

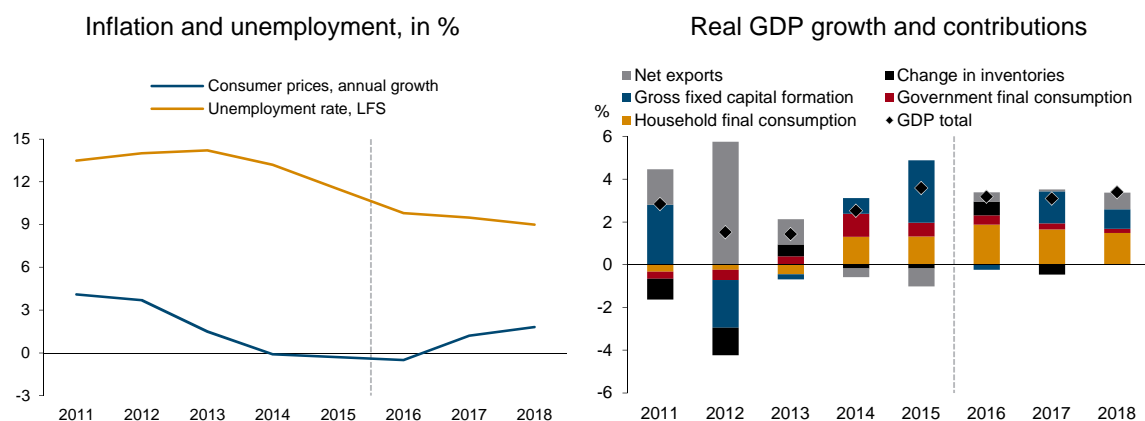


## SLOVAKIA: Solid growth

DORIS HANZL-WEISS

An unexpectedly high GDP growth of 3.6% in the first half of 2016 has resulted in Slovakia being one of the most rapidly growing countries in the region. While investments will drop in the course of the current year, growth has been backed by household consumption and net exports. For the years ahead, new capacities in the automotive industry will lend a fresh impetus to growth.

**Figure 41 / Slovakia: Main macroeconomic indicators**



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

Slovak GDP grew by 3.6% in the first half of 2016, at about the same pace as in the previous year. It was backed by accelerating household consumption, rising by almost 3% in the first half of the year. This was due to ongoing positive developments in the labour market and real wage growth of 3.6%. Consumer prices still declined by -0.5%. Strong growth of credits to households continued: after an increase of 13% in 2015 they rose by 13.4% in the second quarter of 2016; household indebtedness rose strongly while still remaining at a low level. Government consumption also contributed to growth, increasing by 2.6%. Gross fixed capital formation – which had benefited from the speeding-up of EU structural spending last year due to the end of the last disbursement year of the EU's Multiannual Financial Framework 2007-2013 – saw a continuous slowdown in the first six months of 2016. However, overall it still registered a small increase by 0.7%, while gross capital formation rose by 3%. Credit growth to non-financial corporations slowed down in 2016 (7% in 2015, 3% in the first quarter of 2016 and only 0.7% in the second). The construction sector, which had suffered a six-year decline after the economic crisis and recovered finally in 2015, was strongly affected by the end of the last EU

perspective's disbursement period and again saw a drop, by 1%, in the first half of 2016. Construction of civil engineering works decreased in both quarters, that of buildings decreased in the second quarter. Trade performance improved markedly in the second quarter of 2016 and net exports had a positive effect on growth in the first half of the year. Overall, goods exports rose by 3.9%, goods imports by 3.7%. Exports to Germany, Slovakia's largest export partner (accounting for 23% of total goods exports), increased by 4% (imports by 9%). Exports to the Czech Republic, the second most important export partner of Slovakia, accounting for 12% of total exports, remained constant. Exports improved markedly to France (+16%), the United Kingdom (+14%), Italy (+6%), Spain (+23%), the Netherlands (+21%) and Romania (+5%). Exports to the UK take the 5<sup>th</sup> place with 6% of total exports.

Regarding the sectoral structure of growth, manufacturing remained the main growth driver of the Slovak economy. Industrial production increased by almost 4% in the first half of 2016. The automotive industry, the largest manufacturing sector in Slovakia, remains the major engine of growth. After the Brexit vote in June, fears emerged that the new investment by Jaguar Land Rover would not be realised; however, construction actually started in September. The three main established car manufacturers, Volkswagen, KIA Motors and PSA Peugeot-Citroën, had a successful half-year, reporting production increases of one, five and eight per cent, respectively. Volkswagen, the largest producer in the country, kept production levels constant for 2015 (plus 3,000 cars) and the first half of 2016 despite the emission scandal erupting in September 2015.

Continued positive developments prevailed in the labour market. Employment increased by 3% in the first half of 2016 and the unemployment rate was steadily declining. In the second quarter of 2016 it reached 9.6%, approaching the all-time low of 9.5% registered in 2008. However, the structure of unemployed is unfavourable (with large shares of long-term and youth unemployment, and of the Roma population). Also, shortages of skilled labour are emerging, often cited by automotive companies. Efforts to relaunch and promote a dual education system have begun. Meanwhile, teachers have restarted their strike activity in September as they perceive the current government measures (increasing salaries by 6%) as unsatisfactory.

The budget deficit reached 3% of GDP in 2015, with the debt to GDP ratio declining to slightly below 53%. The new government,<sup>45</sup> elected in March 2016, carries on the consolidation process, but in a less ambitious way. The official budget balance targets announced in the Slovak Stability Programme 2016-2019 are: -1.9% for the year 2016, -1.3% in 2017, -0.4% in 2018 and +0.2% in 2019. However, it is questionable whether these targets can realistically be met. On the revenue side, measures of the new government include a reduction of the corporate income tax rate from 22% to 21% as of 2017, the introduction of a tax on dividends of 7%, the extension and increase of a special levy on regulated businesses and taxation changes for insurance companies. On the expenditure side, the implemented measures comprise the increase in salaries for teachers by 6% as of 1 September 2016, additional expenditures related to the Slovak Presidency of the Council of the European Union (including e.g. road construction in Bratislava), the building of the Bratislava ring road (financed by the Juncker Fund), the preparation of an industrial park for Jaguar Land Rover's investment near Nitra, as well as the construction of the national football stadium. A new law for the promotion of small and medium-sized enterprises is under discussion.

---

<sup>45</sup> Consisting of Mr Fico's Smer, the Slovak National Party, Most-Híd and Siet'. However, in the meantime Siet' fell apart and the government now comprises only three parties.

For the year 2016, we have slightly revised our growth forecast upwards by 0.2 pp compared to the Spring Forecast, due to the unexpectedly good performance in the first half of 2016. Growth is estimated to reach 3.2%, which is however still lower than the 3.6% observed in the first half of the year. For the second half of 2016 we expect a decline in gross fixed capital formation, as the strong growth of last year cannot be repeated. Household consumption together with slightly positive net exports will constitute the basis for this year's growth. The economic sentiment indicator is characterised by strong up- and downward movements. It reached a peak in March, followed by a trough in June, and is now again moving upwards. All components of this indicator (including that for industry, construction, services, and consumer confidence) have strongly fluctuated, only the retail-trade confidence indicator has shown an improving trend throughout the year. For the first time since joining the EU in 2004, Slovakia took over the presidency of the Council of the European Union on 1 July 2016 for half a year. Organising various events, including the informal summit in Bratislava on 16 September, have put Slovakia in the spotlight of international attention and media.

In 2017, along with household consumption, gross fixed capital formation will again become a growth driver, not least due to the low base effect. Public investment projects such as the construction of highways and the Bratislava bypass together with private investment, such as the building of the Jaguar Land Rover plant and related investments by car parts suppliers, will take off. However, the latter will also trigger increased imports, which together with sluggish exports will have a neutral effect on net exports. Only with the start of operation at the new Jaguar Land Rover plant at the end of 2018/2019 new export capacities will provide fresh impetus to growth. For the next two years, solid growth is expected (3.1% in 2017 and 3.4% in 2018), while uncertainties surrounding Brexit might pose some risks for the time thereafter.

**Table 24 / Slovakia: Selected economic indicators**

	2012	2013	2014	2015 <sup>1)</sup>	2015 January-June	2016	2016 2017 Forecast	2018	
Population, th pers., average	5,408	5,413	5,419	5,424	.	.	5,429	5,434	5,439
Gross domestic product, EUR mn, nom.	72,420	73,835	75,561	78,071	37,283	38,456	80,200	83,700	88,100
annual change in % (real)	1.5	1.4	2.5	3.6	3.2	3.6	3.2	3.1	3.4
GDP/capita (EUR at exchange rate)	13,400	13,600	13,900	14,400	.	.	14,800	15,400	16,200
GDP/capita (EUR at PPP)	19,700	20,200	21,100	22,000	.	.	.	.	.
Consumption of households, EUR mn, nom.	40,868	41,083	42,010	42,945	21,135	21,594	.	.	.
annual change in % (real)	-0.4	-0.8	2.4	2.4	1.9	2.8	3.4	3.0	2.7
Gross fixed capital form., EUR mn, nom.	15,405	15,292	15,766	17,969	7,459	7,472	.	.	.
annual change in % (real)	-9.2	-1.1	3.5	13.9	8.3	0.7	-1.0	6.5	4.0
Gross industrial production									
annual change in % (real)	8.0	3.8	8.6	7.0	8.4	3.8	3.0	3.0	5.0
Gross agricultural production									
annual change in % (real)	-5.7	6.7	7.4	-4.8	.	.	.	.	.
Construction industry									
annual change in % (real)	-12.4	-5.3	-4.1	17.9	12.9	-0.9	.	.	.
Employed persons, LFS, th, average	2,329	2,329	2,363	2,424	2,404	2,476	2480	2500	2520
annual change in %	0.6	0.0	1.5	2.6	2.6	3.0	2.5	1.0	0.7
Unemployed persons, LFS, th, average	378	386	359	314	322	275	270	260	250
Unemployment rate, LFS, in %, average	14.0	14.2	13.2	11.5	11.8	10.0	9.8	9.5	9.0
Reg. unemployment rate, in %, end of period	14.4	13.5	12.3	10.6	11.6	9.5	.	.	.
Average monthly gross wages, EUR	805	824	858	883	858	884	910	940	980
annual change in % (real, gross)	-1.2	1.0	4.2	3.2	2.6	3.6	3.5	2.5	2.0
Consumer prices (HICP), % p.a.	3.7	1.5	-0.1	-0.3	-0.3	-0.5	-0.5	1.2	1.8
Producer prices in industry, % p.a.	1.9	-1.0	-3.5	-2.9	-3.1	-4.7	-4.5	1.5	2.0
General government budget, EU-def., % of GDP									
Revenues	36.2	38.6	39.2	42.7	.	.	40.8	40.4	40.2
Expenditures	40.5	41.3	41.9	45.6	.	.	43.2	42.6	42.0
Net lending (+) / net borrowing (-)	-4.3	-2.7	-2.7	-3.0	.	.	-2.4	-2.2	-1.8
Public debt, EU-def., % of GDP	52.4	55.0	53.9	52.9	.	.	53.2	53.6	52.3
Central bank policy rate, % p.a., end of period <sup>2)</sup>	0.75	0.25	0.05	0.05	0.05	0.00	.	.	.
Current account, EUR mn	684	1,446	100	-1,016	-4	-197	-800	-1,300	-1,000
Current account, % of GDP	0.9	2.0	0.1	-1.3	0.0	-0.5	-1.0	-1.6	-1.1
Exports of goods, BOP, EUR mn	60,159	62,145	62,581	65,900	32,468	33,760	68,500	71,200	75,100
annual change in %	10.0	3.3	0.7	5.3	3.4	4.0	4.0	4.0	5.5
Imports of goods, BOP, EUR mn	57,653	59,097	59,722	64,064	30,944	32,194	66,500	69,700	73,200
annual change in %	5.4	2.5	1.1	7.3	4.3	4.0	3.8	4.8	5.0
Exports of services, BOP, EUR mn	6,049	6,892	6,833	7,253	3,408	3,563	7,500	7,700	8,100
annual change in %	15.7	13.9	-0.8	6.1	2.8	4.6	4.0	3.0	5.0
Imports of services, BOP, EUR mn	5,628	6,481	6,749	7,163	3,296	3,374	7,300	7,700	8,100
annual change in %	2.4	15.2	4.1	6.1	1.8	2.4	2.0	5.0	5.0
FDI liabilities (inflow), EUR mn	1,356	757	27	1,917	1,583	1,616	2,400	.	.
FDI assets (outflow), EUR mn	-958	976	184	1,028	1,373	2,248	2,700	.	.
Gross reserves of NB excl. gold, EUR mn	620	670	1,165	1,648	1,345	1,606	.	.	.
Gross external debt, EUR mn	54,882	60,444	67,776	67,225	67,252	69,677	70,000	72,000	74,600
Gross external debt, % of GDP	75.8	81.9	89.7	86.1	86.1	86.9	87.3	86.0	84.7
Purchasing power parity EUR/EUR	0.6787	0.6741	0.6616	0.6540	.	.	.	.	.

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

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