



NÁRODNÁ BANKA SLOVENSKA  
EUROSYSTEM

CHAPTER 1

# MACROECONOMIC DEVELOPMENTS

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# 1 MACROECONOMIC DEVELOPMENTS

## 1.1 THE EXTERNAL ECONOMIC ENVIRONMENT

### 1.1.1 GLOBAL TRENDS IN OUTPUT AND PRICES<sup>1</sup>

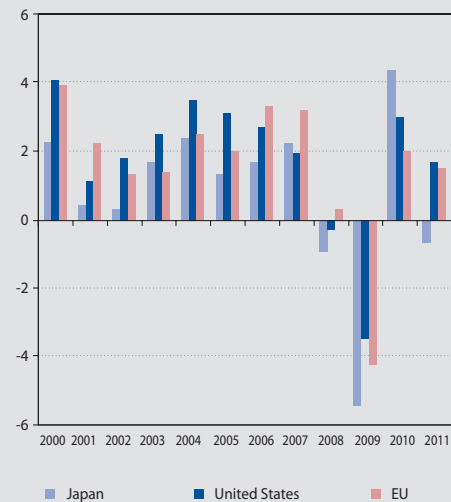
The global economy continued to grow in 2011, but its annual rate of expansion was markedly slower than in the previous year, down to 3.8% from 5.2%. The main causes of the slowdown in economic activity were the natural disaster in Japan, and the sovereign debt crisis mainly in euro area countries which resulted in measures to repair fiscal positions. As in the previous year there were persisting differences in the pace of economic recovery between emerging and advanced economies. Economic activity in emerging economies was far stronger, although it slowed towards the end of 2011. In advanced countries, economic growth was dampened by weak domestic demand, high unemployment and concerns about public debt sustainability. Growth in global external trade decelerated to 6.9% in 2011, from 12.7% in the previous year.

Global price developments accelerated further in 2011. In advanced economies the annual rate of inflation rose to 2.7%, from 1.6% in 2010, while in emerging economies it increased to 7.2%, from 6.1%. Prices in advanced economies were driven up by energy price movements, although they also came under downward pressure from the slowdown in economic activity. Despite the accelerating inflation rate, inflation expectations in advanced countries remained well-anchored. Price inflation in emerging economies fluctuated at high levels, and inflation pressure in some of these countries remained elevated. As regards commodity prices, crude oil prices rose sharply while prices of agricultural commodities, metal commodities and non-metal commodities declined. The rise in oil prices was most pronounced in the first half of 2011, reflecting increased demand, restricted production capacities, and political strains in several oil-exporting countries. Although the oil price was volatile during the rest of the year, it declined gradually. The average price of oil increased by 39% in 2011 (after rising by 29% in 2010).

### 1.1.2 ECONOMIC DEVELOPMENTS IN THE EURO AREA

Annual economic growth in the euro area decelerated to 1.4% in 2011, from 1.9% in 2010. This

Chart 1 Annual GDP growth (%)



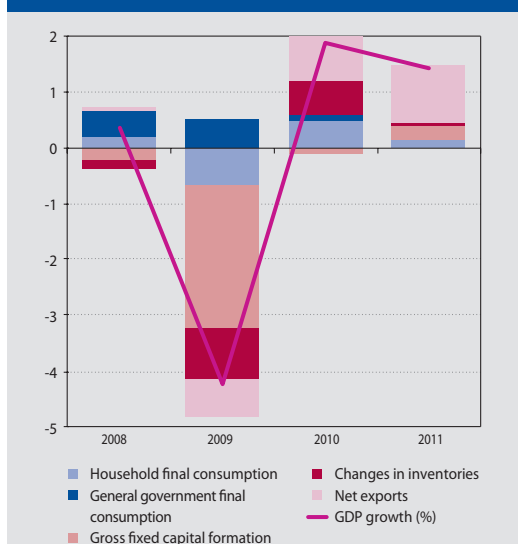
Source: Eurostat.

slowdown was expected due to the moderating growth in global demand and to the difficulties posed by worsening financing conditions (stemming from persisting strains in euro area sovereign debt markets, which escalated towards the year-end). At the same time, both business and consumer surveys showed a deterioration in expectations among respondents. After three quarters of growth, economic activity in the euro area contracted in the fourth quarter of 2011. The downturn was reflected in the labour market, with the unemployment rate edging up over the course of the year, from 10% in January to 10.6% in December. Consumption decelerated, with the result that the contribution of household final consumption to GDP growth declined and the contribution of general government consumption stood at zero. Although global demand moderated, net trade made the largest contribution to GDP growth. The contribution of investment demand increased in comparison with the previous year.

The overall average inflation rate, as measured by the harmonised index of consumer prices (HICP), increased to 2.7% in 2011, from 1.6% in the previous year. The inflation rate remained above 2% throughout the year. Compared to 2010, the rise

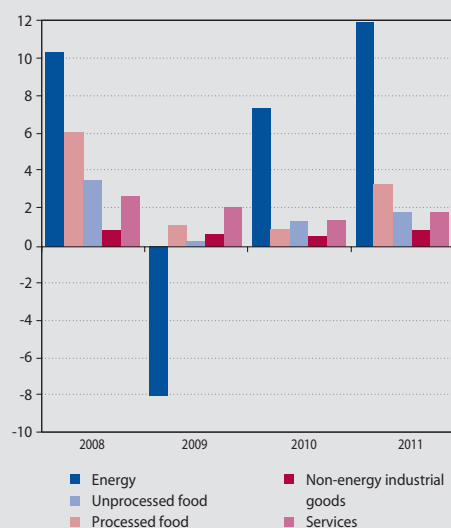
<sup>1</sup> The data are taken from the IMF World Economic Outlook Update published in January 2012.

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



Source: Eurostat.

**Chart 3 HICP inflation in the euro area broken down into components (annual percentage changes)**



Source: Eurostat.

in price inflation was affected to a greater extent by commodity price movements. Other factors were the increase in indirect taxes and administered prices in certain euro area countries, as well as upward pressures from the labour market: wage growth accelerated, labour productivity moderated, and unit labour costs rose at a faster pace. The annual rate of HICP inflation increased to 2.7% in December 2011, from 2.2% in December 2010. Core inflation (the HICP rate excluding prices of energy and unprocessed food) rose to 1.7% in 2011, from 1.0% in 2010.

The exchange rate of the euro against the US dollar continued to be marked by volatility during 2011. It was affected by financial market strains related to the euro area sovereign debt crisis, as well as by multi-level measures aimed at mitigating the repercussions of the crisis. The exchange rate also reflected economic developments in the euro area and the United States. The euro's value against the dollar was 3.2% lower at the end of 2011 than at the end of 2010.

The ECB Governing Council adjusted the key ECB rates on four occasions during 2011 in response to current developments. Amid rising price pressures, the key rates were raised by 25 basis points in April and by the same margin again in July. Pressures in financial markets subsequently escalated

and had a dampening effect on economic recovery; in response, the Governing Council decided to cut the key rates by 25 basis points in November and by a further 25 basis points in December. At the end of 2011 the interest rate on the main refinancing operations and the interest rates on the marginal lending facility and the deposit facility stood at 1.0%, 1.75% and 0.25% respectively.

During the second half of the year the Governing Council responded to renewed strains in financial markets by adopting further non-standard measures. In August it decided to conduct a liquidity-providing supplementary longer-term refinancing operation (LTRO) with a maturity of approximately six months; in October it decided to conduct two LTROs, one with a maturity of 12 months and the other with a maturity of 13 months; and in December it decided to conduct two LTROs with a maturity of 36 months. On 7 August it was announced that the ECB would again begin actively implementing the Securities Market Programme (SMP), which had first been announced on 10 May 2010. At the same time there would be one-week maturity SMP-sterilising liquidity absorbing operations. The Governing Council also decided to continue conducting its main refinancing operations as fixed rate tender procedures with full allotment, and to launch a new covered bond purchase programme (CBPP2) with the first pur-



## MACROECONOMIC DEVELOPMENTS

chases to be made in November 2011. In December the Governing Council decided to increase the availability of collateral for Eurosystem credit operations, to reduce the reserve ratio to 1%, and to discontinue for the time being the fine-tuning operations carried out on the last day of each maintenance period.

### 1.2 MACROECONOMIC DEVELOPMENTS IN SLOVAKIA

The Slovak economy continued in its growth trend in 2011, although the annual rate of expansion was more moderate than in 2010, when the economic recovery was relatively strong. The macroeconomic situation during 2011 was marked by a gradual improvement in economic performance until the middle of the year, followed by a moderate slowdown in the third quarter. This turnaround stemmed mainly from the escalating uncertainty and declining confidence in financial markets as a result of the sovereign debt crisis in some euro area economies. The Slovak economy had grown relatively sharply by the end of the year, despite subdued economic activity at the global level and weaker economic sentiment, and this growth was accompanied by a substantial trade surplus.

According to preliminary data from the Statistical Office of the Slovak Republic (SO SR), the annual rate of GDP growth in Slovakia in 2011 was 3.3% (at constant prices), compared to 4.2% in 2010. External demand continued to be the driver of economic growth. Domestic demand, by contrast, had a dampening effect on economic growth, as household final consumption declined further and general government consumption fell as a result of fiscal consolidation measures. The drop in domestic demand was partly counterbalanced by an increase in gross fixed capital. Looking at the output measure of GDP, its growth was driven mainly by industry and certain services. Towards the year-end, the strongest positive contribution was from net taxes on products, due to the payment of VAT on PPP projects. The relatively strong economic activity and sustained external demand also contributed positively to the profitability of both non-financial enterprises as well as financial corporations. Net exports remained the main source of GDP growth with the nominal trade surplus reaching its highest level since 1995.

The balance of payments current account improved markedly in 2011 and ended the period with a surplus of 0.1% of GDP (following a deficit in 2010). The main positive contribution to that surplus came from a rise in the trade surplus, which in turn reflected increased exports in the automotive sector. Imports grew more moderately owing to a decline in import intensity and increased destocking, amid uncertainty about future developments in external demand.

Labour market indicators performed relatively well in 2011 as economic activity remained relatively buoyant. After declining in 2010, employment increased year-on-year in 2011, although its pace of growth slowed in each of the last two quarters. The number of hours worked increased moderately year-on-year, after stagnating in the previous year. The annual rate of growth in nominal wages accelerated slightly, but real wages declined due to the rising price level. In parallel with GDP growth, labour productivity increased in both nominal and real terms in 2011, albeit at a slower pace than in the previous year. The increase in real labour productivity exceeded real wage growth. Unit labour costs declined year-on-year as growth in real labour productivity was higher than growth in nominal compensation per employee. The unemployment rate remained at a high level, although it declined in comparison with the previous year.

The price level rose at a faster pace during the year owing to a combination of both external and domestic factors. The average rate of HICP inflation increased from 0.7% in 2010, to 4.1%. The inflation rate was to some extent dampened by stagnating domestic demand. The prices of all core components of inflation recorded a higher year-on-year increase, owing to rising world prices of oil and agricultural commodities and a subsequent increase in administered prices and fiscal consolidation measures, and despite a gradual moderation in food commodity price inflation in the second half of the year.

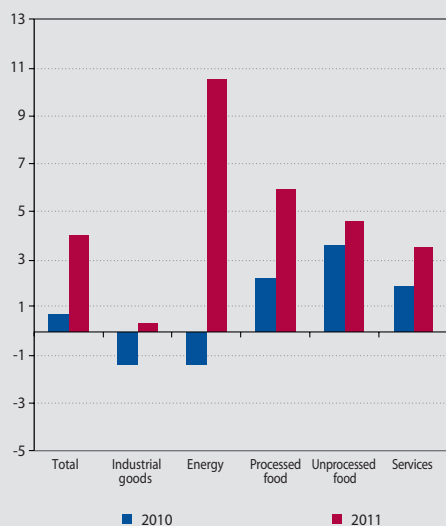
#### 1.2.1 PRICE DEVELOPMENTS

##### CONSUMER PRICES

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

The HICP inflation rate stood at 4.6% in December 2011, which was 3.3 percentage points higher

**Chart 4 Inflation components (average annual percentage changes)**



Source: SO SR; NBS calculations.

than in December 2010. The average inflation rate increased from 0.7% in 2010 to 4.1% in 2011.

All core components of inflation contributed to the higher inflation rate, reflecting the effects of a hike in administered energy prices in January 2011, the implementation of fiscal consolidation measures, and commodity price movements. The Government's consolidation measures (changes in indirect taxes – a hike in the VAT rate, from 19% to 20%, and in excise taxes on cigarettes – and the introduction of various fees and charges) contributed approximately 1 percentage point to the rise in inflation.

### Goods

Food prices had a strongly inflationary effect on goods prices only until the middle of the year. The most pronounced inflation was in prices of sugar, oils, fats, bread, and baked products. Prices of non-alcoholic beverages increased as a result of rising prices of sugar on world markets. Inflation in prices of basic agro-commodities gradually slowed down in the second half of the year, reflecting the movement of unprocessed food prices and the effect of a relatively good harvest. Another cause of the slower food price inflation was the slump in vegetable prices from June to September, which stemmed from fears of E-coli contamination.

As for prices of non-energy industrial goods, their annual rate of change increased moder-

ately in line with developments in the euro area. At the beginning of the year, prices of industrial goods were still declining in year-on-year terms, but by the end of the year they were rising, with the most pronounced increases in pharmaceutical products, footwear and clothing.

Inflation in prices of energy-producing raw materials, particularly oil prices, were directly reflected in strong fuel price inflation and indirectly in hikes in administered prices of gas, heat (not only in January, but also during the year) and electricity.

### Services

Services price inflation increased in 2011, as prices of accommodation, recreational and personal services, and in particular transport services went up gradually over the course of the year. Services prices also came under indirect upward pressure from external factors, specifically the pass-through of higher agricultural commodity prices to restaurant services prices and the pass-through of higher fuel price inflation to transport prices. Prices of both municipal and regional transport rose throughout the year, due to the cost factors of rising fuel prices and also to the efforts of local and regional authorities to make savings (by reducing fare subsidies) in response to the decline in their budget revenue. Transport price inflation included a rise in passenger train fares at the year-end.

### PRODUCER PRICES

Producer prices remained relatively steady during 2011, except for markedly slower annual inflation in overall agricultural product prices in the last quarter of the year.

The annual rate of industrial producer price inflation (2.7%) reflected substantial price rises in the components of food and refined oil products and increasing prices in the manufacture of basic metals and fabricated metal products. A negative contribution to producer price inflation was made by the component of manufacture of transport equipment. In the energy supply component, annual price inflation declined steadily and even entered negative territory, before rising at the end of the year.

The annual rate of change in prices of agricultural products in 2011 was affected mainly by plant product prices, as their movement changed



**Table 1 HICP inflation (average for the period; annual percentage changes)**

	2010		2011					
	Dec.	Q1-Q4	Q1	Q2	Q3	Q4	Dec.	Q1-Q4
<b>Headline rate</b>	1.3	0.7	3.5	4.1	4.1	4.7	4.6	4.1
Goods	1.0	0.1	3.8	4.4	4.4	4.7	4.4	4.3
Industrial goods	-1.1	-1.3	2.8	3.4	4.0	4.6	4.5	3.7
Non-energy industrial goods	-1.1	-1.4	-0.7	0.3	0.6	1.0	1.0	0.3
Energy	-1.2	-1.3	9.8	9.6	10.7	11.8	11.2	10.5
Food	5.1	2.9	5.6	6.4	5.0	4.8	4.3	5.4
Food – processed (including alcohol and tobacco)	2.6	2.3	3.9	5.8	7.2	6.8	6.8	5.9
Food – unprocessed	9.8	3.6	8.9	7.5	1.0	0.8	-0.6	4.5
Services	1.8	1.9	2.9	3.2	3.4	4.6	5.0	3.5
Core inflation (headline rate excluding energy and unprocessed food prices)	0.9	0.7	1.7	2.6	3.1	3.7	3.8	2.8
Headline rate excluding energy prices	1.7	1.1	2.4	3.1	2.9	3.4	3.4	2.9

Source: NBS calculations based on SO SR data.

gradually from a substantial annual increase in the first half of the year to an annual decline in the fourth quarter of 2011. This turnaround was partly explained by the base effect of a sharp rise in plant product prices in the same period of the previous year.

### 1.2.2 GROSS DOMESTIC PRODUCT

Slovakia's gross domestic product (GDP) in 2011 increased year-on-year by 3.3% (at constant prices), according to preliminary data from the Statistical Office of the Slovak Republic. In 2010, by comparison, the country's GDP grew by 4.2%.

In expenditure terms, the growth in GDP was driven mainly by the recovery of external demand, which decelerated gradually towards the end of the year. Domestic demand declined due to lower

private consumption and lower general government consumption. As for the output measure of GDP, the contributions to its growth came mainly from industry and, to a lesser extent, from construction and certain services. Nominal GDP in 2011 amounted to €69,058 million, which was 5.0% higher than the figure for the previous year.

### SUPPLY SIDE OF GDP

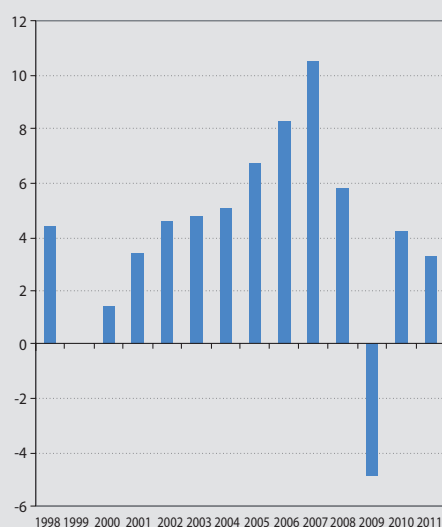
The GDP figure for 2011 was affected by the annual rate of growth in value added (at constant prices), which slowed to 3.0%, from 4.2% in 2010. There was, however, a moderately positive contribution to GDP growth from net taxes on products (value added tax, excise tax, and import tax, less subsidies), which increased by 6.4% mainly due to a one-off payment of VAT made towards the year-end on a completed PPP project.

**Table 2 Average annual producer price inflation (%)**

	2010	2011				
	Q1-Q4	Q1	Q2	Q3	Q4	Q1-Q4
Industrial producer prices	-2.8	2.8	3.0	2.2	2.8	2.7
Mining/quarrying product prices	1.1	6.8	2.3	3.1	7.7	5.0
Manufacturing product prices	0.0	3.9	4.9	4.1	3.4	4.1
Energy prices	-6.7	1.1	0.3	-0.4	1.9	0.8
Water and sewerage charges	6.2	6.8	5.0	4.7	4.4	5.2
Construction work prices	1.0	1.3	1.4	1.2	0.8	1.2
Building material prices	-3.3	1.6	1.5	2.3	1.7	1.8
Agricultural product prices	14.2	26.5	23.8	26.2	1.3	16.7
Plant product prices	29.9	75.9	72.4	33.1	-3.0	22.0
Animal product prices	1.1	7.4	11.5	14.6	9.9	10.8

Source: SO SR.



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

Source: SO SR.

The most pronounced rise in value added was in the industry sector, and there were moderate increases in construction and certain services. By contrast, value added continued to decline in trade and financial services and it fell sharply also in the agriculture and public administration sectors.

**DEMAND SIDE OF GDP**

In terms of expenditure, economic growth in 2011 was attributable mainly to net exports and gross fixed capital formation. There were negative contributions from a further decline in consumption demand and from destocking.

Domestic demand had a dampening effect on GDP growth, due mainly to the decline in consumption demand. Household final consumption maintained a declining trend amid still high unemployment, decelerating growth in house-

hold disposable income (due to lower social benefits and compensation of employees), and low consumer confidence. Consumers therefore preferred increasing savings over consumption, as the high savings ratio confirms. General government consumption also contracted as a result of fiscal consolidation measures. The decline in consumption in 2011 was mitigated to some extent by an increase in gross fixed capital formation, which reflected both the rising profitability of firms and partly also an easing of bank credit standards. The largest contribution to gross fixed capital formation growth came from investments in machinery and equipment and other buildings made by non-financial corporations in the manufacturing sector.

The recovery of external demand in 2011 boosted the economy's export performance. Exports of goods and services increased by 15.2% (at current prices), although the pace of growth slowed gradually over the course of the year. On the other hand, imports of goods and services decelerated more markedly (to 10.0% at current prices), especially in the second half of the year. This may indicate falling import intensity, low domestic demand, and increasing uncertainty about the future situation. As a result of these developments, net exports in 2011 stood at €1,798.8 million, its highest level since 1995. As regards price developments, the import deflator increased more sharply than the export deflator owing to a rise in oil prices, and therefore net exports made a positive contribution (5.5 percentage points) to GDP growth.

Both the export performance and the import intensity of the Slovak economy improved year-on-year in 2011, by around, respectively, 8 percentage points and 4 percentage points. The openness of the Slovak economy, as measured by the ratio of exports and imports of goods and

**Table 3 GDP formation and its components (index: same period a year earlier = 100; at constant prices)**

	2010	2011				
	Q1-Q4	Q1	Q2	Q3	Q4	Q1-Q4
Gross output	108.7	107.5	108.3	103.2	101.8	105.1
Intermediate consumption	111.8	109.9	111.8	103.3	101.4	106.4
Value added	104.2	103.7	102.9	103.2	102.4	103.0
Net taxes on products <sup>1)</sup>	104.0	100.5	110.7	101.3	112.9	106.4

Source: SO SR.

1) Value added tax, excise tax, and import tax, less subsidies.



**Table 4 GDP broken down by expenditure (index: same period a year earlier = 100; at constant prices)**

Indicator	2010	2011				
	Q1-Q4	Q1	Q2	Q3	Q4	Q1-Q4
Gross domestic product	104.2	103.4	103.5	103.0	103.4	103.3
Domestic demand	104.1	100.8	100.4	95.6	97.6	98.5
Final consumption	99.7	99.5	98.7	98.6	98.7	98.9
Household final consumption	99.2	99.8	99.9	99.1	99.6	99.6
General government final consumption	101.1	98.3	94.9	96.8	96.3	96.5
Non-profit institutions serving households	101.4	101.4	101.0	101.4	101.0	101.2
Gross fixed capital formation	112.4	101.6	106.4	105.9	108.4	105.7
Exports of products and services	116.5	116.8	113.1	106.8	107.5	110.8
Imports of products and services	116.3	111.4	110.9	98.2	99.0	104.5

Source: SO SR.

services to nominal GDP, increased by 11.8 percentage points to 175.6%.

### 1.2.3 LABOUR MARKET

With the economy maintaining relatively strong growth, the performance of the labour market in 2011 was favourable compared to the previous year. But although labour market indicators were positive during the year, the rate of employment and wage growth slowed and the unemployment rate remained high.

#### EMPLOYMENT

Employment (on the ESA 95 measure) increased year-on-year by 1.8% (after falling by 1.5% in 2010), but its annual rate of growth declined in each quarter of the year. The number of hours worked rose by 1.0% in comparison with the previous year. Looking at the labour market situation in 2011 on a sector by sector basis, the most marked annual rise in employment was observed in the industry sector (3.2%). Other notable positive contributions to employment growth came from the professional, scientific and technical activities sector and the information and communication sector. There were negative contributions only from the construction sector and the public administration, defence, education and health care sector.

According to the Labour Force Survey, the number of people working abroad in 2011 declined year-on-year by 8.1% (or by 10,100 people), which was greater than the drop recorded in the previous year. The number of employees in the domestic economy increased by 1.6%, and the number of entrepreneurs rose by 1.5%.

#### UNEMPLOYMENT

According to the Labour Force Survey, the number of unemployed fell year-on-year by 5.4% in 2011 amid an upturn in the labour market, and the unemployment rate declined by 0.9 percentage point, to 13.5%.

According to official data from Offices of Labour, Social Affairs and Family, the unemployment rate in 2011 averaged 13.2%, which was 0.7 percentage point higher than in 2010.

#### WAGES AND LABOUR PRODUCTIVITY

The average monthly nominal wage in 2011 increased to €786, while its annual rate of growth declined to 2.2%, from 3.2% in 2010.

The sectors that recorded the highest nominal wage growth were information and communication (8.7%), financial and insurance activities (8.4%), construction (4.1%), and industry (3.6%). Sectors in which the average nominal wage declined year-on-year included the following: administrative services; scientific and technical activities; and public administration, defence and compulsory social insurance. With the annual inflation rate rising, the average real wage in 2011 declined year-on-year by 1.6% (after rising by 2.2% in 2010).

While GDP in 2010 was produced by a far lower number of workers, employment increased moderately in 2011 although GDP growth slowed. The annual rate of growth in labour productivity (measured as GDP per employee) decelerated in 2011 after rising sharply in the previous year.



**Table 5 Labour market indicators**

	2010	2011				
	Q1–Q4	Q1	Q2	Q3	Q4	Q1–Q4
Nominal wage (index)	103.2	102.9	103	102.5	100.5	102.2
Real wage (index)	102.2	99.6	99.1	98.6	96.2	98.4
Nominal compensation per employee – under ESA 95 (index)	104.4	101.6	100.5	101.7	100.2	100.9
Labour productivity in terms of GDP (index, current prices)	106.4	102.1	103.3	102.9	104.4	103.2
Labour productivity in terms of GDP (index, constant prices)	105.8	101.0	101.2	101.3	102.5	101.5
Employment – under ESA 95 (index)	98.5	102.3	102.3	101.7	100.9	101.8
Unemployment rate according to LFS <sup>1</sup> (%)	14.4	13.9	13.1	13.1	14.0	13.5
Nominal unit labour costs (ULC) <sup>2</sup>	98.7	100.6	99.2	100.4	97.7	99.4

Source: SO SR, and NBS calculations based on SO SR data.

1) Labour Force Survey.

2) Ratio of compensation per employee growth at current prices to labour productivity growth (ESA 95) at constant prices.

The increase in real labour productivity exceeded real wage growth by 3.2 percentage points. This disparity was reflected in unit labour costs, whose annual rate of decline moderated by 0.7 percentage points in comparison with 2010, to 0.6%.

#### 1.2.4 FINANCIAL RESULTS

Non-financial and financial corporations in Slovakia made a total profit of €1,763.8 million in 2011, according to preliminary data from the Statistical Office of the Slovak Republic. That figure was 17.7% higher than the total profit in 2010 (which increased by 24.4% year-on-year). Both financial and non-financial corporations contributed to the improved financial result, with the total profit of non-financial corporations rising year-on-year by 12.2% (compared to 30.4% in 2010) and the total profit of financial corporations soaring by 103.0% (after falling by 27.8% in 2010).

In the case of non-financial corporations, the largest contribution to the total profit growth came from the health care sector (3.5 percentage points); the total profit in this sector rose by 892.9% year-on-year due to the forgiveness of hospital debts at the end of 2011 (in relation to the transformation of hospitals' legal status). The profit growth of industrial corporations was driven mainly by the electricity and gas supply sector. On the other hand there was a negative contribution from the manufacturing sector (from two segments in particular: manufacture of basic metal and fabricated metal products, and manufacture of computer, electronic and optical products); the total profit of

this sector fell year-on-year by 8%, after rising by 109.8% in 2010.

Financial corporations made a total profit of €1,125.4 million in 2011, which was €571.1 million higher than the figure for the previous year. Monetary financial institutions made the largest contribution to the annual growth in the financial sector's total profit, and there was also a positive contribution from insurance corporations and pension funds. The only segment that recorded a decline in profits was other financial intermediaries.

#### 1.2.5 BALANCE OF PAYMENTS

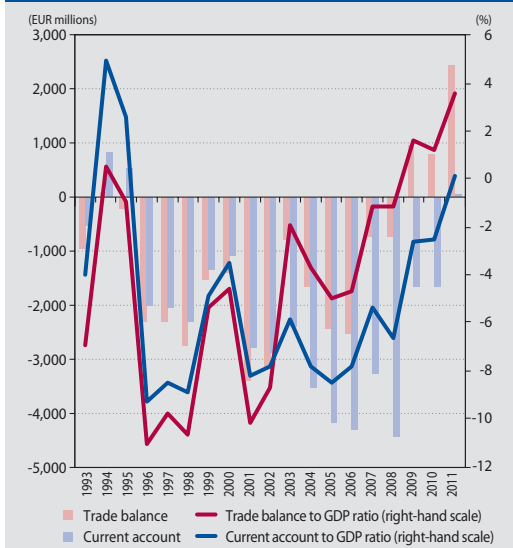
##### CURRENT ACCOUNT

The current account of the balance of payments recorded a surplus of €38.0 million in 2011, which represented a marked improvement in comparison with the previous year and included positive contributions from all components except for the income balance. The ratio of the current account surplus to GDP (at current prices) stood at 0.1%, which represented an improvement of 2.6 percentage points in year-on-year terms.

The trade surplus increased year-on-year in 2011 as it benefited from growth in external demand, which boosted mainly exports in the automotive industry. On the import side there were positive contributions to the balance from the decline in import intensity as well as from the running down of inventories in a climate of uncertainty



**Chart 6 Current account and trade balance developments between 1993 and 2011**



Source: NBS and SO SR.

about the future level of external demand. Both exports and imports increased markedly year-on-year in 2011 by, respectively, 16.9% and 13.6%.

The deficit in the services balance declined largely on the back of improvements in the categories of *services in other activities* and, to a lesser extent, *transportation*. The *travel* category, by contrast, saw a moderate decrease in its surplus, as the growth in expenditure exceeded the rise in receipts. Thus the main cause of the improvement in the services balance was an increase in receipts related to growth in external demand.

**Table 6 Balance of payments current account (EUR billions)**

	2011	2010
Trade balance	2.4	0.8
Exports	56.4	48.3
Imports	54.0	47.5
Services balance	-0.4	-0.7
Income balance	-1.7	-1.2
of which: investment income	-2.9	-2.4
of which: reinvested earnings	-1.2	-0.6
Current transfers balance	-0.4	-0.4
Current account in total	0.0	-1.6
Current account to GDP ratio (%)	0.1	-2.5

Source: NBS, SO SR (GDP).

The year-on-year deterioration in the income balance was caused by a rise in the investment income deficit, which reflected an increase in the amount of earnings reinvested by foreign investors. The current transfers balance improved year-on-year due mainly to positive developments in the *other transfers* sub-category (stemming mainly from an increase in revenues).

#### CAPITAL AND FINANCIAL ACCOUNT OF THE BALANCE OF PAYMENTS

The capital and financial account of the balance of payments recorded a surplus of €3.9 billion in 2011, compared to a surplus of €0.5 billion in 2010.

In the category of *direct investment*, the inflow increased year-on-year as a result of the higher inflow of equity capital; it was dampened only partially by the outflow of other capital, caused by an increase in claims on direct investment enterprises and on direct investors.

In the category of *portfolio investment* there was a moderate inflow in 2011 (after an outflow in the previous year), owing to a rise in demand among non-residents for government securities as well as to lower demand among banks for foreign debt securities and among firms for equity securities.

In the category of *other investment*, the inflow was higher than in 2010 largely due to developments in the Government and NBS sector, where

**Table 7 Capital and financial account of the balance of payments (EUR billions)**

	2011	2010
Capital account	0.9	1.0
Direct investment	1.1	0.0
abroad	-0.4	-0.2
of which: equity capital	-0.1	-0.4
reinvested earnings	0.4	0.2
in Slovakia	1.5	0.3
of which: equity capital	0.8	-0.2
of which: non-privatisation FDI <sup>1)</sup>	0.8	-0.2
reinvested earnings	0.8	0.4
Portfolio investment and financial derivatives	0.0	-1.3
Other long-term investment	1.1	-0.1
Other short-term investment	0.8	0.9
<b>Capital and financial account</b>	<b>3.9</b>	<b>0.5</b>

Source: NBS.

1) FDI – foreign direct investment.



the inflow of deposits to NBS accounts was only partly counterbalanced by the outflow of funds through loan repayments.

#### EXTERNAL DEBT OF SLOVAKIA

As a result of developments in the balance of payments, the external debt of Slovakia increased by €3.9 billion (USD 3.0 billion) in 2011, to €53.2 billion (USD 68.8 billion), mainly due to heightened demand for government bonds, an increase in the short-term foreign liabilities of the Slovak Government and NBS and a rise in the long-term liabilities of business entities from loans and trade credits. Slovakia's ratio of total gross external debt to GDP at current prices was 77 % as at 31 December 2011, representing an increase of 2.3 percentage points in comparison with the ratio for 2010 (74.7%).

#### NOMINAL AND REAL EFFECTIVE EXCHANGE RATES<sup>2</sup>

On average in 2011 the nominal effective exchange rate (NEER) appreciated year-on-year by 0.1%, after depreciating by 3.0% in the previous year. The strengthening of the NEER was mostly attributable to appreciation against the Polish zloty with a contribution of 0.2 percentage points. On the other hand, the NEER also reflected depreciation against the Czech koruna (the only one out of the relevant currencies) contributing -0.4 percentage points.

The effect of a negative inflation differential vis-à-vis relevant trading partners outweighed the NEER's appreciation, and resulted in the real effective exchange rate (REER) based on industrial producer prices – manufacturing depreciating by 2.1%. The rate of the REER's depreciation was 4.4 percentage points slower in comparison with the previous year.

### 1.2.6 MONETARY DEVELOPMENTS

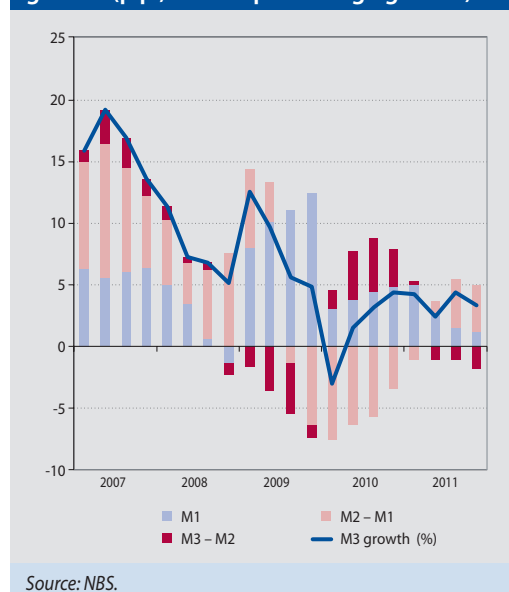
#### MONETARY AGGREGATES AND RETAIL INTEREST RATES

Monetary indicators in 2011 reflected economic developments, which improved gradually in the first half of the year and then moderated in the second half, when there was escalating uncertainty and declining confidence in financial markets as a result of the euro area sovereign debt crisis. The annual growth of the M3 monetary aggregate stopped accelerating in the third quarter of 2011 and slowed markedly in the fourth quarter. As at the year end, the annual M3 growth stood at 1.8%,<sup>3</sup>

compared to 4.3% at the end of the previous year. The relatively low annual M3 growth reflected lower nominal income growth in each of the most important sectors (non-financial corporations and households). However, the most important factor in M3 growth was interest rates, since their level determined the pattern of investment in deposits, especially in the household sector.

Chart 7 shows a comparison of tendencies in M3 components, which reflect developments in retail deposit rates. The household sector in particular took advantage of the advantageous rates on short-term deposits included in the monetary aggregate M2-M1 in the second half of 2011. Banks increased rates on longer-term time deposits mainly towards the end of the year, and the stock of these deposits rose as a result. Although interest rates on the longest-term deposits also had a rising trend, they affected the stock of long-term deposits with an agreed maturity of over two years, which are classed as M3 counterparts. There was a relatively marked increase in overnight deposits (the most liquid deposits, included in the M1 aggregate) mainly in the first half of 2011, in the non-financial corporations sector. This reflected mainly an increase in economic activity and the accompanying accumulation of deposits in the non-financial corporation sector. The stronger economic activity was indicated by production and sales figures, which increased

Chart 7 Contributions of components to M3 growth (p.p.; annual percentage growth)



- <sup>2</sup> The methodology of the effective exchange rate calculation is published on the NBS website at: [http://www.nbs.sk/\\_img/Documents/\\_Statistika/VybrMakroUkaz/EER/NEER\\_REER\\_Methodology.pdf](http://www.nbs.sk/_img/Documents/_Statistika/VybrMakroUkaz/EER/NEER_REER_Methodology.pdf)
- <sup>3</sup> M3 growth in December was affected by a methodological change concerning the classification of money market funds, as a result of which a large proportion of these funds were reclassified as other funds not included in the M3 aggregate. Without this reclassification, M3 growth would have been higher, at around 2.7%.



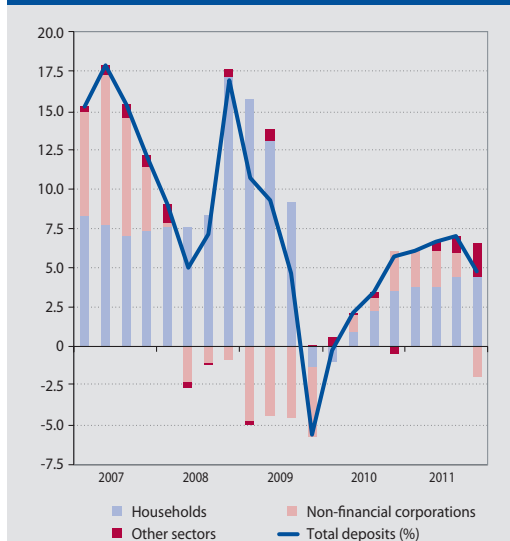
## MACROECONOMIC DEVELOPMENTS

substantially in the given period in year-on-year terms. Their growth subsequently decelerated and in doing so affected the stock of the most liquid deposits; the contribution of these deposits to the growth in the total stock of deposits included in M3 declined quite sharply. Marketable instruments (M3-M2) fell over the course of the year as a result of the mounting sovereign debt crisis. Banks issued fewer debt securities, and investors continued to shift money from money market funds to deposit products. From the sectoral view, households continued the trend of the previous year by making the largest contribution to private sector deposit growth. Due to uncertainty and weak consumer sentiment, households restricted their consumption and accumulated savings. While the contribution of household deposits rose moderately, the contribution of deposits from non-financial corporations became less positive amid the slowdown in economic activity in the second half of 2011, and actually turned negative in the fourth quarter.

As regards the counterparts of M3 there was an increase in lending. Lending to non-financial corporations maintained its positive tendency of the previous year, when the economic growth resumed. The favourable economic situation was reflected in a gradual moderate increase in the annual growth rate of the stock of corporate loans. In the first half

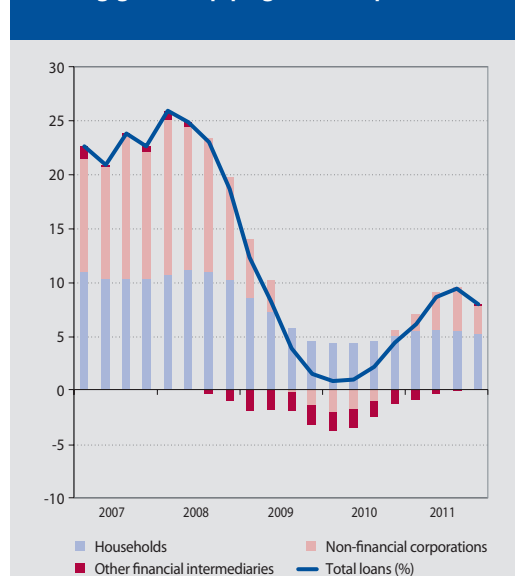
of the year lending growth to non-financial corporations was driven by both short-term loans and long-term loans for investment financing. Although lending rates for non-financial corporations rose slightly in the first half of 2011 – reflecting market rate increases that followed hikes in the key ECB rates – they remained relatively favourable in historical terms. The reduction of the key ECB rates later in the year supported the banking sector, but did not lead to any significant increase in lending. In fact, lending growth slowed in the last quarter of 2011 as the sovereign debt crisis escalated and credit standards were tightened. Growth in lending to households increased very moderately in the first half of 2011 and then slowed marginally in the second half of the year amid concerns about future developments. Both consumer loans and housing loans recorded lower growth. Throughout the year lending activity was supported by falling property prices and by interest rates being at relatively low historical levels. The pass-through from interbank market rates to retail interest rates was most pronounced in the first half of 2011 when retail rates increased. This period saw a widening of the difference between average interest rates on housing loans in Slovakia and in the euro area as a whole. The situation persisted also in the second half of 2011. On the other hand, the adverse situation in the labour market may have had a dampening effect on demand for loans.

**Chart 8 Contributions to the annual rate of private sector deposit growth (quarter-end in p.p.; growth in percent)**



Source: NBS.

**Chart 9 Contributions to the annual rate of lending growth (p.p.; growth in percent)**



Source: NBS.