

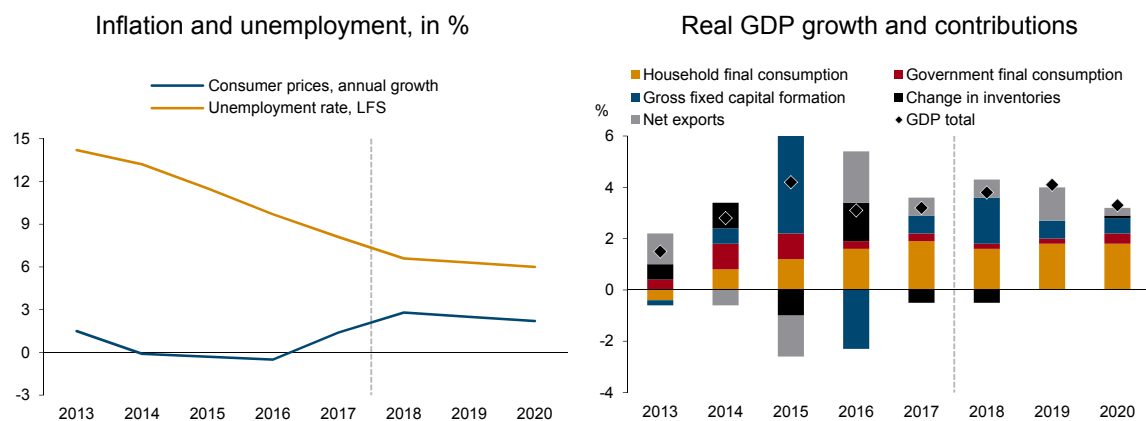


## SLOVAKIA: Growth fostered by automotive industry

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Slovakia's growth accelerated in the first half of 2018 on a broad base. Forecasts for this and next year amount to 3.8% and about 4% respectively, thanks to the new Jaguar Land Rover plant. Main internal risks are growing wages and labour shortages.

Figure 54 / Slovakia: Main macroeconomic indicators



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

**Robust growth performance with accelerating tendencies.** In the first half of 2018, Slovak GDP grew by 3.9%, compared to 3.2% for the whole year 2017. Overall, growth accelerated from the first quarter to the second – from 3.6% to 4.2%. The growth pattern in the second quarter was broad-based but exhibited some surprises. Household and government consumption, gross fixed capital formation and net exports all contributed positively to growth. While the contributions from gross fixed capital formation and net exports came as a positive surprise, the trends for household consumption were more disappointing.

**Household consumption underperforming.** Overall, household consumption grew by 2.8% in the first half of 2018, less than the favourable situation on the labour market would suggest. Growth dropped from a high 3.5% in the first quarter to only 2.3% in the second. The positive situation in the labour market continued in the first half of 2018: employment increased by 1.2%, the unemployment rate (LFS) dropped further to 6.9% – a record-low rate for Slovakia. In fact, the unemployment rate reached about 14% after the crisis between 2010 and 2014 and thus has fallen by seven percentage points since then.

However, there are strong regional differences within Slovakia and high unemployment rates prevail in the East while Western Slovakia in particular (and here especially Bratislava) have the lowest unemployment rates. Due to the strong concentration of the FDI enterprises and domestic firms in Western Slovakia, there are hardly any jobs in the East.

**Tight labour market and increasing wages as main internal risks.** Labour shortages are sharply increasing in Slovakia, especially in industry. The hiring of foreign workers (e.g. Ukrainians, Serbs) is a hot topic in Slovakia and even though conditions for hiring have been somewhat eased since May, it is still seen as inflexible. The shortage of skilled labour as well as government pay increases will drive up wages. In the first half of 2018, real wages increased by 3.8% and the average monthly gross wage was above EUR 1,000 for the first time ever in the second quarter of 2018. Nominal wage increases were eaten up partly by inflation which reached 2.6% in H1. State salaries will increase by 10% in both January 2019 and January 2020, the minimum wage will rise by EUR 40 to EUR 520 in January 2019 and the government has recently proposed hiking the wages of nurses in order to keep them in Slovakia (by up to 16%).

**Hike in investments – is it sustainable?** Investments increased by 17% in the first half of 2018 due to a good performance in the first quarter (+13%) and an even stronger rise in April-June (+20%). However, this might be due to a very low comparison base in 2017 and might not be sustainable for the rest of the year. Overall, investment into other buildings & structures rose sharply in Q2. As inventories were built up, gross capital formation increased by 10% in the first half of 2018.

**Industrial production disappointing but automotive industry on the right track.** Looking at the sectoral structure, industrial production grew by only 1.7% in the first seven months of 2018. However, the main industrial sector in Slovakia – the automotive industry – picked up in the second quarter of 2018 and took over its role as a growth driver again. Production of new car models has started (e.g. the new Volkswagen Touareg generation and new models of the Kia Ceed). The new Jaguar Land Rover plant, which plans to start delivering its first cars to customers at the end of the year, will further add to industrial production and exports. The plant will produce the Land Rover Discovery model, of which the whole production will move from the Solihull plant near Birmingham to Slovakia. About 1,400 employees work in the plant, with training already ongoing on-site in a Training Academy. The plant will produce 150,000 cars per year in the first phase, with planned expansion of the number of employees to 2,800 and an expectation that annual production of cars will eventually reach 300,000. Slovakia was also on the shortlist for the new BMW car plant, but this will now be built in Hungary. As to the other sectors of manufacturing, further sectors contributing to growth in H1 were basic metals & fabricated metal products, machinery, rubber & non-metallic mineral products and food, beverages & tobacco. Production fell in the electricity, the computer, electronic & optical products, the other manufacturing & repair and in the mining & quarrying sectors. In looking at the other sectors of the economy too, value added grew strongly for construction (+10%) and agriculture, forestry & fishing (+7%). Services activity increased by around 3%.

**Slightly positive impact of the external sector on growth.** Growth of goods and services exports accelerated in the second quarter 2018. Overall, net exports contributed slightly to growth in the first half of 2018. Goods exports increased by 7%, as did imports. Goods exports to Slovakia's main partners – Germany and the Czech Republic – expanded strongly by 19% and 5% respectively. Services exports exhibited a moderate growth rate, rising by 6% (e.g. other business services), with services imports also

up by 5.5% (e.g. transport services). Overall, the goods balance reached a positive value of EUR 700m and the services balance of EUR 400m but these were outweighed by primary and secondary income deficits (EUR 700m and EUR 800m respectively). Thus the current account was slightly in deficit in the first half of 2018.

**Fiscal consolidation slowly on track.** The government deficit figure for 2017 reached 0.8% of GDP, while the debt-to-GDP level declined slightly to 50.9%. For 2018, the planned figures are at 0.8% and 49.9% respectively, but these should be seen as lower limits rather than absolute targets. The forthcoming parliamentary elections in 2020 could also worsen deficit figures next year. From the fiscal year 2018 onwards, changes within the Fiscal Responsibility Law have to be kept in mind (the 50-60% debt-to-GDP thresholds will continuously decline by 1 percentage point to 40% by 2027). Municipal elections will take place on 10 November. There are currently ten candidates for the post of the Bratislava mayor.

**Declining but still strong household credit growth increases household indebtedness.** Private credit growth stood at 10% in the first half of 2018. Of that, strong credit growth to households (especially housing loans), which has been of major concern for a long time, has fallen slightly since the end of 2017, although it is still running at around 12% year on year. Credit growth to non-financial corporations has been fluctuating between 6% and 8% per month since the beginning of 2018. The rate of non-performing loans is low (3.6%) and falling.

**Automotive industry helps growth in the next year.** In summary, wiiw's forecasts for this year and the rest of the forecast period have not changed. Despite strong growth in the second quarter of 2018, we maintain our forecast of 3.8% for 2018 as the pattern of Q2 growth might not be sustainable. Next year, the new Jaguar Land Rover car plant will spur exports and provide a major impetus to growth, which we see accelerating to more than 4%. Moreover, growing household consumption should again contribute more substantially. The main internal risks for the future are increasing labour shortages and rising wages, with the consequences thereof. They seem to be more relevant than external risks (such as rising trade conflicts or Brexit) at the moment.

**Table 29 / Slovakia: Selected economic indicators**

	2014	2015	2016	2017 <sup>1)</sup>	2017 January-June	2018	2018 Forecast	2019 Forecast	2020
Population, th pers., average	5,419	5,424	5,431	5,430	.	.	5,440	5,440	5,450
Gross domestic product, EUR mn, nom.	76,088	79,138	81,226	84,851	40,535	43,096	90,500	96,600	102,000
annual change in % (real)	2.8	4.2	3.1	3.2	3.4	3.9	3.8	4.1	3.3
GDP/capita (EUR at PPP)	21,300	22,400	22,400	23,000	.	.	.	.	.
Consumption of households, EUR mn, nom.	41,605	42,496	43,579	45,730	22,371	23,624	.	.	.
annual change in % (real)	1.4	2.3	2.9	3.5	3.5	2.8	3.0	3.4	3.3
Gross fixed capital form., EUR mn, nom.	15,772	19,213	17,280	18,155	7,712	9,250	.	.	.
annual change in % (real)	3.0	21.9	-9.4	3.4	-2.7	16.8	8.5	3.5	3.0
Gross industrial production									
annual change in % (real)	2.9	6.0	3.8	2.9	2.8	1.6	2.5	6.0	3.0
Gross agricultural production									
annual change in % (real)	7.4	-3.2	13.9	-8.9	.	.	.	.	.
Construction industry									
annual change in % (real)	-4.2	18.1	-10.7	3.0	-2.6	7.0	.	.	.
Employed persons, LFS, th, average	2,363	2,424	2,492	2,531	2,520	2,549	2560	2580	2590
annual change in %	1.5	2.6	2.8	1.5	1.8	1.2	1.0	0.7	0.5
Unemployed persons, LFS, th, average	359	314	267	224	231	188	180	170	170
Unemployment rate, LFS, in %, average	13.2	11.5	9.7	8.1	8.4	6.9	6.6	6.3	6.0
Reg. unemployment rate, in %, eop	12.3	10.6	8.8	5.9	6.9	5.4	.	.	.
Average monthly gross wages, EUR	858	883	912	954	921	980	1020	1090	1160
annual change in % (real, gross)	4.2	3.2	3.8	3.3	3.2	3.8	4.0	4.2	3.8
Consumer prices (HICP), % p.a.	-0.1	-0.3	-0.5	1.4	1.0	2.6	2.8	2.5	2.2
Producer prices in industry, % p.a.	-3.3	-2.9	-3.9	2.5	2.8	1.3	2.5	2.5	2.5
General governm.budget, EU-def., % of GDP									
Revenues	39.3	42.4	39.3	39.4	.	.	39.8	40.2	39.5
Expenditures	42.0	45.1	41.5	40.5	.	.	40.9	40.7	39.7
Net lending (+) / net borrowing (-)	-2.7	-2.7	-2.2	-1.0	.	.	-1.1	-0.8	-0.6
General gov.gross debt, EU def., % of GDP	53.5	52.2	51.8	50.9	.	.	50.0	48.9	46.6
Stock of loans of non-fin.private sector, % p.a.	6.7	9.7	9.3	9.9	11.7	10.2	.	.	.
Non-performing loans (NPL), in %, eop	6.0	5.2	4.7	3.9	4.3	3.6	.	.	.
Central bank policy rate, % p.a., eop <sup>2)</sup>	0.05	0.05	0.00	0.00	0.00	0.00	.	.	.
Current account, EUR mn	871	-1,391	-1,756	-1,690	-561	-455	-1,300	-600	-500
Current account, % of GDP	1.1	-1.8	-2.2	-2.0	-1.4	-1.1	-1.4	-0.6	-0.5
Exports of goods, BOP, EUR mn	62,581	64,650	67,164	71,479	35,386	37,782	76,100	82,600	86,500
annual change in %	0.3	3.3	3.9	6.4	5.8	6.8	6.5	8.5	4.7
Imports of goods, BOP, EUR mn	59,823	63,601	65,527	70,789	34,732	37,085	75,000	80,700	84,300
annual change in %	0.5	6.3	3.0	8.0	8.2	6.8	6.0	7.6	4.5
Exports of services, BOP, EUR mn	6,889	7,301	8,350	9,214	4,373	4,627	9,800	10,100	10,400
annual change in %	-1.1	6.0	14.4	10.3	9.0	5.8	6.0	3.0	3.0
Imports of services, BOP, EUR mn	6,713	7,144	7,881	8,334	3,988	4,207	8,800	9,200	9,700
annual change in %	3.6	6.4	10.3	5.7	6.9	5.5	5.0	5.0	5.0
FDI liabilities, EUR mn	-324	1,357	4,326	5,313	3,195	2,022	2,000	.	.
FDI assets, EUR mn	94	1,266	3,684	3,603	2,181	2,328	2,000	.	.
Gross reserves of NB excl. gold, EUR mn	1,165	1,648	1,624	1,609	1,613	3,870	.	.	.
Gross external debt, EUR mn	67,776	67,225	73,750	94,149	78,792	99,963	100,000	105,000	110,000
Gross external debt, % of GDP	89.1	84.9	90.8	111.0	92.9	110.5	110.5	108.7	107.8

1) Preliminary. - 2) Official refinancing operation rates for euro area (ECB).

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