# Recovery of economic convergence in Europe – uneven, insufficient and short-lived?[1]

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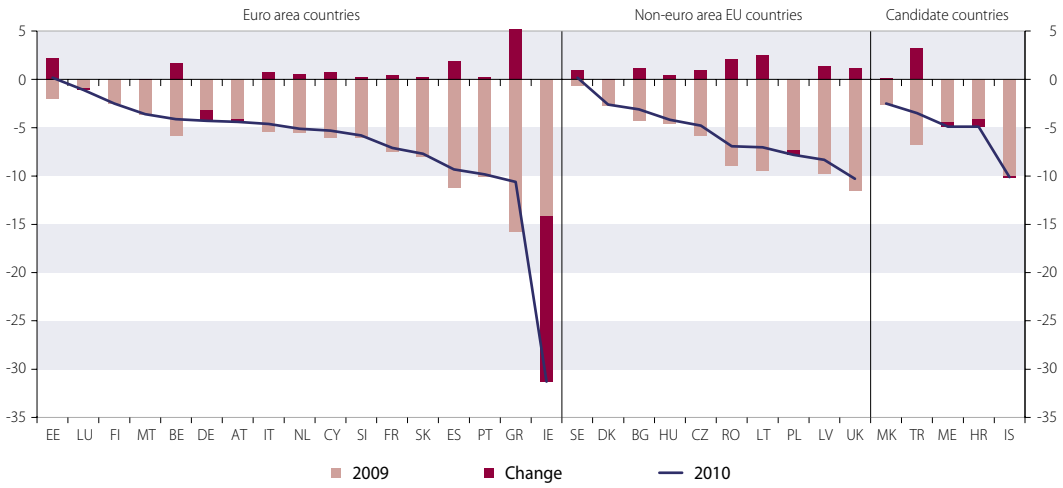
*Reálna konvergencia Slovenska sa v roku 2010 obnovila. Tempo rastu produktivity a HDP na obyvateľa patrilo medzi najvyššie v EÚ. Zaznamenané zlepšenie na trhu práce bolo mierne a nerovnomerné. Rast cenovej hladiny na Slovensku sa javí byť v súlade s vývojom výkonnosti domácej ekonomiky aj v dlhšom období. Maastrichtské kritériá na zavedenie eura by v auguste 2011 plnilo iba Fínsko. V nasledujúcich dvoch rokoch bude Slovensko, ako aj väčšina súčasných a budúcich krajín EÚ pravdepodobne naďalej vykazovať nadmerný deficit. Najvyššiu šancu splniť všetky nominálne kritériá spomedzi krajín EÚ mimo eurozóny bude mať Švédsko. Slovensko by spolu s väčšinou nových členských krajín EÚ a kandidátskych krajín malo pokračovať v približovaní sa k priemeru EÚ. Prehlbujúca sa dlhová kríza a prípadné ďalšie zhoršenie hospodárskeho vývoja v Európe však zvyšujú riziko nenaplnenia prognóz týkajúcich sa procesu dobiehania.*

## State of nominal convergence

The annual downward trend in the general government budget balance came to an end in 2010. The average general government deficit in EU countries stood at 6.6% of GDP, which was 0.3 percentage point lower than the deficit in 2009. The majority of EU countries (including Slovakia) reported an excessive budget deficit and did not meet the Maastricht fiscal criterion. The only countries in which the general government deficit-to-GDP ratio was higher than in Slovakia were those hardest hit by the financial and debt crisis. Ireland, which has spent heavily on reviving its financial sector, reported the largest deficit. Only five EU countries managed to keep their deficit below the 3% of GDP reference value (they were Estonia, Luxembourg, Finland, Sweden and Denmark) and only one candidate country did so (Macedonia).

The persistently high budget deficit had a further upward effect on general government debt. While most countries had taken advantage of the pre-crisis economic boom to reduce their debt-to-GDP ratio (and build up their reserves at least to some extent), there were several EU countries, both old and new, where government debt in the pre-crisis period had risen more sharply than GDP.[2] The average debt ratio of EU countries rose in 2010 to more than 80% of GDP, while the debt ratio of Greece climbed above 140%. Although Slovakia's annual accumulation of debt in 2010 was relatively high, the country remains one of five in the euro area whose debt ratio is lower than 60% of GDP.[3] In the Balkan countries

*Chart 1 General government budget balance in EU Member States and candidate countries (% of GDP)*




*Source: Eurostat, European Commission.*

1 This contribution provides a brief summary of the main findings presented in the NBS publication entitled Analýza konvergencie slovenskej ekonomiky 2011 (Analysis of the convergence of the Slovak Republic 2011) and updates several of the conclusions contained therein.
2 The euro area countries that recorded the highest debt ratio increase in the period 1999 to 2007 were Portugal and Greece. Among the non-euro area EU countries, the most marked debt ratio rises were recorded in Hungary and the Czech Republic.
3 In general, the debt ratio is lower in new EU countries than in old EU countries. The only old EU countries that have a debt ratio below 60% of GDP are Luxembourg and Finland.

and Turkey, the debt ratio is far lower than the reference value, and Turkey even reported a year-on-year decline in its government debt-to-GDP ratio. Among the candidate countries, Iceland constitutes a special case in that its level of government debt rose to 93% of GDP in conjunction with its still high deficit.

The recovery of global economic activity and rising prices of food and energy contributed to an increase in inflation. Given the rise in the reference value, the 12-month average inflation rate in most of the countries under review (including Slovakia) remained below that value.[4] In August 2011, the inflation criterion was met in 17 of the 27 EU countries. In the Czech Republic, Sweden and Denmark, the annual average inflation rate fluctuated below the reference value for more than 12 months.

In Croatia and Montenegro, consumer price increases remained low despite the rise in external inflationary pressures. In August 2011, the average inflation rate in each of these two countries remained far lower than the reference value.[5] In Macedonia the 12-month average inflation rate in May 2011 rose above the reference value. The annual average rate in Iceland was higher than in the western Balkan countries, even though it has reported high annual disinflation. Inflation in Turkey was several times higher than that in the three EU countries with the lowest inflation rate.

Interest rates in the euro area countries hardest hit by the debt crisis climbed to record levels and triggered a rise in the credit risk premium of several of the euro area countries that were not reliant on international financial assistance. By contrast, the 12-month average interest rates in Germany and in certain other old EU countries declined year-on-year. In August 2011, interest rates in EU candidate countries and new, non-euro area EU countries (except the Czech Republic) were higher than the reference value. The countries participating in the exchange rate mechanism satisfied the condition of exchange rate stability. Among the countries under review, only Finland fulfilled all the Maastricht criteria in August 2011, including the requirement of not being subject to an excessive deficit procedure. None of the non-euro area EU countries met all the nominal criteria for the introduction of the euro. Sweden met the fiscal, inflation, and interest-rate criteria, but since the country does not participate in ERM II, it did not satisfy the exchange rate criterion (even though the Swedish krona's exchange rate against the euro was relatively stable). Denmark does participate in ERM II, but although its budget deficit did not exceed the reference value, the country did not satisfy the fiscal criterion since it is subject to an excessive deficit procedure.

The extent of compliance with the Maastricht criteria among all the EU countries under review is summarised in Table 1.

## Outlook for nominal convergence

The increasingly negative repercussions of the excessive debt ratios of certain euro area countries and the slowing growth of significant world economies are fuelling uncertainty about future trends in nominal convergence. The planned consolidation of public finances in the countries under review may in the end be far more challenging than originally expected.

The European Commission's Autumn Forecast (November 2011) assumes that the euro area fiscal deficit will gradually decline, from 6.2% of GDP in 2010, to 3.4% of GDP in 2012. The pace of fiscal consolidation in Slovakia as expected by the EC equals the euro area average.[6] According to available estimates, the process of fiscal consolidation is expected to continue also in non-euro area EU countries. The only country whose general government deficit in 2011 will probably be higher than in 2010 is Denmark.[7] By contrast, Hungary and Sweden could each report a general government surplus in 2011, although Hungary's positive budgetary position will only be tempora-

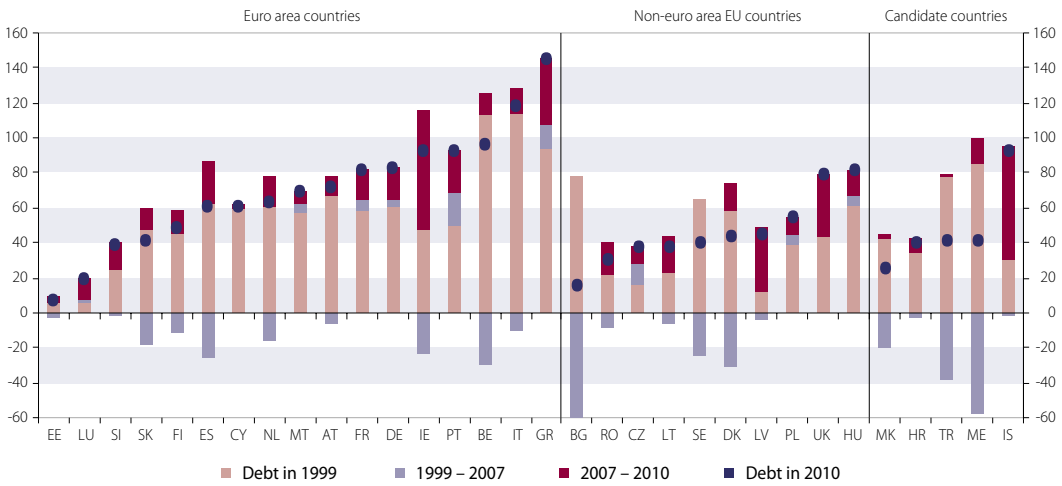
*4 The reference value went up to 3.3%. Although Ireland had the lowest 12-month average inflation rate, it is still considered to be a specific case. The reference value was therefore calculated using the inflation figures in Sweden, Slovenia and the Czech Republic; if Ireland's low annual inflation rate had been included, the reference value would have fallen to 2.8% and far fewer countries would have satisfied the inflation criterion. Slovakia would also not have met this criterion in August 2011.*

*5 The reference value calculated on the basis of inflation data for current EU countries.*

*6 The difference between the general government budget balance in 2012 and 2010 (2.8% of GDP).*

*7 The result for 2010 was boosted by additional tax receipts from pension fund returns (amounting to 2.5% of GDP).*

*Chart 2 Accumulation of general government debt in EU Member States and candidate countries (% of GDP)*




*Source: Eurostat, European Commission.*

*Table 1 Fulfilment of the Maastricht criteria in EU Member States and candidate countries – current state and outlook*

| Country | Inflation (%) | | | General government deficit (% of GDP) | | | General government debt (% of GDP) | | | Interest (%) | Exchange rate (%, ERM) |
|---|---|---|---|---|---|---|---|---|---|---|---|
| | August 2011 | 2011 | 2012 | 2010 | 2011 | 2012 | 2010 | 2011 | 2012 | August 2011 | August 2011 |
| Belgium | 3.4 | 3.5 | 2.0 | -4.1 | -3.6 | -4.6 | 96.2 | 97.2 | 99.2 | 3.9 | euro |
| Finland | 3.0 | 3.2 | 2.6 | -2.5 | -1.0 | -0.7 | 48.3 | 49.1 | 51.8 | 3.1 | euro |
| France | 2.0 | 2.2 | 1.5 | -7.1 | -5.8 | -5.3 | 82.3 | 85.4 | 89.2 | 3.3 | euro |
| Greece | 4.0 | 3.0 | 0.8 | -10.6 | -8.9 | -7.0 | 144.9 | 162.8 | 198.3 | 13.2 | euro |
| Netherlands | 2.1 | 2.5 | 1.9 | -5.1 | -4.3 | -3.1 | 62.9 | 64.2 | 64.9 | 3.1 | euro |
| Ireland | 0.4 | 1.1 | 0.7 | -31.3 | -10.3 | -8.6 | 94.9 | 108.1 | 117.5 | 9.2 | euro |
| Luxembourg | 3.4 | 3.6 | 2.1 | -1.1 | -0.6 | -1.1 | 19.1 | 19.5 | 20.2 | 3.1 | euro |
| Germany | 2.1 | 2.4 | 1.7 | -4.3 | -1.3 | -1.0 | 83.2 | 81.7 | 81.2 | 2.8 | euro |
| Portugal | 3.1 | 3.5 | 3.0 | -9.8 | -5.8 | -4.5 | 93.3 | 101.6 | 111.0 | 8.4 | euro |
| Austria | 2.9 | 3.4 | 2.2 | -4.4 | -3.4 | -3.1 | 71.8 | 72.2 | 73.3 | 3.3 | euro |
| Spain | 3.0 | 3.0 | 1.1 | -9.3 | -6.6 | -5.9 | 61.0 | 69.6 | 73.8 | 5.1 | euro |
| Italy | 2.3 | 2.7 | 2.0 | -4.6 | -4.0 | -3.2 | 118.4 | 120.5 | 120.5 | 4.7 | euro |
| Cyprus | 3.2 | 3.4 | 2.8 | -5.3 | -6.7 | -4.9 | 61.5 | 64.9 | 68.4 | 5.0 | euro |
| Estonia | 5.1 | 5.2 | 3.3 | 0.2 | 0.8 | -1.8 | 6.7 | 5.8 | 6.0 | - | euro |
| Malta | 2.8 | 2.6 | 2.2 | -3.6 | -3.0 | -3.5 | 69.0 | 69.6 | 70.8 | 4.4 | euro |
| Slovakia | 2.9 | 4.0 | 1.7 | -7.7 | -5.8 | -4.9 | 41.0 | 44.5 | 47.5 | 4.2 | euro |
| Slovenia | 1.9 | 1.9 | 1.3 | -5.8 | -5.7 | -5.3 | 38.8 | 45.5 | 50.1 | 4.3 | euro |
| Czech Republic | 1.9 | 1.8 | 2.7 | -4.8 | -4.1 | -3.8 | 37.6 | 39.9 | 41.9 | 3.8 | -3.7/5.2 |
| Hungary | 4.0 | 4.0 | 4.5 | -4.2 | 3.6 | -2.8 | 81.3 | 75.9 | 76.5 | 7.3 | -3.6/4.5 |
| Poland | 3.4 | 3.7 | 2.7 | -7.8 | -5.6 | -4.0 | 54.9 | 56.7 | 57.1 | 5.9 | -5.0/11.5 |
| Lithuania | 3.6 | 4.0 | 2.7 | -7.0 | -5.0 | -3.0 | 38.0 | 37.7 | 38.5 | 5.1 | 0.0/0.0 |
| Latvia | 3.3 | 4.2 | 2.4 | -8.3 | -4.2 | -3.3 | 44.7 | 44.8 | 45.1 | 7.0 | -1.3/0.4 |
| Bulgaria | 3.8 | 3.6 | 3.1 | -3.1 | -2.5 | -1.7 | 16.3 | 17.5 | 18.3 | 5.5 | 0.0 |
| Romania | 7.3 | 5.9 | 3.4 | -6.9 | -4.9 | -3.7 | 31.0 | 34.0 | 35.8 | 7.1 | -3.3/2.1 |
| Denmark | 2.7 | 2.6 | 1.7 | -2.6 | -4.0 | -4.5 | 43.7 | 44.1 | 44.6 | 2.9 | -0.1/0.1 |
| Sweden | 1.6 | 1.5 | 1.3 | 0.2 | 0.9 | 0.7 | 39.7 | 36.3 | 34.6 | 3.0 | -9.6/13.5 |
| United Kingdom | 4.0 | 4.3 | 2.9 | -10.3 | -9.4 | -7.8 | 79.9 | 84.0 | 88.8 | 3.3 | -5.5/6.7 |
| Montenegro | 2.2 | 3.1 | 2.6 | -4.9 | -4.2 | -2.6 | 42.9 | 44.0 | 44.4 | 7.9 | euro |
| Croatia | 1.9 | 2.1 | 1.5 | -4.9 | -5.5 | -5.4 | 41.2 | 45.8 | 50.0 | 6.5* | -1.6/1.6 |
| Macedonia | 3.7 | 3.8 | 2.5 | -2.5 | -2.5 | -2.2 | 26.2 | 29.0 | 31.0 | - | -0.5/0.3 |
| Turkey | 6.2 | 8.5 | 7.2 | -3.5 | -2.4 | -2.4 | 43.2 | 39.7 | 38.7 | 9.0 | -7.9/8.6 |
| Iceland | 3.8 | 4.1 | 3.6 | -10.1 | -5.7 | -4.4 | 92.9 | 92.4 | 90.2 | 7.5* | -8.9/11.8 |
| Reference value | 3.3 | 3.0 | 2.4 | 3.0 | 3.0 | 3.0 | 60.0 | 60.0 | 60.0 | 5.7 | ± 15%** |

*Source: Eurostat, European Commission, central banks and finance ministries of the candidate countries, own calculations.*
*Note: The values marked in green satisfy the given criterion. The value of exchange rate volatility vis-à-vis the euro represents the deviation of the 10-day average daily rate from its long-term average over the period September 2009 to August 2011 (this does not apply to Lithuania, Latvia and Denmark, since they participate in ERM II and therefore the movements of their currencies are analysed as deviations from the corresponding ERM II central parity).*
** Yield on non-indexed bonds with a residual maturity of approximately 10 years.*
*** Denmark has undertaken to maintain its currency's exchange rate in a narrow band (±2,25 %).*

ry.[8] The candidate countries, too, are expected to see an improvement in their fiscal situation over coming years, according to the EC (2011). Besides Macedonia, Turkey is also projected to keep its general government deficit below 3% of GDP in 2011 and 2012, and Montenegro is assumed to do likewise in 2012.

The budget deficits of the countries under review will be reflected in rising debt ratios. Euro area government debt will rise to 90.4% of GDP in

8 *The main source of fiscal revenues will be a one-time transfer of funds from Pillar II of the pension system to the general government budget (at 9% of GDP).*

2012, with Greece recording the highest increase. There will also be double-digit rises in the government debts of Ireland, Portugal and Spain, despite the extensive fiscal consolidation undertaken by these countries. In Slovakia, too, the increase in the debt ratio is projected to be higher than the euro area average. As for the candidate countries (except Iceland), their government debt levels will be relatively low, and Turkey's debt is even expected to decline. Assuming that the projected pace of consolidation is maintained, the number of candidate countries satisfying the fiscal criterion could therefore rise to three by 2012. The number of EU countries meeting both components of the fiscal criterion will probably remain unchanged. The only countries with a deficit lower than 3% of GDP and a debt below 60% of GDP will probably be Finland, Luxembourg, Estonia, Sweden and Bulgaria.

According to the EC forecast (2011), the differences in the inflation rates across EU countries (caused mainly by the varying impacts of oil price increases) will gradually lessen. In Slovakia, the inflation rate will probably exceed the reference value by the end of 2011, given its continuing rising trend and also that the positive effects of low price rises in 2010 are fading away. Consumer price increases are assumed to decelerate in 2012.[9] The EC forecasts that most of the euro area countries (including Slovakia) and three of the non-euro area EU countries could again satisfy the inflation criterion. The candidate countries, too, are expected to see a slowdown in inflation in 2012 as a result of the projected easing of external inflationary pressures; however, only Croatia's inflation rate is assumed to be lower than the reference value. Inflation in the other candidate countries will remain above that level.

The situation in 2011 indicates that, to a greater extent than before, the movement of long-term interest rates in the countries under review will reflect fiscal developments. According to the available forecasts, these are expected to be more favourable in the non-euro area EU countries than in the candidate countries and euro area countries. The currencies of non-euro area EU countries and of candidate countries whose currencies are not pegged to the euro could come under further appreciation pressure if, as expected, the economic upswing in these countries is stronger than in euro area countries.

According to EC estimates, Sweden is the only non-euro area EU country likely to meet all of the Maastricht criteria in the next two years; at present, however, it does not participate in the exchange rate mechanism. No candidate country is likely to meet all the criteria in 2012.

## Current state of real convergence

Global economic growth picked up in 2010 to stand at approximately 5% for the year. The upswing in emerging and developing economies was even higher, albeit still not up to the pre-crisis level. In the EU as a whole, GDP grew by 1.9% year-on-year, while in Germany, Slovakia's largest trading partner, economic growth was substantially higher, at 3.7%. The EU country that reported the strongest growth was Sweden (5.6%). In some EU countries and candidate countries, GDP continued to contract in 2010.[10]

The factors behind the Slovak economy's slump in 2009, i.e. its high openness and large proportion of cyclical industries, contributed to its rapid recovery in 2010. The country's year-on-year GDP growth for 2010 stood at 4.2%, the highest growth of any euro area country and the second highest in the EU.

The economic upturn brought only a partial improvement in the labour market situation. In the euro area as a whole, the unemployment rate exceeded 10% in 2010. The highest unemployment rate was recorded in Spain, at more than 20%. In Slovakia, the unemployment rate in 2010 averaged 14.4% and had a gradually downward trend over the course of the year. The rate continued to fall slowly and steadily in 2011.

The total number of employed persons in the euro area fell in year-on-year terms (by 0.5%), and in several countries the annual rate of decline was significantly lower. In Slovakia, average employment in 2010 was 2.0% lower than in 2009. The average decline in employment in non-euro area EU countries continued to exceed that in euro area countries. The only candidate country in which the labour market situation significantly improved in 2010 was Turkey, which recorded a rise in employment and a drop in unemployment. Macedonia, too, saw a partial annual rise in employment, although its unemployment rate remains very high (31.8%). In the other candidate countries, employment declined and unemployment rose in comparison with the previous year.

The performance of the Slovak economy as measured by GDP per capita at purchasing power parity (PPP) increased to 74.8% of the EU average. Among the EU countries whose economic performance continued to decline were also some that were not among the worst affected by the debt crisis. The downturn was somewhat more pronounced in those countries whose performance fell short of the EU average.

In Slovakia, the relative price level in 2010 fell marginally (to 71.2% of the EU average),[11] as a result of slower domestic price increases. The relative price level rose sharply in those countries that had a floating exchange rate regime, thus correcting the 2009 decline in the price level that was related to the weakening of their currencies. These were mainly the EU countries where the price level exceeded the EU average (in Sweden, by 12.1 p.p., and the United Kingdom, by 5.1 p.p.). Significant price level increases were also recorded in Iceland (12.1 p.p.) and Turkey (8.9 p.p.). In candidate countries, the price level is considerably higher than implied by economic performance. Only Iceland has a price level corresponding to performance.

*9 The only EU countries in which inflation is projected to accelerate in 2012 are the Czech Republic and Hungary.*

*10 Among EU countries, GDP contracted in Greece (-3.5%), Ireland (-0.4%), Spain (-0.1%), Romania (-1.9%) and Latvia (-0.3%), and among the candidate countries, in Iceland (-4.0%) and Croatia (-1.2%).*

*11 The price level of Slovakia in 2008 and 2009 was revised down. According to the original estimates, the price level in 2009 was higher than the performance of the Slovak economy.*

*Box 1*

# A closer look at employment in Slovakia

According to Eurostat, the total number of employed persons in Slovakia in the second quarter of 2011 was more than 5% lower than in the 3rd quarter of 2008, when the figure reached its peak. As for the recovery in employment growth, it was not uniform across all age groups, education levels, employment categories, and regions.

An analysis of the number of employed persons shows that youth employment was falling continuously from the fourth quarter of 2007 (or in the age group 25 to 34 years, from the third quarter of 2008). By contrast, employment among older workers showed a long-term rising trend and reached a record level in the second quarter of 2011. In the first quarter of 2008, the number of employed persons in the age groups 15 to 24 and 55 plus were approximately the same, but three years later the number of persons in the old group was almost twice as high as the number in the young group.* Although the annual decline in the number of employed persons aged 15 to 24 and 25 to 34 was gradually easing up to the second quarter of 2011, it exceeded the rise in the number of employed persons aged 55 or over (Chart A).

A similar trend could be seen in employment developments as broken down by level of education, and it was the category of persons with tertiary education that had the largest effect. The number of employed persons who have a secondary school education was falling year-on-year up to the second quarter of 2011. The growth in total employment in the second half of 2010 and at the beginning of 2011 was driven by an increase in the number of persons with tertiary education.**

Large differences in employment trends were also observed between the main sectors of the national economy. The different sectors responded to changes in economic developments at varying paces and with differing intensity. The changes in overall employment in Slovakia were driven mainly by employment developments in the industry sector. Employment in the trade sector and certain segments of the services sector rose during 2009 and declined 2010, when employment in the industry and transport sectors was already rising. During the most substantial slump in employment, the employment situation in the services sector did not have a significant effect on overall annual rate of change in employment (even though the sector accounts for 40% of overall employment).

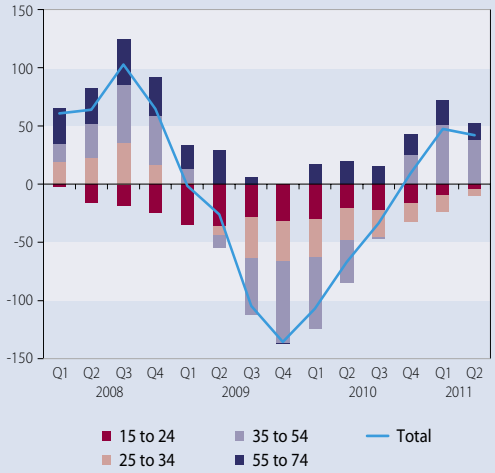
In the period from the 1st quarter of 2010 to the second quarter of 2011. i.e. between the trough and the most recent date for which data are available, the number of employed persons increased only in the industry, transport and services sectors. The growth in employment in services exceeded the decline recorded in the period from the third quarter of 2008 to the first quarter of 2010. Employment in industry remained far below its 2008 level.

In all regions of Slovakia, employment declined during the economic crisis and increased, at least to some extent, during the five quarters under review, according to the results of a Labour Force Survey. The upturn in employment was slowest in Bratislava Region, which during the crisis had recorded the lowest drop in employment.

* *For the purpose of this Box, 'young' means aged between 15 and 24 years and 'old' means aged 55 years and over. Not only did employment fall sharply, so did the employment rate among young people.*

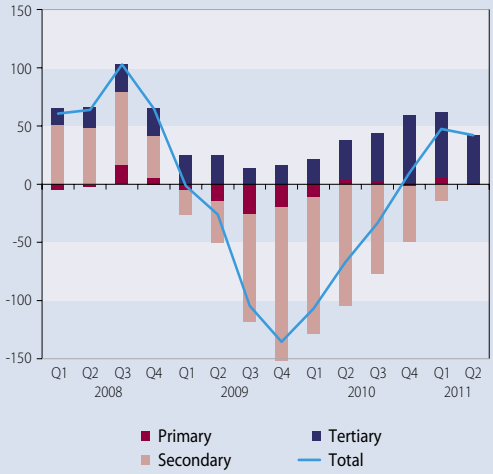
** *'Primary education' is here understood to include pre-primary education, primary education, and lower secondary education (levels 0-2), while ‚secondary education' includes upper secondary and post-secondary education (levels 3-4). Tertiary education (levels 5-6) constitutes the third group.*

*Chart A Employment by age (annual change in thousands)*




*Source: Eurostat.*

*Chart B Employment by level of education (annual change in thousands)*




*Source: Eurostat. Note: levels of education defined in ISCED 1997.*

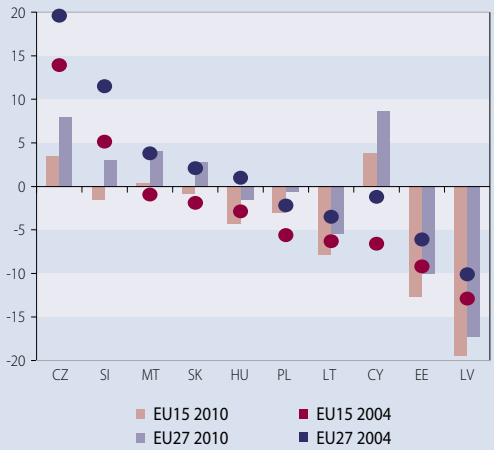
Box 2

# The price level and performance of the Slovak economy since Slovakia joined the EU

When the relative price level data were revised, the position of Slovakia in terms of the state of real convergence improved. According to the latest estimates, the price level in Slovakia in 2009 was lower than the relative performance of the Slovak economy. This applies only to indicators that describe the state of the Slovak economy vis-à-vis the average of all 27 EU countries. As regards the fulfilment of expectations for domestic economic development following EU accession, it is better to look at how the price level and performance have developed in comparison with the average for the countries that were already EU Member States when Slovakia joined the EU, i.e. in comparison with the EU-15. Analysing real convergence data in relation to the average figures of the old EU countries will give rise to different conclusions.

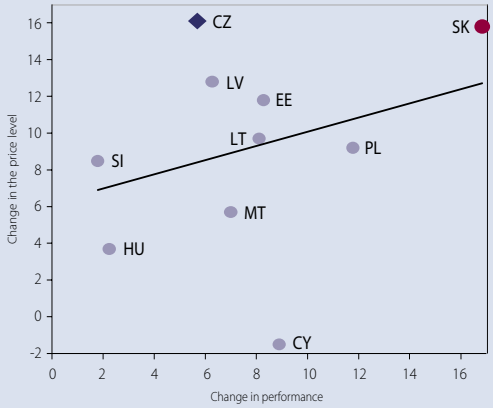
According to revised data, Slovakia when it joined the EU had a negative difference between its performance and price level. In the period 2005–2007, relative performance was slightly higher than the price level, while since 2008 the price level has again been exceeding the performance of the Slovak economy. In 2010, the difference between economic strength and

*Chart A Differences between performance and price level in new EU Member States (in p.p.)*



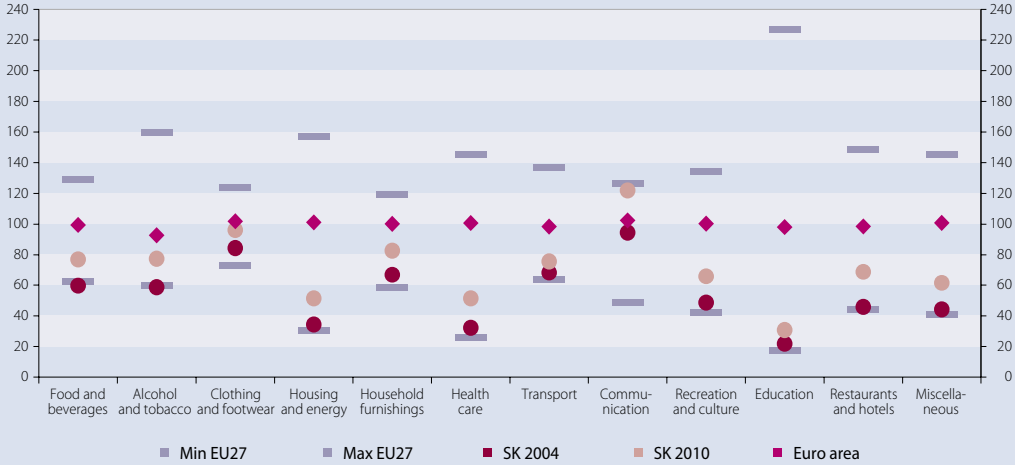

*Source: Eurostat, own calculations.*

*Chart B Change in relative price level and performance in new EU Member States in the period 2004–2010 (in p.p.)*




*Source: Eurostat, own calculations.*
*Note: Calculated on the basis of ratios to the EU-15 average.*

*Chart C Relative price level of main expenditure categories of goods and services (% of the EU-15 average)*




*Source: Eurostat, own calculations.*
*Note: The minimum and maximum value in the EU and the average for the euro area are given for 2010.*

*Box 2 – continued*

the price level of Slovakia was half as low as in 2004 (Chart A). Compared with the other countries that joined the EU alongside Slovakia, the situation has remained largely unchanged. Generally speaking, the price level in Slovakia has remained more or less in line with performance (Chart B). In the Baltic States, the misalignment has become even more pronounced since EU accession, while in the Czech Republic and Slovenia, where performance is higher the price level, the gap has narrowed considerably.

Prices of different goods and services did not increase evenly following EU accession (Chart C). The price level differences between individual categories of goods and services widened. In 2004 there was no category in which prices reached the price level in the old EU countries. The price level of communication services, which back in 2004 were the most expensive services in Slovakia, was 20% higher than the EU-15 average in 2010. High price increases have also been recorded in hotel and restaurant services and in health care, although these remain relatively cheap in comparison with the average in the old EU countries (at 70% and 50% of the EU-15 average). Prices of education services in Slovakia, which at the time of its EU accession were among the lowest in any EU country, including the new Member States, have remained at a low relative level.

More detailed data about price levels in Slovakia indicate other price items, besides communication services, that are significantly more expensive here, including prices of software (20% higher than the EU-15 average) and certain foodstuffs, mostly oils and fats (5% higher). Also more expensive are clothing and electrical and optical equipment. As for goods and services (besides health care) that are relatively cheaper in Slovakia, transport service prices are just slightly more than half of the average in the EU-15.*

* *If the prices of goods and services were expressed relative to the average prices for 27 EU countries, the relative price level of some goods and services would rise. The main conclusions would be basically the same, however, with the vast majority of goods and services in Slovakia being cheaper than the EU average. Only the items mentioned above would cost more than 100% of the EU average.*

The pick-up in international trade in 2010 did not have a significant effect on the external balances of the countries under review. Most EU countries and candidate countries saw a year-on-year improvement in the current account balance of their balance of payments.[12] In Slovakia, the current account deficit increased slightly in comparison with the previous year, to 3.6% of GDP. In Greece, the deficit declined, but it remained very high at (12.3% GDP). Only Montenegro had a higher deficit (24.8% of GDP).

## Outlook for real convergence

According to the NBS forecast (2011a), the pace of economic growth in Slovakia in 2011 will be slower than in the previous year, at 3.4%. The main driver of growth will continue to be net exports. In 2013, the contribution of household consumption growth to Slovakia's GDP growth is expected to be higher than that of net exports. In 2012, GDP at constant prices is projected to rise by 3.8%. According to the more recent European Commission Autumn Forecast (2011), GDP growth is expected to slow down. However, Slovakia is assumed to continue growing faster than the EU average and to remain on a convergence course.

Domestic economic recovery has created conditions for employment growth and a decline in unemployment. The unemployment rate in Slovakia is expected to come down in 2011 and remain at the same level in 2012. Euro area average unemployment will also stay relatively high (above 10%).

According to the EC Autumn Forecast (2011), all EU countries except Portugal and Greece are assumed to record positive economic growth over the next two years. In 2012, GDP at constant prices will rise more sharply in non-euro area EU countries than in the euro area, with Lithuania expected to report the strongest growth. Labour productivity growth will slow down in every EU country, while in Portugal, Luxemburg and Hungary it will probably decline year-on-year.

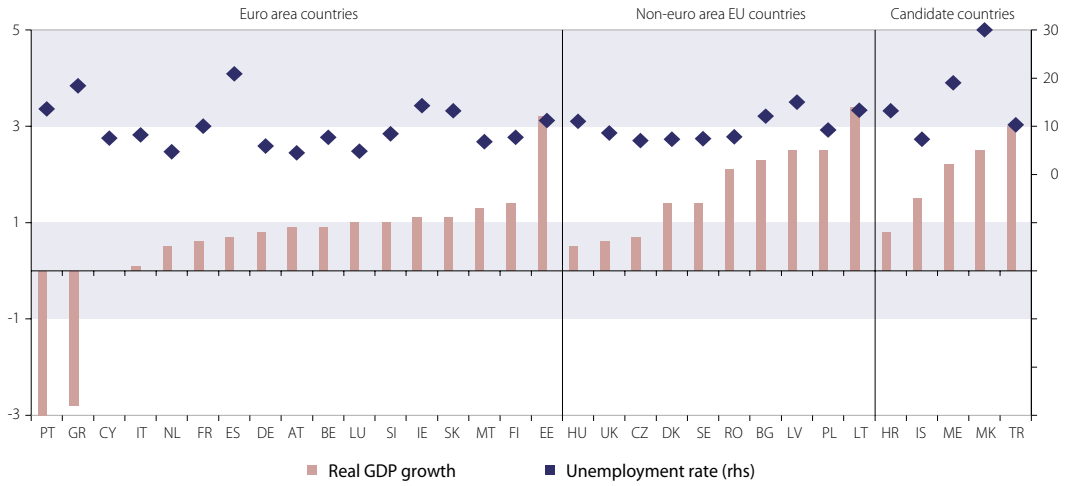
The most dynamic progress in real convergence over the next two years is expected to be reported by Lithuania, Estonia and Turkey. Although their economic growth will slow, it will remain above or close to 3% per year. In all the candidate countries, GDP growth over the next two years is expected to be higher than the EU average. This should result in the economic performance of candidate countries converging more closely towards EU levels. Unemployment will remain very high, especially in the former Yugoslav Republic of Macedonia (at 30 %).

In Slovakia, export growth is expected to be higher than import growth over the next two years. It is assumed that as the trade surplus rises and the balance of services deficit declines, the current account deficit of the balance of payments will gradually fall. According to the NBS forecast, the current account should be balanced in 2013. Several other euro area countries are also expected to see a decline in their external imbalance. As for the euro area as a whole, its current account deficit is assumed to increase somewhat, reaching 0.5% of GDP in 2012.[13] Cyprus and Greece will have the highest deficits among all EU countries.

The external imbalances of candidate countries are also expected to remain high, amid a recovery of domestic consumption. The only exception will probably be Croatia, where the current account deficit is projected to decrease to 0.6% of GDP. In Turkey, the current account deficit will again exceed 8%, and in Montenegro it will be over 20%.

12 *In Luxembourg, the current account surplus rose to 8.1% of GDP.*
13 *According to the EC forecast (2011), the current account deficit of Slovakia for 2012 will be 1.2% of GDP.*

*Chart 3 Expected economic growth and unemployment (2012; %)*




*Source: Eurostat, European Commission.*

According to our estimates, based on current macroeconomic forecasts,[14] the ratio of GDP per capita (at PPP) in Slovakia could reach 80% of the EU average in 2013. By the end of that year, assuming that the currencies of non-euro area EU countries maintain stable exchange rates against the euro, the comparable price level in Slovakia will have risen by approximately 2 percentage points despite an expected change in the inflation differential between Slovakia and the EU average in 2011 and 2012. Slovakia will therefore maintain a favourable ratio between performance and price level.

The ratio of GDP per capita to average EU GDP per capita will rise also in other new EU countries in 2011 and 2012, according to the EC forecast. Several countries whose GDP per capita ratio is higher than the EU average are recording a moderate decline in performance in comparison with the EU average. Lithuania will report the most rapid convergence, with its relative performance rising above 60% of the EU average. The outlook for the years ahead indicates that the catching-up process will continue even in the candidate countries, with Turkey catching up at the fastest pace.

## Conclusion

The convergence of the Slovak economy to the EU average picked up in 2010, and the relative level of performance and labour productivity increased. The labour market situation showed only a partial improvement, and the general government budget deficit far exceeded the reference value. In almost all EU Member States and candidate countries, the general government budget figures were unfavourable. Interest rates in the countries most affected by the debt crisis rose to record levels. Only Finland would fulfil all the Maastricht criteria in August 2011, including the requirement of not being subject to an excessive deficit procedure.

The outlook for EU economic growth in the years ahead points to a significant slowdown. The pace of growth in non-euro area EU countries and candidate countries is expected to be brisker than in the euro area countries. In most of the countries under review (including Slovakia), planned fiscal consolidation measures will not be enough to remove the excessive deficit. According to the available forecasts, price developments should moderate in 2012 and Slovakia will probably meet the inflation criterion. Sweden appears to be the non-euro area country that is most likely to fulfil all the nominal criteria.

Given that the debt crisis is deepening and that the euro area's economic situation could further deteriorate (with severe consequences for other European countries), the risks to the forecast recovery in the overall catching-up process are mounting.

*14 NBS (2011a) and EC (2011).*

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