

Watch

MONTHLY REVIEW

2008

Slovak Economy in Comments and Analyses

SPECIAL FOCUS

Economic Growth Will Slow, Convergence Won't Stop

Fears and uncertainties. Will the financial crisis bring a painful but quick economic sobering or will the world fall into a deep and long-lasting depression? This question currently haunts managers, economists as well as politicians all around the globe.

The world's financial system is shaking at its base. Real estate bubble, inflated through trades with derivatives, as well as the stock market bubble in the US and many other countries burst. This way, they uncovered the mistakes of politicians, bankers, auditors, rating agencies and central banks. Their short-term goals and underestimation of risks (if not even hiding) led for years to strong growth in consumption, profits, employment, shares and real estate prices. With a time lag, this subsequently caused the severest crisis of trust that is remembered by the current generation of financial specialists.

Monetary blood stream of the world's economy has almost collapsed. Massive interventions of central banks have in time brought enough liquidity to the markets. Governments helped commercial banks with additional capital. The willingness of banks to lend to other banks, firms and households, however, is returning very slowly. After years of risk underestimation, there came a time of risk overestimation, which will necessarily cause a downturn in growth of consumption and at least a short-term recession. In the worse case, longer-term economic crisis comes into question.

Crisis in the right time

Will Slovakia feel the effects of global economic crisis in 2009? The answer is definitely "yes", and even more than the country felt it so far. It will not mean any tragedy, however; rather the opposite. The crisis hit the small country under the Tatras in the best time possible, and it can bring it more than it destroys. Why?

The crisis stopped an unhealthy and unsustainable price growth in the real estate sector. This puts a brake on the hectic construction "at any costs" in an environment, where sharply rising prices of apartments and fat margins of developers pushed also prices of construction works

and materials too high. In the last two years, developers would easily receive generous bank financing as well as orders from clients. However, more demanding current conditions from banking institutions and the worsened position of buyers fundamentally reduced the pool of projects that will start within the next two years.

This provides for additional pressure for increased quality of construction works,

decrease in their costs and costs of often overpriced construction materials. This "creative destruction" will ensure that the economic purge will happen sooner than the developers would have, in an excessively optimistic mood, built thousands of too costly flats.

From a long-term point of view, economic deceleration will help the domestic businesses as well. Local industry has lived through too many good years recently. This period of expansion has forced too few firms to go bankrupt, which may have led to carelessness in the choosing of business partners or setting contract conditions. Moreover in the way of financing. Why dealing with long-term credit when short-term is so cheap? Many

firms will change this strategy in 2009. Renewing credits will not be as self-evident as it used to be. Neither will be the credit discipline, which could surprise negatively the unprepared. Generally, everybody will have to pay close attention to the risks out there.

Weakening foreign demand for Slovak products will accelerate the closing of less-efficient productions in the textile, garment and shoemaking industries. It will also free labor for some of the more prospective branches, such as electronic and mechanical

engineering. Several thousands Slovaks will lose their jobs abroad. Labor shortage in various domestic regions can thus disappear. This will increase the space for expansion for efficient firms as well as arrival of new investors. Slovakia will be the only country in the Visegrád Four that offers a unique combination of cheap labor, pleasant geographic position and a zero exchange rate risk vis-à-vis Euro.

While in other countries multinational concerns are limiting their production, this does not mean that in Slovakia they will expand. It means that Slovak facilities will shed labor only in the most necessary cases, and when the sales in Europe revive to their pre-crisis levels, they will be the first adepts for expansion of production capacities. Despite for it being a hard period, the outlook for Slovak industry remains positive also in 2009.



Consumption pulled by wages and disincentives to save

A true economic crisis depressing real wages will not arrive in Slovakia. Strong growth in domestic demand will continue, mainly thanks to the household spending and increased public investment. Although the overall GDP growth will slow considerably due to stagnating export, its dynamic will stay above four percent. At this speed, the economic growth is still faster than a dynamic of developed countries in their best years. Slovakia will thus be the fastest-growing economy of the Eurozone this year. Catching up with the developed countries will this way not come to a halt.

Final household consumption will be the decisive driving factor behind local economic growth. TREND Analyses expects it to decelerate only modestly – its growth should be still above five percent. Contrary to the USA or Western Europe, consumption in Slovakia is financed only partially through consumer credits. Moreover, the availability of this kind of loans will not change much. Mortgage loans, however, got a bit more expensive. Nevertheless, even they should become cheaper again during 2009.

Nominal wage growth as well as the increase in gross disposable income of households will definitely decelerate. The average gross wage in the economy will however keep on growing at above seven percent. From this increase, only a small fraction of purchasing power will be taken away by inflation. This will be so, because with a time lag, the disinflationary effect of Koruna appreciation will take place in 2009. Real wages will in this setting grow by solid 4.5% according to TREND Analyses' prognosis. Alongside wage growth, lower interest rates on bank deposits will further stimulate consumption. Motivation to save will be much lower compared to 2008.

Amid much weaker export growth, stronger domestic consumption in 2009 will cause a deepening of trade deficit. On the other hand, significantly lower prices of oil and gas as well as some other commodities will decrease the money value of imports. Investment-related imports will be most probably smaller than last year. This way, a greater trade deficit will most probably be avoided.

More public construction

A strong growth impulse to the economy will be provided also by public investments. The Cabinet will not be able to start the highways construction through PPP projects in the promised volume, however, construction production in this segment will be much higher compared to extraordinary weak year 2008. In 2009, production in this branch will be further advanced by the installation of electronic road toll system on highways and motorways. Another stimulus for GDP growth will be a noticeable drawing of Eurofunds. This way, the focus of construction will shift from dominating private investment increasingly towards road, railway and municipal infrastructure.

Increase in unemployment will occur in Slovakia as well, since thousands of workers at home and abroad will lose their jobs. In 2009, in addition, much fewer new jobs

will be created. The chances to find a decent employment will deteriorate compared to the period of last few years. However, such state will be only temporary. Longer-term growth of unemployment rate is improbable. The only advice to the "victims of crisis" will be using the time for re-qualification and upgrading one's language skills.

Prices will Please with Modest Growth

'New currency is here = let's shop, prices will get much higher!' That is a simplified model of most Slovak consumers' thinking. It reflects a pervasive experience with changes, which people lived through themselves or which they came to know from the memories of elders. If anybody by any chance would doubt this view, leading politicians headed by Prime Minister Robert Fico have pushed this perspective throughout the whole of 2008. Although indirectly and perhaps not consciously.

Let us leave aside the fact whether R. Fico really believes in the threat of Euro-related high inflation or just uses it to increase his popularity. Either way, through his repeated statements, he has mentally prepared consumers for increasing prices, which serves very well the local retailers. The real result of his pursuit is not really the legislation banning speculative increase in pricing, but rather the frequent medialization of the inflation theme, which plays much in favor to the merchants. In times when Koruna unprecedentedly appreciated and media should have been full of pressure for the prices of imported goods (that is, of almost everything) to decrease, the threat stays only at the level of a ban to change price tags upwards. Half a year before Euro adoption as well as half a year after the switchover.

It might be that the vendors have not even expected how the Prime Minister will help them reach higher profits with his inflationary rhetoric. Apart from questions of journalists asking when will stores finally decrease their prices of imported goods, the merchants were asked much more pleasant questions, such as what do they think about the government's intention to punish arbitrary price increases. Decreasing one's prices in this setting would not make much sense. The supposed threat from the Cabinet had thus an effect of unexpected help to the retailers. They increased profit margins by not decreasing their prices or changed their price tags downwards only symbolically compared to the exchange rate appreciation.

Result? Retail trade in Slovakia is for the second year the branch with the highest growth in profits. According to the figures of the Statistical Office, in 2007, tradesmen's aggregate profit increased by more than € 350 million, and by even larger amount in the first three quarters of 2008. The total profitability of the sector during the first nine months of the year reached € 2.16 billion, which equals the aggregate profits of the entire industrial production, that has a much greater weight in the economy. 'Thank you, Mr Prime Minister,' the retailers and importers can say when assessing their final financial results for 2008.

What does this all mean for the 2009 inflation outlook? Good news. Prices of most goods should not only have any reason to increase, what is more, they should

decrease. Starting with foodstuff and groceries, which got significantly more expensive after the last year's bad harvest. This year's very good crop yields will push prices downwards. Next, automobiles' prices excluding taxation in Slovakia are the highest in Europe, often even after a significant discount. This will also work as a break to any further price increases. One who waited with greater purchases (of construction materials, cars or household equipment) has done well, since the prices of these goods might be lower in 2009.

Huge profits of retailers as well as comparison of prices to Slovakia's neighbors show that more than 30% appreciation of local currency against Euro has been translated into domestic prices very limitedly. This way, retailers and importers possess a thick profitability buffer. However, the answer to the question, whether and when the respective prices will decrease, depends on the level of market competition, pressure of media, consumers' behavior and their willingness to travel for shopping to

much cheaper regions in the neighboring countries. Concerning Hungary or Poland, this holds also thanks to their strongly depreciating currencies.

TREND Analyses expects that the margins of retailers will narrow in 2009, which will lead to a considerable downward pressure on inflation – to reach 2.5% (forecasts of bank analysts are higher: 2.8-4.1%). The major source of inflation will be prices of services, although some of them got more expensive already before rounding up prices in Euros. Disinflationary pressure will be felt also from tradable goods, which is supported apart strong conversion rate also by the decreasing prices of fuels for transport. Regulated prices of energies will in 2009 influence the overall price growth positively, as well. Electricity will get more expensive only for large households, prices of natural gas will practically stay the same after the recent fall in oil prices, and the prices of heat will be even lower than their level from summer 2008 – that is, before their last increase. □

Slovakia in 2009									
(prognoses of banking analysts and TREND Analyses)									
	ČSOB	ING	SLSP	TABA	UniCR	VÚB	spread	average	TA
Economic Indicators									
Nominal Gross Domestic Product (€ bn)	73.8	73.4	73.8	73.3	73.3	72.5	72.5 – 73.8	73.4	73.5
Growth of Nominal GDP (% , yoy)	8.0	7.7	7.9	7.7	7.5	6.4	6.4 – 8.0	7.5	8.2
Growth of Real GDP (% , yoy)	3.9	3.7	4.8	4.5	4.2	3.0	3.0 – 4.8	4.0	4.5
Real Consumption of Households (% , yoy)	4.0	2.5	5.3	4.6	3.5	2.7	2.5 – 5.3	3.8	5.2
Current Account Balance (% GDP)	-4.0	-4.4	-4.6	-3.5	-5.8	-6.0	-6.0 to -3.5	-4.7	-4.0
Trade Balance (% GDP)	-1.0	0.0	-0.2	0.3	0.0	-0.2	-1.0 to 0.3	-0.2	-0.5
Fiscal Deficit (% GDP)	2.2	2.1	2.4	2.2	2.1	2.1	2.1 – 2.4	2.2	2.5
Consumer Inflation (HICP, %, dec-dec)	2.6	3.3	3.6	2.1	3.5	2.6	2.1 – 3.6	3.0	2.1
Consumer Inflation (CPI, %, dec-dec)	2.8	4.1	4.0	3.0	3.9	2.8	2.8 – 4.1	3.4	2.5
Consumer Inflation (CPI, %, annual average)	3.2	4.2	4.3	3.0	3.6	3.3	3.0 – 4.3	3.6	2.8
Core Inflation (CPI, %, dec-dec)	2.6	3.7	4.4	4.1	3.9	2.7	2.6 – 4.4	3.6	2.9
Production Prices (PPI, %, dec-dec)	3.5	2.9	3.8	1.1	3.0	2.8	1.1 – 3.8	2.9	2.0
Growth of Real Gross Wages (% , yoy)	3.5	2.2	3.8	4.3	2.0	2.5	2.0 – 4.3	3.1	4.5
Rate of Unemployment (%)									
ILO methodology (4Q)	10.4	9.9	9.5	9.4	10.1	9.9	9.4 – 10.4	9.9	10.5
registered (December)	9.0	8.4	6.8	7.6	8.0	8.5	6.8 – 9.0	8.1	8.0
Interests and Exchange Rates									
2-week ECB repo rate (end of year)	1.50	1.00	1.75	1.25	1.50	2.00	1.00 – 2.00	1.50	1.50
3M EURIBOR (annual average)	2.40	2.20	2.65	2.30	2.40	2.80	2.20 – 2.80	2.46	2.30
3M EURIBOR (end of year)	1.80	1.60	2.25	1.70	2.10	2.70	1.60 – 2.70	2.03	2.10
10Y Slovak Bonds (ytm, end of year)	3.45	3.70	4.80	4.70	4.35	3.10	3.10 – 4.80	4.02	4.20
10Y German Bunds, (ytm, end of year)	3.20	3.00	4.40	3.80	4.15	2.40	2.40 – 4.40	3.49	3.60
EUR/USD (annual average)	1.26	1.15	1.32	1.22	1.25	1.33	1.15 – 1.33	1.25	1.28
EUR/USD (end of year)	1.17	1.10	1.30	1.30	1.27	1.35	1.10 – 1.35	1.25	1.20

Source: analysts of commercial banks, TREND Analyses

LEGISLATIVE INITIATIVES

Policy Index in Red Again

During the third quarter of 2008, the HESO policy index posted its worst negative result of minus 41.1 points. This means that forty selected experts evaluated the legislative changes in the period since July till

September 2008 very disapprovingly. The worst rated policies passed include the Law on General Economic Interest in the Energy Sector, the approval to the construction of a landfill in the City of Pezinok, the amendment to the Law on Prices as well as the amendment to the Law on the Minimum Wage.

The Law on General Economic Interest in the Energy Sector provides the government with the powers to

directly set prices and duties for electricity and gas suppliers. This does not only go against the pricing principles of a free market economy, it also contradicts the governance of pricing within network industries by an independent regulator. The government's attempts to stop price increases at any costs could lead to underinvestment in energy infrastructure and innovation as well as over-consumption and the pressure for high price increases in the future.

Regulation of price setting pertains also to the amendment to the Law on Prices. It expands the power of the state in regulating prices during the conversion to Euro. More or less arbitrary price ceilings could lead to a shortage on the market and make potential investors think twice about their future plans in the country. Finally, the amendment to the Law on the Minimum Wage increased this wage floor by 10% – that is, by more than previously agreed in valid legislation, which could negatively affect employment of low-skilled workers. The only positively evaluated measure of the third quarter 2008 has been the amendment to the Civil Judicial Code, which eases and shortens civil court trial procedures.

More Changes to the Private Pension Pillar

Within the system of old-age social security system, further legislative modifications can be expected. The first group of changes, according to Minister of Labor Viera Tomanová relates to purchasing a pension rent in form of annuity, which will be offered by commercial insurers. So far, there is no legislative framework for the paying-out of money saved in the private pension pillar. Other changes will ensure education on the two-pillar pension system, which will most probably enter also into high school textbooks. The ratio of contributions to the pay-as-you-go and the private savings system will remain unchanged. Other amendments are being considered according to Prime Minister Robert Fico. The major one is a state pension fund that would be run by the public Social Insurance Company. Moreover, fees for managing private pension funds will most probably be decreased. At the moment, there are six private pension fund managers (DSS) operating within the "second pillar" in Slovakia and their operation is strictly regulated.

Metal Repurchase Strictly Regulated

Since January 1st 2009, repurchasing metals at collection sites is more regulated than before; the change brought with the amendment to the Act on Waste. Collection site shall register not only the identity card in case of physical persons, but basic identity information also in case of corporate clients. The operation of a collection repurchasing site will entail also keeping a database with the description or photographic documentation of each larger piece of non-ferrous metal repurchased from physical persons. This will help domestic producers of metals from scrap, such as

Kovohuty Krompachy or Železiarne Podbrezová, which face frequent thefts of commodities. Other theft-related materials often brought for sale include rails, street signs and hatches. Breaching the duty to register received material might cost the respective repurchase site a fine from seven to sixteen thousand Euros. After a repeated breach, the site can lose its license.

Private Schools' Financial Discretion Endangered

Minister of Education Ján Mikolaj from SNS party is proposing a legislation restricting the use of resources in private education. Private schools will thus not be able to use parents' contributions to whatever end they choose, such as covering their rental costs. "A private school cannot use the resources on what it pleases. Contributions from parents must go into education," stresses J. Mikolaj. In exceptional cases, the resources may be used for emergency expenses. Teachers' salaries will remain allowed outlay. The Association of Private Schools objects this view, criticizing also its disinvolvement in the preparation of the legislation. The state currently supports private schools with subsidies for each pupil. This money is used mostly for the day-to-day operation. Rents are often covered with parent contributions.

Changes the New Year Brought

New Year is traditionally the date when much new legislation is taking effect and this year is no exception. Old-age pensions are since January 1st 2009 by 6.95% higher compared to the previous period. With the increase in the so-called 'minimum for living' (from € 170 to € 179 a month), also the personal income tax deductible bottom level is raised from € 3,269 to € 3,435 a year. Within the Eurozone, Slovakia will also enjoy cheaper money transfers, as respective international account operations are treated as domestic ones. The same holds for ATM withdrawals.

Prices of electricity for most households will remain practically unchanged. Four-fifths of households will pay only 0.11% more for a unit of electrical energy than before. Large households will face a 10.8% increase. In the prices of heat, a noticeable decrease due to lower price of natural gas has been announced. However, regulated prices of energies pertain to households only. Firms and entrepreneurs continue to be charged prices at free market rates.

Employment bonus for low-wage workers is being introduced from January. Based on the principle of negative income tax, the employment bonus will lower the respective income tax. However, the height of the bonus is so far only symbolic (up to € 5.8 a month). The monetary incentives to travel to work will, however, increase as well. An employee traveling up to 30 kilometers to work, for example, will receive reimbursement of up to € 36.5 a month.

Lower Threshold for VAT Eligibility

From January 1st, 2009, twelve thousand more small entrepreneurs will be subject to the value added tax (VAT). This is so, because with the Euro adoption, former eligibility floor is raised from a turnover of approximately € 49.8 thousand to € 35 thousand. Entrepreneurs reaching this turnover during the last 12 months have to register at a respective tax office by January 20th. Ministry of Finance justifies this change by the requirements of a European directive. Respective entrepreneurs will be able to reduce their VAT in assets used in their businesses. From a fiscal point of view, the amount of these reductions is going to be higher than the additional tax volume collected. According to the Institute of Finance Policy at the Ministry, the negative impact on the budget is expected to reach € 11 million in 2009. In 2010-2011, the impact of the amendment should be slightly positive towards public finance. □

MACROECONOMIC SUMMARY

Slovakia Joins the Euro Club

The Slovak Republic has joined the Eurozone on January 1st, 2009, by adopting the European Common Currency. Until January 16th, both Slovak Koruna and Euro currencies will circulate in the national economy, with Korunas being drawn out of the market within 16-day period. Afterwards, Euro will be the only legal tender in the country. Slovakia has thus become the sixteenth member of the currency union with 329 million consumers.



Slovakia is entering the Eurozone with the lowest interest rates in its history, since the local central bank had to follow the downward steps of the European Central Bank and cut its key rate to 2.50%. The country is adopting Euro with a relatively high inflation rate – almost two percentage points higher than the Eurozone average. The accession is marked by turbulent times on world markets, with firms shedding labor and cutting production due to economic turmoil in the West. Slovakia is acceding with a GDP per capita at around 72% of the EU27 average and a price level of about 68% of the EU average. It will be the poorest and cheapest country of the Eurozone; however, with a solid economic growth expected to continue, it will most probably overtake Portugal in GDP per capita as of 2009.

Adopting Euro brings several shifts to the local economy. Abolishing exchange rate costs and volatility as well as higher price transparency are to be cited among the major positive effects. Euro in Slovakia will be another convincing argument, apart from relatively cheap

labor costs, for foreign investors to place or even keep their production here. Euro adoption is to bring also a positive anti-inflationary effect stemming from cheaper imports from V4 countries, whose currencies have depreciated against Euro in the last months quite markedly. Slovak Koruna is ending its history with the highest annual appreciation of all emerging markets' currencies (11.7%). One major caveat of Euro adoption is the loss of independent monetary policy, since any decisions on interest rates will be made solely from Frankfurt.

Industrial Production Stagnating

The expansion of Slovakia's industrial production has been brought to a halt after three years of continuous upswing. According to the Statistical Office, the year-on-year growth of local industrial production, adjusted for the number of workdays, has stagnated at 0.0% in October. After a stronger September, the tenth month of the year was the first one lacking growth after more than three years. Banking analysts have predicted a 4-percent increase in the October industrial production. Sales of the industry adjusted for inflation decreased by 1.5%. Lower value added in manufacturing was reported also in the third-quarter national account report of the statisticians. In the Eurozone, industrial production ended up even lower – with a decrease of 5.2%. The neighboring countries – the Czech Republic and Hungary reported even more dramatic declines. Slovak industry has been decelerating since summer 2007, when its annual growth reached more than 15 percent.

For the first time after a long while, most industries have recorded October production with a decrease. Manufacturing of vehicles has posted a decline of roughly 13%, which was caused by very low consumption of durable goods such as cars in Western and partly also in Central Europe. Only some months ago, local carmakers were expanding their production by tens of percent in year-on-year terms. Steel production, another important segment of the local economy, declined by a fifth in October according to the World Steel Association.

Marked growth has been registered only in the production of electrical and optical equipment, dominated by LCD television set manufacturing of Samsung and Sony. This segment grew by more than a fifth. Index above one hundred was posted also in production of pulp and paper as well as of rubber and plastic products. Recession in exporting markets is, however, going to continue taking its toll on the local industry. Presence of the global crisis can be illustrated also by falling real wages in industry, which are earned by almost a quarter of all employed in the country.

Inflation Narrowing Slowly

The EU-harmonized annual inflation in Slovakia has narrowed to 3.9% in November, from 4.2% a month earlier. Month-on-month, consumer price growth slowed

to 0.1%. However, inflation in the Eurozone is declining much faster (from 3.2% to 2.1% in November and to preliminary 1.6% in December). The difference between the two is thus increasing. While prices in Slovakia are rising faster than in Western Europe, the country could exceed the Maastricht convergence criterion already for December or January, as a novice in the Euro club.

The structure of local price growth is similar to that posted last month. Much of the still quickly growing prices has to do with the costs of housing and utilities, which accelerated to 6.5% in November and have the greatest weight in the consumer basket. Foodstuff prices, on the other hand, decelerated further to 3.1%, and as such grew for the first time after more than a year slower than the overall index – pulling the overall inflation down.

A high annual increase in prices was registered also in the category "alcoholic beverages and tobacco products" due to the effect of higher excise tax on tobacco. Hotels, cafes and restaurants also posted a high price dynamic, possibly in part due to rounding-up their price tags in expectance of conversion to Euro in January. The disinflation trend in overall prices, however, should continue in the months to come – due to the plunge in major energy- and agro-commodities prices and strong conversion rate of Koruna to Euro, which has not been yet fully translated into local prices of imported goods.

Another Foreign Trade Surplus

A surplus of € 134 million was registered in Slovakia's October foreign trade statistics. This came as positive news for the financial markets, since it was the second largest monthly surplus in Slovak history, while analysts have predicted a much lower excess of exports over imports. The October figures contributed to the fact that the ten-month trade balance posted the lowest historical shortfall of € 102 million (0.2% of GDP).

Behind this data, there were no swiftly growing exports to be found, however. Due to the economic recession in Western World and other major markets, Slovakia's trade has shrunk compared to October 2007. Exports declined by 1.8%; however, imports narrowed thanks to falling prices of oil even more – by 4.2% in year-on-year terms. Due to the global economic crisis, exports shrunk for the first time since 2004. The overall figures report that Slovakia's external trade with goods was in a balance during 2008. November and December traditionally bring a deficit due to the imports of Christmas-related goods; however, 2008 figures will depend heavily on the new local production of LCD TV sets, which continue to be exported at a high pace.

Major net importers include Russia, South Korea and

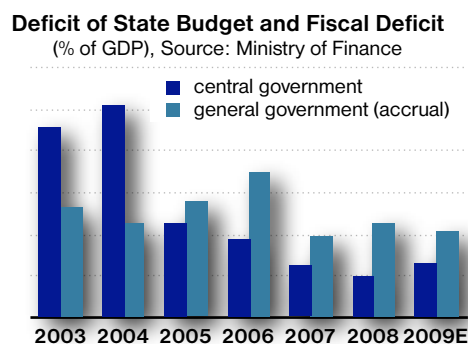
China, where commodities (oil and gas in case of Russia) and consumer as well as investment goods (in case of the latter countries) are being imported from. On the other hand, the highest trade surpluses were recorded in trade with the UK, Austria and Poland. Most of Slovakia's foreign trade happens within the EU: more than two-thirds on the import side, and 85% of exports. For the first nine months of 2008, exports have grown mostly in the segments of LCD TVs, oil products and cars. The greatest increases in imports were registered with oil and gas products – due to record price increases on the commodities markets during the first half of the year.

Unemployment Increasing Due to Crisis

Registered unemployment in Slovakia has increased in November by 0.3 percentage point to 7.8% according to the Center for Labor, Social Affairs and Family. The figure represents the first year-on-year increase in rate of joblessness since 2004. The effects of economic crisis in Western Europe have thus spilled over and became clearly visible, since during the last few years, the unemployment always declined in the eleventh month of the year. The recession has forced some of the less-efficient productions to close or economize. Hundreds of workers lost or are going to lose their jobs in mining companies Siderit and Slovomag, shoemaker Gabor as well as textile producer Zekon. On the other hand, employers are more cautious when creating new jobs. The rate of unemployment could further go up in winter as the Ministry of Finance estimates that some 9,200 more jobs are currently in danger. The highest unemployment rate of more than 20% has been registered in districts of Rimavská Sobota, Revúca and Rožňava. Capital city Bratislava reported traditionally the lowest joblessness rate.

State Budget with the Lowest Shortfall

Central government ended the year 2008 with a deficit of € 704 million. Approximately 1.0% of GDP is the lowest share ever recorded. The 2008 state budget revenues amounted to € 11.35 billion and expenses to € 12.06 billion. One year earlier, the budget posted a shortfall of € 781 million. Last year's deficit was smaller than planned, despite starting deceleration due to the world's financial crisis. However, both revenues as well as expenses were smaller than budgeted. Revenues were fulfilled to 98.2% – for the first time less than 100% after a number of years with more revenues than planned. Expenses were kept relatively tight, when they reached only 95.5% of the plan. The neighboring Czech Republic recorded a total fiscal deficit of CZK 19.4 billion, which is 1.2% of GDP. Poland and Hungary, on the other hand, are going to report higher shortfalls. In 2009, the state budget



deficit is planned at € 1.01 billion (1.4% of GDP) in Slovakia. The global economic crisis, which is expected to prevail particularly during this year, as well as the government reluctance to keep public finance consolidating, might further increase the fiscal minus for the whole of public finance up to 2.5% of GDP. □

KEY INVESTMENT PROPOSALS

Volkswagen Got Approved Tax Allowances for its Investment

The largest Slovak exporter and car producer Volkswagen will expand its production despite current world economic crisis and the related fall in demand for automobiles. In the end of 2008, sales of cars in Europe have fallen by a quarter in year-on-year comparison; in the US, the decline has been even greater. However, major foreign investors in Slovakia continue with their expansion plans, thanks to lower local production costs. Slovak automotive industry can thus partly benefit from the car-makers' troubles in the West.

One proof is the expansion of Bratislava-based subsidiary of German concern Volkswagen, which will invest € 300 million into the production of two new smaller models: VW Up! and Audi Q3. Bratislava plant is currently producing three sport utility vehicles VW Touareg, Porsche Cayenne and Audi Q7, as well as middle-class model Škoda Octavia. The current number of 9,000 employees in Slovakia will thus grow by two more thousand. Volkswagen got approved for this expansion also tax allowances of more than € 14 million, which is five percent of the investment costs. Production of small car models with lower fuel consumption will support the local facility, because its today's core production - SUVs are facing a sharp decline in demand.

Korean Kia in Žilina is also expanding. It intends to add another engines-producing facility for € 200 million to its production of Cee'd and Sportage models. In addition, a new model of Hyundai Tucson is to be attached soon. This way, Kia is following its roadmap of expansion in Slovakia. Currently, it is producing 200,000 vehicles a year. Soon, this number should increase to 300,000 cars. From the three major car assemblers in the country, only PSA Peugeot-Citroen is to keep production at the current output of 200,000 vehicles a year. Target of 300,000 cars annually will come into consideration after the economic crisis is over.



ČEZ – Partner for Construction of New Nuclear Power Station

Czech giant ČEZ became a strategic partner of Slovak government for construction of a new nuclear power station in Jaslovské Bohunice (Western Slovakia). This information has been confirmed by prime ministers Róbert Fico and Mirek Topolánek. Both countries agreed also on preparing a new project of a common market with electricity aiming to better connection between electrical networks of both states. ČEZ should create a joint venture with Slovak state company Jadrová a vyradovacia spoločnosť, a.s., (JAVYS) before the end of May 2009. According to Minister of Economy Ľubomír Jahnátek, the Slovak company is to hold 51% share in the joint venture. ČEZ has been selected from ten potential partners (RWE, EdF, E.ON, Enel, GdF Suez, Electrabel, Vattenfall, Iberdrola, Fortum Oyj). According to the minister, construction of new power plant should cost € 4 to € 6 billion. Final costs will be stated by study of the project that should be finished in the first half of 2010. Ľ. Jahnátek has not announced a type of the new nuclear power plant and source of its financing. The plant should be finished in 2020 at the latest, while preparation phase should last until 2014, when the construction works are to be started.

Hoppecke to Build a Factory in Slovakia

German company Hoppecke Batterien is planning to build a new factory for manufacturing of industrial batteries in Slovakia. Total investment will reach around € 27 million. The company considers two potential locations - one in Western and another in Southern Slovakia. There is no other producer of industrial batteries operating in Slovakia up to now. The company wants to start operation in its new factory at the beginning of 2011. Product portfolio will consist of batteries for back-up generators and manipulation equipment. All output will be customized according to requirements of client. It is expected that over 90% of batteries will be exported. Slovak facility will be the fifth Hoppecke's factory in the world. Currently Hoppecke operates three plants in Germany and one in China. It will create around 240 new jobs in Slovakia.

Blomquist trucking Continues in Purchases of New Trucks

Slovak company controlled by Norwegian capital Blomquist trucking has arranged more than € 33 million for acquisition of new trucks. The contract on purchase of 300 vehicles with DAF has been signed in October 2006. Since May 2007 the company took already over 200 of all contracted trucks and despite the current

global financial crisis it wants to take over the remaining 100 trucks in 2009. Large forwarding agencies using so called "trucking model" are main customers of Blomquist. Principle of the model is that transportation company operates its own towing trucks used for transportation of foreign trailers according to requirements of forwarding agencies. According to DAF, Blomquist is the only firm of its kind in Slovakia. Besides saving expenditures on inefficient return journeys, the "trucking model" helps to save costs also in overseas transportation of cargo by ferries. Blomquist is successful in using this model for transportation of cargo from Sweden to Germany. Largest customer of the company is a Danish forwarding agency DSV. Revenues of Blomquist trucking should reach from € 20 to € 23 million in 2008.

Proma to Build New Headquarters

Žilina based designer and expert agency for construction industry Proma is planning to invest nearly € 10 million into construction of new administrative center in Žilina (Northern Slovakia). It prepared design of two energy-saving administrative buildings and parking house. Construction works are to be performed by company Promto, partially owned by Proma. Promto was created in August 2008 and its representatives were previously employed in another Žilina based construction firm BCI. Proma is active in construction business since mid-90s. It operates several regional centers and one subsidiary in Moscow. In 2006 it created a subsidiary Proma Invest focused on development activities, real estates trading and lease. In 2007 it acquired an authorization for certification of energy performance of new and traded buildings. It also owns a license for providing design and engineering activities in Russia valid until 2011 and license for providing design services and supervision of construction works in the Czech Republic.

Group IN Expanding Warehousing and Production Capacities

Group IN plans to invest nearly € 3 million into construction of new open warehouse for large prefabricated construction components in trade and industrial zone Zavorská cesta in Trnava (Western Slovakia). The open warehouse, covering nearly 3.2 hectares of land, is to be built close to trade center Domino owned by the group. Construction works should be performed by IN subsidiary IN VEST since March to September 2009. IN is planning to build a new plant for production of concrete pavers in Geča (Eastern Slovakia) for around € 7.3 million. It thus will extend its capacities and variety of concrete materials. Construction works managed by subsidiary IN VEST should start this year. IN VEST is active in construction industry and manufacturing. Recently, IN VEST has opened a new plant for production of prefabricated concrete components for constructions of its own halls. Investment into the new plant in Šaľa (Southern Slovakia) is worth € 3.3 million, where the company hired 70 new

employees. Group IN employs 840 workers in total and its revenues on Slovak construction market should reach around € 200 million in 2008. Another subsidiary INVEST IN controls also company Mlyny, the developer of entertainment and shopping center Galéria Mlyny in Nitra (Western Slovakia). STAVMAT IN, its subsidiary focused on retail business with construction materials operates 29 shops in Slovakia and 13 shops in the Czech Republic. Besides these investments, IN considers future expansion of its retail chains Domino and STAVMAT IN.

Slovaktual to Expand Production of Plastic Windows

AFG Arbonia-Foster-Holding, the new owner that purchased a Slovak manufacturer of plastic windows Slovaktual in January 2008 for € 33 million, is preparing area for new capacities in Slovaktual's site in Pravenec (Western Slovakia). New hall worth € 3.3 million for production of plastic windows is to be finished in 2010 when the company wants to buy new production lines. Its revenues reached € 20 million in the first half of 2008. Besides expansion of capacities in Slovakia, AFG is still negotiating potential acquisition of a windows producer in the Czech Republic. In 2007, Slovaktual was the only growing out of the five largest plastic windows producers in Slovakia. Its revenues nearly reached € 32 million recording € 5 million increase compared to previous period. Revenues of Fenestra SK in Zlaté Moravce, Prievidza based Incon or HSF in Malacky (all three companies situated in Western Slovakia) were falling in 2007 compared to previous year. Equally, revenues of Spišská Nová Ves-based (Eastern Slovakia) company Noves fell by € 2.3 million to nearly € 18 million. Ambition of AFG is to rank among top five producers of windows in Europe. Nevertheless, the strong competition grows for AFG in the currently forming group under control of Slovak private equity group Penta as well as in associations arising in the Czech Republic.

Duslo to Invest into Production of Ammonium Sulfate

Czech agrochemical concern Agrofert continues in modernization and expansion of Duslo Šaľa (Southern Slovakia), the largest Slovak chemical company (excluding petrochemistry). Previous investments have been focused on lowering ecological footprint and construction of large warehouses so as the company may store its production for later sales for favorable prices. Nowadays, the company plans to invest € 7 million into production of its own ammonium sulfate used in fertilizers manufactured by the company. Thus, it will save costs of its transportation from other suppliers as well as eliminate its dependence on varying supplies.

Annual capacity of ammonium sulfates production should exceed 120,000 tons. Ammonium sulfates should be produced from main raw materials ammonia and

sulphur acid. The whole investment into modern equipment creating jobs for only six people is to be performed during the second half of 2009. Besides Duslo, Agrofert controls a large chemical company known as Istrochem in capital city Bratislava. Currently, both companies are merged into one enterprise called Duslo Šaľa. Both are focused on production of synthetic fertilizers and chemicals for rubber industry. The company produces also smaller amounts of pesticides, stickers or explosives. Revenues of both plants exceeded € 400 million in 2007 thus reaching net profit € 16 million.

Heat Producer Termming Investing in Biomass

Bratislava-based heat supplier Termming is bringing a new fuel into the heating of the capital city. It will burn wood chips in its heat-producing plant in the district of Vrakuňa. Termming won a long-term rental contract for this facility from the local municipality already some time ago. It is the largest local heat-producing plant, supplying up to a half of the households in Vrakuňa. Reconstruction of the boiler for a new kind of fuel will cost almost € 3.5 million. Other heat productions in the city will continue to use natural gas as their source of energy. Termming is investing into biomass because it is cheaper than other sources. The firm has experience with this kind of business from its other facility in small town Malacky (Western Slovakia). This way, the firm wants to keep the prices of heat at the same level than before. The new heating facility should start operating in 2010.

Stama to Buid a New Production Site

Producer of frozen food Stama is going to erect a new production site in the industrial park of Poprad (Northern Slovakia). The investment costs will reach more than one million Euros. The firm belonging to local entrepreneurs will employ 50 workers there. Stama is specializing on ready-made frozen food, focusing on traditional Slovak meals such as pirohy, halušky or knedle with various fillings. □

CORPORATE HEADLINES

Sony to Postpone its Investment in Nitra

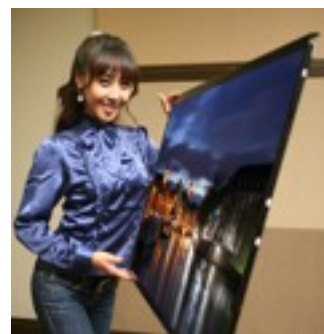
Japanese company Sony, the world's second largest manufacturer of consumer electronics, is introducing a new cost-cutting policy in all its subsidiaries. Company plans to cut 16,000 jobs, postpone new investments and close down several factories. Sony will delay also the planned expansion of its plant in city of Nitra (Western Slovakia). According to previously announced information, investment reaching € 240 million should enable the Nitra factory to increase capacities from 4 million to 6 million TVs per year. Nevertheless, the same output should be reached if the three-shifts operation is

introduced. Thus, investment promising to create 2,500 new jobs was postponed to a non-specified term. Sony currently employs some 3,000 people in Slovakia. Even if its investment into significant expansion in Nitra has been rescheduled, Sony will build a new manufacturing hall for unspecified production program on its premises this year. Construction costs should reach € 1 million. Decision on production program for the new hall should be taken in the first half of 2009.

Sony Slovakia will manufacture around 4 million TV sets by the end of the current fiscal year (ending in March 2009). The company estimates, that its output should reach 5 to 6 million units next fiscal year, depending on revival in demand. Sony Slovakia is the largest factory of Sony for manufacturing of TVs in the world. According to the previously mentioned cost-cutting plan, it intends to close down one tenth out of its 57 factories worldwide. Sony currently operates two facilities for TVs manufacturing in Europe. If the decrease in demand will persist, it may close down its second European facility – in Barcelona, Northern Spain. In such a case, all its activities including design should be moved to Nitra. The concentration in Slovakia would help the company to save not only personal, but also other operating costs.

LCD TV Manufacturers Hope for US Path

Sony, Samsung and Universal Media Corporation (UMC), all manufacturing LCD TV sets in Slovakia, are witnessing only a slight slowdown of demand in Europe. While Samsung has not specified any decline in interest for its products, Sony reports no more than 5% decrease compared to last year. UMC has signed new contracts and is prepared to almost double its Slovak capacities. This year its production should rise up to nearly one million TVs. Anyway, all LCD TV manufacturers hope that Europe in crisis will act the same way as US market. Sales of LCD TVs in the USA jumped by 52% during the second quarter of 2008 compared to the same period of previous year. Analysts monitoring electrical engineering predict that in times of recession consumers will limit spending on cars but not on household appliances. According to their opinion, US market would witness a growth of demand for LCD TV sets, as well as Blue-ray players or cameras in 2009. Now, companies producing similar household equipment hope that European markets will respond to a global recession in the same way. Even if European consumers are more conservative when spending their decreasing incomes, there are millions of old CRT TV sets in Europe that are to be substituted. In Germany, for instance, more than 170 million TV sets should be replaced during the next few years.



Samsung to Accomplish Transition to Cell Line Production

Samsung Electronics Slovakia in Galanta (Southern Slovakia) finished transition process from classic line to cell line production started in 2006. By the end of 2008 all its products – LCD and PDP TV sets, satellites, MP3 players, DVD recorders or Blue-ray players will be produced solely in "cells", where all output is manufactured in units with 1-3 employees assembling and testing the product. All operations are not made in one line, but in one place. This diminishes repetitive aspects of the job and foments personal responsibility for quality of final products. According to Samsung, their productivity per employee rose due to rearrangement to cell line production by 20-30% depending on the type of product. Another operational advantage is flexibility of the cells, which can adjust to manufacturing various products or product types. Although, cell production has been invented in Japan, for example Japanese Sony decided for a different manufacturing strategy in its factory in Nitra (Western Slovakia). According to Sony being devoted to Kaizen philosophy, TV sets assembling is more efficient in line production.

Steel Production and Aluminum Exports Tumbling

Since September 2008, steel production in Slovakia registered sharp plunge compared to the same periods last year. Steel output fell by 29% in September, 25% in October and as much as 47% in November according to the World Steel Association, while the whole EU recorded smaller decreases. An economic recession in major exporting markets is to be blamed for the development, since four fifths of the Slovak production are being exported. Yet, part of total drop corresponds to the general maintenance at blast furnaces in U.S. Steel Košice (Eastern Slovakia).

In addition, of all products exported from Slovakia, during the first three quarters, the greatest decline was registered in the segment of raw aluminum. In September 2008, the aluminum export was by 32% lower compared to the same month last year. This has to do with company Slovalco based in Žiar nad Hronom (Central Slovakia), the major aluminum producer in the country. Apart from poorer foreign demand, the cut in export of raw aluminum could be related also to increase in processing capacities within Slovakia. Prices of aluminum could not have caused the decline. During the first three quarters of 2008 they were on average the same as in previous year, although, at the end of September they were already at a quite low level and continued to decline in the following months. A decrease in exports during the first three quarters of 2008 has been posted also by half-made ferrous products and steel.

Viena to Lower Number of Employees

Viena International, one of the most important

manufacturers of metal sheet pressings and precise mechanical engineering parts operating its plant in Martin (Northern Slovakia), has announced that it will dismiss 76 employees in February 2009. The number represents 18% of the total staff. Saving program will affect mainly internal services positions. Dismissals are result of heavy impacts of deepening global crisis on mechanical engineering industry. Viena International, exporting 95% of its output, is quite susceptible to changing conditions in western markets. It tries to reduce social impacts of dismissals by releasing mainly people heading for retirement. The company is an important supplier for many industries including electrical engineering, automotive, industrial automatization or many producers of household appliances. Among the most important customers are listed Philips or Sony. Production of the Martin-based plant is exported mainly to the EU countries. Due to decreasing demand in last months of 2008, the company lowered its estimate of revenues for 2008 from € 35 million down to € 25 million. Viena International has been established in 1951 as a manufacturer of tools and moulds for military industry. After privatization in 1992 it has been in 2001 incorporated into Austrian group Rejlek Metal & Plastics Group.

Slovak Chemical Industry not Hit by the Global Crisis, Yet

Global chemical industry experiences severe contraction due to impacts of financial crisis on demand for its production. Chemical concerns are facing drop in orders from most industries. For example, sales of new vehicles declined by more than a quarter by the end of 2008. Thus, chemical concerns are forced to reduce production or even to discontinue operations of whole factories. Slovak chemical industry, on the contrary, may profit from the current situation, as several chemical producers intend to increase their engagement in Slovakia thanks to lower operating costs.

Some domestic chemical companies have announced dismissals before the end of 2008, but that would take place even if the global financial crisis did not hit the industry as a whole. The only large Slovak processor of chlorine and producer of calcium carbides Novácke chemické závody (NCHZ, Western Slovakia) plans to dismiss 150 workers, one tenth of its employees. Vegum in Dolné Vestenice (Western Slovakia) intends to fire 200 people, approximately one fifth of its personnel. Around 200 people, nearly one third of employees, will be dismissed in Chemlon Humenné (Eastern Slovakia). In all cases, the dismissals are caused by progressing restructuralization of the companies after changes in ownership structure. NCHZ was recently acquired by Cypriot firm Disor, Vegum is now controlled by a Slovak entrepreneur Pavol Jakubec, and Chemlon was acquired by domestic investment group Slavia Capital.

The largest Slovak chemical company Duslo Šafa (Southern Slovakia) does not plan to dismiss employees; nevertheless, due to the lowering demand for synthetic fertilizers it will decrease its production. Impact of global financial crisis has been confirmed only in SaarGummi, a company based in Dolné Vestenice. Western European car producers cut their orders for rubber seals for automobile bodies. Factories operated by BMW, General Motors, Volkswagen or Daimler are its most important customers. Number of dismissed people was not announced up to now; nevertheless, the company states that it will call the people back to work when market conditions allow it to do so. Even more, it plans to grow in Slovakia, as it wants to build another brand new factory worth

€ 6.65 million. After finishing it, annual revenues of the Slovak subsidiary should rise up to € 66.5 million.

Slovak suppliers of local assemblers of automobiles and electrical appliances are experiencing a different situation. These companies plan to keep current output or even

increase production of several items. From the three automobile factories located in Slovakia, only French PSA Peugeot-Citroën plans to keep annual production of 200,000 cars in upcoming years. Volkswagen in Bratislava intends to invest € 300 million in manufacturing of two smaller models VW Up! and Audi Q3. After expansion of production program, Volkswagen currently employing around 9,000 people would hire 2,000 new ones. Kia plans to build the second plant for manufacturing automobile motors in Žilina for around € 200 million. Even more, it wants to introduce production of a new model – Hyundai Tucson, as well.

Main producers of household appliances – Samsung and Sony also plan to keep production stable, so chemical companies supplying plastic and rubber parts for their final products are facing a quite solid situation. Subcontractors for automotive industry in Slovakia should get more orders for rising automobile production. Electrical engineering industry suppliers face quite stable situation as well. Even more, the whole Slovak chemical industry may profit from falling prices of their basic raw materials, oil and natural gas. By lowering production costs they may attract more customers.

Chemlon to Dismiss and Invest

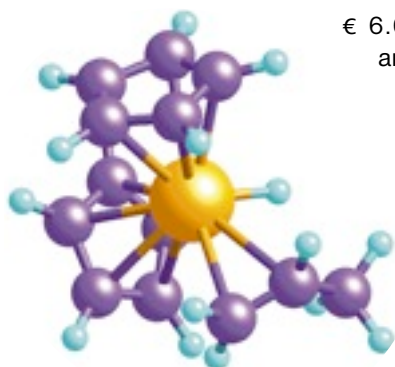
Manufacturer of synthetic fibers for textile industry, Humenné-based Chemlon (Eastern Slovakia), announced dismissal of 200 employees in the first quarter of 2009. Owner of the company, financial group Slavia Capital recently announced that number of dismissed employees may be lower, also thanks to

performing previously outsourced activities. Therefore, while Chemlon could keep its staff, several supplying companies will lose current contracts. Slavia Capital stresses out that financial crisis is not the only reason of dismissals. The most important one is necessity of restructurization of the company as it was acquired from French owner Rhodia in very bad condition. Previous owner didn't introduce measures for increasing productivity during the last three years.

Slavia Capital acquired the Humenné based factory after French Rhodia lost control over the economic situation in the company at the beginning of 2007. This subsidiary using trade name Nylstar Slovakia got under control of banks and other creditors. Slavia Capital won the tender for acquisition of assets belonging to Nylstar Slovakia and after acquisition of the company Slavia Capital gave it the name Chemlon that the factory was using in Communist era. Slavia restored standard financing of the company's operating necessities and succeeded to keep its key customers. Two thirds of synthetic fibers produced in Chemlon are exported to Western European textile companies. Since the company must count on potential loss of its customers in Europe, it started to search for clients in India, China and Mexico. After stabilization of the company, Slavia Capital started to invest into modernization of its operations, production of caprolactam water and polymerizing line. In 2009 it plans to invest € 2.5 million into the reconstruction of air conditioning equipment and acquisition of new warping machines.

Slovak Government to Revive Energy Prices Regulation

Cabinet of Prime Minister Robert Fico released a set of measures aiming to help businesses to face global crisis. Potential regulation of electricity or heat prices for large industrial firms is listed among them. Club 500, the association of large Slovak companies employing more than 500 people each, encourages the Slovak government to start the regulation of energies costs. Lobbying entrepreneurs expect that government would help them to keep prices of electrical energy, gas or heat low as it currently helps to citizens and small companies employing less than 50 workers each. Nevertheless, the announcements on preparing regulation of energy prices for large industrial companies may end up as only populist declarations. Superior legislation of EU ordered all European countries to liberalize pricing of energy for industrial companies. Member countries are allowed to introduce regulation if necessary only for households. Even more, government is facing potential court procedures for previous regulation of energies prices for households. After pressure on optically independent Regulatory Office for Network Industries it enforced only symbolical increase of price of electrical energy for households in 2009. Price of gas remains unchanged and price of heat should be even by 15% lower.



Forceless Act on "Unfair Trade Relations"

Domestic retail chains protested against adoption of new Act on Unfair trade relation because the new legislation valid since January 1st 2009 constitutes discrimination of retail vendors in negotiations with food producers. Thus, according to opinion of retailers, government violates free market principles by favoring suppliers in negotiating contractual conditions. They also noticed, that they can evade the law by increasing imports of foodstuff and negotiating new contracts for upcoming years in their foreign affiliates out of reach of the Slovak legislation.

Finally, retail chains found a simple solution for evading the forceless act. Kaufland, Tesco or Metro Cash & Carry have suggested their domestic suppliers to sign declarations, that they are not economically dependent on supplies to respective retail chain and they are not forced to accept unfair conditions in negotiating new contracts. All contracts with such a declaration thus are excluded from the regulation scope. Vendors are reluctant to confirm, but a supplier refusing to sign the declaration may subsequently lose deliveries contracts for the whole vendor's chain, mainly if the supplier is the only one among many others offering similar products that may substitute each other. Only foodstuff producers controlling large market shares are strong enough to refuse to accept such a declaration. For example, there is only one large producer of vegetable oils and only two large producers of sugar in Slovakia.

Vendors are reluctant to accept 3% limitation on fees for various services such as product placement, usage of their logistics network or leaflet campaigns. The new act imposes on vendors also a restriction in low-price sales as well. According to the act, a vendor is allowed to sell a product for lower-than-purchase price only with approval of the respective supplier.

Slovak Farmers Call for Higher Prices of Milk

Slovak farmers are only occasionally encouraged to organize public protests. Nevertheless, at the beginning of December 2008 they took an action and symbolically discharged few cans of milk into manure containers in front of doors to the largest domestic milk processor – Bratislava-based company Rajo (Western Slovakia). This way they expressed their dissatisfaction with sharp fall of prices for milk proposed by domestic milk processors. Slovak farmers were selling a liter of milk for around 40 cents at the beginning of 2008. By the end of autumn the milk prices for processors fell down to 32 cents and later the milk processors submitted offers on purchase of milk for only a bit more than 27 cents. Farmers are now complaining that the current prices are even insufficient to cover costs of milk production.

Nevertheless, milk processors defend their policy by claiming that prices of milk are falling throughout the whole Europe. According to their argumentation, rise in prices caused surplus production of milk. Only in France,

production of milk in 2008 was by around a billion liters higher compared to 2007. Farmers expect that government will state a minimal price for milk that would correspond to its production costs. Slovak government used this kind of market intervention several times in past. Nevertheless, superior European legislation does not allow the government to use it now. For present, based on farmers' protests, Antimonopoly Office will pay attention to decreasing prices of milk for processing. The Office plans to examine possibility that domestic milk processors coordinate their pricing policy, thus forming illegal cartel.

Slovak Farmers Starting Direct Sales of Their Products

Slovak farmers are allowed to start direct sales of their own products four years after EU accession. Slovak Veterinary and Food Administration finally issued list of requirements for ensuring consumers' protection. Thus, farmers satisfying all conditions are at last allowed to sell fresh milk, meat, eggs or poultry directly to consumers. New Minister of Agriculture Stanislav Becik is satisfied with his successful lobbying at the administration for early action. According to his opinion, direct sales of farmers' products may boost development of countryside as well as reverse the long-term decrease of livestock production in Slovakia. By direct sales, farmers may gain higher prices for part of their production compared to prices offered by processors. Customers, as well, may gain lower prices compared to prices in shops, including margin of processors and vendors.

Ministry of Agriculture, on the other hand, does not expect severe effects on market shares of foodstuff industry and retail chains. According to its estimation, direct sales of farmers could reach from five to ten percent share of their total production. It is expected, that mainly local ecological farms will increase share of direct sales of their final products. Slovak citizens tend to increase consumption of food raised without using synthetic fertilizers or chemicals. Up to now, production of ecological farms was mainly exported or sold among the mix of common food. This way, farmers may gain their own customers. Currently around 350 ecological farms cultivate nearly 10 percent of Slovak fields.

FINANCIAL INSTITUTIONS

Banks Fully Euro-Operable

By January 5th 2009, the transition period for banks to switch over to Euro has ended. All local banks in Slovakia thus managed to convert their services, as the country adopted common European currency on January 1st. Bank outlets, Automatic Teller Machines, POS terminals as well as internet banking systems are now fully Euro-operable, after a few-days break. The banks will also continue to convert Korunas to Euros at the official exchange rate (30.126 SKK/EUR) free of

charge, which is the requirement of the legislation in force. In the first days of January, roughly 250,000 clients visited their banks with related intentions. Some statistics indicate that the common European currency is being diffused in Slovak economy slower than it was in the case of Slovenia, Malta and Cyprus, which adopted Euro recently. On the second day after the switchover 18% of Slovaks paid in stores with Euros compared to 19% in Slovenia and 36% in Malta. Often, too, people still get change in Korunas instead of Euros. Korunas will remain accepted in stores until January 16th.

State Guarantee for Corporate Loans

Prime Minister Robert Fico has initiated negotiations with the Slovak Banking Association resulting in a state guarantee for specific private-bank corporate loans in December 2008. He justified the agreement by the need

to support small and medium-sized businesses, which face tougher credit conditions due to current mistrust on the financial markets. "It would be very bad if a firm operating on the local market for ten to fifteen years should bankrupt just due to the excessive cautiousness in the banking sector," R. Fico said. However, the available credit statistics do not reflect yet any declines in local corporate lending. The banks have this way won shifting some of their crisis-related risks to all taxpayers. This strategy of shifting costs to others is, however, creating a moral hazard in lending, which may lead to the wrong kind of investments. Nowadays, the state guarantees a maximum of 50% from a particular corporate credit volume, through its Slovenská záručná and rozvojová banka. By January 15th 2009, the Ministry of Finance shall submit a legislative proposal supporting corporate loans, which were rejected by the traditional bank procedures.



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