V4 TRADE AND FDI OBSERVER

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ICEG European Center

Visegrad Fund

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TABLE OF CONTENTS

FOREWORD

The objective of launching the regular publication „V4 Trade and FDI Observer" is to provide a quarterly overview of the main processes of external trade, foreign direct investment (FDI) and outward foreign direct investment (OFDI) in the Visegrad countries. The publications of the series offer compact and comparable information on these topics for a broad public including officials, professionals, academia, businesses, students and interested citizens. The authors and the editors hope that reading the „V4 Trade and FDI Observer" will be useful not only for V4 readers but also for readers from elsewhere interested in the development of the V4 economies.

The present – first – issue of the „V4 Trade and FDI Observer" has been prepared in the framework of the "V4 Trade and FDI Observer" project, supported by the "Small Grant" Programme of the International Visegrad Fund (Small Grant No. 11140172). The research institutes participating in the project are ICEG European Center, Budapest (coordinator of the project); EUROPEUM Institute for European Policy, Prague; Institute of Economic Research of the Slovak Academy of Sciences, Bratislava; Polish Institute of International Affairs, Warsaw (project partners). They belong to the leading research centres in the Visegrad countries in the field of economic analysis.

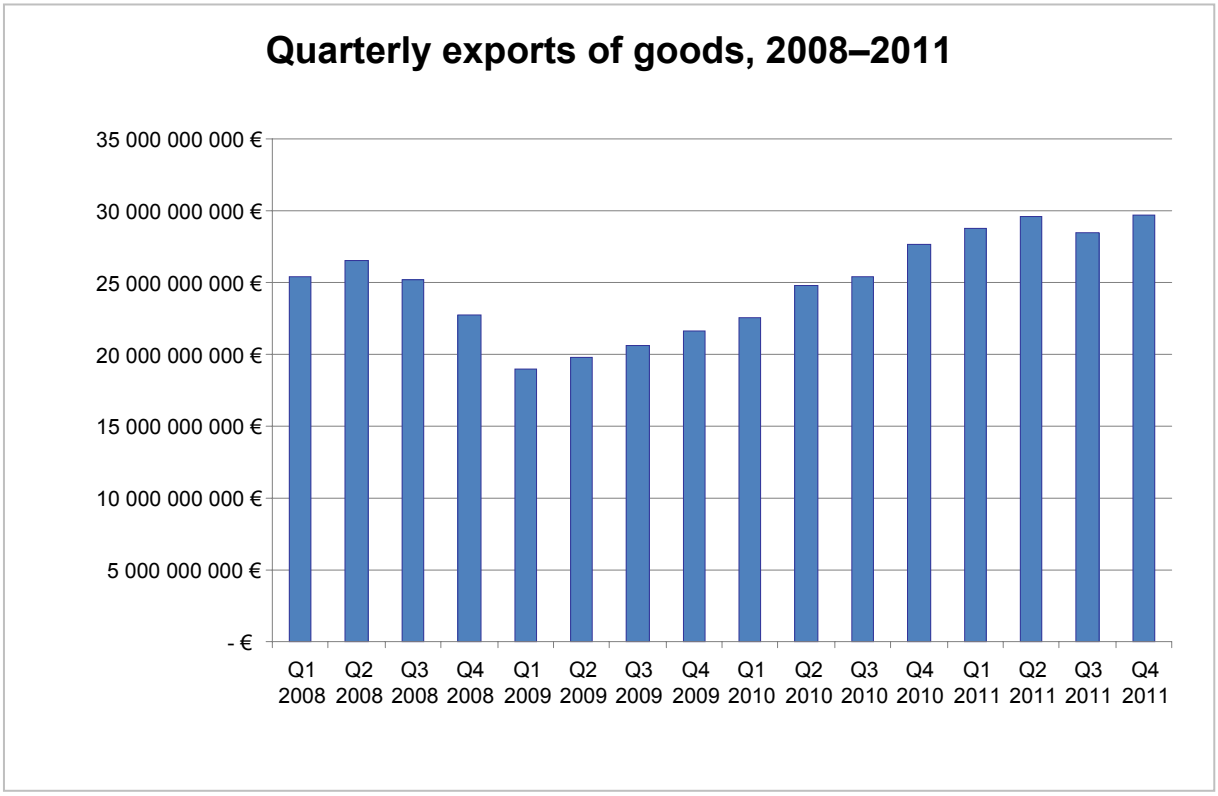
In this issue of the „V4 Trade and FDI Observer" we concentrate on the developments of the period 2008–2011 and present four country analyses of both short- and mid-term changes in the field of trade and FDI/OFDI. Although it is always dangerous to draw simple conclusions, the analyses presented in this issue clearly reveal that the financial and economic crisis has caused important changes in these processes in all the Visegrad countries. There are similarities in these changes, but, obviously (due to the differences between the countries themselves), differences are also important. By opening the „V4 Trade and FDI Observer", You already took the first step in the discovery of these similarities and differences.

CZECH REPUBLIC

Exports and imports

Even though the economy went through a recession phase, which has an impact also on foreign trade, the long-term trend of increase in exports has still remained. The absolute amount of exports in the last quarter of 2011 reached almost € 30 bn. There were imported goods for € 27.4 bn in the same period.

The intensive trade with Germany causes that there are two main influencing factors of Czech foreign trade: growth in the Czech Republic and growth in Germany. Czechia is a small and open economy, which means that exports and imports have very important role in the economy and a big share on the GDP.

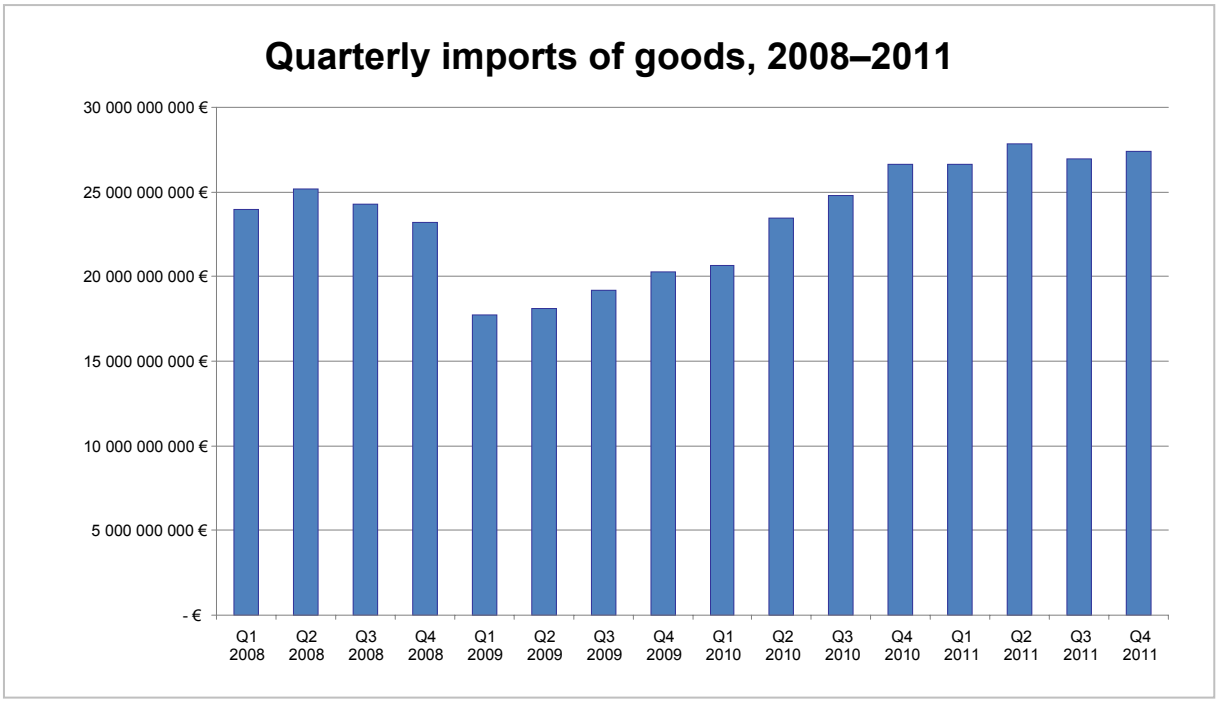


Source: Eurostat, Comext

Czechia has still an independent central bank, currency and exchange rate that have a relatively big influence on the share of exports and imports. Although the price of one € in 2008 was only about 23 Czech crowns, and in 2009 almost 29, nowadays the exchange rate

is fluctuating between 25-27 crowns/€, with a long-term appreciation tendency. Independent monetary policy helped to soften the recession; on the other hand, many Czech exporters still consider the introduction of the € as an economic necessity.

The situation in the field of services is also influenced by the recession, which has lowered the output in 2009. The total amount of exported services in 2010 was almost € 15.8 bn, with the biggest share of "travel" and "other services" categories. The volume of imports reached € 12.8 bn, with the biggest amount in the "other services" category.



Source: Eurostat, Comext

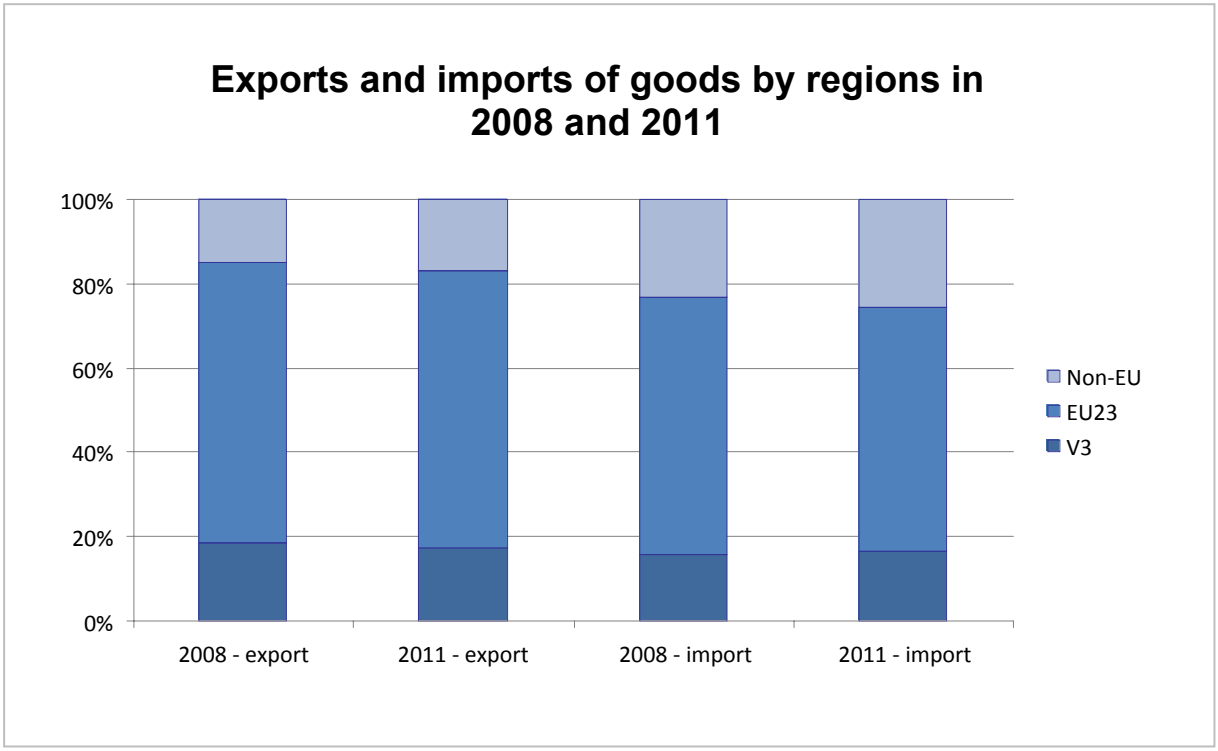
Many Czech companies started to open new markets outside Europe, especially in the BRIC[1] countries and in the United States.

Exports and imports by regions

The above described tendency can be seen very well in the regional distribution of exports in 2008 and in 2011. Although the shift may not be regarded as very important, it has to be said that the most important partner for Czech exports is Germany with a more than 30 % share of total exports of the Czech Republic. So the move from the EU Member States as destination countries to countries outside Europe signalises that Czech companies have finally realised that in the global economy they have to actively seek new business

[1] Commonly used abbreviation for Brazil, Russia, India and China.

opportunities even in countries far away. This can be the beginning of a new diversified picture of Czech exports where the economy is not so dependent on the current situation in the EU, but can compensate the problems in Europe by contracts around the world and vice versa.



Source: Eurostat, Comext

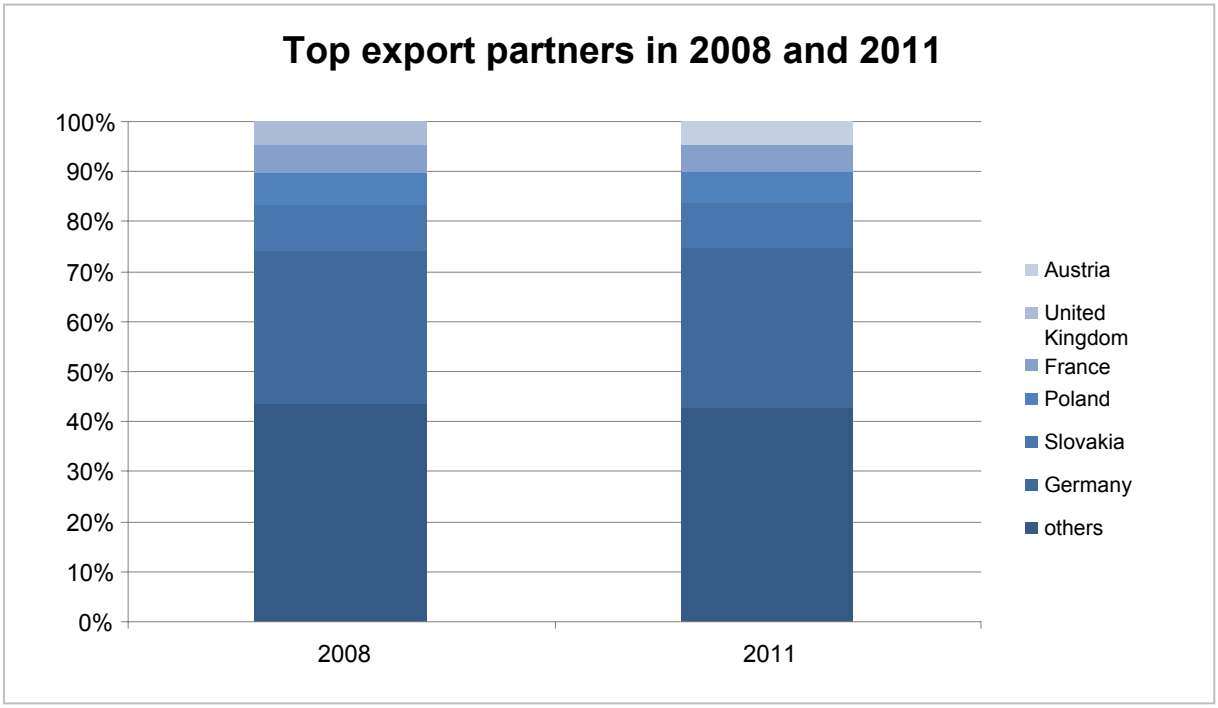
Imports were already more oriented towards non-EU countries, mostly because of oil, gas and other mineral resources imported from Russia or other countries. The tendency of finding partners outside the European Union is also present here; within the EU, an increase in imports from the V3[2] is a positive trend. As the volume of exports and imports has not yet reached the values of 2008, the shift is well noticeable. Czechia has a positive trade balance with the V3 as well as with the EU23[3].

Exports and imports by partners

Germany was the most important export partner in 2008 and it even improved its position in 2011 with 32 % of total goods exported. The second place belongs to Slovakia and proves the special relationship between the two countries. This fact is also supported and influenced by the strong capital relations (see the text on FDI/OFDI later). The share of exports to

[2] V3: Visegrad countries minus the „reporting" country (in this case, the Czech Republic).
[3] EU23: EU26 (the EU minus the „reporting" country – in this case: the Czech Republic) minus V3.

Slovakia is almost 9 %. Poland as third has 6.2 %, France 5.5 %. The switch between the United Kingdom and Austria can be explained by the relatively small difference between them[4]. The share of Austria was 4.5 %.

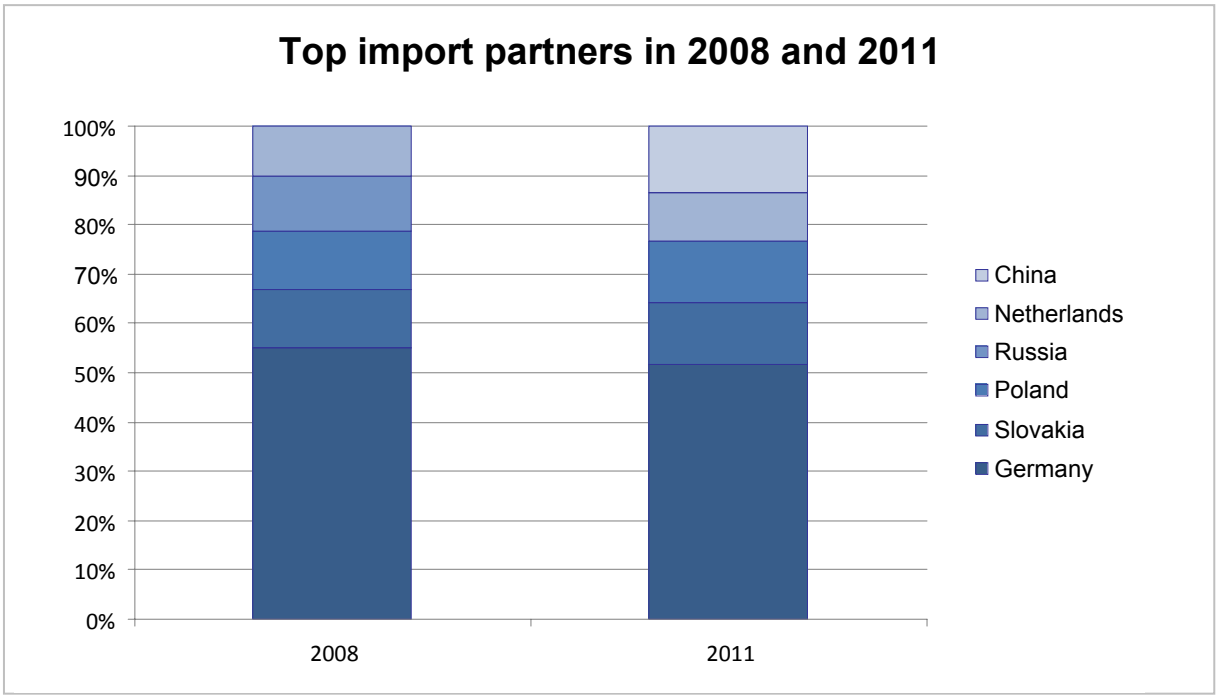


Source: Eurostat, Comext

Changes in imports are more important. The time between 2008 and 2011 can be described as "China time" because the volume of imports from this country almost doubled – it increased from € 4.7 bn in 2008 to € 8.3 bn in 2011.[5] This has also consequences for the ranking of top 5 countries where China replaced Slovakia on the second position with 7.6 %. Germany has lost one percentage point (p.p.), but is still on the first place with 29 %, confirming its unique role. Slovakia and Poland have slightly improved their positions to 7 % each. The Netherlands hold 5.5 % closely followed by Russia and Austria.

It looks like traditional old partnership based on close borders and geographic position is slowly replaced by the international trade based on economic efficiency. The share of exports to V3 countries remained unchanged on 18 %, imports have increased by one p.p. to 17 %.

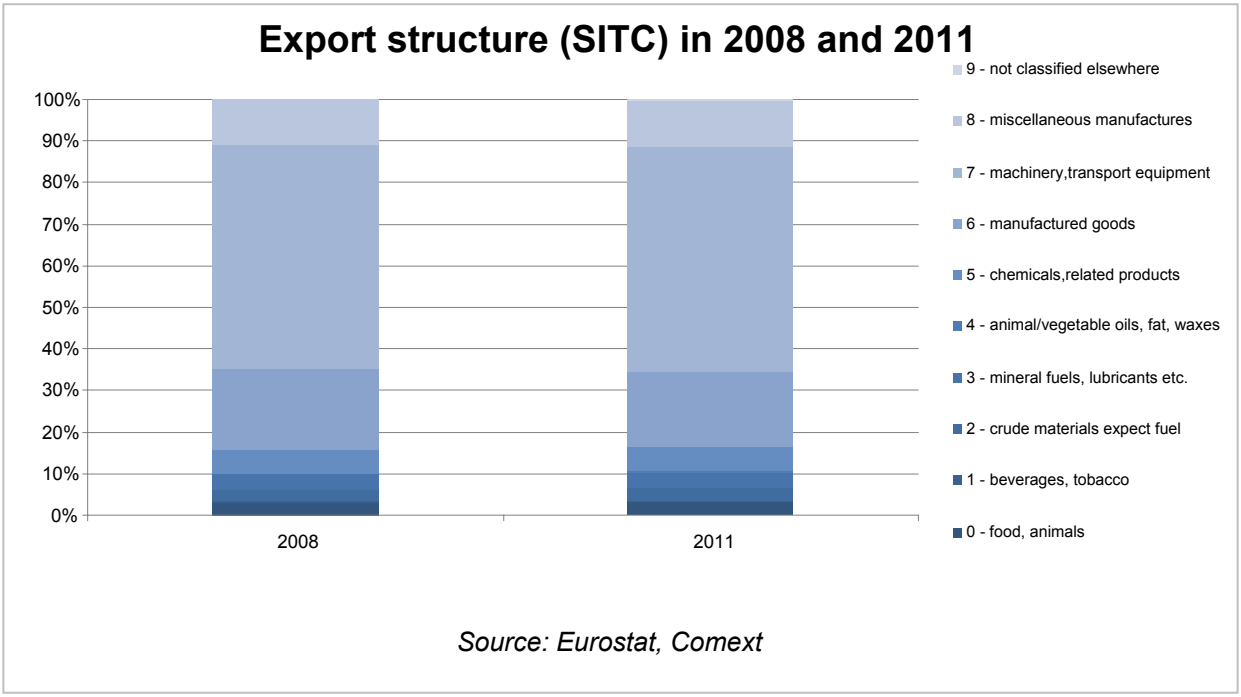
[4] Regarding the absolute amounts of Czech exports; the third country with a very similar position is Italy.
[5] But the biggest relevant change occurred in the imports from the Republic of Korea, from € 0.5 bn in 2008 to € 1.4 bn in 2011.



Source: Eurostat, Comext

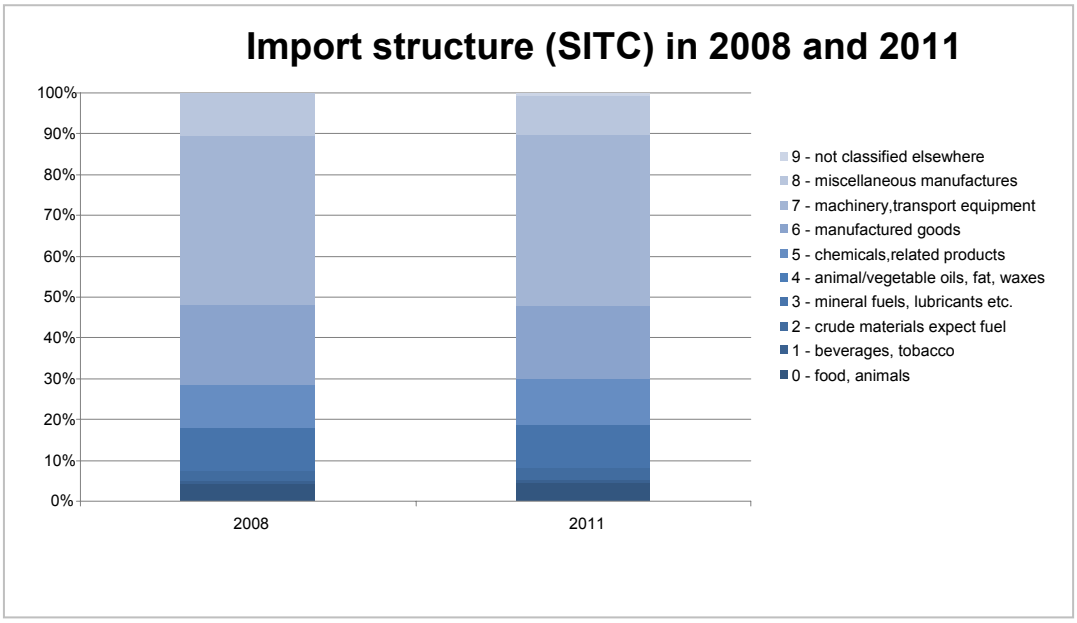
Exports and imports by SITC classification

Czech exports are based mostly on machinery which has been massively supported in the past years by the investments into car industry. The share of machinery and transport equipment has increased slightly and passed 54 % in 2011. On the second place are manufactured goods with 17.6 %, 2 p.p. less in comparison with 2008. Third are miscellaneous manufactures with 10 %, followed by chemical products with almost unchanged 6 %. There is a small increase in the share of mineral fuels and lubricants to 3.8 %. The next category is food and animals with a small increase to 3.2 %. Crude materials have 2.8 %, 0.2 p.p. more than in 2008. All the other categories have a share under 1 %.



Source: Eurostat, Comext

The share of machinery and transport equipment in imports is not as significant as in exports. Still, this category has a 41 % share, almost unchanged between 2008 and 2011. On the second place are manufactured goods with more than one p.p. decrease to 13 %, followed by chemicals and mineral fuels, both with a slight increase, both with 11 %. Miscellaneous manufactures, with a minimal decrease, hold 10 %. Food and animals are responsible for almost 5 % of all imports. Crude materials have somewhat increased to 3 %. All the other categories have a share under 1 %.



Source: Eurostat, Comext

There are two SITC categories that are at the margin of Czech foreign trade. Animal/vegetable fats, oil, wax is under 1 % as well as beverages, tobacco. The composition of imports is more influenced by the needs of resources, which are not available within the country, such as oil or gas. Otherwise the structure of imports and exports is quite similar, which is an important characteristic of a small open economy.

Outlook

The biggest threat in the near future is the decrease in automobile demand. Exports are quite focused on the automobile industry so any major change at the market will have a big impact on the current exports.

Another challenge is the energetic security, because Czechia is very dependent on supplies of oil and gas from Russia, and, as it has already become clear, it is not a reliable source and state reserves can withhold only for a few months.

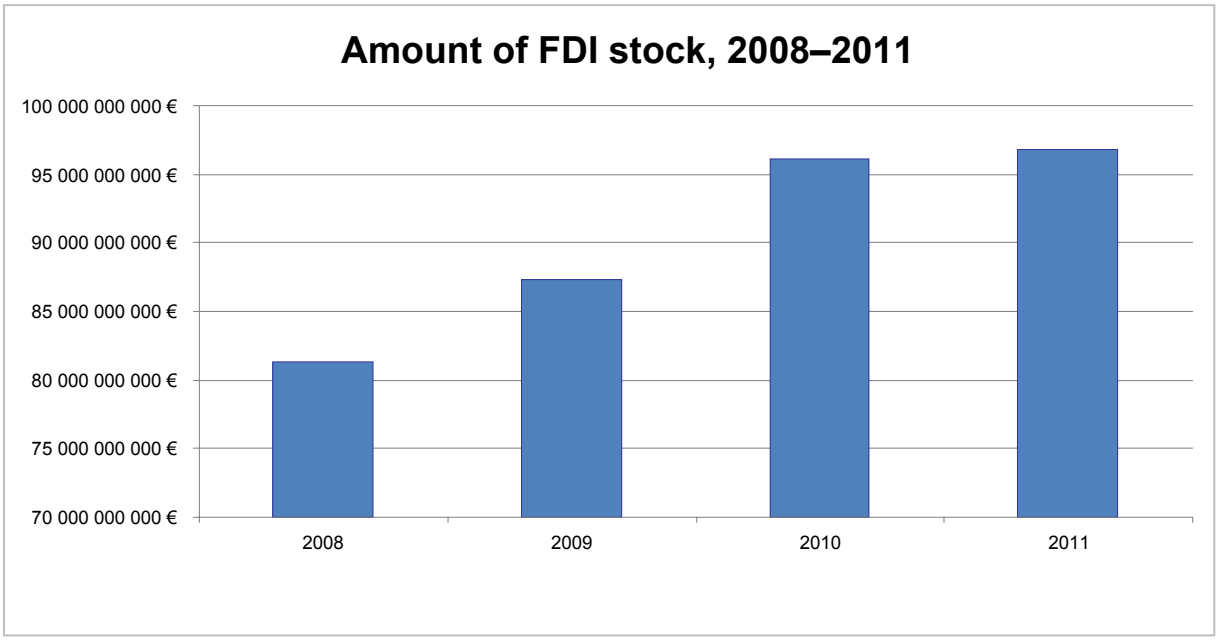
Also there is a government plan to induce new taxes and increase current ones, which could affect trade negatively.[6]

FDI and OFDI

The general picture of FDI in the Czech Republic might look very well at the first sight. The total amount of investment is not rising so sharply as in recent years but there is still a good increase. In the time of the world recession or stagnation at least, this should be the good news telling that Czechia is still recognized as a good place to invest in.

The problem is that there is no big investment project which should be started in the next years. There were big investments in the past times mostly into machinery and industry in general (car industry, oil refining and tools). All of these big projects are now up and running and it is good to say that these projects were mostly focused on the cheap work force. Nowadays the price of the work is not considered to be the main advantage, Czechia is transforming more into a knowledge-based economy.

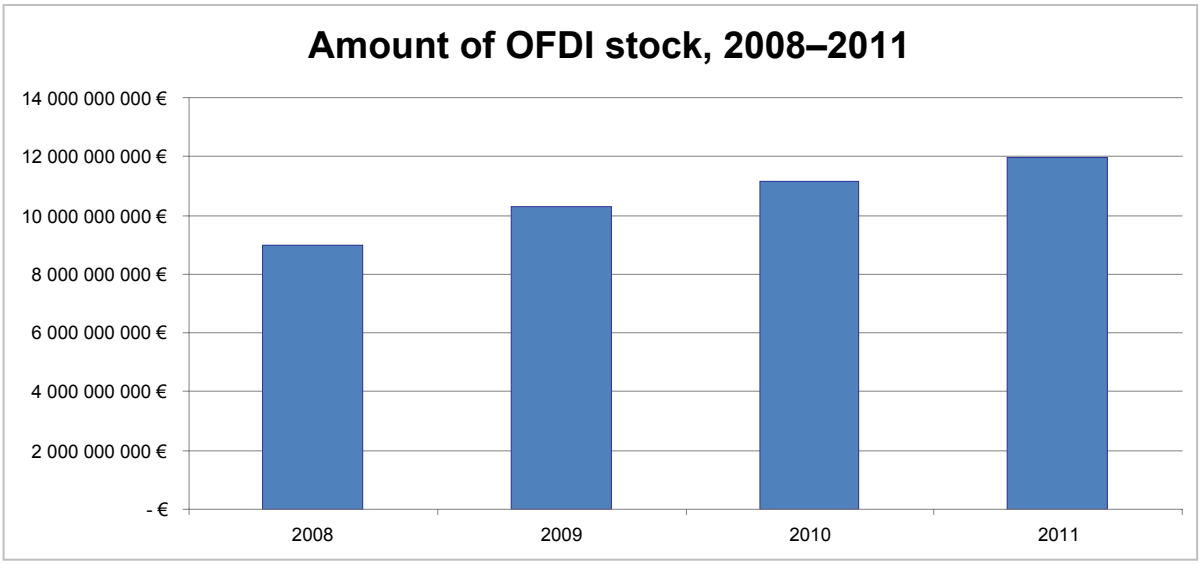
[6] For example, taxes on wine.



Source: Czech National Bank

Another problem of the foreign investments in the Czech Republic is an issue of recognising the country as an individual state with individual parameters. Investors still consider Central Europe as one region with the same economic attributes.

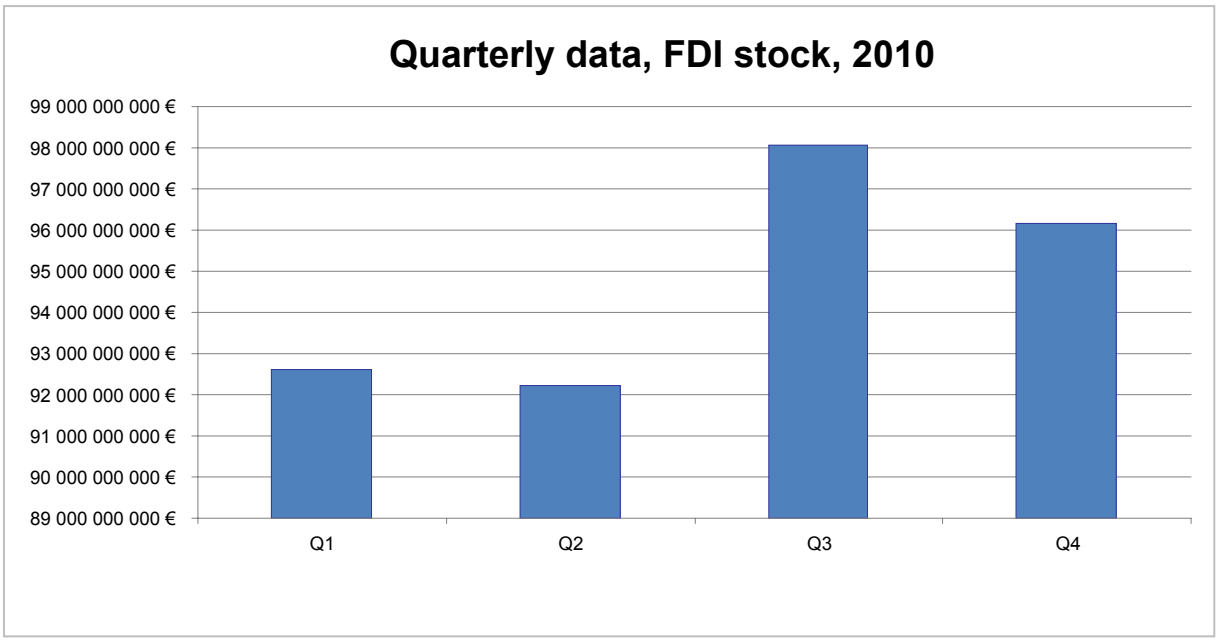
OFDI still remains relatively low regarding its absolute value, but the amount is constantly growing despite the recession. The interesting thing here is the relatively high amount of Czech direct investments in Slovakia. The main reasons for OFDI are the lowering of taxes, asset investment (especially in the case of ČEZ Group in power engineering), and expansion.



Source: Czech National Bank

FDI

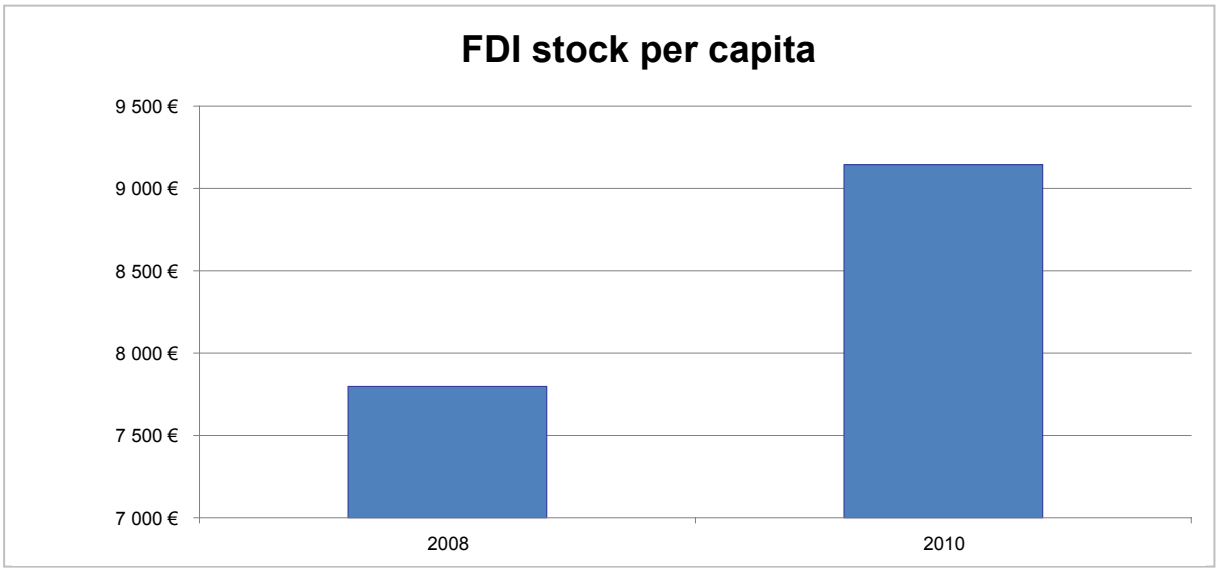
FDI data for 2010 look still quite good; a small decrease at the end of the year is a general feature. We have a situation when the real economy is in a relatively good shape, GDP is not growing but stagnating, and there seems to be a capital outflow. The ECB and the FED are practising a very easy monetary policy which means a lot of free liquidity on the market, but we are facing a continuous crisis of trust. The actual amount of FDI in the country is around € 95 bn.



Source: Czech National Bank

The decrease at the end of the year can be partially explained by the seasonal trends. Investors are also drawing their money back after they earned on investment.

Between 2008 and 2010 there was also a rise of the amount of investments per capita. It has risen from € 7795 in 2008 to € 9142 in 2010, even though the number of inhabitants has slightly increased to almost 10.5 mn. The birth rate is still quite low, but thanks to the immigrants and to the extension of life expectancy, the population will be stable in the next few years. The investments per capita might decrease in 2012 because of the decrease in total amount.



Source: Czech National Bank

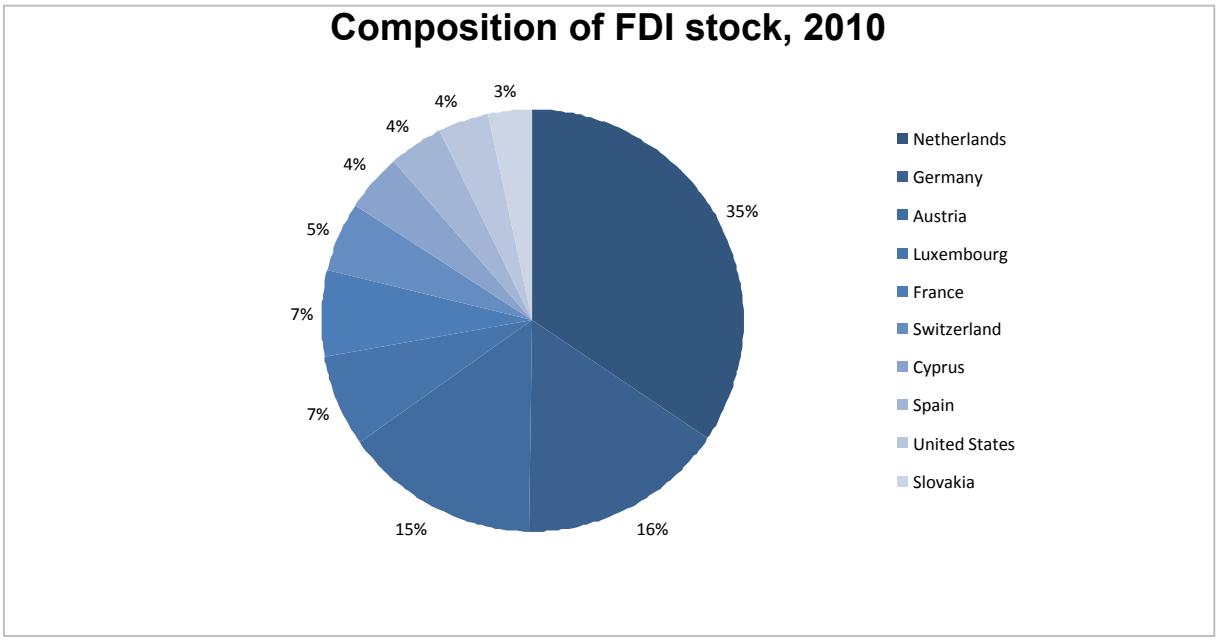
The main problem for many investors is an unstable legal framework. There are no long-term investment plans at the state level which are followed at least roughly[7].

On the other hand, there are also positive moves. A few new funds focused on venture capital[8] started to invest into promising small companies. This signalises that the capital market is evolving and approaching the functioning of markets in the developed countries.

As the composition of FDI is concerned, 35 % of all investments come from the companies registered in the Netherlands, followed by 16 % from Germany and 15 % from Slovakia. These three countries together are responsible for 2/3 of all direct investments in Czechia. This conclusion is not as surprising as it might be. Links between Slovakia and the Czech Republic are still very strong.

[7] States in the EU are obliged to support investments into the clean sources of power, but the conditions in Czechia were set so free and so profitable that after two years the system was completely unsustainable. Prices of electricity went up and fields of solar power plants were built on the agriculture fertile soil. The state afterwards lowered the subsidy, which was considered as a retroactive change of conditions.

[8] Capital which is invested into new small companies, typically in e-business or high-tech branches.



Source: Czech National Bank

Thanks to the former conjoint state and very close culture, the economic flow is unusually high if we take into account the fact that Slovakia has half of the Czech population.

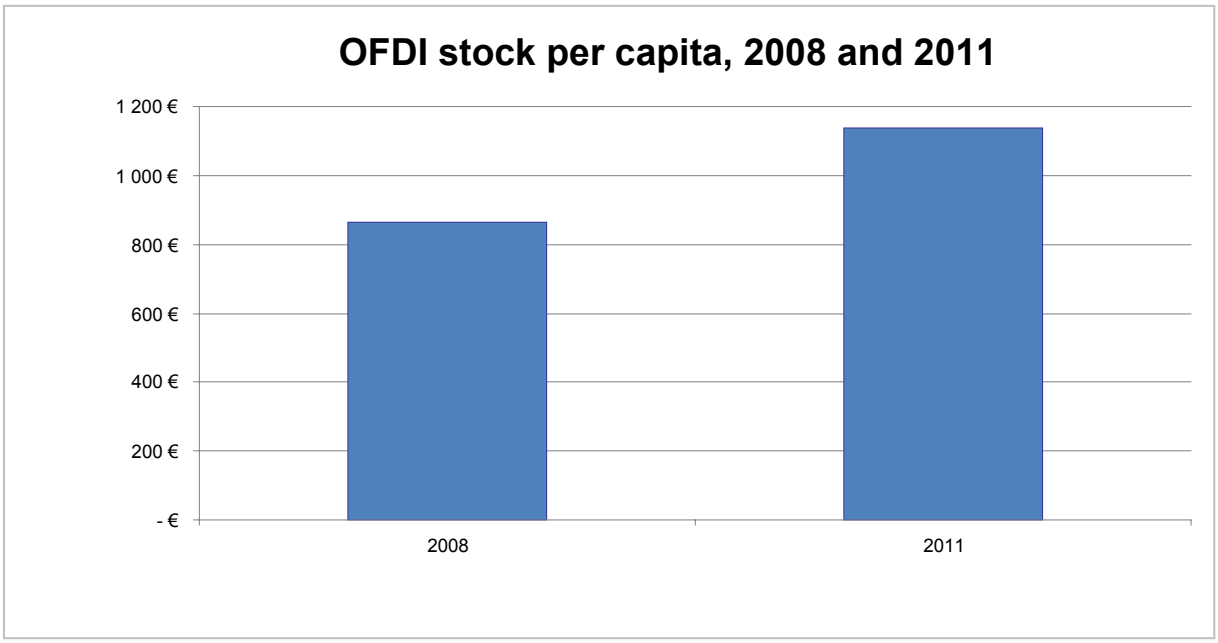
Germany is a traditional business partner, especially Bavaria and Saxony. German companies know the Czech business environment, also have good road and railroad connection and they profit on smaller wages and close geographic position. Also there is a role of Volkswagen Group as a holder and investor of Škoda Auto.

The Netherlands are a special category. They are considered to be a European "off-shore" country, because of a quite friendly administrative framework, including many treaties on protection of investments and low taxes. So investments from the Netherlands can be considered as some kind of aggregate of holdings from around the world.

OFDI

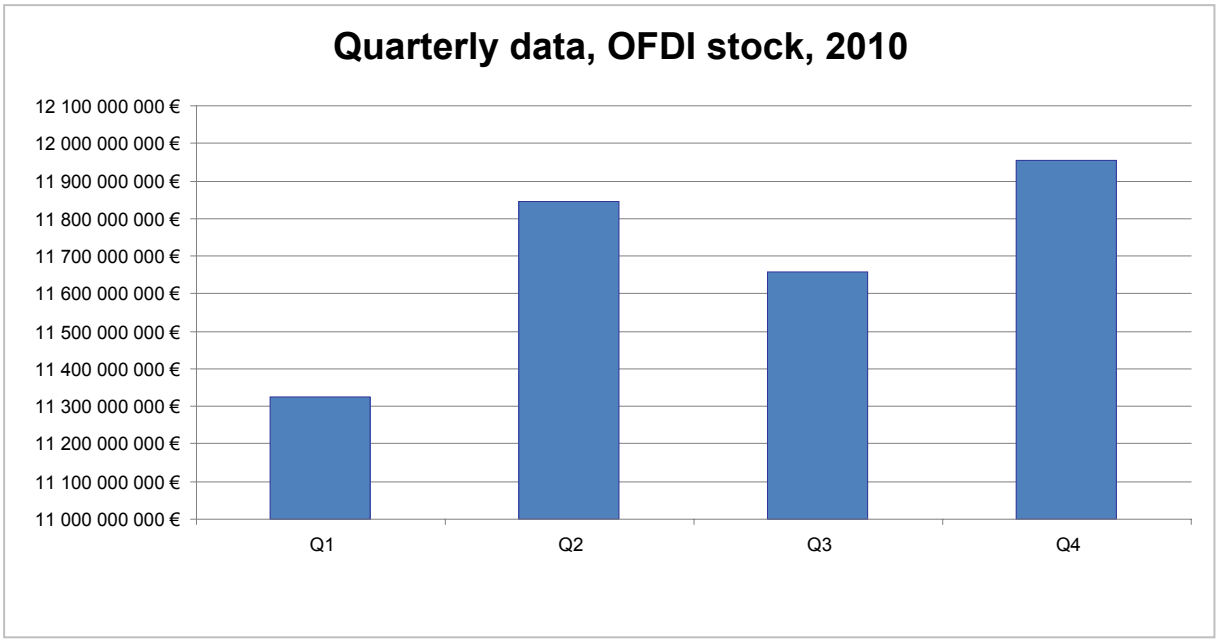
Outward investments still remain very small in comparison with the incoming investments. Even though the trend – despite the recession – is still positive, the total amount was only about € 12 bn in 2011. The difference between 2009 and 2010 is almost € 890 mn euro, which is not very much, if one considers that part of the investment consists of re-invested earnings. The difference is 7.5 % of the total value of investments, so it is very likely that the biggest part of yearly OFDI growth comes from reinvestments only. The last data suggests that the difference between 2010 and 2011 will be similar. It was only between 2008 and

2009 that we experienced a growth (of almost € 1,275 bn). The slow development is also supported by the value per capita.



Source: Czech National Bank

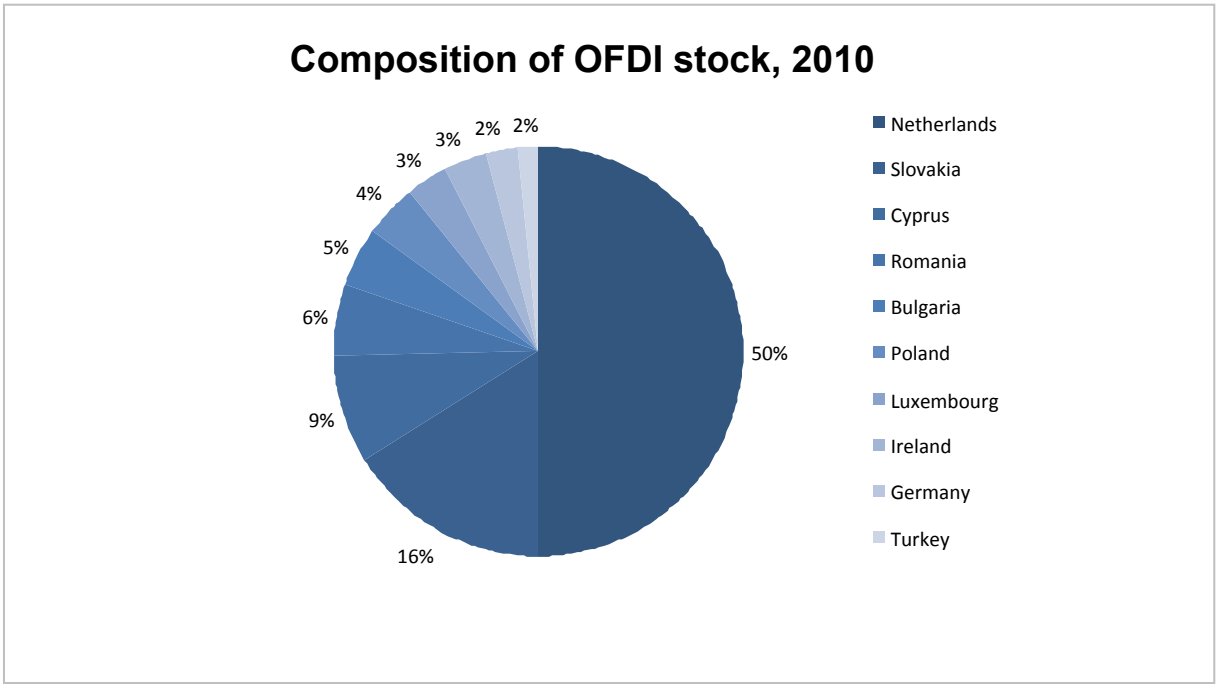
It must be said on the other hand that reinvestments are also investments, which means that companies can withdraw them back to Czechia, but they rather prefer to invest abroad even in the time of recession. This conclusion is supported by the quarterly figures of 2010 when the investment in the last quarter are not lowered but even raised.



Source: Czech National Bank

Three countries are holding 75 % of Czech investments abroad. The Netherlands have a key part also in the OFDI – 50 % of investments are realised via some holding companies in the Netherlands so the real target is unknown.

It is also commonly known that the Czech owners invest into some company in the Netherlands, which invests afterwards in Czechia, so the money does not virtually leave the country, but FDI and OFDI figures are raised by the operations. The owner profits on the treaties on the protection of investment, so when a problem occurs he can sue his own state via the Dutch company.



Source: Czech National Bank

The second position belongs to Slovakia (16 %) which confirms the already mentioned special relationship between this country and Czechia. Cyprus represents with 9% another off-shore tax residence for company holdings.

Outlook

The current political situation in the Czech Republic is not favourable to any potential investments. The government has a very unstable position, and, at the same time, fiscal restriction came together with the increase of taxes. The growth of GDP is “positive zero” and public finances are still in a very big annual deficit. Although the right-wing cabinet is trying to lower the deficit (or at least decrease its percentage share in the GDP under 3 %), not even fiscal plans for 2014 count with a deficit under 2 % of GDP.

These structural reforms are now introduced in many European countries. In comparison with them, Czechia has a quite good position – a stable economic, relatively low unemployment, social coherence, companies able to deal with pressures and to increase the productivity of labour, strong industry.

FDI is expected to fall slightly in the next months; the next rise will have a different basis, and it will be more focused on the high-tech industry and knowledge economy. The data of 2011 suggest that there will be a slight reduction or stagnation at least in the next years. Investments are reacting to the worse macro data only with some delay. OFDI will continue its steady growth; as the ČEZ Group has announced the end of its expansion[9], there are no big projects scheduled.

[9] The company will focus on the completion of the nuclear plant in Temelín.

HUNGARY

Exports and imports

The openness of the Hungarian economy and the share of exports in the GDP have strongly increased since the last year before the world economic crisis. While in 2008 exports made up ca. 70 % of GDP, in 2011 the share has been close to 80 %. Hungary is part of the international production chains, multinational companies give approximately 80% of its exports.

The main trends that have been present since the mid-1990s, parallel with the progress of Hungary's integration into the world economy have been continued in 2011. On the one hand, the development of Hungarian exports has followed the conjuncture cycle of the European Union, the eurozone and the German economy. On the other hand, the dynamics of exports and imports has shown a high degree of similarity. These circumstances remained unchanged during the crisis and also afterwards.

Quarterly data show the sensibility of Hungarian foreign trade to the cyclical changes. The growth of exports and imports slowed down in the first half of 2008, stagnated at the end of the summer and fell from October 2008. This contraction lasted for 12 months and occasionally the GDP decreased by 30%. Imports – with the exception of three months – decreased more rapidly than exports. The turning point was in November 2009 when both exports and imports began to grow again.

From the beginning of 2010 foreign trade increased by two-digit numbers. In the beginning, the high growth was justified by the very low basis, but also later on (even after the increase of the basis), the development of exports and imports remained vivid. This trend turned again in the second half of 2011: the growth of exports and imports slowed down; in December, it stagnated compared to the same month of the previous year. On the whole, exports reached their 2008 level in 2011 again, but imports still remained below their 2008 level.

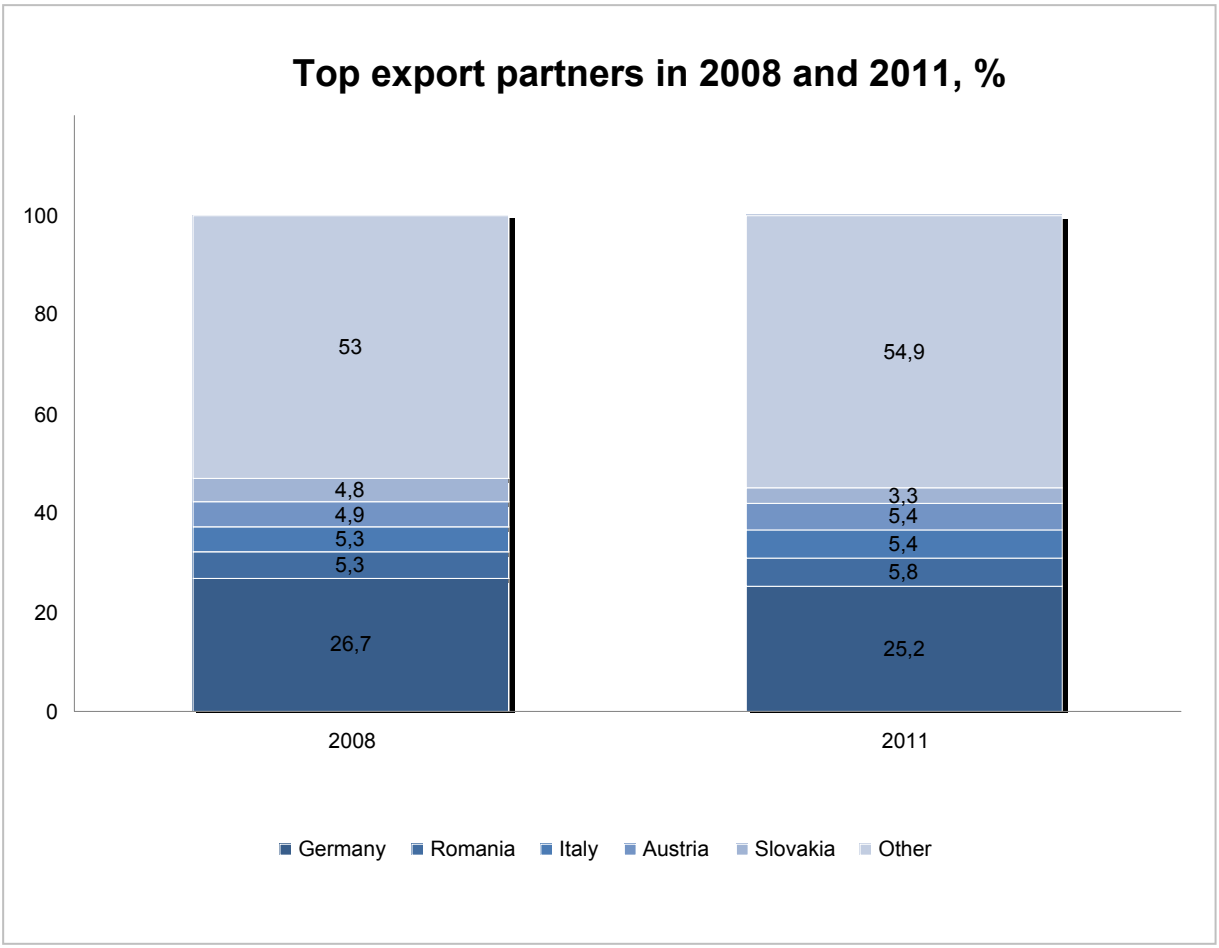
The most impressive phenomenon of the past four years is the rapidly increasing significant surplus of the foreign trade. The primary reason for it is the decline of the investments and consumption since years. But the increasing domestic value added plays a role, too.

Regarding the geographical relations, Hungary has a significant foreign trade surplus with the EU and a deficit with the non-EU relations (driven only by Asia). Regarding the Visegrad countries, Hungary exports more than it imports. Concerning the product structure, the trade surplus is the highest in the case of machinery products.

Geographical structure

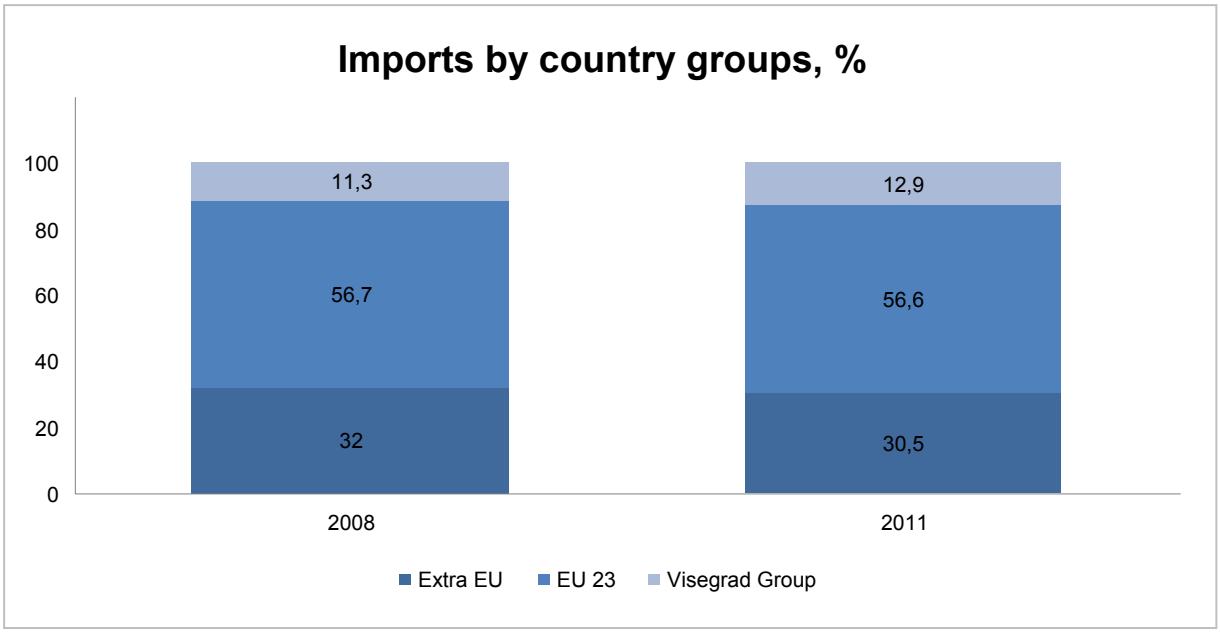
The share of the EU is decisive in the Hungarian foreign trade. The crisis had only a slight effect on this share and this effect was different on exports and imports. In Hungarian exports, the share of the EU was 78.2 % in 2008, this raised to 79.2 % in 2009 but decreased in 2010 and 2011 to 76.1 %. Within the EU the share of the Visegrad countries increased somewhat. The non-EU countries increased their share, as well, from 21.6 % to 23.9 % in 2011. These countries are mainly European and Asian countries.

The „top 5“ foreign markets remained the same for Hungary between 2008 and 2011. The most important foreign market for Hungary is Germany: more than one quarter of Hungarian exports is directed to this country. Compared to 2008, the role of the German relation decreased a bit, from 26.7 % to 25.2 %. Other important directions are Romania (5.8 %), Italy (5.8 %), Austria (5.4 %) and Slovakia (3.3 %).



Source: Hungarian Central Statistical Office, own calculations

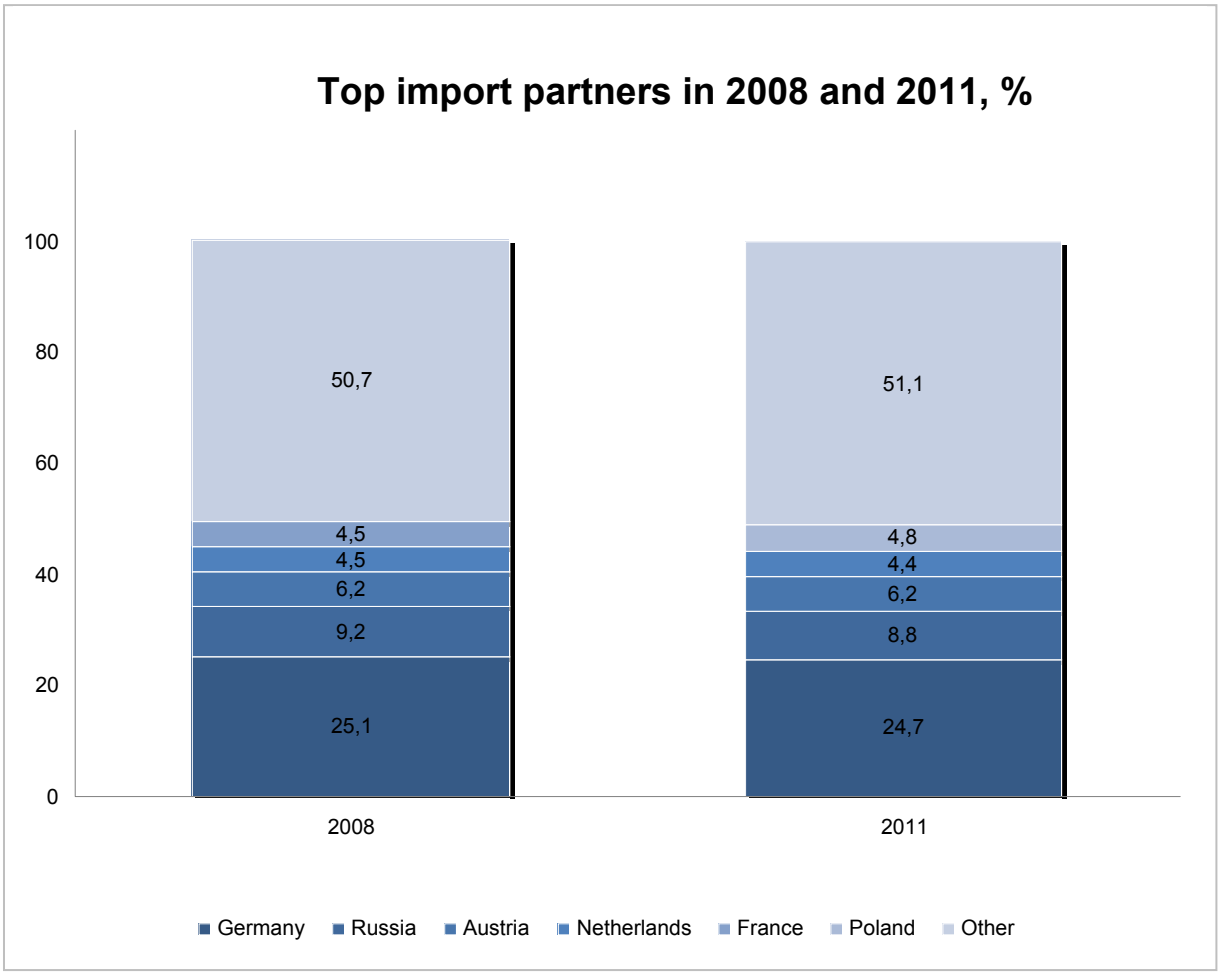
The share of the EU increased to certain extent in Hungarian imports from 2008 to 2011. The reason for this is the growing significance of the Visegrad Group. The share of extra-EU countries decreased from 32 % to 30.5 %, mainly because of the fall in imports from Asia.



Source: Hungarian Central Statistical Office, own calculations

Like in exports, Germany is the most important partner in Hungarian imports. Around one quarter of Hungarian imports stems from Germany; in this respect, there is no change during the observed period. Russia is the second most important partner because of energy imports, but its share decreased a little in 2011. Austria is on the third place, both in 2008 and in 2011 6.2 % of Hungarian imports came from this country. The Netherlands remain on the fourth place with 4.5% of imports. On the fifth place, however, Poland replaced France.

In the past four years the share of the EU decreased and the share of extra-EU regions increased in Hungarian exports. Within the EU, the share of old members decreased and the share of new members increased.



Source: Hungarian Central Statistical Office

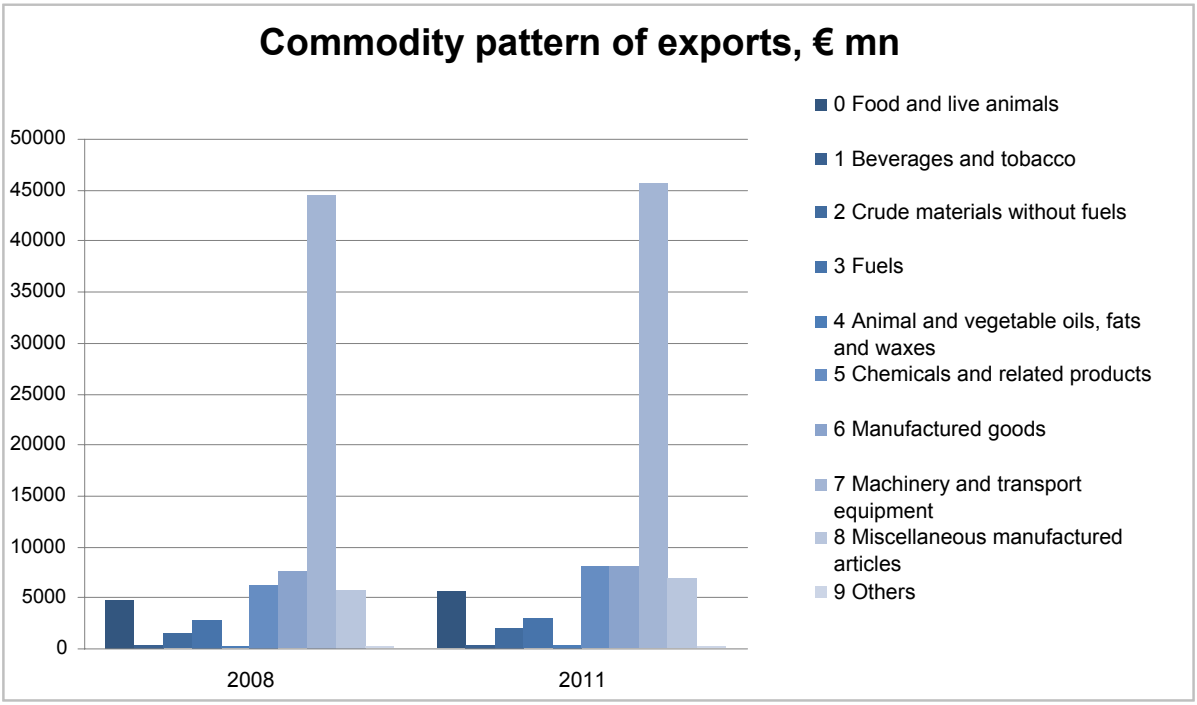
The share of the Visegrad countries increased too, together with the positive cyclical signs. Slovakia is among the top five export partners. Regarding imports, the share of the EU increased a bit, and so did the share of the V3. From the Visegrad group, Poland is among the top five import partners of Hungary.

Commodity structure

As mentioned, in the last two decades Hungary has become part of the international production chains, first of all in the automotive and telecommunication industries, and electronics. Thus, in Hungarian exports and imports the products of machinery industry have the highest share since mid-1990, and since mid 2000 this share is around 60 %.

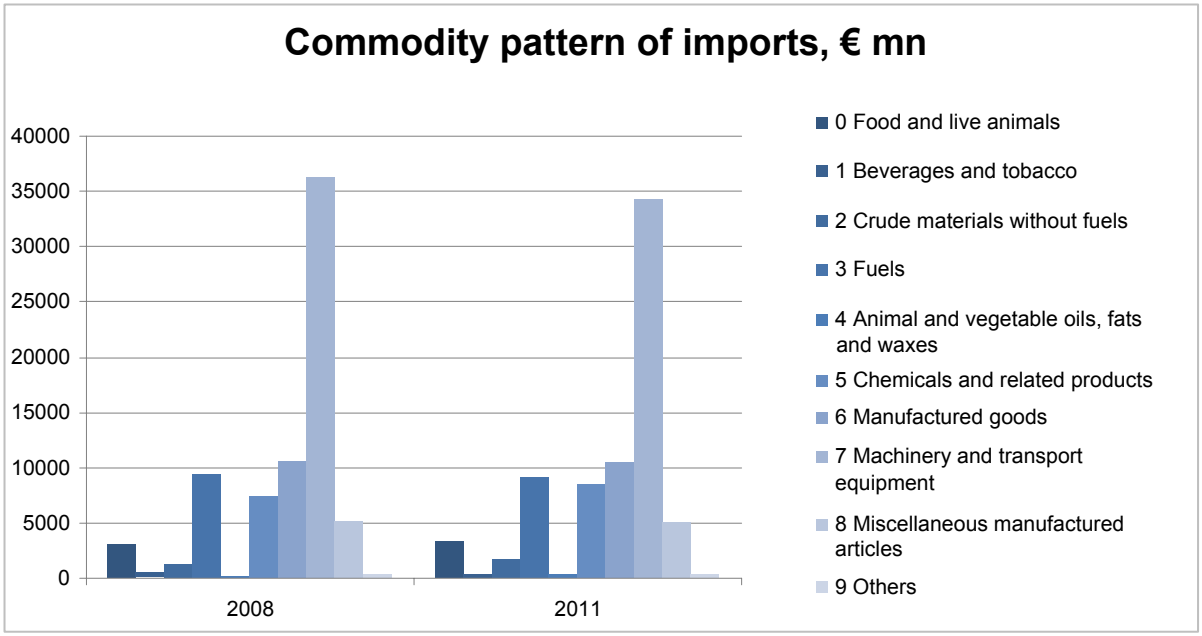
The crisis hit Hungarian automotive exports hard, causing a general fall in exports. However, later this product group played a major role in the recovery. Just before and during the crisis

several investments of multinational firms took place. Tyre and car electronics production increased significantly. Tyre production appears in the increase of exports of chemicals and related products from € 6.3 bn to € 8 bn (also pharmaceuticals performed well in this product group). Car electronics belong to manufactured goods; the exports of this group show only a slight increase from 2008 to 2011, from € 44.5 bn to € 45.7 bn. The reason for it is that the exports of telecommunication equipment (TV sets, mobile phones) fell, because of the decrease of the demand and as a result of outsourcing production from Hungary. Exports of food products – mainly because of good harvests of cereals – increased by € 1 billion to 2011. Altogether, the structure of Hungarian exports changed little: the share of machinery industry decreased from 60 % to 57 % , and the share of manufactured goods, rubber and food products increased.



Source: Hungarian Statistical Office

In Hungarian imports (just like in exports) the weight of machinery industry is decisive (although its share was lower already before the crisis than in the exports). The bulk of machinery imports consists of components to automotive and electronic products. The imports of these components decreased during the crisis and recovered later. Another part of machinery imports is connected to investments. As investments have been decreasing for years, import have also decreased. Thus, in 2011 the value of Hungarian machinery imports was by € 2 bn less than in 2008 (€ 34.3 bn compared to € 36.2 bn). Energy imports also lagged behind their 2008 value. Import of chemical products increased by almost € 1.2 bn.



Source: Hungarian Statistical Office

Outlook

We expect that because of the new – first of all, European – recessive trends Hungarian exports will decrease significantly (there were signs in the first quarterly data of 2012). As for there are recent investments in automotive industry and these firms begin production this year, we do not expect a fall, but we expect that the share of vehicle industry in Hungarian foreign trade will further increase. According to our forecast, the surplus of foreign trade will increase and presumably surpass € 8 bn.

FDI and OFDI

Hungary was the first among the Visegrad countries even before the start of the transition process in 1990 to open up its economy towards FDI. In the nineties, it was among the largest host countries both per capita and in terms of the FDI stock in the region. While in the years 2000 it is still a major host to FDI, its leading position is now over both in relative (per capita) and absolute terms.

In terms of OFDI, the country was also among the frontrunners, and in leading position both in relative and absolute terms well into the years 2000. Hungarian OFDI started to become substantial because of two inter-related factors. These were partly due to earlier start in FDI from the point of view of indirect OFDI, partly due to enhanced competitiveness of local companies owing to the competitive pressures because of the earlier liberalisation of foreign

trade and investments and knowledge gained about privatisation-related restructuring. At the end of 2011, Hungary was host to more than € 65 bn FDI and Hungary-based firms invested more than € 18 bn abroad.

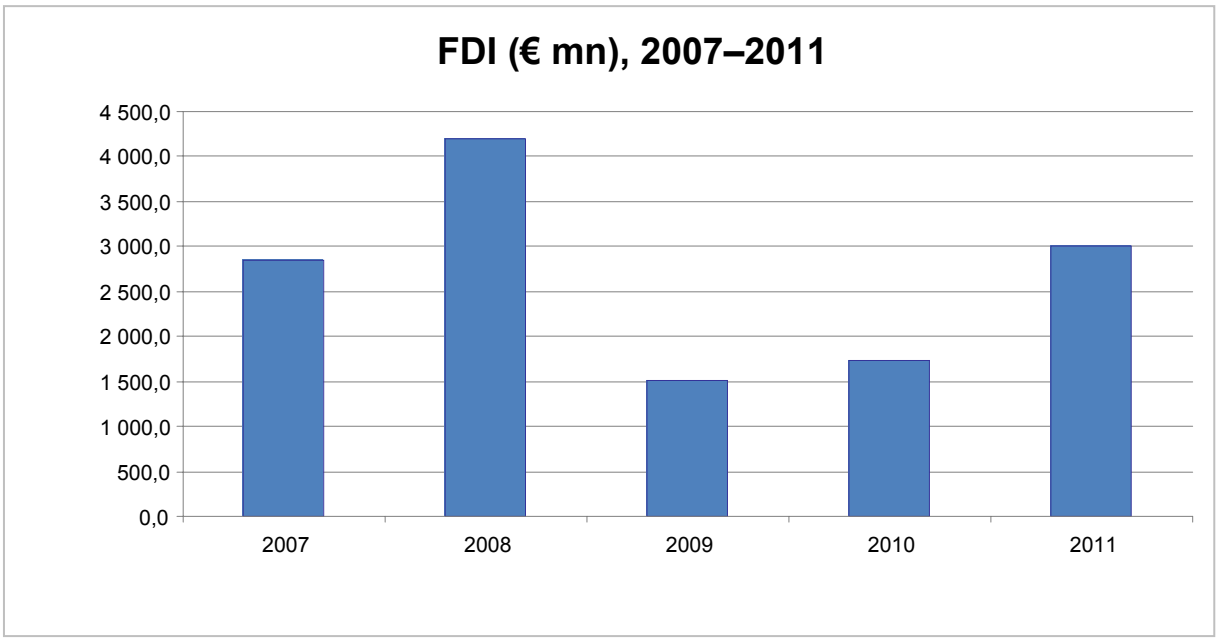
A cautionary methodological note must also be added to the analysis. The Hungarian National Bank publishes two sets of data for foreign direct investments: with and without special purpose entities. According to the National Bank's definition, "special purpose entities" (SPE) are playing a role in the intermediation of substantial financial resources within groups of company, due to channelling funds (the direction and size of which are controlled by their parents), rather than being a target for direct investment (net flows on various financial instruments are close to zero taking a longer period). One major characteristic of SPEs is that they channel relatively large funds. Consequently, recording their transactions particularly strongly increases the gross figures of the financial accounts." That is why we use data, which do not contain transactions made by SPEs.

Moreover, another distinction was made especially on the basis of the FDI data of the fourth quarter of 2011, between "transit" and "normal" FDI. In the case of "transit FDI", a multinational company reallocates capital between countries via its operational subsidiaries, which may inflate actual FDI (and OFDI) data. This happened in Hungary at the end of 2011. According to the estimation of the Hungarian National Bank, € 2.5 bn of the € 4 bn euros FDI and of the € 2.7 bn OFDI was thus related to this type of multinational activity, which is actually recorded in the balance of payments in FDI and OFDI, but in reality does not result in lasting direct investments inside and outside of Hungary

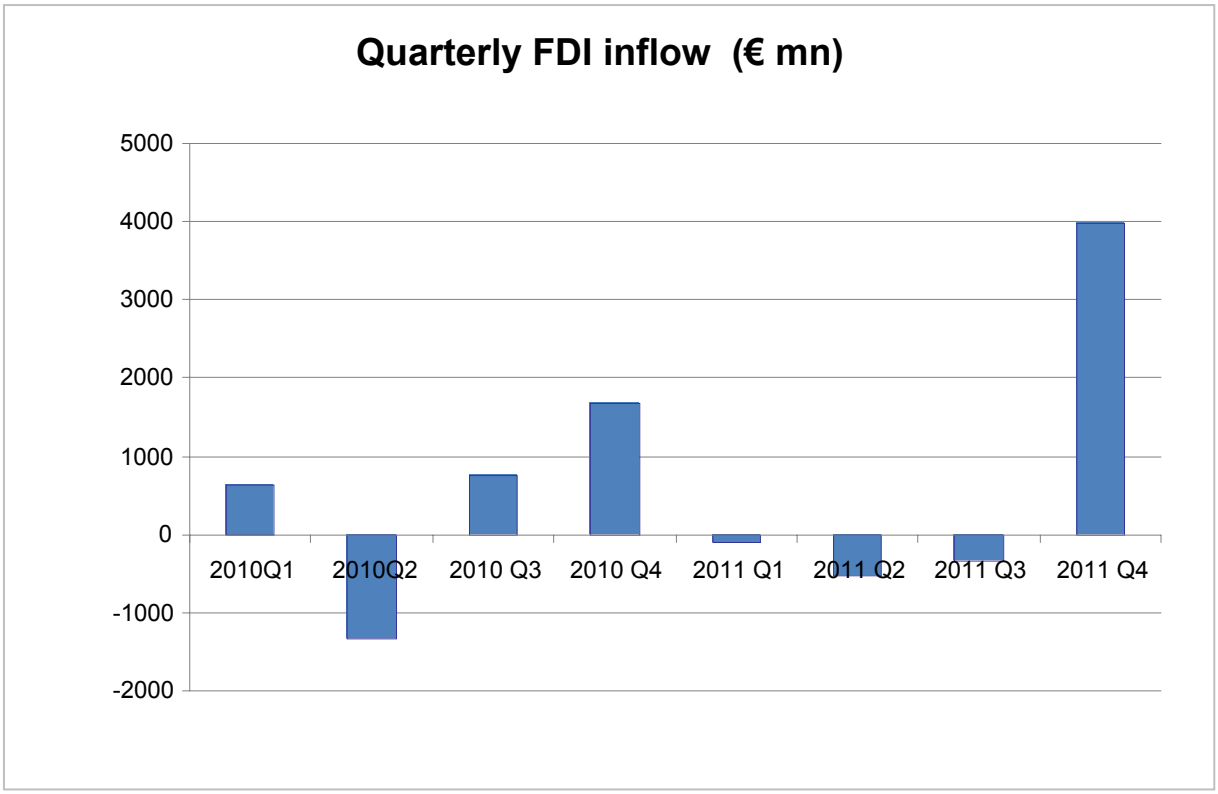
FDI

In the last quarter of 2011 a substantial FDI inflow was recorded in the balance of payments as opposed to negative numbers in the previous three quarters of the year. This resulted in a relatively high inflow for the year as a whole, substantially larger than in 2010 or in 2009, and reaching the pre-crisis levels of annual inflows.

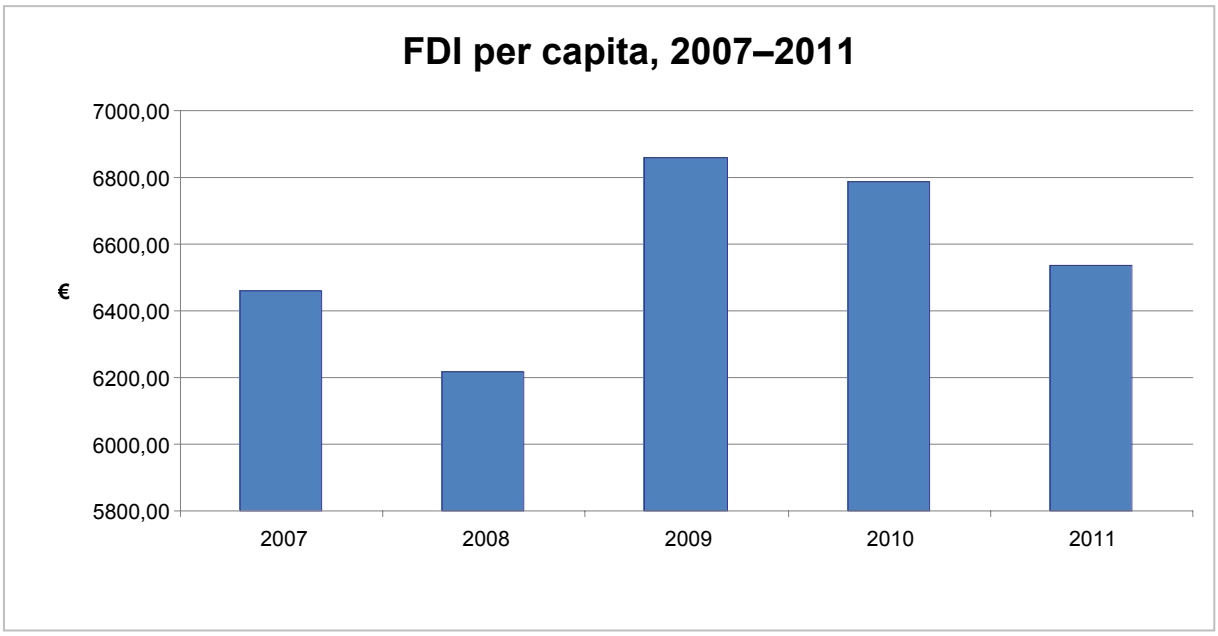
In per capita terms, the Hungarian FDI stock fluctuated between € 6200 and 6900. The financial and economic crisis undoubtedly left its mark on the development of FDI; on the other hand, the slightly but continuously decreasing population also influenced the annual data.



Source: Hungarian National Bank

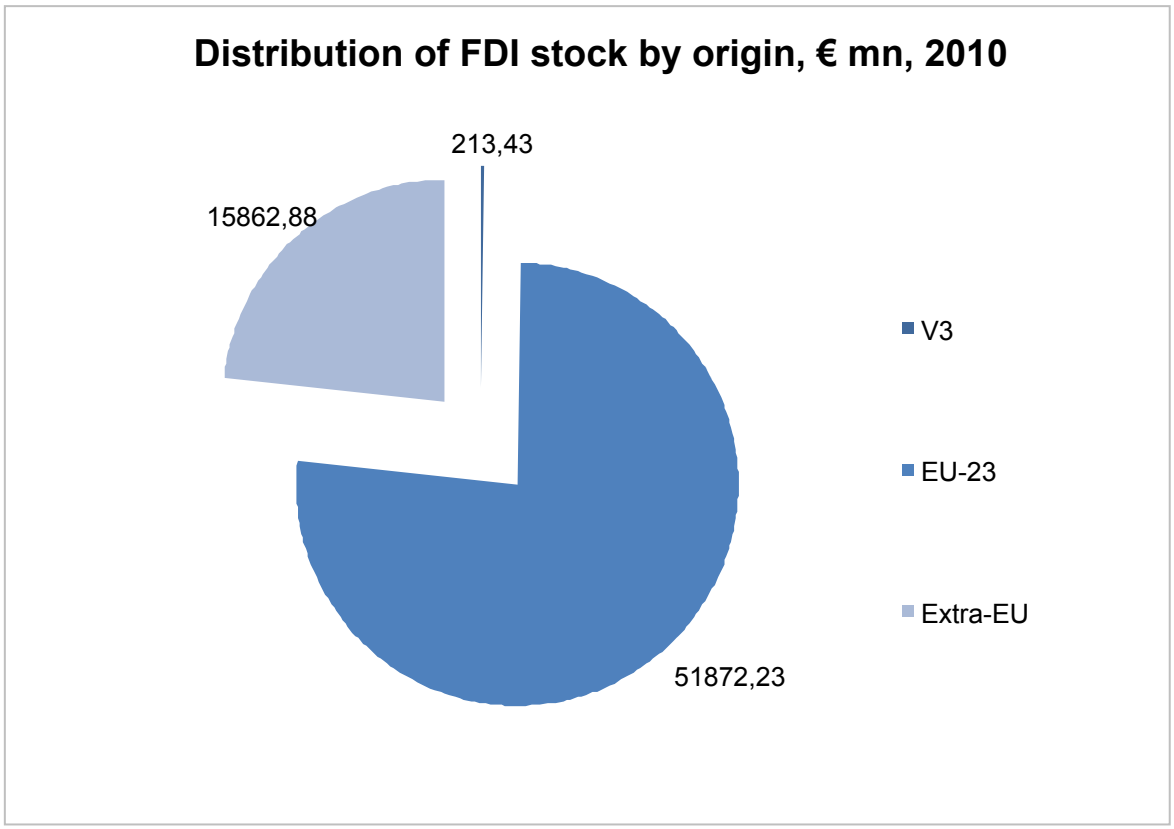


Source: Hungarian National Bank



Source: Hungarian National Bank

In 2010, more than two thirds of the stock of FDI in Hungary originated from the European Union. The share of the other three Visegrad countries was very low, only 0.3 %. In terms of the investor countries, the sustained dominance of German investors can be observed, with at present almost one quarter of the total FDI stock originating from there. The second place of the Netherlands with 18 % of the total FDI stock is also continuous historically, which is partly due to the presence of "indigenous" Dutch multinationals in Hungary, and partly to the phenomenon of the "Dutch sandwich", when because of tax optimisation reasons, a Dutch affiliate is inserted into the transaction. Similar reasons may play a role in the relatively high share (8 %) of Luxembourg investments in Hungary. Austria (13 %), which is on the third place, is a traditionally strong economic partner for Hungary, partly due to common history and geographical closeness. Other European investors with significant shares are France (5 %), Switzerland (4 %), Belgium and the United Kingdom (3 % each). From outside Europe, multinationals from the USA are the most active in Hungary, with a 5 % share in total FDI stock. An interesting case is the 3 % share reached by the Dutch Antilles, which may be due to one transaction, which had its counterpart on the OFDI side, as well.



Source: Hungarian National Bank

In 2010 and 2011, the largest greenfield investments have been realised in the automotive sector, by the German Mercedes and Audi, and the US GM/Opel (which latter realised its investment through the Dutch affiliate of the US multinational, which was sold in 2009 to the Spanish affiliate). Audi announced a capacity extension of the value of around € 1 bn in 2010. A similar project is made by GM/Opel with the value of around € 500 mn. The total value of the Mercedes investment is around € 800 mn. All these large investments are realised in a 2–4 years' time frame, thus they affect inflows for a number of years. Interestingly enough, the realisation of these well-known projects is not reflected by the sectoral data: in both years the numbers for FDI inflows in the automotive sector are negative, mainly due to a negative other capital component.

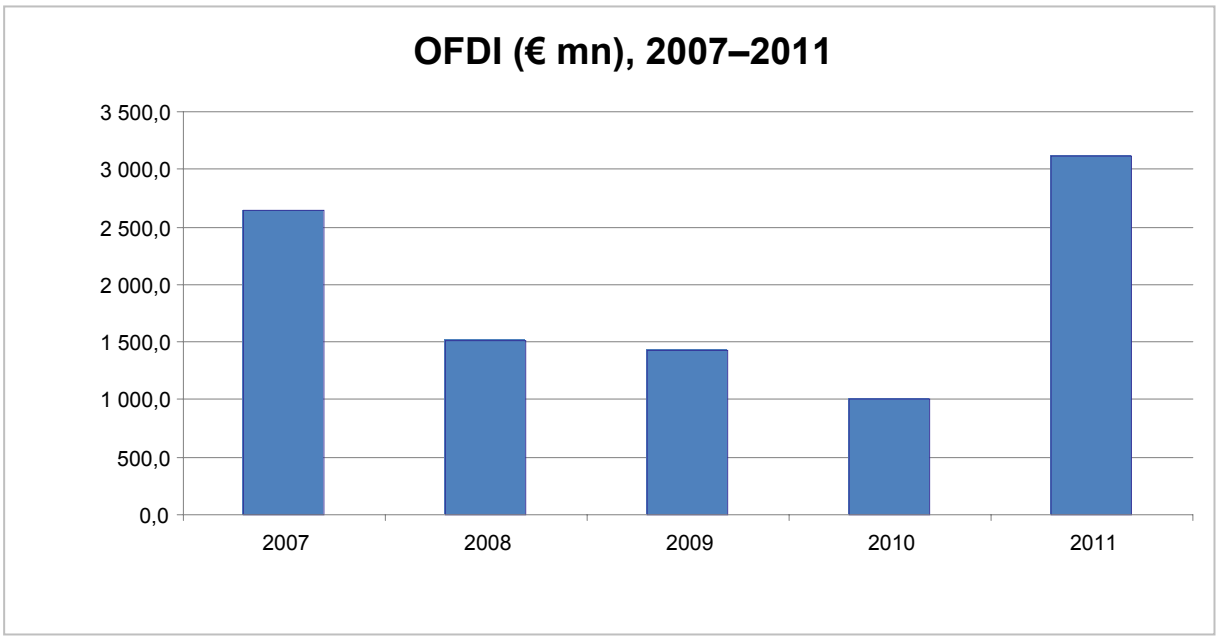
A relatively large greenfield project originating from another Visegrad country is realised by the Czech ČEZ, the value of which is around € 200 mn. As for M&A projects, one of the largest ones is the acquisition of Borsodchem by the Chinese Wanhua Group from the British private equity firm, Permira, which was realised in tranches throughout 2010 and 2011. The total value of the transaction was around € 1.2 bn. As another large transaction, Turk Telecom acquired the wholesale trade branch of Invitel International for € 221 mn in 2010.

To our knowledge, there are two larger M&A transactions involving an acquirer from another Visegrad country. In January 2010, the Slovakian Asseco acquired 70 % of the shares of Statlogics Zrt.; both companies are operating in the pre-packaged software industry. This transaction on the other hand, involves another Visegrad country, as Asseco is a Polish multinational, expanding successfully not only in the Eastern, but also in the Western part of Europe. As for the second transaction, in December 2010, the Czech Trinecke Zelezarny bought D&D Drótáru Zrt. in Miskolc (Northern Hungary), which produces prestressing steel wires and strands.

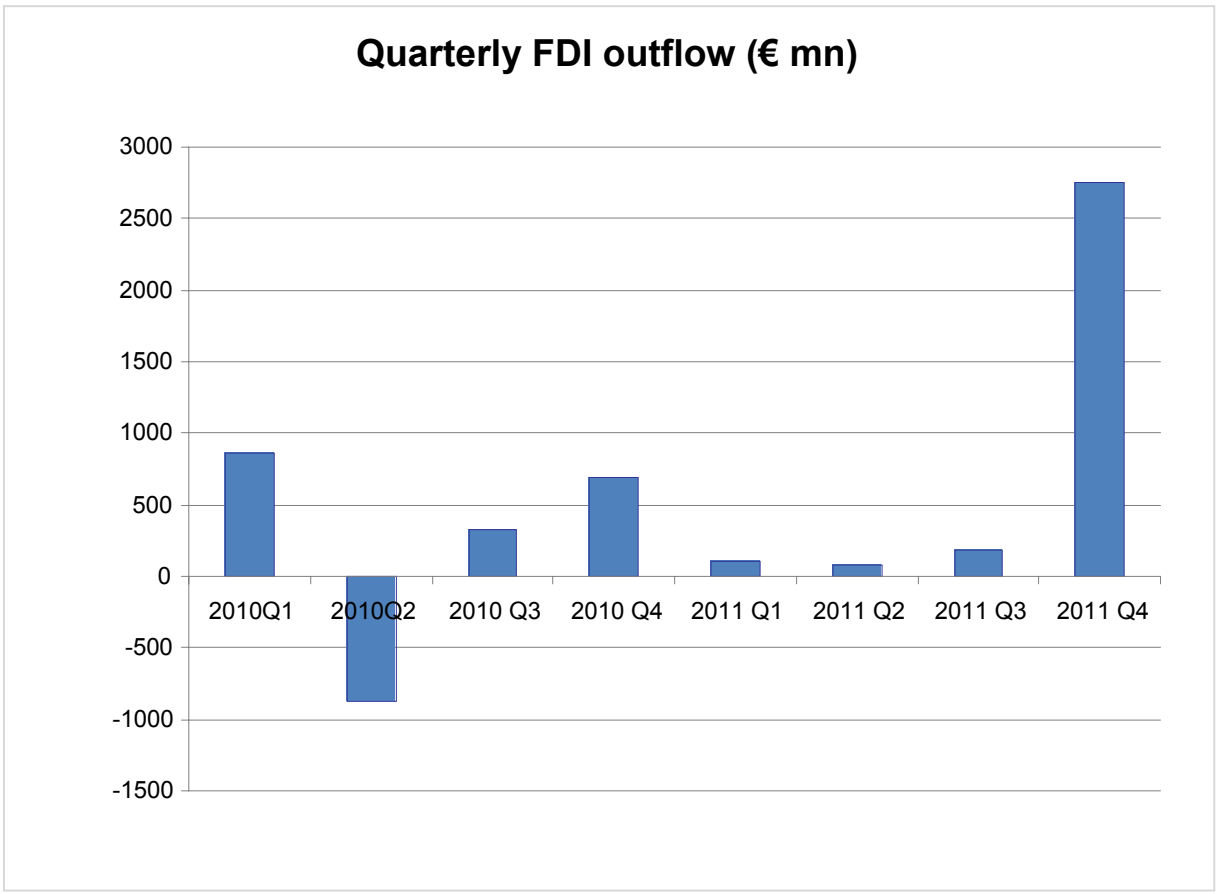
OFDI

Outward FDI was also exceedingly high in the last quarter of 2011. For the year as a whole, the contribution of the last quarter resulted in a record high outflow, which was even exceeding the level of outflows in the four preceding years. The already mentioned phenomenon of “transit capital” may explain part of the high level of outflows.

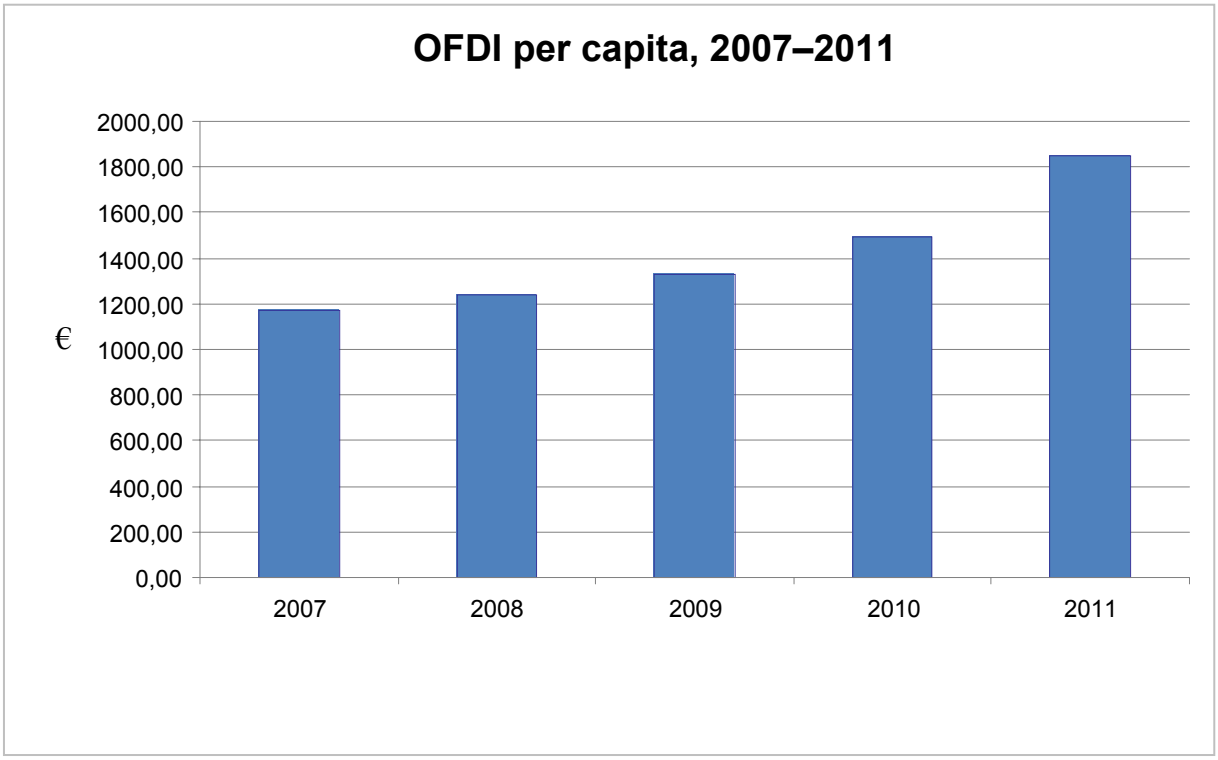
Per capita OFDI increased dynamically during the analysed period from € 1172 in 2007 to € 1847 in 2011, with the largest jump occurring between 2010 (€ 1491) and 2011.



Source: Hungarian National Bank



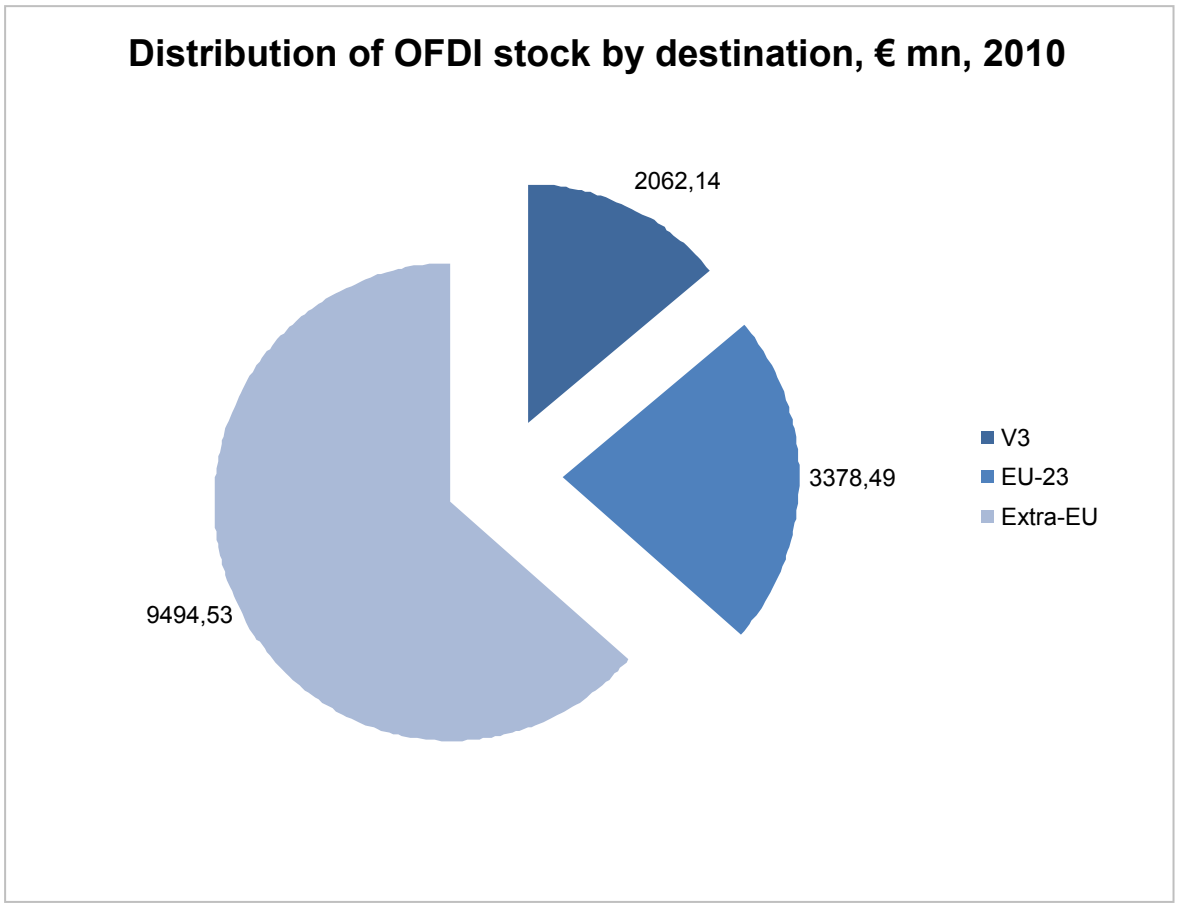
Source: Hungarian National Bank



Source: Hungarian National Bank

In terms of country groups, in 2010, the other three Visegrad countries hosted almost 14 % of Hungarian OFDI, mainly due to the high share of Slovakia. The remaining 23 members of the European Union received 23 %, while the main targets were outside-European Union countries, with almost 64 %.

The main target countries of Hungarian outward FDI can be grouped into three categories. The primary targets are neighbouring or geographically close countries at a similar level of economic development compared to Hungary: Croatia (14 %), Slovakia (8 %), Bulgaria (5 %), Romania (3 %), Ukraine and Serbia (2 % each). The second group is composed of countries used because of tax optimisation purposes, which may act as “transmitters”, i.e. affiliates of Hungarian multinationals established there realise further foreign investments. This may be the case at least for a certain part of the total OFDI stock in Cyprus and Switzerland (4 % each). For example, in Switzerland, Richter Gedeon, the Hungarian pharmaceutical firm made a large acquisition last year (that of PregLem, a Swiss pharmaceutical company), which obviously does not form part of the “transmitter” category. Furthermore, Hungarian investments in the USA may be of more a composite nature: knowledge-seeking investments, smaller transactions by born-global companies and horizontal type of investments may also be present in this case.



Source: Hungarian National Bank

We suspect that the second place of the Dutch Antilles (11%) may be due to a single transaction – similarly, a single transaction put South Korea in the second place at the beginning of the 2000s. This may happen in the case of countries where the total outward stock is not very big and one-off large transactions may cause changes in the country and sector composition of the whole OFDI stock.

Richter Gedeon is a good illustration of the fact that large transactions and a handful of large investing companies dominate Hungarian OFDI. Besides the pharmaceutical company, OTP (financial services) and MOL (oil and gas) are the most important investors. The largest greenfield projects in 2010 were realised by two pharmaceutical firms: Richter Gedeon established a joint venture in China with a Chinese partner investing around € 2 mn, while Omninvest was active in this field in Uzbekistan, when establishing a joint venture with a local state-owned firm. To our knowledge, there was one larger transaction in another Visegrad country by a Hungarian investor, when Jeans Club, operating in the clothing sector, established Jeans Club Slovakia.

As far as the M&A transactions are concerned, Richter Gedeon was the most active Hungarian firm, which besides the Swiss PregLem, acquired 100 % of the shares of the German Grünenthal-Contraceptives for € 236.5 mn. As for Visegrad-related transactions, a venture capital fund, Cisco Growth Fund of Hungary acquired in November 2010 a minority stake in the Polish Iklu-Rankomat, which provides insurance related e-commerce services.

Outlook

In the coming years we expect Hungary to remain an important host and source country for FDI compared to other countries in the region. Recent economic policy developments made the Hungarian stance more ambiguous towards FDI: on the one hand certain, mainly vertical, export-oriented type of FDI is generously encouraged, on the other hand additional tax burdens and disputes with local co-owners hit first of all horizontal type, domestic market oriented FDI hard. The result can be a slight decrease in the annual inflow of FDI.

OFDI seem to be maintained, especially because the state encourages it through various programs trying to target SMEs and new foreign locations. Moreover, certain local companies look for other locations due to domestic economic problems, which may also enhance OFDI. An important change is the increased state ownership and thus intervention into foreign strategies of especially MOL and to a much more limited extent of Richter Gedeon, two of the three most important foreign investor companies located in Hungary.

POLAND

Exports and imports

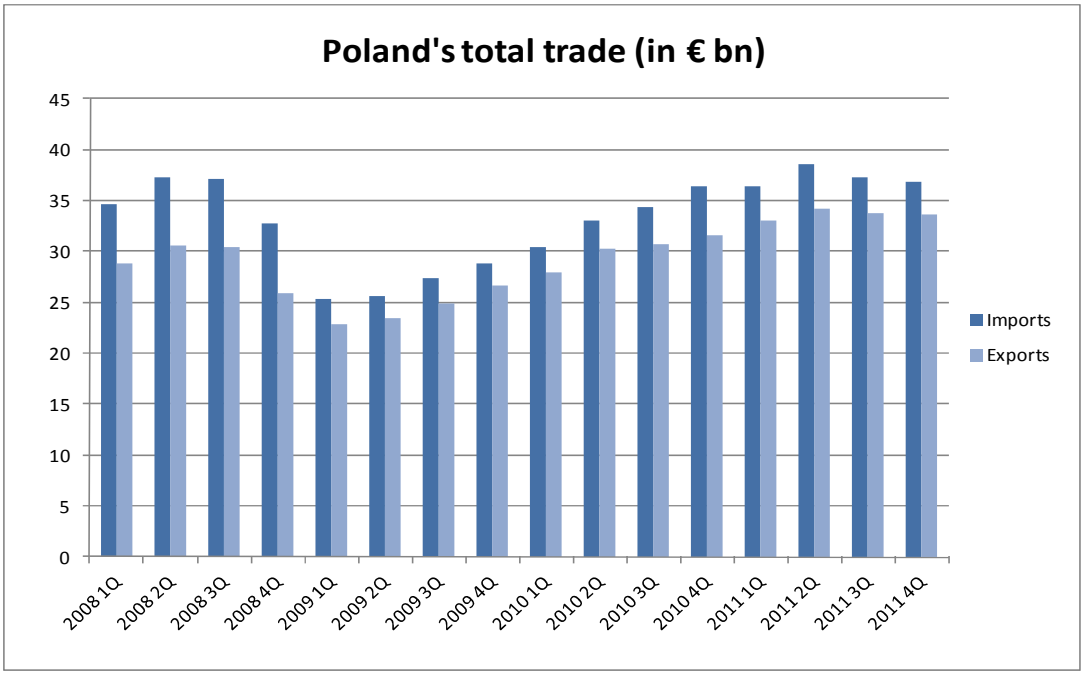
Poland benefited from the 2004 European Union enlargement in many aspects. The economic relations with the states that were in the EU for a longer time as well as with those ones which joined the EU with Poland or even later had there a crucial meaning. Foreign trade takes an important part of these relations and its growth was due to the abolishment of trading barriers (namely entering the Single Market), the application of common standards in production and common rules of products information. Since 2004 Poland's exports and imports growth rate – particularly with the EU Member States – strongly accelerated up to 2008. Among the trading partners from the EU, the boost in Poland's total trade was particularly strong with the countries of Central and Eastern Europe (among them the most important ones are these gathered in the Visegrad group). This phenomenon occurred thanks to the rapidly growing region's prosperity.

However, 2008 was a year that opened a new chapter in Poland's trade. At the end of 2008 the economic and financial crisis hit the global economy, which deteriorated overall trade in 2009. It took one year to recover the losses in Poland's imports and consequently two years in Poland's exports. The economic crisis still overshadows Poland's trade with the EU, where it transformed to sovereign debt crisis in the eurozone countries. This enforced austerity measures which impeded short term economic growth and then the propensity to import (also from Poland).

Trade patterns instantly reflected the emergence of economic crisis. In the three first quarters of 2008 the volume of imports as well as of exports has systematically increased up to € 37.2 bn and € 30.5 bn in the 3rd quarter, respectively. However, after Lehman Brothers' collapse a drop in trade was highly visible. In IV quarter 2008 imports shrunk to € 32.8 bn, whereas exports decreased to € 25.9 bn.

The value of exports and imports in 2009 was significantly lower (a decrease down to € 25.3 bn in imports and € 22.9 bn in exports in the 1st quarter) compared to the 2008 levels. The trade values were even less than those in 2007. In the 1st semester of 2009 the declines in exports as well as in imports occurred only in the 1st quarter. Since then, the recovery has started and lasted to 2011, when both exports and imports achieved bigger levels than in comparable quarters in 2008 (in case of exports it took place even earlier, in 2010). However

in 2011 the 2nd half-year brought a trade slow-down, which is probably a sign of aggravation of eurozone debt problems, and most of Poland's trade is clearly bound with this group of countries. The imports and exports hit the record in the 2nd quarter of 2011 with € 38.6 bn and with € 34.2 bn, respectively.



Source: Eurostat, Comext

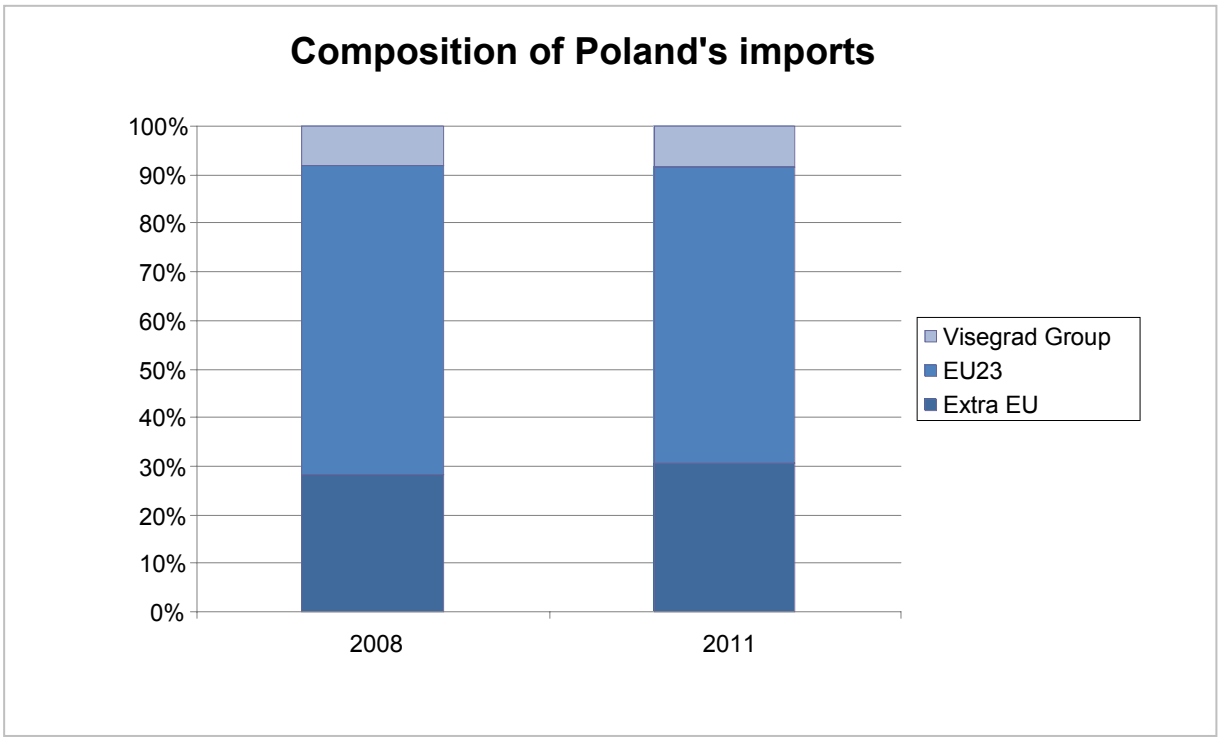
The crisis also influenced trade in services. In 2009 total Polish exports in services dropped by about 17% to € 20.7 bn. However, in 2010 credit in total services recovered to € 24.7 bn, which was bigger by € 0.6 bn than in 2008. The value of imports of services also declined in the first full year of crisis prevalence. It plunged up to € 17.3 bn in 2009 from € 20.7 bn in 2008, so the relative decrease was rather severe and amounted to almost 20% of the 2008 value. The recovery in 2010 was strong and the debit in total services reached € 22.4 bn. What is also interesting is the fact that Polish trade in services is 5-6 times less than trade in goods, what points at the big potential of developing this sector.

Geographical structure

The influence of the economic crisis is not as visible as expected in terms of geographic composition of Poland's trading partners. A change in exports structure since 2008 was almost petrified. The main group of consumers of Polish goods is composed of the EU member states, without the Visegrad countries. This destination stood for 66.9 % of exports in 2008, which is a significant share. The share of exports to countries outside the EU amounted for 22.2 % in 2008 and it has not changed in 2011. Worth noting are Visegrad

countries where Poland exported 10.9 % of its total exports in 2008 and 11.2 % in 2011. Taking into the consideration that these countries represent only 0.65 % of global economy, it is visible that the trade intensity with this group is relatively strong.

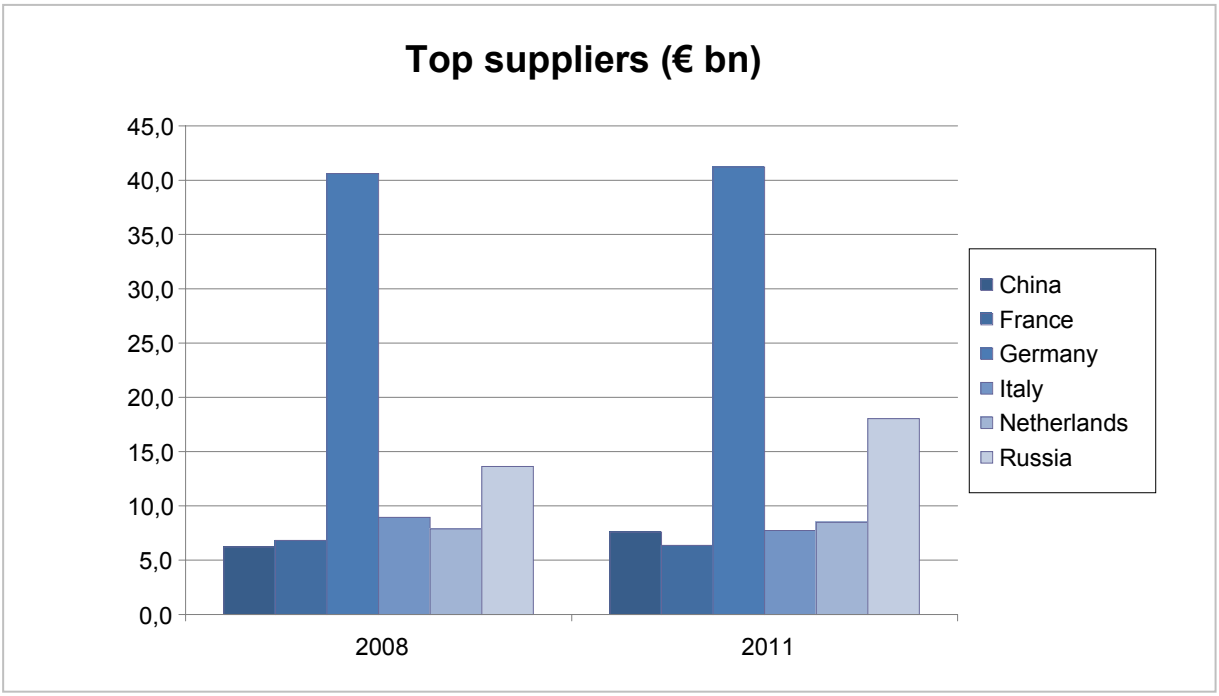
The geographical structure of Poland's imports changed in the recent three years. The share in the biggest group – the EU23 – dropped from 63.9 % in 2008 to 61 % in 2011. A loss of 2.9 percentage points (p.p.) in four years is moderate, but not insignificant. This decline occurred at the advantage of the group of countries outside the EU. The share of imports with this group increased by about 2.5 p.p. in 2011 up to 30.6 % compared to 28.1 % in 2008. The third group – the Visegrad countries – also supplied Poland more intensely in 2011, and the share of Polish imports from this set of countries increased from 7.9 % in 2008 up to 8.4 % in 2011.



Source: Eurostat, Comext

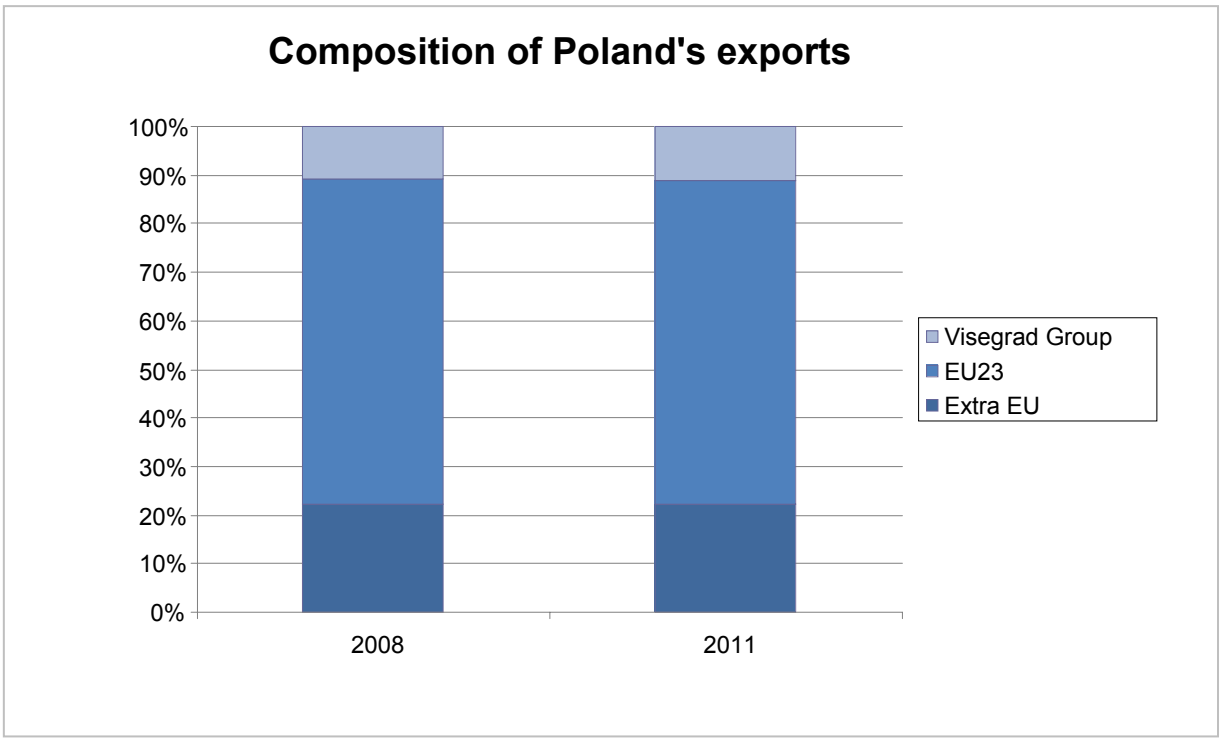
Some switches occurred in the shares of the main countries of origin of Polish imports. The biggest supplier of foreign merchandise remained Germany, delivering goods for a total value of € 40.6 bn in 2008 and € 41.2 bn in 2011. It supplies Poland with goods of a total value three times bigger than the 2nd top exporter, the Russian Federation. This latter country provided € 13.7 bn of merchandise in 2008 and this sum rose up to € 18.1 bn in 2011. The goods sold by Russia were mainly crude materials, such as natural gas, ore or petroleum.

Italy didn't manage to maintain its 3rd position from 2008, when it exported goods with a value of € 8.9 bn, whereas in 2011 it supplied Poland with goods for € 7.7 bn and was caught up by the Netherlands. This latter country entered 3rd in 2011 when it reached € 8.4 bn in sales to Poland. China recently overtook the 5th position with goods exports of € 7.6 bn, and replaced France which sold goods to Poland for € 6.3 bn in 2011.



Source: Eurostat, Comext

The structure of main export destinations did not change significantly, either. Germany remained the biggest consumer of Polish goods, by importing € 29 bn in 2008 and € 35.1 bn in 2011. It is worth noting that the 2nd biggest importer bought more than 4 times less than Germany, which points at the size of this partner and close mutual economic relations. The Czech Republic advanced from 3rd to 2nd position and increased the consumption of Polish goods from € 6.6 bn in 2008 to € 8.3 bn in 2011. It was probably a result of a relatively better economic performance during the crisis compared to France and Italy, which consumed more Polish products before the downturn. Their imports amounted to € 7.2 bn and € 6.9 bn in 2008, respectively. However, in 2011 the values of their purchases of Polish goods were lower then Czech imports from Poland in that year. France bought Polish commodities in 2011 for € 8.3 bn, whereas Italy spent € 7.2 bn for goods from Poland.

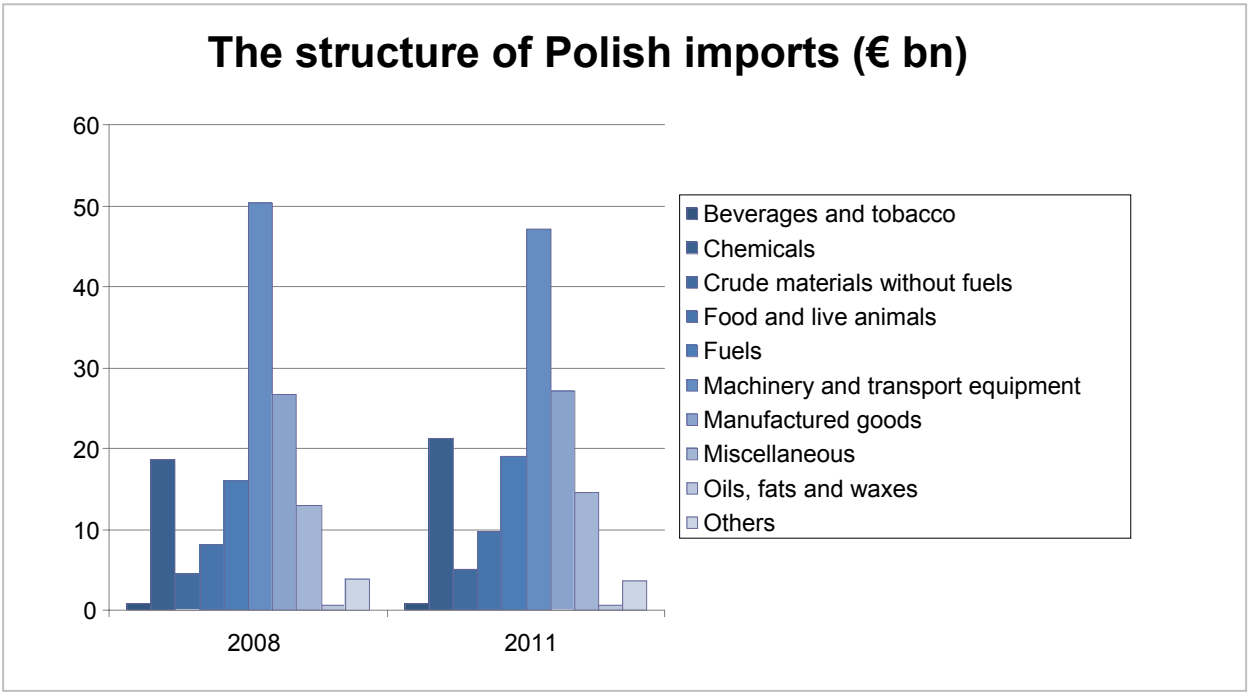


Source: Eurostat, Comext

Source: Eurostat, Comext

Commodity pattern

Poland, which became a part in the global supply chain, due to foreign direct investments of multinationals, intensified its demand on parts of durable goods, electronics or on semi-products used in the automotive industry. This all happened among others thanks to the enlargement of the European Union in 2004. Several changes in the structure of imports took place; however, they were not significant. The dominant category in purchases is machinery and transport equipment, which is mainly used in the automotive industry, and the further-processed components or final vehicles are sold abroad. € 50.3 bn and € 47.1 bn were spent on these foreign goods in 2008 and 2011, respectively. It is visible here that the crisis hit strongly the automotive industry, due to the fact that consumers in times of austerity abstain from buying new cars or other vehicles. The demand for cars, and then for parts of them was sharply reduced and it did not fully recovered even in 2011.

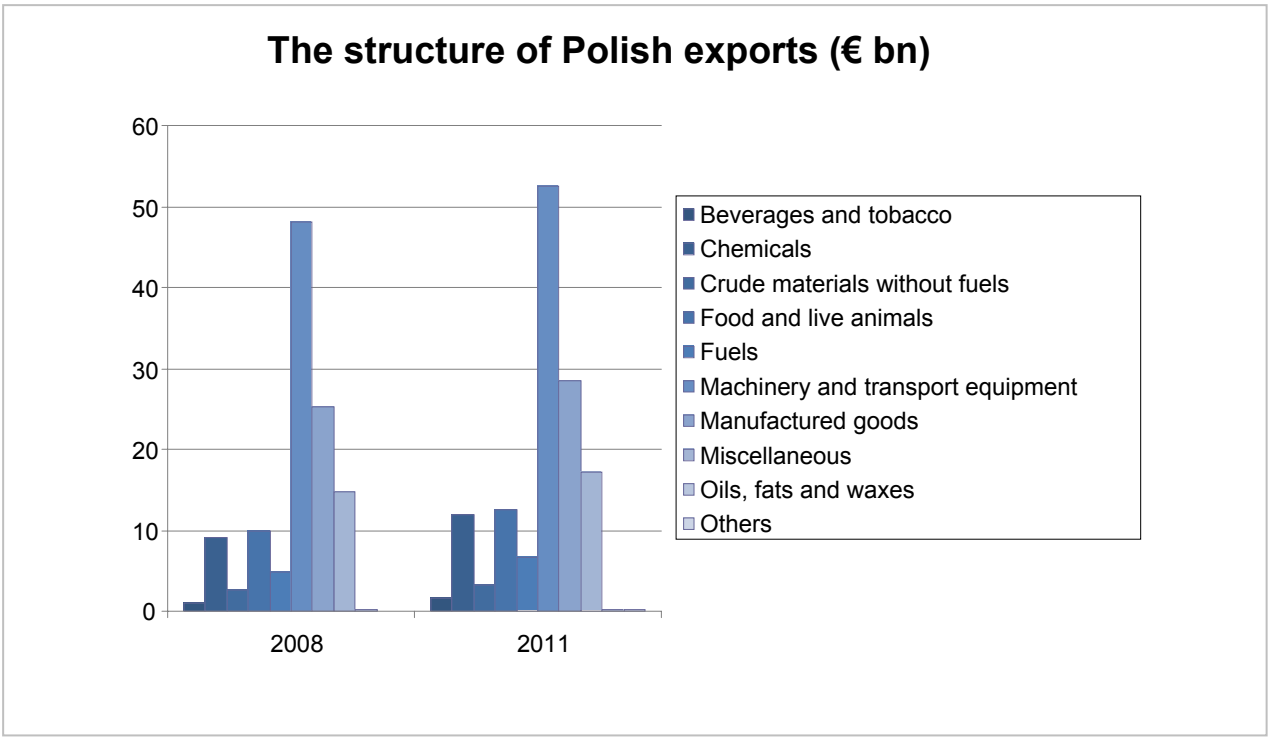


Source: Eurostat, Comext

The next biggest spending category is constituted by manufactured goods which stand for about 18% of total purchased assortment abroad in 2011. Their share amounted to € 26.6 bn in 2008 and € 27 bn in 2011, hence a slight increase in purchases took place. Poland also imports a significant amount of chemicals which is the 3rd biggest spending position. The purchases of this category reached € 21.2 bn in 2011 and they were higher by € 2.7 bn than spending on the same product group in 2008. The 4th biggest group of imported products is

constituted by fuels. Their share in total Polish imports in increased from 11.2 % in 2008 up to 12.7 % in 2011, which was most probably caused by the recovering and then rising fuel prices.

Poland's export structure also experienced minor changes. No group achieved better or worse position in 2011 compared to 2008. Just as on the import side, the biggest selling category is linked with the automotive industry. Poland sold abroad € 48 bn of these items in 2008 and it increased its sales up to € 52.5 bn in 2011. This increase is interesting, because one might expect that exports should decrease as a consequence of deteriorating moods in the eurozone, which is a natural buyer of Central and Eastern European vehicles. Additionally, the expectations on decreasing would be reasonable as at the same time the imports (which reflect the demand for parts needed to process the vehicles in order to sell them later) in this branch dropped by about € 3 bn. It may also point at the maintaining production in Poland by multinationals in times of crisis. However, in relative terms, the share of exports in this category dropped by 2 p.p. The 2nd biggest export group is that of manufactured goods, occupying the same position in Polish imports. Its share amounted for € 25.3 bn and € 28.6 bn in 2008 and 2011, respectively. The 3rd biggest category is that of miscellaneous products consisting of (among others): travel goods, furniture, footwear. Poland sold these items for € 14.8 bn in 2008 and € 17.1 bn in 2011. Poland also specialises in food processing and its sales abroad in this industry intensified from € 9.8 bn in 2008 to € 12.5 bn in 2011. Chemical industry follows closely with sales of € 9.1 bn in 2008; its sales increased significantly up to € 12 bn in 2011, and its relative rise was almost the highest (the sales soared by 31%).



Source: Eurostat, Comext

The most important traded services groups are linked with transportation, travel and business services. Within the first group, Poland exported € 6.6 bn in 2010. Travel services brought to Poland € 7.2 in 2010, whereas business services gave € 7.3 bn. The structure of imports of services is generally similar. Polish economic agents spent € 4.6 bn on transportation, € 6.5 bn on travel and € 5.6 on business services in 2010.

Outlook

Poland was perceived as a “green island” as it was the only EU Member State that maintained economic growth during the entire known phase of the ongoing economic crisis. This was also reflected in relative declines in Polish imports in 2009, which quickly recovered. However, the prospects of Polish further growth in 2012 are fading, hence the imports’ growth rate could be significantly slower or even negative.

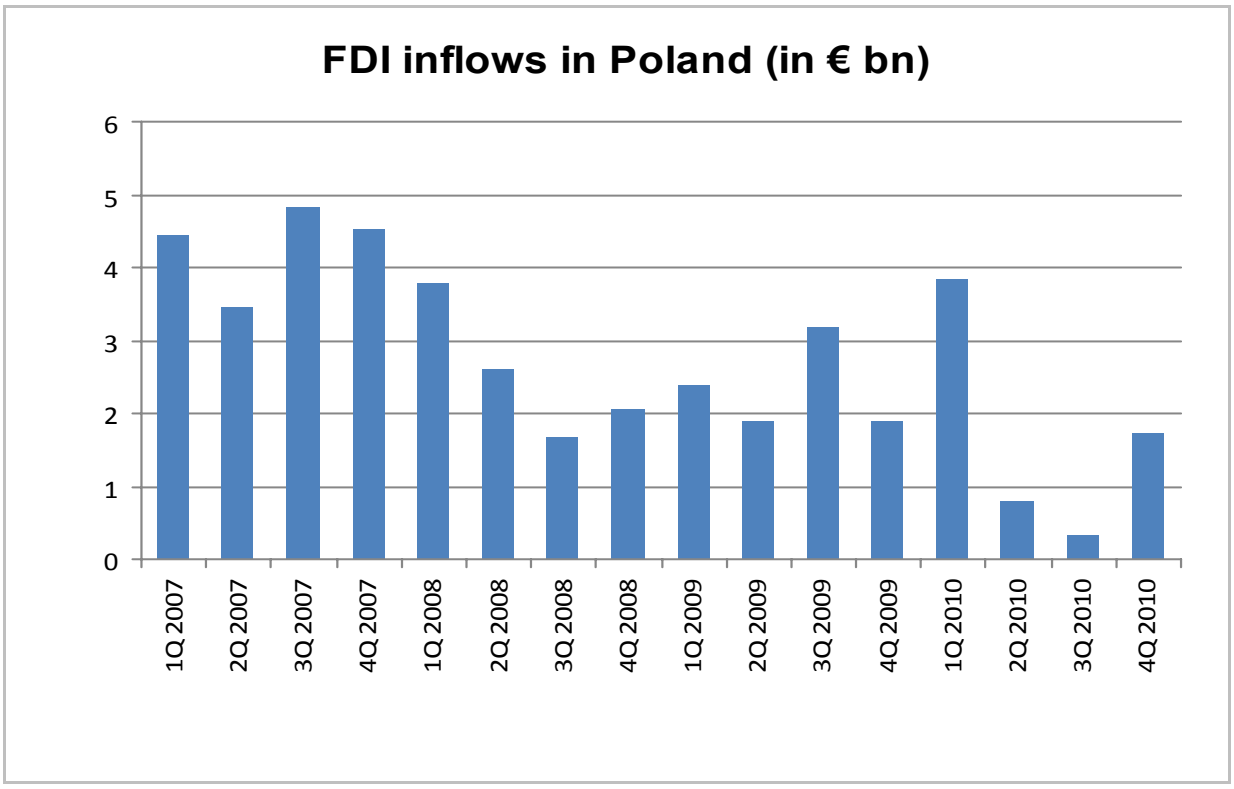
In the case of exports, Poland's hope is probably a good performance of the German economy, which is the main purchaser of Polish goods. However, the rest of main Polish clients would suffer from the sovereign debt crisis, and less orders are expected. What is more, Poland's advantage of inexpensive labour would also be weaker through the aggravation of burdens on businesses (e.g. an increased healthcare contribution), which now

affects higher prices and lower competitiveness of selling goods. Thus the overall direction of changes in export values is rather ambiguous.

FDI and OFDI

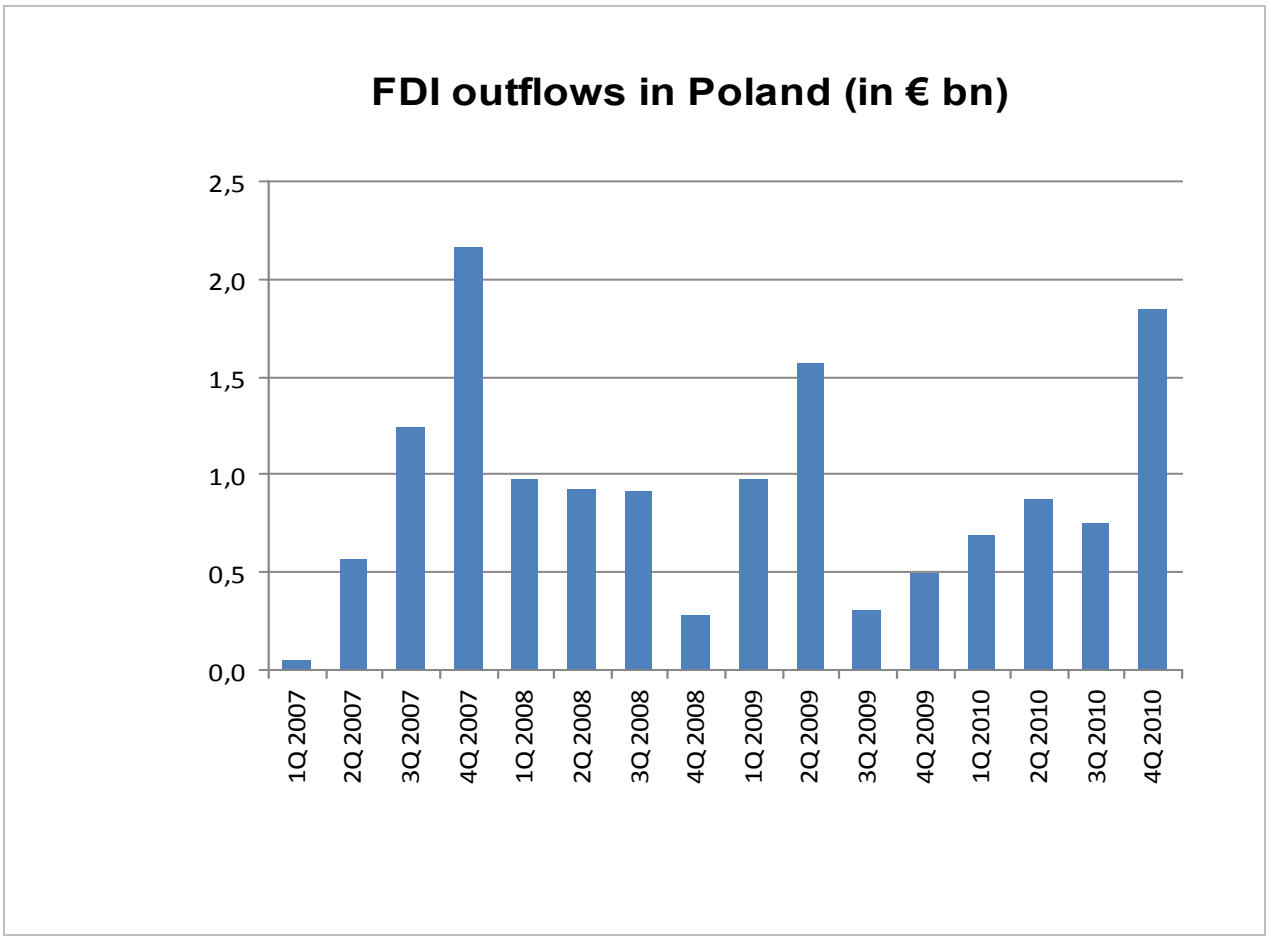
Foreign direct investments (FDI) play an important role in the Polish economy. However, due to the size of the whole economy these investments are not as crucial as in the other Visegrad Group countries. Nevertheless, it does not mean that FDI would not be important for Poland. Foreign investments bring not only the so needed capital and create new jobs, but also help spread innovations that would ameliorate the pace of modernisation. Before the start of the global economic downturn, the amount of FDI inflows into Poland increased year by year, which was mainly caused by the growing confidence of foreign investors (mainly multinationals) in the stability of the Polish economy. This was strengthened by Poland's accession to the EU, which was included in some of the ratings cautiously prepared by financial institutions. Also, entering the Single Market and thus lifting many barriers to capital flows induced more European FDI. As a consequence, the majority of FDI in Poland comes from the EU.

However, the global economic crisis affected FDI in Poland in two quite opposite ways: first, in general, the growing uncertainty and lowering propensity to take risks by investors decreased global FDI flows, second, the investors seek to cut costs, thus they relocate their capital to areas where labour is relatively inexpensive. One of these places is Poland. The data presented below come from the National Bank of Poland; the figures for 2010 and 2011 are preliminary.



Source: National Bank of Poland

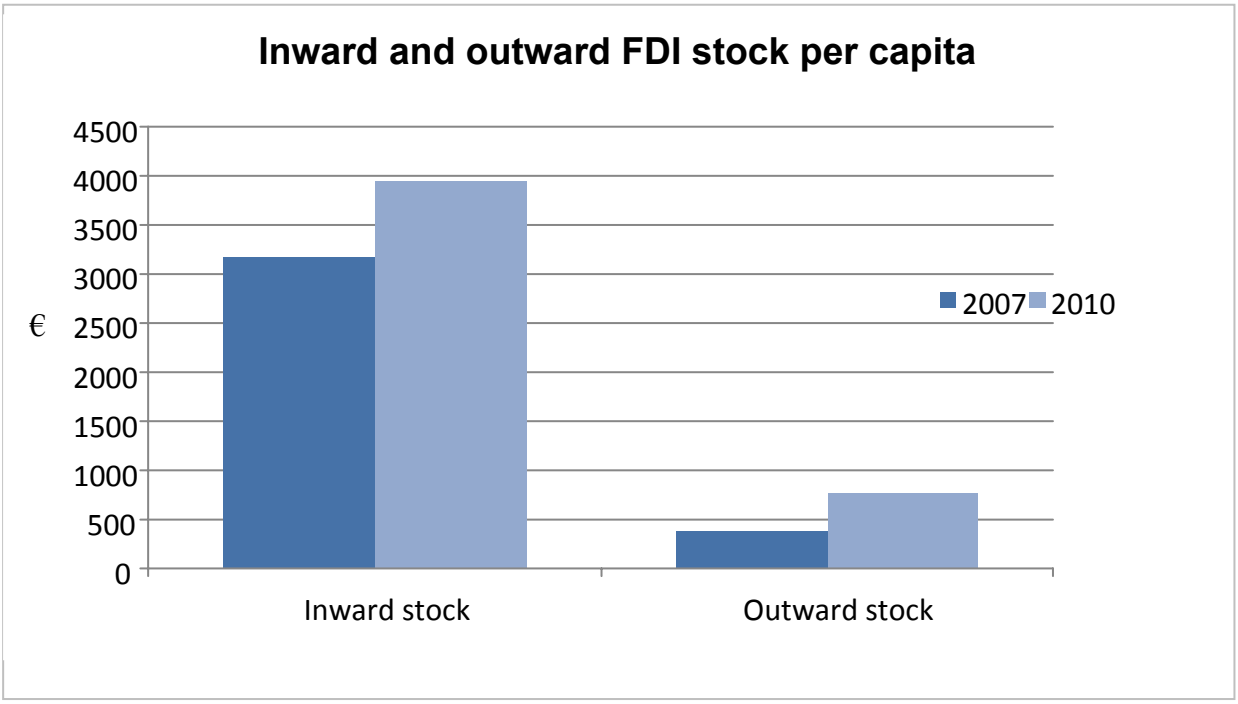
2007 was the year with top high FDI inflows (€ 17.2 bn), and the following years brought significantly lower levels of investments. Their value in the 3rd quarter of 2008 (€ 1.7 bn) was the lowest since 2006, which indicated the growing uncertainty in the global economy. The next quarter provided a greater inflow of foreign capital by € 0.3 bn. 2009 brought an even weaker yearly inflow, however, the quarterly flows were higher than the one in the 3rd quarter of 2008. Nevertheless, none of them was as intense as the inflow in the weakest quarter in 2007. The weakening of flows was intensified in 2010, which was the mildest year since 2003. It brought only € 6 bn of FDI in the entire year, and both the 2nd and 3rd quarters generated foreign investments at the level of € 1 bn. This proves that the investment climate still remains unclear, and, bearing in mind that the majority of investments are European, it also points at the aggravating situation in the EU.



Source: National Bank of Poland

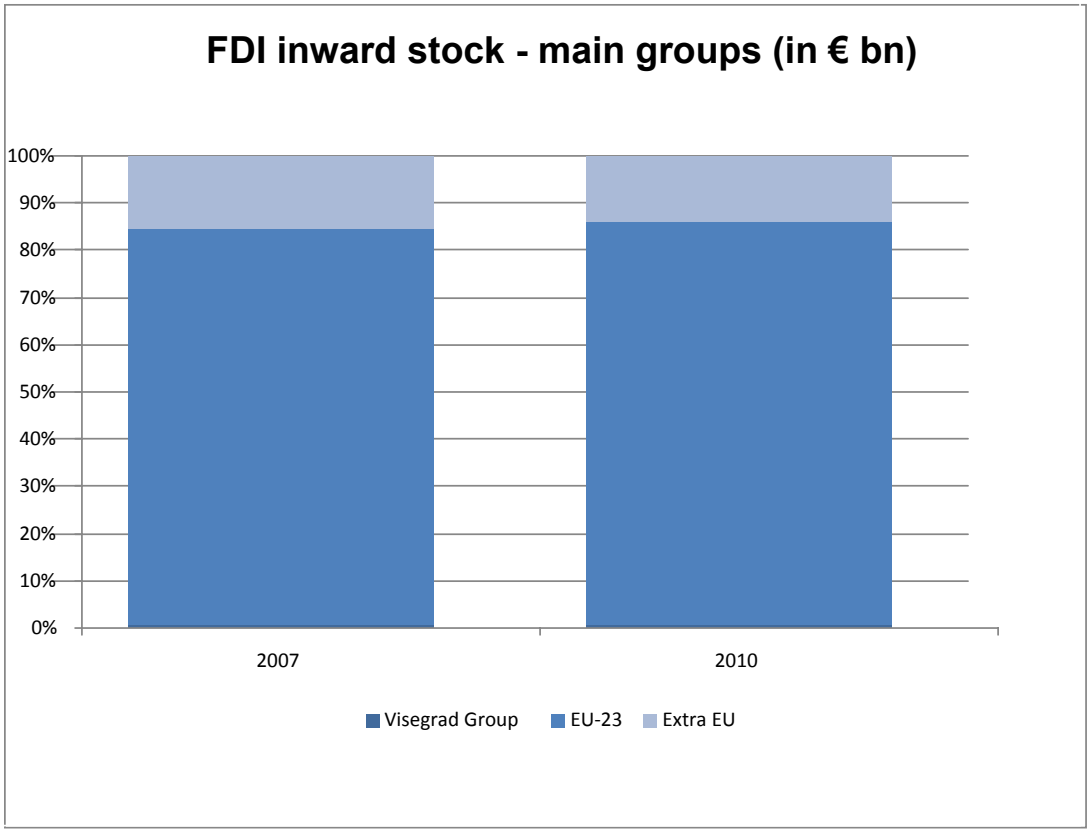
The investment activity of Polish economic agents abroad is significantly less intense than foreign investors' activity in Poland. This shows evidently the factor endowment in this country (a relative scarcity of capital). During the crisis, the yearly outflow remained quite stable, however, in 2008, in contrast to 2007, the 4th quarter was significantly weaker (and achieved then a value of less than € 0.3 bn). This was probably a consequence of instant capital dry-out in the domestic market and thus the lack of financing resources for investments plans: for domestic as well as for foreign investments. The next quarters were much more optimistic (€ 1 bn in the 1st quarter of 2009 and €1 .6 bn in the 2nd quarter of 2009) until the moderate 3rd quarter of 2009 when the foreign investments of Polish economic agents reached only € 0.3 bn. The modest outflows at the level of € 0.3 bn in the 3rd quarter of 2009 and € 0.5 bn in the 4th quarter of 2009 pointed at the fact that the barriers to gain finances to make investments (also abroad) still exist, but are, however, weaker. The next year (2010) brought some recovery in outflow intensity (€ 4.1 bn) and outpaced the weaker years of 2008 and 2009. Especially worth noting is the last quarter of 2010, during which Polish entrepreneurs invested € 1.8 bn abroad. This could point at the relative stabilisation of Polish businesses.

The intensity of capital stock in Poland is rather moderate, however, rising. Accumulated FDI reached € 3.2 thousand *per capita* in 2007 and € 3.9 thousand *per capita* in 2010. The intensity of outward investments is far more modest. Only about € 400 per inhabitant were located cumulatively abroad up to 2007. For 2010, however, this intensity has almost doubled.



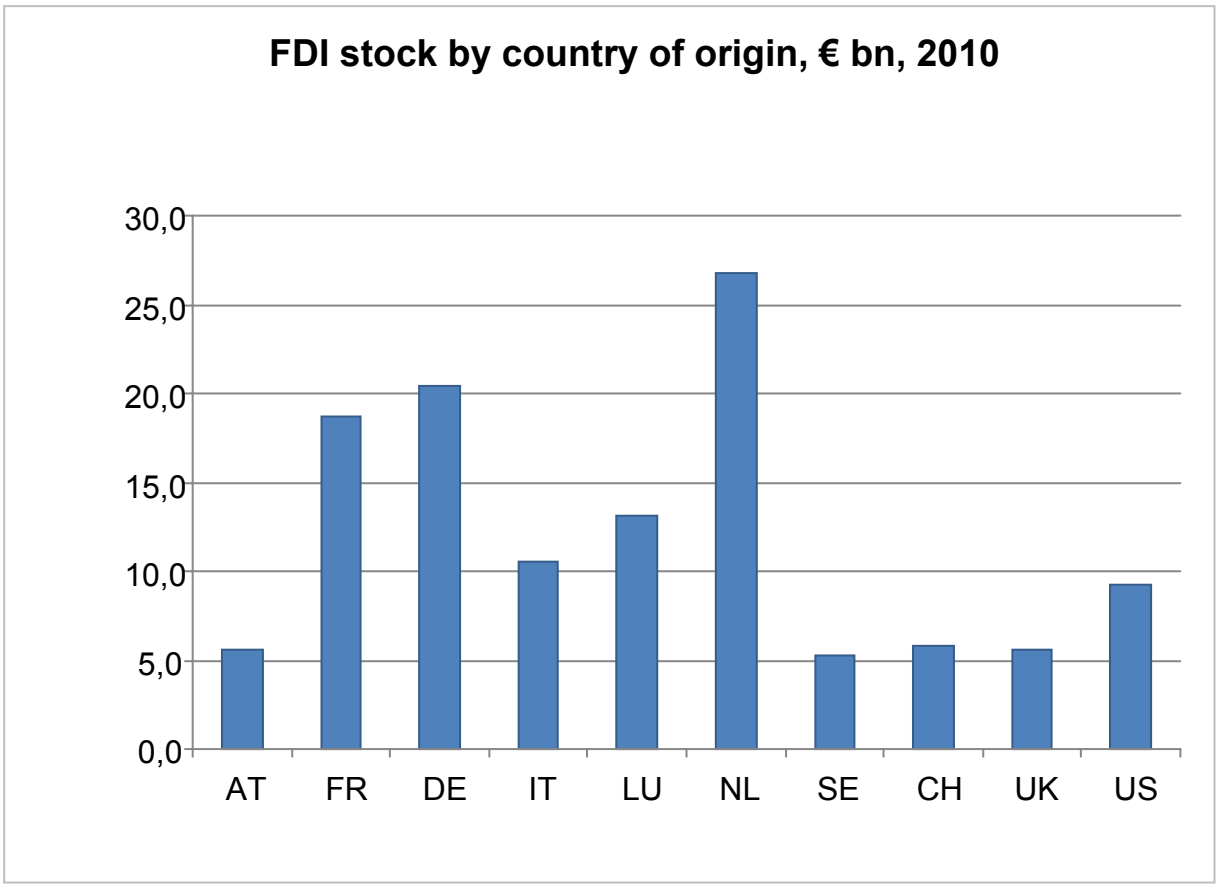
Source: National Bank of Poland

Most of the invested capital in Poland comes from the EU. The crisis did not change significantly the structure of FDI in Poland by region of origin. In 2007 the share of FDI stock that originated from the EU23 amounted to 84 %, which was translated to € 101.9 bn. By 2010, the amount of financial means that come from the EU23 increased to € 128.5 bn, and the share in total FDI increased only by 1.4 p.p. Capital from outside the EU stood for only



Source: National Bank of Poland

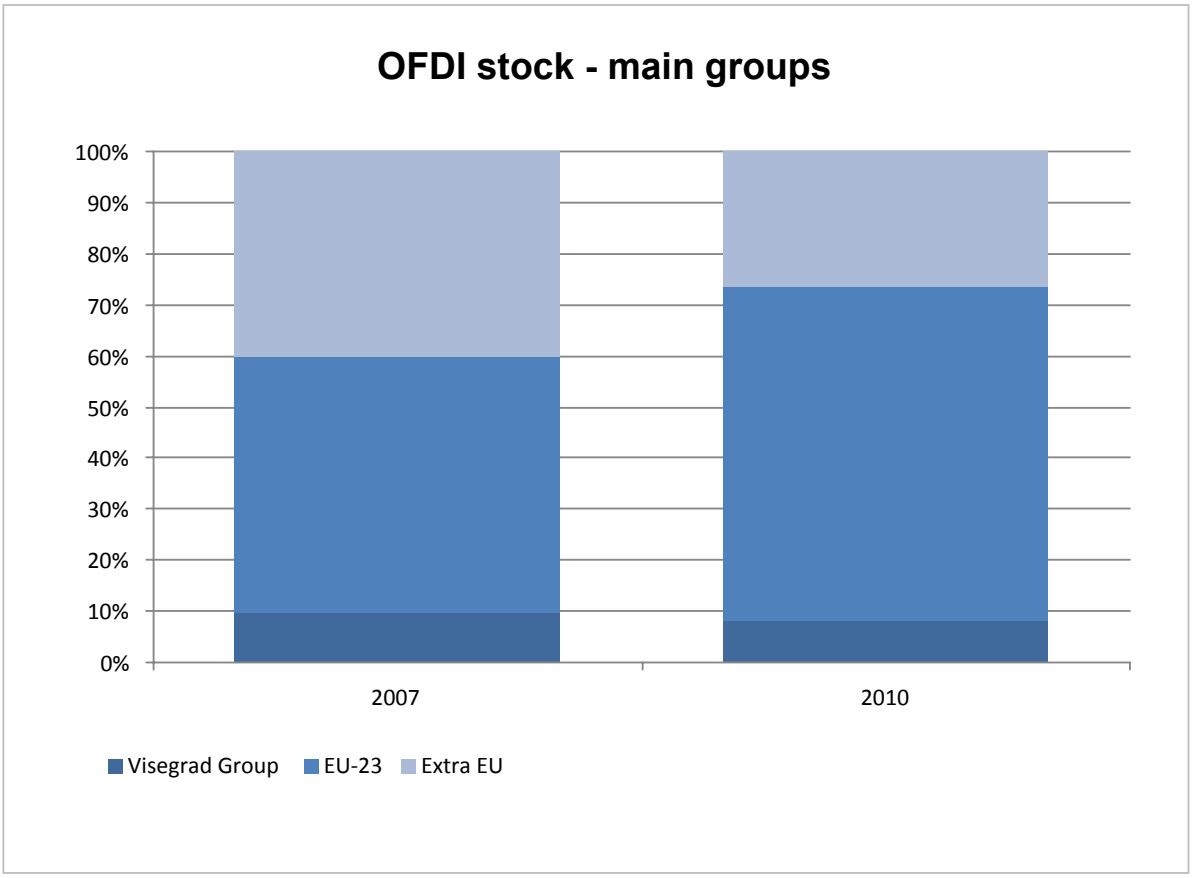
15.4 % of the total FDI stock in Poland in 2007, and constituted € 19.7 bn. In 2010, the total amount of invested money was increased up to € 20.9 bn, however, the share of capital coming from outside the EU dropped by 1.5 p.p., which to some extent proves the fact that the close links of Poland and the rest of the EU somehow intensify the capital flows and crowds out the capital from elsewhere. This would be weakened by the emerging problems of the eurozone countries in 2011. A negligible share of investments comes from the Visegrad countries – it is less than 1% in total foreign capital located in Poland.



Source: National Bank of Poland

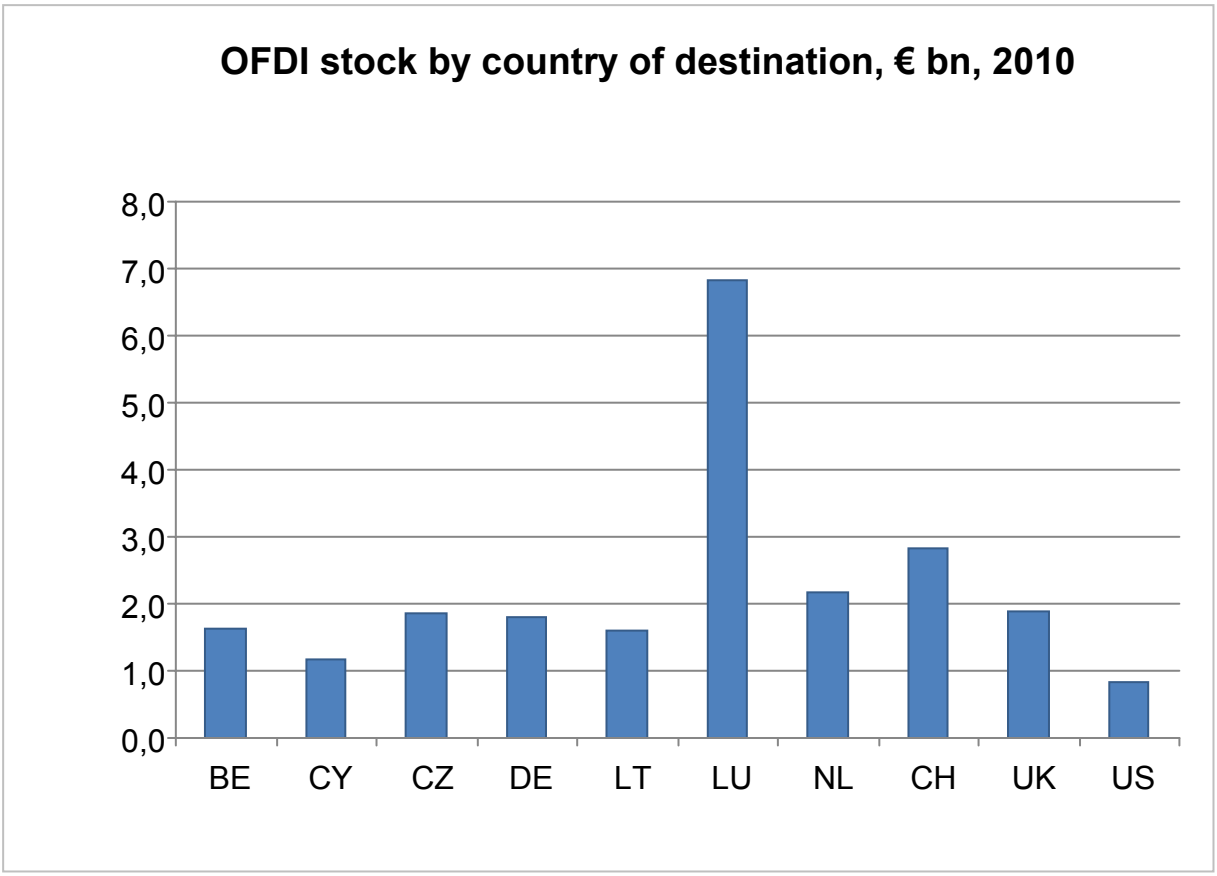
The biggest capital provider to Poland is Netherlands which directed there cumulatively about € 26.8 bn up to 2010. A significant part of this stock was generated since Poland's accession to the EU. The next biggest investing countries are Germany, which spent € 20.3 bn, and France, which invested in Poland for a total sum of € 18.6 bn. In the case of the first country, one may see stagnation in investing since the beginning of the economic crisis. Contrary to Germany, French investors withdrew € 0.8 bn of capital in 2008, but in the next two years the growth rate of their FDI stock was bigger than € 2 bn. The next biggest contributor to the investments in Poland is Luxembourg (with a stock of € 13.1 bn), which has more than doubled since the EU enlargement. However, this country is rather small and often perceived as a transmitter of capital with unknown origin, hence it is difficult to assess, how much of these investments comes truly from Luxembourg – even a significant share of money might simply come from Poland. On the 5th position of the list of top investors in Poland is Italy with a total accumulated capital of € 10.5 bn; this country has more than doubled its investments since 2006. The biggest net contributor of capital from outside the EU is the United States, which generated € 9.3 bn of FDI in Poland up to 2010, and thus, it is the 6th biggest FDI provider in Poland. The rise of capital located in Poland by US economic agents since 2006 was also strong, but not as strong as the rise of the activity of European

countries. The next supplier of capital is Switzerland. The amount of capital has doubled since the Poland's EU accession and reached in 2010 € 5.8 bn.



Source: National Bank of Poland

The EU's enlargement in 2004 facilitates capital flows across Europe. It is also visible in the structure of the Polish outward FDI stock. The share of Polish investment spending in the EU has been increasing since the EU enlargement in 2004. In 2007, 60 % of total Polish OFDI are located in the EU (with 9.7 % of total OFDI stock spent in the Visegrad countries) and totally amounted to € 8.7 bn. In 2010 this share has risen up to 73.4 % (including the Visegrad countries) and the absolute amount was € 21.4 bn. Hence, the relevance of countries outside the EU as Polish OFDI destination is constantly decreasing. In 2010 a moderate decline in the share of the Visegrad countries was observed, however, the nominal figures show an increase by € 1 bn up to € 2.4 bn in 2010 compared to 2007. More important is the fact that Polish investments in these countries outpaced the capital originated from these countries and located in Poland. This is to some extent natural, because Poland is significantly bigger than the other Visegrad countries, however, this result also means that Polish economic agents perceive these countries as attractive destinations to allocate their capital.



Source: National Bank of Poland

Polish economic agents located their capital mainly in Luxembourg (about 23 % of Polish OFDI, or € 6.8 bn). Polish economic agents favoured this destination due to the competitive conditions of locating the means there. The means gathered there are also often used further to make business elsewhere. To some extent the same is the case with Switzerland, the 2nd biggest destination country, where total investments amounted to € 2.8 bn up to 2010. The 3rd favourite destination of Polish OFDI is the Netherlands, where € 2.1 bn was accumulated up to 2010. Almost the same amount of capital (€ 1.9 bn in 2010) was located in the United Kingdom and in the Czech Republic. Comparing the size of these two countries, it may be visible that Polish economic agents perceive the Czech Republic as a relatively attractive destination to their capital.

Recent developments and outlook

2011 is a year during which a moderate recovery is seen in terms of capital flows. Total FDI inflows in 2011 rose to € 10.3 bn. In contrast to this, the intensity of FDI modestly decreased (to € 3.7 bn).

The (inward) FDI stock shrunk in 2011 to € 147.7 bn, which could be an effect of capital depreciation. However, the outward FDI stock increased up to € 34.3 bn. This is a sign of recovery of businesses, which became able to mobilise means to invest abroad.

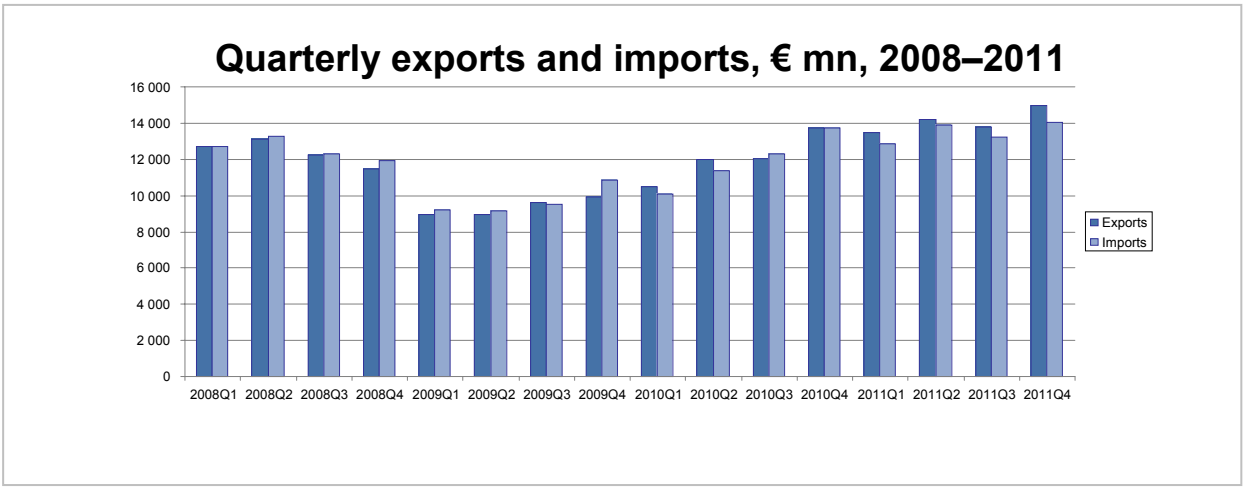
The year 2012 can be ambiguous in terms of capital flows, but much more probable is the weakening of inflows intensity, because of increasing costs of doing business. Additionally, the aggravating problems within the eurozone (which highly contributes to overall FDI inflows) would affect negatively the location of capital in Poland. However, possible increases in the reference rate may attract some additional capital, nevertheless, mainly of short-term interest. Also, higher running business costs may encourage increased outflows of capital at the cost of decreasing domestic assets. It is probable that a significant part of these outward investments would target the other Visegrad countries.

SLOVAKIA

In the last decade, Slovakia experienced a rapid economic development accompanied by a high inflow of foreign direct investments (FDI) and changes in the structure and volume of foreign trade. The economic reforms, which had been introduced since 1998 opened the country for potential investors and with the objective to join the EU, the Slovak government gradually implemented various structural reforms, which together with the inflow of FDI and other factors, contributed to impressive GDP growth rates in the last decade. In the last years, prior to the financial and economic crisis, the economic development of Slovakia was characterised by above European average growth of GDP as well as GDP per capita at purchasing power standard, productivity and employment and declining unemployment rates. During this period the country also experienced significant convergence towards the EU average. The financial and economic crisis influenced the Slovak economy with some delay especially at the end of 2008 and at the beginning of 2009. However, already in 2010 and 2011 the country experienced renewed economic growth driven mainly by the external demand. Therefore the aim of this chapter is to provide a concentrated look at the development of changes in the structure and volume of trade and foreign direct investments in Slovakia.

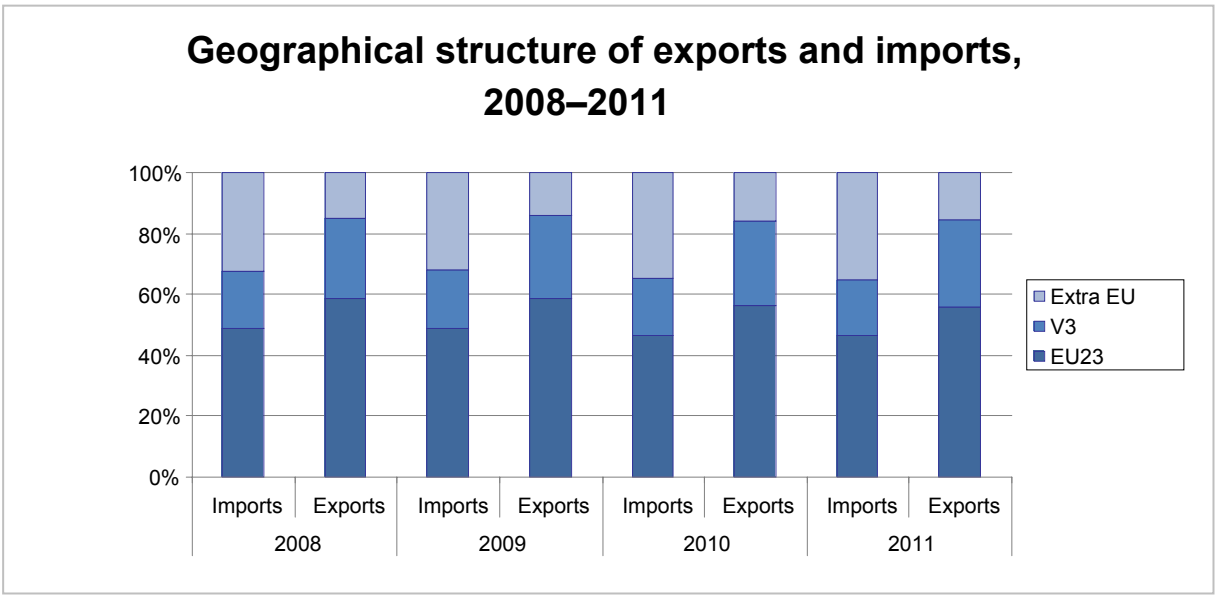
Exports and imports

Slovakia is a landlocked, small and open economy and highly interconnected with the rest of European countries. Trade is one of the most important contributors to economic growth and the export oriented industries are employing a large number of domestic labour force. Due to the impact of the financial and economic crisis, the total exports and imports of goods started to decline in the last two quarters of 2008. The decline was even more visible in the first quarter of 2009. The volume of exports in 2009 amounted to € 39.7 bn which means a year-on-year decline of 19.8 %. The decline of exports was accompanied by a similar decline of imports. In 2009, the volume of imports reached € 38.8 bn, meaning a year-on-year decline of 22.9 %. Since the second quarter of 2009, foreign trade started to grow and already in the second quarter of 2011 reached the pre-crisis levels. Moreover, since the first quarter of 2010 the foreign trade balance went into surplus (except the third quarter of 2010), which was not usual in the pre-crisis period. This indicates that the crisis contributed (together with other factors as increase in productivity) to structural change in the Slovak economy towards products with higher added value. At the end of 2011 the foreign trade surplus reached € 931 mn.

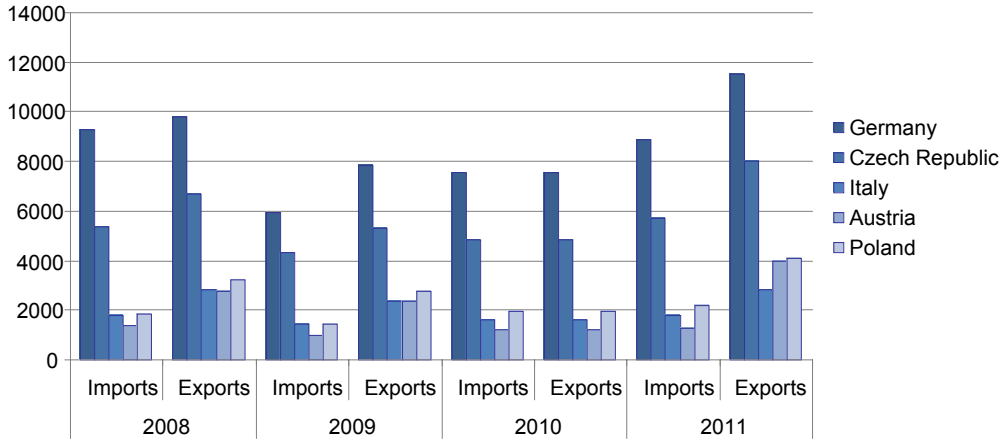


Source: Statistics Office of Slovakia

In 2009, exports of goods declined by € 9.8 bn, imports of goods declined even more, by € 11.5 bn. Despite the decline of foreign trade, the share of the analysed trading partners (V3 countries, EU23 and extra EU) remained relatively stable. The average share of EU23 countries on total exports was 57.4 %, the share of V3 countries 27.5 %, and the share of extra EU trading partners 15.1 %. The average share of EU23 countries on total imports was 47.5 %, the share of V3 countries was 19 %, and the share of extra EU trading partners was 33.5 %. In the observed period, the trade balance of Slovakia has been positive with EU23 countries as well as with the V3 countries. The trade balance with extra EU trading partners remained traditionally negative, mainly due to the dependence of Slovakia on high imports of mineral fuels.

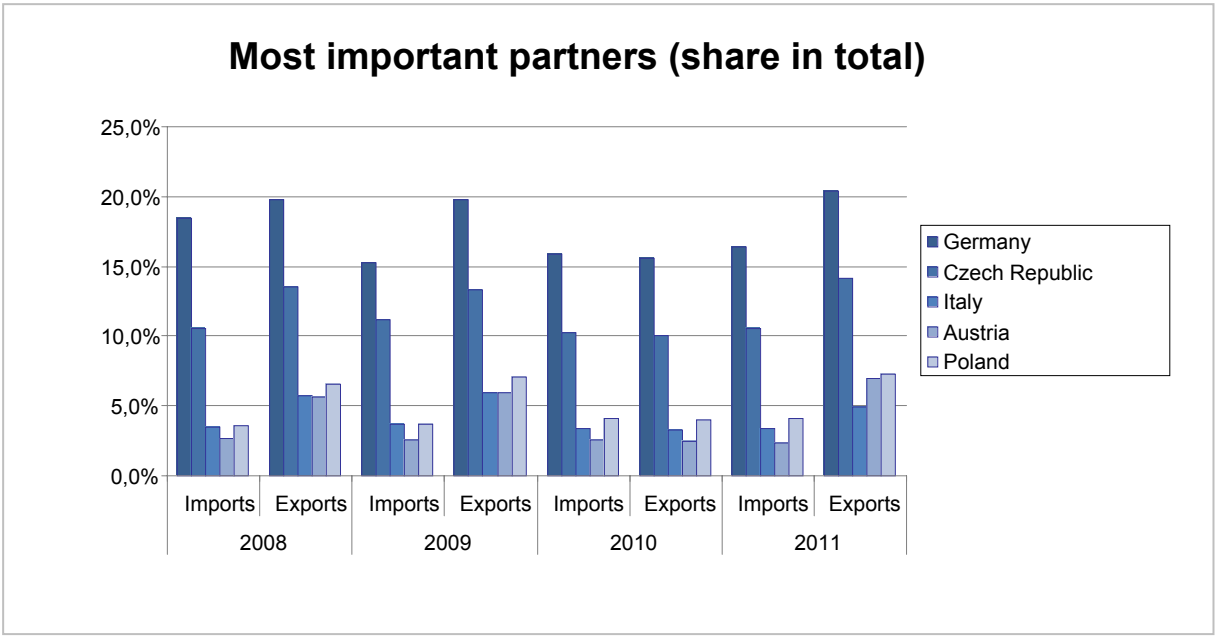


Source: Statistics Office of Slovakia, own calculations



Source: Statistics Office of Slovakia

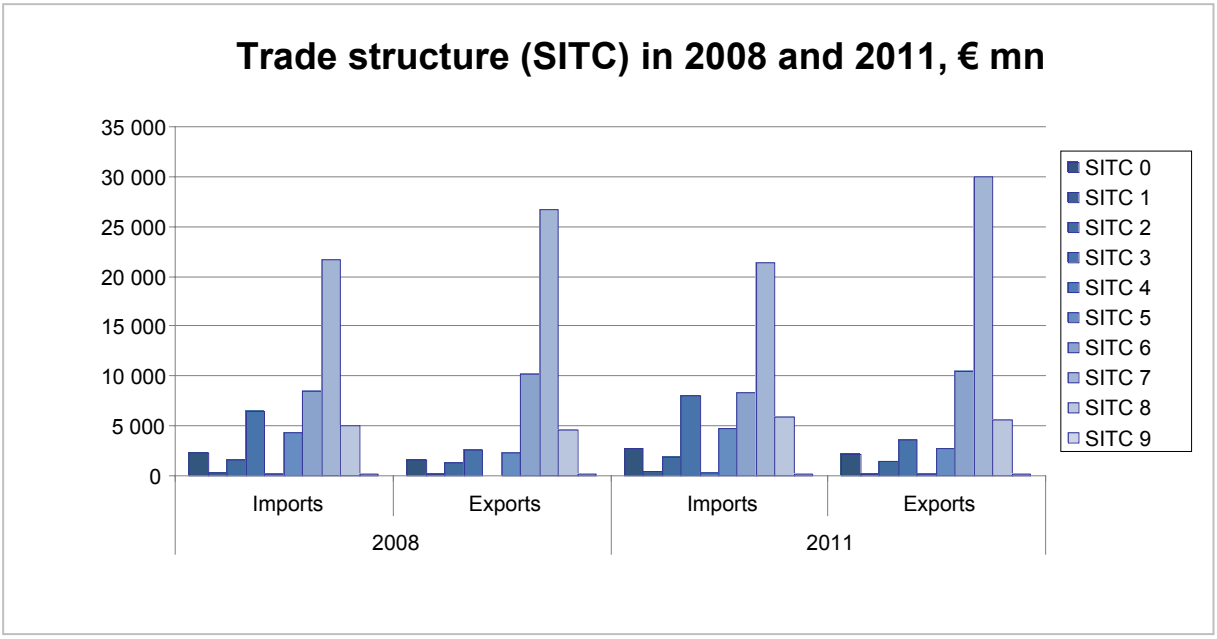
Foreign trade is highly interconnected with the EU countries. In 2010, the share of exports to the five most important trading partners amounted to 53.8 % and the share of imports from the five most important trading partners amounted to 36.7 %. The most important trading partner is Germany with 20.4 % share in total exports and 16.4 % share in total imports. The second most important trading partner is the Czech Republic with 14.2 % share in total exports and 10.6 % in total imports. The third most important trading partner is Poland with 7.3 % share in total exports and 4.1 % of total imports followed by Austria with 7.0 % share in total exports and 2.3 % of total imports. Italy is the fifth most important trading partner with 5.0 % share in total exports and 3.4 % in total imports.



Source: Statistics Office of Slovakia, own calculations

From 2008 to 2011 the share of exports on total exports of all five most important trading partners grew by 2.6 percentage points (p.p.) except Italy (decrease by 0.8 p.p.). The highest increase in the share of exports on total exports was with Austria by 1.4 p.p. followed by Poland with 0.8 p.p. and Germany and the Czech Republic with 0.6 p.p.. In 2011, the volume of exported goods of the five most important trading partners amounted to € 30.4 bn and recorded an increase by approximately € 5 bn since 2008.

From 2008 to 2011 the share of imports in the total imports of the five most important trading partners decreased by 2.1 p.p. except Poland (increase by 0.4 p.p.). The most significant decline in imports share in total imports was that of Germany by 2 p.p. and Austria by 0.4 p.p.. In the case of the Czech Republic the share of imports remained at the 2008 level. In 2011, the volume of imported goods of the five most important partners amounted to € 19.8 bn, and recorded only a minor increase by € 282 mn since 2008.



Source: Statistics Office of Slovakia. Note: 0 -Food & live animals, 1- Beverages & tobacco, 2- Crude materials, 3 - Mineral fuels, 4- Oils & fats, 5 – Chemicals, 6- Manufactured goods classified by material, 7 - Machinery and transport equipment, 8 - Miscellaneous manufactured articles, 9- Others.

A more comprehensive look (according to SITC classification) shows that during the last four years, the structure of exports remained relatively stable with only minor changes in trade categories. The highest share in total exports is recorded in the category Machinery and transport equipment (mainly road vehicles)[10]. In 2011, the share of exports in this category in total exports amounted to 53 % followed by manufactured goods classified by material (mainly iron and steel production) with 18.6 % share in total exports.

From 2008 to 2011, the share of imports has fallen especially in machinery and transport equipment (3.4 p.p.), which leads to the conclusion that this sector is gradually shifting towards the production of products with higher added value. On the other hand, the share of mineral fuel imports on total imports grew by 2.1 p.p., which can be explained by the increased domestic consumption and growing prices for these commodities.

[10] This broad category is divided into the following subcategories: Power-generating machinery and equipment, Machinery specialized for particular industries, Metalworking machinery, General industrial machinery and equipment, and machine parts, Office machines and automatic data-processing machines, Telecommunications and sound-recording and reproducing apparatus and equipment, Electrical machinery, apparatus and appliances, and electrical parts, Road vehicles (including air-cushion vehicles) and Other transport equipment.

Outlook

The preliminary data for the first two months of 2012 show that the domestic export oriented industries are in a good shape and are able to sell their production on international markets. In February 2012, total exports of goods amounted to € 4.7 bn, which represent an 8.7 % year-on-year increase. Total imports of goods increased by 5 % and amounted to € 4.4 bn. The foreign trade balance was in a surplus of € 347.7 mn (by € 170.2 mn higher than in February 2011), which indicates that the export oriented industries are further increasing production. In January and February, compared with the corresponding period of last year, total exports of goods increased by 8.5 % to € 9.2 bn and total imports of goods went up by 6.5 % to € 8.5 bn. The foreign trade balance was in a surplus of € 611.6 mn (by € 194.5 mn higher than in the corresponding period in 2011). This positive development is, however, dependent on the economic development of major trading partners, but the expectations for the present year are mostly positive.

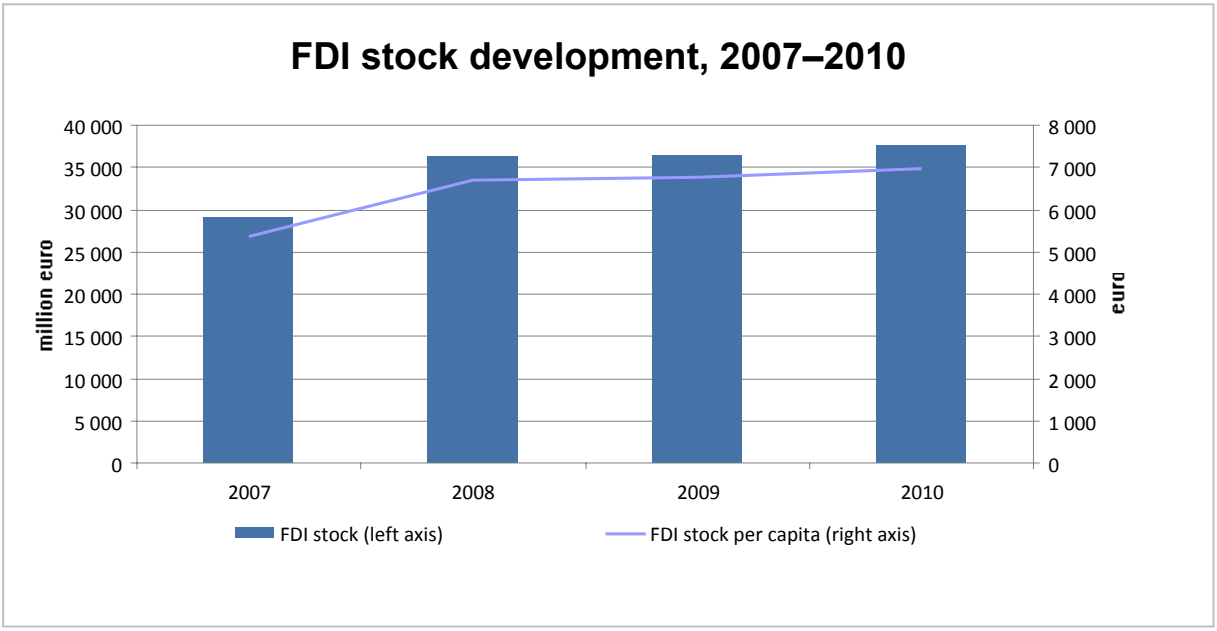
FDI and OFDI

FDI

The impact of the financial and economic crisis contributed to lower the annual increase of FDI stock in Slovakia in recent years. This was especially visible in 2009, when the annual increase of FDI stock reached only € 243 mn. In 2008 the annual increase reached € 7.2 bn. However, the development of FDI stock shows that already in 2010 the FDI stock grew by € 1.2 billion and preliminary data for 2011 show similar numbers. Although the inflow of FDI in the Slovak economy has lost momentum in the last years, we can expect an increase of FDI inflow especially in the automotive industry (especially the announced investment of Volkswagen AG, and the start of production of small city cars as well as other new models in other car factories). The country is facing strong competition in this field of FDI attraction and needs to create more attractive conditions for further FDI inflow. From a regional perspective it is also important to adopt measures which motivate the potential investors to allocate the FDI to the central and eastern regions of the country.

Foreign direct investment has been playing an important role in the restructuring of the Slovak economy. During the last decade, the inflow of FDI was influenced by large-scale privatisation of state-owned companies as well as green-field and brown-field investments in various sectors of the Slovak economy. Since 1998 Slovakia experienced a constant increase of FDI stock, where in 1998 the stock of FDI amounted only to € 2.6 bn, at the end

of 2010 the FDI stock amounted to € 37.6 bn. In the last four years, FDI per capita grew by € 1589 and the FDI stock went up by € 8.6 billion[11].



Source: National Bank of Slovakia

From a sectoral perspective (according to broad NACE rev. 2 classification), the highest share of FDI stock was recorded in manufacturing (35.4 %), financial and insurance activities (21.8 %) and water supply, sewage, waste management and remediation activities (15 %). In absolute terms the volume of FDI stock amounted to € 13.33 bn in manufacturing, € 8.2 bn in financial and insurance activities and € 5.6 bn in water supply, sewage, waste management and remediation activities.

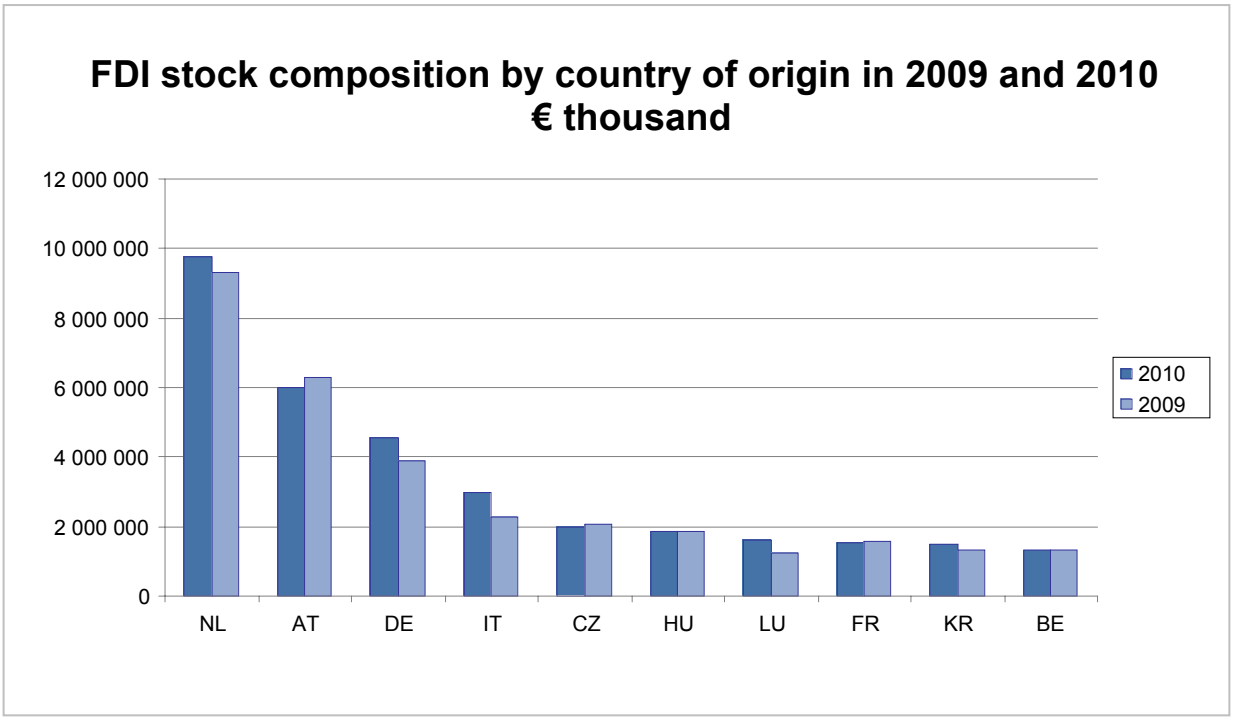
A more detailed look at the individual sectors shows that the highest stock of FDI is allocated to financial service activities, except insurance and pension funding with 14.5 % share on total FDI stock due to high share of foreign capital in the domestic banking sector, which was restructured and privatised during the last decade. The second highest stock of FDI is allocated in electricity, gas, steam and air conditioning supply with 14.3 % share and is again a result of privatisation of state-owned network industries. The third highest stock of FDI is allocated to manufacturing of motor vehicles, trailers and semitrailers with 8.64 % share of total FDI Stock, especially the investments in the automotive industry, which creates together with other manufacturing industries the backbone of the Slovak economy. The fourth largest stock of FDI is allocated in the telecommunications sector with 6.73 % followed by manufacture of basic materials with 4.11 % and manufacture of coke and refined petroleum

[11] In 2011, the population of Slovakia amounted to 5 397 036

products with 4.07 %. The share of insurance, reinsurance and pension funding (except compulsory social security) reached at the end of 2010 3.96 %, retail trade (except motor vehicles and motorcycles) reached 3.91 % and wholesale (except motor vehicles and motorcycles) reached 3.65 %. The tenth largest stock of FDI is allocated in manufacture of computer, electronic and optical products with 2.89 % on total FDI Stock.

From a regional perspective (NUTS III level) the highest share of FDI on total FDI stock in Slovakia is located in Bratislava region with a share of 68.3 %, followed by Trnava region with 7.5 % and Košice region with 6.2 %. The lowest share of FDI Stock is located in Prešov region with minor 1.3 % and Banská Bystrica region with only 2.4 %.

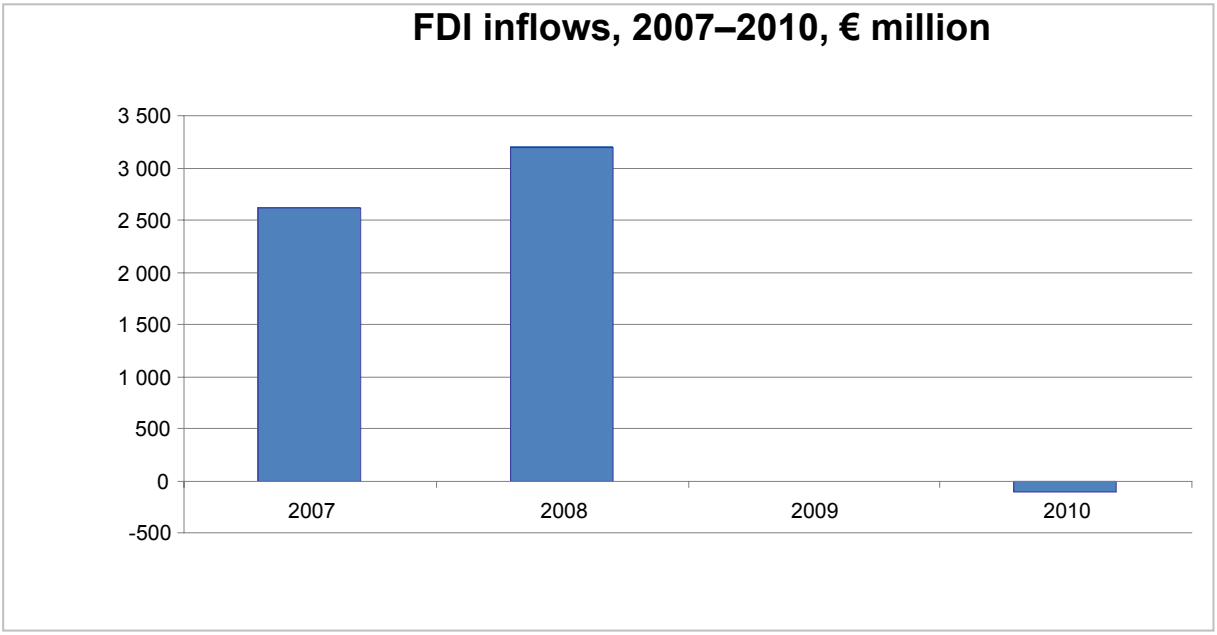
The FDI stock composition by country of origin shows that the largest volume – approximately a quarter of all investments – originated from the Netherlands, followed by Austria with 16 %, Germany with 12.1 % and Italy 7.9 %. Most of the "top 10" countries contributed to the annual increase of FDI stock, except Austria, Czech Republic and France. In 2009, the share of the "top 10" countries on total FDI stock in Slovakia reached 85.6 % and in 2010 increased by 2.4 percentage points to 88 %.



Source: National Bank of Slovakia

Since 2008 Slovakia experienced a negative inflow of FDI, due to the impact of the financial and economic crisis. The highest inflow of FDI in 2010 came from the Netherlands (€ 111.2 mn), Cyprus (€ 85.5 mn), Germany (€ 66.5 mn), Austria (€ 49.5 mn), the United Kingdom (€

15.8 mn), Italy (€ 14.1 mn), France (€ 9.6 mn), Belgium (€ 7.4 mn), Lichtenstein (€ 2.1 mn) and Luxembourg (€ 0.37 mn).

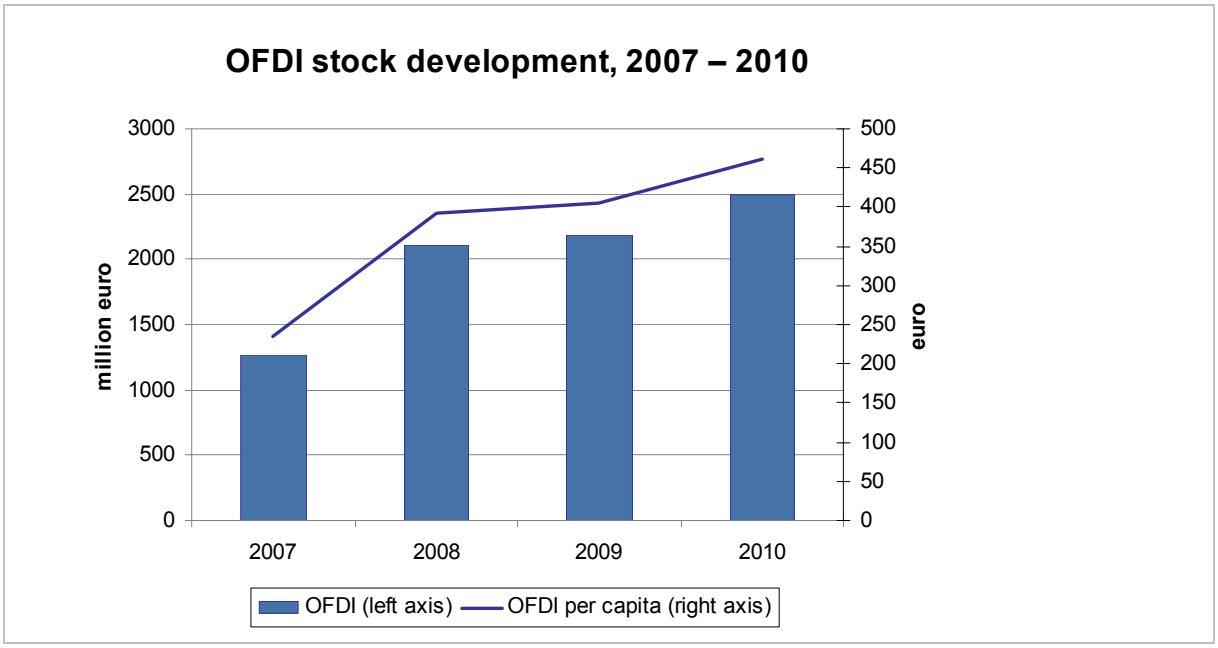


Source: National Bank of Slovakia

There has been also a significant shift of the countries which contributed to FDI inflow in the last two years. In 2009 countries like Thailand, South Korea, Brazil, Argentina, the United States, Finland, Malta and Spain were among the top ten most important countries investing in the Slovak economy. In 2010, all countries, which contributed to FDI inflow, were EU countries.

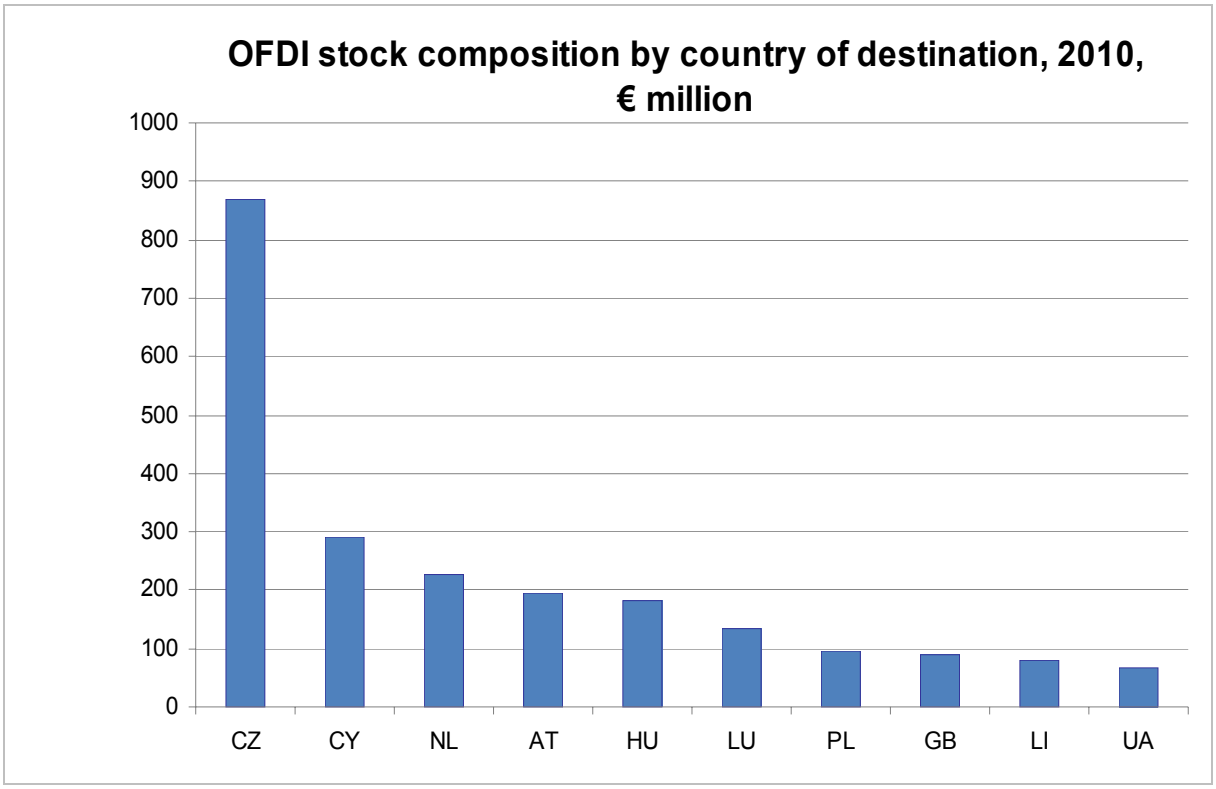
OFDI

The development of outward foreign direct investments (Slovak enterprises investing abroad) has been gradually growing in the last four years. However, the impact of the financial and economic crisis is clearly visible. The annual increase of OFDI slowed down significantly in 2009 and slightly recovered in 2010. In 2008, the annual growth of OFDI recorded an impressive 66.6 % year-on-year growth. However, in the next year the growth rate slowed down to 3.5 %; in 2009, it was 14 %. This indicates that, especially after 2008, domestic enterprises have been influenced by the financial and economic crisis and reconsidered their investment plans abroad.



Source: National Bank of Slovakia

The largest share of OFDI of Slovak enterprises is located in the Czech Republic, followed by Cyprus, Austria and Netherlands. The total share of the "top 10" OFDI destination countries on total OFDI reached in 2009 93 % and slightly decreased in 2010 to 89.3 %. The share of OFDI reached 34,8 % in the Czech Republic, 11.6 % in Cyprus, 9.1 % in the Netherlands, 7.9 % in Austria, 7.2 % in Hungary, 5.4 % in Luxembourg, 3.8 % in Poland, 3.6 % in the United Kingdom, 3.2 % in Liechtenstein and 2.7 % in Ukraine. In 2010 relative to 2009, the most significant decrease of OFDI stock by € 49 mn was recorded in the Czech Republic and by € 8 million in Cyprus. However, this negative development was offset by the increase of OFDI Stock in the rest of the "top 10" countries.



Source: National Bank of Slovakia

From a sectoral perspective (according to broad NACE rev. 2 classification), the highest share of OFDI stock was recorded in professional, scientific and technical activities (31.3 %), financial and insurance activities (20.9 %) electricity, gas, steam and air conditioning supply (15.6 %), wholesale and retail trade, repair of motor vehicles and motorcycles (8.4 %), real estate activities (7.1 %) and manufacturing (5.5 %). In absolute terms, the volume of FDI stock amounted to € 781.7 mn in professional, scientific and technical activities, € 521.5 mn in financial an insurance activities, € 364.2 mn in electricity, gas, steam and air conditioning supply, € 210.6 mn in wholesale and retail trade, repair of motor vehicles and motorcycles, € 177 mn in real estate activities and € 137.9 mn in manufacturing.

A more detailed look at the individual sectors shows that the highest stock of OFDI is allocated to activities of head offices, management consultancy activities with 22.5 % share in total OFDI. The second highest stock of OFDI is in electricity, gas, steam and air conditioning supply sector with 14.3 % share in the total OFDI stock. The third highest stock of OFDI is allocated financial service activities, except insurance and pension funding with 8.64 % share. The fourth largest stock of OFDI is allocated in the real estate activities sector with 7.1 %, followed by advertising and market research with 6.3 % and activities auxiliary to financial services and insurance activities with 5.9 %. The structure of OFDI suggests that the largest share of investments of domestic enterprises has been allocated to the service sector and only a minor share to traditional manufacturing sectors.