

*INSTITUTE OF SLOVAK AND WORLD ECONOMY
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*Economic Development of Slovakia
in 2003*

**(Study Prepared on Behalf of the United Nations Economic
Commission for Europe)**

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Bratislava 2004

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The analysis used information provided
by the Statistical Office of the Slovak Republic,
by the National Bank of Slovakia,
by the Ministry of Finance of the Slovak Republic
and by Law Reports of the Slovak Republic.

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Bratislava 2004

Print: REPRO-PRINT

ISBN 80-7144-138-4

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1. Overall economic development

The year 2003 in the Slovak Republic was a year of intensive economic-political activities focused not only on strengthening of macroeconomic stability, but also (this was missed out in previous applications of stabilization measures) on creating conditions for its enduring maintenance. These particular activities were content of preparation and implementation of labor market reforms, reforms of social security, pension, healthcare and education systems, and of public finance and public administration reforms. The immediate goals of comprehensive reforms are as follows: 1. increase of activity and participation of the population in solving of their social-economic situation; 2. improvement of business environment and strengthening of business initiative; 3. more effective functioning of public administration and better use of public finance; 4. increase of attractiveness of the SR to foreign investors, and 5. preparation of the SR for admission to the EU and later accession to the monetary union.

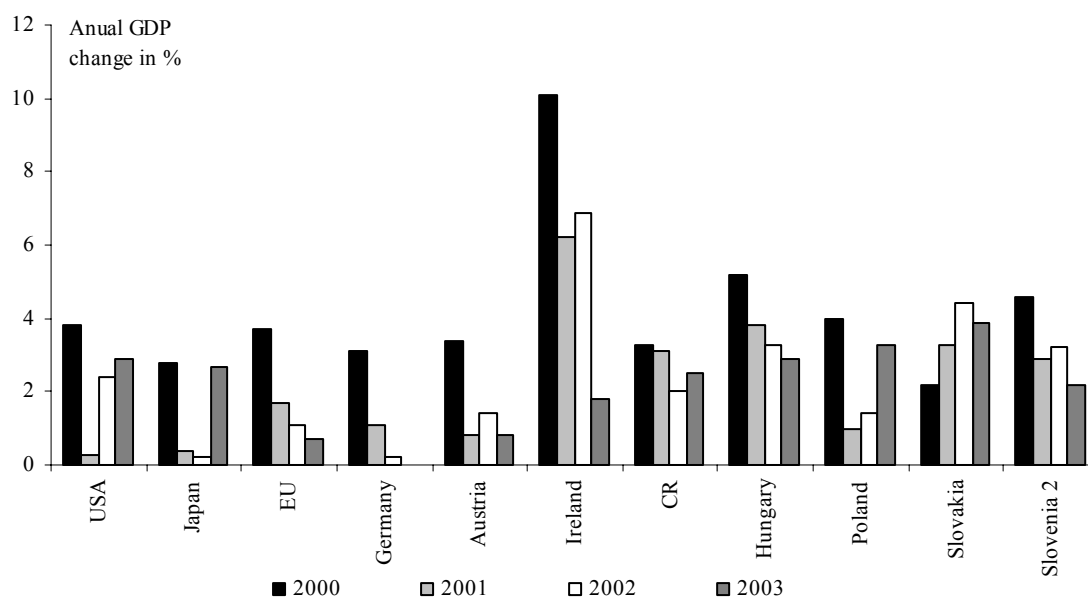
Positive effects of the reforms, implemented or at least started in 2003, will start to be unambiguously and to a larger extent visible only in multi-year period. In the short term, the positive effect on conditions for economic activities, immediate impact on decrease in living standard of the population and reduction in self-government resources – all this combines in results of the reform measures. Criticism related to the reforms carried out by the government from the side of opposition political parties and trade unions found response in adoption of a petition for referendum on early election scheduled for April 2004.

Results of the economic development of the SR in 2003 were satisfactory despite the simultaneous reduction in domestic demand by restrictive stabilization measures. It probably was the result of enterprise and banking sector restructuring carried out so far which strengthened the competitiveness of the Slovak economy and its export activities even in difficult situation of still not fully overcome recession (especially in EU countries).

In relation to the previous statement, it is necessary to mention that the openness of the Slovak economy measured by ratio of its export of goods and services to GDP has permanently increased (from 57 % in 1993 to 60 % in 1998, 72 % in 2002 and to as much as 75 % in 2003). Thus, the extent of its involvement in the world exchange already achieved a level at which results of its development in 2003 cannot be assessed in disregard of trends in world economy.

Analyses of the world economy development often evaluate the year 2003 as a period of “strengthening, but unfinished recovery”.¹ Incompleteness of overcoming the economic recession is markedly reflected also in imbalanced development or in timely unsynchronized transition of individual economic regions from recession to recovery (see chart 1).

Chart 1
International comparison of economic growth rate in 2000 – 2003¹



¹ According to: OECD Economic Outlook, 74, December 2003. Figures for 2003 are estimates.

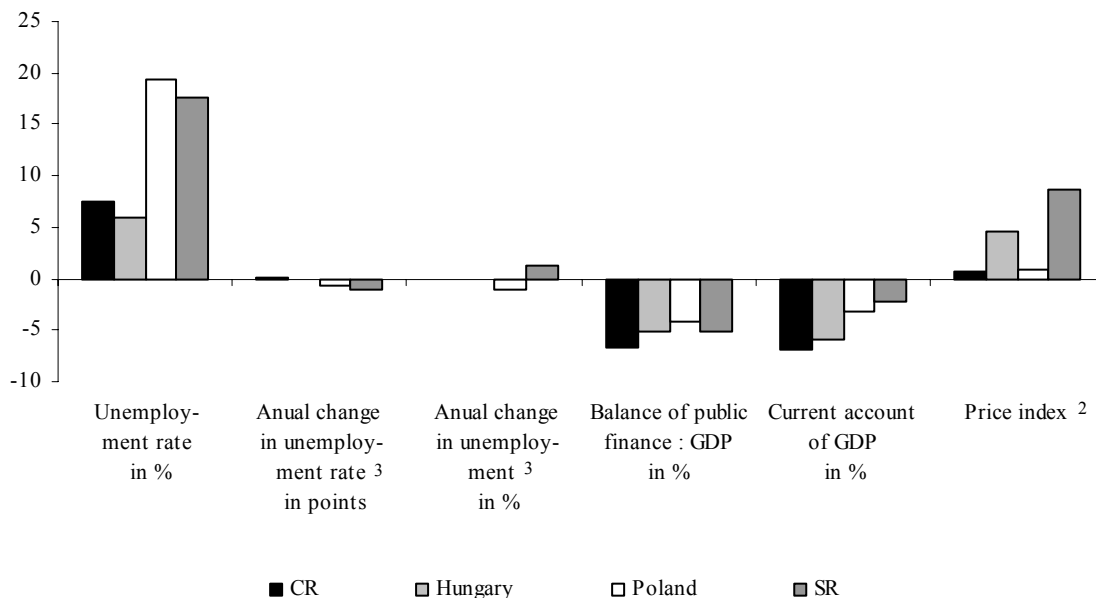
² 1Q – 3Q, according to: CANSTAT, 2003/3.

¹ OECD Economic Outlook, 74, December 2003.

In 2003, the positive trend in GDP development in the USA strengthened and in Japan at least started, while in the European Union as a whole (and except for Greece also in its individual countries) the economic performance development further worsened. In 2003, the SR achieved a relatively high, and among the central European transition economies the highest rate of growth. It is basically as much favorable as in 2002 and better than in 2000 and 2001, mainly thanks to unusually extensive increase in export. It is a certain paradox that it happened in situation of continuing recession in the Western Europe that creates almost two-thirds of external demand of Slovakia².

The macroeconomic development of the SR in difficult situation of its economic environment is shown in chart2.

Chart 2
Comparison of labor market situation and stability in transition economies of the central European region in 2003¹



¹ According to: OECD Economic Outlook, 74, December 2003.

² Annual change in consumer prices.

³ Commonly used definitions.

² Export growth, which is in more detail described in a special part of the study, was supported by maintenance of the Slovak economy's competitiveness (based mainly on low, compared to the EU-15 average – less than a third, and also compared to the CR and Hungary considerably lower unit labour costs [see: wiiw Research Reports/303, special issue on the transition economies, February 2004]), increase in production-export effect of foreign direct investment, but also by recovery of import to the USA and Germany.

In comparison with other central European transition economies, the SR achieved acceptable results in 2003 not only in terms of economic growth rate, but also in terms of values of important macro-stability indicators. Public finance deficit to GDP ratio decreased from -7,2 % in 2002 to -5,1 % in 2003. Current account of balance of payment to GDP ratio in the same period changed from -8,1 % to -2,2 %. Chart 2 indicates that in relation to compared economies there was also more favorable labor market development in Slovakia in 2003. Decrease in unemployment rate contrasted with its in 2003 still high level caused by restructuring of the enterprise sphere in the previous years. Growth of inflation rate (from 3,1 % in 2002 to 8,6 % in 2003) appears to be a symptom of worsening stability, but in a deeper view, it is a result of the reform steps ensuring future maintaining of stability.

Chart 3 shows how the results of the Slovakia's overall economic development in 2003 entered in its multi-year trends.

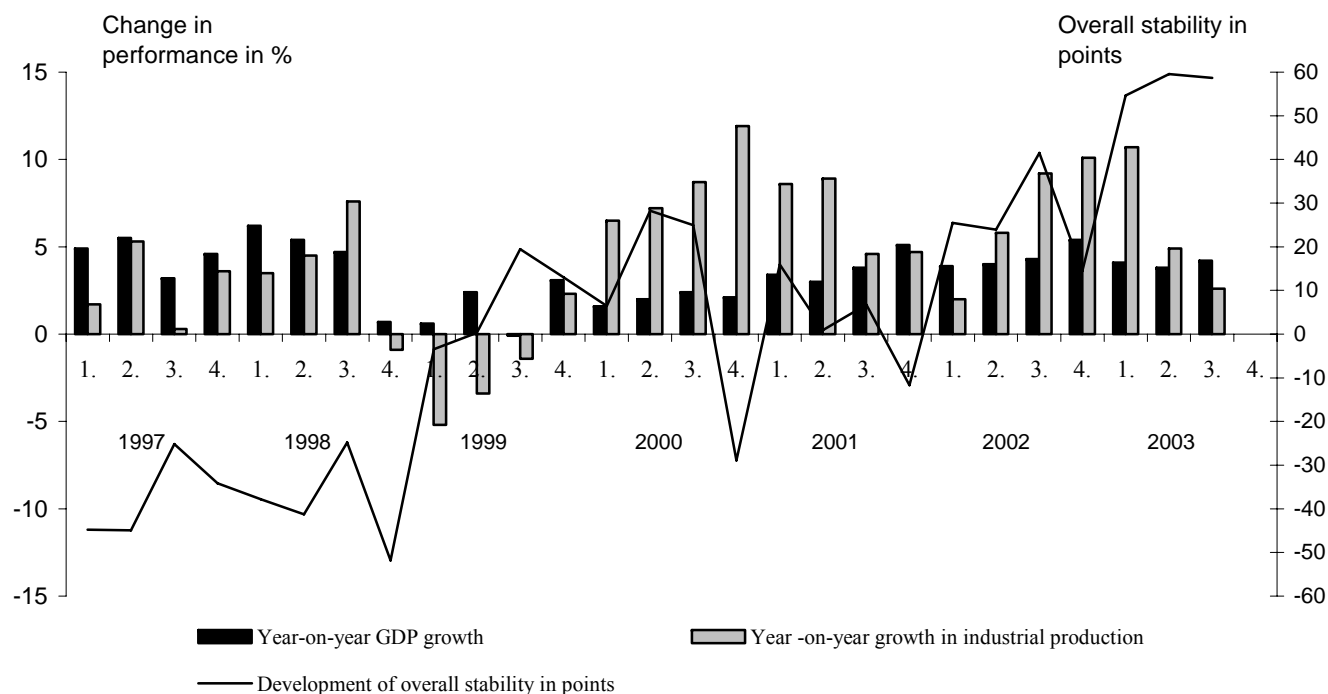
Development trend of the overall macroeconomic stability lasted also in 2003 at evidently increasing line, which started already in 2002. The satisfactory (in the whole examined period above-average) level of stability can be regarded as one of the factors, which in 2003 supported maintenance of GDP growth rate at above-average level (in terms of international comparison). Probability of its maintenance gives good prospects of GDP growth also in 2004.

More detailed view of results of 2003 and their reflection in development trends in economy performance, its stability and population situation provides table 1.

Growth rate of production in industry, which remains the most important segment of the Slovak economy in terms of financial development sources formation, room for the commerce services advancement and base for improving the foreign-trade position, achieved 5,7 % in 2003 and thus it was higher than 4.6 % average growth rate in 1993 – 2003.

Chart 3

Performance and stability development of the Slovak economy in 1997 – 2003¹



¹ Trend of the overall stability summarizes development of its following partial components (indicators): year-on-year rate of core inflation, ratio of public finance balance combined with quarterly values of share of public consumption in GDP to GDP, net export to GDP ratio, and difference between increment in labor productivity and increment in real wages. Values of each partial indicator identified in given period are expressed separately in points (in the range from +100 to – 100 points) according to their ratio to the mid-span between the maximal and minimal value of relevant indicator in the whole time series. Average from the summation of points achieved in individual periods by partial indicators is regarded as the value of the overall balance.

Average state of the overall balance in the SR for examined period is identified in the chart as its zero value. Positive values in the chart express its above-average level and negative values express its below-average level.

Table 1
Social-economic development in 1993 – 2003

	1993	1994	1995	1996	1997	1998	1999	2000	2001	2002	2003
	A. Economy performance development										
GDP index ¹ Previous year = 100 1989 = 100	101,9 79,4	106,2 84,3	105,8 89,2	106,1 94,7	104,6 99,0	104,2 103,2	101,5 104,7	102,0 106,8	103,8 110,9	104,4 115,7	104,2 120,6
Industrial production index ^{1,2} Previous year = 100 1989 = 100	96,3 62,5	104,6 65,4	108,3 70,8	102,5 72,6	101,3 73,5	103,6 76,2	98,0 74,6	108,6 81,1	107,4 87,1	106,8 93,0	105,5 98,1
Labor productivity index in national economy 1989 = 100 ³	92,3	99,7	103,7	106,2	112,0	117,0	122,4	126,7	130,1	135,7	139,0
Labor productivity index in industry 1989 = 100 ²	83,0	94,0	100,8	105,0	108,8	117,6	118,0	132,4	139,6	148,5	157,6
Cost profitability in non-financial organizations in %	4,0	3,7	3,7	3,3	3,1	1,2	2,3	3,5	5,2	5,7	6,0
	B. Stability indicators										
Inflation rate in % ⁴ of which: core inflation rate in %	23,2 .	13,4 .	9,9 .	5,8 .	6,1 .	6,7 6,1	10,5 6,0	12,0 5,7	6,7 4,3	3,3 2,1	8,5 2,6
Average interest rate on credits in % ⁵	14,4	14,6	13,3	13,3	18,4	19,4	16,9	11,8	9,3	9,1	7,6
Balance of public finance /GDP in % ⁶	.	.	.	-3,2	-4,8	-4,7	-3,7	-7,5	-6,2	-4,8	-5,1
Annual Δ in productivity ³ – annual Δ in real wages in national economy in points	-1,3	3,7	0,9	-4,6	0,5	1,7	8,2	8,6	4,0	-1,4	3,7
Net export/GDP in % ¹	-5,0	4,6	1,7	-11,2	-9,6	-10,6	-4,3	-2,5	-8,2	-7,1	2,7
	C. Social development										
Employment index, previous year = 100 ⁷	99,2	98,1	101,7	103,6	99,1	99,7	97,0	98,6	101,0	100,2	101,8
Average unemployment rate in % ⁷	12,7	13,7	13,1	11,3	11,8	12,5	16,2	18,6	19,2	18,5	17,4
Annual change in real wages in %	-3,9	3,2	4,0	7,1	6,6	2,7	-3,1	-4,9	1,0	5,8	-2,0
Index of real wages in national economy 1989 = 100	72,8	75,1	78,1	83,7	89,2	91,6	88,8	84,4	85,2	90,2	88,2
Share of social sector in expenditure of public finance in % ⁹	.	.	.	62,0	60,4	62,0	64,5	59,5	61,1	61,9	

¹ In constant prices.

² In 1998, the methodology of industry performance computation changed. Computation of the industrial production index instead of computation of the production of goods and services is used.

³ According to GDP in constant prices per worker in national economy.

⁴ According to consumer prices, in average per year.

⁵ From credits drawn from commercial banks, in average per year.

⁶ According to data of the MF; Data for 1993 – 1995 are not comparable.

⁷ According to labor force survey, in average per year.

⁸ Share of summation of expenditure on education, healthcare, social security, living, communal, needs, recreation, culture and religious affairs in overall expenditure of public finance.

Production in industry in 2003 closely approached the level achieved in 1989 and with a high probability it will surpass the pre-transformation level already in 2004. This has happened in situation of substantial increase in share of its tradable production and in situation of other qualitative changes, which are described in a part of the study devoted to a supply side of economy.

Presentation of the stability indicators' values points out that mainly the significant improvement of value of net export to GDP ratio and considerable lagging in the rise in real wages behind the labor productivity rate contributed to favorable development of the overall macro-stability (presented in chart 3) in 2003. The markedly positive impact of the mentioned factors benefited from the improvement of results of public finance and continuing decline in interest rate despite an increase in core inflation, which, however, in relation to total inflation rate was very low. The values of partial stability indicators along with characteristics of economy performance development prove that functioning of the economy in 2003 encountered the economic policy aiming at balancing of acceptable growth rate with macro-economic stability required also for approaching functioning of the SR in the EU.

Certain "tax" for the economic policy oriented on stabilization was reflected in controversial results of social development. A rank of positive changes manifesting mainly in the growth of employment and decline in unemployment rate in 2003 has continued with increasing intensity. On the other hand, the level of real wages, after a temporary increase in 2002, repeatedly decreased.³

If, the assessment of the overall economic development of Slovakia requires, on the one hand, an international comparison of its results, then, on the other hand, the regional comparison cannot be omitted (especially before accession to the EU which emphasizes importance of removing differences at the regional level) in the assessment either (see table 2).

³ Identified lagging in the real wages development behind the GDP growth was caused by several factors. Of them it is necessary to mention at least prices deregulation, advance in mixed incomes rate in business sector before rise in average wages, and elimination of influence which distribution processes realized in the CSFR in pre-transformation period (i.e. also in 1989) had on the level of wages in the SR.

Table 2

Selected characteristics of social-economic situation in regions of the SR¹

Region	Share in number of inhabitants of the SR in %		Share in receipts of industry in % ⁵			Rate of registered unemployment in % ²			Ratio of monthly wage to the Slovak average in %		
	1998 ¹	2002 ²	1997 ³	2002	2003 ⁴	1997	2002	2003 ⁴	1997	2002	2003 ⁴
Bratislava	11,5	11,1	26,6	39,3	41,6	4,6	5,2	4,0	125,9	131,6	131,6
Trnava	10,2	10,2	8,5	7,9	8,9	11,5	13,0	11,1	97,3	90,3	93,1
Trenčín	11,3	11,2	11,1	9,8	9,3	9,1	10,9	9,9	90,3	86,9	88,1
Nitra	13,3	13,2	9,0	7,4	6,4	15,0	21,5	19,1	86,3	83,4	84,5
Žilina	12,8	12,9	11,0	10,2	10,1	11,7	14,7	13,2	90,7	84,7	87,6
Banská Bystrica	12,3	12,3	10,3	7,8	7,0	15,9	23,8	22,8	88,5	84,0	85,1
Prešov	14,5	14,8	7,7	5,6	5,5	18,9	23,0	19,6	79,6	78,3	78,6
Košice	14,1	14,3	15,8	12,0	11,2	18,3	24,3	22,2	100,1	94,9	99,2
SR	100,0	100,0	100,0	100,0	100,0	13,4	17,5	15,6	100,0	100,0	100,0

¹ As of 1 July.

² As of 31 December.

³ Share in manufacture of goods in industry.

⁴ 1Q – 3Q.

⁵ Including estimate on tradesmen.

Differences in the level of socio-economic development in the Slovak regions are, according to information provided in table 2, considerable and in the examined period, 2003 including, they were increasing. Continuation of this unfavorable trend will weaken the social cohesion and already today it becomes a source of tenseness contributing to weakening of the political stability. It can be expected that the economic policy will strengthen its regional dimension.

2. Production development

Growth rate of gross domestic product (GDP) during 2003 gradually increased from 4,1b% in the first quarter to 4,7 % in the last quarter, and reached an annual average of 4,2 %. The GDP growth was reached in situation of faster growth of value added (5 %) than of gross production (6,4 %) and intermediate consumption (4,3 %). Consequently, the share of value added in gross production modestly increased (from 37,9 % in the previous year to 38,1 % in 2003). The growth in value added contributed to the GDP growth by 4,5 percentage points (p.p.). Development of other components of GDP negatively affected its growth (it decreased the GDP growth by 0,3 p.p.).

Table 3

GDP formation development in 2000 – 2003 (in constant prices)

	2000	2001	2002	2003	2000	2001	2002	2003
	Year-on-year changes in %				Contribution to GDP growth in p.p.			
Gross Domestic Product	2,0	3,8	4,4	4,2
of which								
Agriculture	1,5	9,6	9,9	5,6	0,1	0,4	0,4	0,2
Industry in total	-1,5	3,8	-0,3	9,5	-0,4	1,0	-0,1	2,4
manufacturing	0,7	11,3	-1,2	6,6	0,2	2,6	-0,3	1,5
Construction	12,0	-11,0	9,3	6,9	0,4	-0,4	0,3	0,2
Services in total	2,9	8,2	7,7	3,2	1,5	4,4	4,3	1,9
financial intermediation	23,0	3,7	47,5	29,4	0,7	0,1	1,7	1,5

Industry contributed the most (2,4 p.p.) to the GDP growth in 2003. This is the highest value reached in this sector since 1996. This development was supported by 1,5 p.p. by the manufacturing and by 1 p.p. by the sector gas, electricity and water supply.

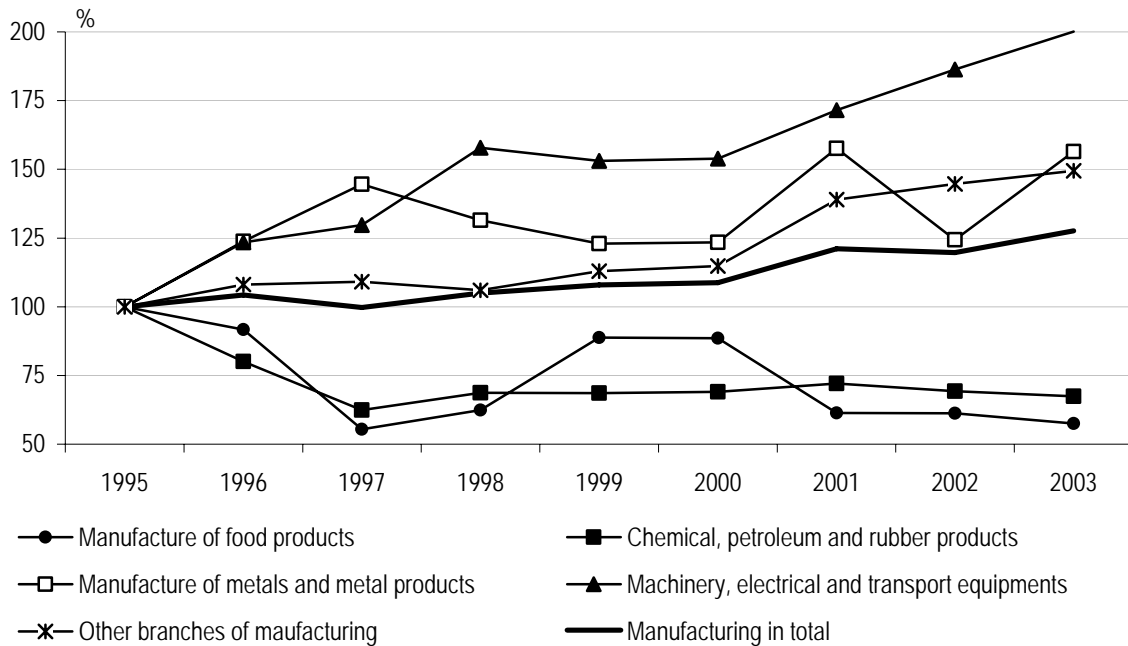
Contribution of the service sector, which was in last two years the strongest support of economic growth, decreased to less than a half (from 4,3 p.p. to 1,9 p.p.). This change was raised mainly by decrease or stagnation of value added in three biggest (in terms of share in value added) branches of the service sector – in trade, transport, telecommunications, as well as in real estate sector, renting and commercial activities. Strong growth was maintained only in the financial intermediation and education sector. The value added increased in other branches of public services as well.

In the manufacturing the value added increased by 6,6 % in 2003, and mainly manufacture of metals and metal products (4,1 p. p.) and manufacture of machinery, electrical and transport equipments (2,3 p.p.) played a role in it. Manufacture of food, chemical, petroleum and rubber products negatively affected the value added growth in the manufacturing (they decreased its growth by 0,4 p.p.), other manufacturing sectors contributed to its growth by 1,1 p.p.

As can be seen from the chart 4, in the long term, the value added development in the manufacturing is characteristic by its stagnation in manufacture of food products and in sectors of chemical industry. Unambiguous tendency towards the growth is evident in a widely viewed machinery complex (including electrical and automobile industry) and in other sectors of the manufacturing. In the manufacture of metals and metal products the value added development is largely determined by conjectural swings (after a sharp decline in 2002 a sharp increase in 2003).

Chart 4

Value added development in manufacturing sectors, 1995 = 100, in constant prices



Production in the industry increased in 2003 by 5,7 % in real terms, of which the manufacturing by 8,1 %. Production decreased in the mining of raw materials by 5,7 % and in the sector electricity, gas and water supply by 4,8 %.

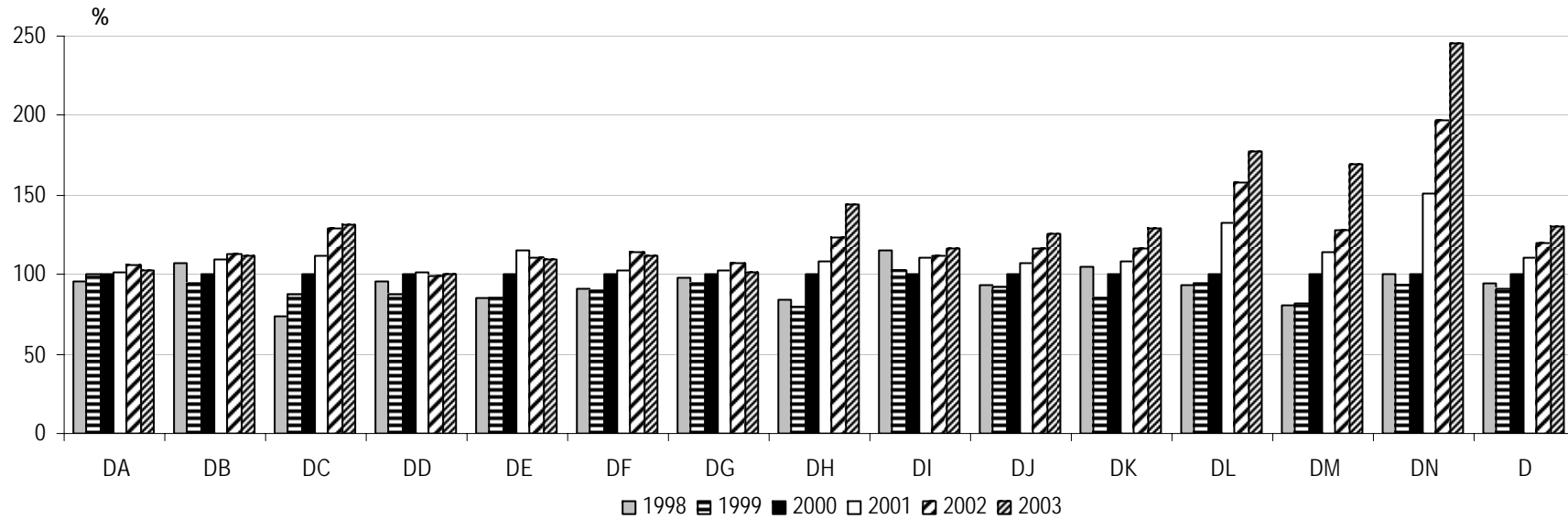
Production in individual manufacturing sectors developed in considerably wide range – from a drop of 5,2 % in manufacture of chemical products to a rise of 33,3 % in manufacture of transport equipments. Above-standard growth was also achieved in manufacture of products not elsewhere classified (24,5 %), rubber and plastic products (17,5 %), and in manufacture of electrical equipments (12,2 %) and machinery n. e. c. (10,9 %).

As the chart 5 shows, in the manufacturing several sectors that permanently achieve a relatively rapid growth of production were told off in last years. Besides the manufacture of electrical and transport equipments and manufacture of rubber and plastic products, some sectors which relatively slowly recovered from the transformation recession (manufacture of machinery n. e. c., manufacture of footwear, but especially very rapidly growing manufacture of furniture) are also included among them.

Chart 5

Industrial production index

Indexes adjusted for number of working days, average month of the year 2000 =100



DA	Manufacture of food products, beverages and tobacco products	DI	Manufacture of other non-metallic mineral products
DB	Textiles and textile products	DJ	Manufacture of metals and metal products
DC	Leather processing and manufacture of leather products	DK	Manufacture of machinery and equipments n. e. c.
DD	Wood processing and manufacture of wood products	DL	Manufacture of electrical and optical equipments
DE	Manufacture of pulp, paper, publishing and printing	DM	Manufacture of transport equipments
DF	Manufacture of coke, petroleum products and nuclear fuel	DN	Manufacture of products n. e. c. (especially manufacture of furniture)
DG	Manufacture of chemicals, chemical products and fibers	D	Industrial production in total
DH	Manufacture of rubber and plastic products		

Real growth in receipts from own output and goods in industrial enterprises in 2003 was substantially higher (11,8 %) than in 2002 (4 %). Their development was affected by industrial enterprises, in classification by the ownership type,⁴ in a very different way. The real growth in receipts was achieved only in the group of industrial enterprises in foreign (62 %) and international private (15 %) ownership, while in the group of industrial enterprises in private domestic ownership the receipts dropped by 3,7 %, and in state ownership by almost 11 %. At the same time, in the industrial enterprises in foreign ownership the number of workers increased by 32 % (by around 20 thousands workers) in rise in average monthly wage by 17 %; in other ownership groups the number of workers decreased.

In enterprises of the manufacturing, the receipts from own output and goods increased by 14,1 % in real terms (4,4 % in 2002); more than three-fifths of the total nominal increment in receipts were realized in the manufacture of transport equipments (real growth of receipts by 70 %). Above-average growth in receipts was also achieved in the leather processing (24 %), manufacture of rubber and plastic products (21 %) and in the manufacture of machinery n. e. c. (19 %). In the manufacture of food products, pulp, paper, coke and petroleum products, as well as in the manufacture of chemical products the nominal level of receipts in 2003 was lower than in 2002.

Different development of performances in individual manufacturing sectors has led to large changes in production structure (represented by receipts from industrial activities), value added and export since 1995. Basic overview is shown in table 4.

In particular, the substantial changes in mutual proportions between the manufacture of metals and metal products, on the one hand, and widely viewed machinery complex, on the other hand, can be regarded as very positive. While in 1995 the position of these two sectors in terms of share in receipts from

⁴ Only for organizations with 20 and more employees and organizations with number of employees up to 19 persons and with turnover above 100 mill. SKK.

industrial activities was roughly the same; in 2003 the share of machinery complex was higher by 27 p.p. In terms of share of value added the difference between these two sectors increased from 4,4 p.p. to 12 p.p., and in terms of share in export (2003 compared to 1998), the difference increased from 21 p.p. to 35 p.p. to the benefit of the machinery complex.

Table 4

Share of sectors in manufacturing performance in % (in constant prices)

Sectors	1995	1998	1999	2000	2001	2002	2003
Share of sectors in receipts from industrial activities							
Manufacture of food products, beverages and tobacco	15,5	15,5	14,8	13,4	12,4	12,6	10,4
Manufacture of chemicals, chemical and rubber products	22,5	18,2	18,3	21,8	21,5	19,2	15,6
Manufacture of metals and metal products	20,1	17,0	16,7	16,3	16,3	15,7	14,8
Manufacture of machinery, electrical and transport equipments	20,6	30,4	31,2	31,1	31,1	33,5	41,9
Other sectors of manufacturing	21,2	18,9	19,0	17,5	18,6	19,0	17,4
Share of sectors in value added							
Manufacture of food products, beverages and tobacco	13,1	13,4	17,6	17,8	11,5	12,5	11,8
Manufacture of chemicals, chemical and rubber products	25,3	17,0	17,0	17,0	16,6	15,1	13,7
Manufacture of metals and metal products	15,2	16,5	14,6	14,2	18,7	16,5	18,2
Manufacture of machinery, electrical and transport equipments	19,6	26,0	24,5	24,1	25,2	28,5	30,2
Other sectors of manufacturing	26,7	27,2	26,4	26,8	28,0	27,4	26,2
Share of sectors in export							
Manufacture of food products, beverages and tobacco	.	3,2	3,0	2,7	3,0	2,9	2,6
Manufacture of chemicals, chemical and rubber products	.	17,1	17,0	18,6	17,9	17,4	14,0
Manufacture of metals and metal products	.	18,5	15,9	16,0	16,0	15,4	14,5
Manufacture of machinery, electrical and transport equipments	.	39,4	41,6	41,7	41,0	41,6	49,4
Other sectors of manufacturing	.	21,9	22,4	21,0	22,1	22,7	19,5

Share of the manufacture of food products in the manufacturing continually decreases; this basically corresponds to usual trends in growing economy. Overall position of the chemical manufactures also weakens, but this does not apply to all sectors of this group. Decreasing share is evident especially as regards the manufacture of chemicals, chemical products and fibers. On the contrary, the manufactures of rubber products and plastics, and with some fluctuations, also

the manufactures of coke and petroleum products unambiguously maintain their share. Share of other sectors of the manufacturing slightly decreases; however, some sectors in this group have shown strong tendencies toward strengthening of their share in the manufacturing structure (e.g. footwear and furniture manufactures) in recent years.

Dominant role in these changes is naturally played by the manufacture of transport equipments. In 2003, its share in receipts from industrial activities was 27 % (in 1995 only around 8 %) and in total export of the manufacturing it was almost 30 %. At the same time, the manufacture of transport equipments plays a special role in increase in share of technologically oriented export, which already today represents 26 % of total export of the manufacturing (21 % in 1998).

The automobile industry as a whole (not only finished cars, but also components, chassis, etc.) decisively – by as much as 83% contributed to a substantial improvement of the trade balance of the manufacturing in 2003 (in 2002 deficit of SKK 0,2 bn, in 2003 surplus of SKK 69,3 bn). It contributed to a considerable decrease in overall trade deficit by 79 %.

Overall, it can be stated that despite the fact that the Slovak industry only today overcomes its pre-transformation level,⁵ its character did not radically change during the economic transformation. It concerns not only quantitative structural changes, which we endeavored to characterize in table 4, but also significant qualitative changes which were decisive particularly for the fact that given product, production branch or sector were able to maintain in the structure of production, export etc. These changes are reflected above all in increased

⁵ Comparison of the pre-transformation level of industry with its current level on the basis of comparable prices does not create ideal conditions for full comparability of quantitative variables. We know, for example, that a large portion of pre and post-production services was incorporated in industrial enterprises. At the very beginning of the first transformation period these services became independent and were incorporated in the service sector. Naturally, the process of service separation from production sectors takes place also in developed countries. However, in transformation conditions the process was realized more intensively, and it could have a relatively significant influence on deformation of the industry development in the transformation period.

technological level of production, its quality and design that are an inevitable precondition for tradability of products on the open domestic market and on demanding foreign markets. On the contrary, in the pre-transformation period the Slovak industry had an advantage consisting in the fact that it operated on the closed domestic market and on foreign markets with limited and little differentiated supply. As important it is necessary to consider also the fact that during the transformation the Slovak industry was able to implant as a relatively independent part of international division of labor in which it participated mostly through mediation of the Czech economy.

Production growth in the construction in 2003 accelerated to 6 % (4,1 % in the previous year), namely as a result of increase in construction production abroad by more than a half; the growth in domestic production in 2003 remained at a level of 4,4 %. Unmistakable sign of overcoming the stagnation in the construction is relatively strong increase in receipts by 8,5 % and in employment by 4 %.

In the agriculture the year 2003 was not favorable. Extraordinary problems were caused by a great dryness which decreased harvests of all basic sorts of crops (except for barley, sunflower and grape) below the level of average of three previous years. At the same time, the sale of all main livestock products in weight units except for swine dropped. Overall receipts from sales of products in real terms stagnated, but in nominal terms they decreased by almost 5 %. The unfavorable development was fully reflected in negative economic result of the sector (SKK 1,9 bn).

Financial results of corporations in 2003 developed very differently. In the sector of financial corporations the performance ended with a loss (SKK 15,1 bn) for the second consecutive year. On the contrary, in the sector of non-financial corporations a profit higher by SKK 14 bn than in 2002 was achieved. It increased mainly in the industry (by more than SKK 19 bn, of which in the manufacturing by SKK 11 bn and in the sector electricity, gas and water supply

by SKK 8 bn). The agriculture ended with a loss. Somewhat lesser profit than in the previous year was achieved in the construction and services. See overview in table 5.

Table 5
Development of financial position of corporations in 1998 – 2003

	1998	1999	2000	2001	2002	2003
	Economic result in bn SKK					
Non-financial and financial corporations in total	31,2	73,8	88,0	134,8	133,7	138,0
Financial corporations	8,4	26,7	8,8	12,8	-5,5	-15,1
Non-financial corporations	22,8	47,1	79,2	122,0	139,1	153,1
of which:						
Agriculture	-1,6	-2,0	-0,3	1,2	1,9	-1,9
Manufacturing	-5,2	6,4	26,3	44,7	42,6	53,2
Construction	3,2	1,5	3,3	4,9	8,9	8,4
Services in total	13,5	23,1	36,2	55,0	56,0	55,4
Profitable and unprofitable non-financial corporations with 20 and more employees	6,5	21,6	49,4	86,2	95,3	115,2
of which: profitable	86,8	75,6	81,3	112,3	127,4	146,6
unprofitable	-80,3	-54,1	-32,0	-26,0	-32,2	-31,3
	Cost profitability in %					
Non-financial corporations	1,2	2,3	3,5	5,2	5,7	6,0
Agriculture	-2,7	-3,6	-0,5	1,7	2,7	-3,1
Manufacturing	-0,8	0,9	3,4	5,2	4,7	5,0
Construction	3,0	1,8	3,2	4,8	8,6	7,8
Services in total	1,5	2,2	3,3	5,2	5,0	5,1

In the manufacturing the profit was achieved by all sectors except for the manufacture of textiles and textile products. In individual sectors the year-on-year profit growth developed relatively unequally. In several sectors the profit in 2003 decreased, but after considerable increase in the previous year (e.g. in the manufacture of food products), or considerably increase, for example in the manufacture of metals and metal products (by SKK 12 bn after the previous drop of SKK 8 bn). Continual increase in profit can be recorded in the manufacture of rubber and plastic products, manufacture of machinery n. e. c., and in the manufacture of electrical equipments.

In 2003 a higher increment in profit than in the whole sector of non-financial corporations was achieved in non-financial corporations with 20 and more employees (SKK 20 bn); above all increase in profit in profitable organizations (by SKK 19 bn) and to a small extent also decrease in loss in unprofitable organizations contributed to the increment. Difference between the increase in profit in the whole sector of non-financial corporations and non-financial corporations with 20 and more employees indicates that smaller enterprises were less successful in 2003 than in the previous years. Their profit dropped (for the first time since 1998) roughly by SKK 6 bn. This was result of more or less depressed demand on the domestic market on which small-sized enterprises usually orient.

3. Price level development

Increase in price level in 2003 sharply accelerated compared to the previous year (the increase in consumer prices accelerated 2,6 times). Considerable difference in inflation rate between 2002 and 2003 was caused mainly by a different extent of adjustments in regulated prices. The fact that in 2002 the lowest increase in price level (3,3 %) in the SR's history was recorded was accepted with caution: it was known that it is only a temporary phenomenon raised rather by political decision on postponement initially planned adjustments of regulated prices. Therefore, the acceleration of price level growth in 2003 was expected.

The price development was counterproductively affected by internal and external factors. The internal factors had the effect of price level increase (administrative measures in the form of adjustments of regulated prices and consumption taxes, change in VAT rates, increase in consumption taxes). Share of administrative measures in the overall price increase represented more than 75 %. Rise in energy prices had also its logical secondary effect on more substantial increase in prices of market services. Another internal factor affecting the price

level was strengthening of rise in food prices in comparison with the previous year.

Influence of the external factors acted against the increase in price level. Appreciation of the Slovak koruna exchange rate against the euro and US dollar was reflected in prices of fuels (these after adjustment for changes in indirect taxes decreased by 0,5 %). Development of the Slovak koruna exchange rate had an impact on price level also in the form of a low so-called imported inflation that was reflected in a slower growth of tradable goods prices.

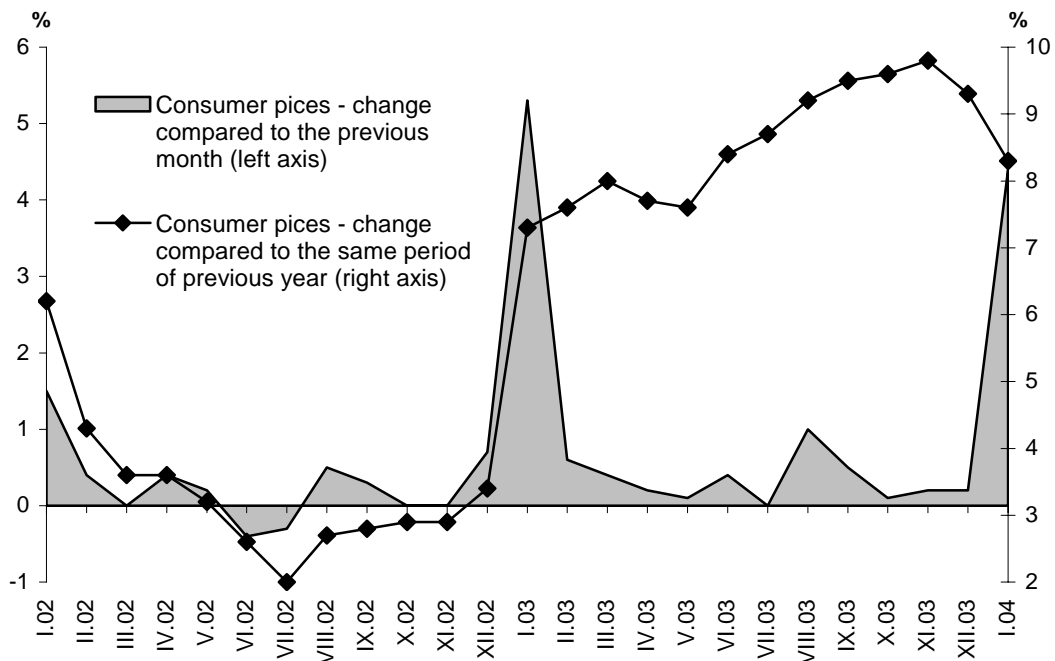
Effect of majority of substantial expected impacts on inflation was manifested at the very beginning of the year. Consequently, the consumer prices increased in January by 5,3 %, month-on-month. The month-on-month change in the price level was comparable to July 1999 (5,8 %), when, after a change of government, the first considerable adjustment of regulated prices in the framework of series of measures removing price deformations was realized. The second, more moderate jump in price level occurred in August 2003, when the prices were affected by initially unplanned change in consumption taxes. The annual average inflation rate in 2003 reached 8,5 %.

All price indexes of production sphere in 2003 lagged behind the index of consumer prices. The highest dynamism achieved the index of industrial producers which reached a level of 8,3 % (in 2002 only 2,1 %). However, its analysis proves that this relatively high value was caused by increase in producers' prices of electricity, gas, steam and hot water by 17,9 %, while products of industrial production raised prices only by 2,6 %. Agricultural producers incurred further decrease in prices of their products (which in situation of rise of other price indexes again handicaps agricultural producers). Product prices of the agricultural production in 2003 decreased in average by 4,8 %, year-on-year (in the previous year – 0,7 %). The product prices of the agricultural production decreased with rise in prices (of related products) of food products (by 2,8 %)

and in rise in consumer prices of foodstuffs and non-alcoholic beverages (by 3,4 %).

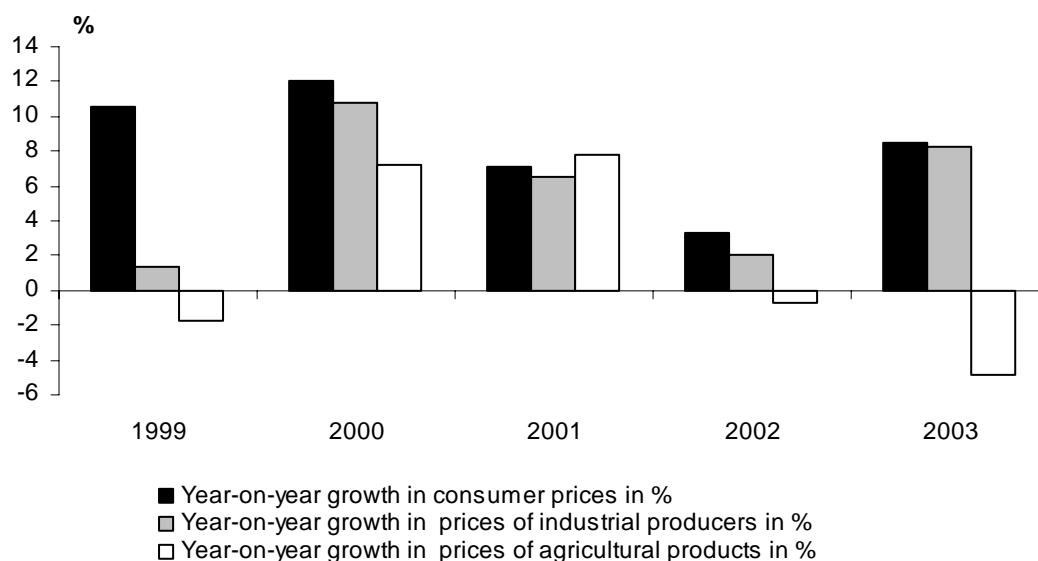
From the standpoint of the macroeconomic stability and quality of economic environment, it can be reminded that a sudden decline in inflation rate in one year (2002) accompanied by its sudden increase in following year is not, from the purely economic standpoint, the appropriate solution. From the standpoint of the environment predictability and stability, it would be more advantageous if the adjustments of regulated prices were made in such way, which enables a gradual year-on-year decrease in price growth rate. On the other hand, it is positive that the last radical increase in regulated energy prices scheduled for 2004 will remove the price deformations.

Chart 6
Growth rate of consumer prices



Source: Statistical Office of the SR.

Chart 7
Average year-on-year growth in price level in %



Source: Statistical Office of the SR.

Outlook for 2004

Decisive influence determining the growth rate of price level in 2004 is the extent of regulated price adjustments carried out at the beginning of the year. On the basis of inflation data for January, it can be confirmed the assumption that the price jump at the beginning of 2004 was less significant than that at the beginning of the previous year (at the beginning of both years, adjustments of regulated prices and indirect taxes were carried out). The January jump in 2004 should be the last inflation shock caused by the adjustment of regulated energy prices. Consumer prices increased in January by 4,4 %, month-on-month (in January 2003 + 5,3 %). The increase in consumer prices was caused mainly by influence of the administrative adjustments⁶ (regulated prices and change in VAT); more than 60 % of this increment was caused by the rise in regulated

⁶ Data for January do not include increase in prices of regulated rent (Decree of the Ministry of Construction and Regional Development of the SR regulating prices of rental housing came into force only in January).

prices. It is not surprising that the strong rise in prices in January (month-on-month) is concentrated in housing, electricity, gas and other fuels (in consequence of adjustments in regulated prices and of VAT rate increase), and in foodstuffs and non-alcoholic beverages (in consequence of VAT rate increase). Smaller administrative effect on prices will occur in May 2004, when the consumption tax on tobacco products will be adjusted (revenues from tax increase amounting to approx. SKK 200 mill should be used for completion of financing of regional education system).

For reason of the mentioned smaller extent of adjustments of regulated prices in January 2004, in contrast to January 2003, the dynamism of year-on-year inflation rate decreased to 8,3 % (in December 2003 it was 9,3 %). On year-on-year basis, the core inflation reached 3,1 % (in December 3,0 %).

Risk factor for the estimate of growth rate of the price level can be effects of EU accession, which can be raised objectively (e.g. principles of the common agricultural policy) and speculatively as well. We expect that the convergence of price level of domestic economy to EU states will continue rather gradually than suddenly. Purchase effective demand of domestic consumers will play an important role here. In case of some agricultural commodities (mainly sugar, oil-seeds, milk), a more rapid increase in prices will probably occur, but it can be said that there will be no jump increase in the overall price level. If we assume that the price increase will be spread over a longer period and (except for several commodities) will not be concentrated to the period immediately after accession to the EU in 2004, we can expect a result of average inflation rate in the interval of 6,5 % – 7,5 % in 2004.

4. Labor market

After overcoming the critical phase in 1999 – 2001, we state a moderation in imbalance in the labor market. The very data on labor market for 2002 showed signs of turn (the first decline in unemployment rate, though moderate, was recorded since 1997). In 2003 this tendency strengthened. However, the development

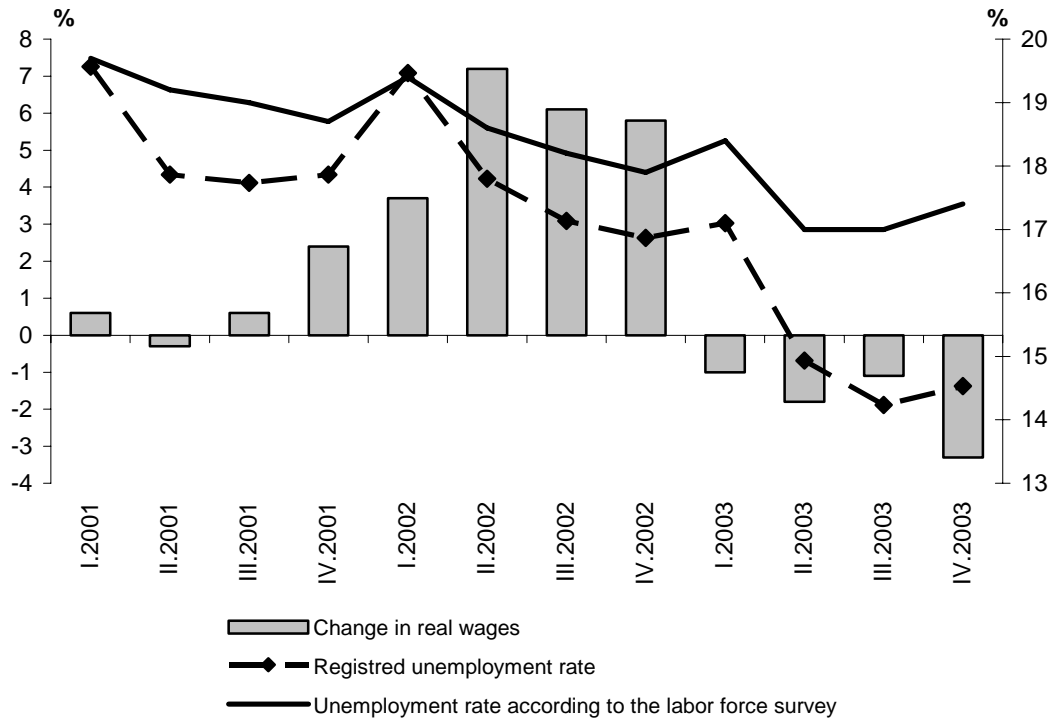
in 2003 was not continuation of tendencies from the previous year, several characteristics radically changed. Decline in unemployment rate in 2002 was still not accompanied by a substantial increase in employment (unemployment declined rather in connection with overall diminution of labor force in the labor market). The development in 2003 was qualitatively better: there was present employment increase along with decrease in unemployment rate.

However, the statistical data for 2003 are interpretable with difficulties. The reason for this is their inconsistency. There are considerable differences in data depending on their source. These problems are accompanying phenomenon of qualitative changes in the labor market. The unemployment rate identified according to the number of registered unemployed declined more significantly than the unemployment rate identified according to the labor force survey. This difference cannot be clarified without taking into account legislative changes in the labor market. Legislative changes brought tightening of the contact regime of registered unemployed with labor offices and opportunities for self-governments to involve unemployed in municipal services. These measures contributed to substantial fall in unemployment rate expressed according to the number of registered unemployed. Existing significant difference between the two unemployment rates (chart 8) raised indications that a section of persons removed from the registers of labor offices continues to state in labor force survey (i.e. in questionnaire) that they have no employment.

The average unemployment rate in 2003, according to the labor force survey, reached 17,4 %, while in the previous year it was 18,5 % (with increase in number of employed persons by 1,8 %). As a result of the mentioned measures, the registered unemployment rate declined to as much as 15,2 % (annual average), at the same time, in contrast to the past, its seasonal fluctuations accentuated. At the end of the year, the registered unemployment rate (which at the end of year regularly increases due to completion of seasonal work) increased more

substantially than would be expected on the basis of so far known seasonal fluctuations.

Chart 8
Unemployment rate and real wage growth



Source: Statistical Office of the SR.

It can be explained by the fact that in summer and autumn months the seasonal decline was stronger than in the past, at the end of the year the seasonal increase was also stronger than in the past.⁷ It is probable that mobilizing unemployed achieved thanks to more strict rules for remaining in registers of labor offices since 30 January 2003, led to a higher number of seasonally employed persons.⁸ In compliance with this assumption, it purports that according to the

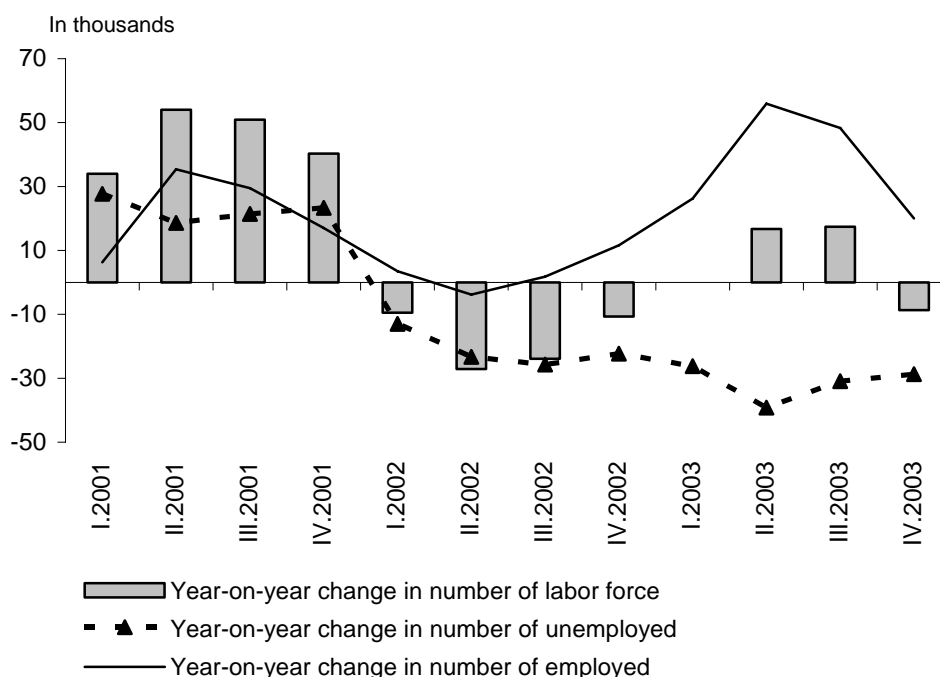
⁷ Number of new registered unemployed which in December exceeded 50 thousands is beyond the usual seasonal fluctuation.

⁸ It must not concern only the increment in seasonal work. Part of this work probably existed also in the past, but they were not registered and their performers could remain in the register of unemployed. Changes in the legislation forced them to deregister during the work, after its completion they probably again register.

labor force survey the strong increment in employed persons was recorded in the sector of construction (by 10,7 %) and hotels and restaurants (16,1 %). Therefore it is apparent that with thus oriented employment policy it is necessary, in the interpretation of continuous data, to take into account a changed rate of seasonal fluctuations.

Chart 9

Development tendencies in labor market according to the labor force survey



Source: Statistical office of the SR.

Positive signal is the shift in less monitored indicator of the labor market: the average length of stay of unemployed in the register was slightly shortened (in December it reached 12,4 months). Shortening of stay spent in the registers of labor offices can be a manifestation of labor market flexibility.

Development of labor cost in 2003 significantly differed from the previous year. Despite the fact that the growth of living costs substantially increased in this period the pace of nominal wage growth slowed down. The average wage in 2003 achieved SKK 14 365 and increased only by 6,3 %, year-on-year. This

in situation of increased inflation (and thus in increased growth of living costs) meant a decrease in real wage by 2,0 %. This is a significantly different development of real wage in comparison with the previous year. At that time, in so far record low inflation rate (3,3 %) the nominal wage growth was significantly higher (9,3 %); this led to an increase in real wage by 5,8 %.

Changes within the framework of rules of the labor market functioning already resulted from interpretation of some indicators. Since the beginning of 2003 the legislative changes has tightened conditions for remaining in registers of labor offices (contact every 14 days). At the same time, the nation-wide Program for maintenance labor habits by the form of smaller municipal services replaced so far applied program for socially beneficial job. Starting January 2003 the local self-government co-operates on contractual basis with labor offices (registers of unemployed are confronted with the self-government; the self-government has a right to employ them for municipal service.

The stricter regime of remaining persons in register of unemployed itself is not a guarantee of sustained decrease in unemployment. This instrument weakens one of several causes of unemployment, but not the main one (which is the lack of jobs). On the other hand, it is shown that cleaning of the labor market database is accompanied by an increase in number of employed persons.

In order to enhance the labor market flexibility the legislative framework of the labor market was changed by an extensive amendment to the Labor Code (effective as from July 2003). Aim of this regulation was to ensure higher flexibility of employment relations and restrict coercive provisions of the Code. Without enumeration the changes, which the amendment has brought, it is possible to identified tendencies for the benefit of which the new regulation acts. This includes the deregulation of working time, simplification of establishment of alternative employment relations, reduction of protection of employees against dismissal, and overall enhancement of flexibility of relations between

employee and employer. The amended Labor Code should stimulate creation of new jobs.

The labor market and also formation of labor cost is concerned by the Strategy of reform of employment in public sector. Its aim is that the public sector would be able to compete with the private sector in recruiting and maintaining quality human resources. Principles of employment in the public sector have to get closer to the conditions in private firms.

Outlook for 2004

Repeatedly tightened rules, which aim is further stimulation to active job seeking, have been effective since January 2004. Benefit for moving for job should help the higher mobility of unemployed. At the same time, the duration of providing unemployment benefit was shortened from 9 to 6 months. The offices of labor, social affairs and families (which replaced labor offices) ensure creation of the so-called individual action plan for unemployed. It is one of the elements in transition of the labor offices from the position of administrators to the position of consultants.

Common feature of the new rules in employment policy (those which were implemented in 2003 and at the beginning of 2004) is to support the motivation on the supply side (i.e. on the side of labor forces). The demand side of labor market can be indirectly stimulated through the income tax reduction; however, this effect especially in the short-term horizon should not to be significant. Stimulation of unemployed through conditions tightening will gradually strike limitations of their possibilities, if at the same time the job creation will not improve.

The year 2004 has started in compliance with trends of 2003: the registered unemployment continues to fall, year-on-year. We expect that also the introduced package of changes in the employment policy contribute to it. The

registered unemployment rate achieved in January 2004 a level of 16,6 %, which is 1,1 percentage points less than in January 2003. It simultaneously means that year-on-year decline is lower than in last year, at that time in January it was recorded decline by 2 percentage points. This result is in compliance of logic of our expectations, according to which the registered unemployment rate should continue to decrease, albeit at slower pace than in the previous year (between 2002 and 2003 it decreased from 17,8 % to 15,2 %, in 2004 it will probably decrease to around 14,3 %). In addition, it is very probable that results gotten through the labor force survey will continue to be less favorable, and it can be counted with a decrease to a level of around 16,5 % (from 17,4 % in 2003).

With respect to the slowdown in growth of living costs it can be counted with more favorable results of development of the real wages. Since the enterprises will not be burdened with similar shock of increase in energy prices as in 2003, it can be expected also bigger willingness of employers to increase nominal wages. In combination with lower inflation rate it will probable lead to slight increase in real wages in the amount of around 1 %. The renewed (albeit only weak) increase in real wages will enable also increase in dynamism of final household consumption, which, in contrast to 2003, will again contribute to an increase of real GDP.

5. Balance of payments and foreign capital

5.1. Balance of payments

Development of the balance of payments and particularly of the trade balance in 2003 was characteristic, especially in its second half, by positive trends from the previous years. As a result of this fact, also development of the current account of the balance of payments achieved the best level since 1995.

Table 6
Development of balance of payments in 1999 – 2003 (in mill USD)¹

	1999 ²	2000 ³	2001 ⁴	2002 ⁵	2003 ⁶
Trade balance	-1 103	-916,8	-2 134,7	-2 131,4	-641,4
Balance of services	149	439,4	479,5	455,5	234,5
Income balance	-128	-235,5	-100,7	-261,1	129,0
Current account	-1 083	-713,0	-1 755,9	-1 938,9	-277,3
Capital and financial account	1 823	1 413,0	1 719,0	5 175,3	1 339,0
Other non-classified items	-19	120,2	180,2	409,3	-170,1
<i>Overall balance</i>	<i>721</i>	<i>923,7</i>	<i>140,4</i>	<i>3 645,7</i>	<i>1 231,7</i>

¹ State as of 31 December 2003.

² Used rate 41,417 SKK/USD.

³ Used rate 46,200 SKK/USD.

⁴ Used rate 48,347 SKK/USD.

⁵ Used rate 45,335 SKK/USD.

⁶ Used rate 36,773 SKK/USD.

Decrease in the trade balance deficit resulted mainly from the faster export growth compared to import, with more favorable export structure in which the share of economically progressive productions increased.

However, more unfavorable results brought up the development of the balance of services, in which a decrease in revenues by \$ 210,0 mill was recorded. This decrease was caused not only by reduction in transportation services and gas transfer, in simultaneous increase in expenditure on freight transportation, in particular on automobile transportation, but also by undesirable slow-down in growth rate of tourism revenues which does not create favorable conditions for further development of this sector in 2004. The lower level of services and the rise in prices thus open competitive room for neighboring countries.

Also further increase in foreign exchange reserves corresponded to the positive results of the balance of payments development. Their total state as of end of the year amounted to \$ 12,1 bn, which represented approx. 5,8 month import cover for goods and services.

The achieved balance or surplus of the overall balance was ensured above all by the surplus of capital and financial account in the amount of SKK 64,5 bn (\$ 1,3 bn) created by foreign and other short-term investments, while in the portfolio investments of financial derivatives and other long-term investments an outflow occurred.

5.2. Foreign capital

Long-term financial and capital resources decreased by SKK 188 bn (\$ 4,1 bn) in 2003 compared to 2002. The sharp decrease (as of the end of September 2003) occurred mainly in FDI inflow (by SKK 139 bn, \$ 2,8 bn). In particular, the completion of privatization of state-owned property shares in network sectors manifested here, however, the privatization revenues from these sectors still participated to a certain extent in the FDI inflows (supplementary payment for the SPP privatization, privatization of the “Východoslovenska and Západoslovenska energetika”).

Table 7
Foreign capital in the SR in 2003

	1Q – 3Q 2002		1Q – 3 Q 2003		Difference	
	bn SKK	mill \$	bn SKK	mill \$	bn SKK	in mill \$
Balance of FDI in total	156,6	3 367,3	17,7	471,6	-138,9	-2 895,7
assets	-0,6	-13,4	0,4	10,9	1,0	24,3
liabilities	161,2	3 465,7	25,4	679,1	-135,8	-2 786,6
Balance of portfolio investment	20,3	437,9	-15,9	-424,5	-36,2	-862,4
assets	15,4	331,7	-16,3	-435,5	-31,7	-767,2
liabilities	4,9	106,2	0,4	11,3	-4,5	-94,9
Balance of other long-term investment	-0,9	-13,1	-13,9	-370,4	-13,0	-357,3
assets	6,1	138,9	10,7	286,0	4,6	147,1
liabilities	-7,0	-152,0	-24,6	-656,4	-17,6	-504,4
Balance of long-term foreign investment in total	176,0	3 792,1	-12,1	-323,3	-188,1	-4 115,4
assets	20,9	457,2	11,5	-138,6	-9,4	-595,8
liabilities	159,1	3 419,9	-15,5	11,7	-174,6	-3 408,2
Balance of short-term capital	-9,4	-201,8	18,5	451,1	27,9	652,9
assets	8,8	188,6	-16,7	-445,7	-25,5	-634,3
liabilities	-18,2	-390,4	35,2	896,9	53,4	1 287,3
Balance of foreign capital in total	166,6	3 590,3	6,4	127,8	-160,2	-3 462,5

Note: FDI include only equity capital + reinvested profit.

Source: NBS – balance of payments – January – September 2002 and 2003.

Consequently, the sector structure of FDI inflow also changed in comparison with 2002. Share of FDI inflow considerably increased mainly in the manufacturing (from 1,4 % to 38 %) to the detriment of the energy sectors (from 83 % to 39 %), although their share remained still relatively high (table 8).

Table 8
FDI in enterprise sphere of the Slovak economy by sectors

Main sectors of FDI inflow	FDI inflow				FDI stock as of 30 September 2003	
	1Q – 3Q 2002		1Q – 3Q 2003		bn SKK	%
	bn SKK	%	bn SKK	%		
Manufacturing	2,3	1,4	9,0	37,7	121,8	37,2
Electricity, gas and water supply	132,8	82,5	9,4	39,1	38,8	11,8
Trade	6,1	3,8	4,6	19,3	39,6	12,1
Transport, telecommunications	0,6	0,4	0,3	1,2	34,1	10,4
Banking sector and insurance industry	17,2	10,7	1,8	1,5	75,7	23,1
Total	160,9	100,0	24,0	100,0	327,2	100,0

Source: Monetary Survey of the NBS, December, 3.

In terms of FDI stock per capita Slovakia recorded the highest dynamism of growth in 2003 (as of 30 September 2003) with volume of \$ 1680, which is more than in Poland (\$ 1253 as of 30 September 2002), but less than in the CR (\$ 4469), Hungary (\$ 3079) and also than in Slovenia (\$ 2012).

The major investor countries in 2003 were Germany (36,7 %) along with Hungary (31,7 %) and the United Kingdom (10,9 %). Investments from Germany were oriented mainly to the enterprise sphere, and investments from Hungary, the United Kingdom and also from Italy were oriented to the banking sector. The share of Germany in the total FDI stock represented 22,7 %, mainly in the enterprise sphere, followed by the Netherlands (21,0 %), also in the enterprise sphere, Austria (17,4 %), and Italy (10,7 %), mainly in the banking sphere.

The regional orientation of the FDI inflow in 2003 did not radically change. The total FDI inflow was shared out between the Bratislava (72,8 % of the total FDI inflow) and Košice regions (20,1 %). Share of the Bratislava

region in the FDI stock as of 30 September 2003 decreased to 62,8 %. The Košice region was in the second position (16,1 %). Shares of other regions ranged between 3,5 % and 4,4 %. The lowest share traditionally belonged to Prešov region (2,4 %).

Decline of financial resources from portfolio investments, compared to 2002, by SKK 36,2 bn (\$ 862 mill) was caused above all by bigger debts repayment by non-residents and by purchase of foreign stocks by residents than by debts repayment by domestic debtors and by purchase of stocks by non-residents.

Decline in other long-term capital, compared to 2002, by SKK 13 bn (\$ 357 mill) was caused mainly by a higher repayment of foreign loans than was their drawing. Increase in short-term capital was related mainly to transactions between mother banks abroad and their branches in the SR.

Despite the overall decline in financial and capital resources by SKK 160,2 bn (\$ 3,5 bn), their net inflows during the first – third quarters of 2003 in the volume of SKK 6,4 bn (\$ 128 mill) sufficed for refinancing of the achieved relatively low current account deficit of SKK 2,7 bn (\$ 73 mill).

In 2004, it is assumed that the development of financial and capital resources will be decisively influenced by the dynamism of FDI inflow. Return to traditional – production and non-privatization spheres of its allocation, trend of which already started in 2003, are expected. Increase in FDI inflow to these spheres, mainly to the manufacturing, advise not only agreements on construction and manufacture already concluded with the companies Peugeot, Citroen, KIA Motors – Hyundai, but also other foreign investors from the sphere of electrical engineering, electronics, machinery and construction as well.

Further rise in FDI inflow and from it resulting impact on the economy of the SR, especially as regards direct and indirect employment and export, can be thus expected. However, in view of the longer start-up time of FDI

oriented on production, the substantially bigger impacts of FDI are not expected until years 2005 – 2007.

6. Foreign trade in 2003 and its outlook for 2004

Foreign trade of Slovakia recorded a significant improvement in 2003 in comparison with 2002. Its results were even the best since 1995.

Trade balance deficit was lower by SKK 72,4 bn compared to 2002 and reached only SKK 23,6 bn, i.e. 2 % of GDP compared to 8,8 % in 2002 (table 9). The considerable decrease in the deficit of foreign trade resulted from significantly higher export dynamism and only lesser increase in import dynamism.

Table 9

Development of basic indicators of foreign trade of the Slovak Republic

Indicator	2000	2001	2002	2003 ¹
Exports, FCO, bn SKK, current prices	548,5	611,3	652,0	803,0
Annual change, current prices, %	+29,5	+11,4	+6,7	+23,2
Imports, OP, bn SKK, current prices	590,3	714,1	747,9	826,6
Annual change, current prices, %	+25,9	+21,0	+4,7	+10,5
Balance, bn SKK	-41,7	-102,7	-96,0	-23,6
Balance /GDP, %	-4,7	-10,4	-8,8	-2,0 ²
Export performance, % GDP	61,8	61,8	61,1	67,2
Import intensity, % GDP	66,6	72,2	70,1	69,1

¹ Preliminary data.

Source: Statistics of foreign trade of the SR for 2000, 2001, 2002, Statistical Office of the SR; webpage of the Statistical Office of the SR – foreign trade 2003; GDP according to www.statistics.sk; own calculations.

In terms of commodity structure, vehicles, vessels and transport equipments, which increased their share in the SR's total export from 21 % in 2002 to 29 %, contributed the most to a considerable export growth. However, the decisive share in this growth had the automobile industry and within it, yet, dominant firm – sister company Volkswagen that markedly increased its production, particularly by introduction of a new product (land rover Touareg). But there

was also a significant increase in export of machinery, electrical equipments and equipments for video and sound recording and reproduction (by 23 % with share of 19 % in total export), basic metals and metal products (by 16 % with share of 13,5 % in export) and various industrial products. In 2003, the Slovak export sector recorded further significant improvement of the export commodity structure in favor of more processed products.

On the import side, compared to 2002, a lower growth was recorded in major items - products of food industry (decrease by 6,7 %), mineral products (by 0,6 %) and products of chemical industry (by 2,5 %). In addition, import of textile and pulp-paper products recorded certain stagnation (below-average growth). On the contrary, above-average and markedly faster growth, compared to 2002, was recorded in import of machinery, electrical equipments, equipments for video and sound recording and reproduction (by 13,7 % with increase of share in the total SR's import to 26,3 %), vehicles, vessels and transport equipments (by 30 % with increase of share to 15 %), basic metals and metal products (by 11 % with share of 9 %) and plastics and plastic products (by 25 % with growth of share to 7 %).

As a result of these export and import relations, the trade deficit in 2003, compared to 2002, decreased in mineral products to SKK 60,1 bn, machinery and electrical equipments to SKK 67 bn and in food products to SKK 12 bn. On the contrary, the deficit increased in chemical products (to SKK 37 bn), plastics (SKK 15,4 bn) and in optical equipments (SKK 13,5 bn).

Increase in trade balance surplus was recorded mainly in vehicles, vessels and transport equipments (to SKK 109,6 bn) and in basic metals and metal products (to SKK 34 bn).

As for the territorial structure of the foreign trade of Slovakia in 2003, a larger change, compared to 2002, occurred in relation to the USA. Export to this territory enormously increased by SKK 32,8 bn to SKK 42,2 bn (index 449,7). The share of Slovakia in this market thus increased from 1,4 % to 5,3 %

and the trade balance deficit of SKK 6,6 bn in 2002 changed to a surplus of SKK 26,1 bn. The share of EU market remained basically the same, however, Slovakia achieved significantly higher positive trade balance here. However, the share of CEFTA countries modestly decreased; as a result of higher increase in import than export, there was recorded a decrease in positive trade balance. A certain market enlargement for the Slovak exports in Russia, which enabled to decrease the high deficit, can be also positively evaluated. In trade with Asian countries, the import accelerated, and this deteriorated the trade balance (table 10).

Table 10
Basic territorial structure of foreign trade of the Slovak Republic

Country, country group	2002			2003		
	Share in %		Balance in bn SKK	Share in %		Balance in bn SKK
Exports	Imports	Exports		Imports		
Total	100,0	100,0	-96,0	100,0	100,0	-23,6
of which:						
USA	1,4	2,1	-6,6	5,3	1,9	+26,1
EU	60,6	50,3	+18,5	60,6	51,4	+62,3
CEFTA	28,3	23,0	+12,2	25,2	23,6	+7,6
of which:						
CR	15,2	15,2	-14,3	12,9	14,3	-14,7
CEFTA without CR	13,1	7,8	+32,1	12,3	9,3	+22,3
Russia	1,0	12,5	-87,3	1,2	10,7	-78,8
Asia	3,1	7,7	-37,9	2,9	8,5	-47,0

Source: Foreign trade of the SR, 2002, 2003; web-page of the Statistical Office of the SR, 2004.

The achieved significant export growth was affected by several factors. Above all, it was the continuing trend in recovery of world economy, which should even more intensify in 2004. This favorable outlook partially motivated foreign demand to higher standard pre-supplies in final months of 2003.

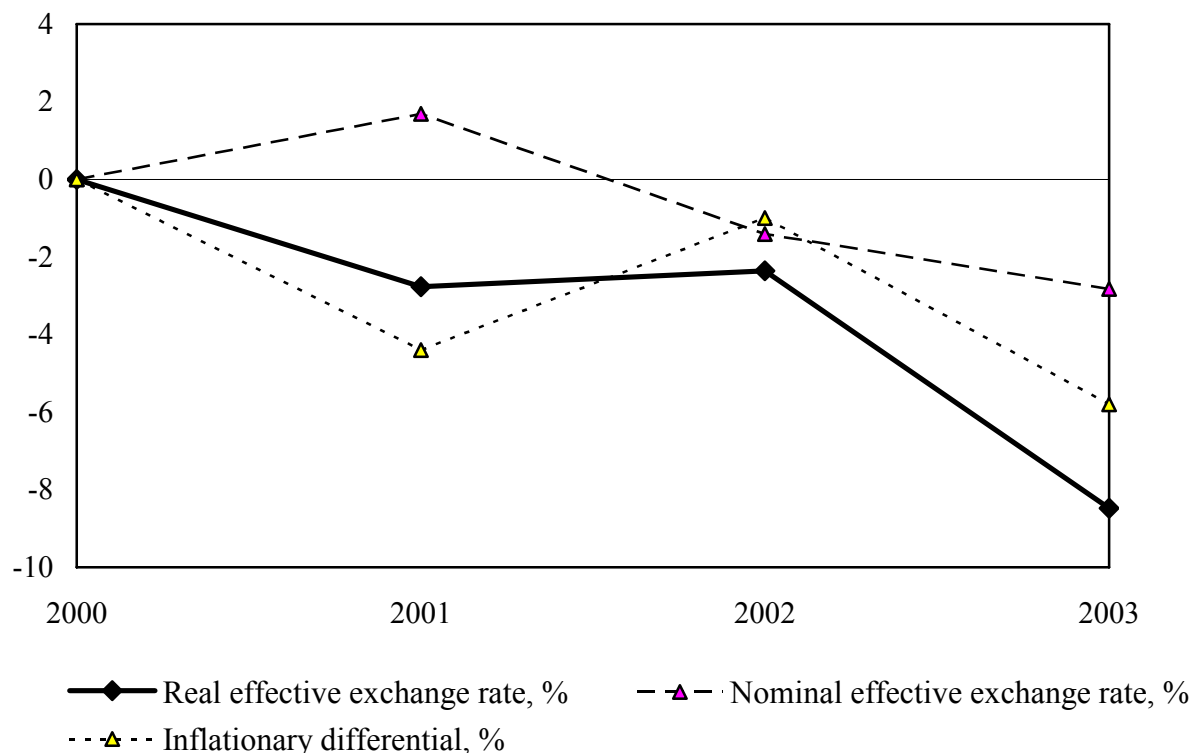
Considerable share in the significant export growth had increasing qualitative competitiveness, which was guaranteed mainly by direct foreign investors in the manufacturing. Share of the manufacturing in direct foreign investment inflows increased from 1,4 % in 2002 to 37,7 % in 2003. However, the dynamic export growth was favorably influenced also by the cost-price competitiveness

of the export sector. This is proved in particular by the index of unit labor costs according to which the nominal wages in the manufacturing rose, unlike in 2002, more slowly than the real labor productivity (from receipts).

On the contrary, the nominal (2,8 %), but also real (8,5 %) appreciation of the Slovak koruna against the euro, in which is realized as much as 70 – 80 % of the Slovak foreign trade, had a certain decelerating effect on export, mainly of small and medium-sized domestic enterprises. (Chart 10: percentage values $< 0 \rightarrow$ appreciation, $> 0 \rightarrow$ depreciation.) As for the large-sized enterprises with foreign participation where export is realized on concluded contracts, this effect was marginal.

Chart 10

Year-on-year development of nominal and real effective exchange rate of the Slovak koruna against the euro (%)



However, the koruna appreciation to a greater extent affected the import growth, on the contrary, the decrease in the overall domestic demand, which was

manifested mainly by a relatively lower import growth in technological equipments and some inputs, played a negative role here. This decrease functioned as a factor of export growth, since domestic producers had to seek for placement for a section of production on foreign markets. Despite the turbulent development on the world oil market in 2003, its price, which ranged between 25 and 26 \$/barrel, did not significantly affect the import value. On the contrary, further depreciation of the US dollar affected the decrease in import value.

Development of the foreign trade of the SR in 2004 should depend on several relevant factors. It should be positively affected mainly by very favorable prospects for world boom if sufficient reserves in capacity coverage of expected increase in domestic demand exist. It is expected appreciation of the US dollar that will raise imports paid in this currency (oil). As for the oil price, despite a great uncertainty, analysts assume a tendency toward slow decline in 2004. In the development of aggregate demand, it is not expected more significant change in so far stagnation tendency, however, a certain increase in investment demand, also with a view to tax allowance of investors, could occur. Inflow of new FDI will probably develop pressure on increase in import of components for construction and production; however, further involvement of Slovak producers in subcontracting for enterprises with FDI will have contrary effect.

Based on these facts and also with a view to increased initial level, the growth in export of goods should continue, albeit with a lower dynamism. The import of goods should slightly increase its so far dynamism. The negative trade balance could increase to a level of around SKK 30-50 bn in current prices. See the table 11.

Table 11
Outlook for foreign trade in goods for 2004

		2003	2004 ²	
			a	b
Exports of goods, bn SKK	cur. pr.	803,0	907,4	907,3
	con. pr.	622,5 ¹	703,4	703,4
Annual change, %	cur. pr.	+23,2	+13,0	+13,0
	con. pr.	+26,2 ¹	+13,0	+13,0
Imports of goods, bn SKK	cur. pr.	826,6	954,7	934,1
	con. pr.	610,7 ¹	705,4	690,0
Annual change, %	cur. pr.	+10,5	+15,5	+13,0
	con. pr.	+13,4 ¹	+15,5	+13,0
Net exports of goods, bn SKK	cur. pr.	-23,6	-47,3	-26,8
	con. pr.	+11,8	-2,0	+13,4

¹ Estimate.

² Alternative *b*, compared to alternative *a*, takes into account only the lower import growth.

7. Financial and monetary policy

7.1. Financial and budget policy

Basic orientation of the financial and monetary policy in 2003 was determined mainly by the integration aims and intensification of preparation for the accession of the Slovak Republic to the Euro area. As a part of the long-term strategy further budgetary consolidation and maintenance of planned level of budgetary deficit had contributed to it. Preliminary data on achieved results indicate that these budgetary aims were fairly fulfilled.

Although some positive results in development of the state budget and public finance in 2003 were achieved, the radical turn in solving of some problems, in particular in stabilization of revenues, was not reached yet. In spite of the overall increase in tax revenues by SKK 11,3 bn, a serious problem on the revenue side of the state budget continued to be the low fulfillment of the value added tax, in which only SKK 83,8 bn, i.e. 84,3 % of planned state budget revenues amounting SKK 99,4 bn were fulfilled, and the low fulfillment of the tax on legal entities, in which only SKK 31,9 bn, i.e. 95,5 % of budgeted sum of

SKK 33,4 bn were fulfilled, which only in these taxes led to the budget deficit of SKK 16,1 bn. Missing resources could not even be compensated by favorable results of consumption taxes. Overall non-fulfillment of the tax revenues amounted to SKK 15,4bn in total. The unfavorable development of the tax revenues led to non-fulfillment of the overall budgetary revenues, which achieved only 99,0 % of level planned in the approved state budget for 2003.

Table 12
Development of budget revenues and expenditures in 1999 – 2003¹

	Actual state (in bn SKK)					Budget 2003	Budget fulfillment 2003 in %	Index 2003 /2002 in %
	1999	2000	2001	2002	2003 ²			
Total revenues	216,7	213,5	205,4	220,4	233,1	235,4	99,0	105,8
Of which:								
A. Tax revenues	160,4	173,8	165,1	188,8	200,2	215,6	92,8	106,0
Of which:								
taxes on income, profit and capital gains	62,3	60,0	57,5	69,3	72,9	74,7	97,5	105,2
taxes on goods and services	84,1	99,0	102,0	115,6	123,3	137,2	89,8	106,7
taxes on international trade	12,5	13,1	3,9	4,0	4,1	3,7	111,1	101,7
B. Non-tax revenues	41,7	19,9	24,8	20,8	17,1	12,0	141,9	81,9
C. Grants, transfers and other revenues	.	18,4	13,7	10,7	15,8	7,8	202,5	147,7
Total expenditures	231,4	241,4	249,7	272,0	289,0	291,4	99,2	106,3
Of which:								
A. Current expenditures	182,6	203,5	213,3	237,1	250,1	253,5	98,7	105,4
B. Capital expenditures	21,0	25,4	27,5	32,4	31,1	32,5	95,6	96,0
C. Property share and loans	27,8	12,2	8,9	2,4	7,9	5,4	144,8	.
Surplus (+), deficit (-)	-14,8	-27,6	-44,4	-51,6	-56,0	-56,0	99,9	108,4
Share in GDP (in %)	1,82	3,11	4,59	5,0	4,7	.	.	.

¹ Data of the Ministry of Finance of the SR.

² Data for 2003 are preliminary till the approval of the state budget by the National Council of the SR. Expected savings of planned and unused expenditures and interests on deposits of the Government in the NBS, which represent in total SKK 16,7 bn, reflected in decrease in the deficit share in GDP to a level of 3,3%.

Current expenditures represented 87,0 % of the overall budgeted expenditures; in reality they reached 86,5 %. However, the unfavorable development of budgetary revenues in particular in education, healthcare and social security sectors supported endeavor to implement reforms in mentioned areas.

Table 13
Development of fulfillment of planned budget revenues in 1999 – 2003
(Fulfillment of state budget in %)

	1999	2000	2001	2002	2003
Total revenues	120,5	116,1	113,7	100,2	99,0
Of which:					
tax revenues	102,4	105,3	104,4	104,5	92,8

¹ Data of the Ministry of Finance of the SR and ISWE SAS.

Problematic sphere of the financial policy in 2003 continued to be the capital market, which did not fulfill its role – to ensure capital needs for the economy development and structural changes.

7.2. Monetary policy

Objectives of the monetary policy in 2003 embodied in the monetary program of the NBS were determined mainly by the strategy adopted for the final stage of integration process and ensuring conditions for accession of the SR to the European monetary union.

At the same time, it was expected that, in contrast to 2002, there would be further stabilization of results of the public finance, optimization of development of the fiscal deficit and in particular improvement of results of the external economic relations. This along with a drop in interest rates had to create conditions for an increase in investment activity.

The monetary program was based on intensification of the reform process, completion of the price deregulation, though, connected with an increase in overall inflation, but without more significant increase in core inflation. Under these conditions the exchange rate development of the Slovak koruna had to meet the basic requirement – to ensure balanced economic growth and optimal currency appreciation with maintenance of competitiveness of the Slovak economy.

Preliminary results of fulfillment of the monetary program of the NBS in 2003 indicate that the development of key monetary indicators basically met the strategic monetary goals. It is proved by the fact that the inflation development kept within the target corridor when in anticipated overall year-end inflation rate in the interval of 7,7 – 9,7 % (i.e. having the average annual rate of inflation of 8,2 – 9,3 % and core inflation of 2,7 – 5,0 %) the actual average annual rate of inflation achieved 8,5 % with share of core inflation of 1,99 percentage points. In development of the balance of payments, there was achieved a significant stabilization which also favorably influenced development of the exchange rate during the year.

Positive results were achieved in development of values of indicative monetary aggregates. Basic interest rates of the NBS during 2003 decreased from 6,5 % to 6,0 %. Money supply M2 increased by 5,2 % in 2003 (in 2002 it increased by 5 %). Increase in volume of the overall loans and also of loans provided to enterprises and households in 2003 was somewhat faster than in the previous year.

Table 14
Average annual dynamism of growth in money supply M2
(in current exchange rate) in %¹

	1999	2000	2001	2002	2003
Money supply (M ₂)	9,1	14,0	11,9	7,7	5,5
Currency outside banks (M ₀)	0,1	16,0	19,1	14,1	9,7
Demand deposits	-10,1	10,2	24,0	12,0	17,0
Time deposits	13,2	14,5	6,1	3,9	5,2
Of which: households	14,2	9,7	1,7	1,1	-2,5
Foreign currency deposits	34,1	15,5	13,9	10,7	-11,4
Of which: households	25,8	1,9	14,6	11,6	-12,9

¹ According to data of the NBS.

During last five years the structure of money supply recorded gradual changes especially as a result of changing preferences in decision-making of economic entities. Changes in the time deposits of households (their decrease)

are caused mainly by changes in interest rates on deposits, while the deposits of enterprises (including insurance companies) have an increasing tendency. Favorable development of the Slovak koruna exchange rate, characterized since 2002 by increase in its value against the US dollar, is manifested in decrease of households' interest in deposits in foreign currency supported by the fact that these deposits yield low interests.

T a b l e 15

Development of deposits (in bn SKK) and average interest rate on deposits (in %) in 1999 – 2003¹

	1999	2000	2001	2002	2003	Index 2003/2002
Deposits in SKK	421,7	505,6	554,7	649,7	714,1	109,9
Of which: households	286,7	304,8	324,7	323,5	323,1	99,9
Foreign currency deposits (converted into SKK)	80,2	99,2	110,8	118,4	97,1	82,0
Deposits in total	504,8	604,9	665,6	767,6	811,2	105,7
<i>Interests on deposits in total</i>	10,5	7,2	5,2	4,6	3,3	.
Of which: demand deposits	3,8	3,5	2,6	3,7	1,6	.
time deposits	12,8	8,5	6,2	5,6	4,6	.

¹ According to data of the NBS (preliminary).

Policy of low interest rates favorably affected the investment activity also in 2003. However, the drop in interest rates on deposits with the current inflation rate (and especially with its forecasted increase in 2004) leads to decrease in households' interest in deposits of their savings in financial institutions.

In the banking sector the process of its consolidation continued. During the course of the consolidation their performance further stabilized and their profits increased. However, desired increase in extension and enlargement of differentiation of banking services was connected also with groundless rise in their prices, mainly by increase in bank fees for settlement and accounts' administration in banks.

Development of the external economic relations and results of the balance of payments in 2003 was reflected in position of the Slovak currency

that appreciated against all major world currencies including the euro, which is for Slovakia the most important currency. In the monetary policy, this raises a question how to maintain further development of the exchange rate in terms of maintaining the competitiveness of the Slovak economy at the level corresponding to its overall economic development.

8. Gross domestic product development in 2003 and outlook for its change in 2004

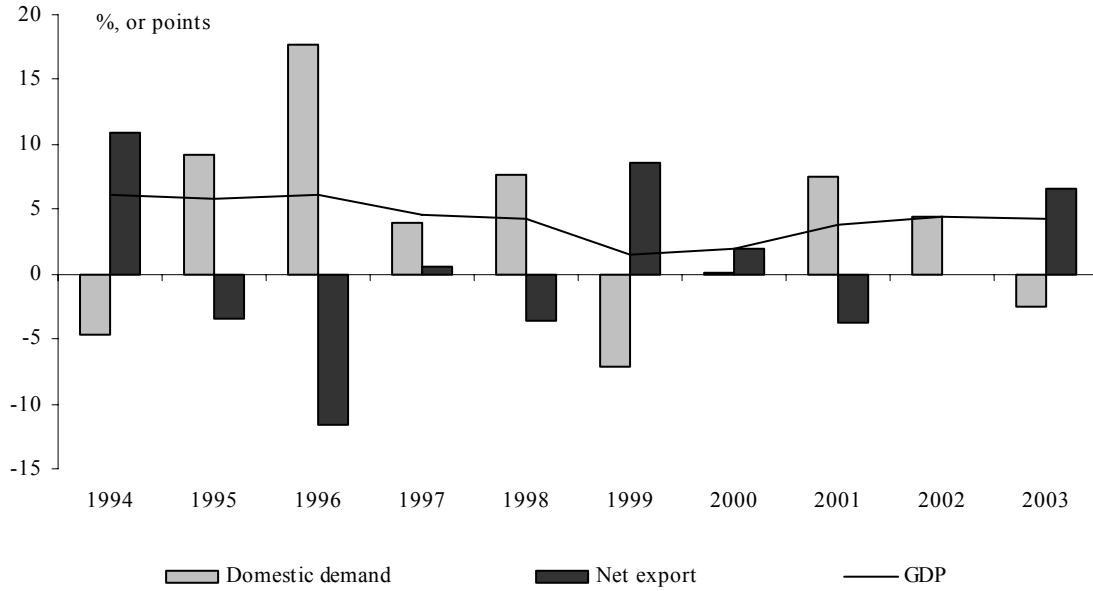
8.1. Recent development of demand side of the economy

Before prediction of the Slovak economy's performance development in 2004, it is useful to complete the previous analytical explorations with a view of the relationship between changes in GDP and demand components. On this purpose, the chart 11 serves.

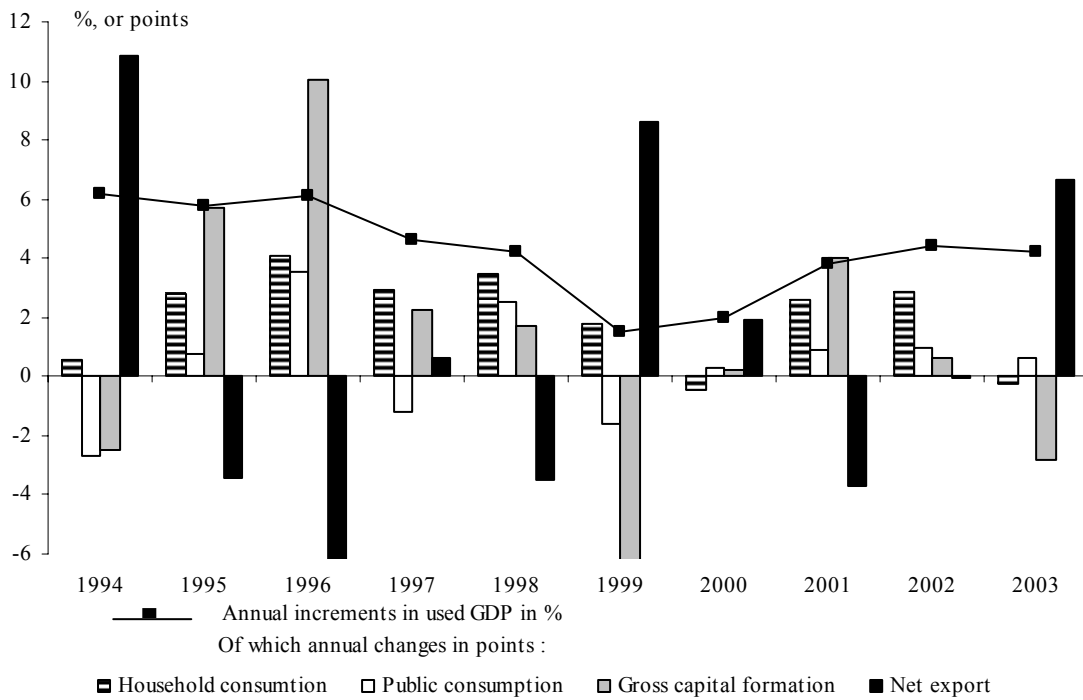
From the viewpoint of segmentation of the final demand into domestic and external demand represented by net export (see part (a) of the chart 11), the structure of increments of used GDP in 2003 is very similar to that presented in the chart for the years 1994 and 1999. In all these years, the economic policy reduced the domestic demand. This showed (also in 2003) in considerable lagging in the pace of import growth behind the pace of export growth. In these cases (i.e. in 1994 and 1999 like in 2003), the GDP growth was raised only by net export expansion, which compensated also certain reduction in domestic demand.

Chart 11
Effect of demand components on GDP changes in constant prices

a. Effect of domestic demand and net export



b. Effect of net export and components of domestic demand



Similarity of relation between the GDP development and final demand in 1994, 1999 and 2003 also shows in decomposition of the domestic demand into the household demand, demand of public sector and investment demand (see part (b) of the chart 11). In 1994 and 1999 only the household consumption contributed to the GDP growth; in 2003, only the public consumption had slightly positive impact on the GDP growth.

Focus of the government policy on completion of reforms directed also at stability strengthening will continue after 2003. It can be expected that the economic policy will have restrictive impacts also in 2004. Therefore, the household and public consumption will contribute to the GDP growth only to a limited extent. As a result of stimuli from expected takeoff of economic recovery also in EU countries, likely increase in FDI inflow to the SR and of advised increase in government expenditure on transport infrastructure as well, the growth in investment demand (gross capital formation) could be expected in 2004. Overall influence of the domestic demand on GDP growth will thus be probably positive in 2004 (unlike 2003).

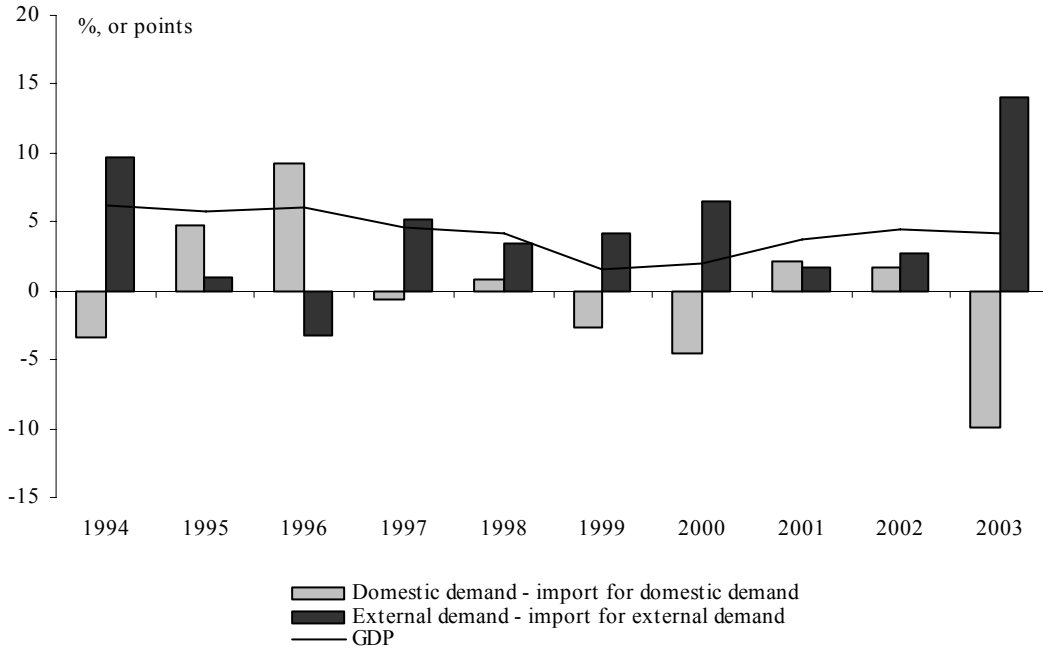
Disadvantage of the standard method of examination of effects of individual demand components on GDP development is its identification of effect of external demand with net export, which indicates effect of result of international exchange of goods and services.

In this approach the effect of external demand on GDP increment is underestimated owing to the fact that a whole volume of import reduces export, which has to express extent of the external demand, in it. Thus, in the external demand, there are not counted in also those components of import which relate to individual items of domestic demand and without which household consumption, public consumption and gross capital formation could not exist in their identified extent. From the viewpoint of the mentioned relation between import and all demand components, we adjust the view of development of used GDP in chart 12.

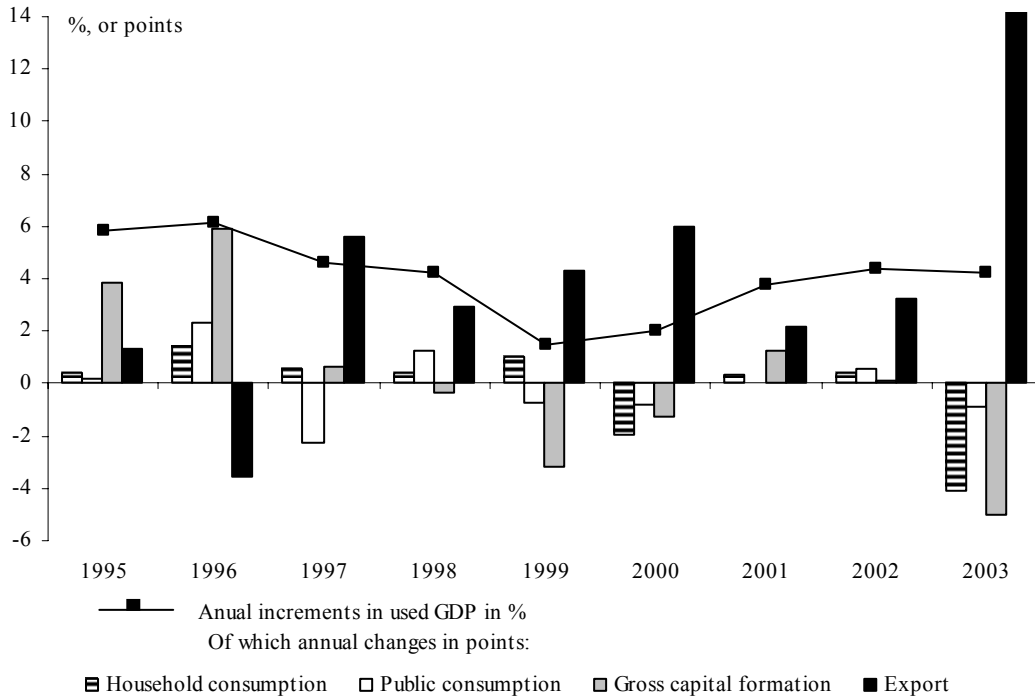
Chart 12

Effect of demand components reduced by them raised import on GDP changes in constant prices¹

a. Effect of domestic demand and export



b. Effect of export and components of domestic demand



¹ Import related to individual components of GDP use is estimated on the basis of commodity-sector tables of supplies and use.

Impact of the aggregate domestic demand and its components on annual GDP changes, which is represented by bars of chart 12, expresses only that part of their contributions to annual GDP change created in domestic production. Here, the impact of the export represents a summation of values of production exported as an equivalent to imports covering part of domestic demand and of net export. Thus, the chart 12 shows the result of relation among foreign trade, production and demand side of the economy about which informs table 16.

Last line in part (a) of the table 16 expresses the relative import intensity of domestic demand. As a result of increase in its values, the share of domestic production in material coverage of domestic demand during the examined period constantly decreased. Values of the total export index, but also values of the export index reduced by its import intensity confirm increasing export intensity of economic growth in the SR. In 2003, these trends were notably intensive.

8.2. Demand development and economic growth expected in 2004

Domestic demand – possibilities for its development in 2004

Development of the final household consumption (their demand) has resulted from the process of formation and use of their incomes. Its course in the previous years and prediction for 2004 shows table 17.

In consequence of alternation of political cycles, a sharp turn of development of the final household consumption and its components occurred in 2003. Real household consumption in 2003 (for the first time since 2002 and for the second time during the independent existence of the SR) reduced mainly as a result of the decrease in real wages and decline in interest rate on savings. Negative effect of these factors on the household consumption was to a large extent compensated by the common action of growth in gross mixed income, decrease in real expenditure of households and reduction of their savings.

Table 16

Development of resources and change in their structure necessary for ensuring domestic and external demand

a. Domestic demand

		1994	1995	1996	1997	1998	1999	2000	2001	2002	2003 ^o
Indexes (1993 = 100)	Total	95,5	105,0	124,2	128,7	138,0	129,3	129,4	139,1	145,1	139,5
	From domestic production	94,9	102,5	118,2	117,1	118,5	113,3	104,4	108,8	112,5	92,9
	From import	96,6	109,5	134,9	149,7	173,2	158,1	174,5	193,8	203,9	223,6
Shares in %	Total	100,0	100,0	100,0	100,0	100,0	100,0	100,0	100,0	100,0	100,0 ¹
	From domestic production	63,9	62,8	61,3	58,5	55,3	56,4	51,9	50,3	49,9	42,9 ¹
	From import	36,1	37,2	38,7	41,5	44,7	43,6	48,1	49,7	50,1	57,1 ¹

b. Exports

		1994	1995	1996	1997	1998	1999	2000	2001	2002	2003 ^o
Indexes (1993 = 100)	Total	114,7	120,0	118,6	139,5	157,4	165,3	187,9	199,7	210,6	251,7
	From domestic production	129,2	132,6	121,5	140,7	153,8	170,1	196,4	203,1	214,5	269,7
	From import	92,9	100,9	114,2	137,8	162,5	158,1	175,2	194,5	204,7	224,5
Shares in %	Total	100,0	100,0	100,0	100,0	100,0	100,0	100,0	100,0	100,0	100,0 ¹
	From domestic production	67,6	66,5	61,6	60,6	58,8	61,9	62,9	61,2	61,3	64,5 ¹
	From import	32,4	33,5	38,4	39,4	41,2	38,1	37,1	38,8	38,7	36,5 ¹

^o Estimate.

¹ 1Q – 3 Q.

Table 17
Effect of factors forming final household consumption on its annual percentage changes in points¹ (in constant prices)

	On increments in household consumption in current prices				On increments in household consumption in constant prices			
	2001	2002	2003 ²	2004 ^P	2001	2002	2003 ²	2004 ^P
Current income in total	12,1	11,3	9,0	12,2	3,6	7,7	-4,2	1,3
Of which:								
Compensation of employees	7,2	6,3	4,3	6,3	2,8	4,5	-3,5	0,7
Gross mixed income	4,9	3,0	3,3	3,7	2,7	2,0	3,0	0,8
Property income								
- revenues	-1,6	-0,1	-0,6	0,2	-1,9	-0,3	-4,0	-0,1
Social benefits	1,1	1,7	1,6	1,6	-0,2	1,2	0,3	-0,1
Other current transfers								
- revenues	0,5	0,4	0,4	0,4	0,2	0,3	0,0	0,0
Current expenditure in total ³	-3,7	-2,3	-2,2	-2,0	-1,6	-1,4	1,7	0,8
Of which:								
Current taxes	-0,6	-0,4	-0,5	0,7	-0,2	-0,2	0,2	1,2
Social contributions	-2,3	-1,5	-1,7	-2,3	-1,0	-0,9	0,1	-0,4
Other current expenditures	-0,8	-0,4	0,0	-0,4	-0,4	-0,3	1,4	0,0
Gross disposable income	8,4	9,0	6,8	10,2	2,0	6,3	-2,5	2,1
Of which:								
Gross household savings ⁴	1,3	-1,1	0,3	-0,1	2,0	-0,9	2,5	0,2
Final household consumption	9,7	7,9	7,1	10,1	4,0	5,4	0,0	2,3

¹ Own calculations according to data of the Statistical Office of the SR.

² 1Q-3Q.

³ Positive values of expenditure are caused by year-on-year reduction of their volume. They express their positive effect on gross disposable income and thus also on final household consumption.

⁴ Positive values of effect of changes in gross savings on increments in household consumption occur when year-on-year gross savings decrease. Growth in gross household savings reduces increments in their final consumption.

⁵ Prediction.

In connection with the completion of price deregulation, a relatively high rate of inflation is expected also in 2004. However, a pace of increase in nominal wages will slightly exceed inflation, and thus also a certain increase in real wages will be ensured. Considering difficulties of predictability of impacts of tax and contribution reforms on tradesmen and small businessmen, it is counted with a lower growth rate in gross mixed income than in the previous years. Moderate growth in overall real household incomes along with expected decline in expenditure related to the tax reform should cause that the real household consumption in 2004 will again increase and contribute to real GDP growth.

Development of the final public consumption is determined mainly by the development of current expenditure of state budget. Weight of this assumption is verified and used for prediction of public consumption development in 2004 in table 18.

Table 18

	1999	2000	2001	2002	2003	2004
Current expenditure of state budget deflated ¹ = A	134,3	136,5	137,1	147,0	145,6	146,8 ²
Public consumption in constant prices = B	137,3	139,5	145,9	152,8	157,2	161,5 ^P
B : A	1,02	1,02	1,06	1,04	1,08	1,10

¹ Current expenditure of the state budget deflated by expenditure on debt service. Adjusted by deflator of final public consumption, 1995 = 100. The value of deflator for 2004 is estimate according to the inflation rate expected by the NBS and ratio of deflator of public consumption to household consumption in 2003.

² According to the state budget for 2004.

^P Prognosis.

Prognosis of the final public consumption takes into account the trend of slightly increasing effect, which off-state budget resources have on its creation. According to used assumptions, the increase in public consumption in 2004, compared to 2003, in constant prices by SKK 4,3 bn. or by 2,7 %, can be expected.

Prediction of the gross fixed capital formation for 2004 expects an increase in its volume because of several factors. One of them is the impact of improvement of conjunctural situation and with it related import growth in main areas of export activities of the SR. The growth of gross fixed capital formation will strengthen the inflow of foreign direct investment to the production (non-banking) segment of the economy and increase in volume of investment to the transport infrastructure. From the standpoint of the sectoral structure, the annual increase in gross fixed capital formation in non-financial corporations by 7,7 % and in households by 2,5 % is expected in 2004. In the sector of financial

corporations and public administration, it is expected that the real gross fixed capital formation in 2004 will remain at the level of 2003. According to these assumptions, the gross fixed capital formation in the national economy in 2004 will increase by 5 %, year-on-year.

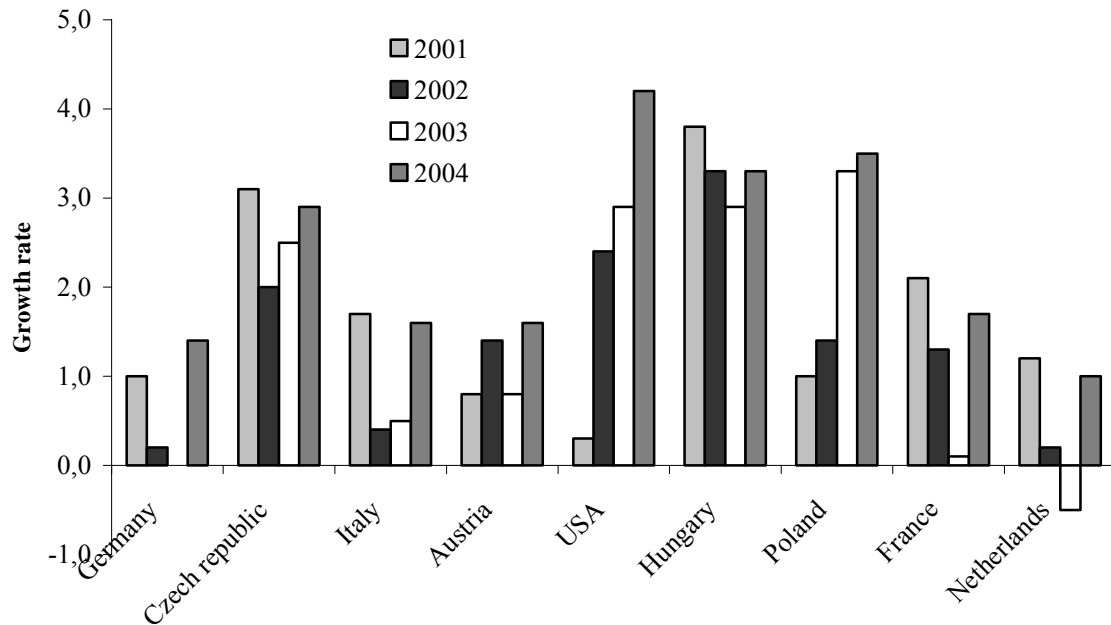
External demand – preconditions of its development and impact on GDP growth in 2004

Development of the external environment should create better conditions for export of goods and services in comparison with the previous year. The economic recovery in the biggest world economies induced above all by combination of expansive fiscal and monetary policy seems to be at present sustainable. There was a partial détente, which largely negatively affected the development in 2003. According to available prognoses (IMF, HWWA, OECD), we expect overall acceleration of economic growth in OECD countries, which represent major trade partners of the SR (see chart 13). Real growth in these countries should accelerate by 1 p. p. to 2,3 %, year-on-year.⁹

In terms of effects of the external environment on the economic development of the SR, the development of Slovak koruna exchange rate is an important factor. On the basis of so far positive development of the foreign trade and inflow of foreign direct investments, we expect slight appreciation of the Slovak koruna against the reference euro. The appreciation of the Slovak koruna against the reference currency can be affected by the unstable political environment and policy of the central bank. Development of the US dollar exchange rate against the Slovak koruna will depend above all on development on foreign exchange markets, overall economic development in the USA and on their economic policy.

⁹ We took into account countries, which share in the Slovak export in 2003 represented 79,8 %. Of which Germany 30,8 %, Czech republic 12,9 % Italy 7,5 %, Austria 7,4 %, USA 5,3 %, Hungary 4,8 %, France 3,5 %, Netherlands 2,7 %.

Chart 13
Changes in economic growth rates



Resource: OECD.

In terms of effect of the external environment on the domestic price level, we expect increase in price level mainly in the second half of 2004 as a consequence of the adoption of the common agricultural policy of the EU. Prices of non-agricultural commodities should not more significantly contribute to increase in the domestic price level.¹⁰

Dynamism of export and import will slow down in 2004. Year-on-year rate of export of goods and services should decrease from 22,6 % achieved in 2003 to 10,5 %. In case of import, it should decrease from 13,8 % to 9,0 %.

¹⁰ According to available prognoses, the price of BRENT oil in 2004 should range between \$ 28 and \$ 30.

***Overall outlook for economic performance development
of the Slovak Republic in 2004***

Predictions of the development of individual demand components in 2004, summarized in table 19, give us a view on GDP changes which can be expected in the SR in this year.

Table 19
Prognosis of GDP development and structure of its use in 2004¹

	In bn SKK		Indexes (previous year = 100)		Share in GDP use in %	
	2003	2004 ^p	2003	2004 ^p	2003	2004 ^p
Household consumption ²	409,5	418,9	99,6	102,3	52,5	51,4
Public consumption	157,2	161,5	102,9	102,8	20,2	19,8
Gross capital formation ³	191,9	201,5	90,3	105,0	24,6	24,7
Domestic demand	758,6	781,9	97,7	103,1	97,3	95,9
Export of goods and services	723,4	799,4	122,6	110,5	.	.
Import of goods and services	702,7	765,9	113,8	109,0	.	.
Net export of goods and services	20,7	33,5	.	.	2,7	4,1
Gross domestic product	779,3	815,4	104,2	104,6	100,0	100,0
Final consumption	566,7	580,4	100,5	102,4	72,7	71,2
Gross savings	212,6	235,0	114,9	110,5	27,3	28,8

¹ In constant prices.

² Including consumption of non-profit organizations serving to household.

³ On the assumption that the state of stocks changes proportionally to the gross fixed capital formation.

⁴ Without statistical difference between produced and used GDP.

^p Prognosis.

Change in relation of individual items of expenditure structure of GDP to its development that occurs in 2004 (according to the prognosis in table 19) can be interpreted in two ways.

The first consists in statement that all demand components will contribute to modest acceleration of economic growth rate in 2004. This simultaneously (on the second level of interpretation of considered change) means that in 2004 the GDP increment will be utilized to the benefit of increase in all components of the final consumption and gross savings.

Changes, which can be expected in 2004 in the structure of GDP use, are relatively small, but they lead to several extreme values. According to the assumptions of our prognosis, not only the share of overall final consumption, but also shares of its main components, i.e. shares of household consumption and public consumption in GDP in 2004 will be the lowest in all so far history of economic development of independent Slovakia. Share of gross capital formation in GDP decreased to low level already in 2003 and in 2004 it continues at this level.¹¹

Significant change in the structure of GDP use in 2004 could be an increasing excess of the share of gross savings over the share of gross capital formation.

Cumulative effects of the implemented restrictive macroeconomic policies manifest in the GDP use trend, which started to advance in 2003 and which will probably continue also in 2004. It is likely that not only the fiscal policy striving for decrease in deficit of the public finance, but also the monetary policy contribute to insufficient utilization of gross savings to the benefit of the gross capital formation.

Information on development of the Slovak economy performance, which we expect in 2004, is completed in table 20 with data on share of individual components of GDP use in its overall increment.

The real shares of individual demand components in demand determination of annual GDP increment as well as the share of individual ways of use of GDP are expressed by data of variant A. From its view, in 2004, the share of domestic demand will again exceed the import share in the structure of increment in used GDP. Data of variant B have analytical meaning: they show to which extent the growth of domestic GDP use will depend on the growth of export performance of the Slovak economy.

¹¹ Share of gross capital formation in GDP ranged in 1993 – 1995 between 20,6 % and 24,8 %, in 1996 – 1998 between 32,9 % and 33,9 % and in 1999 – 2002 between 26,1 % and 29,0 %.

Table 20
Share of demand components in percentage GDP increment in points¹

	Variant A ²			Variant B ³		
	2002	2003	2004 ^p	2002	2003	2004 ^p
Household consumption	2,8	-0,2	1,2	0,5	-4,0	-1,4
Public consumption	1,0	0,6	0,6	0,6	-0,9	-0,5
Gross capital formation	0,6	-2,9	1,2	0,1	-5,0	-0,2
Domestic demand	4,4	-2,5	3,0	1,2	-9,9	-2,1
Export of goods and services	.	18,5	9,7	3,2	14,1	6,7
Import of goods and services	.	-11,8	-8,1	.	.	.
Net export of goods and services	0,0	6,7	1,6	.	.	.
Gross domestic product	4,4	4,2	4,6	4,4	4,2	4,6

¹ In constant prices. See notes to the table 19.

² See notes to the chart 11.

³ See notes to the chart 12.

9. Overview of selected legislative and economic-political measures

The ruling coalition focused in 2003 on fulfillment of two basic goals: completion of preparation for EU membership and preparation of several important reforms.

Process of legislation approximation to the EU in the parliament came to a close end. Approval of the Treaty of Accession to the European Union can be considered its symbolic completion. Issues related to participation of Slovakia in decision-making on common issues in the EU (approved Act on election to the European Parliament, position of the parliament on draft of the Constitution of the European Union, etc.) had gradually gotten to the fore. In the government, on the contrary, the adoption of approximation regulations as well as preparation of several program documents, in particular in relation to drawing the EU support funds, continued in 2003. Joint Strategy of the Government and National Bank of Slovakia for adoption of the euro in the SR was also adopted.

Implementation of reforms, which should enhance market principles in the economy, stop debt growth in the public sector, activate economic entities

and emphasize responsibility of individuals, became a pillar of legislative and economic-political activity of the government in 2003.

The most extensive economic-political measures, which were approved in 2003, are undoubtedly changes in the tax system. As from 1 January 2004 a new unified tax of 19 % on personal and corporate incomes was introduced. Non-taxable base of a taxpayer was increased to 19,2 multiple of subsistence minimum level. At the same time, a unified 19 % VAT rate was set. Consumption taxes on tobacco, tobacco products and mineral oils increased at the beginning of the year and for the second time since August 2003. To this date also a consumption tax on beer was increased. Starting January 2003 as well as 2004, energy prices especially for households were radically increased.

Important package of reform measures is related to pension reform, which should enable to transform the existing system into a gradual link between the contribution amount and contribution period to the system on the one hand, and the amount of pension on the other hand. The Act on social insurance that was adopted first, reforms the existing pension system, which in the reformed system will form the so-called first pillar. The Act regulates a gradual increase of the retirement age, introduces option of earlier retirement with corresponding reduction in the amount of old-age pension and radical changes in the mechanism of pension calculation. The Act on old-age pension saving (effective as from 2005), which links to the previous act, defines the so-called second pillar of the pension system based on capitalization of savings in individual accounts at pension funds. The third regulation – draft of the Act on supplementary pension saving (the so-called third pillar of the pension system) is in approval procedure.

Reform steps started to implement in the healthcare system. The Act on medical care, which, starting 1 June 2003, introduced several flat fees for services in the healthcare system can be regarded as a first step. Its basic goal was to reduce excessive consumption of drugs, medical services and devices, change the process of drug categorization, but in particular to stop continual increase in

debt of the healthcare system. As from 1 July 2003 the price of capitation and point in the healthcare system were changed by the price regulation. Other acts embodying reform changes in the healthcare system are prepared.

The Act on financing of elementary and secondary schools and school facilities set norm regarding pupil which should ensure better and more transparent use of means, support competition between school operators, and increase effectiveness of the regional education system.

In order to support business several positive changes were undertaken in 2003. In this respect, as important it can be marked the extensive amendment to the Labor Code, which enhanced the flexibility of labor market by regulating only its basic framework; specification of employment relations is realized at the enterprise level depending on conditions of employer, region and particular sector. There were implemented also measures improving functioning of the business register and contributing to reduction of barriers to business. The overall reduction of tax and partially also of contribution burden of employers (reduction unemployment contribution of employer) starting 2004 has a great importance. The reform of public administration and process of decentralization of state administration, which in our view creates necessary conditions for particular solving of problems of enterprise entities in given region and their cooperation, has continued.

The amendment to the Act on conditions of transfer of state property to other entities abolished the provision according to which the state must retain 51% share in strategic enterprises. The amendment enables to complete the privatization process in these enterprises. Preparations of privatization of the waterworks Vodárne a Kanalizácie as well as of the Slovenské elektrárne has continued in 2003.

In order to decrease the unemployment and increase effectiveness of the social system several changes in the area of *social policy* were made. The government endeavors to solve the problem through reinforcement of individual motivation to

seek and maintain employment, more effective providing of services in the area of labor market and social affairs and through reduction of possibilities to misuse the social system. In this spirit the conditions for remaining the unemployed in register of labor office, granting unemployment benefit and social assistance benefits for persons in material need were considerably tightened. Tools of the active labor market policy are modified by the *Act on employment services*, which replaced the Act on employment. The Act does not envisage the institute – socially beneficial work; the benefit contribution for job creation at the employer can be granted only in relation to disadvantaged job seeker. Moving benefit and activation benefit is being introduced. Differentiated obligation of job seekers to visit the labor office is being applied. This Act transferred financing of the active labor market policy from the National Labor Office to the state budget; direct responsibility for execution of the employment policy was transferred to the Ministry of Labor, Social Affairs and Family; unemployment insurance (collection of contributions and benefit payments), under the Act on social insurance, was transferred to the Social Insurance Agency. The Act creates room enabling also private agencies to engage, besides the bodies of state administration, in providing employment services.

On 1 January 2004 came into force the Act on assistance in material need. The new Act does not distinguish between material need for subjective reasons and material need for objective reasons. The basic social assistance benefit is set at the amount of SKK 1 450 for a childless person, SKK 4 210 for a couple with more than 4 children. In addition, the person in material need can receive an *activation benefit* in the amount of SKK 1 000 (increase of qualification, participation in smaller municipal services or voluntary work), *protection benefit* in the amount of SKK 1 000 (pensioners, disabled persons, care for disabled child or seriously disabled person, etc.) *housing benefit* for a single person and family in the amount of SKK 780 and SKK 1 330 respectively, *benefit for medical care* in the amount of SKK 50 and *unrepeated benefit in material need*.

Starting 2004, child allowances were set for all dependent children at monthly amount of SKK 500 (allowance to child allowances was abolished). The new tax system enables taxpayer to deduct SKK 4 800 from the annual tax for each child (so-called tax bonus). The Act on subsistence minimum level set fixed sums for the purpose of state social benefits, namely, in the amount of SKK 4 210 for persons of age, SKK 2 940 for other commonly assessed person and SKK 1 910 for a child under age.

Effective from 1 October 2003, a minimum monthly wage increased to SKK 6080. Starting 1 July 2003, pensions increased by 6 % (maximum amount of pension was adjusted to SKK 9 219). Starting February 2004, it was increased by further 4 %. Relations in the area of sick leave insurance also radically changed. Employee is entitled to the sick leave benefit only as of the 11th day of temporary incapacity for work. The income compensation in the situation of employee's temporary incapacity for work is transferred to the employer.

In conclusion, it can be stated that in 2003 the government embarked on a wide spectrum of measures and changes which basic goal is in particular the recovery of the public finance. For a long time, there have been calls for these reforms and they undoubtedly are of great importance for healthy functioning of the economy. Accumulation of their several adverse effects on the living standard (especially increase in prices with reduction of social transfers) into a short period of time has caused that majority of population do not endorse the reforms and perceive them negatively. Among others, for reasons that the need for explanation of their necessity and preparation of the population for planned changes was underestimated.

ECONOMIC DEVELOPMENT OF SLOVAKIA IN 2003

(Study Prepared on Behalf of the United Nations Economic
Commission for Europe)

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