Doris Hanzl-Weiss

Slovakia:
Successful year achieved, challenges ahead

While Slovakia achieved a successful year 2011 – with a GDP growth of about 3.3% – main challenges lie ahead. Due to the ongoing European debt crisis and worsened outlook for its main trade partners Germany and the Czech Republic, we revised our growth forecasts downwards and expect GDP to grow by 1.5% this year. Net exports might remain the main driver of GDP provided that external demand does not weaken even further. In addition, uncertainties derive from the forthcoming parliamentary elections to be held on 10 March 2012. In case of a government dominated by the leftist Smer party led by Robert Fico, we may expect weaker fiscal consolidation and thus slowly reviving private consumption.

GDP continued to grow in 2011, albeit slower than in 2010: Growth reached above 3%, compared to 4.2% in the year before. While growth was robust during the first half of the year, dynamics slowed down in the third quarter 2011, but surprisingly improved again in the fourth (preliminary data suggest an increase of 0.9% month on month and 3.4% year on year). The main source of growth has been net exports due to increased exports to Slovakia's main trading partners Germany and the Czech Republic. Exports of motor cars were particularly buoyant. This success is based on improved competitiveness as a result of declining unit labour costs. On the other hand, final consumption as well as gross capital formation contributed negatively to growth in 2011. While household consumption stagnated, government consumption declined due to fiscal consolidation taking place. Although the employment situation somewhat improved, household consumption remained flat as real wages were eroded by high inflation. Gross capital formation declined, but gross fixed capital formation developed favourably (+4.7% in the first three quarters). This points to destocking of inventories taking place in expectation of diminishing demand for the country's exports.

In 2011, industrial production increased by 6.9%, with manufacturing expanding by 8.9%. The highest growth sectors were machinery and equipment (+20.8%) and transport equipment (+17.3%) – the latter being the main industrial sector in Slovakia due to its important car industry. Two sectors declined, the computer and electronic products sector (-7.7%) and pharmaceuticals (-3.7%). The former sector benefited from the opening of a production plant by Taiwanese Au Optronics in June, while it suffered some setbacks too[1]. Apart from industry, contributions to GDP were slightly positive for construction but remained negative for agriculture and services in 2011.

Inflation – after reaching historically low levels below 1% in 2009 and 2010 – was among the highest in the eurozone in 2011. The price increase of 4.1% resulted from rising energy and food prices and was also due to fiscal consolidation measures. VAT was temporarily increased at the beginning of the year from 19% to 20% and certain tax exemptions were cancelled.

After two years of deterioration, the situation on the labour market improved in 2011 as real growth transferred to the labour market: employment grew by about 1.5% and unemployment fell by 1 percentage point to 13.4%. Overall, Slovakia has one of the highest unemployment rates in Europe, with a particularly high rate of long-term unemployment and youth unemployment. In addition, regional differences within the country are large and the eastern part faces even higher unemployment rates (nearly 20% in the Košice region). The highest unemployment rate is found among the Roma minority population.

After a hike in the level of public debt from 28% in 2008 to 41% of GDP in 2010, public debt increased further in 2011. It is expected to reach about 44% of GDP – still much lower than in other eurozone countries. Fiscal consolidation is taking place but at a lower rate than envisaged. The reform-oriented cabinet of Prime Minister Iveta Radičová announced an ambitious consolidation programme for the years 2011-2013 (2011 deficit target 4.9%, 2012 target 3.8%, 2013 less than 3%). In theory, the envisaged target was met in 2011. Official statements announced a state deficit of 4.6% for 2011, i.e. 0.3 percentage points less than planned. However, the inclusion of outstanding debt of state-owned railway companies and hospitals for the period 2008-2010 increases the overall public finance deficit by 1% of GDP to about 5.7% in 2011. Also the fall of the government in October over the vote on ratification of the European Financial Stability Facility (EFSF) stopped reform projects affecting the budget for this year (e.g. failure of payroll-tax reform). Still, the interim government managed to pass the budget for 2012: the deficit is officially projected to reach 4.6% of GDP instead of the originally planned 3.8% of GDP. Priority is given to highway construction and pay rises for teachers and doctors (after protests led to a state of emergency in fifteen hospitals in December 2011). A banking tax has been introduced as

[1] In August 2011, Hansol, the Korean-based producer of components for television sets, terminated production and laid off 1400 persons; Samsung has applied for a EUR 28 million tax relief in order to continue production in Slovakia; and in January this year, Foxconn announced the layoff of 600 employees, citing global difficulties in LCD television sales.

of 1 January 2012. In addition, the parliament has approved a constitutional debt brake law seeking to limit public debt at 60% of GDP. As the consolidation process will depend on the forthcoming election results, we have so far carried forward the projected deficit for 2012 to the coming years.

Regarding the Slovak banking sector, 95% of bank assets are in foreign ownership, with a dominance of Austrian banks. The capitalization of banks is at a prudent level, the capital adequacy ratio stands at about 12.7% (as of 30 June 2011). In the first half of 2011 banks' profits soared by 79% in year-on-year terms, mainly due to a decline in the costs of non-performing loans. The ratio of non-performing loans was decreasing steadily during 2011 (from 5.8% in January to 5.4% in December 2011), with the ratio of non-performing loans to both households and corporations declining slightly (as of December 2011, the ratio was 4.5% for household loans and 7.1% for corporate loans). Bank lending to households increased in the first half of 2011 while weak demand persisted among corporations (except industry) due to some deleveraging process going on.

Good news comes from the main automotive companies, all located in the more prosperous western regions of Slovakia; they have reported successful figures for 2011 and have announced new investment plans for the future: (1) VW Bratislava plans to expand welding and body building capacities as well as to open a research and innovation centre. Investment is said to reach EUR 1.5 billion in the coming years. In addition, the company is creating 650 new jobs and launches a third shift from April onwards producing models of the New Small Family car series. (2) The PSA Peugeot Citroen plant located in Trnava started to hire 900 persons for work on a new car model and a third shift. (3) KIA Motors Slovakia (Žilina) reported a 20% rise in car production and a 12% increase in engine production in 2011. – In general, the economic sentiment indicator was at its height at the beginning of the year 2011 but fell continuously from July onwards. In December 2011 and January 2012 it again improved slightly, thanks to growing confidence of entrepreneurs in industry and of consumers.

Overall, wiiw has revised its growth forecast for Slovakia downwards, mainly because of the ongoing European debt crisis and the worsened outlook for Slovakia's main trading partners Germany and the Czech Republic. Thus we expect GDP to grow by 1.5% this year (down from previously 2.1%). GDP growth will accelerate to 3% in 2013 and about 4% in 2014. Although trade growth will slow down this year, net exports may remain the main driver of GDP growth provided that external demand stemming from Germany and the Czech Republic does not weaken even more. With a new government, probably dominated by the leftist Smer party of Robert Fico, we can expect fiscal consolidation in

Slovakia to be weaker than envisaged. As a result, the so far stagnating private consumption might contribute modestly to GDP growth. Although positive news has cropped up recently, major downside risks prevail over the resolution of the European debt crisis. In addition, uncertainties derive from the forthcoming parliamentary elections to be held on 10 March 2012, which are overshadowed by a large corruption scandal.

Table SK

Slovakia: Selected Economic Indicators

	2006	2007	2008	2009	2010	2011 [1]	2012	2013	2014
								Forecast	
Population, th pers., average	5391.4	5397.3	5406.6	5418.6	5430.1	5445	5460	5480	5490
Gross domestic product, EUR mn, nom.	55001.6	61449.7	66932.3	62895.5	65887.4	70800	73700	78200	83800
annual change in % (real)	8.3	10.5	5.9	-4.9	4.2	3.3	1.5	3	4
GDP/capita (EUR at exchange rate)	8300	10200	11900	11600	12100	13000	13500	14300	15300
GDP/capita (EUR at PPP)	15000	16900	18200	17000	18000	18800	.	.	.
Consumption of households, EUR mn, nom.	30891.1	33902.0	37572.7	37640.2	37740.0	39300	.	.	.
annual change in % (real)	5.9	7.0	6.0	0.1	-0.8	0	0.5	1.5	2.5
Gross fixed capital form., EUR mn, nom.	14588.8	16096.5	16575.9	13024.8	14615.5	15900	.	.	.
annual change in % (real)	9.3	9.0	1.0	-19.7	12.4	4.5	2.5	3	4
Gross industrial production									
annual change in % (real)	15.7	17.0	3.3	-13.8	18.8	6.9	4	6	7
Gross agricultural production (EAA)									
annual change in % (real)	-2.9	-4.5	10.6	-12.3	-8.2	7.5	.	.	.
Construction industry									
annual change in % (real)	14.9	5.7	11.9	-11.2	-4.6	-1.7	.	.	.
Employed persons - LFS, th, average	2302.3	2357.7	2433.7	2366.3	2317.5	2352	2350	2390	2430
annual change in %	3.9	2.4	3.2	-2.8	-2.1	1.5	0	1.5	1.5
Unemployed persons - LFS, th, average	355.4	295.7	255.7	323.5	389.2	366	.	.	.
Unemployment rate - LFS, in %, average	13.4	11.1	9.5	12.0	14.4	13.4	13.5	13	12.5
Reg. unemployment rate, in %, end of period	9.4	8.0	8.4	12.7	12.5	13.6	13.5	13	12.5
Average gross monthly wages, EUR	623	669	723	745	769	790	.	.	.
annual change in % (real, gross)	3.9	4.4	3.4	1.4	2.3	-1	.	.	.
Consumer prices (HICP), % p.a.	4.3	1.9	3.9	0.9	0.7	4.1	2.5	3	3
Producer prices in industry, % p.a.	3.0	-1.4	2.5	-6.6	0.1	4.4	2	3	3
General governm.budget, EU-def., % GDP									
Revenues	33.3	32.4	32.8	33.5	32.3	33.1	.	.	.
Expenditures	36.5	34.2	34.9	41.5	40.0	38.9	.	.	.
Net lending (+) / net borrowing (-)	-3.2	-1.8	-2.1	-8.0	-7.7	-5.7	-5.0	-4.7	-4.4
Public debt, EU-def., in % of GDP	30.5	29.6	27.8	35.5	41.0	43.5	46.8	48.6	49.7
Central bank policy rate, % p.a., end of period [2]	4.75	4.25	2.50	1.00	1.00	1.00	.	.	.
Current account, EUR mn	-3490	-2912	-4021	-1627	-2278	0	-500	-1000	-1500
Current account in % of GDP	-7.8	-5.3	-6.2	-2.6	-3.5	0	-0.7	-1.3	-1.8
Exports of goods, BOP, EUR mn	33144	42260	49521	39721	48791	57000	61000	66000	71000
annual growth rate in %	29.2	27.5	17.2	-19.8	22.8	17	7	9	8
Imports of goods, BOP, EUR mn	35227	42916	50280	38775	48652	55500	59000	64000	69000
annual growth rate in %	27.8	21.8	17.2	-22.9	25.5	14	6	8	8
Exports of services, BOP, EUR mn	4321	5140	6001	4342	4398	4700	5100	5700	6600
annual growth rate in %	22.0	19.0	16.8	-27.6	1.3	7	8	12	15
Imports of services, BOP, EUR mn	3716	4751	6488	5367	5140	5200	5600	6300	7200
annual growth rate in %	13.1	27.9	36.6	-17.3	-4.2	1	8	12	15
FDI inflow, EUR mn	3729	2636	3323	-4	335	500	500	.	.
FDI outflow, EUR mn	406	441	376	652	250	500	.	.	.
Gross reserves of NB excl. gold, EUR mn [3]	9639	12280	12674	481	541	659	.	.	.
Gross external debt, EUR mn	24449	30156	37286	45338	49262	55000	.	.	.
Gross external debt in % of GDP	54.9	55.0	57.8	72.1	74.8	77.7	.	.	.
Average exchange rate EUR/EUR	1.2359	1.1211	1.0377	1.0000	1.0000	1.0000	1	1	1
Purchasing power parity EUR/EUR	0.6816	0.6721	0.6813	0.6810	0.6758	0.6922	.	.	.

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 2009 official refinancing operation rates for euro area (ECB), two-week repo rate of NB before. - 3) 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.