CHAPTER 1

# MACROECONOMIC DEVELOPMENTS

1

# 1 Macroeconomic developments

## 1.1 THE EXTERNAL ECONOMIC ENVIRONMENT

### 1.1.1 Global trends in output and prices

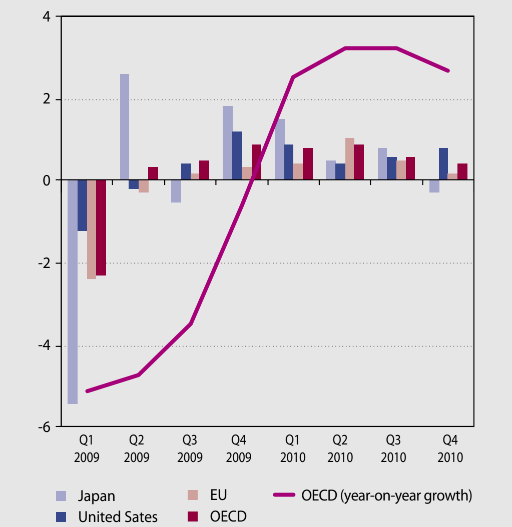
In 2010, world economic growth continued to recover gradually from the slump caused in the previous year by the global economic crisis. According to the IMF,[1] the global economy recorded year-on-year growth of 5.0% in 2010, compared with a contraction of 0.5% in 2009. However, the pace of economic recovery was not uniform. Growth in the first half of the year was stronger than in the second half, as it included the termination of fiscal stimulus measures implemented in 2009. There were also disparities in the pace of recovery between emerging economies and advanced economies. Emerging economies achieved substantially higher growth due to strong domestic demand, the continuation of economic support measures, and capital inflows. Advanced economies, by contrast, continued to suffer from weak domestic demand, high unemployment, sluggish real estate markets, and concerns about the sustainability of public debt levels in some advanced countries. These factors represent the highest risks to the acceleration of the economic recovery in advanced economies. On the positive side, the global economy was boosted by a revival in external trade, which increased by 12.1% in 2010 after declining by 10.9% in the previous year. The recovery of external trade was one of the key drivers of growth in advanced economies.

Global price developments in 2010 were marked by accelerating inflation, caused mainly by a substantial rise in energy prices as well as in prices of non-energy commodities. The average annual inflation rate in advanced economies rose from 0.1% in 2009 to 1.5% in 2010, while in emerging and developing economies it increased from 5.2% to 6.2%.[1] In advanced economies, price developments in 2010 were relatively steady and inflation expectations were firmly anchored; in developing economies, on the other hand, prices rose sharply and inflation pressures increased. The rise in commodity prices was driven mainly by strong demand from developing economies. Oil prices remained relatively stable in 2010; they did not record any substantial volatility and increased gradually towards the end of the year. The average oil price increased by 28.9% in 2010, after falling by 36.3% in 2009. The main factor behind this turnaround was strong demand from Asian emerging economies and production capacity constraints. Global prices of agricultural commodities also increased markedly, and given that these commodities have a high share in the consumption baskets of developing economies, they were the main cause of the high inflation pressures in these countries. As a result of the growth in the global economy, prices of metal and non-metal commodities also increased.

### 1.1.2 Economic developments in the euro area

After contracting sharply by 4.1% in 2009, the euro area economy grew by 1.7% in 2010. The recovery of economic activity stemmed mainly from an increase in global demand; this was subsequently reflected in net exports, which made a positive contribution to euro area growth as a result of export growth exceeding import growth (in contrast to the export slump recorded in the previous year). The labour market stabilised during the course of the year and the unemployment rate remained steady at 10%. This

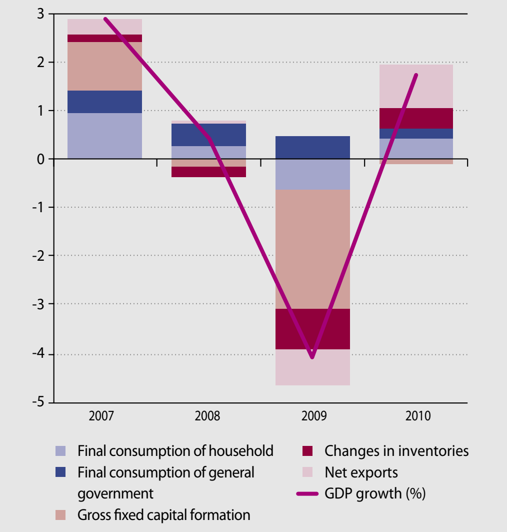
**Chart 1 Quarterly GDP growth (%)**




*Source: OECD.*

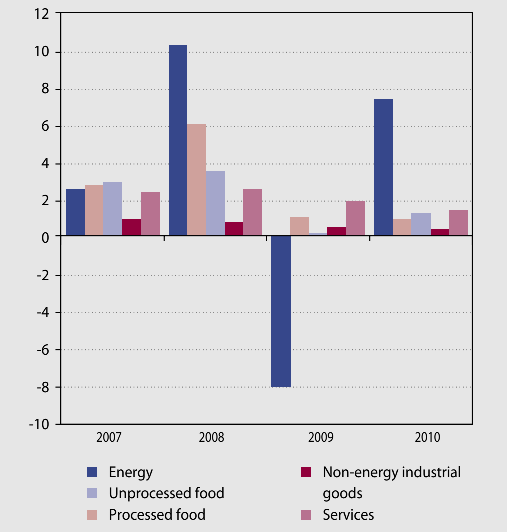
1 *IMF World Economic Outlook – April 2011.*

**Chart 2 Contributions to annual GDP growth (p.p.)**




*Source: Eurostat.*

**Chart 3 Components of HICP inflation in the euro area (annual percentage changes)**




*Source: Eurostat.*

development and the accompanying rise in consumer confidence became evident in consumer demand, which rose moderately in comparison with the previous year. Unlike in 2009, household final consumption made a positive contribution to growth. As for general government final consumption, its contribution was less than in 2009, partly due to the introduction of fiscal measures. Growth was also boosted by an upturn in the inventory cycle. The only component that had a dampening effect on growth was investment demand, although its decline was slower than in the previous year.

The overall average inflation rate, as measured by the harmonised index of consumer prices (HICP), accelerated to 1.6% in 2010, compared with 0.3% in 2009. Whereas commodity prices in 2009 had a dampening effect on price growth, their increase in 2010, along with the gradual economic recovery, was reflected in accelerated price rises. At the same time, however, labour market and wage developments were moderate and did not put upward pressure on prices of non-energy industrial goods and prices of services. The annual HICP inflation rate in December 2010 was higher than in December 2009, at 2.2% compared to 0.9%. Core inflation (overall index excluding energy and unprocessed food) was more-or-less stable during 2010 with an average level of 1.0% (in 2009 its average level was 1.3%).

The euro's exchange rate against the US dollar was considerably volatile during 2010, proving sensitivity to economic developments in the euro area and the United States as well as to fiscal and monetary-policy measures. The value of the euro against the US dollar at the end of 2010 was 6.8% lower than at the end of 2009.

The Governing Council of the ECB did not make changes to its key interest rates in 2010 and thus the interest rate on the main refinancing operations remained at 1.0%, the interest rate on the marginal lending facility at 1.75% and the interest rate on the deposit facility at 0.25%. The ECB continued to apply standard instruments and certain non-standard instruments. Although the Governing Council had decided towards the end of 2009 to phase out certain non-standard instruments (longer-term refinancing operations and liquidity swap facilities in US dollars and Swiss francs), these instruments were reactivated in May as a response to financial market tensions stirred by developments in Greece. Also towards the end of 2009, the Governing Council decided to return to variable rate tender procedures in the regular 3-month LTROs. However this type of tender was allotted only on 28 April 2010 and afterwards it reverted to the policy of fixed rate tender procedures with full allotment. In May, the ECB introduced the Securities Markets Programme (SMP), a temporary non-standard instrument used to purchase selected public and private debt securities. To re-absorb the excess liquidity injected through these interventions, special fine-tuning operations are conducted. Also in 2010, the ECB continued to purchase bonds under the Covered Bond Purchase Programme, a non-standard instrument that was introduced in July 2009 and completed in July 2010. Its purpose, like that of other non-standard instruments, was to ease financial market tensions, to ensure access to sufficient liquidity, and to restore the functioning of covered bond markets.[2]

## 1.2 MACROECONOMIC DEVELOPMENTS IN SLOVAKIA

The macroeconomic situation in Slovakia in 2010 reflected the fading of the effects of the global financial and economic crisis and the gradual stabilisation and revival of global economic activity. Compared with 2009, when the economic fundamentals were affected by recession, the economic recovery in Slovakia showed up in relatively strong economic growth in 2010, influenced mainly by positive developments in external demand. The favourable economic development supported a revival of business investments. The real economy also saw a gradual stabilisation of the labour market. The acceleration of inflation as a result of rising commodity prices at the global level was partially dampened by the stagnation of domestic demand.

Slovakia's gross domestic product (GDP) in 2010, measured at constant prices, increased by 4.0% in year-on-year terms, according to preliminary data from the Statistical Office of the Slovak Republic. In 2009, by contrast, GDP fell by 4.8% year-on-year. Largely due to a base effect, the pace of annual GDP growth slowed from 4.7% in the first quarter to 3.5% in the fourth quarter. The economic revival was driven mainly by the revival of external demand. Domestic demand recorded only modest year-on-year growth, with all components except for household final consumption making a positive contribution to it. Among the components of domestic demand, investment demand rose by the largest margin and an increase in inventories also contributed positively to GDP growth. Looking at economic growth broken down by output, its main drivers were industry and services. The construction sector remained in recession. With external demand rising amid the upturn in economic activities and with favourable terms of trade, there was a relatively strong rise in corporate profits. The most pronounced increase in profitability was reported by non-financial corporations, and the level of investment activity in this sector rose sharply. Another benefit linked to the rise in external demand was that net exports made a positive contribution to GDP growth.

Although the current account deficit of the balance of payments increased slightly in 2010 in comparison with the previous year, its ratio to GDP declined. There was also a change in the current account structure as the year-on-year decline in the trade surplus was offset by improvements in the services balance and current transfers balance. The lower trade surplus stemmed from the adverse effects of rising import intensity and the increasing prices of raw materials on world markets.

Despite persisting structural imbalances, the labour market began gradually to stabilise in 2010 owing to the recovery in economic activity. This was reflected in the unemployment rate, which fell over the course of the year. Average employment for the whole of 2010 (ESA 95 methodology) declined year-on-year; nevertheless it increased in the last two quarters. The number of hours worked recorded a year-on-year rise in 2010, after falling in the previous year. Given the upturn in the economy, both nominal and real wage growth accelerated slightly in the year-on-year comparison. Labour productivity increased year-on-year in both nominal and real terms, as a result of the rise in GDP. The increase in labour productivity overtook the real wages growth. Unit labour costs declined in year-on-year terms, largely because the rise in nominal compensation per employee was relatively low compared with real labour productivity growth.

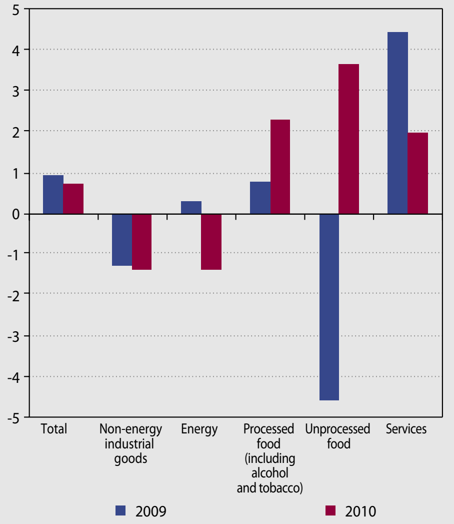
Price developments in 2010 were influenced by the global recovery of economic activity and the consequent gradual increase in the price level, which in December 2010 recorded a year-on-year rise of 1.3%. The gradual acceleration of inflation was driven by both external and domestic factors. World prices of oil and agricultural commodities put upward pressure on the price

2 *Further details can be found on the ECB website at www.ecb.int*

level, while stagnating domestic demand had a partially dampening effect. Commodity prices affected inflation mainly through the increase in prices of fuel and food. The slower rise in services prices reflected the level of consumer demand, which remained low amid uncertainty about future developments in the labour market and due to the decline in disposable income.

As regards the implementation of monetary policy in 2010, the ECB continued to focus on addressing the negative effects of the recession. The Governing Council made no changes to the ECB's key interest rates, and thus the main refinancing rate remained at 1.0%, the marginal lending facility rate at 1.75% and the deposit facility rate at 0.25%.

Chart 4 Inflation components (average rise in %)




Source: SO SR and NBS calculations.

### 1. 2.1 Price developments

#### Consumer prices

***Inflation as measured by the Harmonised Index of Consumer Prices (HICP)***

The average inflation rate slowed from 0.9% in 2009 to 0.7% in 2010. As for core inflation (the headline rate excluding including prices of energy and unprocessed food), it averaged 0.7% in 2010, which was 0.9 percentage points lower than in the previous year. The annual headline inflation rate for December 2010 reached 1.3%, representing an increase of 1.3 percentage points on the rate reported in December 2009.

That the average inflation rate fell despite a substantial rise in food prices was attributable to a fall in regulated energy prices in January 2010, to slower inflation in services prices, and also to slightly lower growth in prices of non-energy industrial goods. The gradual increase in prices of commodities (both energy and non-energy) led to a gradual acceleration in the annual rate of inflation, and by the end of 2010 the rate was higher than in December 2009.

Price developments in 2010 were determined by a combination of external and domestic factors. The domestic price level was influenced, on one hand, by the acceleration in global prices of oil and agricultural commodities, and, on the other hand, by the stagnation of domestic demand. The effect of commodity price developments on the inflation rate was seen mainly in prices of fuel and food. Consumer demand remained subdued amid uncertainty about the future (rising unemployment / declining employment), and dampened the rise in services prices.

***Goods***

Food prices represented the strongest inflationary component of goods prices in 2010. They were driven up by prices of agricultural commodities, which had a rising trend throughout the year. On average, food prices were higher during the whole of 2010 and their increase was most pronounced in the first three quarters. Prices of unprocessed food rose more sharply than prices of processed food. Annual food price inflation did not accelerate in the last quarter of the year because the year-on-year rise in processed food prices slowed towards the year-end. As for prices of unprocessed food, they accelerated sharply throughout the year. Processed food prices reflected the increase in prices of agricultural commodities, with rising prices of bread and flour-based products, milk and dairy products, and oils and fats. Concerning unprocessed food, fruit and vegetables became more expensive in 2010. The reduction in regulated energy prices in January 2010 translated into an average decline in energy prices for the year as a whole. However, fuel prices increased and thus mirrored the development of global oil prices. Prices of non-energy industrial goods declined on average over 2010, amid the

**Table 1 HICP inflation (average for the period; year-on-year change in %)**

| | 2009 | | 2010 | | | | | |
|---|---|---|---|---|---|---|---|---|
| | Dec. | Q1–Q4 | Q1 | Q2 | Q3 | Q4 | Dec. | Q1–Q4 |
| **Headline rate** | 0.0 | 0.9 | 0.0 | 0.7 | 1.0 | 1.1 | 1.3 | 0.7 |
| Goods | -1.3 | -0.8 | -1.0 | 0.1 | 0.6 | 0.7 | 1.0 | 0.1 |
| Industrial | -0.8 | -0.7 | -1.4 | -1.2 | -1.4 | -1.3 | -1.1 | -1.3 |
| Non-energy industrial goods | -1.8 | -1.3 | -1.6 | -1.5 | -1.3 | -1.1 | -1.1 | -1.4 |
| Energy | 0.9 | 0.3 | -1.3 | -0.8 | -1.7 | -1.6 | -1.2 | -1.3 |
| Food | -2.2 | -0.9 | -0.2 | 2.7 | 4.6 | 4.6 | 5.1 | 2.9 |
| Processed food (including alcohol and tobacco) | -0.8 | 0.8 | 0.3 | 2.7 | 3.4 | 2.8 | 2.6 | 2.3 |
| Unprocessed food | -5.2 | -4.6 | -1.7 | 1.9 | 6.7 | 8.1 | 9.8 | 3.6 |
| Services | 2.8 | 4.4 | 2.0 | 2.0 | 1.9 | 1.8 | 1.8 | 1.9 |
| Core inflation (headline rate excluding energy and unprocessed food prices | 0.4 | 1.6 | 0.3 | 0.8 | 1.0 | 0.9 | 0.9 | 0.7 |
| Headline rate excluding energy prices | -0.1 | 1.1 | 0.2 | 1.0 | 1.5 | 1.5 | 1.7 | 1.1 |

*Source: NBS calculations based on data from the Statistical Office of the Slovak Republic.*

continuing downward trend in demand (retail sales fell) as well as the slow rise in prices of non-energy industrial goods in the euro area.

***Services***

Services prices rose at a slower pace in 2010 owing to lower price increases in all the main categories, particular in prices of transport services, holidays and leisure services, and health care services. This was caused by developments in regulated prices (in the case of transport and health care, they increased more slowly than in 2009) and low demand and cost factors (affecting prices of holidays and leisure services).

### Producer prices

Producer price developments during 2010 were relatively heterogeneous. While industrial producer prices and construction material prices decreased in year-on-year terms over the most part of 2010, construction work prices and agricultural product prices increased in comparison with the previous year.

Industrial producer prices fell by 2.8% year-on-year, mainly because energy prices recorded an annual drop of 6.7%, which in turn was largely caused by a sudden reduction in electricity prices in the first two months of the year. By contrast, refined oil products had the largest inflationary effect, as they increased by 30.3%.

Agricultural product prices recorded an average annual increase of 14.2% in 2010, rising from an annual drop of 8.5% in the first quarter to a relatively substantial increase of 30.0% in the fourth quarter. This change was largely due to a sharp rise in plant product prices in the second half of the year.

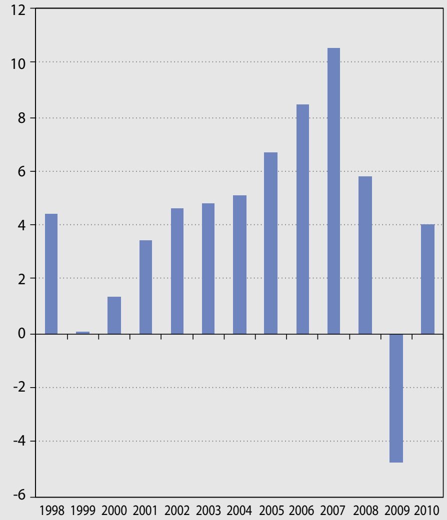
Construction work prices in 2010 rose by a modest 1.0% in year-on-year terms, without any volatility throughout the year. Construction material prices recorded an average annual decline of 3.3%, from a substantial drop of 8.4% in the first quarter of the year to a slight growth of 0.3% in the last quarter.

### 1.2.2 Gross domestic product

Slovakia's gross domestic product (GDP) in 2010, measured at constant prices, increased by 4.0% in year-on-year terms, according to preliminary data from the Statistical Office of the Slovak Republic. In 2009, by contrast, GDP fell by 4.8% year-on-year.

In expenditure terms, the growth in 2010 was driven mainly by the recovery of external demand, while domestic demand recorded only a modest rise. Looking at annual GDP broken down by output, the main components contributing to its growth were industry and services. The nominal volume of GDP for 2010 amounted

**Chart 5 Real GDP (annual percentage growth)**




*Source: SO SR.*

to €65,906 million, which was 4.5% higher than the figure for the previous year.

Owing to a base effect, the pace of annual GDP growth slowed from 4.7% in the first quarter to 3.5% in the fourth quarter.

After seasonal adjustments, growth continued to pick up. In quarter-on-quarter terms, GDP accelerated moderately over the year and recorded an average increase of 0.8%.

### Supply side of GDP

GDP formation in 2010 was boosted by the value added component, which at constant prices recorded a year-on-year rise of 4.5% (compared to a drop of 4.6% in 2009). There was, however, a slightly dampening effect from net taxes on products (value added tax, excise tax and import tax, less subsidies), which fell by 0.7% mainly due to developments towards the year-end (in 2009 these taxes declined by 6.9%).

The sectors in which the rise in value added was most pronounced were industry and services. By contrast, the agriculture and construction sectors reported decreases in value added.

### Demand side of GDP

In terms of expenditure, economic growth in 2010 was driven mainly by the continuing revival of external demand (up by 16.4%) and to a lesser extent by the slight rise in domestic demand (2.4%).

Looking at the components of domestic demand in 2010, investment demand rose by the largest margin and an increase in inventories also contributed to GDP growth. The consumption component continued to decline moderately, largely due to a decrease in household consumption. General government consumption remained flat.

***Domestic investment demand***

As economic activities gradually picked up in 2010, so too did the financial situation of firms. The combination of increasing profitability and an easing of bank credit standards led to a gradual recovery in corporate investment activities, especially in the second half of the year. As a result, gross fixed capital formation (constant prices) increased in 2010 by 3.6%. The main contributions to this growth were from investments of non-financial corporations in machinery and equipment and in other buildings. Almost all sectors contributed to the increase in gross fixed capital formation, with the manufacturing sector providing the largest boost.

**Table 2 GDP formation and its components (index, same period a year earlier = 100, constant prices)**

| | 2009 | 2010 | | | | |
|---|---|---|---|---|---|---|
| | Q1–Q4 | Q1 | Q2 | Q3 | Q4 | Q1–Q4 |
| Gross output | 90.2 | 106.6 | 108.2 | 108.5 | 105.7 | 107.2 |
| Intermediate consumption | 86.9 | 107.5 | 111.3 | 112.1 | 106.1 | 109.1 |
| Value added | 95.4 | 105.2 | 104.0 | 103.9 | 104.9 | 104.5 |
| Net taxes on products[1)] | 93.1 | 99.5 | 106.2 | 102.9 | 89.4 | 99.3 |

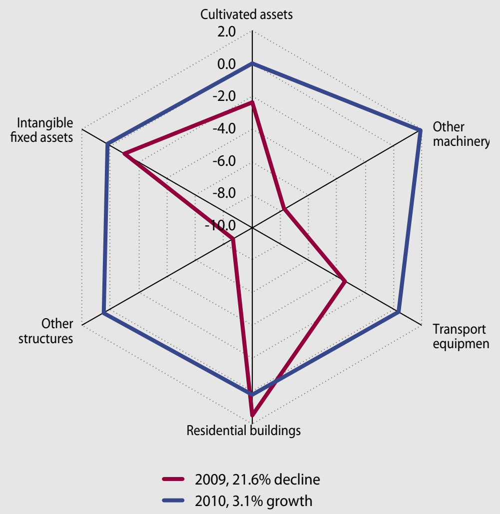
*Source: SO SR.*
*1) Value added tax, excise tax and import tax, less subsidies.*

**Table 3 GDP broken down by expenditure (index, same period a year earlier = 100, constant prices)**

| | 2009 | 2010 | | | | |
|---|---|---|---|---|---|---|
| | Q1–Q4 | Q1 | Q2 | Q3 | Q4 | Q1–Q4 |
| Gross domestic product | 95.2 | 104.7 | 104.2 | 103.8 | 103.5 | 104.0 |
| Domestic demand | 92.7 | 99.7 | 104.0 | 104.0 | 101.5 | 102.4 |
| Final consumption | 101.5 | 101.2 | 98.7 | 100.0 | 99.5 | 99.8 |
| Household | 100.2 | 99.9 | 98.6 | 99.7 | 100.5 | 99.7 |
| General government | 105.6 | 105.9 | 98.9 | 100.9 | 96.7 | 100.1 |
| Non-profit institutions serving households | 100.7 | 103.1 | 102.2 | 102.1 | 101.7 | 102.3 |
| Gross fixed capital formation | 80.1 | 96.6 | 101.8 | 104.8 | 110.6 | 103.6 |
| Exports of products and services | 84.1 | 118.3 | 116.1 | 117.3 | 114.3 | 116.4 |
| Imports of products and services | 81.4 | 110.9 | 116.0 | 119.2 | 113.5 | 114.9 |

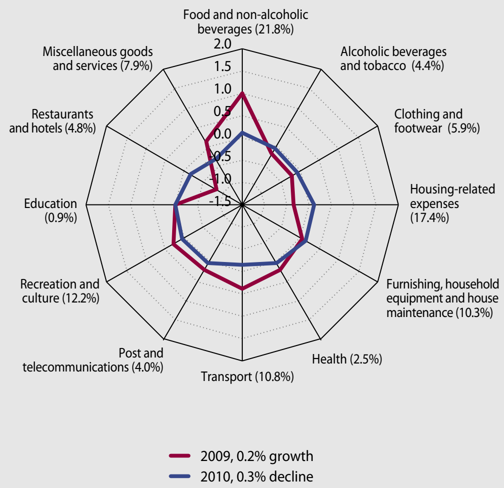
*Source: SO SR.*

**Chart 6 Contributions to the growth in fixed investment (p.p.; current prices)**




*Source: SO SR. and NBS calculations.*

**Chart 7 Items of consumption expenditure by contribution to household final consumption growth (shares in %)**



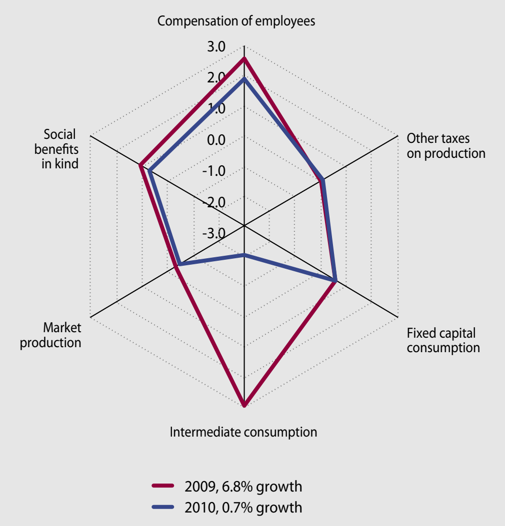

*Source: SO SR. and NBS calculations.*

***Domestic consumption demand***

Final consumption expenditure for 2010 fell slightly in year-on-year terms, mainly due to a decline in household consumption. General government consumption remained flat.

The pickup in economic activity during 2010 was reflected in an improving labour market situation; nevertheless, household final consumption continued to decline owing to a combination of still-high unemployment, a slight decrease in household disposable income (due to lower social benefits and property income), and low consumer confidence. Looking at consumption expenditure broken down by item, its decline was largely caused by decreases in spending on various goods and services and on transport, and by slower growth in spending on food. The main upward pressure came from housing-related expenditure.

**Chart 8 Contribution to the growth in general government final consumption (p.p.; current prices)**




*Source: SO SR and NBS calculations.*

***Exports and imports of goods and services***

As external demand picked up in 2010, the economy's export performance increased and exports of goods and services rose by 19.7% at current prices. Given the existing level of import intensity, the volume of imports surged by 20.5%. Owing to the accelerated growth in imports, as well as to the rebuilding of inventories, the deficit of nominal net exports increased from €279 million in 2009 to €672 million in 2010. Price developments in external trade were related to rising prices of oil, metals, and other non-energy commodities, especially in the second half of the year. This increase was reflected mainly in the import deflator, which rose by 4.9%. The increase in the export deflator (2.9%), which was influenced by the rise in industrial producer prices, reflected the rise in commodity prices to a lesser extent owing to their lower weight. Thus, the terms of trade improved in 2010 and net exports made a positive contribution (of 2.1 percentage points) to GDP growth.

Both the export performance and the import intensity of the Slovak economy in 2010 recorded a year-on-year increase of around 10 percentage points. The openness of the Slovak economy, as measured by the ratio of exports and imports of goods and services to nominal GDP, reached 162.7% in 2010.

### 1.2.3 Labour market

#### Employment

The situation in the labour market gradually began to stabilise in 2010. Average employment (ESA 95) for 2010 as a whole fell by 1.4% year-on-year (compared to an annual drop of 2.5% in 2009), but it increased in the second half of the year in quarter-on-quarter terms. In contrast to the employment trend, the number of hours worked in 2010 rose by 1.8% year-on-year, after falling by 6.6% in 2009.

Looking at the decline in employment by sector, the largest fall in 2010 occurred in industry. The only sectors in which employment did not drop below the previous year's level were real estate and rental activities, general government and defence, and education.

The number of persons working abroad declined by 1.8% (or 2,300 persons) in 2010. Across the domestic economy, the number of employees fell by 2.4% and the number of entrepreneurs increased by (0.1%).

#### Unemployment

The number of unemployed (measured by a labour force sample survey) rose in 2010 by 20% in comparison with the previous year, despite the pickup in economic activity. This was reflected in the unemployment rate, which climbed by 2.3 percentage points to 14.4%. A factor in this development was the lagged effect of the GDP contraction on employment. Because of the impact of the economic crisis, firms in Slovakia began to cut production and, in an effort to protect jobs, many of them put employees on short time. Thus, in the first half of 2009, the number of hours worked fell sharply year-on-year. From the second half of 2009, the contraction of GDP was already putting downward pressure on employment, as firms were no longer able to survive simply by reducing the number of hours worked. As a consequence, and despite the recovery of economic activity, employment continued to fall in 2010 and the number of unemployed rose. According to the registers of Offices for Labour, Social Affairs and Family, the average unemployment rate in 2010 was 12.5%, which was 1.1 percentage points higher than in 2009.

#### Wages and labour productivity

Evidence of the gradual improvement in the labour market in 2010 was provided by the average monthly nominal wage, which increased slightly by 3.2% in comparison with 2009, to €769. The highest nominal wage growth in this period took place in the sectors of real estate (6.0%), industry (5.4%), accommodation and food service activities (4.7%), health care and social work (4.0%), and construction (3.6%). By contrast, the average nominal wage remained below the level of the previous year in the administrative services sector and other activities sector.

Average real wage growth in 2010 represented 2.2% year-on-year, which was 0.8% higher than in 2009 owing to lower annual inflation.

The volume of GDP in 2010 came very close to the pre-crisis level, but it was produced by a far fewer number of workers. Thus labour productivity (GDP per employee in the economy) increased in both nominal and real terms in 2010, after declining in 2009.

The increase in labour productivity exceeded real wage growth by 3 percentage points, and this development had a favourable effect on unit labour costs, which fell by 2.7% in year-on-year terms. That figure was 10.2 percentage points lower than the increase recorded in 2009, and it may help to strengthen the country's competitive advantage in the area of labour costs.

### 1.2.4 Financial results

Profits of financial and non-financial corporations in 2010 amounted to €9,144.3 million, according to preliminary data from the Statistical Office of the Slovak Republic. This represented a rise of 24.4% compared with 2009 (profits in that year fell by 17.8%). The upturn in the financial result was mainly attributable to profits of non-financial corporations, which rose by 30.4% year-on-year (after falling by 30.8% in 2009). This favourable trend stemmed from the revival in economic activity during the year. However, the increase in profitability of non-financial corporations was partially offset by the profits of financial corporations, which slumped by 27.8% compared with the previous year.

The profitability growth of non-financial corporations reflected the higher profits generated in all sectors of the economy amid the overall economic recovery. The most substantial contribution to the profit growth of non-financial corporations was made by the industry sector (a contribution of 17.4 percentage points from a year-on-year profit increase of 40.7%). All other sectors also recorded a substantial rise in their financial result in comparison with the previous year, with all sectors achieving a severalfold increase in profits. Profitability in the industry sector was boosted mainly by profits in manufacturing, which climbed by 109.8% year-on-year; the sectors that made the largest contributions

**Table 4 Labour market indicators**

| | 2009 | 2010 | | | | |
|---|---|---|---|---|---|---|
| | Q1-Q4 | Q1 | Q2 | Q3 | Q4 | Q1-Q4 |
| Nominal wage (index) | 103.0 | 102.1 | 103.5 | 103.7 | 103.8 | 103.2 |
| Real wage (index) | 101.4 | 101.6 | 102.3 | 102.6 | 102.7 | 102.2 |
| Nominal compensation per employee – under ESA 95 (index) | 105.0 | 103.0 | 103.3 | 101.5 | 102.5 | 102.7 |
| Labour productivity in terms of GDP (index, current prices) | 98.6 | 106.4 | 106.2 | 106.3 | 103.8 | 105.7 |
| Labour productivity in terms of GDP (index, constant prices) | 99.7 | 108.1 | 105.8 | 104.3 | 102.8 | 105.2 |
| Employment – under ESA 95 (index) | 97.5 | 97.0 | 97.7 | 99.3 | 100.5 | 98.6 |
| Unemployment rate according to a LFSS[1] (%) | 12.1 | 15.1 | 14.4 | 14.1 | 13.9 | 14.4 |
| Nominal unit labour costs[2] | 107.5 | 95.4 | 96.9 | 97.1 | 99.6 | 97.3 |

*Source: SO SR, and NBS calculations based on SO SR data.*
*1) Labour force sample survey.*
*2) Ratio of compensation per employee growth at current prices to labour productivity growth (ESA 95) at constant prices.*

to manufacturing profits were manufacture of transport equipment, manufacture of metals and metal products, and manufacture of chemicals and pharmaceutical products.

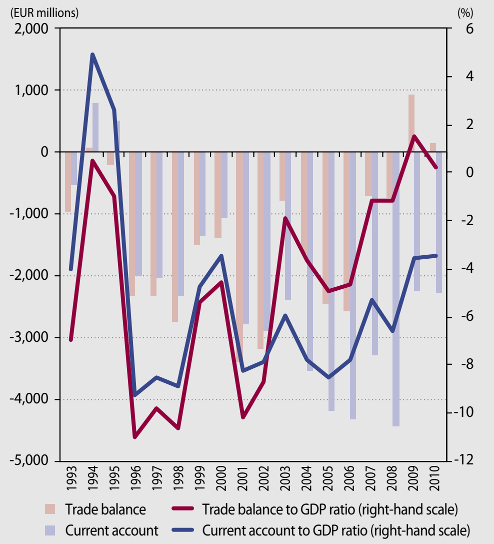
The profits of financial corporations in 2010 amounted to €554.3 million, representing a year-on-year drop of 27.8%. The sector largely responsible for the deterioration in the financial result was monetary financial institutions, owing to the loss reported by Národná banka Slovenska. Financial corporations not including NBS reported profits that were 53.5% higher than in the previous year. Other financial intermediaries also recorded profit growth, while the profits of insurance corporations and pension funds were almost the same as in 2009.

### 1.2.5 Balance of payments

#### Current account

In 2010, the current account of the balance of payments amounted to €2.3 billion. Although this represented only a slight increase on the previous year, the structure of the current account underwent a substantial change. The year-on-year decline in the trade balance surplus was offset by improvements in the services balance and current transfers balance, while the income balance deficit recorded only a minimal change compared to the previous year. The ratio of the current account deficit to GDP (at current prices) represented 3.5%, which was similar to the ratio in 2009. The current account in 2010 reflected the fading of the effects of the financial and economic crisis, mainly through an increased volume of exports and imports, improvements in the balance of services, and a moderate rise in dividend payments as a result of positive expectations for the future.

**Chart 9 Current account and trade balance developments**




*Source: NBS and the SO SR.*

The year-on-year deterioration in the trade balance surplus stemmed from the negative effect of rising import intensity, the increasing prices of raw materials on world markets, and the higher investments and inventories. These factors substantially outweighed the positive effect of export growth (stimulated by the pickup in external demand that followed the fading of the economic crisis). Thus exports and imports recorded strong year-on-year growth in 2010, after falling in 2009. Exports increased by 22.8% and imports by 25.5%.

**Table 5 Balance of payments current account (EUR billions)**

| | 2010 | 2009 |
|---|---|---|
| Trade balance | 0.1 | 0.9 |
| Exports | 48.8 | 39.7 |
| Imports | 48.7 | 38.8 |
| Services balance | -0.7 | -1.2 |
| Income balance | -1.2 | -1.3 |
| of which: investment income | -2.4 | -2.4 |
| of which: reinvested earnings | -0.6 | -0.5 |
| Current transfers balance | -0.4 | -0.7 |
| Current account in total | -2.3 | -2.3 |
| Current account to GDP ratio (%) | -3.5 | -3.6 |

*Source: NBS and the SO SR.*

The deficit in the services balance contracted in comparison with the previous year, mainly due to an improvement in the balance of *other services in total*, caused by a drop in expenditures on financial services and by an increase in revenue for provided computer services. Owing to weak domestic demand, the balance of *tourism services* improved through a decline in expenditure. By contrast, expenditure on transport services climbed as a result of the higher volume of transported goods, and this development put upward pressure on the deficit in the balance of transport services.

The year-on-year improvement in the income balance was attributable to the *compensation of employees* balance, which recorded a higher surplus owing to a decline in remittances of non-resident workers in Slovakia. The *investment income* balance remained largely unchanged owing to the effect of opposing factors. On one hand, expected increase in foreign direct investment enterprises profits was reflected in the rise in dividends paid to external investors; on the other hand, this effect was offset by positive developments in interest income in the NBS sector.

The current transfers balance recorded a year-on-year improvement in 2010 due to an increased surplus in the balance of *general government transfers*, where the rise in income from EU funds was accompanied by a decline in payments to the EU budget.

### Capital and financial account of the balance of payments

The capital and financial account of the balance of payments recorded a surplus of €0.5 billion in 2010 (compared to a surplus of €3.4 billion in 2009). The inflow of funds to the capital and financial account declined in year-on-year terms, largely due to a drop in received deposits in the balance of *other investments* (which was caused by the robust inflow of funds to the Government and NBS sector in 2009 when NBS borrowed funds through TARGET2).

**Table 6 Capital and financial account of the balance of payments (EUR billions)**

| | 2010 | 2009 |
|---|---|---|
| Capital account | 1.0 | 0.5 |
| Direct investment | 0.0 | -0.3 |
| Abroad by Slovak residents | -0.2 | -0.3 |
| of which: equity capital | -0.4 | -0.3 |
| reinvested earnings | 0.2 | 0.0 |
| in SR | 0.3 | 0.0 |
| of which: equity capital | -0.2 | 0.8 |
| of which: non-privatised FDI[1)] | -0.2 | 0.8 |
| reinvested earnings | 0.4 | 0.5 |
| Portfolio investment and financial derivatives | -1.3 | -0.7 |
| Other long-term investment | -0.1 | -0.8 |
| Other short-term investment | 0.9 | 4.8 |
| **Capital and financial account in total** | 0.5 | 3.4 |

*Source: NBS.*
*1) FDI – foreign direct investment.*

Foreign direct investment rose in 2010 mainly due to inflows of other capital, as domestic direct investment enterprises recorded a decline in claims of affiliated enterprises on direct investors and an increase in liabilities to them.

In the *portfolio investment* balance, the year-on-year rise in the outflow of funds was caused by an increase in demand among residents for foreign securities, which was only partly offset by higher demand among non-residents for government debt securities.

In the *other investment* balance, the year-on-year decline in the inflow of funds was caused mainly by developments in the Government and NBS sector in 2009, when funds flowed into the sector as a result of the policy adopted by NBS after Slovakia joined the euro area (in order to meet its liabilities vis-à-vis the banking sector, the central bank borrowed funds from the Eurosystem through TARGET2, instead of using its foreign reserves).

### External debt of Slovakia

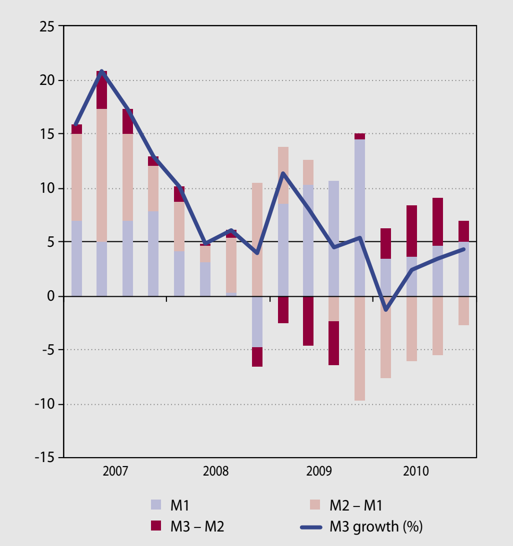
As a result of developments in the balance of payments, the external debt of Slovakia in 2010 increased by €3.9 billion (USD 0.5 billion), to €49.3 billion (USD 65.8 billion). This mainly reflected a rise in demand for government bonds and an increase in the share of the commercial sector's short-term external liabilities. According to preliminary data, Slovakia's total gross external debt as a share of GDP at current prices reached 74.7% as at 31 December, representing an increase of 3.1 percentage points compared with 2009.

### Nominal and real effective exchange rates

The nominal effective exchange rate (NEER) index weakened by an average of 2.7% year-on-year in 2010, after appreciating by 8.0% in the previous year. The depreciation of the NEER index largely accounted for weakening against the Czech koruna, to the extent of 0.9 percentage point.

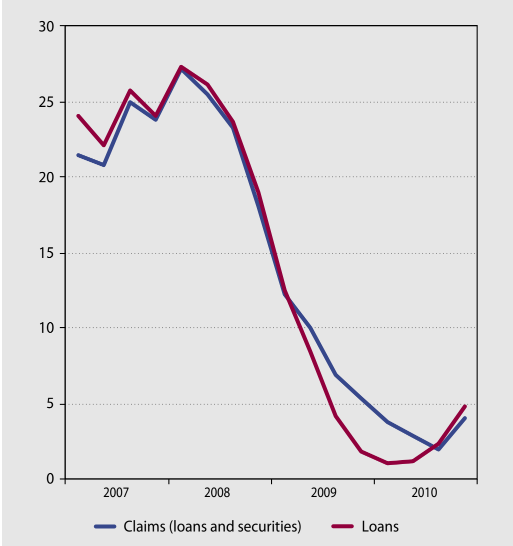
The weakening of the NEER index was reflected in the real effective exchange rate (REER) index

**Chart 10 Contributions of components to M3 growth (p.p.; annual percentage growth)**




*Source: NBS.*

**Chart 11 MFI claims on the private sector (quarterly average in %)**




*Source: NBS.*

based on industrial producer prices – manufacturing, which depreciated by 7.1% in 2010 after appreciating by 6.4% in the previous year.

### 1.2.6 Monetary developments

#### Monetary aggregates

Monetary indicators showed positive tendencies in 2010 as a result of favourable economic developments. The contribution of monetary financial institutions (MFIs) to the euro area's M3 monetary aggregate began rebounding in the third quarter of 2009 and it increased at a gradually accelerating pace in 2010. As at the year-end, the annual growth of M3 represented 4.3%. The main contributor to this growth was the increase in incomes in the household and non-financial corporation sectors. Another determinant of monetary aggregate developments was the shape of the yield curve. On the counterpart side, M3 growth was accompanied by an increase in lending.

Turning to the sectoral breakdown, the increase in private sector deposits was driven mainly by an increase in deposits of non-financial corporations. This reflected positive macroeconomic developments that were largely the result of rising external demand. The growth in output and sales that led to an increase in deposits occurred mainly in export-dependent sectors (industry, and transport and storage). The types of deposits of non-financial corporations which recorded the largest growth were the most liquid deposits. As for household deposits, they also increased during 2010, reflecting the weak consumption in this sector and the consequently higher savings ratio. The growth in deposits in 2010 was also supported by a moderate acceleration in wage growth. In seeking higher remuneration on their deposits, households gravitated towards long-term fixed deposits not included in M3. Thus the amount of M3 deposits recorded a slight year-on-year decline throughout 2010.

Turning to claims, their amount as at the end of 2010 was 4.5% higher than a year earlier. The growth in claims was accounted for mainly by loans to the private sector, with securities remaining flat. The preferred sources of financing for non-financial corporations were own funds and loans rather than the issuance of securities, particularly in the last quarter of 2010.

Towards the end of 2010, lending growth to non-financial corporations ceased its year-on-year downward trend and entered positive territory. Most of the growth was accounted for by short-term loans. This development reflected the rise in economic activity, with firms having to finance inventories and increased production. There was also growth in long-term loans with a maturity of more than five years, which may have been affected by the slightly higher investment demand. As for long-term loans with a maturity of between one and five years, their declining tendency became more pronounced.

Lending to households increased in the favourable macroeconomic circumstances. In this case, real estate loans continued to account for most of the growth, and the rise in these loans accelerated slightly in 2010. This mainly reflected the continuing moderate decline in property prices, the loosening of credit standards (through the slight lowering of interest rates and easing of collateral requirements – to allow loans for up to 100% of the value of the property), and positive expectations for economic developments in the future. The household sector's demand for loans as a means of refinancing older loans remained relatively strong.

### Investment in open-end investment funds (OIFs)

For all categories of OIFs in Slovakia (both euro-denominated and foreign currency-denominated funds), total net sales in 2010 amounted to €377.3 million.[3] This was more than three times higher than the figure for 2009, and the breakdown of the sales by fund category showed considerable differences. Money market funds reported negative net sales in 2010, after being the clear market leader among investment funds in 2009. Other fund categories had positive net sales for the year, with bond funds and mixed funds recording the highest sales.

### Interest rates

The European Central Bank (ECB) made no change to its key interest rates in 2010. Through longer-term and short-term operations, the ECB provided liquidity and ensured that the interbank market functioned smoothly. This was reflected in market interest rates, which remained relatively stable throughout the year and in retail rates, particularly in deposit and lending rates for non-financial corporations. Lending rates for households recorded a slightly downward trend in 2010, owing to the strong competition among banks for customers and to the fact that funds for the financing of the credit expansion were relatively cheap and accessible.

Lending rates for non-financial corporations remained stable in 2010. In the household sector, prices of real estate loans maintained a slightly falling trend. This favourable development was largely due to the fact that banks had the scope to set lower interest rates. This is evidenced by the difference between average interest rates in Slovakia and in the euro area as a whole, which reached 2 percentage points. As a result of competition, however, this difference fell in the last quarter to around 1.4 percentage points. In the case of consumer loans, interest rates remained stable, although relatively high (at around 13%).

*3 The merger of investment funds and their conversion into euro funds at the end of 2008 caused a significant increase in the number of funds denominated in the domestic currency (euro) and decrease in the number of funds denominated in foreign currency (from around 550 to 460), according to data from the Slovak Association of Asset Management Companies. In 2009, the number of funds again fell sharply (from 574 in July to 495 by the year-end), and in 2010 the number stabilised at between 494 and 511 (the year-end number of 498 was only slightly higher than the figure at the end of 2009).*