

Slovakia: growth backed by domestic demand

The Slovak GDP expanded by more than 4% in 2002 compared to 3.3% growth in 2001. Growth was driven mainly by private consumption, which rose by over 5%. At a historically low inflation rate and strongly rising wages real household income expanded considerably. The volume of private credits (mainly mortgages and consumer loans) increased as well. Gross fixed capital formation stagnated. The contribution of foreign trade (goods and services) to GDP growth remained negative. The foreign trade deficit was yet diminishing, particularly so in the last quarter of 2002, despite the real appreciation of the Slovak koruna (SKK). Supported by FDI, exports are gradually shifting to high-value-added branches such as manufacturing of transport equipment and electrical and optical equipment, which together account already for about 40% of merchandise exports.

Gross industrial production increased by more than 6% in 2002; labour productivity rose by more than 3%. In manufacturing, growth rates were highest in electrical and optical equipment, leather & leather products, and rubber & plastic products (about 24%, 14% and 12%, respectively). However, with more than 10% growth transport equipment, the largest manufacturing sub-sector, contributed most to the expansion of manufacturing. Car production (VW Bratislava) increased by nearly 30% and has again become the main driving force of manufacturing growth. Output of the construction sector rose by more than 3% in 2002, following stagnation in 2001 and three years of decline before.

The historically low inflation rate of 3.3% year on year was mainly the result of the postponement of price deregulation due to the parliamentary elections in September 2002. In addition, lower oil prices, low EU inflation, appreciation of the currency as well as weak food prices push consumer prices down. With tax collection improving, Russia's debt being repaid and expenditures being cut in the last two months of the year, the central government's deficit fell slightly to some 4% of GDP in 2002, compared to 4.5% in 2001.

In the course of 2002 the unemployment rate dropped by about 1 percentage point to 17.4% at year-end. Nevertheless, there is hardly any sign that the accelerated GDP expansion is essentially easing the unemployment problem. Rationalization measures adopted by new owners after acquisition of over-staffed companies and lack of labour market reform often impede any further drop in unemployment. Furthermore, the employment effects expected by green-field investments have been so far moderate. Long-term unemployed, less adaptable to new jobs, are taking an increasingly larger share in total unemployed. Regional disparities are becoming ever more pronounced. Economic activity is focusing on the already flourishing western region where both domestic and foreign investors find highly skilled labour, a well-developed infrastructure and, in retail

trade, also outlets for consumers with strong purchasing power. As a result, with unemployment rates of about 30% in the country's eastern regions, the Slovak labour market features the largest disparities of all CEE candidate countries.

Those regional disparities are likely to even increase in the near future as the French car maker PSA Peugeot Citroen will build an auto factory in the Trnava industrial park, some 40 kilometres northeast of Bratislava. Total FDI into the project is to amount to close to EUR 0.7 billion by 2006 when the annual output capacity will reach 300,000 cars and more than 3000 workers will find jobs there. This is certainly good news for the Slovak economy as a whole. But experience from other big FDI projects allocated in western Slovakia indicate that spillover effects, if there are any, have again been confined mostly to the western, better developed part of the country. Total FDI inflows in 2002 probably exceeded USD 4 billion, of which however more than 98% went into the Bratislava region; the lion's share, nearly EUR 3 billion, was invested in a 49% stake in the Slovak gas utilities. By concluding the latter deal the largest part of the Slovak privatization programme has been implemented.

In the wake of strong FDI and portfolio inflows, the Slovak koruna has appreciated by about 7% in nominal terms since August 2002. Nevertheless, due to expanding high value-added exports (mainly cars), the foreign trade deficit dropped slightly to less than EUR 2.3 billion in 2002. As a result the current account deficit fell slightly as well, to some 8% of GDP in 2002 as compared to 8.6% in 2001.

The new coalition government, in power since October 2002, will probably push through an economic programme that is first of all targeted at the stabilization of public sector expenditures such as healthcare, education and public administration. Thus greater fiscal prudence is expected for 2003 and 2004. Domestic demand will probably lose momentum in its role as the main driving force behind the country's economic growth. However, as exports will further expand, GDP growth in 2003 will decelerate only modestly to some 3.5%. For 2004 we expect higher GDP growth, thanks to expanding exports and slight recovery in domestic demand. The inflation rate will rise to about 7%, as the government restarted, at the beginning of 2003, to deregulate controlled prices for utilities, rents and public services. The current account deficit will decrease substantially, to 4% of GDP in 2003, again thanks to the export expansion but also benefiting from the weak US dollar that counteracts the current high oil prices. In 2004 the current account deficit may decrease even further because of strong exports. At the same time, the expected high FDI and portfolio inflows on the eve of EU accession will trigger an appreciation of the domestic currency, which however may undermine long-term gains in export competitiveness.

Table SK

Slovak Republic: Selected economic indicators

| | 1996 | 1997 | 1998 | 1999 | 2000 | 2001 | 2002 ¹⁾ | 2003 | 2004 |
|---|----------|--------|---------|---------|---------|---------|------------------------|-------|-------|
| | forecast | | | | | | | | |
| Population, th pers., mid-year | 5373.8 | 5383.2 | 5390.7 | 5395.3 | 5400.7 | 5379.8 | 5378.6 | . | . |
| Gross domestic product, SKK bn, nom. | 628.6 | 708.6 | 775.0 | 835.7 | 908.8 | 989.3 | 1055 | 1140 | 1245 |
| annual change in % (real) | 5.8 | 5.6 | 4.0 | 1.3 | 2.2 | 3.3 | 4.2 | 3.5 | 4.5 |
| GDP/capita (USD at exchange rate) | 3816 | 3915 | 4080 | 3740 | 3642 | 3804 | 4330 | . | . |
| GDP/capita (USD at PPP - wiiw) | 9590 | 10320 | 11070 | 11430 | 11280 | 12040 | 12600 | . | . |
| Gross industrial production | | | | | | | | | |
| annual change in % (real) | 2.5 | 2.7 | 5.0 | -2.7 | 8.6 | 6.9 | 6.3 | 5.5 | 6 |
| Gross agricultural production | | | | | | | | | |
| annual change in % (real) | 2.0 | -1.0 | -5.9 | -2.5 | -12.3 | 7.8 | . | . | . |
| Goods transport, mn t-kms | 18785 | 17672 | 17808 | 19996 | 19829 | 17486 | . | . | . |
| annual change in % | -7.9 | -5.9 | 0.8 | 12.3 | -0.8 | -11.8 | . | . | . |
| Gross fixed capital form., SKK bn, nom. | 203.4 | 242.9 | 280.9 | 252.9 | 267.9 | 309.6 | . | . | . |
| annual change in % (real) | 30.9 | 14.3 | 11.0 | -18.5 | 1.2 | 9.6 | 1 | 5 | 7 |
| Construction industry | | | | | | | | | |
| annual change in % (real) | 4.4 | 9.2 | -3.5 | -25.8 | -0.4 | 0.8 | 3.4 ^{I-XI} | . | . |
| Dwellings completed, units | 6257 | 7172 | 8234 | 10745 | 12931 | 10321 | 8513 ^{I-XI} | . | . |
| annual change in % | 1.6 | 14.6 | 14.8 | 30.5 | 20.3 | -20.2 | 25.2 ^{I-XI} | . | . |
| Employment total, th pers., average ²⁾ | 2224.9 | 2205.9 | 2198.6 | 2132.1 | 2101.7 | 2123.7 | 2119.1 ^{I-XI} | . | . |
| annual change in % | 3.6 | -0.9 | -0.3 | -3.0 | -1.4 | 1.0 | 0.0 ^{I-XI} | . | . |
| Employment in industry, th pers., average ²⁾ | 690.0 | 665.8 | 662.5 | 630.3 | 615.3 | 629.1 | 639.8 ^{I-XI} | . | . |
| annual change in % | 6.1 | -3.5 | -0.5 | -4.9 | -2.4 | 2.2 | 2.3 ^{I-XI} | . | . |
| Reg. unemployed, th pers., end of period | 329.7 | 347.8 | 428.2 | 535.2 | 506.5 | 533.7 | 504.1 | . | . |
| Reg. unemployment rate in %, end of period | 12.8 | 12.5 | 15.6 | 19.2 | 17.9 | 18.6 | 17.5 | 17 | 16 |
| LFS - unemployment rate in %, average | 11.3 | 11.8 | 12.5 | 16.2 | 18.6 | 19.2 | 19.0 | 18 | 17 |
| Average gross monthly wages, SKK | 8154 | 9226 | 10003 | 10728 | 11430 | 12365 | 12924 ^{I-XI} | . | . |
| annual change in % (real, gross) | 7.1 | 6.5 | 1.7 | -2.8 | -4.5 | 0.8 | 5.7 ^{I-XI} | . | . |
| Retail trade turnover, SKK bn ³⁾ | 296.5 | 328.8 | 379.4 | 442.1 | 481.1 | 301.1 | 287.7 ^{I-XI} | . | . |
| annual change in % (real) | 6.9 | 4.8 | 8.6 | 9.8 | 2.3 | 4.5 | 3.8 ^{I-XI} | . | . |
| Consumer prices, % p.a. | 5.8 | 6.1 | 6.7 | 10.6 | 12.0 | 7.1 | 3.3 | 7 | 7 |
| Producer prices in industry, % p.a. | 4.2 | 4.5 | 3.3 | 4.3 | 10.8 | 6.5 | 2.1 | . | . |
| Central government budget, SKK bn | | | | | | | | | |
| Revenues | 166.3 | 180.8 | 177.8 | 216.7 | 213.5 | 205.4 | 220.4 | . | . |
| Expenditures | 191.9 | 217.8 | 197.0 | 231.5 | 241.1 | 249.7 | 272.0 | . | . |
| Deficit (-) / surplus (+) | -25.6 | -37.0 | -19.2 | -14.8 | -27.6 | -44.4 | -51.6 | . | . |
| Deficit (-) / surplus (+), % GDP | -4.1 | -5.2 | -2.5 | -1.8 | -3.0 | -4.5 | -4.9 | . | . |
| Money supply, SKK bn, end of period | | | | | | | | | |
| M1, Money | 173.9 | 166.1 | 147.2 | 153.9 | 187.2 | 228.5 | 228.6 ^{Nov} | . | . |
| M2, Money + quasi money | 416.9 | 453.5 | 466.1 | 523.6 | 601.5 | 680.3 | 703.9 ^{Nov} | . | . |
| Discount rate, % p.a., end of period | 8.8 | 8.8 | 8.8 | 8.8 | 8.8 | 8.8 | 6.5 | . | . |
| Current account, USD mn | -1960 | -1804 | -1982 | -980 | -701 | -1756 | -1900 | -1300 | -1000 |
| Current account in % of GDP | -9.6 | -8.6 | -9.0 | -4.9 | -3.6 | -8.6 | -8.2 | -4.5 | -3.3 |
| Gross reserves of NB incl. gold, USD mn | 3473 | 3285 | 2923 | 3425 | 4077 | 4189 | 9195 | . | . |
| Gross external debt, USD mn | 7810 | 10700 | 11900 | 10518 | 10804 | 11043 | 12200 ^{Oct} | . | . |
| Exports total, fob, EUR mn ⁴⁾ | 7048.0 | 7299.0 | 9540.6 | 9602.2 | 12879.5 | 14115.4 | 15255.7 | 16800 | 18600 |
| annual growth rate in % | 6.2 | 3.6 | 11.9 | 0.6 | 34.1 | 9.6 | 8.1 | 10 | 11 |
| Imports total, fob, EUR mn ⁴⁾ | 8877.7 | 9119.0 | 11634.7 | 10627.7 | 13859.8 | 16487.8 | 17519.2 | 18400 | 19900 |
| annual growth rate in % | 30.9 | 2.7 | 12.3 | -8.7 | 30.4 | 19.0 | 6.3 | 5 | 8 |
| Average exchange rate SKK/USD | 30.65 | 33.62 | 35.24 | 41.42 | 46.20 | 48.35 | 45.33 | . | . |
| Average exchange rate SKK/EUR (ECU) | 38.40 | 38.01 | 39.60 | 44.12 | 42.59 | 43.31 | 42.69 | 41.5 | 41 |
| Purchasing power parity SKK/USD, wiiw | 12.20 | 12.75 | 12.99 | 13.55 | 14.92 | 15.28 | 15.57 | . | . |
| Purchasing power parity SKK/EUR, wiiw | 13.22 | 13.63 | 14.16 | 14.77 | 15.30 | 15.78 | 15.84 | . | . |

Notes: 1) Preliminary. - 2) Based on Labour Force Survey. - 3) From 2001 according to NACE, excluding VAT. - 4) Converted from the national currency to EUR at the official exchange rate; from 1998 new methodology.

Source: wiiw Database incorporating national statistics; wiiw forecasts.