DEVELOPMENT OF KEY MACROECONOMIC INDICATORS AND COMMERCIAL INSURANCE IN V4 COUNTRIES IN 1995 – 2004

Part 1
THE SLOVAK REPUBLIC

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Every economy develops against a certain macroeconomic background, with its indicators determining its structural evolution at the same time. In the financial corporations sector, insurance companies play a major role. Offering financial services, they accumulate and allocate money in the economy and take part in its credit system. They pool spare funds of largely medium- and long-term nature by selling a variety of insurance products, which they may later invest in compliance with the legal framework in financial markets in the form of credits to borrowers in the economy.

From the point of view of national accounts, output is an important indicator of the sector production. The production of insurance companies comprises[1] total underwritten premiums and total supplementary premiums (consisting of yield of technical reserves) investments. This amount is reduced by the sum of insurance claims from insured events and by changes in technical reserves and in reserves for profit-sharing insurance policies.

In the first part of this paper, we will discuss selected macroeconomic aggregates which have a crucial impact on developments in the insurance industry. In the second part, we will look at the development of main indicators in the insurance industry, explain correlations between individual indicators and outline future trends in the sector in terms of underwritten premiums and insurance patterns.

1. Macroeconomic environment

After transition decline in early 1990s Slovakia's GDP reached the level of 1990 (96.2%) in 1995. The uptrend seen in 1995 (6.7%) went on in 1996 (the growth of 6.1%). In terms of macroeconomic performance, this period can be rated as successful.[2] It was marked by robust GDP growth, decline of inflation, and positive net exports. In comparison with following period there was a relatively low unemployment rate. However, Slovakia failed to take advantage of the recovery spell to implement vital structural and institutional reforms. Efficiency growth continued without interrupting economic stability since there was possible to implement capacities formerly freed up during the transformation slump (1991 – 1993). The GDP development in constant prices is shown in Table 1.

Table 1 Development of gross domestic product

Indicator	1995	1996	1997	1998	1999	2000	2001	2002	2003	2004
GDP in SKK bill.	576.5	611.9	640.1	667.9	676.9	690.6	716.8	749.9	783.4	826.4
Growth (%)	6.7	6.1	4.6	4.2	1.4	2.0	3.7	4.6	4.5	5.5

Source: Statistical Office of the Slovak Republic, National Accounts, note: GDP at constant prices of 1995

Rapid economic growth, in excess of 6%, was accompanied by growing internal and external imbalances which later turned out to be intolerable. This period comes down as a time of an overheated economy. "An expansive fiscal policy in 1995 and 1996 and an expansive monetary policy resulted in excessive economic growth, supported by foreign loans, because of the lack of domestic funds."[3] Emphasis was given to social motives and to the role of the state, preferring strong economic growth supported

[1] as defined by National Accounts of the Statistical Office of the Slovak Republic

[2] ssee e.g. Marcinčin, A. – Morvay, K.: Macroeconomic Illusion and Microeconomic Reality – Slovakia's Example, in: Finance and Credit 2001, No. 3, ISSN 0015-1920, p. 130 – 146.

[3] A Ministry of Finance of the Slovak Republic document – part "Problem Areas of the Slovak Economy in 1998 and 1999" in "Specification of Government Objectives and Actions in Financial Policy", Bratislava 1999.

by instruments more fit for a demand-oriented economic policy (boosting demand by heavier public spending, infrastructure investments, and running budget deficits in the name of support for so-called development incentives, etc.). At the same time, the most important segments of economic policy lacked proper coordination.

The problems faced in the previous period peaked in the last quarter of 1998, when GDP growth was down to 0.1% and annual growth reached 4.2%.

The end of 1998 brought a revision of the transformation concept. Balance was to be restored at the price of a temporary economic slowdown. Growth was expected to recover on the back of the completion of the institutional framework, restructuring and increasing corporate competitiveness. For the 1999-2000 period the government said it would pursue a stabilisation policy aimed at cutting the public finance deficit down to 2% of GDP and reducing the current account deficit to 5 – 6% of GDP[4], even at the expense of slower economic growth. As a result of the government's restrictive fiscal policy in 1999 and 2000, the GDP went up by 1.4% to 2.0%, respectively.

Critics of the stabilisation package had different views on the necessity and acceptable severity of restrictive measures required to delaying of domestic demand. Early experience from the stabilisation quest suggested one of the government's missions – to reduce the external imbalance – was a success. However, the restoration of balance brought about an extraordinarily high unemployment rate and a falling standard of living shown by a drop of real wage and delaying of final household consumption.

The GDP began to accelerate within 2000 and the trend continued in 2001, when average year-on-year growth reached 3.7%. In 2002 and 2003, annual GDP growth surpassed 4% to soar to 5.5% in 2005, making Slovakia one of the fastest growing economies in Central Europe. The stabilisation effort did not lead to negative GDP gains and paved the way to a steady growth of the Slovak economy lasting to present.

The development of inflation (based on the Consumer Price Index, period average, annual change in %) is shown in Table 2.

Table 2 Development of inflation in the Slovak Republic

Indicator	1995	1996	1997	1998	1999	2000	2001	2002	2003	2004
Inflation	9.9	5.8	6.1	6.7	10.6	12.0	7.3	3.3	8.5	7.5
Core inflation	4.4	5.0	6.2	5.2	7.0	5.7	4.4	1.9	2.2	1.1

Source: NBS annual reports

In 1995 CPI inflation reached 9.9%, dropping to single digits for the first time since the outset of transformation. This favourable trend went on in 1996 – 1998, when inflation stayed below 7% and the switch to a new exchange rate regime in October 1998 affected inflation less than expected.

Inflation remained at single digits in 2001 – 2004, despite ongoing impacts of rising regulated prices and fluctuating prices of food and market services. As a result of the SKK exchange rate development, the 2004 surge in world fuel prices had no major impact on inflation.

Table 3 Unemployment in Slovakia according to labour force surveys

Indicator	1995	1996	1997	1998	1999	2000	2001	2002	2003	2004
Number of unemployed.*	333	330	348	428	535	506	508	487	459	480
Unemployment rate**	13,1	12,8	12,5	14,6	18,2	19,2	19,2	18,5	17,4	18,1

Source: Statistical Office of the Slovak Republic,
note: *number of unemployed in thousands, ** official in %

The unemployment problem in Slovakia comes down to the following arguments.

Unemployment has a strongly structural nature with seasonal effects, with a persistently low job offer, a high percentage of jobless with low qualification, a large share of the workforce being long-time unemployed, a substantial share of young people and school graduates in the total number of unemployed, and lingering sharp disproportions in regional job offers.

At the same time, falling employment in most sectors coinciding with a growing GDP signals an ongoing restructuring with rising pressure on productivity growth. All in all, this particular indicator is considered problematic in Slovakia which, along with Poland, reports the highest unemployment rates among European Union countries.

Although **wage regulation** in Slovakia was practiced irregularly and only for brief periods of time, nominal wage growth has been modest. Since real wages grew at a fairly low rate during transition, they still fall short of the 1989 level.

[4] same source

Table 4 Development of nominal wages in Slovakia

Indicator	1995	1996	1997	1998	1999	2000	2001	2002	2003	2004	Index 04/95
Nominal wage in SKK	7195	8154	9226	10003	10728	11430	12365	13511	14365	15825	**219.94**

Table 5 Development of interest rates

Indicator	Unit	1995	1996	1997	1998	1999	2000	2001	2002	2003
Average interest rates										
– on loans	%	13.34	11.89	12.53	13.48	11.07	9.79	8.36	9.93	7.75
– on deposits	%	8.29	6.70	8.00	10.16	10.45	7.23	5.15	5.70	3.76
margin	%	5.05	5.19	4.53	3.32	0.62	2.56	3.21	4.23	3.99

Source: NBS annual reports

The development of nominal and real wages was determined by the cost of living and a changing labour market. Real wages posted a sharp slump in 1990-1991 when soaring costs of living sent real wages plummeting all the way down to 67.3% of the 1989 level. Later on, both the cost of living and nominal wages grew at a relative high pace. The average growth in the cost of living in 1989-2000 worked out to 27.1%, while nominal wage growth averaged 22% in the same period.

In the 1992-2002 period, both key indicators followed a steady path, with larger turbulences only seen in the cost of living. In particular, there were the effects of repeated price deregulation which disrupted the natural tendency of the economy to stabilise. Consequently, real wage growth slowed down considerably in 1999 – 2000, even recording a drop. Another tendency observed since 1998 is an overall slowdown of nominal wage growth due to restrictive stabilisation measures implemented by the government. Wage development is also affected by lingering problems with the (non)functioning of the tripartite system.

Overall, wage development in Slovakia can be said to have no proinflation effect, as wages trail productivity of labour in the long run.

The insurance economy is also influenced by the interest rate, developing as shown in Table 5.

As regards interest rates, both the average interest rates on loans and deposits and the margins charged by commercial banks across the period reviewed were sensitive to macroeconomic imbalances.

The initially adverse impacts of transformation (1993, 1994) combined with a shortage of available funds and, consequently, high interest rates, were later dampened by a positive inflation record and discount rate cuts, triggering a general interest rate decline in 1995 and 1996.

The year 1997 spelled a turnaround into a rise due to a growing macroeconomic imbalance.

The stabilising measures set in motion in 1999 paved the way to a more sustained interest rate decline in the Slovak economy together with banking sector consolidation resulted in better availability of spare funds for borrowers.

As far as the functioning of the entire financial sector is concerned, 2004 saw a general strengthening and rising stability. This was partly the result of a sound economic development and improving internal management mechanisms. Furthermore, the sector has become more resilient to external shocks. Despite some of the problems related to economic development mentioned above, economic growth should remain strong in 2005, benefiting the sector and its credit exposure alike. The current economic boom should also generate funds to cover future risks, which might appear in case of an economic recession. These conclusions apply fully to the insurance industry as well.

To be continued in issue 9/2005.