SLOVAKIA: Strong growth at stake?

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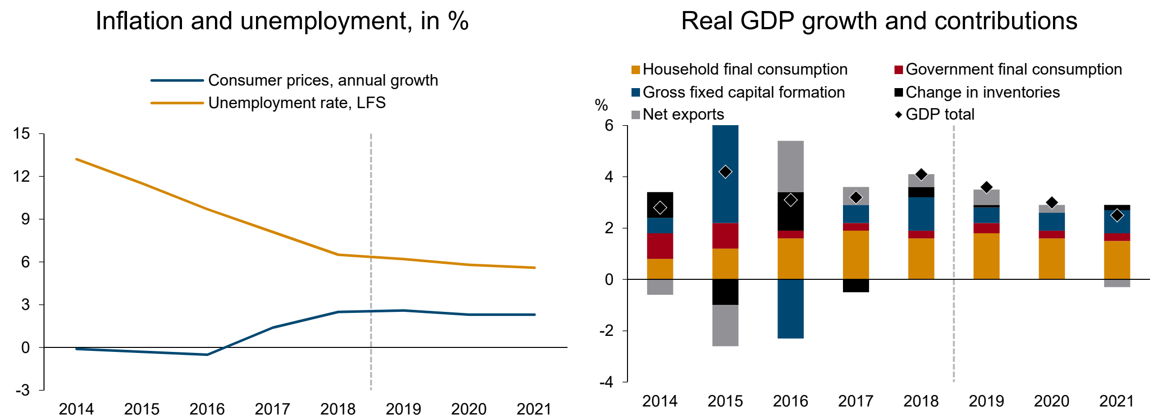
Slovakia saw high growth in 2018, thanks to increasing household consumption and gross capital formation. However, our forecasts for this and next year have been revised downwards and amount to 3.6% in 2019 and about 3% thereafter. Domestic and external risks are on the rise.

Figure 6.20 / Slovakia: Main macroeconomic indicators



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

Growth was strong in 2018, but slowed towards the end of the year. Slovak GDP saw a substantial rise in 2018, increasing by 4.1%, compared to about 3% in the previous two years. However, GDP growth in the fourth quarter (3.6%, year on year) was somewhat lower than in the second (4.5%) and third quarters (4.6%) (non-adjusted data). Overall, growth was driven mainly by household consumption, which increased by 3% during the first three quarters. Also consumption of government rose slightly (+1%). Gross capital formation surged by 7%, mostly thanks to growth in gross fixed capital formation (+6%) as well as building up of inventories. Construction experienced a favourable development in 2018, expanding by 8.4% during the whole year. Exports of goods and services rose by 4.8% during the first three quarters, imports by 4.4, thus showing a slightly positive effect.

The labour market is tight, which will ensure that high wage growth continues, but part of this will find its way into higher savings rather than consumption. Household consumption rose less than the good conditions on the labour market would suggest, due to an increase in the savings rate. Employment is growing and the unemployment rate is going down. The number of persons employed increased by 1.3% during the first three quarters of 2018 while the unemployment rate fell to 6.7% (LFS). This represents a huge improvement, with the unemployment rate coming down from 14% after the economic and financial crisis. Still it has to be noted that large regional disparities exist, with low unemployment rates in the West and higher ones in the Eastern part of the country where less jobs and

FDI is located. On the other hand, shortages of skilled labour are increasing. In order to counteract this trend, measures to simplify work permit processing have been in effect since January 2019. The number of foreign workers (in particular from Serbia, Ukraine or Romania) goes slightly up.

Rising wages and surcharges are putting off weekend shifts in the automotive industry already and might deter future investment plans. During the first three quarter of 2018, real wages grew by 3.6%, still lower than expected. Part of the nominal wage increase was made up by inflation, which reached 2.5% in 2018. Administrative measures, such as an increase in state salaries of 10% (in January 2019 and also January 2020), the continuous increase of the minimum wage (which rose by EUR 40 to EUR 520 as of January 2019), or surcharges for night and weekend work (in two steps, May 2018 and May 2019) push up wages further.

Industrial production rose thanks to the automotive industry in 2018 but there are clouds on the horizon. Looking at the sectoral structure of growth, industrial production increased by 4.5% in 2018 (based on data from the Slovak Statistical Office). This was also partly due to a revision of transport equipment measurement at the end of the year. The automotive industry – the main industrial sector in Slovakia in terms of production and exports – thus contributed most to the expansion of industry last year. The now four car plants in the country – VW Bratislava, KIA Motors, PSA Peugeot-Citroën and Jaguar Land Rover – produced 1,080,000 cars in 2018, up from 1,025,000 in 2017. The new Jaguar Land Rover plant officially started production on 25 October. Located in Nitra, in the Western part of Slovakia, it is going to produce 150,000 cars annually with about 1,500 employees in one shift. An expansion of shifts is planned for the end of 2019. However, first clouds appeared on the automotive horizon at the beginning of 2019. KIA was the first to announce a reduction in the number of employees due to lower demand for cars with diesel engines. Although the stated number was small (27) it was the first negative signal from the automotive sector. In the meantime also Volkswagen announced larger layoffs/shifts of employees citing lower growth in China and the drop in Germany's industrial production as main reasons (first announcements rose from 500 to 3,000). Apart from transport equipment, other sectors contributing to industry growth in 2018 were machinery & equipment, rubber & plastic & other non-metallic mineral products, and the food industry. In contrast, production declined in five industries, including computer, electronic & optical products and the other manufacturing & repair sector.

The external sector had a balanced impact on growth. During 2018, goods exports from Slovakia increased by 6.9% while goods imports to Slovakia rose much faster, by 8%. Exports to Slovakia's main trading partners Germany and the Czech Republic grew by 17% and 10% respectively (the respective imports rose by 14% and 5% respectively). Already before the Brexit, trade with the United Kingdom declined on both sides. Exports to the UK fell by about 5% in 2018, and the UK now accounts for about 5.2% of Slovak exports (being the eighth largest export destination). The overall trade balance will most probably be zero in the balance-of-payments statistics for 2018, while the services trade balance is slightly positive. Together with a negative primary and secondary income balance (about EUR 3 billion), the current account for 2018 will turn out slightly negative.

In 2019 a balanced budget is planned for the first time but parliamentary elections are ahead in 2020. For the first time ever, revised plans for the general government budget foresee a balanced budget in 2019; the debt-to-GDP-ratio should decline to 47.3%. However, as parliamentary elections are ahead at the beginning of 2020, this figure might not hold. In fact, a number of social measures are planned targeting families and older persons (e.g. free school lunches; a Christmas bonus for pensioners; holiday/recreation vouchers). On the other hand, taxes have been newly introduced or reformed. A new levy on retailers has been in effect as of January 2019, and an insurance tax has replaced the insurance levy. In addition, there is the Fiscal Responsibility Act with its incorporated changes (thresholds for the debt-to-GDP level started to decline from the fiscal year 2018 onwards, i.e. the 50-60% debt-to-GDP thresholds continuously go down by 1 percentage point to 40% by 2027).

Growth will slow during the forecast period. wiiw has revised its growth forecasts for Slovakia for the coming years slightly downwards. For 2019, GDP growth will be lower than in 2018 and will probably reach about 3.6%; nevertheless, growth is pronounced compared to regional peers and the economy is in a good condition. The new Jaguar Land Rover car manufacturing plant, which started operation in October 2018, will shift up car production and exports, which should provide a major growth impetus. However, declining external demand and negative news from the other car manufacturers might represent counteracting factors. Still, increasing household consumption will provide a stable basis for growth in the next years based on favourable labour market developments. After strong investment expansion in 2018, the pace of growth will moderate and revive only when the EU-funding cycle draws to a close (2021/22). The push from Jaguar Land Rover will vanish after 2019 and growth will go down to normal levels around 3% in the years thereafter. Internal risks such as growing labour shortages as well as external risks such as the approaching Brexit are becoming more pronounced and acute. A hard Brexit and/or an increase in tariffs on automotive imports by the US would have a strong negative impact on the Slovak economy.

Table 6.20 / Slovakia: Selected economic indicators

	2014	2015	2016	2017	2018 [1]	2019	2020 Forecast	2021
Population, th pers., average	5,419	5,424	5,431	5,439	5,445	5,450	5,455	5,460
Gross domestic product, EUR mn, nom.	76,088	79,138	81,226	84,851	90,215	95,900	101,000	105,900
annual change in % (real)	2.8	4.2	3.1	3.2	4.1	3.6	3.0	2.5
GDP/capita (EUR at PPP)	21,300	22,300	22,500	22,900	24,100	.	.	.
Consumption of households, EUR mn, nom.	41,605	42,496	43,579	45,730	47,760	.	.	.
annual change in % (real)	1.4	2.3	2.9	3.5	3.0	3.3	3.0	2.8
Gross fixed capital form., EUR mn, nom.	15,772	19,213	17,280	18,155	19,510	.	.	.
annual change in % (real)	3.0	21.9	-9.4	3.4	6.0	3.0	3.5	4.0
Gross industrial production								
annual change in % (real)	2.9	6.0	3.8	2.9	2.2	2.0	1.0	1.0
Gross agricultural production								
annual change in % (real)	7.4	-3.2	13.9	-6.1	-1.4	.	.	.
Construction industry								
annual change in % (real)	-4.2	18.1	-10.7	3.0	8.4	.	.	.
Employed persons, LFS, th, average	2,363	2,424	2,492	2,531	2,560	2580	2590	2590
annual change in %	1.5	2.6	2.8	1.5	1.2	0.7	0.5	0.1
Unemployed persons, LFS, th, average	359	314	267	224	180	170	160	150
Unemployment rate, LFS, in %, average	13.2	11.5	9.7	8.1	6.5	6.2	5.8	5.6
Reg. unemployment rate, in %, eop	12.3	10.6	8.8	5.9	5.0	.	.	.
Average monthly gross wages, EUR	858	883	912	954	1,010	1080	1150	1210
annual change in % (real, gross)	4.2	3.2	3.8	3.3	3.7	4.0	3.8	3.2
Consumer prices (HICP), % p.a.	-0.1	-0.3	-0.5	1.4	2.5	2.6	2.3	2.3
Producer prices in industry, % p.a.	-3.3	-2.9	-3.9	2.5	2.3	2.5	2.5	3.0
General governm.budget, EU-def., % of GDP								
Revenues	39.3	42.5	39.2	39.4	39.8	39.1	38.9	38.6
Expenditures	42.0	45.1	41.5	40.2	40.7	39.8	39.5	38.9
Net lending (+) / net borrowing (-)	-2.7	-2.6	-2.2	-0.8	-0.9	-0.7	-0.6	-0.3
General gov.gross debt, EU def., % of GDP	53.5	52.2	51.8	50.9	48.7	48.1	47.2	46.3
Stock of loans of non-fin.private sector, % p.a.	6.7	9.7	9.3	9.9	9.8	.	.	.
Non-performing loans (NPL), in %, eop	6.0	5.2	4.7	3.9	3.3	.	.	.
Central bank policy rate, % p.a., eop [2]	0.05	0.05	0.00	0.00	0.00	.	.	.
Current account, EUR mn	871	-1,391	-1,756	-1,690	-2,255	-1,500	-1,300	-1,100
Current account, % of GDP	1.1	-1.8	-2.2	-2.0	-2.5	-1.6	-1.3	-1.0
Exports of goods, BOP, EUR mn	62,581	64,650	67,164	71,479	76,539	80,700	83,700	86,600
annual change in %	0.3	3.3	3.9	6.4	7.1	5.5	3.7	3.5
Imports of goods, BOP, EUR mn	59,823	63,601	65,527	70,789	76,491	80,000	82,800	85,900
annual change in %	0.5	6.3	3.0	8.0	8.1	4.6	3.5	3.7
Exports of services, BOP, EUR mn	6,889	7,301	8,350	9,214	9,810	10,300	10,800	11,600
annual change in %	-1.1	6.0	14.4	10.3	6.5	5.0	5.0	7.0
Imports of services, BOP, EUR mn	6,713	7,144	7,881	8,334	9,037	9,500	10,000	10,400
annual change in %	3.6	6.4	10.3	5.7	8.4	5.0	5.0	4.0
FDI liabilities, EUR mn	-324	1,357	4,326	5,313	5,726	.	.	.
FDI assets, EUR mn	94	1,266	3,684	3,603	5,497	.	.	.
Gross reserves of NB excl. gold, EUR mn	1,165	1,648	1,624	1,609	3,426	.	.	.
Gross external debt, EUR mn	67,776	67,225	73,750	94,149	100,000	105,000	110,000	110,000
Gross external debt, % of GDP	89.1	84.9	90.8	111.0	110.8	109.5	108.9	103.9

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.