

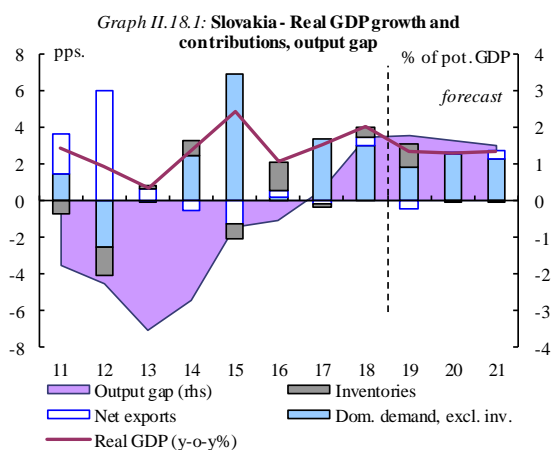
18. SLOVAKIA

Strong growth set to decelerate to more sustainable levels

Slovakia's brisk economic expansion is expected to give way to slower growth from 2019 onwards. Though decelerating, domestic demand is set to drive growth, with private consumption backed by buoyant real wage increases. Investment is forecast to normalise after sluggish growth in the first half of 2019. Net trade is forecast to weigh on growth in 2019 but to contribute positively in subsequent years. Consumer price inflation is expected to be fuelled by wage increases and robust private demand, but to moderate over the forecast period. The general government deficit is forecast to grow, mostly due to increases in public wages and social benefits.

Growth slows markedly

After Slovakia's economy expanded by 4.0% in 2018, real GDP growth is forecast to slow markedly to 2.7% in 2019 and then to remain at similar rates of 2.6% in 2020 and 2.7% in 2021. On the back of strong wage increases and record-low unemployment, private consumption will continue to be a significant source of GDP growth over the forecast horizon. Weaker demand in key EU trading partners is projected to take its toll on exports, particularly in 2019. Investment growth is expected to normalise after sluggish growth in the first half of 2019.



Exports hit by weak trade outlook

As a very open economy, Slovakia's exports are registering the impact of slowing foreign demand throughout 2019. Temporary factors, such as changes and delays in production in Slovakia's large, export-focused automotive sector, have exacerbated the slowdown. Exports are thus likely to gradually pick up thereafter and expand by around 4.5% in 2021. In a similar pattern, the trade balance is projected to dip into negative territory in 2019, but to slowly recover in 2020-2021, when Slovakia is likely to gain export market shares.

However, this recovery remains uncertain and will depend on prospects in Slovakia's key trading partners, and any developments affecting the car industry, such as the possible imposition of U.S. tariffs.

Wage growth to support spending

After years of strong employment growth, the rate of job creation has been slowing in 2019 and may continue doing so in 2020-2021, in line with the more subdued economic outlook. The unemployment rate is forecast to decrease slightly to a new record low of 5.9% in 2019 and to hover around this rate throughout 2020-2021. While the positive effect from job creation on household disposable income is expected to fade, strong wage growth should prop up earnings and incomes. After strengthening in 2019 on the back of a tight labour market and supported by strong salary increases in the public sector, wage growth is set to ease slightly in 2020-2021. In view of the low unemployment risk and supportive financial conditions, this should continue to bolster consumer spending.

Demand pressures will drive inflation

HICP inflation is forecast to remain slightly elevated over the forecast horizon, first rising to 2.7% in 2019, and then moderating to 2.5% in 2020 and 2.2% in 2021. Services, food prices and energy are all expected to contribute substantially to overall inflation. Services price inflation is expected to remain elevated as a result of rapid wage growth. Moreover, increases in regulated energy prices will contribute to HICP inflation in 2019. Food prices are likely to grow at a high rate in 2019 but to moderate somewhat thereafter.

Government deficit expected to increase

Slovakia's general government deficit in 2018 rose by 0.1 pps. to 1.1% of GDP. This minor

deterioration took place against the background of fast revenue growth and swift economic expansion. High transfers from the EU also boosted revenues. On the expenditure side, these transfers corresponded to higher current transfers, subsidies, and compensation of public employees. Gross fixed capital formation increased significantly for the central and local government. On the other hand, intermediate consumption grew moderately and interest spending fell. Overall, the consolidation effort slowed in 2018, with the structural balance deteriorating to around -1³/₄% of GDP.

In 2019, the headline deficit is expected to decrease to 0.9% of GDP, with total revenues and expenditure changing slightly. Buoyant private consumption and the strong labour market are expected to support VAT receipts, income taxes and social contributions. On the expenditure side, the largest spending increases are expected for employee compensation and social benefits. These will be partially counterbalanced by developments in investment and interest spending. In structural terms, the general government balance will improve by around 0.1 pps.

In 2020, the general government deficit is expected to increase to 1.2% of GDP due to the introduction of government fiscal measures decreasing the tax burden and introducing minimum pensions. The fiscal expansion is dampened by restrained investment and measures to enhance tax collection. A discussion is ongoing regarding some further potential measures. The structural balance is projected to deteriorate by 0.2% of GDP to nearly -1.8% of GDP.

In 2021, the headline deficit is forecast to rise by 0.1% of GDP. The use of EU funding for investment is expected to increase as the end of the programming period approaches. Risks to the fiscal outlook are tilted to the downside, linked to uncertainties in macroeconomic developments and insufficiently specified austerity measures to achieve the set fiscal targets.

The general government debt-to-GDP ratio is forecast to remain on a declining path, thanks to the pace of nominal economic growth. It is projected to decline to 48.1% this year, 47.3% in 2020, and 46.9% in 2021.

Table II.18.1:

Main features of country forecast - SLOVAKIA

	2018			Annual percentage change						
	bn EUR	Curr. prices	% GDP	00-15	2016	2017	2018	2019	2020	2021
GDP	89.7	100.0		4.0	2.1	3.0	4.0	2.7	2.6	2.7
Private Consumption	50.2	55.9		3.1	3.9	4.3	3.9	1.8	2.4	2.1
Public Consumption	16.7	18.6		2.7	1.9	1.0	0.2	3.0	3.5	2.6
Gross fixed capital formation	19.0	21.2		3.0	-9.3	3.9	3.7	1.0	2.6	2.8
of which: equipment	8.4	9.3		4.3	-2.0	0.8	-3.5	0.7	1.8	2.3
Exports (goods and services)	86.2	96.1		9.5	5.0	3.5	5.4	1.2	3.8	4.5
Imports (goods and services)	84.4	94.1		8.0	4.8	3.9	5.0	1.6	3.8	4.1
GNI (GDP deflator)	88.3	98.4		3.8	2.0	3.6	4.5	2.7	2.5	2.8
Contribution to GDP growth:		Domestic demand		3.0	0.2	3.4	3.0	1.8	2.5	2.3
		Inventories		0.1	1.6	-0.2	0.5	1.3	0.0	0.0
		Net exports		0.9	0.3	-0.2	0.5	-0.4	0.1	0.4
Employment				0.6	2.4	2.2	2.0	0.8	0.2	0.2
Unemployment rate (a)				14.8	9.7	8.1	6.5	5.8	5.7	5.6
Compensation of employees / head				6.0	2.2	5.4	5.6	7.1	5.4	4.9
Unit labour costs whole economy				2.5	2.5	4.5	3.5	5.2	3.0	2.4
Real unit labour cost				0.0	3.0	3.3	1.4	2.7	0.6	0.2
Saving rate of households (b)				7.5	8.6	8.2	8.4	9.9	10.3	9.8
GDP deflator				2.6	-0.5	1.2	2.0	2.4	2.3	2.2
Harmonised index of consumer prices				3.8	-0.5	1.4	2.5	2.7	2.5	2.2
Terms of trade goods				-0.5	-0.4	-0.8	-0.9	-0.5	-0.2	-0.2
Trade balance (goods) (c)				-1.7	2.3	1.1	1.1	0.3	0.2	0.6
Current-account balance (c)				-3.0	-2.0	-1.8	-1.6	-2.4	-2.6	-2.3
Net lending (+) or borrowing (-) vis-a-vis ROW (c)				-2.5	-2.1	-2.5	-1.3	-2.1	-2.4	-2.0
General government balance (c)				-4.9	-2.5	-1.0	-1.1	-0.9	-1.2	-1.3
Cyclically-adjusted budget balance (d)				-4.5	-2.3	-1.1	-1.7	-1.6	-1.8	-1.8
Structural budget balance (d)				-	-2.2	-1.1	-1.7	-1.6	-1.8	-1.8
General government gross debt (c)				43.1	52.0	51.3	49.4	48.1	47.3	46.9

(a) as % of total labour force. (b) gross saving divided by adjusted gross disposable income. (c) as a % of GDP. (d) as a % of potential GDP.