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## **Slovakia: Robust exports, strained labour market**

***wiiw expects a respectable GDP growth of 4% for 2011 and the two years thereafter. Growth is mainly driven by net exports, the major driver being foreign demand for products of the Slovak automotive industry – most orders coming from Germany. Domestic demand will remain subdued owing to the fiscal austerity measures that are being implemented. Although the labour market is showing some positive signs, unemployment remains high.***

During the first quarter of 2011 Slovakia's GDP continued its upturn starting in the first quarter of 2010 and expanded remarkably (3.5%). The main driving force behind GDP growth has been foreign demand for products of the Slovak car industry coming mostly from Germany – Slovakia's main trading partner. Exports and imports (goods and services) increased by 15.6% and 11.3% respectively in the first quarter of 2011. At the same time, domestic demand remained subdued. This results from a combination of lower public consumption (-2.5%) and stagnating private consumption. Both are consequences of the fiscal austerity measures which aim at a reduction of the government budget deficit and which have been introduced this year, when major austerity measures (see below) should be implemented. Real wages have stagnated as well, not only due to austerity measures but also because of a surge in inflation, while unemployment remains high. The good news is that gross capital formation grew modestly, by 2.2%, with gross fixed capital formation expanding by 1.2%.

By the end of 2010, industrial production exceeded the 2008 pre-crisis level. Industrial output increased by 11.5% in the first quarter of 2011, with manufacturing expanding by 13.4%. The highest growth (27.7%) was recorded in the transport equipment sector (i.e. production of cars) – the largest industrial sector in the Slovak Republic – followed by the machinery and equipment sector with 25.1% growth. The important metal and fabricated metal products sector increased its output by 9.6%. A decline was reported only in one sector: food, beverages and tobacco. The contribution to GDP was still negative for agriculture, construction and services in the first quarter of 2011.

Inflation is on the rise, with HICP rising by 3.5% in the first quarter of 2011 – mainly on account of increases in food and energy prices and the adjustment of indirect taxes (VAT, excise tax). Hence, our forecast for HICP has to be revised from 2% to 3% for this year.

Several positive signs have appeared on the labour market. Slow recovery started by the end of last year, with an increase in employment by 0.5% (against the previous year's period) and employment growth accelerated in the first quarter of 2011, when total employment increased by 2%. The unemployment rate improved slightly but still amounted to 13.9% in the first quarter of 2011. Moreover, this average masks large regional disparities. Regional unemployment rates are highest in the eastern part of the country (Košice region, 19.3%). This can be explained by a combination of structural features such as low labour mobility, skill mismatches, low FDI presence (due to underdeveloped infrastructure) and also the largest share of Roma community. The new Labour Code under preparation should result in more flexibility on the labour market.

With government expenditures growing strongly and revenues remaining the same in 2010, the fiscal deficit again reached 8% of GDP last year – one of the highest in the EU. The public debt to GDP ratio is rapidly increasing (to 41% in 2010); nevertheless, it is still lower than the EU average of 80%. Fiscal consolidation is set to take place in the period 2011-2013, the main part of the burden falling on the current year (measures summing up to 2.5 percentage points of GDP this year and to 1 percentage point of GDP in 2012 and 2013 each). For 2011, measures on the expenditure side include cuts in the public wage bill and a decline in the consumption of goods and services. On the revenue side, VAT was temporarily raised by 1 percentage point to 20%, some excise taxes increased (e.g. on tobacco). The government's very ambitious deficit target is for 4.9% of GDP this year. However, we expect it to exceed 5%, as revenues may not live up to expectations and risks prevail on the expenditure side (healthcare system). A reform of tax legislation and the social security contribution system is under preparation.

Foreign direct investment inflows had plunged during the economic crisis in 2009 and even turned negative in that year as some investors liquidated their exposure. In 2010 – despite the rapid recovery of GDP – FDI grew only modestly. For 2011 stronger inflows are expected since the main automotive companies – all located in the prosperous western region of Slovakia – announced additional investment plans for the years to come: (1) VW Bratislava intends to invest EUR 1 billion over the next five years, with the previous volume summing up to EUR 1.9 billion until 2010. The focus will be put on new production technologies and on expanded production of cars in Bratislava and of car components in Martin. A new press shop for EUR 85 million is planned to be built at VW's Bratislava plant

until 2012. (2) PSA Peugeot Citroën, located in Trnava, plans to invest EUR 120 million in the production of a new car model. It will start a third work shift in spring 2012. (3) The main supplier to KIA, Mobis Slovakia, will build a new brake production plant located near Žilina, which is to open in 2012. Overall, industrial new orders increased by 20% in the first quarter of 2011. The economic sentiment indicator was at its height at the beginning of the year and then fell in March and April, only to rise again in May. It is now only 2.5% lower than the long-term average and was driven by increasing confidence in services, industry and consumers.

For the year 2011 and the next two years, wiiw expects robust GDP growth at about 4% – no change compared to our previous assessment. This upbeat forecast rests on the optimistic assumption that the economic environment remains favourable and growth continues in Slovakia's major trading partners, particularly in Germany and the Czech Republic. Net exports will continue to be the major driving force behind this development. A recovery of private consumption is not expected for this year, as the labour market remains precarious in spite of modest improvement. Despite a pick-up in FDI, unemployment will not be reduced considerably. Private consumption may recover somewhat next year, as purchasing power will finally resume thanks to higher employment, and austerity measures will be felt less severely. Investment will continue to take on.

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**Slovakia: Selected Economic Indicators**

	2007	2008	2009	2010 <sup>1)</sup>	2010 1st quarter	2011	2012 Forecast	2013	
Population, th pers., average	5397.3	5406.6	5418.6	5430.0	.	.	5440	5450	5440
Gross domestic product, EUR mn, nom.	61555.0	67007.3	63050.7	65905.5	15148.5	15833	69200	72700	77100
annual change in % (real)	10.6	5.8	-4.8	4.0	4.7	3.5	4	4	4
GDP/capita (EUR at exchange rate)	10200	11900	11600	12100	.	.	12700	13300	14200
GDP/capita (EUR at PPP)	17000	18100	17200	18100	.	.	.	.	.
Consumption of househ., EUR mn, nom.	33902.0	37604.3	37714.3	37928.0	9203.0	9534.8	.	.	.
annual change in % (real)	6.9	6.1	0.3	-0.3	-0.1	-0.1	1	3	4
Gross fixed capital form., EUR mn, nom.	16096.5	16575.9	12991.1	13390.4	3054.3	3118.8	.	.	.
annual change in % (real)	9.0	1.0	-19.9	3.7	-3.4	1.2	4	5	6
Gross industrial production									
annual change in % (real)	17.0	3.3	-13.8	18.8	19.7	11.5	8	8	6
Gross agricultural production									
annual change in % (real)	-4.5	10.6	-12.3	-9.9	.	.	.	.	.
Construction industry									
annual change in % (real)	5.7	11.9	-11.2	-4.6	-13.9	-2.5	.	.	.
Employed persons - LFS, th, average	2357.7	2433.7	2366.3	2317.5	2283.1	2332.0	2360	2380	2400
annual change in %	2.4	3.2	-2.8	-2.1	-4.4	2.1	2	1	1
Unemployed persons - LFS, th, average	295.7	255.7	323.5	389.2	407.1	375.6	.	.	.
Unemployment rate - LFS, in %, average	11.1	9.5	12.0	14.4	15.1	13.9	13	12	12
Reg. unemployment rate, in %, end of period	8.0	8.4	12.7	12.5	12.9	13.1	12	11	10
Average gross monthly wages, EUR	669	723	745	765	725	746	.	.	.
annual change in % (real, gross)	4.4	3.4	1.4	2.0	1.6	-0.4	1	.	.
Consumer prices (HICP), % p.a.	1.9	3.9	0.9	0.7	0.0	3.5	3	3	3
Producer prices in industry, % p.a.	-1.4	2.5	-6.6	0.1	-3.4	5.3	4	2	2
General governm.budget, EU-def., % GDP									
Revenues	32.5	32.9	33.6	33.1	.	.	.	.	.
Expenditures	34.3	35.0	41.5	41.0	.	.	.	.	.
Net lending (+) / net borrowing (-)	-1.8	-2.1	-8.0	-7.9	.	.	-5.4	-5.0	-4.5
Public debt, EU-def., in % of GDP	29.6	27.8	35.4	41.0	.	.	45.1	47.4	47
Central bank policy rate, % p.a., end of period <sup>2)</sup>	4.3	2.5	1.0	1.0	1.0	1.0	.	.	.
Current account, EUR mn	-2912	-4021	-2023	-2270	-247	57	-3000	-3600	-4000
Current account in % of GDP	-5.3	-6.2	-3.2	-3.4	-1.6	0.4	-4.3	-5.0	-5.2
Exports of goods, BOP, EUR mn	42260	49521	39715	48791	10655	13209	54000	57000	60000
annual growth rate in %	26.7	17.2	-19.8	22.9	18.8	24.0	10	6	5
Imports of goods, BOP, EUR mn	42916	50280	38528	48652	10366	12854	53000	56000	59000
annual growth rate in %	19.8	17.2	-23.4	26.3	12.3	24.0	9	6	5
Exports of services, BOP, EUR mn	5140	6001	4522	4409	983	1066	4800	5400	6200
annual growth rate in %	18.9	16.8	-24.6	-2.5	-4.2	8.4	10	12	15
Imports of services, BOP, EUR mn	4751	6488	5768	5141	1259	1187	5700	6400	7400
annual growth rate in %	25.4	36.6	-11.1	-10.9	-11.5	-5.7	10	12	15
FDI inflow, EUR mn	2636	3323	-35	397	309	147	1500	2000	.
FDI outflow, EUR mn	441	376	311	247	-10	23	.	.	.
Gross reserves of NB excl. gold, EUR mn <sup>3)</sup>	12280	12674	481	541	516	573	.	.	.
Gross external debt, EUR mn	30156	37286	45338	49262	46290	50686	.	.	.
Gross external debt in % of GDP	54.9	57.7	71.9	74.7	70.2	73.2	.	.	.
Average exchange rate EUR/EUR	1.1211	1.0377	1.0000	1.0000	1.00	1.00	1	1	1
Purchasing power parity EUR/EUR	0.6720	0.6836	0.6755	0.6712	.	.	.	.	.

Note: Gross industrial production, construction output and producer prices refer to NACE Rev. 2.

1) Preliminary. - 2) From 2009 official refinancing operation rates for euro area (ECB), two-week repo rate of NB before . - 3) 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.