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Slovakia:
after three-year boom, settling down to moderate growth

On 1 January 2009 Slovakia became the sixteenth country to join the eurozone. Since June 2008, when the conversion rate of the SKK to the euro was fixed, the process of adopting the euro has eased the impact of the financial crisis on the Slovak economy, providing a stable anchor for this small and very open economy. Whereas in the second half of 2008 the currencies in the neighbouring countries (the Czech Republic, Hungary and Poland) weakened against the euro at double-digit rates, the Slovak koruna stood firm.

Without doubt, the switch to the euro has removed the exchange rate risk and lowered both transaction and administrative costs for traders. The government hopes that the euro will attract more foreign investment and boost foreign trade, thus yielding a more rapid rise in the standard of living. However, with the Slovak koruna having appreciated by 28% over the period November 2005 to June 2008, imports have been made easier and exporters have come under heavy cost-related pressure. In fact, the strong currency has undermined Slovakia's competitiveness vis-à-vis its NMS neighbours – and hence the stability of the corporate sector. The pressure to rationalize has increased, with negative repercussions for both GDP growth and the labour market.

Despite weaker foreign demand (mostly in the final quarter), the GDP in Slovakia rose by 6.4% in 2008. Growth was driven in particular by household consumption and gross fixed capital formation. The former was stimulated by greater purchasing power attributable to rising employment and higher real incomes. Hitherto a major driving force behind GDP growth, exports lost momentum in the fourth quarter of 2008 when foreign demand plunged. Since the Slovak economy is extremely open, the impact of the global crisis has been felt quite strongly. After the extraordinarily high FDI-driven growth in the industrial sector in 2006 and 2007, the expansion of gross industrial output slowed down to 2% in 2008. As industrial employment (LFS data) rose by some 2%, labour productivity stagnated. With nominal wages rising by some 7%, unit labour costs went up. Nevertheless, the competitiveness of Slovak tradable goods still relies on relatively low nominal wages (and thus low unit labour costs). However, especially in the final two months of 2008, the effect of the financial crisis on the Slovak export-oriented industries became quite visible: output was down owing to a drop in global demand. The basic pillars of industry (predominantly in the hands of foreign investors) have been car manufacture, electro-technology, machinery and steel production. All of them were hit by falling foreign demand, recording a drop in output in the final months of 2008.

Owing to declining economic expansion, labour market conditions are worsening. Nevertheless, employment may drop only modestly as companies can reduce labour capacities by exploiting part-time work and early retirement schemes. However, unemployment will rise with the return home of Slovak migrant from abroad in the wake of rationalization measures in the host countries.

On account of the global financial crisis, both the opportunities for potential strategic investors to gain access to loan financing and the trust between entrepreneurs and banks have also worsened in Slovakia. Furthermore, the drop in foreign demand will probably sweep the market clean as weaker (especially small) firms become susceptible to risk, although the government is trying to help by offering them guaranteed loans. Moreover, in an effort to preserve employment, the government plans to lend financial support to certain sectors which have yet to be explicitly identified. The sum envisaged for supporting employment is of the order of EUR 300 million or 0.4% of the GDP. Further suggestions are expected to emerge from the so-called ‘crisis group’ set up by the cabinet, the membership of which has been drawn from the ranks of the banking sector, trade unions and employers, as well as town and village administrations. This advisory body has set itself the priority task of trying to minimize the negative impact of the global crisis on the Slovak economy.

GDP growth will undoubtedly slow down in the years to come, primarily on account of the slump in foreign demand. In addition, seen from the supply-side perspective, industrial production in January 2009 was hit by energy shortages caused by the interruption of gas supplies from Russia via Ukraine. Because Slovakia relies fully on Russian gas and has no emergency storage capacities, the country was one of the hardest hit as some thousand Slovak companies were forced to cut back their gas consumption to a minimum for nearly two weeks. In addition to the problem of external supplies, Slovakia has also suffered some home-made energy shortages that will have an impact on the country’s energy balance over the next few years. Pursuant to its commitment to the EU, Slovakia shut down the first reactor at the nuclear power-station in Jaslovske Bohunice at the end of 2006, followed by a second reactor two years later. Although, Slovenske Elektrarne (SE), a subsidiary of the Italian company Enel, has started to put the finishing touches to two units at the nuclear power plant in Mochovce, Slovakia currently has to import electricity.

Following the period of extraordinarily high economic expansion and despite the steep decline in external demand, the Slovak economy may maintain modest positive rates of growth over the years to come. The period of high FDI-inflows will definitely not return for a couple of years. However, little new production capacity will be required over the next two or three years, because the current under-exploited potential may suffice to accommodate lower demand, thus making for moderate GDP growth of around 2%. Compared to other EU countries, this is still relatively rapid economic expansion. For the most part, it will be driven by domestic demand because, in line with EU policy, the Slovak government will stimulate domestic demand by means of deficit spending. Generous social transfers will fuel household consumption. Thanks to EU transfers, the state will co-finance ambitious infrastructure projects and thus support economic expansion. Indeed, with public debt accounting for just 29% of GDP, Slovakia has more financial manoeuvring space in which to adopt extraordinary measures in these extraordinary times than most other EU countries. Nevertheless, Slovakia’s first euro-denominated state budget deficit has been set at only 2.1% of the GDP for 2009, the lowest in recent history. However, given the pro-growth measures and the co-financing needs of the EU funds, the approved deficit seems highly optimistic – in the light of the slowdown in economic growth and thus lower budgetary revenues. It is evident that, in the euro club, fiscal discipline will be sacrificed in favour of swifter recovery from recession. The foreign trade deficit will rise modestly, particularly on account of the sharp drop in foreign demand. However, the total external position will worsen only slightly as both the slowdown in GDP growth in Slovakia and the reduction of economic activities in the major trading countries will constrain foreign trade turnover in terms of both exports and imports.

Table SK

Slovak Republic: Selected Economic Indicators

	2003	2004	2005	2006	2007	2008 [1]	2009	2010	2011
								Forecast	
Population, th pers., average	5379.6	5382.4	5387.0	5391.4	5397.3	5406.0	.	.	.
Gross domestic product, EUR-SKK mn, nom. [2]	40607.1	45211.5	49315.2	55081.9	61501.1	66100	68100	70200	73800
annual change in % (real) [2]	4.7	5.2	6.5	8.5	10.4	6.4	2	2	3
GDP/capita (EUR at exchange rate)	5500	6300	7100	8300	10200	11800	.	.	.
GDP/capita (EUR at PPP)	11500	12400	13500	15000	16700	17300	.	.	.
Consumption of households, EUR-SKK mn, nom. [2]	22635.3	25327.5	27691.8	30753.1	33795.3	.	.	.	.
annual change in % (real) [2]	1.6	4.2	6.6	5.9	7.1	6	4	2	3
Gross fixed capital form., EUR-SKK mn, nom. [2]	10050.5	10836.0	13089.5	14588.8	16048.5	.			
annual change in % (real) [2]	-2.7	4.8	17.6	9.3	8.7	6	2	2	3
Gross industrial production									
annual change in % (real) [3]	5.0	4.2	3.6	9.8	13.2	1.3	-3	0	2
Gross agricultural production									
annual change in % (real)	-3.7	12.5	-8.7	-2.9	-4.5	5.0	.	.	.
Construction industry (build.& civil engin.)									
annual change in % (real) [3]	5.9	5.8	14.7	14.9	5.7	11.9	.	.	.
Employed persons - LFS, th, average	2164.6	2170.4	2215.2	2302.3	2357.7	2438	.	.	.
annual change in %	1.8	0.3	2.1	3.9	2.4	3.4	.	.	.
Unemployed persons - LFS, th, average	459.2	480.7	430.0	355.4	295.7	270	.	.	.
Unemployment rate - LFS, in %, average	17.4	18.1	16.3	13.4	11.1	10.0	11	12	12
Reg. unemployment rate, in %, end of period	15.6	13.1	11.4	9.4	8.0	8.4	9	10	10
Average gross monthly wages, EUR-SKK [4]	477	525	573	623	669	730	.	.	.
annual change in % (real, gross)	-2.0	2.5	6.3	3.3	4.3	5.0	.	.	.
Consumer prices (HICP), % p.a.	8.4	7.5	2.8	4.3	1.9	3.9	2	2	3
Producer prices in industry, % p.a. [5]	8.3	2.6	5.4	5.7	-1.2	2.8	2	2	3
General governm.budget, EU-def., % GDP [6]									
Revenues	37.4	35.4	35.3	33.5	32.7	32.0	.	.	.
Expenditures	40.1	37.7	38.1	37.1	34.6	34.3	.	.	.
Net lending (+) / net borrowing (-)	-2.7	-2.3	-2.8	-3.5	-1.9	-2.3	-3.0	-3.0	-3.0
Public debt, EU-def., in % of GDP [6]	42.4	41.4	34.2	30.4	29.4	28.8			.
Discount rate of NB, % p.a., end of period	6.0	4.0	3.0	4.8	4.3	2.5	.	.	.
Current account, EUR mn	-1747	-2656	-3268	-3636	-3141	-4000	-4500	-4800	-5000
Current account in % of GDP	-5.9	-7.8	-8.5	-8.2	-5.7	-6.3	-6.6	-6.8	-6.8
Exports of goods, BOP, EUR mn	19359	22248	25654	33349	42171	48000	48000	49000	51000
annual growth rate in %	26.8	14.9	15.3	30.0	26.5	14	0	3	5
Imports of goods, BOP, EUR mn	19924	23485	27571	35817	43009	49000	49000	50000	53000
annual growth rate in %	13.7	17.9	17.4	29.9	20.1	14	1	3	5
Exports of services, BOP, EUR mn	2912	3000	3542	4322	5140	6000	6200	6400	6800
annual growth rate in %	-1.5	3.0	18.1	22.0	18.9	17	4	4	6
Imports of services, BOP, EUR mn	2703	2785	3285	3790	4752	6000	6400	6800	7200
annual growth rate in %	9.2	3.0	18.0	15.4	25.4	26	6	6	6
FDI inflow, EUR mn	1914	2441	1952	3311	2108	1600	.	.	.
FDI outflow, EUR mn	219	-17	120	292	149	200	.	.	.
Gross reserves of NB excl. gold, EUR mn	9338	10605	12567	9639	12277	12600	.	.	.
Gross external debt, EUR mn	14654	17421	22705	24449	30156	39000	.	.	.
Gross external debt in % of GDP	49.3	49.6	57.9	50.7	54.7	59.0	.	.	.
Average exchange rate EUR-SKK/EUR	1.377	1.328	1.281	1.236	1.121	1.038	1.00	1.00	1.00
Purchasing power parity EUR-SKK/EUR	0.657	0.679	0.676	0.681	0.683	0.706	.	.	.

Note: Slovakia has introduced the Euro from 1 January 2009. For statistical purposes all time series in SKK as well as the exchange rates and PPP rates have been divided by the conversion factor 30.126 (SKK per EUR) to EUR-SKK.
The term 'industry' refers to NACE classification C+D+E.

1) Preliminary and wiiw estimates. - 2) According to ESA'95 (FISIM adjusted and real change based on previous year prices). - 3) Enterprises with more than 20 employees. - 4) From 2006 including wages of armed forces. - 5) Until 2003 domestic output prices. - 6) According to ESA'95, excessive deficit procedure.

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