The structure of private consumption in Slovakia and a comparison with European countries

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Gradual convergence of Slovakia towards developed countries also includes catching up with the level of household final consumption. The level of private consumption should approach that of developed countries, as the population income is rising and the country's economy is developing. The convergence occurs not only at the level of the volume of household consumer expenditures, but also within their structure – both the structure of services and of goods in the consumer basket. However, the convergence to more developed countries, also in consumption, could be partially interrupted due to the global economic crisis, which is reflected in a decline of consumer confidence. Deteriorated consumer sentiment could be reflected in a contraction of overall consumption and its structure, in which necessary food and energy expenditures will predominate. This could stop or slowdown the convergence in catching up with both the level and the structure of consumption.

In its first part, this paper deals with the development of final consumption and with comparing its level with the European average. In the second part, it evaluates similarities of consumer baskets in Slovakia and Europe. Further parts analyze the influence of consumption convergence on the price developments and the current development in the 1st quarter of 2009. Because the article is an update to already existing material[1], it focuses on the development over the last years.

Development in private consumption

The main determinant of the growth in household final consumption is their disposable income, whose rapid growth over recent years was also reflected in the growth of consumption. In addition to economic indicators, many social and geographical factors, such as the structure of society by age and education, degree of price regulation, degree of economic development of the country, consumer traditions etc. also affect the development of the structure and level of consumption. Slight differences in the consumption structure of individual countries should continue to prevail in connection with these determinants.

Slovakia achieved one of the most rapid growths in real household consumption within EU 27 countries in 2008; Cyprus was the only country to show a more rapid growth. The markedly higher growth in consumption compared to the Euroarea or EU 27 average also became evident in the consumption level approaching the EU 27 average. In the period to follow, these developments might be partly interrupted due to the economic crisis, which also caused the contraction in private consumption in the 1st quarter of 2009. A decrease in private consumption should occur in all European countries, so that the final impact of the economic crisis on convergence towards developed countries can be more moderate.

To compare the relative standard of living in various countries, we have used the Eurostat indicator comparing the volume of final consumption per capita in a given country with the average volume of consumption in EU 27 countries at purchasing power parity. In 2008, Slovakia reached the level of 69.5%, which was in line with economic performance (71% of the EU 27 average) as measured by GDP per capita at PPP. The Baltic countries, V4 countries, new euro area members (except Cyprus) and Portugal, Sweden and Denmark did not reach a level below the EU 27 average. Due to its rapid economic growth and thereby also growth in consumption over the last two years, Slovakia improved its position by 3 places (by 7.2 percentage points) compared with 2006, when its consumption level outstripped that of Hungary, Estonia and Latvia.

Private consumption structure

The structure of private consumption is one of the relative measures of the population's stand-
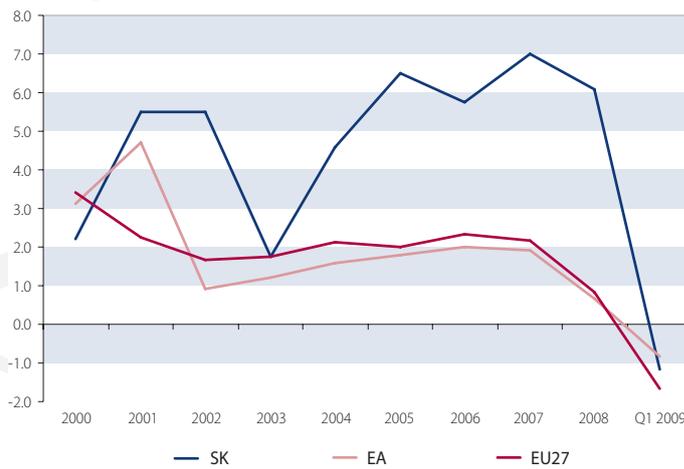
Chart 1 Household final consumption and disposable income (current prices, index same period previous year = 100)
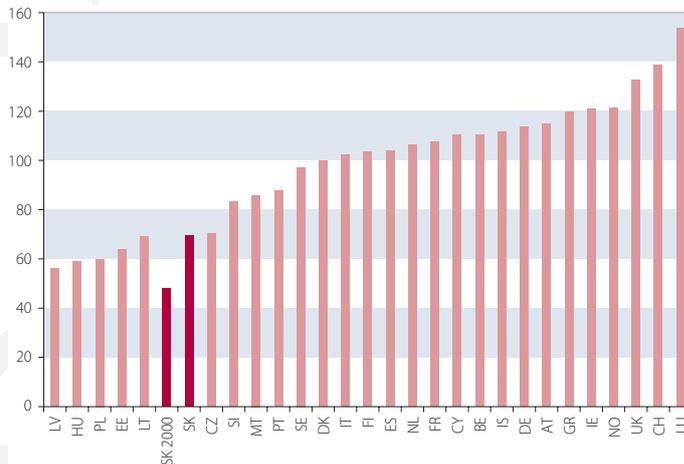

Source: Statistical Office of the Slovak Republic.

Chart 2 Growth of household final consumption at constant prices (%)

Source: Eurostat, own calculations.

Chart 3 Level of final consumption per capita at PPP in 2008 (EU 27=100)

Source: Eurostat.

ard of living, as convergence to the structure of consumer baskets of developed countries means improvement of the standard of living. To express the degree of similarity of consumer baskets, we have used the Gatev index[2], for which a value closer to zero means higher similarity of consumer baskets. Consumer baskets of harmonized consumer price indexes in 2009 have been used in the calculation; the components were divided into 6 groups of goods and 6 groups of services.[3]

Based on the Gatev indexes, Slovakia belongs to countries whose consumer basket is least similar to that of the EU 27 average. In relation to 2006, its position slightly improved, as the index reached the value of 0.24 (0.28 in 2006) and, in addition more dissimilar consumption structure had besides Malta, Latvia and Poland, also Hungary and Norway. The goods to services ratio in the consumer basket is a possible cause of this dissimilarity. The European average was 59.6:40.4, while the goods to services ratio in Slovakia was 67.7:32.3 in 2009. The higher share of goods related to EU 27 can be a sign of a lower standard of living, as – according to theory – with increasing household income demand for services increases faster than demand for goods. However, convergence towards developed countries occurs in this field as well. The share of services in the consumer basket gradually increased from 20.9% in 1996 to the current level of 32.3%. The different goods to services ratio in the consumer basket does not sufficiently explain overall dissimilarity, as a goods to services ratio similar to EU 27 was also recorded in Malta (60.7:39.3), although the overall consumption structure in Malta significantly differs from the European average (the Gatev index value is 0.26). This dissimilarity is due to differences within the individual items of goods and services.

From the Gatev indexes is clear that Slovakia has converged faster in the structure of services than in the structure of goods. The value of the index by six service groups (0.19) makes Slovakia rank 12th among the compared countries, so that Slovakia achieved a relatively high similarity with the European average (the ranking does not change when comparing with the euro area average). In addition, the services structure is more dissimilar not only in the other V4 countries and Baltic countries, but also in some euro area countries. On the other hand, significant differences dominated in the goods part of the consumer basket. In spite of catching up also in this part of consumption over the last few years, Slovakia still belongs to countries with the most different structure based on a comparison in six goods groups (energy, processed food, unprocessed food, non-durable goods, semi-durable goods, and durable goods). The differences in the structure of goods were caused mainly by the high percentage of energy in the consumer basket. Their level was increasing up to 2006, when it reached its maximum of almost 19% (the share of energy was stable at about 9% in EU 27 and the euro area). The growth in the share of energy in the past was also con-

nected to increases in their prices, which in connection with the energy's low elasticity resulting from price regulation and its nature of a necessary item in household consumption lead to a reduction in demand for other goods. These are mainly semi-durable and durable goods, whose percentage is underestimated in spite of a slight convergence in recent years.

As regards the EU 27 countries, the most similar consumer basket structure to Slovakia was recorded in V4 countries, mainly Hungary and the Czech Republic (an index value of 0.16) followed by the Baltic countries (0.17 to 0.21). A higher share of goods and a lower share of services in the consumer basket as compared to the European average is a common feature of these countries. As for the goods, a high share of energy and processed food and a low share of semi-durable and durable goods is common to the countries. The most differing consumer structure compared to that of Slovakia was in Norway (0.36) and Malta (0.35).

INFLUENCE ON THE PRICE DEVELOPMENTS.
The share of semi-durable and durable goods together with the share of services should increase within the ongoing convergence of the structure of the consumer baskets towards developed countries. The average rise in prices of the surveyed consumer basket items over last three years implies that the prices of individual items of services were growing faster than the prices of goods (except for communication services, whose prices decreased). A further growth of the share of services in the consumer basket along with a growth of their prices, regarding the level of which Slovakia falls behind, should represent the materialization of price convergence in the future.
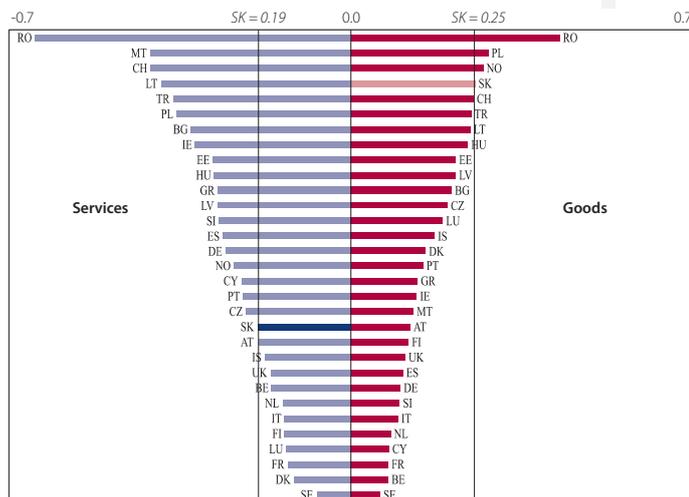
As regards the structure of consumer goods, there is room for increasing the share of semi-du-

Chart 4 Degree of consumer basket similarity to EU 27 in 2009

Source: Eurostat, own calculations.
Note: Values closer to 0 correspond to a higher similarity of consumer baskets.

Chart 5 Degree of the similarity in the structure of goods and services in 2009

Source: Eurostat, own calculations.
Note: Values that are closer to 0 correspond to a higher similarity of consumer baskets.

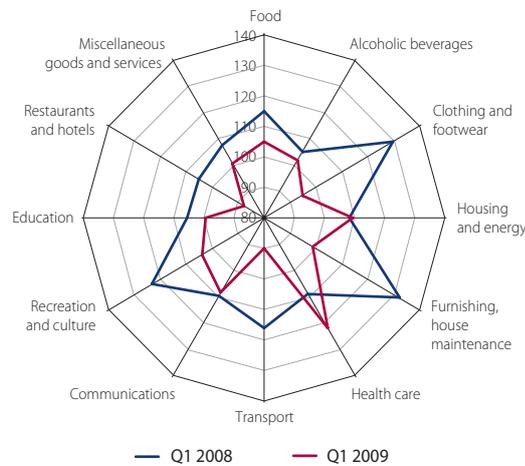Chart 6 Goods consumption structure
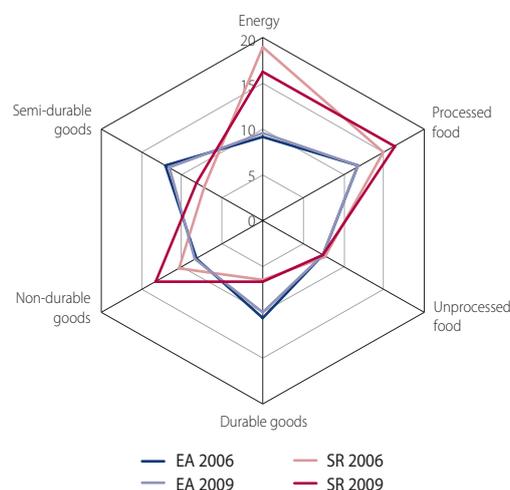
Source: Eurostat.

Chart 7 Year-on-year growth of prices (2006-2008 average in %)

Source: Eurostat, own calculations.

Chart 8 Household final consumption according to COICOP (index same period previous year = 100)

Source: Statistical Office of the Slovak Republic.

rable and durable goods consumption at the expense of energy, processed food and non-durable goods. On the other hand, such convergence in goods should dampen the growth of prices in the future, as most of these goods come from imports with strong price competition and their prices are comparable to the price levels in developed countries. The prices of semi-durable and durable goods were falling or only slightly rising in recent years.

CURRENT DEVELOPMENTS

The development of consumption indicates a possible slowdown or interruption of convergence in the structure of household consumption at the beginning of 2009. The decline of consumer household expenditures was mainly due to a decline in consumer confidence during the crisis, which was also reflected in a decrease in service expenditures. Expenditures in the category restaurants and hotels and transport were the main to decrease; regarding goods, expenditures on clothing and footwear decreased. The crisis also affected the growth of the share of mandatory household expenditures for food and housing, which account for most household consumption (a total of 44.1% in the 1st quarter of 2009).

CONCLUSION

Gradual convergence of Slovakia towards developed countries also includes catching up with the level of household final consumption. The consumption of Slovak households reached the level of 69.5% of EU 27 countries' average consumption in 2008 and Slovakia got ahead of another 3 countries during the last 2 years. The convergence occurs both in the volume of expenditures for consumption and in the consumption structure. Nevertheless, Slovakia ranks among countries, whose consumer basket is least similar to the European average. These differences stem mainly from the structure of goods, while the structure of services underwent quick convergence and is very similar to the European one. As to goods, the most outstanding difference is in the high weight of energy and processed food. These necessary expenditures are partly withdrawing funds from households and thereby decreasing the demand for semi-durable and durable goods, whose share is markedly underestimated. The above analysis implies that the level as well as the structure of consumption of Slovak households should continue approaching that of developed European countries in the long run. The share of services should continue to increase and significant changes can also be expected in the share of individual components in the goods part of the basket. However, this development can be partly interrupted soon due to the economic crisis, which was also reflected in a decrease in private consumption in the 1st quarter of 2009. Because deterioration in consumer confidence was the main reason of the decline in consumption, we can expect an interruption of convergence in the structure of consumption and hence an increase in the share of necessary expenditures on food and energy. Since we expect a growth of consumption as soon as at the end of 2009 and in the following years, this interruption of convergence should be of short-term nature only. A similar development will occur in all European countries, so that the final impact of the economic crisis on convergence towards developed countries can be more moderate.