-2.2	-0.3	-3.8	-7.1	-1.5	-2.7	-4.4	-4.6
	C. Social development										
Year-on-year employment index[5]	103.6	99.1	99.7	97.0	98.6	101.0	100.2	101.8	100.3	102.1	103.8
ϕ unemployment rate in %[5]	11.3	11.8	12.5	16.2	18.6	19.2	18.5	17.4	18.1	16.2	13.3
Annual change in real wages in %	7.1	6.6	2.7	-3.1	-4.9	1.0	5.8	-2.0	2.5	6.3	3.3
Index of real wages in NE 1989 = 100	86.3	92.0	93.6	91.0	86.9	87.8	92.8	91.3	93.6	99.5	102.8
Index of real household consumption/cap. 1989 = 100	89.0	94.0	99.5	102.1	101.1	106.4	112.3	111.4	115.4	122.1	129.8
Share of social benefits in household consumption in %	23.6	23.3	22.8	23.3	22.5	21.3	21.2	21.6	20.2	19.6	19.4

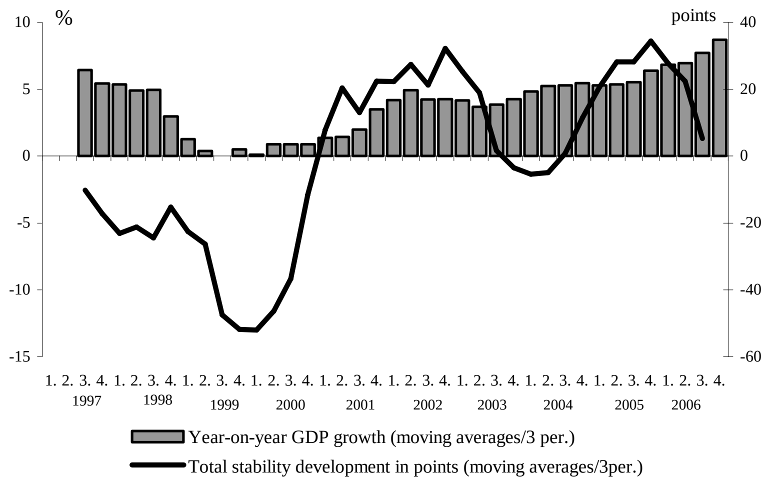
[1] At constant prices. [2] According to GDP at constant prices per 1 worker. [3] According to consumer prices, in average per year. [4] From credits drawn from commercial banks, in average per year. [5] ,According to Labour Force Survey, in average per year. [6] For the first time incl. the impact of introducing the second pillar pension scheme. Without that the public finance balance in 2006 comes to 2.3 % GDP.

Information in table 1 is supplemented by the chart 1. It's A. part expresses how the generating favourable macro-level affected entrepreneurial activities and constantly improving results of enterprising entities. A sight at the real convergence trends /part B of the chart 1) shows a close coherence between performance and price level in the Slovak economy approaching the EU level.

Development of macroeconomic stability along with the economic growth course (with GDP development) is given in the chart 2.

Chart 2

Economic performance and stability development in SR over 1997 – 2006



[1] Trend of the overall stability summarizes development of the following partial indicators: year-on-year rate of core inflation, ratio of the public finances balance combined with quarterly values of the share of public consumption from GDP, proportion of net export to GDP and difference between increase in work productivity and increase in real wages. Each partial indicator separately and its values identified in the pertinent period are expressed by points (spanned from + 100 to -100 points) according to their proportion to the half span between maximum and minimum values of the concerned indicator within the total time series. The average of the total points achieved in individual periods by partial indicators is considered to be the value of the overall stability.

The average value of the overall stability in SR in the reference period is identified in the chart as its zero value. Positive values in that represent the above-average level of stability and negative values its under-average level.

In 2006, the overall macroeconomic stability (the way of its survey is given in the footnote to the chart 2) extended its worsening trend from the previous year. However, its values stayed above average of the whole reference period and they expressed the macroeconomic environment which did not hinder economic growth.

Deterioration of the macroeconomic stability in 2006 against the previous period resulted from the increased rate of inflation and the interest rate growth which followed. The main factor in growing rate of inflation was the increase in fuel prices on world market and increase of foodstuff prices. The results of external balance over the recent two years did not change and wages development (in proportion to the work productivity development) exerted a positive influence on movement of the overall macroeconomic stability.

In the charts 3 and 4 attention is paid to economic growth from the perspective of impact caused on its results (on the speed of GDP growth) by changes of individual demand components.

Chart 3
Impact of domestic demand and net export components on GDP changes in constant prices

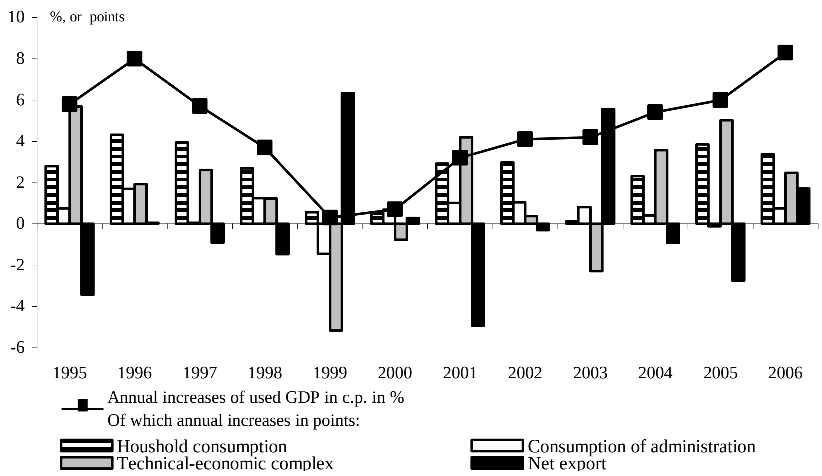


Chart 3 suggests that in 2006 (similarly like in the two recent years) the GDP growth was backed namely by household demands growth and investment activities growth. In the chart 3 we can see characteristic great and sudden changes in the whole reference period as to the influence of demand components on the rate of economic growth. For understanding of more long-term trends, data contained in table 2 may serve.

T a b l e 2
Average values of impact of demand components on GDP increase[1]

	1995 – 1998	1999 – 2002	2003 – 2006	1996 – 2006
Average annual GDP increases in %	5.8	2.1	6.0	4.6
Of which shares in points of:	.	.	.	
Household consumption	3.4	1.8	2.5	2.5
Publ.adminis.consumption	0.9	0.3	0.5	0.6
Gross capital formation	2.9	-0.4	2.4	1.6
Net export	-1.4	0.4	0.6	-0.1

[1] At constant prices.

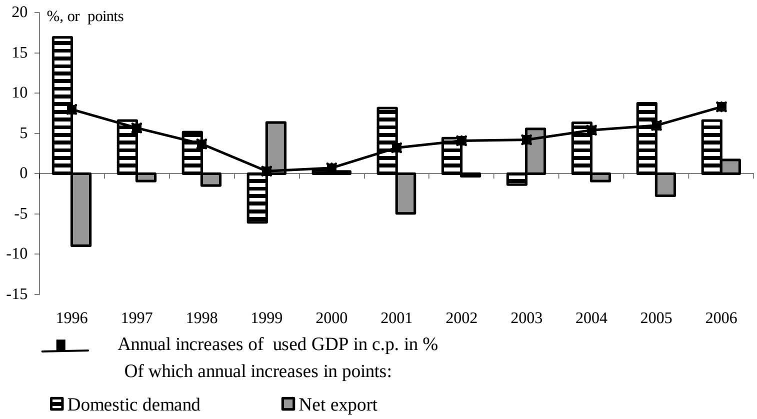
Relatively stable and for the complete reference period the highest contribution to the GDP growth is reported by the consumption of households development. The least impact on GDP growth exerted the public administration consumption development. Deviations in the impact of gross capital formation on economic growth are obviously connected with scaling down the investment activities over the periods of declining GDP growth, or with their increase over the periods of revival. What is really surprising on table 2, those are data on weak impact of net export which might mislead to a false view at the role of export in economic development of Slovakia.

It is necessary to bear in mind the fact that the impact of net export on GDP change is characterized merely by the impact of difference (balance) between the export and import, and not by the impact of total export (external demand). The way how to ascertain the impact of the external demand (export) on the process of economic growth is to grasp that for satisfying all demand components the production is needed, which requires certain volume of import. The question is about import which meets the demand component either directly (in the form of imported products), or indirectly (through products manufactured from the imported raw material, semiproducts, energy etc.). Therefore, if we want to know the extent of fulfilment of the individual demand components out of resulted economic activities, then we have to divide the total import into parts which serve to fulfil the individual demand components, and results of such a division will be deducted from the pertinent demand components. The described procedure is applied for the purpose of measuring the impact of domestic demand and external demand on the annual GDP increases. This has been done in the chart 4 which, first (in the part A) presents the traditional approach (by which total import is deducted from export), and in the part B it presents the impact of domestic and external demands on GDP increases, but reduced by the export related to both types of demand.

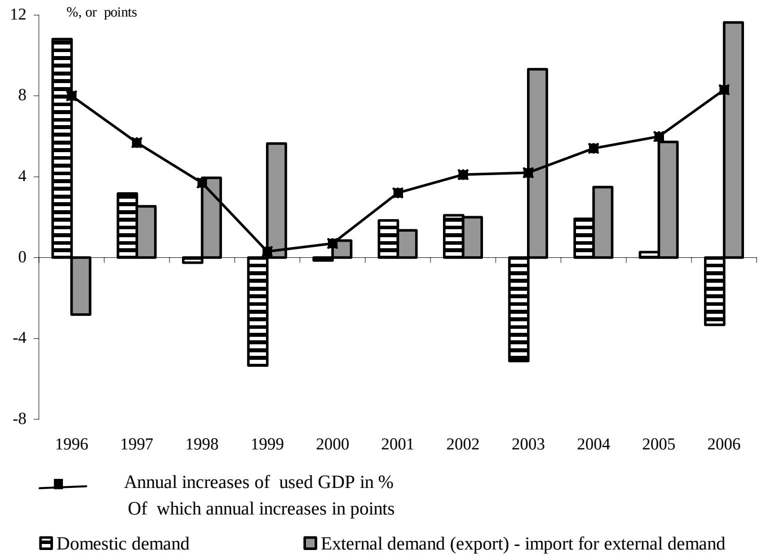
C h a r t 4

Impact of demand components on GDP changes in costant prices

A. Impact of domestic demand and net export



B. Impacts of domestic and external demands reduced by import required by them



The impacts of domestic and external demands development on economic performance development (on GDP growth speed expressed in both parts of chart 4) are diametrically opposed. This is characterized by data in table 3.

T a b l e 3
Impact of demand components on average annual GDP increases

	1996 –1998	1999 – 2002	2003 – 2006	1996– 2006
GDP increases in %	5.8	2.1	6.0	4.5
which are shared				
in variant A: by domestic				
demand in points	9.5	1.7	5.3	5.2
by net export				
in points	-3.7	0.4	0.7	-0.7
in variant B: by domestic output				
for domestic demand in points	4.6	-0.4	-1.3	0.6
export in points	1.2	2.5	7.3	3.9

Data on impact of net export on GDP development suggest the external demand to prove as negligible or even, viewing the whole reference period (1996 – 2006 years) as negative factor of economic growth. The whole GDP increase over 1996 – 2006 would be in this case (showed as variant A in the chart 4 and table 3) ascribed to the influence of domestic demand. Against this conclusion stands an intuitive disagreement which approves of data of variant B, in which the relative parts of import are deducted from the domestic and external demands. Accordingly, over 1996 – 2006 the increase in performance of the Slovak economy was provided above all by the output determined for export and in substantially lesser extent by output satisfying domestic demand. This proportion between the role of external and domestic demands was confirmed within the reference period and in 2006 it achieved its maximum value. On ground of this it can be said that competitiveness of the Slovak producers is developing better on the world market than on the home market. Explanation can be found by that on the world market operate foreign firms located in Slovakia, while on the home market operate Slovak firms.

The mentioned conclusion on the prime importance of external demand corresponds to the fact that the results of the Slovak economy in 2006 were heavily conditioned[2] by the high degree of openness, mainly towards the countries of European Union. However, the broad integration in the international exchange brought about not only current positive results but also revealed some weak sides of the Slovak economy. Its competitiveness is and obviously even in the nearest years will be based mainly on the advantage of low costs for relatively qualified labour which is abundantly used by the transnational firms operating on the territory of Slovakia. Even from the view of European average, the extremely low innovation potential of the Slovak economy, which is due to its isolation from the driving forces of the knowledge

[2] The ratio of export to GDP in Slovakia amounted in 2006 in current prices 86 %, while the EU countries' share in export of SR was 85 %.

economy, becomes a risk factor of a long-term socio-economic development of Slovakia.

The basis of the satisfactory trends appearing in the Slovak economy in 2006 is with all probability not only accomplishment, but also functioning of a large-scale line of reforms[3]. To say it simply, a more complete form have the reforms allowing market function in the field of resources formation, while in many other fields, mainly in the use of public funds, the reforms remained behind.

The new government with the leftist domination announced in its Programme declaration to modify the current functioning of economy so as "to satisfy the rightful efforts of the European Union to support social-market economy." According to the government Programme declaration and also the first practical steps to its accomplishment, as the main lines of this plan to realization can be considered, first, the changes in distribution in favour of people with low-income backgrounds, second, strengthening the trade unions position on labour market, and, third, shifting the focus of impact on socio-economic changes (reforms) from the market regulators to the state institutions activities.

The new government assumed all commitments which Slovakia adopted as a NATO and EU member. They adopted also the SR program of entering the European Monetary Union as originally scheduled on January 1, 2009. In their economic policy up to now (expressed namely through the budget of public finance for 2007 – 2009 and in the support to anti-inflation policy of the National Bank of Slovakia) we can see the efforts to maintain the macroeconomic stability on the level needed after the country enters the Eurozone.

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[3] There can be included here namely revitalization and restructuring of banks, price deregulation, reform of public finances incl. tax system reforms and with it connected changes in the position and financing the selfgovernments, measures strenghtening flexibility of labour market, reform of the pension insurance system, adoption of rules of granting individual state assistance to foreign investors and lastly the privatization procedure of state ownership.

2. PRODUCTION DEVELOPMENT

The real 8.3 % growth of gross domestic product was achieved in 2006 along with the 10.6 % growth of value added and 8.7 % decline of taxes on products (reduced subsidies). Due to a slower growth of value added than the gross output (10.6 % against 13.7 %) the share of value added in output decreased compared to 2005 by 1.1 p. p. (current prices), but it reached such a level (40.5 %) which has been the second highest since 1995.

To the GDP growth in 2006 mostly contributed, i. e. by 5.1 p. p. the services sector[4] which was developing substantially more favourably than in previous years. A little less than in the previous year was the contribution by industry to the GDP growth (2.5 p. p. against 4.9 p. p. in 2005). The overall development tendencies are characterized in table 4.

T a b l e 4

Development of GDP formation in 2003 – 2006

(on basis of constant prices in 2000)

	2003	2004	2005	2006	2003	2004	2005	2006
	Year-on-year changes in %				Contribution to GDP growth in p. p.			
GDP	4.2	5.4	6.0	8.3	.	.	.	.
of which:								
Agriculture	-0.2	13.3	13.9	6.3	0.0	0.5	0.6	0.3
Industry total	19.4	8.9	16.0	10.6	5.0	2.6	4.9	3.5
Manufacturing	15.1	7.9	22.3	10.7	3.4	2.0	5.7	3.1
Construction	-4.9	2.8	4.4	9.8	-0.3	0.2	0.3	0.6
Services total	-1.2	0.2	-3.4	11.8	-0.6	0.1	-1.6	5.1

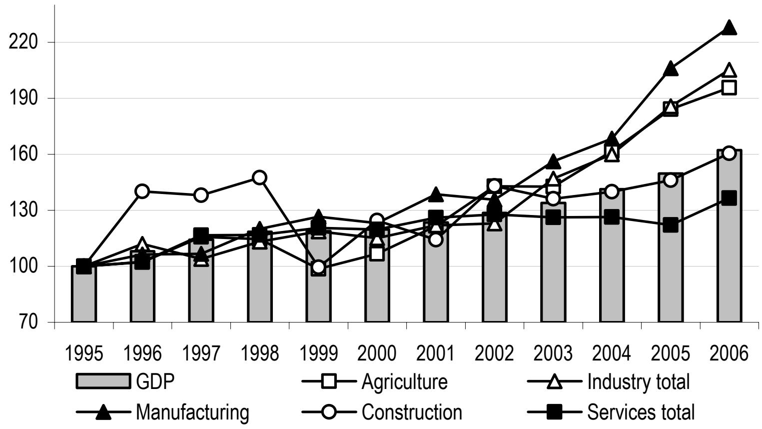
From a longer perspective the economy of SR is dominated by a real growth of value added in industry, namely in manufacturing industry and in agriculture and to certain extent its growth falls behind in services sector[5]. See chart 5.

[4] An extraordinary high real growth of value added was reached in business (22,8 %) and in other municipal, social and personal services (18,9 %).

[5] After the last revision of quarterly national accounts and calculation of individual indicators to constant prices of 2000, the view at the value added development changed substantially in the basic branches of national ecoomy.

C h a r t 5

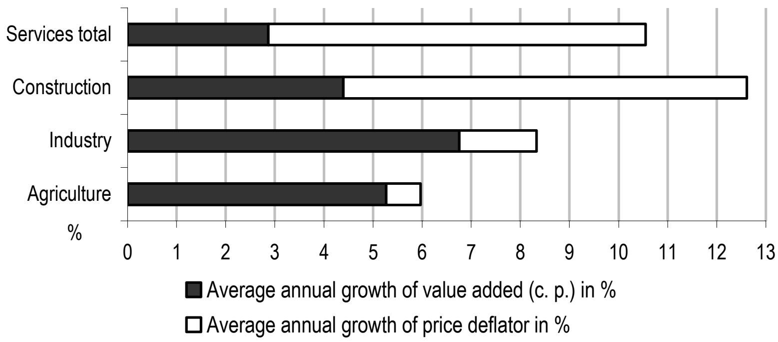
Value added development in basic branches of SR in %
1995 = 100, on basis of constant prices 2000



Conversely, value added in current prices, grew very fast in services and also in construction, and slower in industry and agriculture. The chart 6 illustrates the average annual value added growth in nominal expression, which consists of two components: of an average annual real value added growth and of a relevant price deflator.

C h a r t 6

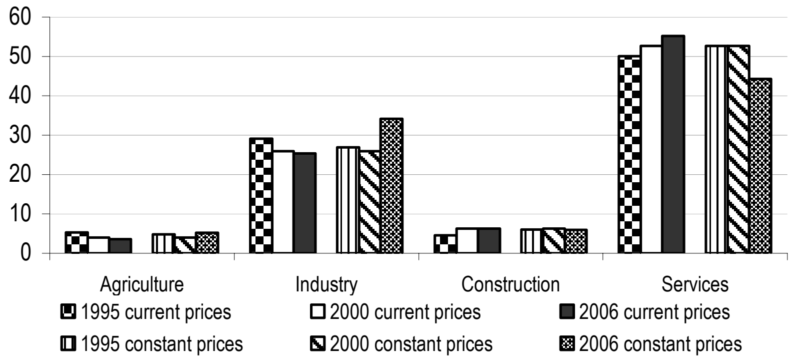
Value added development in current prices by branches (1995 – 2006)



The different price deflator growth in basic economic branches is caused namely by different competition conditions in which a tradeable and non-tradeable economic sector operates[6]. In the tradeable sector (created mainly by manufacturing industry) which operates mostly in a global competitive environment, wages grow in harmony with the real work productivity growth. In the non-tradeable sector (major part of services) the wages growth, and also prices growth, are adjusted to the wages growth in tradeable sector, namely, without regard to real development of its work productivity[7]. Analysis of the years 1995 – 2005 confirms that nominal wages growth in industry was more or less in accord with real work productivity growth, while in services sector it highly exceeded the real growth of its productivity and was even higher than in industry. It can be expected that this trend including its impact on the inflation development will continue also further, because a comparable price level in services reached in 2005 only 35.2 % of the EU 15 level compared with 71 % for goods and 50.6 % for GDP.

Differences in price deflator growth are fully reflected in different development of the share of basic branches of economy in value added in nominal and real expression, as it is illustrated in chart 7.

C h a r t 7
Share of basic branches in GDP in % (1995, 2000 and 2006)



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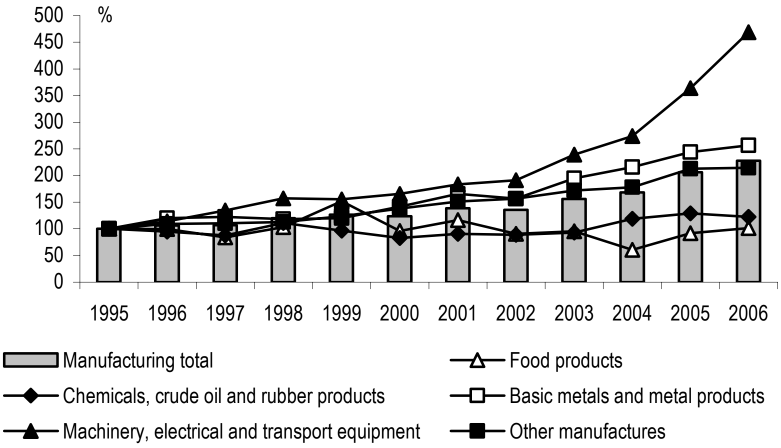
[6] This phenomenon is theoretically explained by Balassa-Samuelson effect.

[7] In an opposite case the work force would be transferred into tradeable sector.

The real value added growth in *manufacturing industry* by 10.7 % supported in 2006 mainly its 28.9 % growth in manufacture of machinery, electrical and transport equipment, which makes up 2.9 p.p. (more than one third) of the overall economic growth and 9.8 p. p. of value added growth in manufacturing industry. Value added increased in real terms in manufacture of food products by 10.1 %, in manufacture of basic metals and metallic products by 5.2 % and in other manufacturing branches[8] by 0.7 %; in manufacture of chemicals, crude oil and rubber it decreased by 5.1 %.

In the long-term context, the value added development in manufacturing is characterized by its above-average growth in manufacture of machinery, electrical and transport equipment and in manufacture of metals and metallic products. For more details see chart 8.

Chart 8
Development of value added in manufacturing branches
(1995 = 100, on basis of constant prices of 2000)



[8] Total of manufactures of textile and textile products, leather and leather products, wood and wood products, pulp, paper, publishing and printing, manufacture of other non-metal products, mineral products and n. e. c.

Value added growth in the services sector by 11.8 % was supported in 2006 mainly by business (5.2 p. p.), 2 p. p. accrued to the branch of real estate, renting and business services and 1.6 p. p. to transport and telecommunication.

In 2006 output in *industry*[9] increased in year-on-year terms by 9.9 % (by 6 p. p. more than in previous year), of which in manufacturing industry by 12.4 % (by 7.2 p. p. more than in 2005). Extraordinary increased output was recorded in manufacture of textile products (38.2 %), manufacture of metal constructions (32.3 %), manufacture of radio, TV and telecommunications equipment (30.9 %), manufacture of motor vehicles (28.1 %) and in manufacture of machinery n. e. c. (24 %).

Acceleration of growth of industrial output reflected also in a noticeable real growth of turnover in industrial enterprises, which accelerated year-on-year from 5.3 % to 14.5 %, in manufacturing industry from 6.1 % to 16.1 %. The highest growth of turnover was reached already in the third year in the row in manufacture of electrical equipment (36.5 %, in previous two years 35.5 % and 28.8 %).[10] The above-average growth of sales in 2006 was reached also in manufacture of transport equipment (31.6 %), in manufacture of chemical products (25.3 %) and in manufacture of machinery n.e.c. (20.8 %).

Real growth of turnover in 2006 in industry was reached at the decline of number of employees (by 1.3 %) and at the 16 % growth of work productivity; in manufacturing industry the employment declined by 1.1 % and the work productivity increased by 17.4 %.[11]

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[9] By the index of industrial output.

[10] Namely in spite of the fact that in 2006 manufacture of office and computing machinery declined deeply (only to 6 % of the 2005 level), which was a driving force in this branch within the previous two years. Its performance was substituted by manufacture of radio, TV and telecommunications equipment, which increased to 4.5 multiple of the 2005 level.

[11] Work productivity calculated on basis of turnover.

Increase in performance of manufacturing industry (namely growth of its output and sales) was accompanied in 2006 by an accelerated growth both of its export (by 24.8 % against 11.5 % in 2005) and import (by 24 % against 12.7 % in previous year). The total surplus of foreign trade exchange with products of manufacturing industry achieved SKK 73 billion, i. e. by SKK 20 billion more than in 2005 and so far the highest reached value.[12]

In 2006 exporters with highest value of export and with highest surplus were manufacture of transport vehicles and manufacture of metal products. The second place since last year from view of value of export has been occupied by manufacture of electrical equipment, which, however, remains so far a deficit branch, though the proportion between its export and import is improving from year to year (in 2006 the export covered 89 % of import, while three years ago it was only 68 %).

An overall view at the foreign trade of manufacturing industry[13] in 2006 by branches is presented in table 5.

Over the recent years strong growth was recorded in exports of goods with high technology intensity (in 2003 by SKK 10 billion, in 2004 by SKK 23 billion, in 2005 by SKK 43 billion and in 2006 by almost SKK 67 billion). Their share is growing in total exports (and imports as well) of manufactured goods, namely on account of low and medium technology intensive goods. This situation reflects rapid development of an internationally cooperated production in electro-engineering industry, which becomes apart from the automotive industry the second pillar of the Slovak industry. An overview of changes in export and import structure of manufacturing by technological group is presented in table 6.

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[12] In 2006 total deficit of balance of trade was by SKK 15.3 billion higher than in 2005, mainly due to the increased deficit in trade of mineral raw materials by SKK 31 billion.

[13] In 2006 manufacturing industry's share in total export was 97 % and in total import 85 %.

T a b l e 5
Foreign trade of manufacturing industry in 2006

	Export			Import			Balance
	Billion SKK	Share In %	Growth In %	Billion SKK	Share In %	Growth In %	Billion SKK
Industrial output in total	1 202.9	100.0	24.8	1 129.5	100.0	24.0	73.4
Of which:							
Manufacture of food products	37.7	3.1	12.2	57.2	5.1	7.3	-19.5
Textiles and textile products	35.7	3.0	-0.9	44.1	3.9	6.5	-8.4
Manufacture of leather	18.7	1.6	1.3	16.0	1.4	11.3	2.7
Manufacture of wood	19.7	1.6	17.6	11.1	1.0	27.3	8.6
Manufacture of pulp and paper	40.2	3.3	13.2	27.1	2.4	7.6	13.1
Manufacture of coke, refined petroleum products	65.9	5.5	9.1	30.0	2.7	16.2	35.9
Manufacture of chemical prod.	70.5	5.9	19.4	111.3	9.9	15.8	-40.8
Rubber and plastic products	49.4	4.1	13.1	59.4	5.3	18.4	-10.0
Manufacture of non-metallic products	22.9	1.9	3.8	18.5	1.6	13.4	4.5
Manfuacture of metal products	196.7	16.4	24.0	141.0	12.5	25.0	55.7
Manufacture of machinery and equipment n.e.c.	106.4	8.8	18.7	116.3	10.3	16.0	-9.9
Manufacture of electrical equipment	247.1	20.5	47.7	278.8	24.7	42.8	-31.7
Manufacture of transport equipment	264.7	22.0	34.5	193.8	17.2	27.5	71.0
Manufacturing n. e. c.	27.3	2.3	6.9	25.1	2.2	31.9	2.2

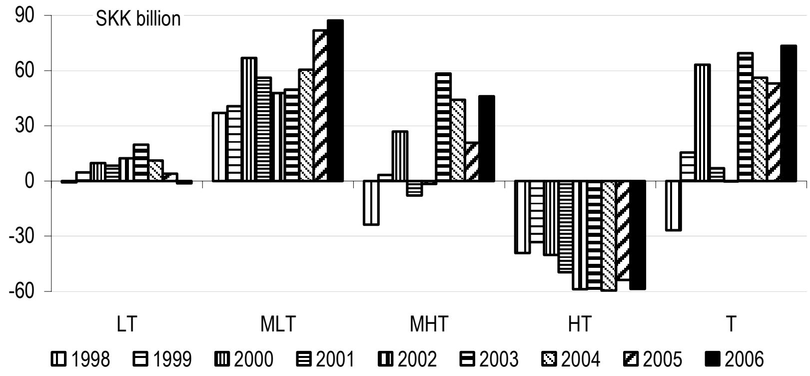
T a b l e 6
Share of technological groups in export and import of manufacturing industry in %

	1998	2004	2005	2006	1998	2004	2005	2006
	Export				Import			
Low technologies	21.7	18.2	17.2	14.9	20.4	18.1	17.8	16.0
Medium low technologies	30.5	28.2	29.8	28.0	19.1	22.7	22.6	22.0
Medium high technologies	42.4	45.8	41.6	42.5	45.6	43.5	41.7	41.2
High technologies	5.4	7.8	11.4	14.6	15.0	15.7	17.9	20.8

From the aspect of trade balance, the trade with high-tech categorized goods remains still its weak side. Its trade deficit continues to be extra high (almost SKK 59 billion in 2006). Other technological groups are achieving surplus, or but slight deficit. See more in chart 9.

C h a r t 9

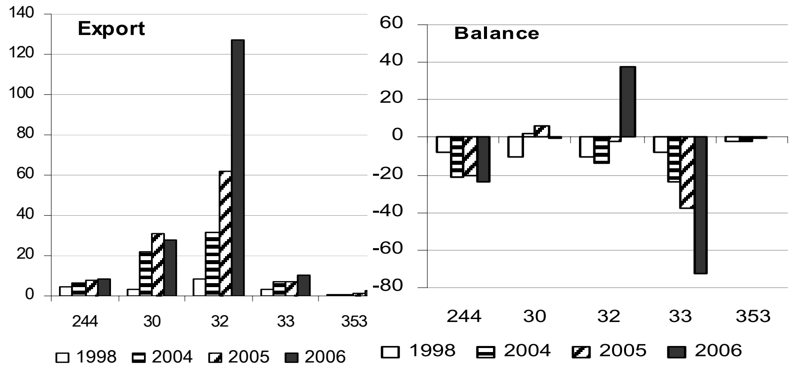
Development of trade balance in segments of manufacturing by technology intensity (in SKK billion)



In 2006, in the segment of the most high-tech intensive goods position of individual groups changed markedly. An extra increase (more than 100 %) was registered in export of radio, TV and communications equipment, which led into trade surplus in these commodities. On the other hand we can observe strong growth in imports of medical, precision and optical instruments (by 85 %) leading to high deficit (SKK 73 billion) which is rather more than deficit in pharmaceuticals that had been the highest in long-term. See more in chart 10.

The growth in *construction* in 2006 was characterized by continuing strong real growth in construction production (14.9 %) which supported in this way increase in number of employees by 9.3 %, as well as growth in work productivity by 5.2 %. Construction production grew in inland year-on-year by 16.1 %, namely in new construction, incl. reconstructions and modernizations by 19.2 %. Construction works abroad declined by 12.1 %. Dynamic growth of turnover in construction firms continued by 13.3 %.

C h a r t 10
Development of exports and trade balance in high technologies segment (in SKK billion)



Notes: 244 — pharmaceuticals, 30 — office, accounting and computing machinery, 32 — radio, TV and communications equipment and instruments, 33 —medical, precision and optical instruments, 353 —aircraft and spacecraft.

In *agriculture* the turnover increased by 1.6 % in real terms, while sales for crop products increased by 2.8 % and for animal products by 0.2 %. In total, sales of agricultural products (in physical terms) in 2006 – except for certain products (oil plants, vegetables and slaughtered pigs) decreased. For example, especially declined (by 8.2 %) sale of cereals.

In 2006, profit/loss of corporations increased by SKK 19 billion (comparing with SKK 70 billion in 2005). Its growth was negatively influenced by the sector of financial corporations which ended the year 2006 with negative profit/loss result amounting to SKK 12 billion (in contrast to profit amounting to SKK 28.7 billion in 2005).[14] On the contrary, in the non-financial corporations

[14] The negative profit/loss result of financial corporations was impacted by the loss of National Bank of Slovakia (NBS) (according to decade balance of assets and liabilities of the NBS, as of December 31, 2006) to the tune of SKK 45 billion; commercial financial institutions generated profit of SKK 19.7 billion, profit of insurance corporations and pension funds achieved SKK 4.4 billion and of other financial mediators SKK 9 billion.

sector, profit increased substantially, more than in 2005 – by almost SKK 60 billion, while in 2005 the increase in profit achieved only incomplete SKK 29 billion (see table 7).

Table 7
Development of financial position of corporations over 2002 − 2006

	2002	2003	2004	2005	2006
	Profit/loss in SKK billion				
Non-financial and financial corporations-total	133.7	138.0	180.0	249.5	268.4
Financial corporations	–5.5	-15.1	-12.3	28.7	-12.0
Non-financial corporations, of which	139.1	153.1	192.3	220.9	280.4
Agriculture	1.9	-1.9	1.0	-0.3	1.3
Manufacturing	42.6	53.2	70.0	73.1	91.4
Electricity, gas and water supply	28.8	37.0	42.2	46.7	52.5
Construction	8.9	8.4	10.2	12.3	14.4
Services – total	56.0	55.4	67.4	86.2	116.1
Profitable and unprofitable non-financial corporations with 20 or more employees	95.3	115.2	149.3	172.9	223.6
of them: profitable	127.4	146.6	173.0	204.1	252.8
unprofitable	–32.2	-31.3	-23.7	-31.2	-29.2
	Cost profitablity in %				
Non-financial corporations	5.7	6.0	7.0	7.1	7.7
Agriculture	2.7	-3.1	1.6	-0.5	2.0
Manufacturing	4.7	5.0	6.2	5.7	5.9
Electricity, gas and water supply	14.2	17.0	19.8	20.0	18.0
Construction	8.6	7.8	8.6	8.3	8.7
Services – total	5.0	5.1	5.6	6.3	7.4

The highest increase in profit within the non-financial corporations was generated in services sector (almost SKK 30 biliion), namely in branches transport, storage, posts and telecommunications (increase by SKK 14 billion) and in business (increase by SKK 13 billion). In the industry profit increased by SKK 25 billion, of which in manufacturing by SKK 18 billion and in electricity, gas and water supply by almost SKK 6 billion.

In manufacturing the profit grew in all branches, except for manufacture of food, and coke and refined petroleum products (decrease by SKK 2.6 billion), however, mostly in manufacture of metals and metallic products (by SKK 5.4 billion), in manufacture of electrical equipment (by SKK 4.1 billion) and in manufacture of transport means (by SKK 2.8 billion). Favourable results were generated also in construction (increase in profit by SKK 2 billion).

As the table 7 reveals, in spite of gradually increasing cost profitability of non-financial corporations, there exist relative large and increasing differences among individual branches, for example in manufacturing compared with electricity, gas and water supply. Among the branches which achieved in 2006 above-average cost profitability, except electricity, gas and water supply, can be arranged mining and quarrying (22.6 %), manufacture of metals and metallic products (14.2 %), manufacture of non-metallic products (11.4 %), transport, storage, posts and telecommunications (13.2 %) and the sector of real estate, renting and business activities (13.1 %). Among the branches with low profitability can be included mainly agriculture, manufacture of textiles and textile products and, surprisingly, also manufacture of transport means (2.2 % in 2006).

In 2006, out of total number of non-financial corporations with 20 and more employees, roughly 28 % were unprofitable corporations (by 2 p. p. less than in 2005). The volume of generated loss has decreased by SKK 2 billion and profit in profitable corporations increased by SKK 48.6 billion. Profit in small enterprises with up to 19 employees increased by SKK 8 billion and achieved incomplete SKK 57 billion, most of which in business – SKK 34,4 billion. [15]

[15] Wholesale and retail; repair of motor vehicles, motorcycles and consumption goods.

3. EXTERNAL ECONOMIC RELATIONS

3.1. Balance of payments

Development of economic relations of Slovakia with outside world in 2006 cannot be assessed very positively. The balance of payments recorded deficit for the second time in the independent Slovak Republic (for the first time in 1998) in the amount of 4.8 % GDP (table 8). Foreign exchange reserves of the NBS fell by SKK 78.1 billion, namely due to interventions in favour of the Slovak crown carried out by the central bank in June and July, while in the previous year their increase by slightly lower value occurred.

Table 8

The development of basic items of the balance of payments of the Slovak Republic in 2002 - 2006

	2002	2003	2004	2005	2006
Trade balance (billion SKK))	-96.0	-23.4	-49.6	-76.0	-91.6
Balance of services (billion SKK)	20.7	8.7	8.6	9.9	19.7
Income balance (billion SKK)	-20.7	-66.8	-70.9	-61.3	-62.1
Current transfers (billion SKK)	8.8	9.0	5.5	0.5	-1.6
Current account (billion SKK)	-87.2	-72.5	-106.4	-126.9	-135.6
Capital and financial account (billion SKK))	239.9	112.1	159.3	176.9	32.4
Overall balance (billion SKK)	160.6	51.9	55.2	71.4	-78.1
Current account/GDP (%)	-7.8	-6.0	-7.8	-8.6	-8.3
Overall balance/GDP (%)	14.4	4.3	4.1	4.9	-4.8
Degree of the coverage of current account by capital and financial account (%)	2.75	1.55	1.50	1.39	0.24

Source: NBS, 2007; own calculations.

Worsening of the balance of payments result compared to 2005 was caused mainly by development on capital and financial account, the surplus of which considerably declined because of unfavourable changes in other short-term investments in year-on-year comparison, namely to the level of SKK 32.4 billion. The main reason for this fall was development of short-term sources in banking sector. While in 2005 the volume of short-term deposits of non-residents in Slovak banks increased, in 2006 a considerable outflow of them took place due to weak position of the Slovak crown in the period after the elections to the National Council.

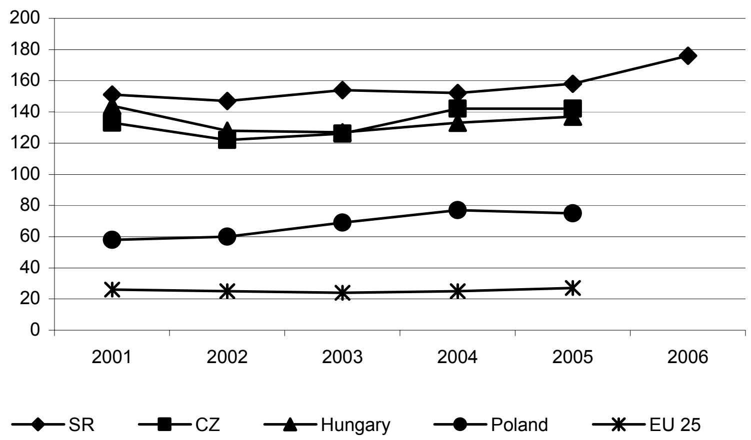
Deficit of the current account compared with 2005 grew up by SKK 8.7 billion, but with respect to a high growth of the Slovak economy its share in GDP moderately declined to 8.3 % on year-on-year base. The mentioned development of main issues of balance of payments reflected in considerably accelerated decrease of rate of covering the current account by capital and financial account when compared with previous year.

The largest share in deficit of current account of balance of payments represented the trade balance and balance of revenues. Contrary to the previous year, deficit was recorded also in balance of transfers, chiefly due to deepening the deficit of balance of private transfers, which was more expressive than growth of net incomes from the EU funds. A year-on-year improvement could be observed solely in the balance of services as the only surplus item of the current account, the balance of which achieved thanks to positive development in all the main subgroups of services approximately double value of surplus recorded in 2003 till 2005.

3.2. Foreign trade

The Slovak Republic as a small open economy with relatively limited scope of internal market is predestined to profound development of international economic relations including international trade. The openness of Slovak economy expressed as ratio of total export and import of goods and services to GDP in current prices grew subsequently over the recent ten years from incomplete 120 % to almost 180 % (chart 11) what increased its sensibility on the economic development in countries of our most significant business partners. The most outstanding growth of openness was observed mainly in 2006, namely with respect to much faster nominal growth in export and import of goods and services in comparison with nominal growth of gross domestic product.

Chart 11
Openness of Slovak economy compared with other V 4 countries (%)



Source: Eurostat, 2007 (data for 2006 were not available in time of publishing); SO SR, 2007; own calculations.

As can be seen in chart 11, Slovakia is the most opened economy among V4 countries. Czech Republic and Hungary which are also marked as small economies, are only moderately behind Slovakia, while the openness of Poland as relatively large economy, attains in comparison with Slovakia only half level.

In 2006 export and import of SR compared with 2005 grew approximately in the same pace, however, the total results of foreign trade of SR worsened and increase in deficit to SKK 91.6 billion developed (table 9).[16] Hence the share of trade deficit in GDP mildly grew to 5.6 %.

[16] All data on foreign trade are stated in current prices.

T a b l e 9
Development of foreign trade of the Slovak Republic with goods in 2002 - 2006

	2002	2003	2004	2005	2006
Exports (SKK billion, c. p.)	652.0	803.2	898.1	993.5	1 239.4
Annual change (%, c. p.)	6.7	23.2	12.0	11.5	24.6
Imports (SKK billion, c. p.)	748.0	826.7	948.5	1 069.5	1 331.0
Annual change (%, c. p.)	4.7	10.5	14.7	13.7	24.3
Balance (SKK billion, c. p.)	-96.0	-23.4	-50.4[1]	-76.0	-91.6
Balance/GDP (%)	-8.6	-1.9	-3.7	-5.2	-5.6
Export performance (% GDP)	58.7	66.2	66.3	67.5	75.7
Import intensity (% GDP)	67.3	68.2	70.0	72.7	81.3

[1] This data was taken from the publication Foreign trade of Slovak Republic (definitive data) 2004 (March 2006), while the data presented in table 8 was obtained from the balance of payments published by National Bank of Slovakia (February 2007).

Source: Foreign trade of Slovak Republic 2002 – 2006. SO SR; own calculations.

The highest level of debit trade balance was recorded by SR in foreign trade exchange with Russian Federation, Republic of Korea and People's Republic of China, on the other hand the highest credit trade balance was achieved with Netherlands, Austria and United Kingdom. Export to the EU countries grew year-on-year almost in the same way as total export from the SR, while import from the EU increased less than total import to SR; this resulted in stabilization of export share into these countries to 85.1 % of total export and in decline in import share to EU countries to 68 % of total import of SR (table 10). On the other hand, the import share from Russia (due to surge in crude oil prices), South Korea (construction of the automotive plant Kia Motors Slovakia) and China increased in the course of recent two years.

High prices of crude oil in world markets were important factor for continuing growth of share of fuels in Slovak import. On the side of export, rise was noted in shares of machinery and transport equipment by as much as 4 % (table 11), while along with the export of machinery also the export of motor cars and components rose, as well as export of other motor vehicles, constructed especially for transport of persons. Automotive industry shared the total export, as well as the total industrial output of SR in 2006 approximately by one third.

T a b l e 10

Development of territorial structure of foreign trade of SR in 2004 - 2006

Country/ grouping	2004			2005			2006		
	Export (%)	Import (%)	Balance (SKK billion)	Export (%)	Import (%)	Balance (SKK billion)	Export (%)	Import (%)	Balance (SKK billion)
Total	100.0	100.0	-47.0	100.0	100.0	-76.0	100.0	100.0	-92.1
EÚ	85.2	73.7	66.1	85.4	71.1	87.7	85.1	68.0	149.3
Russia	1.2	9.3	-77.5	1.6	10.7	-99.4	1.6	11.3	-130.6
USA	4.7	1.6	27.4	3.1	1.4	16.2	3.2	1.2	22.6
China	0.3	2.7	-23.2	0.4	3.2	-30.6	0.5	4.0	-46.1
South Korea	0.1	1.8	-16.2	0.1	2.6	-27.2	0.1	3.9	-49.7
Japan	0.3	2.0	-15.9	0.3	1.9	-17.4	0.3	2.0	-23.6

Source: Foreign trade of Slovak Republic 2004 — 2006. SO SR.

T a b l e 11

Development of commodity structure of foreign trade of SR in 2004 – 2006 (by commodity groups SITC Rev. 3)

Group SITC	2004		2005		2006	
	Export (%)	Import (%)	Export (%)	Import (%)	Export (%)	Import (%)
Total	100.00	100.00	100.00	100.00	100.00	100.00
SITC 0 Food	3.00	4.08	3.80	4.71	3.66	4.33
SITC 1 Beverages and tobacco	0.31	0.70	0.18	0.89	0.20	0.57
SITC 2 Crude materials	2.89	3.70	2.68	3.55	2.35	3.12
SITC 3 Mineral fuels	6.42	12.53	7.19	13.88	6.50	14.33
SITC 4 Oils and fats	0.20	0.21	0.16	0.19	0.13	0.21
SITC 5 Chemicals	5.35	9.80	5.85	9.56	5.50	8.89
SITC 6 Manufactured products	24.78	18.96	24.98	17.94	23.55	17.05
SITC 7 Machinery and equipment	45.78	39.48	44.60	37.76	48.66	38.39
SITC 8 Manufactured articles	11.14	10.44	10.41	10.90	9.35	12.83
SITC 9 Others	0.13	0.11	0.15	0.62	0.10	0.29

Source: Foreign trade of Slovak Republic 2004 — 2006. SO SR.

Likewise in 2005, in total export we can see almost 41 % share of ten most important Slovak exporters with the leading companies Volkswagen Slovakia, followed by U.S. Steel Košice and Slovnaft. Volkswagen and Slovnaft reported at the same time the highest share in total import.

3.3. Foreign capital

Capital and financial account achieved in 2006 a surplus amounting to SKK 32.4 billion, which, however, did not make even one fifth of surplus of 2005 (table 12). A strong impact on the mentioned decline exerted development of other investments. The change of deficit in other long-term investments to surplus amounting to SKK 18.6 billion could not cover the generated deficit of other short-term investments which attained the amount SKK 141.3 billion. The reason of this diametrically different development in this item in comparison with the previous year lies in the fact mentioned already above that while in 2005 a considerable inflow of short-term deposits of non-residents arrived into Slovak banks, in 2006 these means recorded outflow.

The surplus of foreign direct investments on year-on-year base almost doubled and attained SKK 112.9 billion. This increase was reached prevailingly by more than doubled inflow of equity capital into SR in comparison with previous year (especially in connection with the entry of the Italian company Enel in the Slovak power plant) and by relatively noticeable increase in net inflow of foreign direct investment (FDI) in the form of other capital. Growth of other capital was due to growth of import commitments as well as to decline of export receivables towards the firm headquarters. On the other hand the volume of reinvested earnings in SR decreased on year-on-year base by SKK 14 billion and it did not reach so much as half of the reinvested earnings in 2003 and 2004.

In 2006, the portfolio investments after net outflow in 2005 recorded their net inflow in the value of SKK 48.2 billion, which was brought about mainly owing to emission of Eurobonds in March in the value of SKK 37.6 billion. Growth in portfolio investments in SR was influenced also by increased interest in debt securities of the government and banks denominated in SKK. On the other hand lesser interest of Slovak enterprises and banks in foreign debt securities reflected in lower outflow of means abroad.

Table 12

Development of key items of the SR balance of payments' Capital and financial account in 2003 — 2006 (SKK billion)

	2003	2004	2005	2006
Direct investment	70.4	98.4	60.5	112.9
SR abroad	-9.1	0.7	-4.9	-10.9
Of which: Direct investment abroad	-0.7	-2.7	-2.6	-9.5
Reinvested earnings	-1.3	-2.5	-1.2	-1.2
Other investments	-7.1	5.9	-1.0	-0.2
In SR	79.4	97.8	65.4	123.8
Of which: Direct investment in SR	38.9	37.5	23.2	56.0
Reinvested earnings	55.6	52.0	39.0	25.0
Other investments	-15.0	8.2	3.2	42.8
Portfolio investments	-20.5	28.9	-30.2	48.2
SR abroad	-26.6	-26.0	-20.7	-5.7
In SR	6.1	54.9	-9.5	53.9
Other long-term investments	-12.7	-10.1	-15.0	18.6
Assets	7.1	-2.5	-9.8	5.3
Liabilities	-19.8	-7.5	-5.2	13.3
Other short-term investments	70.7	37.1	163.0	-141.3
Assests	-9.0	-2.0	-4.7	-38.3
Liabilities	79.7	39.0	167.7	-102.9
Capital and financial account	112.1	159.3	176.8	32.4

Source: NBS, 2007.

Inflow of FDI (*equity capital)* to SR attained in 2006 comparing with 2005 higher value by almost SKK 36 biliion (table 13). Foreign direct investments were directed exclusively to corporate sphere, while in the banking sphere a decrease appeared, even more striking than in previous year. The highest share in last year FDI inflow have the sources coming from the April privatization of the Slovak power plant by the Italian company Enel in value of SKK 31.7 billion, as well as investments into industrial production representing SKK 14.8 billion.

Table 13

Inflow of foreign direct investments (equity capital and reinvested earnigns) to SR over 2000 — 2006 by sphere of investment (in SKK mil., net change in the given year)

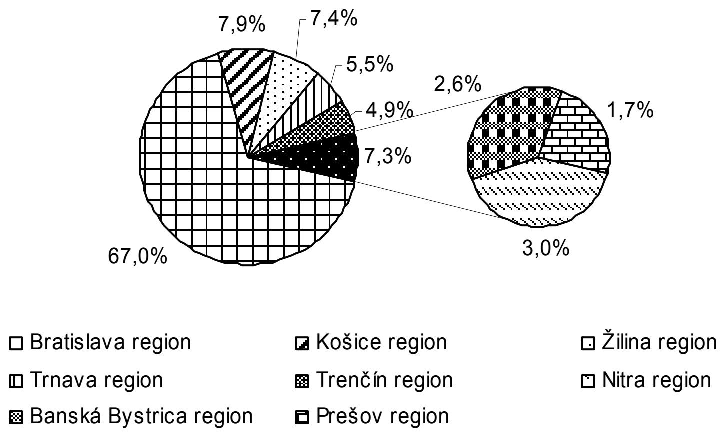
	2000	2001	2002	2003	2004	2005	2006
Corporate sphere	97 454	24 353	174 180	37 157	29 008	21 885	58 159
Banking sphere	2 107	37 095	11 414	1 813	5 115	-2	-456
Total	99 561	61 448	185 594	38 970	34 123	21 883	57 703

Source: Monetary survey 2/2007. NBS.

Over the recent four years Slovakia witnesses a slow softening of regional disparities in FDI distribution. The share of Bratislava region in their inflow was decreasing every year up to 2005, what led also to decline of its share in total FDI in Slovakia. However, in previous year due to investment by the Enel company almost three quarters of total FDI inflow were directed to that region and this fact caused that the share of Bratislava region moderately increased in total FDI position in Slovak Republic, i. e. to 67 % (chart 12).

C h a r t 12

Structure of foreign direct investment in SR by regions as of December 31, 2006



Source: Own elaboration by data from the Monetary survey 2/2007. NBS.

Since 2002 the regions of Žilina, Trnava and Trenčín recorded a slight growth of their share in total FDI, while the share of Košice region was gradually decreasing, but simultaneously at maintaining the second highest value from among all Slovak regions. The share of FDI realized in Nitra, Banská Bystrica and Prešov regions is stagnating and towards the end of previous year it amounted to only 7.3 %, which is less than in the Žilina region itself, where the increase in FDI share was gained mainly thanks to the investment of the South Korean automotive plant Kia Motors Slovakia. Therefore, though regional disparities reduced, it is inevitable to permanently improve conditions for the FDI inflow even to underdeveloped regions of Slovakia, but this requires inter alia also building the infrastructure and provision of qualified labour force in these regions.

4. LABOUR MARKET DEVELOPMENT

The favourable development of macroeconomic indicators, but especially the increased dynamics of economic growth strongly contributed to growth in labour force demand, which reflected in both quantity and quality on decline in unemployment rate, on growth of number of working people as well as on growth of real wage, which, however, grew more slowly than in 2005.

Decline in unemployment rate on labour market was accompanied by change of structure of economically active people. Number of working people grew by 3.9 % and at the same time even development of unemployment was favourable, number of unemployed declined by more than 17 %. In spite of year-on-year growth in number of economically active people the rate of economic activity decreased by 0.4 p. p. and reached thus the level of 59.1 %, which was caused by increase in the share of population aged 65 and more. A survey of development of individual parametres on labour market over several years is given in table 14.

T a b l e 14

Development of basic indicators on labour market through 2001 – 2006

	2001	2002	2003	2004	2005	2006
Unemployment rate accord. to SO SR (%)	19.2	18.5	17.4	18.1	16.2	13.3
Unemployment rate accord. to OLSA+F (in %)	17.7	15.1	14.0	15.1	14.1	12.0
Economic activity rate (in %)	60.7	60.2	60.3	60.2	59.5	59.1
Employment rate 15 – 64 (in %)	56.5	56.7	57.6	56.9	57.7	59.4
Number of workers in thous. accord. to LFSS	2 123.7	2 127.0	2 164.6	2 170.4	2 216.2	2 301.4
Number of unemployed in thous. accord. to LFSS	508.0	486.9	459.2	480.7	427.5	353.4
Average monthly wage of employee (in SKK)	12 365	13 511	14 365	15 825	17 274	18 761
Index of nominal wage (prev.year = 100)	108.2	109.3	106.3	110.2	109.2	108.0
Index of real wage (prev.year = 100)	101.0	105.8	98.0	102.5	106.3	103.3

Source: Statistical Office SR; Central Office of Labour, Social Affairs and Family.

The average number of working people increased comparing to previous year by more than 85 thousand persons, and reached thus the highest level since 1993. The change in employment structure was even further positively influenced by growth of employees in private sector. In educational structure of working people the share of persons with second degree of university education increased, while the group of people with complete secondary education asserted worse on labour market. Though the Central Office of Labour, Social Affairs and Family recorded in the fourth Q of 2006 against the previous year a decrease in disponsible number of registered unemployed by 53 thousand, as to the end of 2006 there were still 13,5 persons applying for one vacant post.

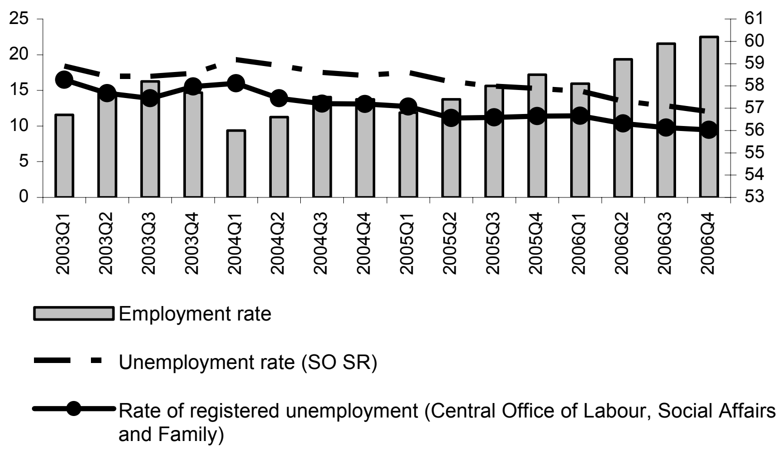
Since 1998 there exist considerable differences in reporting the unemployment rate realized by the Ministry of Labour, Social Affairs and Family of SR and Statistical Office of SR. However, both methods of statistics are justified. Labour offices run registers of unemployed persons who have the right to receive unemployment benefits, or are interested in assistance at finding a job, while the Statistical Office collects data on the unemployment rate by random survey out of a representative sample of households.

Combination of measures like toughening the conditions of register and right on unemployment benefits, reduction and length of time of receiving unemployment benefits make the system often ill used, and the applicants for job are then forced to look actively for job themselves. The current system of labour market places greater though still insufficient emphasis on active policy, realized by means of mediation of employment and additional re-qualification. After approving of these strict measures for the fourth Q of 2006, the registered unemployment rate recorded by the Central Office of Labour, Social Affairs and Family declined to the level of 9.4 %. The average value of unemployment rate 16.2 % in 2005 by the Labour Force Sample Survey, decreased to 13.3 % in 2006. However, as to the end of year it attained already 12 %, which meant the lowest unemployment rate since 1997.

The greatest success was recorded at the unemployment lasting from 3 to 6 months, achieved also by reduction of time of receiving the unemployment benefits which currently are granted for 6 months period. But more problems still exist with eliminating unemployment exceeding two years, because the applicants lose their working habits and this dissuades them from looking for any form of job and thus they form the most difficult removable core of unemployment. The long-term unemployment lasting in our opinion longer than one year represented by Eurostat as much as 76.3 % of total unemployment, and this ranked the Slovak Republic last within the whole European Union.

C h a r t   13

Development of employment and unemployment rates by both methods of its calculation



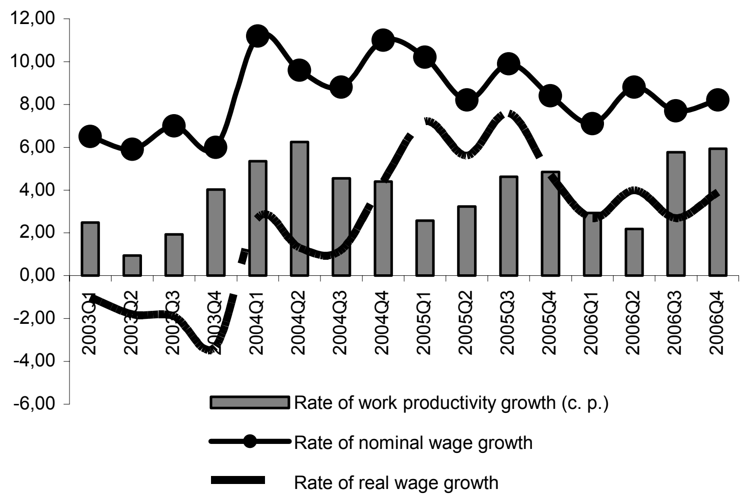
Source: Statistical Office of SR; Central Office of Labour, Social Affairs and Family.

The unemployment development is strongly influenced even by the regional dimension showing differences between economically effective and poor regions. As much as 62.1 % of total unemployment is recorded in the

Košice region (21.5 %), Prešov region (20.4 %) and Banská Bystrica region (20.2 %). Reversely, among most advanced regions we find the Bratislava region, the share of which in total unemployment is only 3.1 %. Main reasons for these differences among regions root in rather different conditions for generating new jobs The backward regions are distinguished by unfavourable educational structure of the job applicants (indeed 40 % of applicants are uneducated or only with elementary education), they tend to long-term unemployment, which is often removed through activating works; while in advanced regions unemployment is shorter and almost all qualified workers can find jobs on labour market. Economic growth in individual regions in different extent is also subject to inflow of foreign investments.

C h a r t 14

Development of work productivity, of growth of nominal and real wage



Source : Statistical Office of SR, own calculations.

In 2006 the average monthly nominal wage per worker in national economy increased by 7.9 % to the level of SKK 18 761. A lesser increase in nominal wages and higher increase in consumer prices was caused – like in previous year – by slow growth in real wage to the level of 3.3 %. On one side, the growth of average nominal monthly wage (7.9 %) exceeded work productivity measured by means of GDP per worker in current prices (7 %), on the other, the growth of real wage (3.3 %) was lower than work productivity measured by means of GDP per worker in constant prices (4.2 %). The wages level in individual branches of economy was developing unevenly. The highest growth of average nominal wage was reached in the branch of financial intermediary, while the branch of hotels and restaurants stayed even further on the lowest wage level.

In 2007, it is anticipated along with the strong economic growth even further positive labour market development. The growth in work productivity will be accompanied by the nominal wages growth. Decline in prices of crude oil, energy, gas and simultaneously the need to abide by the maastricht criterion in the field of price stability would ensure decrease in inflation rate which will reflect also in a notable influence on the real wages.

5. PRICE LEVEL DEVELOPMENT AND MONETARY POLICY

The Slovak economy is though in a longer process of disinflation, but in 2006 total inflation deviated (very likely only for a short time) from the tendency of decline in rate of inflation from the period od 2003 – 2005. While in 2005 the lowest rate of inflation was recorded since the existence of the SR (2.7 %), in 2006 it increased to 4.5 %. Acceleration of price level growth originated in such factors, as adjustment of regulation prices (in October 2005, in January and November 2006), adjustment of some excise taxes, upsurged prices of fuels in the first half-year and partially also high dynamics of domestic demand. The recurring acceleration of inflation rate brought about:

- slowdown in real wages growth in comparing with 2005,
- reaction of NBS in the form of increase in the prime interest rate (in an effort to soften down the growth in domestic demand and hence to soften also a part of inflation pressure),
- concern about fulfilling in the near future the Maastricht inflation criteria in connection with entry to eurozone,
- complication in the inflation expectations: the inflation deviated namely from a well readable corridor of its values which were set by the inflation goals of NBS or by macroeconomic predictions by the Ministry of Finance of SR.

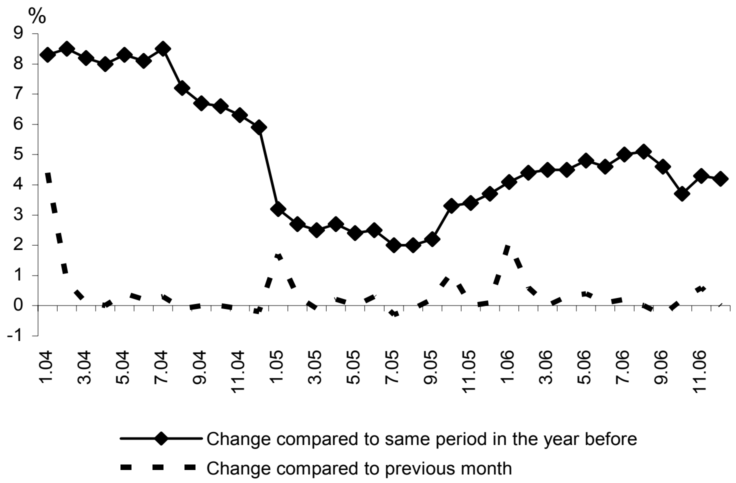
As the chart 15 illustrates, the inflation rate culminated in July and August 2006, since then it was moderately declining (rate of price growth reached in August 5.1 % which was its most rapid growth since December 2004). Towards the end of year this happened thanks to the basic effect: comparative base from 2005 essentially increased, because in October 2005 there came to an inflation jump by virtue of the price upsurge in energy. Thereby the year-on-year growth in price level reduced since October 2006.

Price development in agricultural products was marked by deflation (analogous to many times in years before). The year-on-year price decline in agricultural products by 0.2 % hampers on one side growth of retail prices of food and reduces growth of consumer prices (consumer price index – CPI), on the other side it complicates the profit/loss results in agrosector and adds to dependency on state aid. Price development of manufactured articles was markedly differentiated according to the territorial destiny of output. Prices of goods for domestic market rose by 8.4 %, while prices for export only by 2.7 % (in this case strengthening of domestic currency played a significant role).

In 2006 the Slovak economy was not yet bound to meet the Maastricht criterion of rate of inflation. It is very likely that the rate of inflation from 2005 would have sufficed to meet the Maastricht inflation target, however, its value from 2006 is far from this target.

C h a r t 15

Growth of consumer prices (year-on-year changes in %)



Source: Statistical Office of SR.

Development of monetary policy was marked by the regime of inflationary targeting within the system of exchange rate mechanism ERM II. The National Bank of Slovakia decided on the regime of inflationary targeting still before the end of 2004 in connection with the entry of Slovak Republic in the eurozone. That is to say, that under this regime (when all instruments of the NBS fall into line of maintaining inflation within the pre-defined corridor) it is easier to direct the development towards meeting the Maastricht criterion for introduction of euro. In this way the anchor of monetary policy became the binding goals of maintaining the year-on-year rate of inflation at the end of the given year measured by the harmonized index of consumer prices, which was fixed by the NBS for 2005 at the interval of 3.5 % +/- 0.5 %, for 2006 below the margin 2.5 % and for the consecutive two years below the margin 2.0 %.

However, the central bank is not in the position to effectively impact all factors of the moving price level. Therefore, they set down a few exemptions from the inflationary goal. The central bank would not guarantee fulfilment of the inflationary goal if the price level is affected by a factor outside the sphere of instruments of monetary policy of NBS. Binding definition of inflationary goals and their assessment enable better transparency of the monetary policy performance and may have a positive effect on realization of the inflationary expectations.

In the course of 2006 the tendency of regressive inflation existing up to that time was disturbed. National Bank of Slovakia several times reacted by rising the prime interest rate. This measure could, however, damp only that inflation component, which was pulled by domestic demand growth. It could not have effectively influenced factors caused by adjustment of regulated energy prices or by high prices of energy sources in the first half of 2006 (i. e. it could not influence the so called cost inflation).

The exchange-rate policy (as the component of monetary policy) was performed within the regime of ERM II and in line with the anticipated date of adoption of common European currency on January 1, 2009. The Slovak crown became member of the exchange rate mechanism ERM II in November 2005 with the central parity of 38.4550 SKK/EUR. The crown employs the standard fluctuation band ± 15 %. The topic concerning the fluctuation of exchange was highly interesting in July 2006 and in conclusion of the year. Of course, those were but contradictory situations.

Still before the government could take any practical steps, the change in political garniture was accompanied on exchange rate markets by pressures on softening of currency. These factors resulted in July 2006 to softening of currency by 1.6 % within three weeks. The mentioned value does not mean by itself any dramatical threat, but the situation was on edge, because:

- The value of "only" 1.6 % softening was due to the fact that the central bank repeatedly intervened in favour of domestic currency and for this purpose the bank spent minimum 2 billion euro out of its foreign exchange reserves.
- It is not in line with the rules of ERM II functioning, when the central bank repeatedly impeds any margin of currency movement. The system ERM II has been constructed just with the aim that the currency prove its stability. Any short-term unsteadiness stemming in psychological or political factors is no serious obstacle to functioning within the regime of ERM II.
- The interventions by NBS would have been condemned to failure if the government would not have taken convincing steps indicating their serious interest in maintaining the macroeconomic stability. It would have caused only useless spending of considerable amount of foreign exchange reserves.

There did not exist, however, any economic fundaments for currency depreciation, they were rather of political-psychological nature, and deviations in exchange rate had only a short-term character. Subsequently, again the long-term tendency in strengthening the currency prevailed (which has been persistent with different intensity since 2002). To the end of 2006 steps for strengthening the currency were taken, even with some record levels. The December average exchange rate SKK/EUR achieved the value of 35.025

(the average of the first three quarters was 37.665; in the "problematic" July 38.388). Again the central bank intervened on exchange market (both verbally and directly), this time with the aim to slow down the strengthening of currency. While softening in July was raised by political-psychological factors, the strengthening towards the end of year was connected also with economic reasons (strong economic growth, export expansion etc.). However, the rate of strengthening achieved eventually a level, when there appeared thoughts on the need to switch the central parity within ERM II.[17]

In 2006, it happened for the first time that the value of credits in crowns granted to households outstripped the value of credits granted to enterprises. Thus main clients of commercial banks in granting credits in domestic currency became households (the amount of crown credits to households as of the end of 2006 achieved SKK 232.5 billion). A logical confirmation of the trend from previous years is apparent here. Obviously, the banks considered households to be less risky clients (which is confirmed by the low share of dubious credits in total credit volume granted to households).[18] This factor contributed to growth in domestic demand and to risk of demand inflation.

[17] This measure took place as far as early 2007.

[18] The share of the so called impaired credits in total volume of crown credits granted to households in 2006 represented 3.4 %, in the sector of non-financial corporations analogous share was 5.3 %.

6. PUBLIC FINANCE

Development of public finances, their management and economic activities of most of its components over the recent years can be marked as consolidated with a relatively stable and anticipated framework supported by the existing and regularly updated Convergence programme. The revenues and expenditures are to certain degree subject to some natural deviations both from the side of intentional steps of the government as well as on the side of unexpected events, but their economy is in comparison with the 90's incomparably more foreseeable, transparent and responsible. A significant determinant of this development is a sizeable reform realized in the past in public finances, as well as the reform connected with their management. Not less important as to the overall institutional framework for improvement of the public finances economy, was the perspective of the SR to access the EU and the Economic and Monetary union. Thus the pressure on consolidation of public finances, inevitable for adoption of the common European currency, created undoubtedly one of the most significant incentives to reform the whole system of public finances and with it connected departments in the government.[19]

The framework for management of public finances in 2006 was the approval of the budget of general government for 2006 – 2008 (table 15). In the mentioned year the proposal reckoned with revenues in public finances in amount of SKK 563.9 billion and expenditures amounting to SKK 608.3 billion. Deficit was supposed to reach 2.9 % (excl. expenditures on pension reform), in absolute figures SKK 44.4 billion. The development of state budget deficit was also in conformity with the targets set for 2006. The state budget deficit (less the off-budget accounts and state financial assets) at the level of 1.9 % GDP, or SKK 31.7 billion, represents substantially better result against the planned level. However, along with the state financial

[19] Of course, the optimum state in individual components from view of effectiveness in spending is far from definitive conclusion.

assets and other off-budgetary items the state budget deficit within the ESA 95 methodology, achieved SKK 49.9 billion. Its high share in deficit of public finances confirms the fact that fiscal consolidation in this field is not sufficient, namely in the current phase of the non-precedent economic growth of the Slovak economy which created conditions for a more favourable development of revenues and expenditures of the whole range of public finances.

Table 15
The budget of general government for 2006 – 2008

Revenues/Expenditures	2005	2006	2007	2008
Revenues of public finances	520.5	563.9	588.5	617.3
Expenditures of public finances	568.3	608.3	638.0	665.0
Deficit in public finances (in billion SKK)	*-47.8*	*-44.4*	*-49.5*	*-47.7*
Share in GDP				
Revenues of public finances (in % on GDP)	37.0	36.8	35.7	34. 9
Expenditure of public finances (in % on GDP)	40.4	39.7	38.7	37.6
Deficit in public finances (in % on GDP)	*3.4*	*2.9*	*3.0*	*2.7*

Source: Ministry of Finance SR; own calculations.

With respect to the robust economic growth and favourable development of the state budget economy, the framework of economic management was a success. The public finances deficit achieved the level of 2.3 % GDP in 2006 (3.4 % after including costs of pension reform); this in absolute figures represents SKK 59 billion. Financing of the drop in revenues of the Social Insurance Agency due to introducing of the second pillar represented SKK 18,2 billion (1.1 % GDP). Among the main impacts, which contributed to better than planned economy of public finances in relation to GDP can be included namely the high economic growth, which shared better result by 0.2 p. p.; the favourable development itself shared better economy by 0.4 p. p. From the aspect of individual components the highest share in deficit of public finances had state budget deficit, which achieved 92 %. A more favourable management of the Social Insturance Agency compared to the plan had also a positive effect on total development of public finances.

State budget

In the election year 2006 the economic management of the state budget was favourable (though constantly with deficit). Political cycle did not exert any significant pressure on the expenditure or revenue sides of state budget, which enabled not only to maintain the framework of economic management within the approved budget, but also to achieve much better economic results than planned. A significant factor of favourable state budget development was also the non-precedent economic growth of the Slovak economy.[20] The revenues of the state budget were reckoned in the amount of SKK 272.7 billion and expenditures in amount of SKK 330.1 billion with deficit of SKK 57.4 billion (table 16, chart 16).

The revenue side of state budget developed favourably during 2006, total revenues of state budget were higher than plan by SKK 19.1 billion (1.7 %). Viewing the revenue structure, the higher fulfilment was shared especially by tax on income, profit and capital assets in the value of SKK 11.6 billion and tax on goods and services SKK 8.6 billion; a noticeable rise of SKK 4.5 billion was reached by non-tax revenues. Lower than expected sources on side of revenues can be observed mainly in items of grants, transfers and other revenues amounting to SKK 5.9 billion, above all in the EU budget funds with negative impact in value of SKK 7.4 billion. A more detailed structure of revenues reveals that higher fulfilment compared to planned volume was attained by tax on enterprising and other self-employment by 13.1 %. Essentially higher fulfilment was reached by tax on income of legal persons, when in absolute figures the incomes were higher by SKK 11 billion (30.6 %)

[20] For detailed analysis of economic growth see chapter 1.

than the planned volume. From the view of indirect taxes, higher than planned incomes were reached in value added tax by 7.1 %.

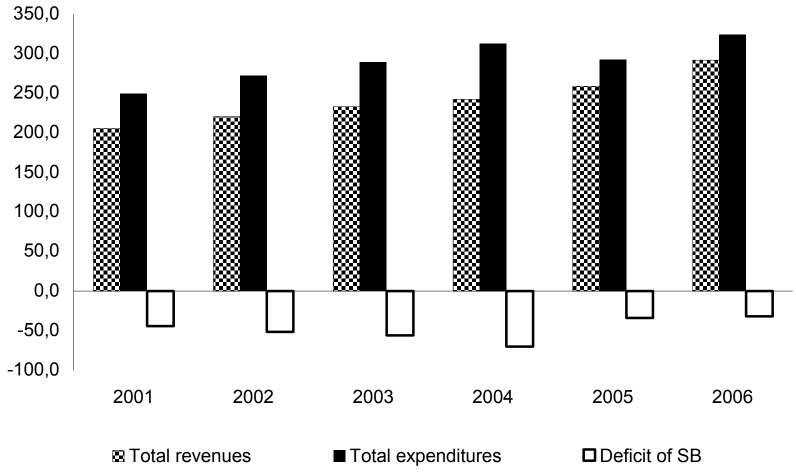
Table 16
The development of the state budget revenues and expenditures, 2001 — 2006

	Actual implementation (in SKK billion)						Difference as opposed to plan 2006 (SKK bil.)
	2001	2002	2003	2004	2005	2006	
Total revenues	205.4	220.4	233.0	242.4	258.6	291.9	19.2
of which							
A. Tax revenues	165.1	188.8	200.0	209.4	222.5	236.2	20.6
of which:							
Tax on income, profit and capital assets	57.5	69.3	70.1	60.5	48.7	54.7	11.6
Tax on goods and services	102.0	115.6	123.2	144.2	172.3	180.5	8.6
Tax on international trade	3.9	4.0	4.0	1.8	0.5	0.6	0
B. Non-tax revenues	24.8	20.8	17.0	21.1	21.1	19.4	4.5
C. Grants, transfers and other revenues	13.7	10.7	12.4	9.8	14.9	36.2	-5.89
of which EÚ budget funds	.	.	.	4.5	13.9	20.4	-7.4
Total expenditures	249.7	272.0	289.0	312.7	292.5	323.6	-6.5
of which:							
A. Current expenditures	213.3	237.1	250.0	.	261.1	282.8	-0.6
B. Capital expenditures	27.5	32.4	31.1	.	31.4	40.8	-5.9
C. Property share and loans	8.9	2.4	7.8	.	.	.	.
Surplus(+), Deficit (–)	-44.4	-51.6	-55.9	-70.2	-33.8	-31.7	25.7
Share in GDP (in %)	4.6	5.0	4.7	5.3	2.3	1.9	.

Source: Ministry of Finance SR.

In 2006, shares of individual revenues in total revenues changed. Share of revenues in grants, transfers and other revenues grew substantially due to higher incomes in the item EU budget funds. These means gradually began to represent a significant source of state budget revenues (in spite of lower drawing of these means than planned).

C h a r t 16
Economic management of state budget in 2001 – 2006 in SKK billion

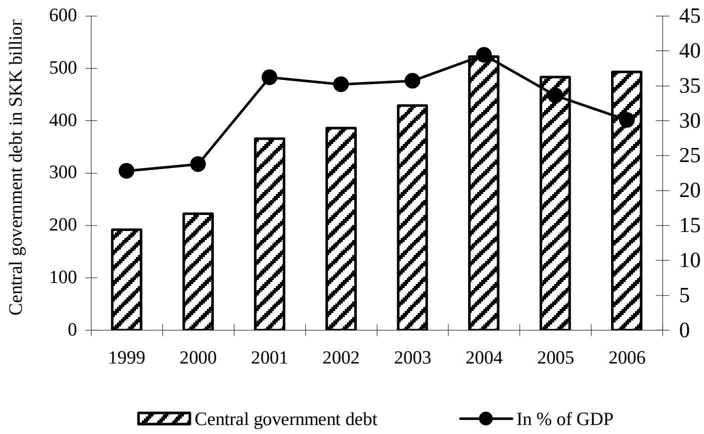


Source: Ministry of Finance SR; own calculations.

In comparison with the state budget revenues side the expenditure side was developing less favourable. Though no serious surpassing of the planned level took place, the expenditures were higher by SKK 6.5 billion. This result was caused by the development in capital expenditures amounting by SKK 5.9 billion higher than planned, current expenditures were higher by acceptable SKK 0.6 billion. In the structure of capital expenditures the plan was mostly exceeded by transfers to municipalities and higher territorial units by 12.6 %. In the part of current expenditures plan was exceeded by higher expenditures on interest repayments and others connected to credits by SKK 2.3 billion (9.7 %). Other items of expenditures developed more satisfactory compared with the plan, what is a sound proof of improving framework of the function and management of state budget or public finances.

The debt of central government (as a result of constant deficit of the state budget) achieved in 2006 the value of SKK 483.9 billion (chart 17).

Chart 17
Development of central government debt, 1999 – 2006



Source: Ministry of Finance SR, Statistical Office SR, own calculations.

The credit for the improving trend in state budget development can be ascribed to the continuing consolidation of public finances, strengthening of the exchange rate of the Slovak crown, but predominantly to the successful growth of the Slovak economy.

7. OUTLOOK FOR 2007

From the preceding parts of this assessing analysis it follows that 2006 was a year of a partial economic-political discontinuity, but meanwhile preserving at least approximate continuity in development of main macroeconomic indicators. When shaping an outlook we can start on base of a relatively sound sustainable growth (with good balance).

One of the summarizing propositions of economic policy of the government, as follows from the Programme Declaration, is providing a more even distribution of economic growth effects. This is a legitimate goal identical for majority of the political groups (including those with liberal or conservative orientation), though its accomplishment may be perceived differently. First of all, a strong economic growth experienced currently in the Slovak economy, is usually uneven. It affects sectors and regions unevenly. It is a customary expression of economic growth. In pursuing its goal the government may direct part of sources to the subjects which do not benefit from the growth, or the government may help to difuse the effects of growth among broader strata of population. However, if the government would proceed hard, insensibly, they might disturb or make insecure even subjects, which actually create the economic growth.

In 2007, the government and NBS will have rather limited space for implementing their tools. Since the access of SR to the EU some parameters of economy must be kept up within agreed intervals. However, in 2007, the Slovak economy has entered the final two-years phase prior to the advised adoption of common currency. This means inadmission of any erros or mistakes impacting economy, such as inflation rate, deficit in public finances, exchange rates or long-term interests. Besides this, these issues are not only to be directed towards the set intervals, but the directions are to have a sustainable character. The most crucial change in pursuing the Maastricht convergence criteria will presumably be to maintain an acceptable inflation rate. The fiscal policy did not create sufficient space for assisting the NBS monetary policy in eliminating inflation risks, because the government did not make full use of the unexpectedly high economic growth advantage for an expressive reduction of public finances deficits.

The economic development will in a short-term horizon be affected by the following factors:

- Need to observe the obligations defined in the Convergence programme. This means to fulfil criteria of nominal convergence aiming at adoption of the common currency in 2009. To the end of 2006, the Ministry of Finance published an updated Convergence programme, which roughly corresponds to previous versions prepared by the former government (it assumes also continuation in the fiscal consolidation).
- Effective use of production capacity of the two big automotive plants (which would subsequently increase output of the cars to almost triple level of 2006, i. e. approx. 840 thousand cars per year. However, it is not yet sure if this production volume could be achieved as early as in 2007).
- As against 2006, by diminishing inflation pressures (pressure from government on decline in energy prices, strong position of the Slovak currency, more favourable development in prices of energy sources early 2007).
- Need to shape new government economic policy, which will probably have stronger solidarity constituent than in the past.

The external economic environment in 2007 ought to act positively. We refer here to development of the *OECD Composite Leading Indicator* which is considered as the so called ex-ante indicator capable to predict for 2 – 3 quarters in advance the growth dynamics in the OECD countries. Relying on development of this indicator in the beginning of 2007 (i. e. January – March) it is possible to eliminate the risk of negative demand shock from abroad, that might complicate export activities of the Slovak producers. The year 2007 means launching new budgeting period in the EU, in the framework of which Slovakia has a chance to become a significant beneficiary of foreign financial sources; however, we do not presume this would show right within 2007.

In absence of more serious external shocks we can expect in 2007 continuation of the favourable development tendencies from 2004 – 2006. A probable maintaining of economic growth pace at the 8 % level, decline in inflation rate to interval of 2.3 – 2.8 % (HICP still lower) and decrease in unemployment to 11.8 % level would mean contribution to real convergence (catching-up of most advanced economies performance), strengthening of stability, and also improving of material conditions of the overall life quality. Macroeconomic trends are currently so significantly predetermined that any present changes in economic policy (if not too much radical) will manifest with delay.

Factors contributing to maintenance of a strong GDP growth and against it, can be defined as follows:

S u r v e y 1

Factors favouring strong growth	*Factors against strong growth*
▪ Multiplication of production in new automotive plants in comparison with 2006 (when they operated only in reduced capacity, and not through the full year) ▪ Considerable public investments (transport infrastructure) ▪ Improving net export (consequence of FDI and more favourable prosperity abroad as well) ▪ Growth in employment and real wage, which would pull demand ▪ Inertia in growth (low sensitiveness on political changes in short-term horizon)	▪ High level of comparable base from 2006 ▪ Strong crown which may complicate some exporters activities ▪ Potential restrictions by NBS in pursue of maintaining inflation target.

It is expected that the impact of these factors may result further in extra strong GDP growth. Similar pace of growth like in 2006 will continue even in 2007 (near to 8 % what is the value acceptable at estimating on base of formation and use of GDP). Only subsequently it will slow down.

In 2007 revival of disinflation trend can be expected which was moderately interfered in 2006. The inflation rate will significantly decrease, from 4.5 % in 2006 to 2.3 – 2.8 %. Inflation measured by harmonized index of consumer prices HICP may decrease as much as to interval 2.1 – 2.6 %. Thereby, possibility of fulfilment of the convergence criterion, set for inflation rate, would grow. The published data for first months of 2007 confirm this assumption. The consumer prices grew year-on-year in first Q 2.8 %, at measuring according to HICP only by 2.1 % (which is by approx. two p. p. less than in the same period of 2006).

A significant slow down in price level growth will be affected positively or negatively by the following factors:

S u r v e y 2

Factors supressing price level growth	*Factors supporting price level growth*
▪ Strong domestic currency (whereby weakening of the external inflation impact) ▪ Absence of periodical increase in regulated prices from the outset of year ▪ Lower price of energy sources at the beginning of year ▪ Decrease of GDP rate on drugs and medical material	▪ Subsequent lacking of electric power due to decrease in domestic production (shut down of two blocks of nuclear power stations) ▪ Strong long-term growth in domestic demand, which can influence growth of prices in non-tradeables sectors (namely, here is no possibility to cover easily the growing demand by import)

It is expected that the strong economic growth will be connected with favourable tendencies on the labour market. Apart from strong GDP growth it will also be decisive here the contribution of production capacity of big foreign investors in automotive industry. Rise in domestic demand supports the tradesman business activity. The rate of growth of labour force may be hampered by the high level of comparable basis from 2006, by reduced stock of skilled workers in some regions (the unemployed reserves consist rather of insufficiently qualified persons), or even by the change of legislature concerning working relations (advised by the government), which would affect flexibility on labour market. Results of employment development in selected branches for the first and second months of 2007 give a positive signal of continuation in employment growth. We assume that after the employment growth in 2006 by 3.8 % (of which 2.2 % in domestic economy) its pace will slow down to 1.6 – 2.1 %, which is still very good result in case of employment. According to sample survey the average rate of unemployment would fall to 11.8 %.

Survey 3

Factors positively impacting labour market indicators	*Factors negatively impacting labour market indicators*
▪ Strong economic growth will positively impact employment growth ▪ Growing scarcity of labour force will support wages growth ▪ Holding of relatively high growth rate of nominal wage along with falling rate of inflation means strong growth of real wage	▪ Want of workers in some professions and in some regions ▪ Risk of approving legislature reducing labour market flexibility ▪ High comparable basis from 2006 which may evoke an impression of poorer quantitative results in 2007

A decisive factor in nominal wages growth will be a subsequent rise in scarcity of labour force. Decline in unemployment rate, growth of number of employed and the threat of stagnation or decrease of number of persons in productive age will obviously exert pressure on retaining of relatively high pace of nominal wage growth even under inflation rate decline. The wage growth will be accompanied by supporting issues, such as high growth in work productivity and government pressure on minimum wage growth. On the other hand, the wage growth will be slowed down by low inflation rate, but this will reflect in wage contracts with delay. We expect that the pace of wage growth will decline only moderately, from 8 % in 2006 to 7.6 % in 2007.

Along with the production of cars when started working (but not only with this) we connect our expectations for improving the balance of current account of the balance of payments:

Survey 4

Factors invoking deficit decline	*Factors invoking deficit growth*
▪ Improving the balance of payments by increase in car exports (products by PSA and KIA Motors) ▪ In other segments of export, favourable impact by good conjunctural situation in OECD countries ▪ Inflow of transfers from EU funds (according to the rules of budget period 2007 – 2013)	▪ A strong crown which makes import cheaper and limits price competitiveness of some exporters ▪ High import intensive productions of the expanding foreign investors ▪ Strong growth of domestic demand pulling import

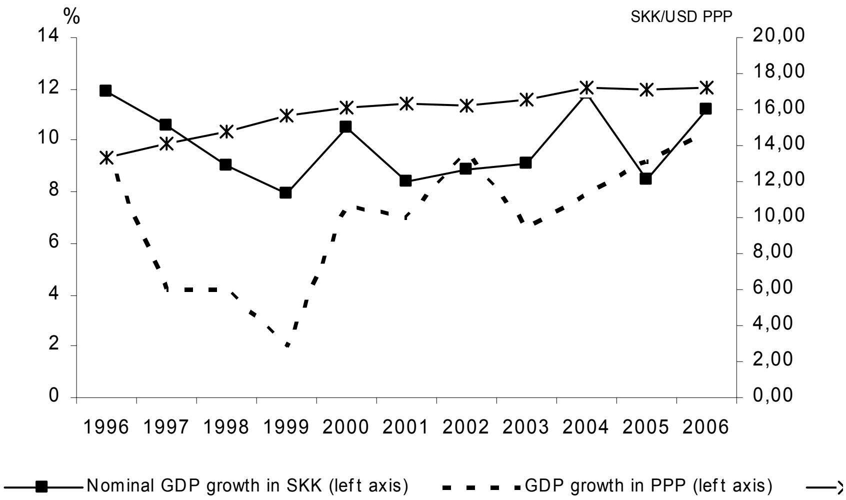
We presume a stronger impact of factors limiting deficit of current account and due to this reason we expect, that the deficit of current account will fall to about 1.5 % GDP.

The mentioned parameters of macroeconomic development will very likely contribute to further substantial progress in real convergence. After a long period of discreet, almost negligible catching up the performace level in average OECD countries, a substantially better relative position developed in 2005 and 2006. In 2007 we can foresee continuation of this tendency.

While in the period of 2002 – 2004 a progress from the 50 % average level of OECD to only 52 % was recorded (performance measured as GDP/cap. by PPP), then in 2006 came to a shift to 57 %. Though the Slovak economy was recording high rates of economic growth even in the past, the exchange rate by parity was shifting to detriment of SR. In the chart 18 we would like to draw attention to the fact, that except for the years 2002 and 2005 the par exchange rate shifted every year to detriment of SR.

C h a r t 18

Development of par exchange rate (towards the US) and comparison of growth dynamics of nominal GDP expressed in SKK and USD by PPP



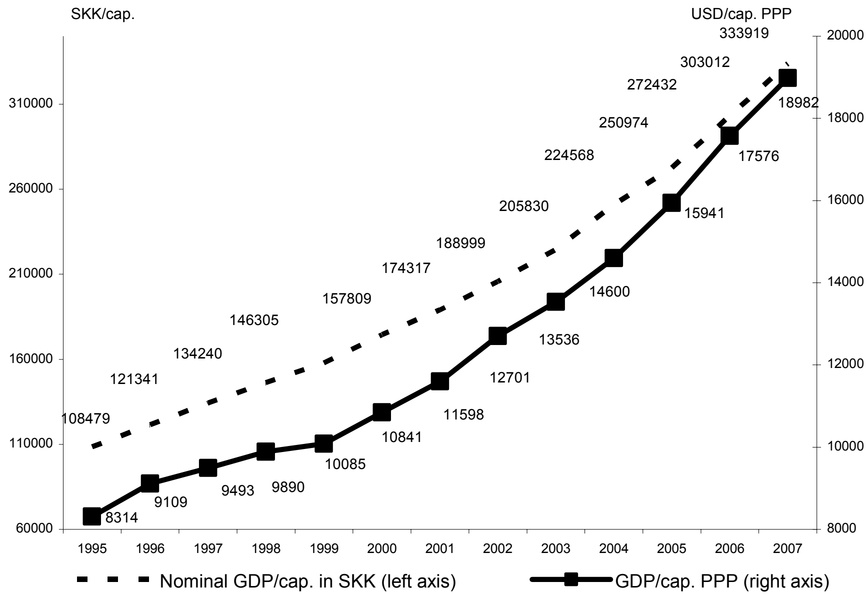
Note: The relative favourable parity development in 2002 was invoked by very low price level growth in SR, the same as in 2005.

Source: Own calculations according to data by Statistical Office SR and OECD.

So, when recomputing the GDP level from SKK on US dollars in PPP, part of the GDP increase got lost because of unfavourable development of par exchange rate. Though according to the official exchange rate the crown was getting strengthened (but as early as since 2002), according to the par exchange rate the crown softened even further. However, the years 2005 and 2006 brought a better constellation: a record-level of strong GDP growth with low price level growth. The par exchange rate moved but slightly and strong GDP growth shifted more sensibly also into the expression of GDP/cap. in par exchange rate.

The gross domestic product/cap. in US dollars by par exchange rate achieved in 2006 the value of approx. 17 576, what equals to 57 % of the OECD countries average (see chart 19 and table 17). From among 30 OECD countries only three countries posted lower performance than SR (Poland, Turkey and Mexico). If the predicted parameters of macroeconomic development in 2007 come into being, the position of Slovakia will very likely improve again by jumping to already mentioned 59 %.

C h a r t 19
The GDP/cap level in SR expressed in SKK and in US dollars by PPP



Note: The data for 2007 is estimated by authors.
Source: Own calculations according to data by Statistical Office SR and OECD.

T a b l e 17

Relative position of countries measured by GDP/cap in PPP (OECD average = 100)

	2003	2004	2005	2006	*2007*
OECD average	100	100	100	*100*	100
Slovakia	51	52	55	57	59
Czech Republic	69	70	70	72	73
Hungary	59	59	60	60	60
Poland	45	47	47	49	50
EU 15	106	105	104	103	103

Source: OECD; prediction for 2007 authors.

T a b l e 18

Basic parameters of macroeconomic development

Indicator	Measuring unit	2004	2005	2006	2007 prediction
GDP growth rate	%, constant prices	5.4	6.1	8.3	8.0
Final household consumption growth rate	%, constant prices	3.8	7.2	6.3	6.2
Final general government consumption growth rate	%, constant prices	2.0	0.5	4.1	4.0
Formation of gross fixed capital growth rate	%, constant prices	5.0	13.8	7.3	5.5
Net export as share in GDP	% on GDP, current prices	2.7	-4.5	-4.0	-1.0
Year-on-year inflation rate	%	7.5	2.7	4.5*	2.7
Unemployment rate by sample survey	%	18.1	16.3	13.6	11.8
Growth of average nominal wage	%	10.2	9.2	8.0	7.6
Year-on-year change of real wage	%	2.5	6.3	3.3	4.8
Change in number of employed	%	0.3	2.1	3.5	1.9

Source : Statistical Office SR and predition by authors.

In 2007, we expect in the development of macroeconomic parametres rather a tendency continuing from the previous period than any striking changes. Continuity of a strong economic growth along with a good macroeconomic stability and balance create the basis for a possibly successful fulfilment of nominal convergence criteria, as well as for catching up the level of economically most advanced countries.

8. AN OVERVIEW OF SELECTED LEGISLATIVE AND ECONOMIC-POLICY MEASURES

The most important event of the year 2006 was the early parliamentary elections in June and the following change in government composition, which notably influenced the activity, legislative activity of the ruling power bodies[21] and the overall directions of the economic policy. Constituting the new government headed by the Prime Minister Robert Fico led to changes in the government policy, the intentions of which were formulated in the *Programme declaration of the Slovak Republic government.* The document expresses diversion from liberal economic policy to more active role of the state. The Program declaration stresses a balance between an individual's responsibility and social solidarity and it is based on integration of economic growth with economic performance, with employment growth, social cohesion and with upgrading the quality of life for all.

The expressive legislative activity focused in 2006 especially on the social sphere. The social policy was touched namely by passing the extensive amendment of the Act on social insurence (amendment No. 310/2006 Code of Act of Digest) which amended the Act on social insurance No. 461/2003 Code of Act of Digest as well as other acts. This legislative change concerns mainly increase in pensions of the so called old pensioners (starodôchodcov), who got wrongfully assessed pensions within the period of 1988 – 2003 prior to introduction of the reform of pension scheme. The amendment imposes responsibility also upon the employer to pay guarantee insurance amounting to 0.25 % also for persons employed on basis of work contracts and contracts on student work brigade. The amendment changes the Act No. 43/2004 Code of Act of Digest on the old-age pension saving. It restricted the possibility of transfer of the saver from one old-age pension administrative company to another at most once per two years with the aim

[21] In 2006 the National Council of SR passed approximately by half less bills than in the previous three years.

to limit the number of speculative transfers and to stabilize the second pillar of pension provision system. These changes can be conceived as a certain correction of reform measures adopted in the previous period.

The Act on social insurance was repeatedly amended with the aim at harmonizing the payments of the invalidity pensions benefits with the rule of the Constitutional Court. Amended was the act on child-birth allowance (extra pay at the first child-birth amounting to SKK 11 000), act on services of social assistance and material needs benefits and act on old-age pension saving. An act on granting Christmas benefits to some selected pensioners passed. The new state social benefit was paid according to the kind and amount of the old-age pension.

Since October 2006 the minimum wage has been raised to SKK 7 600. Since June 1, 2006 the subsistence level sum increased to SKK 4 980 monthly (i. e. increase by SKK 250) in case of one full-age natural person, to SKK 3 480 in case of further natural person, and to SKK 2 270 monthly in case of dependent child.

In the field of healthcare certain immediate measures were adopted. Shortly after constituting the new government some dues paid for the healthcare were abolished (cancelled fees in hospitals, at the physician's and reduction of dues in the pharmacies). Amendment was adopted in case of act on health insurance companies and on supervision of health care. Amendment of act on health isurance increased pays of insurance benefits for citizens, for whom the insurance premium is paid by government, from 4 % to 5 % of average wage.

In spite of expected and proclaimed changes in the tax legislature, measures were adopted that amend essentially the character of tax policy. According to the adopted amendment of act on value added tax, since January 1, 2007 a reduced rate of 10 % came into effect in case of drugs and selected medical material. In case of other products the VAT of 19 % remained unchanged. Amendment of income act introduces only changes in personal income tax in case of persons, whose gross monthly wage exceeds SKK 47 600. Changes touched the 2 % assignat tax (the scope of activities was tightened where the assignat tax may be applied).

In May 2006 the government adopted the document *the National Strategic Reference Framework of the Slovak Republic for 2007 – 2013* (NSRR), as an initial document, on basis of which the Slovak Republic would exploit resources from the EU structural and cohesion funds in the future programming period. During the period of 2007 – 2013 Slovakia will be given the chance to draw from the EU funds more than 11 billion euro. Among the strategic priorities of NSRR are included: infrastructure and regional accessibility, innovation, informatization and a knowledge-based economy, human resources and education. The new government updated and harmonized this document with their Programme Declaration, while the scope of operation programmes extended from 10 to 11. Also the government adopted and updated version of the document *Convergence Programme of the Slovak Republic 2006 – 2010*. In a mid-term horizon the document presents namely the fiscal position and development of economy in connection with the entry of SR to the Economic and Monetary union.

The group of measures supporting informatization society and transfer to the knowledge-based economy includes: the project *Internet for education*, which represented a state allowance amounting to SKK 234 per month in the duration of two years for 40 thousand young people. The aim was at supporting the information literacy and new forms of labour market (teleworking). Act on information systems of public administration, act on electronic highway toll collection system for the use of specific sectors of land communications, and amendment of act on business register, all of them represented measures supposed to support shaping the e-government.

In 2006 amendment of act on banks was adopted, a part of which was an extensive amendment of act on securities. The amendments transposed into our law system the new Basel agreement on capital (the so called Basel II). The amendment will touch also the clients of banks, who would get more information on fees and interests.

Amendment of commercial code concerns the business sector and it recorded amendments in 30 issues. For example, new duties originated in relation to publishing data on an enterprise, but also there are dispositions for companies on successive transfer to euro.

Since June 1, 2007 through the amendment of act on civil service the Office for Civil Service ceased to exist and their competencies were taken over by the Office of government of SR, Ministry of Labour, Social Affairs and Family and supreme service offices.

The election year marked notably even the privatization decrees. In February 2006, the former government of Mikuláš Dzurinda decided under a pressure of political agreements to issue no more privatization decrees. This step brought suspension to all privatization projects of power engineering, heating and transportation firms and to the DMD Group Company. On the other hand the privatization of the Slovak power plants by the Italian Enel company was definitively concluded. The new government cancelled the contract on privatization of the 66 % share in Bratislava airport with the Austrian-Slovak consortium TwoOne.

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