SLOVAKIA: Navigating the political challenges

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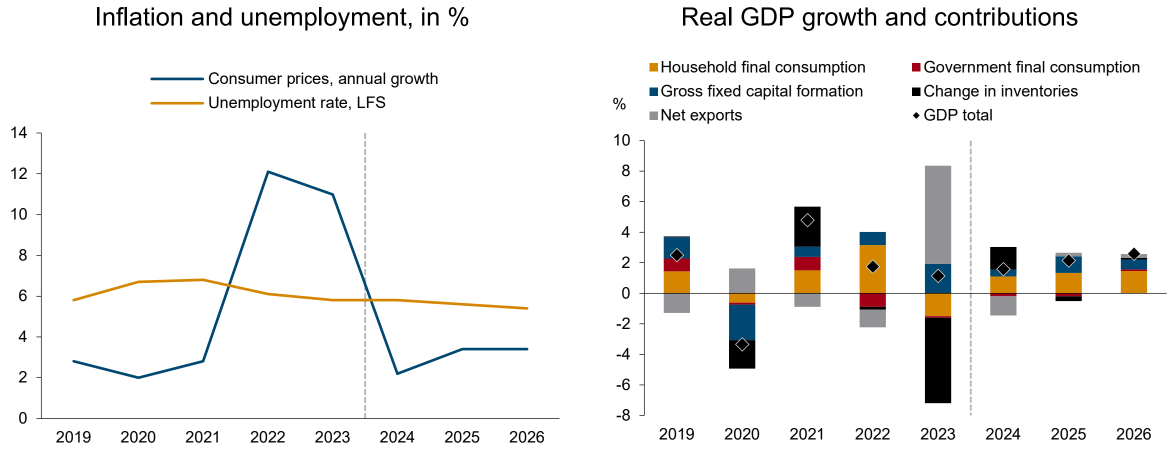
While Slovakia's GDP increased by only 1.1% in 2023, wiiw forecasts a gradual improvement in growth in the coming years. This will mainly be driven by household consumption, bolstered by lower inflation, leading to rising real wages and a favourable labour market. However, the domestic risks are rising due to ongoing political changes.

Figure 6.20 / Slovakia: Main macroeconomic indicators



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

Slovakia's GDP increased by a mere 1.1% in 2023, marking a low point on its growth trajectory of recent years. Since its accession to the EU in 2004, only in 2013 has growth been lower than last year (excluding the crisis years of 2009 and 2020). Nonetheless, up against the other Visegrád countries, Slovakia's performance was the best in the region. The primary driver of growth was net foreign trade, with imports declining more significantly than exports (by 7.4% compared to 1.3%, in real terms). Moreover, increased investment played a significant role, surging by almost 10%. This may be attributed to the end of the financing cycle of EU funds, which (as is often the case) was associated with an upswing in investment activity towards the end of the year. However, a substantial 16% decrease in inventories prevented even higher growth. On the downside, household consumption experienced a decline of 2.5%. This was largely due to Slovakia's very high inflation rate, which at 11% was the highest in the euro area; this resulted in a fall in real wages and household income. Additionally, savings had already been depleted the previous year.

The automotive industry has experienced a sluggish start to the new year. The all-important automotive industry was a key driver of 2023 industrial growth, thanks to its recovery from previous supply-chain disruptions and the shortage of chips, and the subsequent processing of backlog orders. Alongside the pharmaceutical industry and the basic metals and fabricated metals sector, which also showed growth (both up 9%), the automotive industry (at 12%) pushed overall growth of industrial production into positive territory (+1.5%). In 2023, the four major car companies in Slovakia – VW, Kia, Stellantis and Jaguar Land Rover – increased car production by 10%, to an almost record 1.08m cars; this maintained Slovakia's position as the largest car manufacturer per capita globally. While the Slovak Automotive Industry Association (ZAP) expects that output level to be exceeded this year, there are grounds for caution. In fact, in January, automotive sector production declined by approximately 5% year on year, and industrial orders are down across nearly all manufacturing sectors. Although electric car models are gradually being introduced, last year Volkswagen ceased production of its small VW e-up! cars, which were launched in 2011. The ramping-up of electric car production is expected in 2026, coinciding with the completion and commencement of production at Volvo's new electric car production plant.

The current account improved considerably in 2023, but the export trend went into reverse in the first months of 2024. The current account deficit narrowed in 2023 to 1.6% of GDP. This was due to the trade balance again turning positive: goods exports increased by almost 4%, thanks to exports of machinery and transport equipment, including cars (+15%), while imports declined by 4%, due to falling energy prices. Services exports and imports both fell last year, though the services balance remained positive. If we look in more detail at trade developments (based on trade statistics), exports to the country's main trade partners – Germany and Czechia – were up 5%. Trade with Russia has fallen since the invasion of Ukraine and exports were down 35%, while imports nearly halved (due to much lower energy prices). Still, Slovakia has a trade deficit with Russia of EUR 4bn, due to imports of mineral fuels. When we look at trade with Ukraine, exports increased by almost 30%, while imports fell by about 20%. During the first two months of 2024, goods exports declined slightly, also due to a big drop in machinery and transport equipment exports in February, while imports fell by almost 9%.

Positive developments on the labour market and a decrease in inflation are expected to bolster household consumption in 2024. Last year there was a slight increase in the number of employed persons. However, while the service sector experienced a positive trend (up 2.1%), employment in manufacturing declined (by 2.8%). The unemployment rate continued falling in 2023, dropping below 6% for the first time ever (5.8%). However, further reductions may prove challenging due to significant regional disparities and low labour mobility. For instance, while the unemployment rate stood at 2.2% in Bratislava, it reached 10.7% in the eastern part of Slovakia (Prešov region, Q4 2023 data). Positive trends in the labour market persisted in the first months of 2024. A shortage of labour, especially in the automotive and the transport industry (bus and lorry drivers), has led to a plan to increase the number of so-called 'national visas' (from a maximum of 2,000 to 10,000). Inflation peaked in February 2023 at 15.4%, since when it has fallen (to 2.5% in March 2024). With administered energy prices expected to remain low this year, the inflation forecast for 2024 is close to 2%; that said, inflation may rise in subsequent years when subsidies are lifted. Consequently, following a two-year decline, real wages are expected to increase, further stimulating household consumption. Retail trade showed an increase of 2% year on year in January.

The new government is continuing to subsidise energy prices this year, putting off fiscal consolidation. In 2023, government measures aimed at mitigating the impact of high energy prices for households, businesses and municipalities pushed the budget deficit to about 6% of GDP. In the 2024 budget, Prime Minister Robert Fico's new government is maintaining its energy price subsidies, freezing them for households. Expenditure will also increase due to the support for pensioners and mortgage borrowers. On the revenue side, new taxes (such as a bank levy) and higher taxes (such as those on tobacco and alcohol in restaurants) will generate more revenue, but the deficit is still projected to reach 6% this year. While deficits are forecast to decline gradually over the coming years, they will likely remain high. The Multiannual Financial Framework of the EU for 2013-2020 ended in 2023, leading to increased investment toward the end of the year, particularly in transport infrastructure. EU funds may now flow in more slowly, since the new political cycle entails personnel changes and a reassessment of programmes. Moreover, the funds may be at risk not only on account of rule-of-law issues related to changes to the Penal Code and the possibility of a standoff between Brussels and Slovakia's new (populist) government, but also because of a failure to meet milestones of the EU's Recovery and Resilience Facility (such as not approving spending limits and delays to pension reform).

For the upcoming years, wiiw forecasts a gradual improvement in growth, which is expected to reach 1.6% in 2024, 2.2% in 2025 and 2.6% in 2026. With inflation finally coming down and real wages seeing growth this year, household consumption is likely to recover and to become the primary growth driver in this and subsequent years. Conversely, net exports are projected to suffer this year, due to sluggish performance in the euro area, and particularly in Slovakia's main trade partner of Germany. However, net exports are expected to improve in subsequent years, contributing once again to overall growth. All in all, however, the risks remain elevated, and especially the domestic risks are growing. Recent political developments are worrying: the change of government has brought instability (e.g. change in top posts in institutions); the abolition of the special prosecutor's office and amendment of the Penal Code pose risks to EU funds; some downgrades by rating institutions have already occurred; and the risk premium is rising (up since the Russian invasion of Ukraine). Additionally, investor uncertainty is increasing, potentially dampening long-run growth. The victory in the 6 April presidential election of Peter Pellegrini, an ally of the populist Prime Minister Robert Fico, will aggravate the political challenges. Protests are ongoing. Various domestic challenges lie ahead, including the transition of the automotive sector towards electric vehicles electric mobility, diversification of energy supplies and greening of the economy, as well as global challenges such as the ongoing Russian war in the neighbouring Ukraine.

Table 6.20 / Slovakia: Selected economic indicators

	2020	2021	2022	2023 1)	2024	2025 Forecast	2026
Population, th pers., average 2)	5,459	5,447	5,432	5,427	5,414	5,399	5,389
Gross domestic product, EUR m, nom.	93,444	100,256	109,645	122,156	126,800	133,900	142,000
annual change in % (real)	-3.3	4.8	1.8	1.1	1.6	2.2	2.6
GDP/capita (EUR at PPP)	22,350	23,860	25,190	27,290	.	.	.
Consumption of households, EUR m, nom.	52,871	56,042	66,452	71,467	.	.	.
annual change in % (real)	-1.1	2.7	5.7	-2.5	1.9	2.3	2.5
Gross fixed capital form., EUR m, nom.	18,210	19,255	22,020	26,321	.	.	.
annual change in % (real)	-10.9	3.5	4.5	9.6	2.0	5.0	3.0
Gross industrial production							
annual change in % (real)	-8.9	10.7	-4.5	1.5	2.3	3.1	3.5
Gross agricultural production							
annual change in % (real)	3.4	-2.8	-9.5	11.3	.	.	.
Construction industry							
annual change in % (real)	-11.3	-2.0	0.0	0.5	.	.	.
Employed persons, LFS, th, average 3)	2,531	2,561	2,604	2,610	2610	2620	2630
annual change in %	-2.0	-1.7	1.7	0.2	0.0	0.3	0.4
Unemployed persons, LFS, th, average 3)	181	188	170	162	160	160	150
Unemployment rate, LFS, in %, average 3)	6.7	6.8	6.1	5.8	5.8	5.6	5.4
Reg. unemployment rate, in %, eop	7.6	6.8	5.9	5.1	.	.	.
Average monthly gross wages, EUR	1,133	1,211	1,304	1,430	1520	1600	1680
annual change in % (real, gross)	1.8	3.6	-4.5	-0.7	4.0	1.5	1.5
Consumer prices (HICP), % p.a.	2.0	2.8	12.1	11.0	2.2	3.4	3.4
Producer prices in industry, % p.a.	-0.6	6.7	26.3	8.0	-3.0	2.3	2.3
General governm. budget, EU def., % of GDP							
Revenues	39.4	40.2	40.2	41.0	40.5	40.2	39.8
Expenditures	44.7	45.3	42.3	47.0	46.5	45.2	43.8
Net lending (+) / net borrowing (-)	-5.4	-5.2	-2.0	-6.0	-6.0	-5.0	-4.0
General gov. gross debt, EU def., % of GDP	58.9	61.1	57.8	57.4	59.9	62.0	63.4
Stock of loans of non-fin. private sector, % p.a.	5.0	7.2	10.8	3.0	.	.	.
Non-performing loans (NPL), in %, eop	2.3	1.9	1.7	1.7	.	.	.
Central bank policy rate, % p.a., eop 4)	0.00	0.00	2.50	4.50	.	.	.
Current account, EUR m	526	-3,970	-8,046	-1,942	-1,700	-1,200	-1,500
Current account, % of GDP	0.6	-4.0	-7.3	-1.6	-1.3	-0.9	-1.1
Exports of goods, BOP, EUR m	70,011	83,106	96,945	100,513	103,000	108,900	116,000
annual change in %	-7.3	18.7	16.7	3.7	2.5	5.7	6.5
Imports of goods, BOP, EUR m	68,996	83,429	103,006	98,926	100,900	105,900	112,800
annual change in %	-10.0	20.9	23.5	-4.0	2.0	5.0	6.5
Exports of services, BOP, EUR m	9,048	9,580	12,017	11,619	12,000	12,500	13,000
annual change in %	-17.6	5.9	25.4	-3.3	3.0	4.0	4.0
Imports of services, BOP, EUR m	8,085	9,034	11,615	11,026	11,800	12,700	13,700
annual change in %	-17.2	11.7	28.6	-5.1	7.0	8.0	8.0
FDI liabilities, EUR m	-934	2,299	3,873	-303	.	.	.
FDI assets, EUR m	1,475	1,011	1,528	-387	.	.	.
Gross reserves of CB excl. gold, EUR m	6,050	6,850	7,915	8,319	.	.	.
Gross external debt, EUR m	111,746	134,511	113,029	117,863	110,000	105,000	100,000
Gross external debt, % of GDP	119.6	134.2	103.1	96.5	86.8	78.4	0.0

Note: Introduction of new index 2021=100 (new weights) for gross industrial production and producer prices in industry.

1) Preliminary and wiiw estimates. - 2) From 2021 according to census 2021. - 3) From 2021 new LFS methodology 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.