

**INSTITUTE OF SLOVAK AND WORLD ECONOMY
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ECONOMIC DEVELOPMENT OF SLOVAKIA IN 2001

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

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1. An Overall Evaluation of the Economy Development

The revival of the economy growth in the year 2001 reached the level of solid expectations because of two factors. Firstly, it was the recession in the world economy, which started in the autumn of 2001 and retarded the growth in the Slovakia's exports. Secondly, but not less important factor was the incomplete institutional a structural reform required for the Slovak economy to obtain a better position in the sharp competition during the world recession period.

Nevertheless, the uncompleted transformation should not hide the results, which were accomplished in Slovakia during the year 2001 owing to its preparation for the accession to the European Union. The progress of institutional and structural reform benefited from the approximation of the SR legal system in order to comply with the standards in EU countries. At the same time, it was important to set up priorities for the economic policy of the SR in a mutual document signed by the Slovak government and the European Commission. In pursuance of those priorities the revitalisation of the financial sector was almost fully completed. A progress was made in preparation of privatisation of big companies operating within energy industry and transportation sector. Under the pressure of much more rigorous budgetary limits many companies consolidated their financial situation. A certain progress was achieved regarding price deregulation. On the other side, however, the fulfilment of several transformation tasks legged behind because the ruling coalition was not able to find a consensus. In 2001 mainly the social and pension system reforms as well as the health care reform were not implemented and remained painful thus deteriorating the macroeconomic equilibrium. A serious problem is that the law enforcement reached far from the satisfactory degree and therefore debases the actual benefits from closing the chapters pulling the Slovak Republic legislation closer to the EU standards.

The key tendencies in the development of the SR economy in the year 2001 in a comparison with the previous years are presented in Table 1.

Table 1
Key Indicators of the SR Economy Development in 1993-2001

	1993	1994	1995	1996	1997	1998	1999	2000	2001
GDP index ¹ 1989=100	79,4	83,3	88,9	94,4	100,3	104,4	106,3	108,6	112,2
previous year = 100	96,3	104,9	106,7	106,2	106,2	104,1	101,9	102,2	103,3
Industrial production index ² 1989 = 100	62,5	66,8	72,3	74,1	75,3	77,9	75,6	82,6	86,5
Employment index ³ previous year = 100	99,2	98,1	101,7	103,6	99,1	99,7	97,0	98,6	101,0
Unemployment rate in % ³	12,7	13,7	13,1	11,3	11,8	12,5	16,2	18,6	19,2
Annual change in real wages in %	-3,9	3,2	4,0	7,1	6,6	2,7	-3,1	-4,9	0,8
Current account / GDP in % ⁴	-4,4	4,6	3,6	-10,6	-6,6	-9,7	-5,0	-3,7	-8,8
Inflation rate in % ⁵	23,2	13,4	9,9	5,8	6,1	6,7	10,5	12,0	7,3
Of it: the rate of core inflation	.	.	.	.	.	6,1	6,0	5,7	4,3
Total balance of the state budget / GDP in %	-6,2	-5,2	-1,5	-4,2	-5,4	-2,6	-1,8	-3,1	-4,6
φ interest rate from loans in % ⁶	14,4	14,6	13,3	13,4	18,4	19,4	16,9	11,8	9,4
Cost profitability in non-financial organisations (NFO) in % ⁷	3,2	3,4	4,2	2,8	2,5	0,4	1,4	2,7	5,2
The share of profitable NFO on value added of all NFO ⁷	.	83,5	80,0	78,7	81,0	74,9	76,1	83,0	88,3 ⁸

¹ In constant prices.

² In the year 1998 the methodology of industry performance changed. Industrial production index is being calculated instead of production of goods figures.

³ According to labour force survey, in average for a period.

⁴ According to figures of the NBS in the balance of payments.

⁵ According to consumer prices, in average for a period.

⁶ From loans drawn from commercial banks in average for a period.

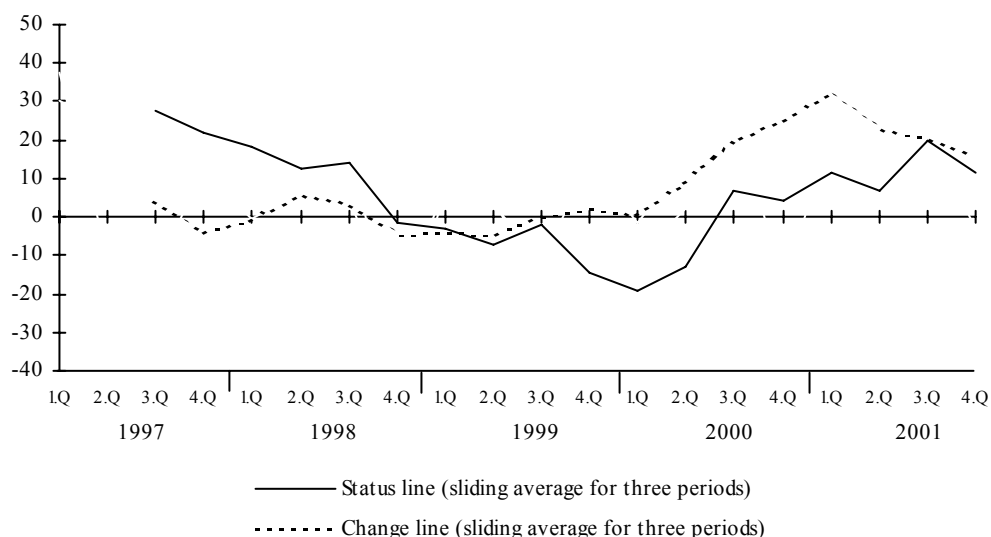
⁷ Non-financial organisations with 20 and more employees.

⁸ 1st-3rd Q.

The Table 1 shows, firstly, that the year 2001 contributed for solving the problems, which generated during the transformation as a legacy from the centrally planned economy, but no positive turnover of the unfavourable development in the social situation of people was made. Secondly, the figures also indicate, that the world recession influenced (see the information on the high negative value of ratio between the current account balance and GDP) also Slovakia, but yet did not hit (in 2001) all sides and processes of the Slovak economy. Thirdly, the sustained fairly good trends in the performance on both macro and micro levels indicate that after the transformation shock recovery certain structural changes supporting its competitiveness have been running in the SR economy.

Chart 1 presents an overview on the SR economic development in the course of years of 1997-2001 based upon summarised values of partial indicators.¹

Chart 1
Overall Tendency in the Economy Development



As we can see in the chart 1 the line of change is usually preceding the change in the status line. The overall line of equilibrium and of the growth reached the lowest level in 1st Q 2000, it means one year after the period when the change line started to go up. A drop of the change line, which is recorded in the chart 1 (likely also associated with the world economy recession) starting from 2nd Q 2001, will show up not later than in 4th Q in the year 2002 as a decline in the line mapping the overall growth and the equilibrium status in the Slovak economy. Presumably in the first two or three Q of the year 2002 such development trends will further continue.

¹ Trend in the overall economy development is examined by quarters of the year based on summarised values of these indicators: y/y GDP growth rate in %, unemployment rate in %, y/y inflation rate in %, current account balance ratio to GDP in %, the share of final consumption of the government from GDP in % and average interest rate from loans drawn from commercial banks in %. It is made in two variants. First one (status line) is derived from the level of values recorded in a respective year Q. Second one (change line) built on the change of value of indicators used for the status line. In both case the originally measured values of the indicators are expressed according to their ratio to average values recorded in the overall time progression regarding a respective indicator in +, or in - points. The line of the chart connects the average from the total points assigned in each quarter of the year and the indicator, which was used.

2. Output Development

In the year 2001 gross domestic product rose by 3,3 %, i.e. by 1,1 percentage points higher in comparison with the year 2000. This increase was especially supported by the value added growth recorded by market services and manufacturing; although a negative impact was received mainly from the drop in value added in electricity, gas and water supply (responsible for the GDP growth fall by 1,3 percentage points). More detailed information is presented in Table 2.

Table 2

GDP Development by Industries and their Contribution to the GDP Growth (based on constant prices)

	1996	1997	1998	1999	2000	2001	1996	1997	1998	1999	2000	2001
	y/y changes in %						contribution to GDP growth in p. points					
GDP	6,2	6,2	4,1	1,9	2,2	3,3	.	.	.	.	.	.
in it												
Agriculture, hunting, forestry, fishing	-3,0	5,2	-0,1	8,8	3,1	2,5	-0,2	0,3	0,0	0,4	0,2	0,1
Industry	7,5	-0,4	1,0	7,3	2,5	-0,1	2,2	-0,1	0,3	2,0	0,7	0,0
<i>manufacturing</i>	4,8	2,8	5,2	2,9	5,5	5,5	1,2	0,7	1,2	0,7	1,3	1,3
<i>electricity, gas and water supply</i>	22,2	-19,1	-28,4	45,3	-11,2	-43,1	0,9	-0,9	-1,0	1,1	-0,4	-1,3
Construction	-1,3	0,1	-5,8	-30,5	-15,0	1,4	-0,1	0,0	-0,4	-1,7	-0,6	0,0
Market services	2,3	9,7	7,5	2,5	5,1	6,5	0,9	3,7	2,9	1,0	2,1	2,7
Non-market services	19,1	16,6	-3,9	-0,6	1,5	2,8	2,2	2,2	-0,6	-0,1	0,2	0,4
Other GDP items	14,6	2,7	22,0	3,1	-3,5	1,0	1,1	0,2	1,8	0,3	-0,3	0,1

Despite the value added growth regarding the manufacturing in the 2001 reached in the annual average a similar rate of growth like in the previous year, the development by quarters of the year indicates (17,9 %, 6,5 %, 1,9 % a -3,1 %), that in this sector, being the most confronted with the development in the external environment, there was a gradual slowdown and in 4th quarter of the year 2001 we recorded a drop also in the rate of the value added growth.

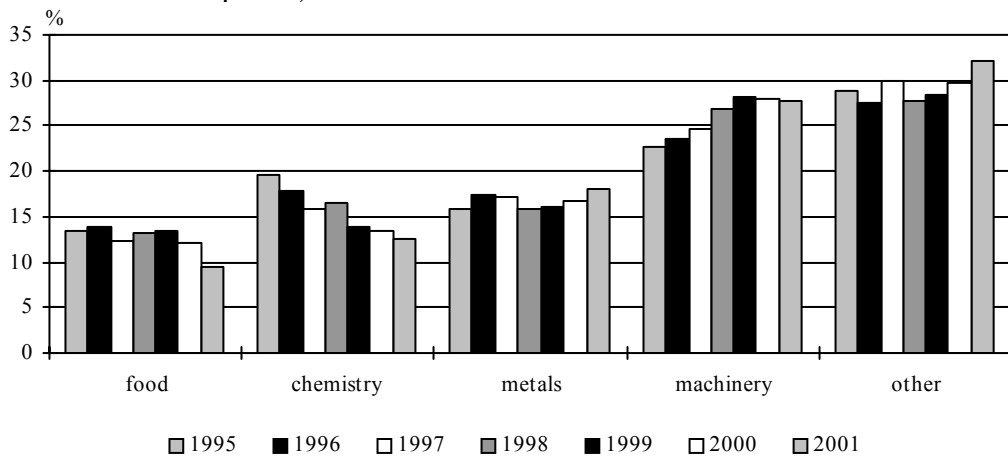
Value added (in constant prices) considering individual sectors of the manufacturing during 2001 indicated a different development. Declines were recorded in manufacture of food products (by 16,7 %) and in manufacture of chemical, petroleum and rubber products (by 0,9 %). A favourable development was made in manufacture of metals

and metal products (up by 12,7 %), in manufacture of machinery, electrical and transport equipment (increase by 4,7 %) and in other sectors of manufacturing (up by 14,1 %).

As a result of the unequal development in the value added by individual sectors of the manufacturing, the position of food and chemical industries considerably worsened regarding its structure during recent years. (See chart 2).

Chart 2

Development in Value Added Structure by Manufacturing Sectors (in %)
(based on constant prices)



Notes:

chemistry – manufacture of coke, refined petroleum products and nuclear fuel; manufacture of chemicals, chemical products and man-made fibres; manufacture of rubber and plastic products;

metals – manufacture of basic metals and fabricated metal products;

machinery – manufacture of machinery and equipment, n. e. c; manufacture of electrical and optical equipment; manufacture of transport equipment;

other – manufacture of textiles and textile products; manufacture of leather and leather products; manufacture of wood and wood products; manufacture of pulp, paper and paper products, publishing and printing; manufacture of other non-metallic mineral products, manufacturing n. e. c.

The GDP growth in the year 2001 was achieved with the same level of value added rate² (36,7 %) like in the year 2000. The value added rate development positively influenced VA growth in the services sector from 48,6 % up to 49,1 % and in agriculture from 43,5 % up to 44,4 %; a decline was recorded in the industry from 24,6 % down to 23,8 % and in the construction from 35,5 % down to 34,4%.

In the manufacturing the rate of value added in the year 2001 to compare the year 2000 slightly dropped (from 25,2 % down to 24,8 %). However, the figures

² Based on current prices.

presented in Table 3 indicate that the group of industries with a low rate of value added (less than 20 %) condensed less than only ¼ of the manufacturing gross output and 28 % of its exports.

Table 3
Value Added (VA) Rate Development in Manufacturing

	VA rate in %		Share on gross output in %		Share on exports in %	
	2000	2001	2000	2001	2000	2001
Manufacturing in total	25,2	24,8	100,0	100,0	100,0	100,0
in it sectors with						
VA rate more than 30 %	31,9	32,1	25,6	25,9	27,3	28,2
VA rate of 20-30 %	27,1	26,1	48,4	50,1	43,0	44,7
VA rate less than 20 %	14,9	14,4	25,9	24,1	29,6	27,0

The growth in *industrial production*³ in the year 2001 slowed down to 4,6 % (in the year 2000 the increase reached 9,2 %, in the year 1999 a decline by 2,4 %); during 2001 the growth rate in the industry fell down (approx. 6 % in 1st and 2nd Q, 5 % in 3rd Q and 1,6 % in 4th Q). The industrial production growth was negatively hit by the drop in mining and quarrying by 2 % and in electricity, gas and water supply by 1,9 %.

The manufacturing achieved 6,3 % growth (10,3 % in the year 2000). Among individual sectors of the manufacturing industry, high rate of growth (more than 10 %) was reached in manufacture of electrical and optical equipment (34,2 %), in manufacturing n. e. c. (19,0 %), in manufacture of leather and leather products (14,1 %) and in manufacture of rubber products and plastic products (11,9 %). Two sectors in manufacturing show a drop in production – manufacture of food products, beverages and tobacco by 2 % and manufacture of chemicals, chemical products and man-made fibres by 5,7 %. The fact that the number of employees stopped to decline (during 1999 and 2000 by 3 % annually) and in the year 2001 actually increased by 1,7 % should be deemed as a positive move towards stable growth tendencies in manufacturing.

Construction production did not break the stagnation level in the year 2001 either; in comparison with 2000 the volume in constant prices increased only by 0,8 % (decline by 0,4 % in the year 2000). The development in the construction production went on in parallel with a decline in the number of employees (by 2,3 %).

³ Evaluated upon statistical figures of selected products and indices cleaned from the influence of the number of working days.

Sales from agricultural products in the year 2001 increased in real values by 9,7 %, nominally as much as by 18,3 %. This is a striking change to compare the year 2000, when these indicators show a real drop and in nominal values reached hardly the level of the year 1999.

The *corporate finance* development 2001 comparing the years 1998-2000 is presented in Table 4.

Table 4
Financial Results of Non-financial and Financial Organisations (1998 – 2001)

	1998	1999	2000	2001	1998	1999	2000	2001
	Profit/loss in bn SKK				Profitability of revenues in %			
Non-financial and financial organisations in total	30,1	73,8	88,0	134,8	1,3	3,0	3,1	4,8
Financial organisations	8,4	26,7	8,8	12,8	2,3	6,8	1,8	3,5
Non-financial organisations (NFO) in it	21,6	47,1	79,2	122,0	1,1	2,3	3,4	5,0
NFO up to 19 employees	16,2	25,6	29,8	35,8	3,8	5,0	6,4	7,1
NFO with 20 and more employees of it	5,4	21,6	49,4	86,2	0,4	1,4	2,7	4,4
Agriculture	-1,6	-2,0	-0,6	0,5	-2,7	-3,7	-1,1	0,9
Manufacturing	-8,4	5,0	22,2	40,3	-1,4	0,8	2,9	4,8
Construction	1,2	0,7	1,2	2,6	1,4	1,0	1,5	3,2
Services in total	3,1	-0,3	14,0	26,8	0,6	0,0	1,9	3,7
<i>From NFO with 20 and more employees</i>								
NFO, which achieved profit	86,8	75,6	81,3	112,3	9,1	7,0	5,6	7,1
NFO, which ended up with a loss	-81,4	-54,1	-32,0	-26,0	-16,4	-10,8	-8,1	-7,2

Regarding the corporate finance results, the development in the year 2001 indicates a further important step towards stability. The following changes are especially significant:

- The increased profit/loss in non-financial organisations with 20 and more employees by almost 37 bn. SKK in the year 2001 (in difference from the previous 2 years) was mostly achieved by higher profit in profitable companies (the losses of the loosing companies decreased only by 6 bn SKK).
- The total profitability of revenues increased by 1,7 percentage points in non-financial companies with 20 and more employees (from 2,7 % to 4,4 %) and by 1,5 percentage points in profitable companies (from 5,6 % to 7,1 %), where the profitability during the previous 2 years declined.

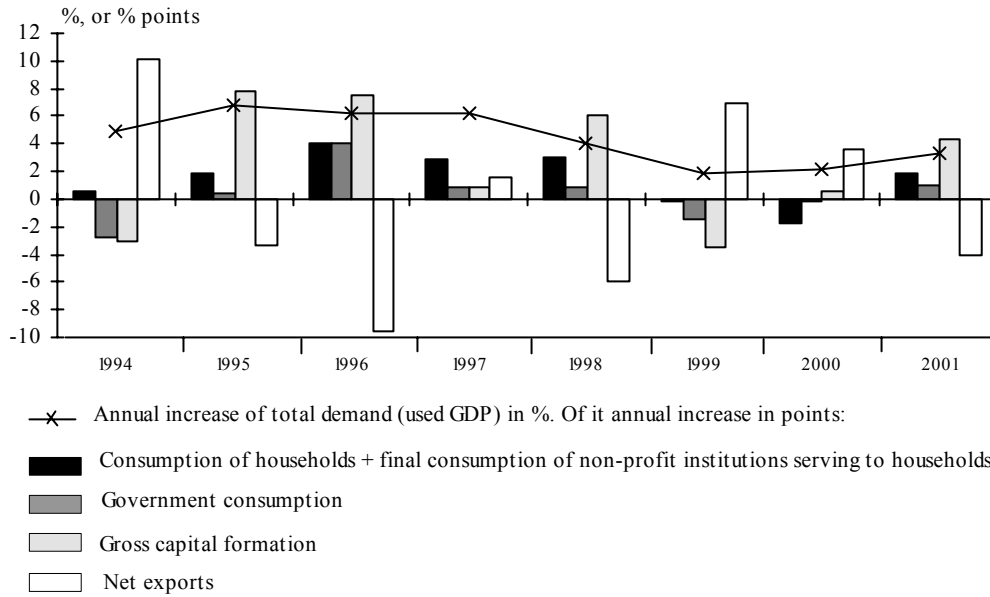
- In the year 2001 the position of losing companies was less important regarding the companies with 20 and more employees: for the first time during the transformation period their share on the total number of companies dropped to 30 %, in 2001 these companies shared 19 % on the total revenues and 16 % on the total value added.

3. Impact of Demand for the Economy Performance

Growing demand and together with it a certain acceleration of the growth in economy performance continued also in 2001 despite the fact, that in the half term the world economy was hit by the recession. Upon changes in the external environment the demand structure also considerably changed. During 1999 and 2000 the GDP growth was achieved only owing to the external demand. In 2001 the GDP increased by 3,3 % since the drop in net exports was, with a certain surplus, compensated by the growth in domestic demand. More details about the changes in the structure of demand are found in the Chart 3.

Chart 3 highlighted not only the same trend observed in the internal demand development during the years 1999 and 2000, but pointed also at some structural differences. In the year 1999 the stabilising steps targeted the improvement of the macro-balance situation were especially seen on a decline in the public sector demand. This is related not only to the lower government consumption (to compare the year 1998 decline by 6,9 %), but also to a decline in the gross capital formation, which was brought on mainly by constricting the public orders (in comparison with 1998 procured investment in the private sector fell by 3,7 %, while in the public sector by as much as 25,5 %). In 2000 the influence of stabilising measures and the core of the decline in domestic demand was transferred as restriction of consumption of households.

Chart 3
Annual Changes in Demand Components in the SR Economy



¹ Including statistical discrepancy taken into consideration through the change in the inventory by adding this figure to the gross capital formation.

The essential breakpoint in the development of all demand components presented in the Chart 3 emerged in the year 2001. Each component of the domestic demand increased while the net exports decreased. The changes made in the development of the key components of domestic demand in the years 2000 and 2001 were abrupt and significant, therefore a more detailed explanation is required. Regarding the demand of households the explanation is provided in Table 5.

Data in Table 5 indicates, that rather different development of the final household consumption considering the 2 previous years (in constant prices the decline in household consumption by 3,4 % recorded in the year 2000 was replaced in 2001 by 4,0 % increase) was caused by several factors. The real decrease in the household consumption in 2000 was caused mainly by the cut down in compensation of employees. A lowered income tax and respective constrictions of current expenditures of households compensated by a decrease in compensation of employees (and its transfer into current incomes) only partially.

Table 5
Impact of Factors Forming the Household Consumption on its Annual Increase in points¹

	On household consumption increase in current prices		On household consumption increase deflated by its price index	
	2000	2001	2000	2001
Current incomes in total	9,7	12,1	-6,9	3,6
Of it:				
Compensation of employees	4,2	7,2	-4,3	2,8
Gross mixed income	4,7	4,9	0,6	2,7
Social benefits	1,4	1,1	-1,2	-0,2
Property incomes	-1,5	-1,6	-2,3	-1,9
Other current transfers - revenues	0,9	0,5	0,3	0,2
Current expenditures in total	-0,4	-3,7	3,6	-1,6
Of it: Taxes and social contributions	0,0	-2,9	3,2	-1,2
Other current expenditures	-0,4	-0,8	0,3	-0,4
Gross disposable income	9,3	8,4	-3,3	2,0
Gross household savings ²	-1,7	1,6	-0,1	2,0
Increase in final household consumption in %	7,6	9,7	-3,4	4,0

¹ Own calculations using figures of the Statistical Office of the SR.

² Negative value of the impact of gross household savings expressed their increase, which subsequently lowered the increase in the final household consumption; positive value of the increase in savings manifested the decline in savings thus increasing the final household consumption growth.

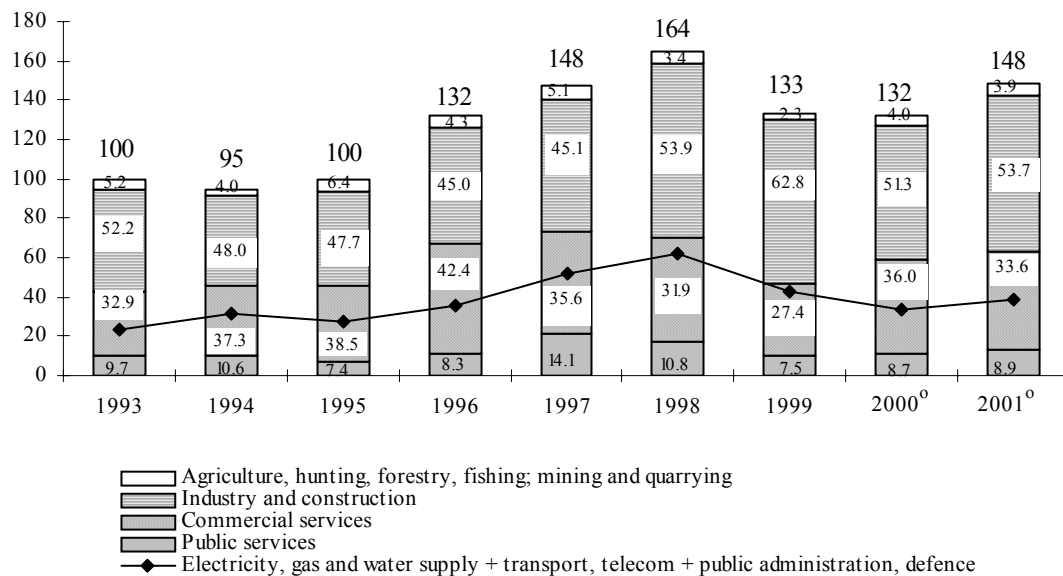
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In 2001 (in contrary to the year 2000) household incomes increased not only in nominal values, but also in real values owing to the increase in compensation of employees and also in gross mixed income (income of individually earning persons). Even if the growth in current expenditures eliminated the increase in current incomes by half, the drop in gross savings, or their use for consumption contributed to the final high 4,0 % increase in the volume of final consumption of households in 2001.

Special factors are accountable for the results in the development of consumption of households. In 2000 there was the influence of lower income tax rates for individual entities and in 2001 a less propensity of households to save, and payoff the state bonds to private bondholders.

The investment demand (gross capital formation and especially gross fixed capital formation) left their sign on quite favourable results of the economic growth in 2001 (see Chart 3). Changes in gross fixed capital formation (GFCF) are presented in Chart 4.

Chart 4
Development of Gross Fixed Capital Formation and its Sector Structure



Figures inside columns show the share of respective sectors and total GFCF
Figures above columns show indices of the real GFCF development

^o Estimate

Y/y change GFCF, which in comparison with recent 5 years reached the highest level (12,0 % in 1997, 11,0 % in 1998, -18,8 % in 1999, -0,7 % in 2000 and 15,0 % in 1st-3rd Q of the year 2001) increased the value of the real GFCF index in 2001 up to the level reached in 1997, but still lagging behind the result from 1998. The GFCF structure (mainly in comparison to the years 1997 and 1998) in 2001 is linked to the results from 2000 especially considering the same low share of public services and rather high (mainly in comparison with the years 1994 -1997) share of industry

and construction. Even if the total share of investment into technical and administration infrastructure as well as into defence slightly rose in 2001 (from 25,2 % in 2000 for 26,3 % in 1st-3rd Q 2001), it still remained much lower to compare the year 1997 (35,0 %) and the year 1998 (37,7 %).

Table 5 presents the impact of changes in the investment demand on the economic growth including additional impact of the quality of investment goods for the exacting trend in the capital intensity of the production.

Table 6
Development of GDP Capital Intensity¹

	1996	1997	1998	1999	2000	2001
National economy	1,95	1,93	1,88	1,93	1,91	1,98 ^o
In it:						
agriculture, forestry, fishing	4,00	3,81	3,78	3,36	3,25 ^o	3,00 ^o
manufacturing	1,52	1,46	1,46	1,47	1,39 ^o	1,37 ^o
electricity, gas and water supply	4,88	5,25	6,93	6,49	6,29 ^o	8,63 ^o
commercial services	1,44	1,42	1,41	1,47	1,40 ^o	1,32 ^o

¹ Ratio of net inventory of fixed assets (NIFA) to GDP. NIFA in the year t was determined as NIFA as of 31st DEC Year t-1 multiplied by a half value of y/y increase of GFCF prices in the year t.

^o Estimate.

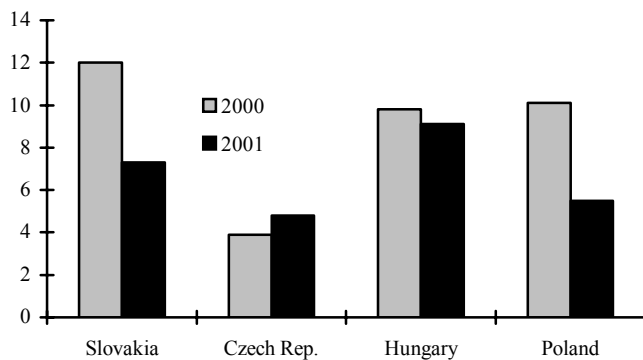
Information on the quite stable capital intensity of GDP formation in the national economy originated as average statistical figures of different development trends for individual fields of the economy. Rather unfavourable development in the capital intensity in the energy sector till 2000 was fully or with a certain surplus compensated by its positive development in agriculture, forestry and fishing, manufacturing and in commercial services. In 2001 however, a sudden increase in the capital intensity of GDP formation in electricity, gas and water supply over different trends in other sectors outweighed and caused the increase in the capital intensity of GDP formation in the whole national economy.

4. Price Development

After temporary, partly also due to administrative corrections spurred higher inflation rate in the year 1999 (10,6 %) and in 2000 (12,0 %), the average inflation rate in 2001 reached the level of 7,3 %. That means it returned down to the 1998 year's

level, before the launch of the macro-economy stabilising program. While in 2000 it was Slovakia where the inflation rate of V4 countries the highest, in 2001 it was Hungary, Slovakia ranked as second, Poland as third, and the lowest inflation rate was recorded in the Czech Republic (Chart 5).

Chart 5
Comparison of Average Inflation Rate within V4 Countries



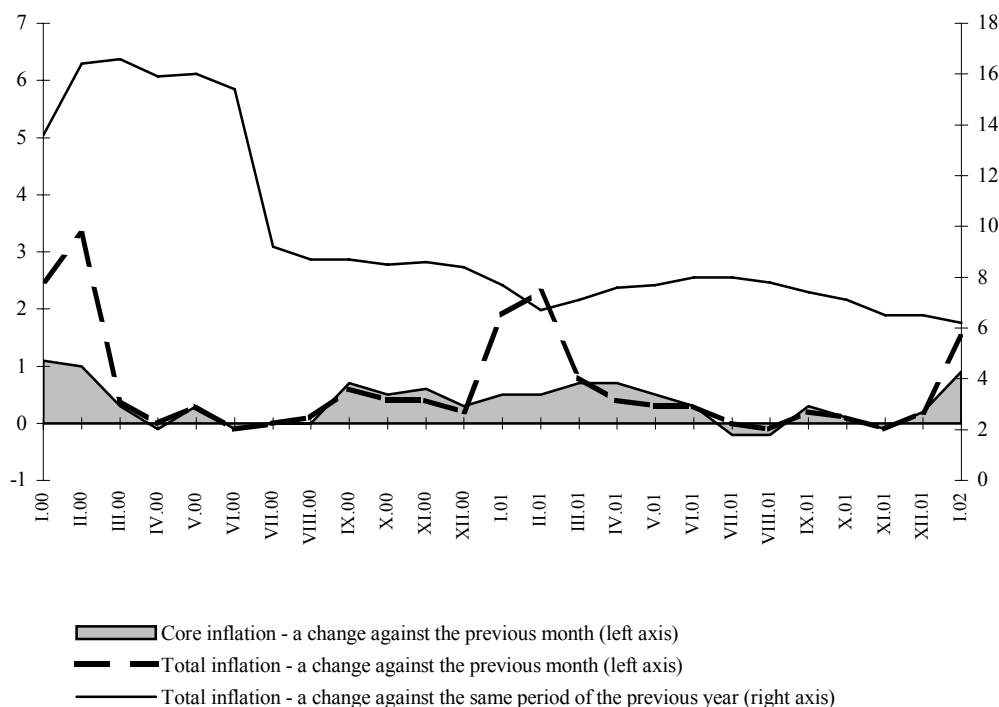
The recovered domestic demand growth did not have any significant inflation effect. The inflation rate development was also in 2001 affected by government measures which were intentionally taken (adjustment of regulated prices – see the growth of the price level at the beginning of the year in Chart 6). In addition, the inflation trend was also affected by other factors independently from the government policy, esp. price fluctuation of non-processed foodstuff (mainly of vegetables), or by more favourable development in prices for liquid fuels to compare the previous year. The retail price hike was kept under a control because of more intense competition in the retail trade (new subjects selling in large-size shopping centres).

There was a non-common phenomenon in 2001 when agricultural product prices were rising more rapidly (by 7,8 %) to compare the producer price growth in other sectors of the economy (industrial producer prices increased in 2001 by 6,5 %, construction work prices rose by 6,8 %⁴). The development in 2001 therefore slightly closed the price scissors, which were permanently opening still more between agricultural

⁴ In 2000 agricultural product prices rose by 7,2 %, industrial producer prices rose by 9,8 % and construction work prices by 9,0 %.

product prices and other prices further thus worsening the unfavourable financial situation in the agriculture sector.

Chart 6
Development of Consumer Prices



The price development in foreign trade commodities was not agreeable for the domestic economy. A substantial difference between the export deflator (5,4 %) and import deflator (8,4 %) caused that the price development was accountable for the dramatic deterioration of results in foreign trade⁵. The price factor accounted for a 37 % of the total y/y deterioration in the net exports figures (net exports expressed as a % on GDP worsened by 6,2 percentage points, of it the change of real exports and imports volume explains the worsening by 3,9 percentage points, the change in export and import prices explains the remaining 2,3 percentage points).

According to OECD analyses Slovakia ranked in 2001 as the country with the lowest comparative price level amongst the V4 countries (also amongst all OECD countries). The price level at the end of the year 2001 in the Slovak Republic made

⁵ While the negative balance of net exports reached only about -4,2 % of the GDP in constant prices, in current prices it represented as much as -8,7 % of the GDP.

86 % of the price level in the Czech Republic, 79 % in Hungary and 65 % in that of Poland (and 41-42 % of the price level in Austria and Germany).

5. Situation on Labour Market

The recovery of the growth in the number of employees (after its dramatic drop in the years 1997-2000) coming together with the growth in the number of unemployed persons was a characteristic feature on labour market development in the year 2001. The number of employees in terms of y/y growth increased by 1,0 % (from labour force survey) while at the same time the unemployment rate reached 19,2 %⁶ (to compare 18,8 % in the same period of the previous year). The number of labour force obviously substantially increased (the labour market supply)⁷.

The declined number of employees was especially responsible for the rise in the unemployment rate (after 1998) only in 1999. In 2000 this factor was less significant, and in 2001 completely disappeared. According to the data presented in Table 7 it is indisputable, that the decline in the number of employees in 1999 was mostly accountable (by 2,5 points) for the most significant y/y increase in the rate of unemployment (in 1999 by 3,7 percentage points from 12,5 % up to 16,2 %), what could be understood with a certain level of simplification as result of layoffs. However, in the further period the higher portion of the increase in the rate of unemployment was caused by the increase in the volume of labour force. In 2001 the rise in unemployment rate by 0,6 points exclusively due to increased number of labour force (that means by increased supply on labour market).

Regarding the employment development, the number of entrepreneurs saw a great growth dynamism, where the total number increased by 6,5 %, while the number

⁶ At the beginning of 2001 a significant growth of the unemployment rate was observed (in January 19,7 % according to the disposable number of registered unemployed). This resulted from the fact that people who were working public works were afterwards again added on the list of unemployed. The number of unemployed per 1 vacancy reached a record value of about 80 (for comparison purposes, at the break of the years of 2001 and 2002 the figure was about 50).

⁷ Y/Y increase in the number of employed in 2001 was by 22 thousand, in the number of unemployed by 22,8 thousand. A total increase of labour force thus represented 44,8 thousand of persons. For comparison, in 2000 the increase in labour force represented 38 thousand persons, in 1999 33 thousand, in 1998 12 thousand. Therefore is quite clear, that the demographic factor in the years of 1999-2001 rather complicated the situation at the labour market, however, the importance of this factor is going to fall down in the future.

of employees increased only by 0,6 %. This is the desired structural move towards self-employment. There is another positive structural characteristics of the employment growth – the hike in the number of employees in the private sector, where the average number of employees rose by 4,2 % (Table 8), was the accelerating component of the total employment growth.

Table 7
Factors Increasing the Rate of Unemployment (in Percentage Points)

	1999	2000	2001
Change of the unemployment rate caused by the increase in labour force	1,2	1,3	1,2
Change of the unemployment rate caused by decreased number of employees (layoffs)	2,5	1,1	-0,6
Y/y change of the unemployment rate in total	3,7	2,4	0,6

Source: own calculation according to figures of the Statistics Office of SR.

Table 8
Development of Total Employment and of Employment in the Private Sector^{1,2}

	1996	1997	1998	1999	2000	2001
Index of the number of employees in the private sector	106,8	106,2	102,5	99,0	100,6	104,2
Index of the overall number of employees	100,8	100,2	99,6	97,8	99,4	101,5

¹ The figure on the total employment growth does not match with the figure presented in another part of the text, due to different survey methodology. Figure in this table come from the quarterly statistical reporting.

² The same period of the previous year = 100.

Source: Statistical Office of the SR.

Slovakia had the highest unemployment rate regarding the V4 countries. In other V4 countries the development at the labour market is extremely heterogeneous.

The lowest unemployment rate (in 1st-3rd Q 2001) was recorded in Hungary⁸ (5,7 %), followed by the Czech Republic (8,2 %). Poland (18,2 %) and Slovakia had serious problems.

In 2001 real wages after a dramatic drop during 1999 (-3,1 %) and 2000 (-4,9 %) increased by 0,8 %. On one side it was due to a moderate speed up in the

⁸ We have to say, that Hungary, the best regarding the unemployment rate, was the core of the unemployment problem during the course of company restructuring still in 1991-1994. But the SR restructuring of the micro-sphere was running in parallel with macroeconomic stabilising or afterwards what increased the unemployment rate. In addition, the rate of economy activity in Slovakia reached by 10-percentage point's higher level (69,1 % in the Slovak Republic to compare 58,9 % in Hungary).

growth of nominal wages (8,2 % in 2001), but especially because of a dramatic decrease in the growth rate of consumer prices. In 2001 the average monthly wages reached the value of 12,365 SKK. At the official parity of exchange rate this wages were the lowest within V4 countries⁹.

Persisting non-sufficient work positions to be created was first problem of the labour market. This issue was linked with another, like the rigidity of the labour market, demotivating effect of social allowances, and the fact that the part of the population is still not ready to bear the responsibility for their economic status (cultural dependencies). Despite functioning of the labour market in Slovakia remained still rather restricted, some key legislative measures were proposed and approved in 2001 (Labour Code, Public Service Act, both effective as of 1st April 2002) which may result in a further restriction of the labour market functionality.

6. Balance of Payments and Foreign Capital

6. 1 Balance of Payments

The balance of payments development in 2001 indicated a substantial change. Contrary to a positive trend outlined in the years 1999-2000, when the current account deficit was falling and foreign investment inflows increased the capital and financial account and the surplus of the total balance, in the course of 2001 the rising deficit on the current account started to endanger the equilibrium of the balance of payments (Table 9).

The results of the SR balance of payments in 2001 rather worsened in comparison with the previous year. It was attributed to the adverse development on the current account and, in these terms, to the impact of worsened results in the balance of trade. While the surplus on the capital and financial account in 2000 already by its half value had offset the differences on the current account, in 2001, however, the active

⁹ If the comparison of wages includes also different comparative price levels (see the chapter Price Development), the differences in wages of the V4 countries are relatively small. Also in this case it was found that the lowest value of the purchase power is in Slovakia.

balance on the capital and financial account was not high enough to offset the difference on the current account balance.

The growth of the NBS foreign exchange reserve in 2001 reached only 19,5 % of the growth in 1999 or 15,2 % of the growth recorded in 2000.

Table 9
Balance of Payments Development during 1997-2001 (in million USD)

	1997 ¹	1998 ²	1999 ³	2000 ⁴	2001 ⁵
Trade balance	-1 471	-2 189	-1 103	-916,8	-2 134,7
Balance of services	75	19	149	439,4	479,5
Income balance	-121	200	-128	-235,5	-100,7
Current account	-1 343	-1 970	-1 083	-713,0	-1 755,9
Capital and financial account	1 684	1 728	1 823	1 413,0	1 719,0
Other non-classified items	-295	-288	-19	120,2	180,2
Total balance	46	-530	721	923,7	143,4

¹ Used Exchange rate 33,616 SKK/USD.

² Used Exchange rate 36,913 SKK/USD.

³ Used Exchange rate 41,417 SKK/USD.

⁴ Used Exchange rate 46,200 SKK/USD.

⁵ Used Exchange rate 48,347 SKK/USD.

6.2 Foreign Capital

While in the year 2000 total capital and financial resources almost twice exceeded the current account deficit, in 2001 the current account deficit was settled by the surplus on the capital and financial account only by 98 %. This was affected by changes in terms of all important forms of foreign investment which it is clear from the following Table 10.

Inflow of foreign direct investments in the year 2001 fell down to the level of 60 % against the year 2000. Privatisation revenues created a considerable portion (as much as 52 %) of the FDI inflows, mainly to the banking sector, which received well about 61 % from the total new FDI increase. The rest of investments supported food production and beverages and chemicals manufacture (15 %), wholesale and retail sectors (13 %), transportation and telecommunications (5 %). In 2001, despite investment stimuli and the membership of the SR in OECD, there was still a low involvement, of mainly strategic foreign investors, in the sophisticated sectors of the Slovak manufacturing with a prospect of value added growth, in the expansion of international

production co-operation, and in increasing the supply to meet the growing domestic demand in consumption a investment commodities also in 2001.

Table 10
Foreign Investment Development in the SR

Item	2000		2001	
	mld Sk	mil. USD	mld Sk	mil. USD
Net FDI	95,1	2 058,1	70,6	1 460,3
inflow ¹	91,3	1 976,5	57,0	1 179,1
outflow ¹	-0,6	-11,9	-2,0	-42,0
Net portfolio investment	36,4	818,9	-10,5	-217,2
inflow	45,6	1 019,3	13,9	287,3
outflow	-9,3	-200,4	-24,4	-504,5
Net other long term investment	23,9	-505,1	-10,6	-221,1
inflow	-20,3	-426,3	-10,1	-210,9
outflow	-3,6	-78,8	-0,5	-10,2
Total foreign investment	155,4	2 371,9	49,5	1 022,0
inflow	116,6	2 569,5	60,8	1 255,5
outflow	-13,5	-291,1	-26,9	-556,7

¹ Equity capital + reinvested profit.

Source: Monetary survey, NBS, February 2002.

Considering the figures in Table 11 in 2001 we cannot expect a substantial move in the foreign direct investments per capita being an indicator which generally correlates with the convergence trends on the economic level.

Table 11
FDI per Capita in Selected Candidate Countries as of the End of 2000

Country	FDI per capita in USD
Slovak Republic	660
CR	2 053
Hungary	1 872
Poland	1 050 ¹
Slovenia	1 411

¹ Estimate.

Source: own calculation based on CESTAT (1995 - 2000).

In 2001 the following countries represented the most important *investors* in the SR: Austria (44 %) predominantly owing to their investments into the banking sector, Holland (12,5 %) with investments directed into the enterprise sector, the Great Britain (11,4 %) with a solid division between banking and enterprise sector, and Germany (9,9 %) with their large FDI inflows into the enterprise sector.

From the *territory* point of view, FDI predominantly directed to the region Bratislava (in total 81,6 %, from investments to the banking sector 100 %, and from investments to the enterprise sector 52,2 %), to Banská Bystrica region 9,2 % (from investments to the enterprise sector 24 %) and to Nitra region 7,0 % (from investments to the enterprise sector 18 %).

Portfolio investments to compare the year 2000 were considerably less. On one side, the volume of domestic securities purchased by foreigners much less exceeded their sales (by 32 bn SKK) and the contrary, the volume of foreign securities purchased by local people much more exceeded their sales (by 10,5 bn SKK).

A decline was recorded also in *other long-term investment* (loans and borrowings). Since this is a key item affecting a total debt, this development in 2001 can be deemed as positive. It is positive, that the borrowers show readiness to pay their investment loans, most likely owing to a further improvement in their financial situation. However, there was a pain regarding the development of this item since the loans were drawn mainly by trading companies (wholesales and retail - up to 37 %), while the loans for industry represented only 11 %.

7. Foreign Trade

After a relatively favourable development of foreign trade in Slovakia in 1999 and especially in 2000, there was an apparent change in 2001 (see Table 12). In the previous year the imports in nominal volume grew much faster (index 120,9) to compare the exports (111,3) while contrary to the year 2000 the rate of growth in exports dropped more than the in imports. As early as in July the deficit of foreign trade exceeded the annual value recorded in 2000 and at the end of 2001 increased up to two and a half of the 2000 level; its portion on the GDP almost reached the highest value 11,6 % from 1998.

The development of foreign trade relations of Slovakia was impacted by several factors. On the export side there was a lower demand in the EU, where the majority of Slovakia's exports is directed. This slowdown in the growth of the European

economies (in 2001 GDP growth only about 1 %), pulled down primarily due to the US economy recession, was sharper in the second half of the year 2001.

Table 12
Key Indicators of the SR Foreign Trade Development

Indicator	1998	1999	2000	2001
Exports , FCO, bn SKK, current prices	377,8	423,7	548,5	610,7
Annual change, current prices, %	+16,6	+12,1	+29,5	+11,3
Imports , OP, bn SKK, current prices.	460,7	468,9	590,3	713,9
Annual change, current prices, %	+16,9	+1,8	+25,9	+20,9
Balance , bn SKK	-82,9	-45,2	-41,7	-103,2
Balance/GDP, %	-11,6	-5,5	-4,7	-10,7 ¹
Export performance, % GDP	52,7	52,0	61,8	63,1 ¹
Import intensity, % GDP	64,2	57,5	66,6	73,8 ¹

¹ Recalculated for the latest estimate of the annual GDP.

Source: Foreign Trade Statistics, 1998, 1999 and 2000, Statistical Office of SR;
web site of the Statistical Office of SR – Foreign Trade 2001; own calculations.

Sluggish EU growth undermined exports to this territory which became visible in consumption (long-term and short-term) goods and mineral fuels which shows a link-up with the declined dynamism of the final consumption in the EU. Considering commodities classified as raw material or intermediate products, which so far represent a significant part of the SR exports (about 36 %), there is again a clear link-up with the lower range of manufacturing processes in the EU. The exports of investment commodities (non-considering road transport equipment) were the least impacted by the sluggish growth in EU countries; these exports grew in current prices similarly to the year 2000.

On the side of imports, firstly, the increased dynamism of the growth in the Slovak economy (from 2,2 % in 2000 up to 3,3 % in 2001) induced a higher growth of household consumption in real value (up 4,0 %), higher government consumption (up 5,2 %) and mainly higher investment demand or gross fixed capital formation up by 11,6 %.

Higher consumption of households called forth-extreme hike in imports of consumption goods includes personal cars and other long-term consumption goods (up 25 % in current prices). It should be said, that under the situation when domestic supply is not sufficiently covering a diversified demand in final consumption commodities,

and when such commodities fully depend from imports, the intense construction of shopping centres in 2001 with their preference of imported goods against domestic ones was also accountable for higher volume in imports.

Similarly, the rapid growth in imports of investment products (the most of all commodity groups - 28,6 %) also relates to the insufficient coverage of internal investment demand, even if the hike in imports of investment products in the form of modern technology equipment may prepare conditions for a future dynamic growth of the economy.

The growth in imports in 2001 (contrary to the year 2000) weakened the favourable development in the price for crude oil and raw materials at the world market. Crude oil price in 2001 was roughly at the level of 25 USD per barrel, which is approx. 8 % drop. At the same time, prices of non-crude oil commodities decreased by 3,4 % in average.

The development of both nominal and real exchange rate of the Slovak crown (REER) regarding the SR foreign trade development in 2001, remained quite neutral. The nominal rate stabilised and its appreciation in real value after the rise in 1st quarter of the year remained on zero level in following quarters. In 1st Q this partially co-produced a decline in the dynamism of exports (not in imports), although in the following period both exports and imports developed independently from the real effective exchange rate (Chart 7).

In consideration of the *territorial* structure of the SR foreign trade, the development in 2001 is provided in Table 13.

Table 13
Territorial Structure of the SR Foreign Trade

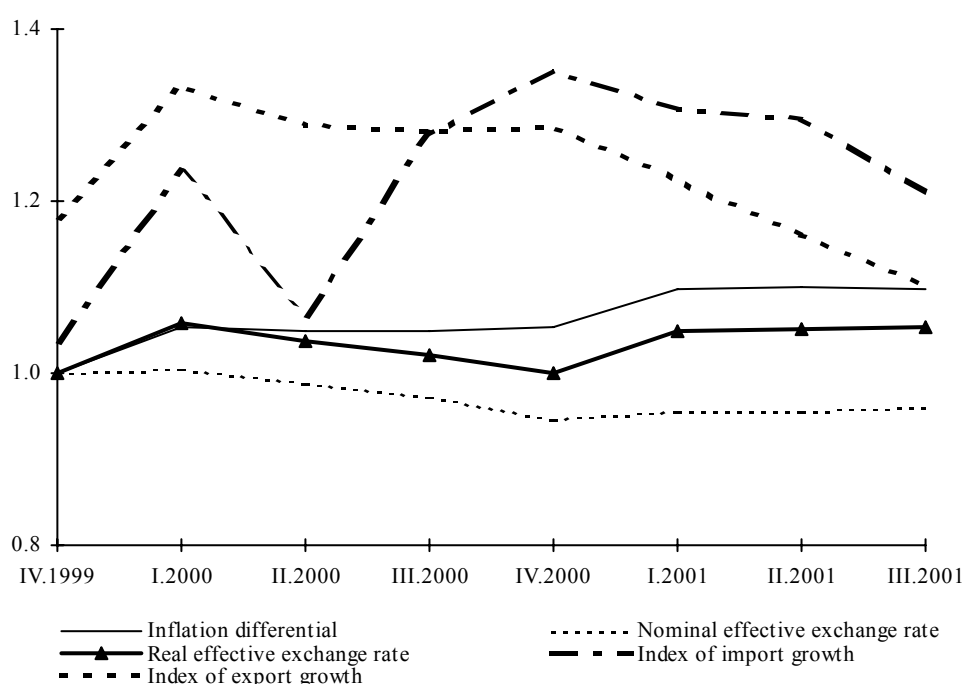
Country - alliance	2000			2001		
	Share in %		Balance in bn SKK	Share in %		Balance in bn SKK
	Exports	Imports		Exports	Imports	
Total	100,0	100,0	-41,7	100,0	100,0	-103,2
of it:						
EU	59,1	48,9	+34,8	59,9	49,8	+10,2
CEFTA ¹	30,2	21,4	+38,9	30,0	22,5	+22,5
of it:						
CR	17,4	14,7	+8,5	16,6	15,1	-6,0
CEFTA without the CR	12,8	6,7	+30,4	14,4	7,4	+28,5
Russia	0,9	17,0	-95,7	1,0	14,8	-99,1

¹ Bulgaria, the CR, Hungary, Poland, Romania, Slovenia.

Source: Foreign trade in the SR, 2000; 2001 – web site of the Statistical Office of SR.

Table 13 shows that the territorial structure of foreign trade in Slovakia remained stable for a longer period. Also in 2001 as much as 91,5 % of the exports targeted OECD and imports from these countries represented 77,5 %. The most important role regarding the share on imports and exports was played by the EU countries (they accounted for approx. 55 % on the total turnover), especially Germany, Austria, Italy and France.

Chart 7
Development of Real Effective Exchange Rate in the SR ¹



¹ REER was calculated based on quarterly average values. Nominal effective exchange rate was found as a weighted average according to the currency structure (EUR, GBP, USD) in the SR foreign trade. Foreign inflation was determined as a weighted average of the consumer price index considering the most important business partners per share on the exports.

Source: Monitor of the economy of the SR, No 11/1 2001; OECD Economic Outlook, No 69 2001/1; Monetary survey, NBS, November 2001.

The surplus balance of 22,5 bn SKK was achieved with CEFTA countries, despite more rapid growth in imports than in exports (index 127,1 against 110,6) even if the surplus was less to compare the year-earlier period by 16,4 bn SKK. Growth in exports outpaced that of imports only regarding Romania. The most important growth in imports came from Hungary. Of the CEFTA countries, the Czech Republic holds the

dominant position in the Slovak foreign trade, although its share on imports and exports has been gradually falling down. The pace of the import growth from the CR in 2001 was 6 times higher than the pace of the export growth. This also reflected in the total balance, which changed from surplus to deficit amounting 6 bn SKK. The drop in exports of paper, card and paper board, of organic chemical products and flat rolled iron and steel products on one side, and the rise of imports of personal cars, their components and equipment, of components for railways and street car vehicles, black coal, refined products, wheat and rye on the other side, accounted for the trade deficit with the Czech Republic. Slovakia reached a positive trade balance with the other CEFTA countries.

In the trade with Russia in 2001 the passive balance further increased representing as much as 96 % of the total SR trade balance deficit. The unfavourable exchange rate of Slovak koruna to the US dollar was mainly accountable for that situation, since Slovakia has to pay for mineral fuels imports in US dollars.

8. Fiscal and Monetary Policy

Fiscal and monetary policy also in the year 2001 targeted stabilising of financial management of the state and the local currency consolidation. The results attained in 2001 however only partially contributed for the goals.

8.1 Fiscal and Budgetary Policy

Preliminary results regarding the state budget of the SR shows, that the deficit assumed in the State Budget (SB) Act was ensured (Table 14).

Table 14

	Reality 1999	Reality 2000	SB Act 2001	Reality 2001 ¹	Difference in bn SKK
SB deficit include restructuring costs (in bn SKK)	14,8	027,6	47,0	44,4	-2,6
GDP share (in %)	1,82	3,11	4,86	4,59	.
SR deficit less restructuring costs (in bn SKK)	14,8	19,1	37,2	36,4	-0,8
GDP share (in %)	1,82	2,15	3,85	3,86	.

¹Preliminary figures.

After subtraction of non-recurrent costs for the restructuring of banks, nonetheless the negative SB balance failed to meet the convergence criterion limit 3 % of GDP. The development structure of the state budget revenues and expenditures is summarised in Table 15.

Table 15
Development of State Budget Revenues and Expenditures in the Years 1997-2001¹

	Reality in bn SKK					Fulfilment of the SB 2001 in %	Index 2001/2000 in %
	1997	1998	1999	2000	2001 ²		
Total revenues	175,8	177,8	216,7	213,5	205,4	113,7	96,2
of it:							
A. Tax revenues	145,5	153,0	160,4	173,8	165,1	104,4	95,0
In it:							
- profit and capital tax	54,9	61,7	62,3	60,0	57,5	97,9	95,8
- tax on goods and services	76,8	78,3	84,1	99,0	102,0	108,8	103,0
- tax on international trade and transactions	12,8	11,6	12,5	13,1	3,9	96,1	29,8
In it: customs tariffs	5,3	5,2	3,9	3,7	3,6	91,0	96,4
import surcharge	7,5	6,4	8,4	9,7	0,3	.	.
B. Non-tax revenues	14,1	12,9	41,7	19,9	24,8	116,3	124,6
C. Grants and transfers	.	.	.	18,4	13,7	.	74,3
Total expenditures	192,8	197,0	231,4	241,1	249,7	114,7	103,6
of it:							
A. Current expenditure	154,1	170,6	182,6	203,5	213,3	105,8	104,8
B. Capital expenditure	34,2	24,1	21,0	25,4	27,5	178,6	108,4
C. Equity and credit particip.	4,5	2,3	27,8	12,2	8,9	.	73,1
Surplus (+), Deficit (-)	-17,0	-19,2	-14,8	-27,6	-44,4	119,3	160,9

¹ Figures from the Ministry of Finance of the SR.

² Figures for the year 2001 are preliminary before the approval of "The State Final Account for the Year 2001" received from the National Council of the SR.

In 2001, the budgetary revenues totalled 205,4 bn SKK thus exceeding the state budget by 13,7 %. Budgetary expenditures were 249,7 bn. SKK, that means 14,7 % over the approved budget. Even if it is true that tax revenues topped 104,4 % against the projected figure, they were 5,0 % less when compared to the year-earlier period. Exclusion of import surcharge in the year 2001 caused a drop in tax income by 9,1 bn SKK, and this gap was not offset by any another tax proceeds, which means that tax revenues in the year 2001 to compare the previous year in real terms declined.

Tax burden adjustment, mainly the tax abatement regarding the legal entity income tax rate from 40 % down to 29 % reflected in 2001 by 4,9 bn SKK less in the proceeds from the above said tax to compare with the year 2000. A certain rise was

recorded regarding the tax on goods and services (by 3 %) owing to increased yield from value added tax.

The effort to ensure the planned balance between revenues and expenditures in the state budget dominated in the budgetary policy also in the year 2001 thus impacting the enduring problems in education, health care, science and research and in the social sphere; solutions were postponed for a future period. The measures that were taken to increase social help benefits and social allowances by 3,1 bn SKK and removal of debts of district offices (1,3 bn SKK) solved only some problems that had been accumulated on this field.

Of the total SB expenditures worth of 249,7 bn SKK the amount of 213,3 bn SKK used to cover current expenditures (105,8 % of the planned budget). The guarantees of the Slovak government which were due and the restructuring costs of the banking sector in the year 2001 amounted up to 8,9 bn SKK and were paid from the state budget (in the year 2000 it was 12,6 bn SKK). These costs, especially expenditures for recovery of banks, had not yet reflected on a substantial move regarding the bank lending recovery or by any vigorous support for the enterprise sector or a faster development of small and medium size businesses either.

8. 2 Monetary Policy

Monetary program for the year 2001 was built on quite positive results regarding the economy and monetary development achieved in the year 2000. The program assumed further stabilising of prices regarding strategic raw materials and the appreciation of Slovak crown. The monetary policy counted on a hike of inflow of foreign resources, especially on direct investments and sustaining of the expected deficit of the SB, which should be deemed as the important factors for further stabilising of the currency. Some of these assumptions, mainly regarding the development of relationship of the Slovak economy towards the external environment, were changed and the monetary program had to be modified through the course of the year.

The stabilising character of the monetary policy for the year 2001 was reflected in the key monetary indicators. The evaluation of the level reached in the year

2001 in real values confirmed that despite some positive results, serious problems with stabilising the monetary development and recovering the banking sector remained. Firstly, we have to highlight the positive y/y inflation rate development of 6,5 %; of it the core inflation 3,2 %. This result was reached owing to lower prices of major import commodities (crude oil, petroleum products), as well as the favourable development of the exchange rate of the Slovak crown. The positive development of the currency stabilisation was also supported by sustained expected level both in the state budget deficit and in the increase in net government loans.

Increase in the money supply M2 by 11,9 % was much less than expected (+12,5 %). In the year to year comparison, there was a certain increase in deposits coming from companies and from the population at the end of the year. Slovak-crown deposits, which create a part of the M2, rose y/y by 10,5 %, of it population deposits by 6,7 % and corporate deposits by 18,6 %. (See Table 16)

Table 16

Deposits (in bn SKK) and the Average Interest Rates Development (in %) in the year 2001

	Status in the year				
	1997	1998	1999	2000	2001
Deposits in SKK	396,4	386,9	424,7	505,6	554,7
of it population	226,7	253,1	286,7	304,8	324,7
Deposits in foreign currency (in SKK equivalent)	49,3	72,9	80,2	99,2	110,8
Total deposits	445,7	459,8	504,8	604,9	665,6
Interest rates from loans drawn in total	20,92	18,62	12,55	10,95	10,78
of it: entrepreneurs	21,25	22,14	12,58	11,07	10,78
public sector	21,30	22,06	19,55	11,23	9,79
private sector	21,19	22,22	19,62	13,13	12,78
population	10,18	9,39	8,03	8,83	10,69

The dynamism of the growth regarding bank loans to enterprises and for the population in SKK slowed down in the year 2001 to compare the year-earlier period when their total volume increased only by 5,3 % (in the year 2000 up by 5,6 %). Even though the increase of crown loans granted to inhabitants was less, it still outpaced the rate of the increase in corporate loans. Foreign currency loans increased by 8,4 %. The sluggish growth regarding the corporate bank loans rather confirm a endurance of sluggish situation especially regarding small and medium size enterprises thus signalling

that restructuring of banks was not yet visible in the banking sector or their support for development of companies or in terms of regional problem solutions. Several operations and some facts that influenced the statistical volume of corporate and private loans in the years 2000-2001 do not allow a longer term analysis and the time series evaluation.

The monetary policy of the central bank (the NBS) in the year 2001 also targeted a long-term stabilisation and lower interest rates. According to preliminary data the real achieved results confirmed a further progress in cutting down interest rates from the loans. Although at the same time, the interest rates from local currency deposits further declined from 5,57 % at the end of 2000 down to 4,94 % at the end of 2001, maintaining relatively more stable medium and long-term deposits. The sustained difference between the interest rate on deposits and the inflation rate (6,5 %) was met with an adverse response from depositors. In the future, this might bring up negative monetary implications, a loss of depositors' will to deposit their money in financial institutions, to increase the real estate prices or to spur foreign currency demand.

9. Outlook for the Year 2002

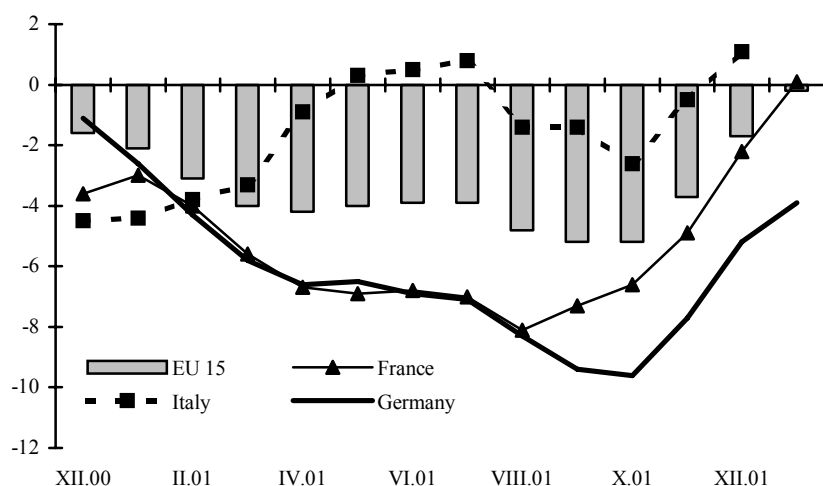
The revealing of main directions of the Slovak economy development in 2002 is driven by considerations in terms of their dependency on the SR economy performance results achieved in the previous year. Our attention was focused on evaluations of sustainability or change of factors, which predetermine the development of individual components of total demand, and we also made a research on the production (competitive) readiness to meet the demand expected for the year 2002.

Current Situation in the World Economy, its Impact on the SR Exports and Imports

The dramatic worsening of development in export of goods and services (and less positive net export results) at the end of 2001 was also pulled down by a negative development in the world economy. Assuming, that in 2002 the situation in the world economy will be slightly better, or at least not worse than in 2001, we can expect the

growth in net exports deficit will slow down. Prognoses on the world economy say that the economy recovery in developed countries is more likely in the second half of the year 2002. The move in the OECD leading indicator¹⁰, which is a half a year or 3 quarters of a year ahead of time able to notify inflexion points in the economy activity, signalled a positive change in October 2001 (Chart 8). The existing knowledge about the relation between the indicator and the real economy development allows forecasting a positive break in the economy performance in OECD countries to start in the summer months in the year 2002.

Chart 8
OECD CLI Leading Indicator in Selected EU Countries (percentage changes)



Note: countries with a relative high importance for the Slovak exports were selected.
Source: OECD.

Chart 9 indicates the relation between the trend in economy activities in EU countries and the trends in exports of goods from Slovakia over the period of 2 recent years. This relation allows for a suggestion that development cycle in exports of goods from the SR in the recent 2 years almost copied GDP development cycle in EU being delayed by a quarter of a year. It is likely that an improvement in the economy activity

¹⁰ OECD CLI indicator is constructed to provide early signals about points of breaks (peaks and bottoms) between expansions and slowdowns in the economy activity. It was build to provide the ratio between value of selected indicators in a respective month to their average value for the period m-12 up to m-1. According to the experience, a break point in GDP development appears approx. after 9 month following the period when this indicator hit the change level.

dynamism in EU, starting in summer 2002, would probably a few months later (more likely in 4th Q 2002) strengthen the growth rate of exports from the SR.

The import development will be driven by the growth in domestic demand components (see further). Insufficient restructuring of the supply side of the economy sustains a high import intensity of domestic demand and of exports. This is one of factors which is responsible that the real growth in imports of goods and services (about 8,5 %) will further outpace the growth in the exports (approx. 7,5 %). It is likely that the results in net exports of goods and services will be slightly worse than in 2001. The share of net exports on GDP in constant prices could be expected to reach -5,2 %. In current prices it can be close to the level of -9 % to -10 % from GDP.

A slowdown in the growth of negative balance in net exports of goods and services (in constant prices) means a constriction of the negative impact of net exports for the real GDP development from -4,1 percentage points in 2001 down to -1,2 percentage point in 2002.

Chart 9

Development of the Economy Activity in the EU and Export of Goods from the SR¹
(y/y growth in %)



¹ 3-year moving averages, the GDP growth in EU was postponed by one period (delayed). Source: OECD and Statistical Office of SR.

Foreign resources acquired from the privatisation process will presumably protect the local currency from depreciation because of external imbalance. The privatisation revenues temporarily serve as a certain exchange rate cushion. If the unfavourable de-

velopment of the external balance sustains (or deteriorates) and at the same time the capital inflow from abroad drops (in the case of "Greenfield" investment it depends mainly on a further fate of the privatisation), the currency depreciation could be under a strong pressure. It is highly likely that pre-election or after election political instability will strengthened these impulses. A change in exchange rate would presumably show an impact on changes of the real development in exports and imports although not earlier than in the next year because the extensive volume of foreign currency revenues gained from the privatisation have an impact on the balance of payments.

Development of Domestic Demand and its Components

The development of domestic demand in the year 2002 will be driven by a combination of factors including the impact of external demand and of the government economic policy. The world economy recession pressure against the Slovak economic activities, which will likely sustain till the autumn in 2002, will cut down the annual growth in exports to 7,5 %. However, this growth rate in exports can guaranty the space for further increase in the domestic demand.¹¹

The economic policy will impact the development of domestic demand in various ways. The government in its last year of the political cycle will push forward the growth of nominal incomes in the public sector, and probably also a more rapid growth in social incomes. A temporary break in regulated price adjustments (and through a corresponding cut in the inflation rate) will spark the growth in real incomes of the population and rise a real consumption of households.

However, the loosening of the income and fiscal policy of the government in 2002, will not be so smooth and solid as expected in the autumn one year earlier. The recession in the world economy and its impacts that increased the foreign trade deficit, as well as a reasonable concern, that public finance deficit in 2002 will sharply exceed the budget approved level, force the government to revise and make cuts in the original expenditure program. The government corrections will constrict the growth chances in domestic and mostly consumption demand, however, a reduced growth is attainable.

¹¹ In the EU-15 countries the average annual growth rate in the real exports of goods and services and the real domestic demand in 80-ties equalled 4,7 %; or 2,3 %; in 90-ties 6,0 %; or 1,9 %.

It is because the pressure put upon the government before elections will be much stronger than the willingness for a fiscal restriction.

Considering the inclusion of the above mentioned impacts in the prognosis of current incomes and current expenditures of households and also into the forecast on savings¹² we can assume, that the final consumption of households in current prices in 2002 will rise by 7,9 % (to compare 10,2 % in 2001). Under the condition that a relevant drop in inflation (CPI measured) in 2002 to compare 2001 will cut deflator of the consumption of households from 5,7 % down to 4,0 %, then in the year 2002 we can expect a real growth in the consumption of households by 3,8 %. In the outlook for the GDP formation in 2002, based on the state budget prerequisites and the objectives seeking a much tight financial policy, we assume that the government consumption in current prices will be higher by 9,0 % (to compare 10,3 % in 2001) and its real growth will be 4,8 % (against 5,2 % in 2001).

The growth rate of gross fixed capital formation in 2001 reached a high value owing to the expectations, which in 2000 sparked a strong investment wave in connection with completion of new capacities in 1st-3rd Q 2001. As early as in 4th Q 2001 the growth rate of GFCF considerably declined, and in 2002 it will continue to go down. The expectation are that it will reach 7,5 % in current prices and 5,4 % in constant prices.

Rather high growth rate in domestic demand (by 4,5 % in constant prices) will also in 2002 provide a basis for the rise of imports in the same speed as assumed in the chapter which forecasts the exports and imports relation. Development in the domestic demand will therefore also in 2002 strengthen the impact of the world economy recession upon the unfavourable trade balance development and upon current account of the balance of payments.

¹² With the drop in the inflation rate the recovery of real interest rate from deposits as a stimulus to stop the decline in savings from the population.

Prediction of Supply Development

The space for the supply development has been given by a capacity expansion and by the investment volumes in the economy in the previous period. Since the Slovak economy is an open economy, the implications from the above said as well as the exports figures are displayed in Table 17.

Table 17

Development and Layout of Production, Exports and Investment Activities (regarding the Gross Fixed Capital Formation - GFCF) in Industry in 2001¹

Branch segment with GFCF index 2001 (2000=100) ²	Index 2001 (2000=100)			Share in 2001 in % on			Ratio on segments participation to		
	GFCF	VA	exports	GFCF	VA	exports	GFCF, value added (VA) and exports		
	1	2	3	4	5	6	4:5	4:6	6:5
up to 100 %	77,4	108,5	113,8	13,1	22,4	25,4	0,58	0,52	1,13
101 – 125 %	120,3	102,0	120,9	52,9	46,8	32,6	1,13	1,62	0,70
over 125 %	188,5	114,2	113,4	34,0	30,8	42,1	1,10	1,24	1,37
Segments in Total	126,7	107,0	115,8	100,0	100,0	100,0	.	.	.

¹ 1. - 3. Q in current prices.

² *1st segment* (with GFCF index up to 100 %) included mining and quarrying, manufacture of chemicals, chemical products and man-made fibres, manufacture of machines and equipment n. e. c., manufacture of textiles and textile products, manufacture of wood and wood products.

2nd segment (with GFCF index 101 – 125 %) included manufacture of food products, beverages and tobacco, manufacturing n. e. c., electricity, gas and water supply, manufacture of basic metals and fabricated metal products, manufacture of electrical and optical equipment.

3rd segment (with GFCF index over 125 %) included manufacture of leather and leather products, manufacture of pulp, paper and paper products, publishing and printing, manufacture of coke, refined petroleum products and nuclear fuel, manufacture of rubber and plastic products, manufacture of other non-metallic mineral products and manufacture of transport equipment.

Regarding an overall rise in GFCF in 2001 (in current prices by 26,7 %, in constant prices by 21,8 %) the values per industry sectors (in 1st – 3rd Q, see 1st column in Table 17) are rather different. The most rapid growth in GFCF was reached in the sectors with a significant contribution to the SR exports. While (this is hidden in aggregated figures per branch segments with the highest GFCF index) in the manufacture of transport equipment (a sector with the highest investment activities in manufacturing) GFCF in 2001 should produce contributions in value added and in exports not earlier than in the year 2002.

The effort of enterprises to widen their production capacity and to improve quality, despite the adverse impact upon the foreign trade balance, is testified also by higher volume of imports in the year 2001. It allows for a conclusion, that imports in

the year 2001 increased due to the hike in imports of industrially processed goods, which were in a large scope used for the investment processes (roughly 40 %), partially due to intermediate consumption and, obviously also due to consumption. In general, the imports of a high quality industrially processed goods should bring positive effects, while the growth in imports of primary energy resources (especially higher prices) more or less complicates the economy activity. The changes in the structure of increase in imports during the years 1997-2001 are specified in the Table 18.

Table 18
Increase in the SR Imports during the Years 1997-2001

	Increase in imports in bn SKK					Share of the increased imports in %				
	1997	1998	1999	2000	2001	1997	1998	1999	2000	2001
Total Imports	57	64	12	122	123	100,0	100,0	100,0	100,0	100,0
SITC 0 - 4 and 9	8	-9	12	50	16	14,2	-13,7	96,5	41,2	13,2
of it mineral fuels	5	-11	11	43	5	8,5	-17,7	87,6	35,0	4,3
SITC 5-8	49	73	0	72	107	85,8	113,7	3,5	58,8	86,8
of it machinery and equipment	20	23	2	18	40	34,7	36,0	14,6	15,1	32,7
transport equipment	4	19	-8	15	18	6,2	29,0	-62,0	12,5	14,4
of it personal cars	-8	5	-4	1	9	-14,5	7,7	-29,4	0,6	6,9

Therefore the development in the year 2001 preconditioned a relatively good starting point for further growth in production of goods and services for the year 2002. However, in the first half of that year the growth in supply will be further constricted because of insufficient external demand.¹³ Presumably, in the second half of 2002, the situation on foreign markets will be much better as for Slovak producers, and enterprises will be able to resume their full export capacity.

Taking into account the trends working the external and domestic economic environment we could assume, that value added (VA) in the year 2002 will rise by 3,8 %. The VA is expected to rise in all sectors: in forestry, fishing and hunting by 3 %, in industry by 3,6 % (with a precondition that VA in electricity, gas and water supply will not sustain its declining trend from the previous 2 years), in construction by 2,7 % and in the sector of services by 4,1 %. The manufacturing in the year 2002 should expect a lower growth of value added to compare the year 2001 (down to 4,0 %

¹³ Less favourable production development in this period is confirmed by also the results of business tendency survey launched by the Statistical Office of SR. According to the survey 34 % of industrial enterprises expect a growth in production in the coming 3 months, a decline is expected in 9 % of enterprises (in a comparable period in 2001 this ratio equalled 50 % to 8 %).

from 5,5 % in the year 2001). GDP growth will deviate from the growth in value added depending on the intake development regarding the VAT, the excise tax and the foreign trade tax. If the situation in the above mentioned field remain unchanged, the expected growth in value added will sustain the GDP growth at the level of 3,5 %.

Overall economy development

The above mentioned findings about possible development on the demand and supply side of the Slovak economy result into the prediction presented in Table 19.

Table 19
Prognosis on the SR Economy Performance in 2002¹

	In bn SKK		Index 2002 2001=100	Share on GDP in %	
	2001	2002		2001	2002
Consumption of households ²	339,2	352,1	103,8	49,5	50,1
Consumption of government	135,0	141,5	104,8	19,7	20,1
Gross capital formation ³	239,4	252,3	105,4	35,0	35,8
Domestic demand	713,6	745,9	104,5	104,2	106,0
Export of goods and services	552,8	594,3	107,5	.	.
Import of goods and services	581,5	636,7	109,5	.	.
Net export of goods and services	-28,7	-37,0	.	-4,2	-5,2
Gross domestic product ⁴	684,9	708,9	3,5	100,0	100,0
Consumption	474,2	708,9	104,1	69,2	70,2
Gross savings	210,7	209,9	99,6	30,8	29,8

¹ In constant prices.

² Including consumption of non-profit institutions serving households.

³ On the assumption that change in inventories will match up the change in gross fixed capital formation.

⁴ Less statistical discrepancy (in year 2001=4,8 bn SKK), which is a difference between the total GDP figures and the sum of basic GDP components.

A summary of the factors that impacted the Slovak economy in the year 2002 is leading to a conclusion on a moderately faster growth rate of the economy. The GDP growth of 3,3 % achieved in the year 2001 should be higher to reach 3,5 % in 2002 (in constant prices) despite worsening of the results regarding the international trade (higher negative value of net exports of goods and services) connected with the recession in the world economy.

A relatively (in ratio to GDP growth) high rate of growth in domestic demand which is expected in the year 2002 may turn into a risk factor for the Slovak economy development in the coming year if the following two prerequisites materialise. Firstly,

if the SR is being considered a less credible in political and economy terms, secondly if the decline of the world economy is going to continue behind the currently estimated time horizon. The second reason is likely to cause a drop in investment activities down below the level, which was taken into consideration for the prediction of gross fixed capital formation. Possible future tensions in the Slovak economy may arise also from the recurring higher difference between the share of gross savings and the gross capital formation from GDP.

An inflation impact of an administrative interference regarding prices, which are usually introduced at the beginning of a year, was in January 2002 less significant to compare the previous years. This is a temporary step aside from the strategy gradually to adjust regulated prices, which is likely to push a much stronger price adjustment in the next year. Since there were fewer administrative price increases when a year-earlier period is compared, y/y inflation rate fell in January 2001 down to 6,2 % and in February further dropped to 4,3 %.

Except for the less administrative adjustments, the inflation dynamism (especially of the core inflation) was lowered also because the moderate rise in industrial producers prices, a relative stability of prices for energy resources on world markets and a relatively stable exchange rate development of Slovak crown against euro. The inflation growth was under a pressure called forth by seasonal volatile food prices, mainly vegetable prices. It seems likely that this factor will be in force only for the time being.

Presumably if no unforeseen change of factors impacting inflation happen in the year 2002, the inflation rate would reach an average value on the level well around 4,5 % being the lowest value so far.

While in the years 1999 up to 2001 the y/y rapid increase of the unemployment rate usually started at the beginning of a year, at the beginning of 2002 the unemployment rate did not significantly differ (in January the registered unemployment reached 19,7 %) from the level recorded in the similar period in the previous year. In the year 2002 we can count on an ongoing trend of a moderate increase in the number of employees. The impact of demographic factor, which during the period of year 1999 through 2001 complicated the situation on labour market, should be less evident.

Therefore in the year 2002 we can expect that the unemployment rate will stop rising and its annual average level will reach 18,8 % -19,0 %.

10. Overview on Selected Legislative and Economic-Political Measures

Legislative and economic-political activity of the government and the parliament was in 2001 fully oriented for the preparation of the entry of Slovakia to the EU. Among numerous important legislative acts targeted a harmonising of the legal systems of the SR and of the EU, a special attention should be given to the approved amendment of the Constitution of the Slovak Republic, which provide a legal environment for the SR entry as a member of the international organisation. The process implementing the European legislative will culminate in the year 2002. With the aim to speed up this process the parliament approved a law, according to which the government will issue approximation provisions in predefined areas and will inform the parliament about such provisions.

Ranking the SR within the group of 10 countries, which are likely – based on the report of the European Commission approved at the summit in December 2001 – till the end of the year 2002 to finalised the negotiations with the EU, is no doubt a positive result of the effort. Certain problems, even if not destroyed an overall evaluation of Slovakia, called forth some doubts in the terms of a transparent spending of funds from European funds. Together with approvals of the new EU legislation, in the year 2001 institutional and structural reforms, which strengthen the market character of the Slovak economy and increased the credibility that our economy is capable to cope up with the existing problems further continued. This was confirmed by the fact that international banking institutions and strategic investors show their willingness to enter into restructuring processes, and also by more favourable evaluation of Slovakia by international rating agencies.

An important move in the reform effort of the government was made by launching the process of decentralisation in the public administration, despite some compromised decisions, which were made on behalf of passing the respective laws in the parliament. Formation a second level of a self-government together with the strengthening

the power of self-government bodies brought an important step towards the deepening of democratic principles in the society and to the decentralising of political power and of public finance.

In the year 2001, the measures taken for the finance sector recovery reached a final phase. The privatisation of several banks was completed (majority stake in the Všeobecná úverová banka - General Credit Bank - was acquired by the Italian IntesaBci, in the Investičná a rozvojová banka by the Hungarian OTP Bank, in the Istrobanka by the Austrian BAWAG.), and the privatisation of the Slovenska poisťovna was also completed with majority owner the German Allianz insurance company. There are other banks which are in the process of preparation seeking a strategic investor namely the Poštová banka and still pending process in the Banka Slovakia. The following banks were closed: Devín banka (bankrupt) and the state owned Konsolidačná banka. The stability of the financial sector and customer protections should strengthen several already approved or proposed legislative changes. Among them it is especially the amendment on the banking law, the amendment on protection of deposits, the amendment on the supervision over the financial market, the act on securities and investment services, and the draft of a new act on insurance houses.

In the year 2001 the privatisation further progressed also regarding large state companies operating in gas and energy sector. The sale of 49 % stake in the Transpetrol company and in the Slovensky plynárensky podnik (Slovak gas company) was completed. A tender was launched for the sale of a similar stake in three energy distributing enterprises. For privatising is waiting the transformed Slovak electric company (only a separated transmission system will remain under the state administration).

The establishing of a new Železničná spoločnosť, a.s., (Railways company, j.s.c.) which started to develop their activities on 1st January 2002 as a business entity separated from the transportation road, which remained under the control of the Železnice SR (Railways of the SR). A visible effort is given in order to speed up the transformation and privatisation of the Slovenská autobusová doprava (Slovak bus company).

In the year 2001 there was an ongoing process adjusting regulated prices. The prices for electric energy for households increased in average by 15 %. The price for natural gas for households increased by 20 %, for small enterprises by 15 % and for

large companies by 25 %. The bus fare increased in average by 20 %, the railways fare rose by 15 %. Slovak Post increased their prices in average by 9,9 %. An overall impact of the above mentioned price hikes upon the growth of consumer prices was in 2001 considerably lower than in the two preceding years. In 2002 only moderate price adjustments are expected, that will affect the company level (as of 1st January 2002 only the gas prices for big users increased by 19,3 %). A definite solution how to narrow the deformed prices will be left to independent offices, which will gradually take over the competence in the sphere of regulations. The most important one, The office for regulation of networking sectors was established in the year 2001 and should take over the regulation of energy prices commencing in 2003.

In 2001, the decreasing of income tax for legal entities further continued (as of 1st January 2002 from 29 % down to 25 %), also the tax rate tears for individual entities lowered (current tears from 12-42 % was adjusted for 10-38 %). Essential changes in the level of payments regarding employees and employers to insurance funds, when the price of labour is lowered could lead to the expected increase in employment did not materialise in 2001 either. There is a key obstruction in the delayed reforms in insurance systems and through them the financing of public services. The approved time schedule of rising the pension age was the first real step made in this field.

In connection with the inflation rate and the growth of cost of living the amount of the living minimum was increased since 1st July 2001 – for one matured individual person up to 3 790 SKK, for another person or an immature child if considered together up to 2 650 SKK, for one for child 1 720 SKK, for old age pensions, which are the sole income of a pensioner up to 4 169 SKK at minimum monthly. Children benefits and allowances increased in average by 40 SKK up to 70 SKK. Since 1st October 2001 old age pensions increased by 7 % (maximum amount rose from 7 740 SKK up to 8 282 SKK monthly). Minimum wage also increased from 4 400 SKK up to 4 920 SKK.

The investment activity should be promoted by the act on investment stimuli which was passed at the end of 2001. This law allows that foreign as well as domestic entities when investing more than 400 million SKK (or 200 million SKK in the regions with the unemployment rate higher than 10 %) are eligible for 10-year tax

holiday, a contribution for training courses amounting up to 10 thousand SKK per person, and a support for creating new jobs. Based on the amendment of the act on employment, since 1st January 2002 several partial provisions were introduced to ease the working start for unemployed persons, specials for school graduates (travel cost reimbursement, wage advance payment contribution, waiver on the employer payments to insurance funds).

ECONOMIC DEVELOPMENT OF SLOVAKIA IN 2001

(Study prepared on behalf of the UN Economic Commission for Europe)

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