SLOVAKIA: Future growth constrained by labour shortages

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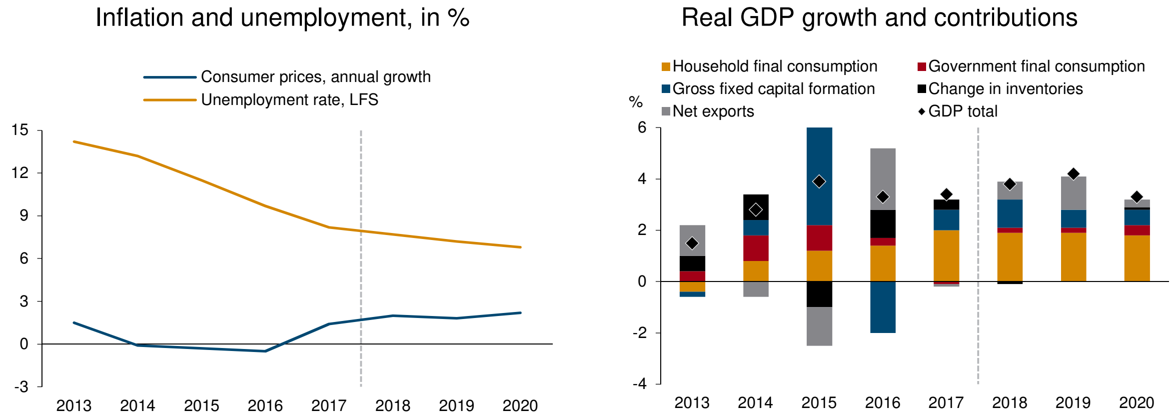
Slovakia grew at a solid pace throughout 2017, fostered by accelerating household consumption. Forecasts for this and the next year amount to 3.8% and around 4%, respectively, thanks to capacity increases in the automotive industry, before falling back to 3.3% in 2020. However, growing wages and labour shortages may threaten future growth prospects.

Figure 58 / Slovakia: Main macroeconomic indicators



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

The stable growth performance has been driven mainly by household consumption. In 2017, Slovak real GDP expanded by 3.4% year on year, only slightly more than in 2016 (3.3%). Although stable, this was below the average of the Central and East European EU countries (EU-CEE) and represented one of the lowest growth rates in the EU-CEE region. Household consumption was the main growth driver, thanks to favourable developments in the labour market. In fact, growth of household consumption accelerated over the first three quarters of 2017 and reached a peak of 3.7%, the highest rate since the 2008 recession. It was backed by rising employment and declining unemployment rates: the number of employed persons increased by 1.5% while the unemployment rate (LFS) fell by 1.5pp to 8.2%. Although the latter rate appears to be high in comparison with other neighbouring countries, it was in fact at a historic low level in Slovakia. Moreover, strong regional differences continue to exist within Slovakia, with low unemployment rates in the West – where most of the manufacturing companies are located – and high unemployment rates in the East with fewer job opportunities.

Household consumption has been fostered by growing wages. Real wages grew by 3.3% in the first three quarters of 2017, still at moderate levels. Inflation made up part of nominal wage increase and reached 1.4% in 2017, after three years of deflation. Wages are pushed up by administrative measures, e.g. government measures to introduce surcharges for night and weekend work (in two steps, May 2018 and May 2019) or continuous increases in the minimum wage. Also, the shortage of skilled labour puts pressure on wages to rise. There is a risk of labour-intensive jobs moving out of Slovakia, also discouraging new foreign investors. At the beginning of 2018, Samsung confirmed that it will shut down its smaller plant in Voderady probably already in April; production and employees are said to move to the Galanta plant (in Western Slovakia). Entrepreneurs have called for legislation to be simplified allowing foreign workers (in particular, Ukrainians and Serbs) to work legally in Slovakia – a step that has been accomplished recently.

Investments are still underperforming. While investment picked up finally in the third quarter of 2017 (+10% in Q3 year on year), gross fixed capital formation was still underperforming over the first three quarters of 2017 (2%). The construction sector improved only marginally, also due to the delay of major infrastructure projects, such as the construction of the Bratislava Ring Road. The never-ending project, the construction of the Bratislava-Košice motorway, may be finished in 2026 ‘at the earliest’. Absorption of EU funds has been typically slow in Slovakia. Overall, however, inventories were built up, raising gross capital formation by 6% in the first three quarters of 2017.

Industrial production went up but automotive industry growth was low in 2017. Regarding the sectoral structure, industrial production grew by 4% in 2017 on an annual basis. Overall, the major industrial sector in Slovakia – the automotive industry – showed a weak performance in 2017 and contributed to growth only at the end of the year. The three Slovak car plants – VW Bratislava, KIA Motors and PSA Peugeot-Citroën – produced a slightly lower number of cars in 2017 than the year before (1.025 million compared to 1.04 million). Still, Slovakia has remained on the first place as the largest car producer per capita worldwide. A change of models and the new Jaguar Land Rover plant (starting production at the end of 2018) will provide a new growth impetus in the coming years. The main sectors contributing to growth in 2017 were thus basic metals & fabricated metal products and rubber & plastic & other non-metallic mineral products, followed by transport and electrical equipment. Only two industries showed declining production figures: computer, electronic & optical products and the textile & leather sector.

The external sector had a slightly negative impact on growth. Goods imports increased faster than goods exports over the first eleven months of 2017. Goods imports rose by 8.6% whereas exports increased by about 7%. While exports to Slovakia’s main trading partner Germany declined slightly (by 1%), those to the Czech Republic (Slovakia’s second major trading partner) rose by some 4%. The trade balance was positive with a surplus of EUR 1 billion (balance of payments statistics). Looking at services trade, exports expanded more dynamically with 10% (e.g. transport services), whereas imports rose by 4%. Overall, the impact of net exports on growth was most probably slightly negative for the whole year 2017. The balance of payments for 2017 remained negative as negative primary and secondary incomes outweighed positive goods and services trade balances.

There are new general government deficit and debt targets. The government deficit figure for 2016 has been revised and became larger, finally reaching -2.2% (instead of -1.7%), while the debt to GDP ratio remained at 51.8%. For 2017, the estimated figures are at 1.6% and 50.9%, respectively. The

General Government Budget Proposal 2018-2020 foresees deficit figures at -0.8% for 2018 and -0.3% for 2019 and 2020. However, these figures must be regarded as lower limits as they are constantly being revised upwards. For 2018, the impact of social measures on the budget is still unclear; wages of civil servants increased as of 1 January. Furthermore, changes within the Fiscal Responsibility Law have to be kept in mind: Thresholds for the debt to GDP ratio will decline from the fiscal year 2018 onwards (the 50-60% debt to GDP thresholds will continuously decline, by 1 percentage point per year, to 40% by 2027).

Capacity increases in the automotive industry will spur growth in the coming years, but some shadows are still ahead. The wiiw forecast for this year and the next has been revised slightly upwards due to stronger expected household consumption. For 2018, growth is going to reach 3.8%; it will accelerate and amount to more than 4% in 2019 before falling back to about 3.3% in 2020. With the new Jaguar Land Rover car manufacturing plant – planned to start operation at the end of 2018 – exports will increase and provide a major impetus to growth. Besides, the booming economy in Slovakia's main trading partners (Germany, Czech Republic) with rising private consumption in these countries will support Slovak exports. In addition, growing household consumption will form the basis of sustained growth. A substantial recovery of investment will occur only beyond the time horizon of our forecast, owing to delayed drawing of EU funds. The booming automotive industry in Slovakia has attracted new investment, plants and suppliers in recent years. Hence, the information that one of the Samsung plants is closing down comes as a surprise. Overall, Samsung is listed as the fourth largest company in Slovakia (after Volkswagen Bratislava, Kia Motors, and Slovnaft, and before PSA Peugeot-Citroën) and flat TV screens are a major export item apart from cars and car parts. Thus, the main risks to our forecast are growing labour shortages and the consequences thereof. External risks such as the Brexit and possible related shrinkage of EU funds remain but will materialise only in the longer run.

Table 28 / Slovakia: Selected economic indicators

	2013	2014	2015	2016	2017 1)	2018	2019	2020
							Forecast	
Population, th pers., average	5,413	5,419	5,424	5,431	5,430	5,440	5,440	5,450
Gross domestic product, EUR mn, nom.	74,170	76,088	78,896	81,154	83,490	88,400	93,800	99,000
annual change in % (real)	1.5	2.8	3.9	3.3	3.4	3.8	4.2	3.3
GDP/capita (EUR at PPP)	20,500	21,300	22,300	22,400	23,300	.	.	.
Consumption of households, EUR mn, nom.	41,084	41,605	42,496	43,473	44,900	.	.	.
annual change in % (real)	-0.8	1.4	2.3	2.6	3.8	3.6	3.5	3.3
Gross fixed capital form., EUR mn, nom.	15,374	15,772	18,890	17,196	17,470	.	.	.
annual change in % (real)	-0.9	3.0	19.8	-8.3	2.1	5.0	3.5	3.0
Gross industrial production								
annual change in % (real)	3.8	3.6	7.3	4.8	3.9	5.0	6.0	3.0
Gross agricultural production								
annual change in % (real)	6.7	7.4	-3.2	13.9	-9.6	.	.	.
Construction industry								
annual change in % (real)	-5.3	-4.1	17.9	-10.7	3.2	.	.	.
Employed persons, LFS, th, average	2,329	2,363	2,424	2,492	2,530	2560	2580	2600
annual change in %	0.0	1.5	2.6	2.8	1.5	1.0	0.7	0.7
Unemployed persons, LFS, th, average	386	359	314	267	230	210	200	190
Unemployment rate, LFS, in %, average	14.2	13.2	11.5	9.7	8.2	7.7	7.2	6.8
Reg. unemployment rate, in %, eop	13.5	12.3	10.6	8.8	5.9	.	.	.
Average monthly gross wages, EUR	824	858	883	912	960	1010	1060	1120
annual change in % (real, gross)	1.0	4.2	3.2	3.8	3.3	3.5	3.5	3.0
Consumer prices (HICP), % p.a.	1.5	-0.1	-0.3	-0.5	1.4	2.0	1.8	2.2
Producer prices in industry, % p.a.	-1.0	-3.5	-2.9	-4.1	2.4	3.0	2.5	2.5
General governm.budget, EU-def., % of GDP								
Revenues	38.7	39.3	42.5	39.3	39.8	39.8	40.2	39.5
Expenditures	41.4	42.0	45.2	41.5	41.4	40.9	40.7	39.7
Net lending (+) / net borrowing (-)	-2.7	-2.7	-2.7	-2.2	-1.6	-1.1	-0.6	-0.2
General gov.gross debt, EU def., % of GDP	54.7	53.5	52.3	51.8	51.1	49.4	48.5	47.3
Stock of loans of non-fin.private sector, % p.a.	5.4	6.7	9.7	9.3	9.9	.	.	.
Non-performing loans (NPL), in %, eop	5.8	6.0	5.2	4.7	3.9	.	.	.
Central bank policy rate, % p.a., eop 2)	0.25	0.05	0.05	0.00	0.00	.	.	.
Current account, EUR mn	1,379	871	-1,391	-1,205	-1,000	-500	300	500
Current account, % of GDP	1.9	1.1	-1.8	-1.5	-1.2	-0.6	0.3	0.5
Exports of goods, BOP, EUR mn	62,410	62,581	64,650	67,206	70,200	74,800	81,200	85,000
annual change in %	3.7	0.3	3.3	4.0	4.5	6.5	8.5	4.7
Imports of goods, BOP, EUR mn	59,503	59,823	63,601	65,542	68,800	72,900	78,400	81,900
annual change in %	3.2	0.5	6.3	3.1	5.0	6.0	7.6	4.5
Exports of services, BOP, EUR mn	6,965	6,889	7,301	7,588	8,300	8,700	9,000	9,300
annual change in %	15.1	-1.1	6.0	3.9	9.4	5.0	3.0	3.0
Imports of services, BOP, EUR mn	6,481	6,713	7,144	7,180	7,400	7,800	8,200	8,600
annual change in %	15.2	3.6	6.4	0.5	3.1	5.0	5.0	5.0
FDI liabilities, EUR mn	757	-324	1,357	3,234	3,000	.	.	.
FDI assets, EUR mn	976	94	1,266	3,725	2,500	.	.	.
Gross reserves of NB excl. gold, EUR mn	670	1,165	1,648	1,624	1,609	.	.	.
Gross external debt, EUR mn	60,444	67,776	67,225	73,750	80,000	82,500	84,000	85,500
Gross external debt, % of GDP	81.5	89.1	85.2	90.9	95.8	93.3	89.6	86.4

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

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