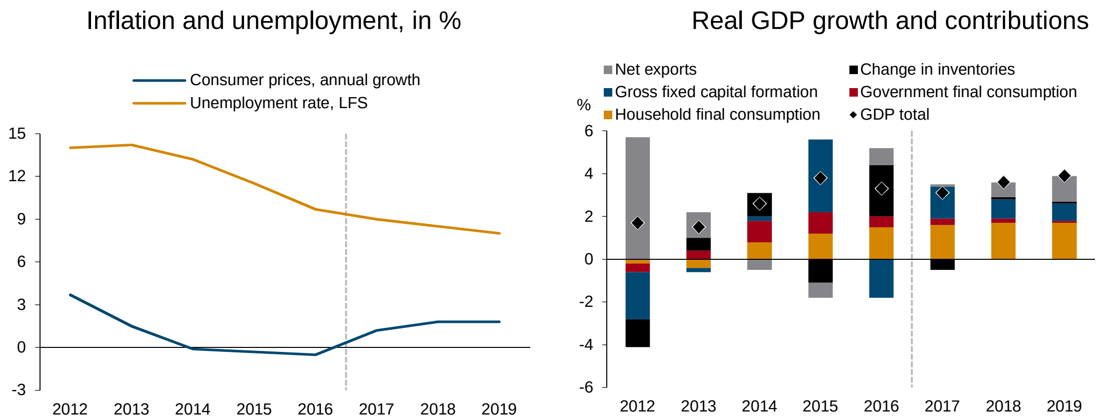
SLOVAKIA: Moving into the fast lane from 2018 amid rising external risks

DORIS HANZL-WEISS

In 2016, a strong decline in gross fixed capital formation depressed GDP growth to 3.3%. For 2017, Slovak growth is forecast to be around 3%, while in 2018 and 2019 an increase in the capacity of the automotive industry should stimulate faster growth close to 4%.

Figure 51 / Slovakia: Main macroeconomic indicators



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

After a strong GDP increase of 3.8% in 2015, growth slowed in 2016 to about 3.3%. This was due to a sharp drop in gross fixed capital formation: the EU's new programme period is only starting, whereas 2015 was the last year of disbursements under the old EU Multiannual Financial Framework. The construction sector, which finally recovered in 2015 after contracting for six years in a row, again saw a double-digit fall in production in 2016 (-11%). On the other hand, growth was supported by an increase in household consumption (+2.8% in the first three quarters). This, however, was lower than expected, considering the significant improvements on the labour market: employment grew by almost 3% in the first three quarters and the unemployment rate fell to a record low of 9.5%. However, regional disparities are still large and unemployment rates range from 3.3% (in some districts in the west) to 24.6% (in Rimavská Sobota, in the Central region, on the border with Hungary). A shortage of qualified labour is emerging, which is also putting pressure on wages. Real wage growth reached about 4% in 2016, supported by deflation. Consumer prices fell for the third consecutive year (by 0.5%). The minimum wage rose at the beginning of 2017 to EUR 435 (up EUR 30 from last year).

The automotive sector is doing well and capacity will increase from 2018/2019 onward. Looking at sectoral trends, industrial production increased by 3.4% in 2016, with the automotive industry – the largest sector of Slovak manufacturing – the major growth driver. The three main car manufacturers – Volkswagen Bratislava, KIA Motors and PSA Peugeot-Citroën – produced more than 1 million cars in 2016, about the same number as in 2015. Major increases in automotive industry capacity are scheduled for the next two years. Jaguar Land Rover is currently building a plant near Nitra, which should start operating in 2018/2019. Initial annual production capacity will be 150,000 cars (rising eventually to 300,000 cars), and about 2,800 workers will be employed. The investment amounts to more than EUR 1 billion. It is also expected that further investment by car suppliers will follow. In addition, the Japanese producer of car parts Minebea is coming to Košice – a major investment in the less prosperous eastern Slovakia. The investment sum amounts to EUR 60 million. About 1,100 jobs will be created and an R&D centre will probably be built later. Moreover, PSA plans to launch the production of engines from 2018/2019. Aside from the automotive sector, the basic metals and fabricated metal products and the electrical equipment industries both contributed significantly to industrial growth. The major Slovak steel plant US Steel Košice, with more than 10,000 employees, may be sold to the Chinese He Steel, after a memorandum of understanding was signed in January 2017. (He Steel took over the Serbian Smederevo steel mill in 2016, which was abandoned by US Steel in 2012.) There are reportedly fears of production changes and massive lay-offs. Back in 2013, the government offered US Steel some incentives, in return for a promise to stay in the country and maintain existing employment levels until 2018.

The external sector contributed to growth in 2016. Goods exports expanded by 3.6%, while goods imports rose by only 3.1% compared to 2015. Germany is the main export destination for Slovak products, accounting for about 22% of total exports and expanding by 1.3% in 2016 (January to November, compared to the same period the previous year). The Czech Republic is the second major export destination, with 12% of exports (down 1% in 2016). Exports to other important partners, such as Italy, France and the UK, expanded by around 10% each, while those to Austria and Poland declined slightly. The current account moved again into positive territory in 2015, thanks to revisions for that year. The negative primary and secondary income balance was reduced (from EUR -3 billion to about EUR -2 billion), but is still the same amount as the goods trade balance of EUR +2 billion. Trends will be the same for 2016.

No major changes in fiscal policy are envisaged; the thresholds of the Fiscal Responsibility Law will decline from 2018 onwards. The Slovak budget deficit was revised downward for 2015 to -2.7% of GDP (instead of -3%), and the debt level declined to 52.5% of GDP. For 2016, the state budget deficit (part of the general government deficit) reached a low level, while health care and local government expenditure will probably have risen. The 2017 budget, on the revenue side, prolonged (and indeed doubled) the special levy for regulated businesses; while on the expenditure side, the corporate tax rate was reduced by 1 percentage point (to 21%). Deficit targets are set to decrease over the next years (2017: -1.9%, 2018: -0.4%), with a balanced budget expected to be reached in 2019. However, such targets have never yet been met. More effort will have to be made, as the thresholds incorporated into the Fiscal Responsibility Law will decline from the fiscal year 2018 onwards (the five sanction's bands between 50% and 60% will decline steadily by 1 percentage point a year to 40-50% by 2027). Loans to households are still increasing by about 13% a month, constituting a rising risk on the domestic market, due to rapidly increasing household debt levels. Loans to corporations are up again since July 2016, increasing by 5% a month since then. Overall, the banking sector is in good shape and the share of non-performing loans is low (about 5%).

The government is stable, with occasional scandals. From 1 July 2016 to December 2016, Slovakia managed its first ever presidency of the Council of the European Union. Though regarded as an overall success (e.g. a major summit took place in Bratislava on 16 September in response to the Brexit vote, producing the Bratislava declaration and Bratislava roadmap; there was agreement on the EU budget for 2017; and there has been progress in eliminating mobile roaming charges and geo-blocking), the presidency ended with a scandal concerning overpriced events. Speculation that the government would last only until the end of the presidency has proved unfounded. A scandal over high energy prices, however, led to some tension in the coalition at the start of the year.

The forecast is good to excellent, despite rising external risks. For 2017, Slovak growth is forecast to hover around 3%, while in 2018 and 2019 an increase in automotive industry capacity should stimulate growth close to 4%. In 2017, growth will be supported by rising household consumption and a revival in gross fixed capital formation. There will be infrastructure investment – such as the construction of new sections of highway and the Bratislava bypass. Net exports are expected to be balanced, as investment in new plants will spur import needs. From 2018 to 2019, these new capacities will create a surge in exports, thus providing a strong growth impetus. However, external risks are on the rise. Brexit is looming, creating uncertainty about possible (trade) effects. The British market is an important export destination for Slovakia, accounting for about 6% of Slovak exports – and probably more once the Jaguar plant starts production. In addition, the new US presidency might introduce further trade barriers. Increasing protectionism could damage export opportunities to the US (currently the export share is 2.4%), redirect investment from the region to the US, or lure US companies back from Slovakia.

Table 22 / Slovakia: Selected economic indicators

	2012	2013	2014	2015	2016 [1]	2017	2018	2019
							Forecast	
Population, th pers., average	5,408	5,413	5,419	5,424	5,428	5,434	5,439	5,439
Gross domestic product, EUR mn, nom.	72,704	74,170	75,946	78,686	80,900	84,400	89,000	94,100
annual change in % (real)	1.7	1.5	2.6	3.8	3.3	3.1	3.6	3.9
GDP/capita (EUR at PPP)	20,100	20,500	21,300	22,300	23,100	.	.	.
Consumption of households, EUR mn, nom.	40,868	41,084	41,605	42,469	43,400	.	.	.
annual change in % (real)	-0.4	-0.8	1.4	2.2	2.8	3.0	3.1	3.2
Gross fixed capital form., EUR mn, nom.	15,446	15,374	15,495	18,108	16,600	.	.	.
annual change in % (real)	-9.0	-0.9	1.2	16.9	-8.0	6.5	4.0	3.5
Gross industrial production								
annual change in % (real)	8.0	3.8	8.6	7.0	3.3	3.0	5.0	6.0
Gross agricultural production								
annual change in % (real)	-5.7	6.7	7.4	-3.2	7.4	.	.	.
Construction industry								
annual change in % (real)	-12.4	-5.3	-4.1	17.9	-10.6	.	.	.
Employed persons, LFS, th, average	2,329	2,329	2,363	2,424	2,480	2500	2520	2530
annual change in %	0.6	0.0	1.5	2.6	2.3	1.0	0.7	0.5
Unemployed persons, LFS, th, average	378	386	359	314	266	250	230	220
Unemployment rate, LFS, in %, average	14.0	14.2	13.2	11.5	9.7	9.0	8.5	8.0
Reg. unemployment rate, in %, end of period	14.4	13.5	12.3	10.6	8.8	.	.	.
Average monthly gross wages, EUR	805	824	858	883	910	950	990	1030
annual change in % (real, gross)	-1.2	1.0	4.2	3.2	3.8	3.0	2.5	2.5
Consumer prices (HICP), % p.a.	3.7	1.5	-0.1	-0.3	-0.5	1.2	1.8	1.8
Producer prices in industry, % p.a.	1.9	-1.0	-3.5	-2.9	-4.1	1.5	2.0	2.5
General governm.budget, EU-def., % of GDP								
Revenues	36.3	38.7	39.3	42.9	40.8	40.4	40.2	40.5
Expenditures	40.6	41.4	42.0	45.6	43.2	42.6	42.0	41.3
Net lending (+) / net borrowing (-)	-4.3	-2.7	-2.7	-2.7	-2.4	-2.2	-1.8	-0.8
Public debt, EU-def., % of GDP	52.2	54.7	53.6	52.5	52.2	52.0	51.7	51.0
Stock of loans of non-fin.private sector, % p.a.	3.2	5.4	6.7	9.7	9.3	.	.	.
Non-performing loans (NPL), in %, Dec	5.8	5.8	6.0	5.2	4.6	.	.	.
Central bank policy rate, % p.a., end of period [2]	0.75	0.25	0.05	0.05	0.00	.	.	.
Current account, EUR mn	684	1,357	904	168	-489	350	830	1,400
Current account, % of GDP	0.9	1.8	1.2	0.2	-0.6	0.4	0.9	1.5
Exports of goods, BOP, EUR mn	60,159	62,410	62,581	66,089	68,298	71,000	74,900	80,400
annual change in %	10.0	3.7	0.3	5.6	3.3	4.0	5.5	7.3
Imports of goods, BOP, EUR mn	57,653	59,399	59,722	63,974	65,865	68,500	71,900	76,600
annual change in %	5.4	3.0	0.5	7.1	3.0	4.0	5.0	6.6
Exports of services, BOP, EUR mn	6,049	6,928	6,821	7,239	7,492	7,700	8,100	8,300
annual change in %	15.7	14.5	-1.5	6.1	3.5	3.0	5.0	3.0
Imports of services, BOP, EUR mn	5,628	6,570	6,713	7,144	7,158	7,500	7,900	8,300
annual change in %	2.4	16.7	2.2	6.4	0.2	5.0	5.0	5.0
FDI liabilities, EUR mn	1,356	757	-324	1,017	4,278	.	.	.
FDI assets, EUR mn	-958	976	94	1,028	3,994	.	.	.
Gross reserves of NB excl. gold, EUR mn	620	670	1,165	1,648	1,624	.	.	.
Gross external debt, EUR mn	54,882	60,444	67,776	67,225	72,000	74,600	75,000	77,000
Gross external debt, % of GDP	75.5	81.5	89.2	85.4	89.0	88.4	84.3	81.8

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.