Doris Hanzl-Weiss

Slovakia:
Growth slowing down

Export-led growth in Slovakia continued in the first quarter of 2013, although it was considerably slower than the previous year when automotive production and exports surged. Owing to this base effect, GDP growth slowed down to a mere 0.6%. GDP should grow moderately throughout the current year depending, however, on external demand in the euro area and the resolution of the latter's debt crisis.

Slovakia experienced a positive growth performance with 2% GDP growth in 2012. This was largely due to an increase in automotive production and exports. However, GDP growth significantly slowed down in the first quarter of 2013 and only reached 0.6%. This was still better as compared to most countries of the European Union. As in 2012, this year's growth has so far come solely from net exports, with goods and services exports rising by 4% and imports by 1.6%. However, goods exports to the main trading partners Germany and the Czech Republic fell (for the first time) when compared to the same quarter of the previous year. This was due to low growth in Germany and the homemade crisis in the Czech Republic. All domestic demand components were flat or slightly declining: domestic consumption declined by 1% (retail trade fell by 1.3% in the first quarter of 2013) because of persistently high unemployment, low consumer confidence and falling wages. Growth of inflation slowed down and is now at 2.2%, about half the average value for 2012. Government consumption declined as well due to fiscal consolidation. The downward trend in gross fixed capital formation and capital formation continued, decreasing by nearly 15% and 8.4% respectively.

As regards the branch structure of GDP growth, industrial production grew at the beginning of 2013, although less than expected. Changing the base year from 2005 to 2010 contributed to a statistical downward revision, i.e. the exceptional industrial growth of 2012 of 10.3% changed to 8.1%. Thus in the first quarter of 2013, industrial production increased by merely 0.3% partly due to this statistical revision, partly due to the base effect. The important transport equipment industry still recorded growth of 5.6%, electrical equipment of 10.5% and textiles even of 12.4%. The basic metals and fabricated metal products industry also grew by 3.3%. Construction still suffered and continued its strong downward trend, falling by 12%. Recently, the main construction company Doprastav has come under trouble. Value added of the service sector contributed positively and increased in the first quarter.

The labour market remains in poor shape: employment stagnated in the first quarter of 2013 and unemployment increased to 14.5% (LFS data). Major problems are the high youth and long-term unemployment (the latter being amongst the highest in the EU – across all Slovak regions), as well as large regional disparities (huge unemployment in the East, in particular within the Roma community, while the main car companies and job opportunities are located in the West). The main employer in Eastern Slovakia is the US Steel plant in Košice with a workforce of 11,000 people. At the beginning of the year the investor allegedly considered leaving Slovakia, but on 26 March a memorandum was signed stating that US Steel will stay in Slovakia for another five years. The government agreed to provide concessions on energy costs and environmental protection (electricity prices for industrial customers are among the highest in the EU in Slovakia). Despite the crisis in the European steel industry, US Steel Košice earned a net profit in 2012, after a loss in 2011. The main investment obstacle for Eastern Slovakia is still the missing highway connection to Košice. A recent landslide after heavy rains has postponed its completion further until 2020-2021.

Fiscal consolidation efforts have been successful in 2012 and continue this year. As against the original 2012 budget deficit target of 4.6%, the actual deficit reached 4.3% only. The public debt level climbed to 52% of GDP in 2012, however (up as much as 8.8 percentage points from 2011), also due to ESM contribution payments. Thus, the 50% threshold stipulated in the Constitutional Law on Budgetary Responsibility ('debt brake law') introduced in 2011 was surpassed and the finance minister will have to inform the parliament of this issue. Major measures introduced at the beginning of this year were the increase in corporate tax from 19% to 23% and the rise in the income tax rate to 25% for individuals with monthly salaries topping EUR 3246. The flat tax has thus been scrapped. For 2013, the government strives to observe a budget deficit target of less than 3%, in order to meet the requirements of the EU's Excessive Deficit Procedure. For the coming two years, the government's targets a 2.6% deficit in 2014 and 2.0% in 2015 – by 0.3 pp more than announced last year. Proposals for the next years include, for example, changes in the social benefits system, which would mean less support for families. The introduction of the tax on financial transactions, on the other hand, seems to have been postponed.

The car industry has been the main driver of Slovak growth for several years already. All three foreign-owned major car producers – VW Bratislava, PSA Peugeot-Citroën and Kia of South Korea – are located in the more prosperous Western part of the country and benefit from competitive unit labour costs. As all of them introduced a third shift at the beginning of 2012, the number of cars produced in Slovakia increased by 45% in that year, with Volkswagen Bratislava even doubling its numbers. Overall more than 900,000 cars were produced, 171 automobiles per 1000 inhabitants, making Slovakia the largest producer in the world in per capita terms (the Czech Republic ranking second). However, the slowdown has already left its mark on the three car manufacturers as could be observed at the beginning of this year (either shortening of the working week or stopping of production for a few days). Good news still prevails, including the announcements for launching new models by all three companies. Overall, car production this year will be about the same as in 2012. Generally, the investment environment for new foreign investment is less promising: While the government grants incentives to selective companies (e.g. to Continental – the German tyre company is investing EUR 250 million in the Slovak plant in Púchov while receiving EUR 20 million in tax relief for two years), on the one hand, corporate taxes increased at the beginning of the year and the Labour Code has become stricter, on the other. New rules for investment aid came into force on 1 May 2013, setting stricter rules for the creation of jobs.

Overall, this year's GDP growth forecast for Slovakia is positive, but lower than last year. This is owing to the exceptionally strong growth in car production and exports last year, which will not be repeated this year. The economic confidence indicator shows an improving trend since the beginning of the year. Thus, for 2013, we expect GDP growth of about 1%, which again only comes from net exports, as household as well as public consumption still stagnate or even decrease due to the ongoing fiscal consolidation process. Yet there are a number of risks to this scenario: the overall European growth performance, in particular that of Slovakia's main trading partners Germany and the Czech Republic, will be of importance. However, also certain export markets within the EU (e.g. Poland) or countries outside the EU, while only constituting a share of 16% of total exports, in particular Russia or Asia, might be important future export destinations with higher growth potential.

Table SK

Slovakia: Selected Economic Indicators

	2009	2010	2011	2012 [1)]	2012	2013	2013	2014	2015
					1st quarter			Forecast	
Population, th pers., average [2)]	5418.6	5430.1	5398.4	5410.0	.	.	5420	5430	5440
Gross domestic product, EUR mn, nom.	62794	65870	69108	71463	16550	16811	73600	77600	82300
annual change in % (real)	-4.9	4.4	3.2	2.0	2.9	0.6	1.0	2.4	3.0
GDP/capita (EUR at exchange rate)	11600	12100	12800	13200	.	.	13600	14300	15100
GDP/capita (EUR at PPP)	17100	17900	18500	19100	.	.	.	.	.
Consumption of households, EUR mn, nom.	37637	37735	39003	40215	9893	10005	.	.	.
annual change in % (real)	0.1	-0.8	-0.5	-0.5	-0.1	-0.9	0.0	1.0	3.0
Gross fixed capital form., EUR mn, nom.	13025	13851	15957	15392	3391	3171	.	.	.
annual change in % (real)	-19.7	6.5	14.2	-3.6	-3.3	-8.4	0.0	3.0	4.0
Gross industrial production									
annual change in % (real)	-15.6	8.2	5.2	8.1	7.3	0.3	3.0	4.0	4.0
Gross agricultural production (EAA)									
annual change in % (real)	-12.3	-8.2	8.7	-9.2	.	.	.	.	.
Construction industry									
annual change in % (real)	-11.3	-4.6	-1.8	-12.6	-9.3	-12.0	.	.	.
Employed persons, LFS, th, average [3)]	2366.3	2317.5	2351.4	2329.0	2324.7	2327.7	2330	2350	2370
annual change in % [3)]	-2.8	-2.1	1.5	0.6	1.2	0.1	0.0	1.0	1.0
Unemployed persons, LFS, th, average [3)]	323.5	389.2	368.3	378.0	380.3	395.5	.	.	.
Unemployment rate, LFS, in %, average [3)]	12.0	14.4	13.5	14.0	14.1	14.5	14.5	14.0	13.0
Reg. unemployment rate, in %, end of period	12.7	12.5	13.6	14.4	13.7	14.7	14.5	14.0	13.0
Average gross monthly wages, EUR	745	769	786	805	770	789	.	.	.
annual change in % (real, gross)	1.4	2.2	-1.6	-1.2	-0.6	0.3	.	.	.
Consumer prices (HICP), % p.a.	0.9	0.7	4.1	3.7	4.0	2.2	2.0	3.0	3.0
Producer prices in industry, % p.a.	-6.9	0.4	4.5	1.9	2.3	0.4	0.2	2.0	2.0
General governm.budget, EU-def., % of GDP									
Revenues	33.5	32.3	33.3	33.1	.	.	.	.	.
Expenditures	41.6	40.0	38.3	37.4	.	.	.	.	.
Net lending (+) / net borrowing (-)	-8.0	-7.7	-5.1	-4.3	.	.	-3.0	-3.0	-2.5
Public debt, EU-def., % of GDP	35.6	41.0	43.3	52.1	.	.	54.8	56.5	56.2
Central bank policy rate, % p.a., end of period [4)]	1.00	1.00	1.00	0.75	1.00	0.75	.	.	.
Current account, EUR mn	-1627	-2454	-1428	1613	372	790	1500	1500	800
Current account, % of GDP	-2.6	-3.7	-2.1	2.3	2.2	4.7	2.0	1.9	1.0
Exports of goods, BOP, EUR mn	39721	48273	56960	62833	14760	15135	64000	66000	68000
annual change in %	-19.8	21.5	18.0	10.3	9.0	2.5	2.0	3.0	3.0
Imports of goods, BOP, EUR mn	38775	47494	55985	59224	13996	13784	60000	62000	65000
annual change in %	-22.9	22.5	17.9	5.8	6.2	-1.5	1.8	4.0	4.5
Exports of services, BOP, EUR mn	4342	4396	4750	5569	1253	1204	5600	5900	6200
annual change in %	-27.6	1.2	8.1	17.2	17.5	-3.9	0.0	5.0	5.0
Imports of services, BOP, EUR mn	5367	5140	5120	5264	1192	1246	5300	5700	6100
annual change in %	-17.3	-4.2	-0.4	2.8	-0.1	4.5	1.0	7.0	7.0
FDI inflow, EUR mn	-4	1336	1541	2199	771	-54	1000	.	.
FDI outflow, EUR mn	652	715	353	-58	-4	-497	200	.	.
Gross reserves of NB excl. gold, EUR mn [5)]	481	541	659	620	612	683	.	.	.
Gross external debt, EUR mn	45338	49262	52934	53755	54235	57470 Feb	.	.	.
Gross external debt, % of GDP	72.2	74.8	76.6	75.2	75.9	78.1	.	.	.
Purchasing power parity EUR/EUR	0.6790	0.6790	0.6910	0.6921	.	.	.	.	.

Note: Gross industrial production, construction output and producer prices refer to NACE Rev. 2. Gross agricultural production refers to Economic Accounts for Agriculture (EAA).

1) Preliminary. - 2) From 2011 according to census May 2011. - 3) From 2012 data according to census May 2011. - 4) Official refinancing operation rates for euro area (ECB), two-week repo rate of NB before. - 5) From January 2009 (euro introduction) foreign currency reserves denominated in non-euro currencies only.

Source: wiiw Database incorporating Eurostat and national statistics. Forecasts by wiiw.