

TREND

monitor

Weekly Service on Slovak Economy in English



Focus: Value added thefts

Fighting evasion might do more than increase in VAT

Slovaks have been paying a 20-percent value added tax (VAT) since the beginning of January. The increase from 19 percent should help decrease the large local public finance deficit.

Yet, the Organization for Economic Cooperation and Development (OECD) has pointed out in its autumn analyses that more money could be raised by more effective collection of the tax. As much as one percent of gross domestic product in additional revenues could be gained if Slovakia achieved the average collection rate in the OECD. Only Greece has a lower VAT collection rate.

One of the reasons for poor tax collection is organized crime. Small limited liability companies of ordinary citizens with fictitious business are often used as a tax deduction vehicle, thus decreasing the taxable base as well as VAT revenues. Other ways of evading VAT include the so-called carousel scams and intra-EU imports, which are VAT-free until used in the destination country. A high-

ly-placed police officer who does not want to be named told TREND that the frauds could amount up to 20 percent of the overall VAT deduction. This might mean as much as one billion euros (1.5 percent of GDP). The financial police registered losses of only €150 million from the VAT scams for the first eleven months of 2010.

Measures directed against VAT fraud are being prepared. At the EU level, a green paper was published by the European Commission in December, introducing various options of simplifying the collection system and making it more effective. The authors propose transferring VAT payments to blocked accounts of the tax offices and creating data centers for tracking real-time VAT transactions. This will make it possible to detect whether later VAT deduction claims are justified. The change would however require all member states implementing it at the same time.

TREND page 26

Contents

*No Room
for Mistakes*



*Confusing
Emission Tax*



35 Hours



Macro Summary



*Bosch and
Siemens*



New Start



*Corporate
Investments*



*Time for
Alternatives*



Pension Misery



IN BRIEF

JANUARY 5. Irish developer Parker Green had started constructing the shopping mall Trnava Park in Trnava. Overall investment costs should reach around €100 million. After completion, the new shopping center could employ roughly 1500 people, excluding jobs created during construction.

JANUARY 6. Automotive firm Kia has already hired one hundred new workers for its new plant, assembling engines in Teplička nad Váhom. 170 additional employees will be sought out through the beginning of the year.

JANUARY 7. Private railway carrier RegioJet will start operating on the connection Bratislava-Komárno in

March 2012. The first private transporter in Slovakia will mean a decrease in necessary state funding by 16 percent on the respective railway section. In addition, the quality of offered transportation services should increase markedly.

JANUARY 10. Last year, almost 71,000 newly-sold personal vehicles were registered in Slovakia. Despite

the improving trend of car sales in the last quarter, the overall number is more than one-fifth lower compared to 2009, when car sales were subsidized by the state via the scrapping bonus.

JANUARY 11. The Ministry of Economy plans to decrease the subsidy for the purchases of solar collectors by households. According to the propos-

al, the state bonus should decrease from €200 per square meter to €100. In addition, the subsidy ceiling will most probably decrease to six square meters only.

- The private second pension pillar should become compulsory for young people entering the labor market. Young people will still have the option to leave the system within three years after their first employment.

NO ROOM FOR MISTAKES

Top manager Luboš Lopatka now leads the state social services provider Sociálna Poistovňa (SP).

» Politicians usually offer managerial positions only for a special relationship.

I have no special relationship to any politician. On the contrary, I am trying to have the standard relations with all of them. I am no member of any party and I have not sponsored any.

» Why did you move to the state sector?

The most important decisions in multinational corporations were made in Western European headquarters. What attracts me now is that I am the top person responsible for a large and complicated institution. Even with cross-societal importance.

» You declare to provide more independence to SP. How are you doing?

The current situation gives no room for more mistakes and I guess politicians understand that. So

far, they are letting me work on the restructuring of the institution.

» Sociálna Poistovňa invests large amounts of money in its IT systems.

Unfortunately some of the systems provided by various suppliers are not compatible with each other, often based on a non-standard platform, and that increases our workload. Our efforts aim at removing such tendencies so as not to be squeezed out of money by the suppliers.

» How would you make social contributions collecting more efficient?

Currently, we are reporting a total of €870 million in missing payments, of which €490 million comes from the period before 2004. These are difficult to collect. Yet we will engage execution services more intensively than in the past.

TREND page 10

CONFUSING EMISSION TAX

The new 80-percent tax on incomes from CO₂ emission sales is a reaction to the non-transparent distribution of the allowances. The former government gave surplus allowances to selected companies, thereby letting them make easy profits. The current Ministry of Finance's reaction may cause various problems however. The Emission Trade Amendment Act poses questions about the legal consistency of state principles. Manufacturing companies and lobbyists now have arguments for lawsuits against the state.

Arguments against the amendment were summed up by the Slovak subsidiary of the international law office White & Case. The lawyers warn that the new taxation may violate international agreements on the protection of investments. "Applying the tax may cause a negative impact on the investments' value and lead to the effort of the allowances' holders to appeal for their rights, mostly through international arbitrage," White & Case warns. The

Finance Ministry declares the risk of lawsuits can never be excluded.

According to White & Case, the high tax may demotivate polluters from launching ecological investments. On the contrary, they may prefer an emissions increase, as they will not pay any tax on the used allowances. Moreover, they may be obliged to pay a higher tax than their income is. The tax base is calculated from the average market price instead of the real price from specific transactions. Last year State Secretary of the Finance Ministry Vladimír Tvaroška declared the surplus in revenues will not be taxed if the company proves it lowered its emissions by investing in modern technologies. So far there is not enough accurate legislation saying that the technology-based emission savings sale will not be taxed. The Ministry declared a specification will be launched in a few months.

TREND page 14

35 Hours

Trade unions started to collect signatures necessary for announcing a referendum about cutting the working week to 35 hours, lowering the ceiling on overtime hours by a half, and conserving the Labor Code in its current version. The Confederation of the Trade Unions (KOZ) declared that its members are also preparing protests. The Ministry of Labor announced its effort to make the Labor Code more flexible but has not given out a specific proposal yet. KOZ President Miroslav Gazdík stated the change will reduce employees' protection in hiring and firing, lengthen the probation period to six months, dismissal to one month, abolish the concurrence of the firing period and compensation, minimum wage and other social benefits.

page 8

The End of Cash

The Ministry of Finance proposes a ban on large cash transfers over €3,000 as a part of its fight against VAT fraud. The OECD, in last year's report, pointed out that Slovakia only raises 72 percent of the expected amount of the VAT. 28 percent of the anticipated VAT incomes are lost, partly in tax frauds. The aim of banning the cash transfers over €3,000 is to prevent fictitious invoices. Those are significant in the so-called carousel VAT frauds. That means a network of related companies declaring virtual transactions with fictional billing that moves the fraudulent behavior out of the authorities' attention.

page 8

CONSTRUCTION STABILIZING

The construction sector seems to be stabilizing. Its November output increased by 0.7 percent compared to the same month in 2009. That is the second month of growth after 21 months of decline. Production in construction was aided by building infrastructure, when engineering projects added almost nine percent to their volumes from the year before. However, large construction companies are currently suffering from not launching the overpriced highway PPP projects. Construction continues only on the R1 speedway from Nitra to Zvolen and the R4 road from Košice to the Hungarian border. In 2011, some highway sections should start to be worked on again, yet probably only by the end of the year. Sales in the construction sector continue to perform below their 2009 level – even when adjusted for price differences. Many companies are still planning to dismiss workers.

Brief Statistical Overview

(Slovakia)

	2009		Current Period		Forecast
GDP	-4.7	3.7	(Q3 2010)	↓	3.3 (Q4 2010)
Consumer Inflation (%)	0.5	1.0	(Nov 2010)	↓	1.3 (Dec 2010)
Producer Prices (%)	-4.9	-1.0	(Nov 2010)	↓	-0.1 (Dec 2010)
Unemployment (%)	12.1	14.1	(Q3 2010)	↓	14.4 (Q4 2010)
Current Account (% HDP)	-3.2	-3.0	(Jan-Oct 2010)	↓	-3.1 (2010)

Notes: Unemployment according to Labor Force Survey. Forecasts based on prognoses of bank analysts and TREND Analyses.

SOURCES: Statistical Office, National Bank of Slovakia

BOSCH AND SIEMENS

Since 1993, electric motors have been manufactured in Michalovce through the joint venture of two German technology icons: Bosch und Siemens Hausgeräte (BSH). The BSH Drives and Pumps factory in Michalovce originally started as a part of the Siemens Automotive division. In 1998 it split into BSH manufacturing electric motors for washing machines and pumps for dishwashers. The division manufacturing cable bundles for the automotive sector was later sold to Yazaki Wiring Technologies.

From electric motors and machines manufactured in Eastern Slovakia, almost 80 percent are for the electric appliances of the BSH group, which is manufacturing washing machines, dishwashers and tumble dryers. The rest of the produced volumes were sold to GE Appliances.

The crisis did not affect production in Michalovce at all. Still more than 7.5 million units are manufactured there each year. The CEO of the BSH concern, Kurt-Ludwig Gutberlet, is convinced that the growing sales of their products are a result of en-

ergy-saving products, which are in demand by European customers. For example, in 2009, the demand for energy saving appliances tripled in Europe. The goal for 2010 was to increase revenues by 10 percent. BSH Drives and Pumps planned to manufacture 7.9 million units of product.

Nowadays there are several types of electric motors and four motors (pumps) manufactured in Michalovce. The crisis affected the workers headcount in the plant, though. In the past, around 900 workers were employed in the plant. In 2009 around 120 were laid off, even though production volumes grew. The reason was that new products were being manufactured on a new production line with more automation and less manual work needed.

The investments of BSH in Slovakia are unknown, but they represent the majority of the Siemens group's investments in Slovakia, which reached over €10 million last year.

TREND page 34

NEW START

The same personnel, the same merchant. Just a slight change in the façade and a new logo. The brand Bala was renamed to Fresh. The reason is that one of Bala's founders, Miroslav Labaš, has started his own grocery chain. After a dispute with other partners in spring last year, Labaš decided to move his wholesale and small shops to a new brand. Bala was formed by Slovpos, a joint venture of several Slovak wholesalers in 1998, as competition to large shopping chains such as Tesco, Carrefour and Lidl. These wholesalers were saving their marketing costs by using one brand, selling their own Bala brand groceries and having a better negotiation position while dealing with food producers. Bala later became one of the most known grocery chains in Slovakia, with small stores scattered around the whole territory. In its peak in 2006, Bala was represented by 730 stores. Now Fresh is having the same challenge as Bala at the start -

to get as many stores to join the chain as possible. The Fresh brand was first applied to Labaš's stores in the eastern part of Slovakia. Soon other wholesalers with their own grocery shops followed: the Bardejov-based Makos and the Žilina-based Libex. Makos was formerly also a part of Bala. Now around 530 small shops are part of the Fresh brand. On the contrary, Bala remains present in 300 shops.

Labaš at first just imported groceries; later he started to buy small shops which were going bankrupt. Nowadays he owns 14 shops as part of the Fresh group. From his Fresh wholesaler, one half of merchandise is delivered to the Fresh retail chain, the rest going to small shops that do not belong to any chain. Labaš is convinced that joining such an alliance as Fresh is the only way for small shops to survive and be competitive.

TREND page 36

WATER TO HASS

Bratislava's water supply partly privatized

Bratislava water supply company BVS is selling part of its subsidiary Infra Services (IS). A 49-percent share is being bought by construction company Hass, which was in the past building water pipes and drainage for BVS. The firm offered €7 million, by which the basic capital stock of IS will be increased in the following weeks. The deal was done only a few days before new mayor of Bratislava Milan Ftáčnik entered office and forbade selling any part of BVS. However, the initiated process could not have been stopped. IS has an exclusive contract with BVS for for the next 11 years.

IS, as well as BVS, were fully municipal-owned companies. The private company entering the water business is one of the most important deals in the industry, since international water companies as well as local private equity groups are interested in entering the business of one of the richest water sources in Europe (Žitný Ostrov). Hass is also not alone in the deal. In recent days, the unknown company Ominvest entered Hass and its basic capital was increased by €1.2 million. Two people close to the transaction confirmed that the deal was done by Penta investment group. Penta claims it is just financing Hass via its Privatbanka. **page 30**

CORPORATE INVESTMENTS

PRINT WORKS OUT OF TOWN. Neografia from Martin is the largest local print works. Now it is planning to put up a new plant in the industrial park of Martin, which is on the outskirts of the town. The project that will get the print works out of the residential zone of

Martin will cost €13 million. All the technology and administration will be moved except for the old rotary press, which will be kept on the old premises and finish its life cycle there. Construction of the new plant will begin in June and will be in operation in 2013. Neografia now employs 750 people. In the new factory, there will be space for 900 workers.

NEW POWER PLANT. Near Plášťovce, a new accumulation power plant will be built by the company Pow-en. With a capacity of 57 MW, the plant will cost €150 million. It will be financed by Pow-en, which is ready to also accept a strategic partner for the entire project. The construction of the power plant using water from the Litava River will begin in 2013 and be in operation by 2017.

NEW MIXING PLANT. The Slovak construction company Zlatner plans to put up a new mixing plant in the town of Levice. The new mixing plant costing €0.5 million will replace an old one in the same city. The new mixing plant will be built next month in the industrial park on the land owned by the Agrostav Group Levice, from which it will be rented by Zlatner.

KRAKOVANY PREMISES. The Slovak company active in basin technologies, aqua and spa projects, Minaral-Aquaservis, plans to put up its new premises with warehouse, store and administration spaces in Krakovany near Piešťany. New premises will start to be built in the second half of this year and ought to be finished next year. The whole project will cost around €1 million.

TIME FOR ALTERNATIVES

Marián Matušovič is the CEO of VÚB Asset Management, local second largest mutual fund.

» What will influence investors this year?

I don't expect Slovaks to change dramatically this year, as they behave very conservatively. That also means that popular products – long-term deposits and foreign exchange funds – will not make them any money, as they probably won't outdo the expected inflation. Such investors should look at alternatives like guaranteed or mixed funds.

» All of predictions rave about equities...

Yes, investment banks expect great things from equities and commodities. These assets have been growing for longer time now. Anytime markets grow the investor should be wary of recommendations to buy. If the crisis taught us something, it is the fact that such recommendations do not always have to come true.

» Is it a mistake that many people stick to money market funds?

Having money in the money market funds is not bad as such. It's a mistake to stay there for five years though. Especially if during that time there are alternatives that could provide much higher returns. It's still better to have savings in a money fund than not to save at all.

» So why invest there at all when banks offer interests on deposits of 2.5 percent?

This is a bit like mixing apples and oranges however. You are comparing the returns at significantly different levels of risk. If we would be choosing the correct comparisons, those would be yearly deposits, which are currently at 1.2 percent per annum. The money market funds will perform comparably in 2011.

TREND page 44

PENSION MISERY

The two private pillars both underwent a similar change in their policies in 2009. The results of the implementations have varied widely though, mainly due to specific differences between the two laws. In both pillars the legislation changed the fee structure to offer less revenue from fees on assets and introduced fees from returns. In theory, the higher the returns achieved, the more the pension manager could retain. In reality the second pillar has been struck dead by the requirement to provide constant growth, otherwise the manager has to pay for the losses. This approach skewed investing heavily towards conservative instruments, leading to an equalization of all types of funds. Therefore in 2010 the average returns of all types of funds were virtually the same and ranged from 1.17% p.a. to 1.21% p.a. In the third pillar there were similar returns only in the largest funds that historically invest more conservatively. The new equity funds have grown

over 5 % p.a., making up for the losses incurred during the crisis. In those times, the drop in equity funds has been in the double digits.

The changes that are currently in the works for the second pillar could swerve it towards more intense investing again. The fees should be differentiated by the types of funds, adding a new super-equity fund that will aim for high returns in exchange for higher risk. The young should be joining the second pillar automatically again. They will have a chance to opt out though. In the third pillar there are no changes imminent, but the change in tax laws could affect their activities. Clients no longer have the possibility to subtract their third pillar payments from taxes, which could withdraw the main advantage from a fifth of the clients. For the others the main motivation to save is the co-payment of the employer, effectively raising the nominal wage.

TREND page 46

Fine for Capital Partners

The Czech central bank has decided on a penalty for the Capital Partners company in the total sum of CZK 20 million (€800,000). The reason was a breach of trust from the securities trader in the years 2007-2009. At the end of 2010, the company ceased to be a member of the Prague Stock Exchange. According to the central bank the company used a technique called churning to generate fees for itself while not keeping the best interests of clients in mind. The company was also involved in trades that were counter to the clients' risk profiles.

page 43

Short-Term Deposits Will Lose

There will be no real returns on short-term bank deposits in Slovakia this year. Although banks have increased the interest rates, the predicted inflation should be at 3.3 percent – higher than the offered interests. The closest one is J&T Banka, which offers 3.1 percent. The caveat is that it demands a deposit of at least €10,000. ČSOB offers three percent for a one-year deposit, but only if the client also invests in its mutual funds. Poštová Banka offers 2.7 percent for a one year deposit of at least €500, the same as Dexia offers until February 2011. Other banks offer lower interest rates on demand deposits.

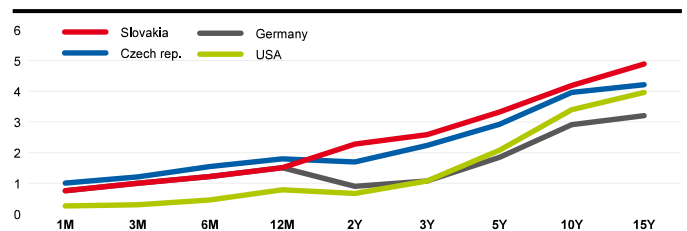
page 50

MORE FEES FOR THE DEPOSITORY

More people will be paying for the account at the central depository of securities in the year 2011. In 2010 it was demanding fees only from accounts holding stocks worth €6,639 or more. Now the limit has dropped to a mere €35. The fee is set at 0.045 percent of total assets, with the minimum of €8 and a maximum of €165. These fees were a tad higher last year. The new fees should motivate clients to be more active: those making at least one operation a year or simply demanding an account statement, will get a rebate of €1.25 to 2.50. The more active ones can get a 20% reduction. The new policy will now also affect those who have worthless shares from voucher privatization. They can still transfer those to the National Property Fund, which will pay fees for them.

Yield Curves

(central banks' reference rates and government bond yields as of January 7, 2011, in % p.a.)



SOURCE: Bloomberg

TREND