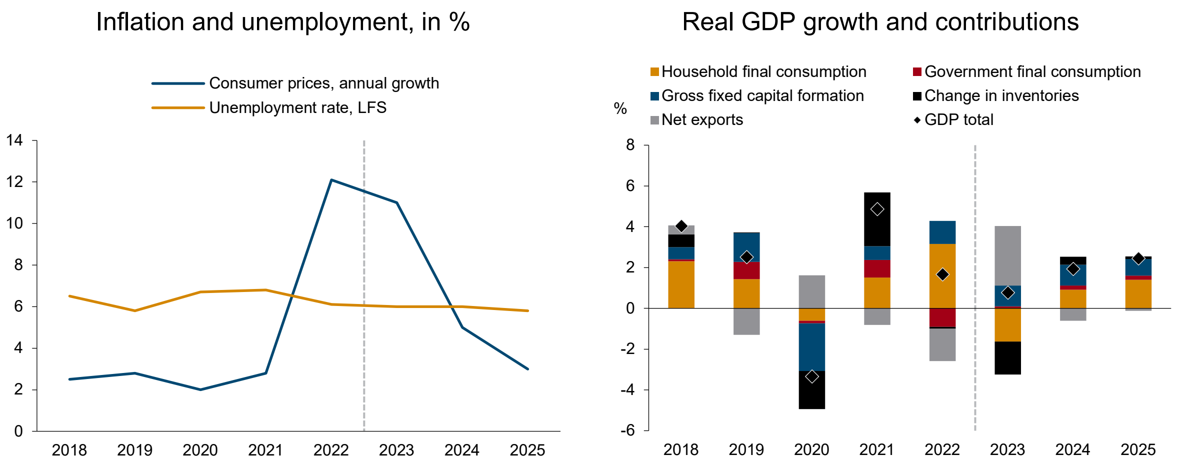
SLOVAKIA: Automotive industry propping up growth, but for how long?

DORIS HANZL-WEISS

In H1 2023, Slovak GDP grew by 1.3% – far better than expected. On the one hand, the important automotive sector supported export growth; on the other, the persistently high inflation deterred household consumption and dragged down GDP growth. Major uncertainties prevail and could dampen future growth.

Figure 6.20 / Slovakia: Main macroeconomic indicators



Source: wiiw Annual Database incorporating national and Eurostat statistics, own calculation. Forecasts by wiiw.

Slovak GDP grew in H1 2023 by 1.3% – slightly less than in 2022 – and remains strongly influenced by the persistently high inflation. While GDP increased by 1.0% year on year in Q1 2023, it actually grew by 1.5% year on year in Q2 – far better than expected. Growth was based first and foremost on positive net foreign trade: imports declined sharply, while exports picked up in Q2. Investment also increased. On the other hand, growth was dragged down by falling household consumption – a casualty of the persistently high inflation and depletion of the household savings used last year. Gross capital formation (declining inventories) fell by 30% in Q1 and by almost 20% in Q2. If we look at trends in the various sectors, those that contribute most to value-added growth were industry (automotive sector); wholesale and retail trade; transportation and storage; accommodation and food services; and construction.

The automotive sector propped up growth in H1 2023, but for how long can that continue? Over the first seven months of 2023, industrial production declined by 2%, with negative contributions from the rubber and plastic sector; computer, electronic and optical products; and wood and paper products. However, the all-important Slovak automotive sector grew by 4% during this time, as it recovered from last year's shortage of components and as EU car registrations surged by 18% in H1 2023 (in Spain and Italy by 20%; in France and Germany by 17%). Preparation of the site for the new Volvo plant is ongoing, with construction due to start in November 2023 and production planned to commence in 2026. Volvo will become the fifth car producer in Slovakia, joining Volkswagen, Kia, Stellantis and Jaguar Land Rover. Together those firms produced about 1m cars in 2022, making Slovakia again the largest per capita car producer in the world. Volvo will manufacture electric cars, with an annual production capacity of 250,000. A planned expansion was announced recently: in the next phase, an additional 250,000 cars will be produced. This would make the Volvo plant the largest car producer in Slovakia (Volkswagen produced about 400,000 cars annually at its peak in 2018; Stellantis and Kia about 300,000). Direct government support has been given to Volvo to the tune of EUR 250m, while indirect support comes through financing of the Valaliky industrial park.[32]

While the labour market remains resilient, the still high inflation and declining real wages have deterred household consumption in 2023. The positive developments on the labour market in 2022 continued into H1 2023, but at a slower pace: the growth in employment has moderated to just 0.2%. More people were employed in services, which are still recovering from the pandemic, and fewer in manufacturing. The rate of unemployment increased slightly in Q1 (compared to Q4 2022), but dropped to an all-time low level of 5.7% in Q2. There are major regional disparities: whereas the unemployment rate in Bratislava was about 2% in Q2, in the east of the country it was in the region of 10%. Real wages declined in H1 2023 by 3.4% on account of the still high inflation, which peaked in February 2023 (15.4% year on year) and has since been falling only slowly. In fact, Slovakia recorded the highest inflation in the euro area in recent months. In August, the rate at long last dipped into single digits (9.6%). This may be attributed to the high proportion of food and beverages in Slovakia's Harmonised Index of Consumer Prices (HICP) basket (at 26.3%, it is the largest share of all the Visegrád countries): comestibles still reflected the largest increase of all the basket's components (16.5% in July). For the whole year 2023, the HICP forecast has been revised upwards, to around 11%. Also for 2024, inflation will remain at a higher level than previously expected. Households are, however, helped by electricity and gas price caps, as well as by a government support package.

The current account improved significantly in H1 2023, but will remain in negative territory in the short term. In 2022, Slovakia posted a record-high current account deficit of 8.2% of GDP, due to rising energy prices. With the fall in energy costs, the current account improved significantly in H1 2023 and was in deficit by only 0.8% of GDP. This was due to a positive trade and services balance: exports of goods and services rose, while goods and services imports fell. Goods exports increased by 8.9% year on year in the first seven months of 2023, while imports grew by only 1%. Exports to the country's main partners – Germany and Czechia – were up 11.5% and 0.9%, respectively. Exports of machinery and transport equipment increased by 20.2%, driven by growth in motor vehicle exports. Trade with Russia halved in terms of both exports and imports, but the trade deficit with Russia is high. Looking at trade with Ukraine, imports declined by 20%, while exports increased by 72%, so that Slovakia runs a trade surplus with Ukraine.

A high public deficit will prevail this year, and the pace of consolidation in the coming years will depend on the complexion of the next government. In 2022, the budget deficit was quite low compared to the crisis years of 2020-2021, making up 2% of GDP, while the public debt level stood at 57.8% of GDP. For this year, a higher deficit is expected, as government measures to help households, businesses and municipalities counter the high energy prices kick in. As such, the budget deficit is

[32] https://www.economy.gov.sk/top/volvo-sa-rozhodlo-pre-sr-preinvestuju-vyse-miliardu-a-vzniknu-tisice-novych-pracovnych-miest

expected to climb to 6% of GDP this year. For the coming years, the deficit should fall again. However, the pace of fiscal consolidation will depend on the outcome of the upcoming parliamentary elections. Disbursements from the EU funding period 2014-2020 (for which Slovakia was allocated EUR 14.5bn) will come to an end this year, while the 2021-2027 Multiannual Financial Framework will take over from next year. Slovakia's absorption rate lags behind that of its peers: as of August, about 76% of the EU funds had been drawn. For the EU's Recovery and Resilience Facility (RRF) – from which an overall EUR 6.3bn has been allocated to Slovakia – anecdotal evidence suggests a better performance.

Our growth forecasts for 2023 and 2025 have been revised slightly upwards, and that for 2024 downwards; but a high level of uncertainty prevails. For this year, the wiiw growth forecast has been revised slightly upwards due to the country's better performance in the first half year; nevertheless, the forecast remains cautious, as we expect growth to falter in the second half of the year. Overall, growth will be based on positive net trade and investment, while household consumption will act as a drag on it. The growth forecast has been revised slightly downwards for 2024, but upwards for 2025. With inflation falling significantly in 2024 and 2025, household consumption will also recover and will make a positive contribution to growth. In addition, investment will be supported by the inflow of EU funds. The effects of net exports will be neutral in the coming years. Overall, negative downside risks remain, and uncertainty is high on the external side, as well as domestically. The weak global environment, the recession in Germany – Slovakia's main export market – and the Russian war in Ukraine are all adverse factors. The outcome of the parliamentary elections on 30 September will add to the uncertainty as well. The Slovak political parties have fragmented over time, making the 5% threshold for entering parliament a decisive factor in terms of the number of parties that make it into the legislature – and then making it difficult for any would-be party of government to find an adequate number of coalition partners. With the Russian war in neighbouring Ukraine rumbling on, the diversification of energy supplies remains on the agenda and greening of the economy generally presents a major challenge for the country.

Table 6.20 / Slovakia: Selected economic indicators

	2020	2021	2022 1)	2022	2023	2023	2024	2025
				January-June			Forecast	
Population, th pers., average 2)	5,459	5,447	5,432	.	.	5,426	5,414	5,399
Gross domestic product, EUR m, nom.	93,442	100,324	109,652	51,802	58,069	122,600	131,200	138,400
annual change in % (real)	-3.3	4.9	1.7	2.1	1.3	0.8	1.9	2.4
GDP/capita (EUR at PPP)	21,560	22,920	24,060	.	.	.	.	.
Consumption of households, EUR m, nom.	52,871	56,042	66,452	31,784	35,088	.	.	.
annual change in % (real)	-1.1	2.7	5.7	7.1	-2.9	-2.7	1.5	2.3
Gross fixed capital form., EUR m, nom.	18,210	19,255	22,332	9,250	11,011	.	.	.
annual change in % (real)	-10.9	3.5	5.9	2.2	5.4	5.0	5.0	4.0
Gross industrial production								
annual change in % (real)	-8.3	10.2	-4.0	-2.7	-1.5	-2.5	4.0	4.0
Gross agricultural production								
annual change in % (real)	3.4	-3.4	-10.3	.	.	.	.	.
Construction industry								
annual change in % (real)	-11.3	-2.0	0.0	-0.1	0.1	.	.	.
Employed persons, LFS, th, average 3)	2,531	2,561	2,604	2,588	2,594	2610	2620	2630
annual change in %	-2.0	-1.7	1.7	2.8	0.2	0.2	0.3	0.5
Unemployed persons, LFS, th, average 3)	181	188	170	172	164	170	170	160
Unemployment rate, LFS, in %, average 3)	6.7	6.8	6.1	6.3	6.0	6.0	6.0	5.8
Reg. unemployment rate, in %, eop	7.6	6.8	5.9	6.3	5.1	.	.	.
Average monthly gross wages, EUR	1,133	1,211	1,304	1,252	1,373	1420	1510	1590
annual change in % (real, gross)	1.9	4.5	-4.5	-3.0	-3.4	-2.0	1.5	2.5
Consumer prices (HICP), % p.a.	2.0	2.8	12.1	10.1	13.8	11.0	5.0	3.0
Producer prices in industry, % p.a.	-0.6	6.8	27.8	27.6	14.5	9.5	4.0	2.3
General governm. budget, EU def., % of GDP								
Revenues	39.4	40.1	40.2	.	.	40.0	39.5	39.3
Expenditures	44.7	45.6	42.3	.	.	46.0	43.9	43.8
Net lending (+) / net borrowing (-)	-5.4	-5.4	-2.0	.	.	-6.0	-4.4	-4.5
General gov. gross debt, EU def., % of GDP	58.9	61.0	57.8	.	.	60.0	59.4	60.1
Stock of loans of non-fin. private sector, % p.a.	5.0	7.2	10.8	11.3	6.2	.	.	.
Non-performing loans (NPL), in %, eop	2.3	1.9	1.7	1.9	1.7	.	.	.
Central bank policy rate, % p.a., eop 4)	0.00	0.00	2.50	0.00	4.00	.	.	.
Current account, EUR m	526	-2,465	-8,938	-3,933	-447	-2,200	-1,700	-500
Current account, % of GDP	0.6	-2.5	-8.2	-7.6	-0.8	-1.8	-1.3	-0.4
Exports of goods, BOP, EUR m	70,011	81,303	96,534	47,764	51,752	101,800	106,900	113,300
annual change in %	-7.3	16.1	18.7	18.7	8.3	5.5	5.0	6.0
Imports of goods, BOP, EUR m	68,996	81,815	103,163	50,517	50,659	102,100	107,700	113,100
annual change in %	-10.0	18.6	26.1	27.3	0.3	-1.0	5.5	5.0
Exports of services, BOP, EUR m	9,048	9,580	11,931	5,333	5,433	12,100	13,000	14,000
annual change in %	-17.6	5.9	24.5	25.8	1.9	1.0	7.5	8.0
Imports of services, BOP, EUR m	8,085	9,034	11,552	5,184	4,991	11,000	11,600	12,100
annual change in %	-17.2	11.7	27.9	27.7	-3.7	-5.0	5.0	4.0
FDI liabilities, EUR m	-934	818	3,876	1,341	-251	700	.	.
FDI assets, EUR m	1,475	1,097	1,528	341	71	500	.	.
Gross reserves of CB excl. gold, EUR m	6,050	6,850	7,915	8,094	7,708	.	.	.
Gross external debt, EUR m	111,746	133,051	113,065	.	.	110,000	105,000	100,000
Gross external debt, % of GDP	119.6	132.6	103.1	.	.	89.7	80.0	72.3

1) Preliminary. - 2) From 2021 according to census 2021. - 3) From 2021 the new LFS methodology is applied in line with the Integrated European Social Statistics Regulation (IESS). - 4) Official refinancing operation rates for euro area (ECB).

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