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Slovakia:
Will export-led growth continue?

Prospects for Slovakia are less promising this year. Exceptionally high growth of production in the transport equipment sector and of its exports caused strong GDP growth in 2012, which will not be repeated this year. Due to this level effect GDP growth will slow down in 2013. However, net exports will probably stay the main driver of growth, supported by export markets outside the EU, which substitute for some export shortfalls coming from depressed European markets.

In 2012, Slovak GDP growth slowed down, but did well as compared to the other countries of the European Union: GDP grew by about 2%. Growth came exclusively from net exports: in the first three quarters of 2012 exports expanded by 9% – thanks to growing exports of cars not only to the shrinking European car markets but also to China, Russia and the US, while imports increased by merely 2%. Household consumption remained flat due to high unemployment and falling real wages. This was also a result of the surge of inflation that year, with consumer prices going up by 3.7%. Savings were on the rise due to negative future expectations. Government consumption slightly declined as fiscal consolidation was (slowly) on track. Gross capital formation fell by almost 12%, because of destocking and a drop in gross fixed capital formation by 3% (data for the first three quarters of 2012).

As regards branches, GDP growth came mostly from huge production increases in the transport equipment sector, surging by 44% in 2012. This was due to the three foreign-owned car manufacturers VW Bratislava, PSA Peugeot-Citroën and Kia – all located in the more prosperous Western region of Slovakia – introducing a third shift at the beginning of the year. (However, PSA Peugeot-Citroën then halted production at the end of the year for several days.) This translated into an increase in manufacturing production of about 12% in 2012. Other manufacturing sectors such as electrical equipment, textiles and clothing and the metals sector grew as well, while production of e.g. refining and chemicals was falling. The construction industry again did very badly in 2012; it shrank the fourth year in a row, resulting in a total contraction by one third compared to the 2008 level. The services sector, on the other hand, experienced small positive growth.

GDP growth was not reflected on the labour market: while employment increased somewhat at the beginning of 2012, its growth reversed in the second half. Unemployment went up at the end of 2012 probably in anticipation of changes in the Labour Code from January 2013 onwards – laying off people has become more expensive, the labour market less flexible. The unemployment rate climbed to 14%. Slovakia struggles with high long-term unemployment (9.2% of active population in 2012 Q3), high youth unemployment (34.4% of youth labour force in 2012 Q3) as well as with huge regional disparities, with regions in the East recording the highest unemployment rates (19.9% in the Košice region, which has a high number of Roma population). The main employer in the East is US Steel Košice with a workforce of 11,000 people. Recently rumours have appeared that US Steel wants to quit Slovakia (possibly due to heavy investment needs for environmental compliance) which would mean a setback to the region. However, unlike in Serbia, where US Steel left at the beginning of 2012, interest has been expressed for the Košice steelworks and the position of the company is there better (as regards products, smaller losses in 2011). US Steel became owner in 2000 and supplies the automotive industry, machinery and electro-technical industries. The European steel industry is currently negatively affected by the crisis, i.e. declining demand, low prices, and strong decline in the construction sector. The main obstacle to investment in Eastern Slovakia is still the missing highway connection to Košice. According to the most recent plans, the D1 highway to Košice will be completed by 2019 at the earliest, as nine stretches still have to be built.

Slovakia started 2013 with the celebration of its 20-year independence. Czechoslovakia ceased to exist on 31 December 1992 and the two new independent states emerged on 1 January 1993. This split was also named the 'Velvet Divorce'. While Slovakia's GDP per capita stood at 60% of the Czech one in 1993, the growth performance in the years following the split was, contrary to some expectations, higher than in the neighbouring countries and catching-up was impressive: in 2012, Slovakia achieved nearly 96% of the Czech GDP per capita level (at current PPPs) and it even overtook Hungary in 2007. All three countries have a successful transport equipment industry today, with shares in manufacturing value added of 18% in Slovakia, 20% in the Czech Republic and 17% in Hungary (2011). Per capita car production is even higher in Slovakia than in the Czech Republic (2011: 118 compared to 114 motor vehicles per 1000 inhabitants), while total vehicle production was about 640,000 in Slovakia compared to 1,200,000 in the Czech Republic in 2011 (for comparison: 202,800 in Hungary). The basic metals industry declined in the Czech Republic to 15%, while it increased in Slovakia to 20% of manufacturing value added, illustrating the importance of US Steel. The success of the Slovak industry has been based on low unit labour costs which have been about the same as in Hungary yet below the Czech level. Today, good relations prevail between the two countries; the Czech

Republic is Slovakia's second most important trading partner after Germany and also vice versa: Slovakia is the second largest export partner (after Germany) also for the Czech Republic.

The year 2013 brought about the abolishment of the famous flat tax in Slovakia, introduced back in 2004 at 19%. In the wake of the budget consolidation undertaken by the Social Democratic government in place since the March 2012 elections, a range of revenue-based measures have been in place either since September 2012 or the beginning of 2013. As of 2013, there has been a rise in the income tax rate to 25% for individuals with monthly salaries topping EUR 3246 (however, the impact will be largely symbolic and irrelevant for revenues taking into account the average monthly wage of EUR 800). More important is the increase in corporate tax from 19% to 23%. Other measures introduced before included a partial shift of pension contributions from the second to the first pension pillar, the extension of the basis of the bank levy or a special levy on corporations active in regulated businesses. In addition, the social contribution burden increased, a 5% tax rate was put on selected public officials and some administrative fees were raised (e.g. higher car registration fees for more powerful cars). Overall, the government strives to meet the EU-based fiscal consolidation targets of deficit to GDP ratios set at 2.9% for 2013, 2.4% in 2014 and 1.9% in 2015. However, the weaker than expected growth performance as well as additional demands by certain occupational groups (e.g. teachers calling for an additional 5% salary increase, or nurses) may put a threat thereon. Even for 2012 we estimate the budget deficit at 5% of GDP, far above the target of 4.6%. While the public debt level stood at 43.3% of GDP in 2011, it climbed to about 52% in 2012, also due to ESM contribution payments. Thus it will exceed the 50% threshold stipulated in the Constitutional Law on Budgetary Responsibility ('debt brake law') introduced in 2011. As a result the finance minister will have to inform the parliament and propose remedial steps.

Car production and exports have been the main drivers of growth. The number of cars produced is reported to have increased to more than 900,000 in 2012 which means a surge of more than 40%. Kia produced 292,000 cars last year, an increase of 15%. For this year Kia plans to produce 290,000 cars and to start production of a new car model. Volkswagen increased its production by 22% in the first half of 2012 and planned to double car production to 400,000. Overall, car production in 2013 will be about the same as in 2012. As regards new foreign investors, they might be discouraged by frequent changes of laws: this year – apart from changes in taxes and the labour code – there will be changes in the law on investment aid (making it stricter), procurement law, and the building law. On the other hand, the minister of economy has recently presented 41 measures to decrease administrative hurdles and to improve the economic framework conditions. A major deal at the beginning of this year is the sale of a 49% stake of Slovakia's main gas utility SPP to the Czech Energetický a Průmyslový Holding (EPH) from Germany's E.ON Ruhrgas and France's GDF Suez, who bought the share back in 2002. The economic sentiment indicator has declined since July last year. Interestingly, there was a quite strong upward trend in industrial confidence (a component of the economic sentiment indicator) in December and a small one in January as well. It remains to be seen whether this has been only temporary or the start of a new upturn.

Overall, future prospects are less promising: the exceptionally high growth figures in the transport equipment sector and its exports in 2012 will not be repeated. Due to this level effect, GDP growth will slow down in 2013 to about 1%. Net exports are nevertheless likely to remain the main driver of growth, as other demand components of GDP continue to be weak: in the course of fiscal consolidation, government consumption will probably decline; household consumption will remain flat as well and investment will recover only slightly. There are main risks to this scenario: growth prospects are fragile not only for Germany and the Czech Republic – Slovakia's main trading partners – but also for the rest of the EU. Exports outside the EU – China, Russia and the US, where growth prospects are more promising – might however substitute for some export shortfalls coming from depressed European markets.

Table SK

Slovakia: Selected Economic Indicators

	2008	2009	2010	2011	2012 1)	2013	2014	2015
							Forecast	
Population, th pers., average 2)	5406.6	5418.6	5430.1	5398.4	5410.0	5420	5430	5440
Gross domestic product, EUR mn, nom.	66842	62794	65870	69108	73100	76000	80200	84300
annual change in % (real)	5.8	-4.9	4.2	3.3	2.0	1.0	2.4	3.0
GDP/capita (EUR at exchange rate)	11900	11600	12100	12800	13500	14000	14800	15500
GDP/capita (EUR at PPP)	18100	17100	17900	18500	19200	.	.	.
Consumption of households, EUR mn, nom.	37573	37637	37735	39003	40200	.	.	.
annual change in % (real)	6.0	0.1	-0.8	-0.5	-0.5	0.0	1.0	3.0
Gross fixed capital form., EUR mn, nom.	16576	13025	13851	15957	16100	.	.	.
annual change in % (real)	1.0	-19.7	6.5	14.2	-3.0	2.0	3.0	4.0
Gross industrial production								
annual change in % (real)	3.1	-14.1	18.3	7.2	10.3	3.0	4.0	4.0
Gross agricultural production (EAA)								
annual change in % (real)	10.6	-12.3	-8.2	8.7	-9.6	.	.	.
Construction industry								
annual change in % (real)	11.9	-11.2	-4.6	-1.8	-12.5	.	.	.
Employed persons, LFS, th, average 3)	2433.7	2366.3	2317.5	2351.4	2330.0	2330	2350	2370
annual change in % 3)	3.2	-2.8	-2.1	1.5	0.5	0.0	1.0	1.0
Unemployed persons, LFS, th, average 3)	255.7	323.5	389.2	368.3	380.0	.	.	.
Unemployment rate, LFS, in %, average 3)	9.5	12.0	14.4	13.5	14.0	14.5	14.0	13.0
Reg. unemployment rate, in %, end of period	8.4	12.7	12.5	13.6	14.4	14.5	14.0	13.0
Average gross monthly wages, EUR	723	745	769	786	800	.	.	.
annual change in % (real, gross)	3.3	1.4	2.2	-1.6	-1.4	.	.	.
Consumer prices (HICP), % p.a.	3.9	0.9	0.7	4.1	3.7	3.0	3.0	2.0
Producer prices in industry, % p.a.	2.5	-6.6	0.1	4.4	2.1	2.0	2.0	2.0
General governm.budget, EU-def., % of GDP								
Revenues	32.8	33.5	32.3	33.2	32.7	.	.	.
Expenditures	34.9	41.5	40.0	38.2	37.6	.	.	.
Net lending (+) / net borrowing (-)	-2.1	-8.0	-7.7	-4.9	-5.0	-3.5	-3.0	-2.5
Public debt, EU-def., % of GDP	27.9	35.6	41.0	43.3	51.8	54.8	56.5	56.2
Central bank policy rate, % p.a., end of period 4)	2.50	1.00	1.00	1.00	0.75	.	.	.
Current account, EUR mn	-4021	-1627	-2453	-1429	1600	1500	1500	800
Current account, % of GDP	-6.2	-2.6	-3.7	-2.1	2.2	2.0	1.9	0.9
Exports of goods, BOP, EUR mn	49521	39721	48272	56960	63000	65000	68000	70000
annual growth rate in %	17.2	-19.8	21.5	18.0	10.6	3.0	4.0	3.0
Imports of goods, BOP, EUR mn	50280	38775	47494	55985	59100	61000	63000	66000
annual growth rate in %	17.2	-22.9	22.5	17.9	5.6	3.0	4.0	4.0
Exports of services, BOP, EUR mn	6001	4342	4397	4750	5400	5700	6100	6400
annual growth rate in %	16.8	-27.6	1.3	8.0	13.7	5.0	7.0	5.0
Imports of services, BOP, EUR mn	6488	5367	5141	5120	5100	5300	5600	6000
annual growth rate in %	36.6	-17.3	-4.2	-0.4	-0.4	4.0	5.0	7.0
FDI inflow, EUR mn	3323	-4	1336	1542	1500	500	.	.
FDI outflow, EUR mn	376	652	714	353	240	200	.	.
Gross reserves of NB excl. gold, EUR mn 5)	12674	481	541	659	620	.	.	.
Gross external debt, EUR mn	37286	45338	49262	52934	53000	.	.	.
Gross external debt, % of GDP	57.9	72.2	74.8	76.6	72.5	.	.	.
Purchasing power parity EUR/EUR	0.6813	0.6790	0.6790	0.6910	0.7054	.	.	.

Note: Gross industrial production, construction output and producer prices refer to NACE Rev. 2. Gross agricultural production refers to Economic Accounts for Agriculture (EAA).

1) Preliminary and wiiw estimates. - 2) From 2011 according to census May 2011. - 3) From 2012 data according to census May 2011. - 4) From 2009 official refinancing operation rates for euro area (ECB), two-week repo rate of NB before. - 5) 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.