18. SLOVAKIA

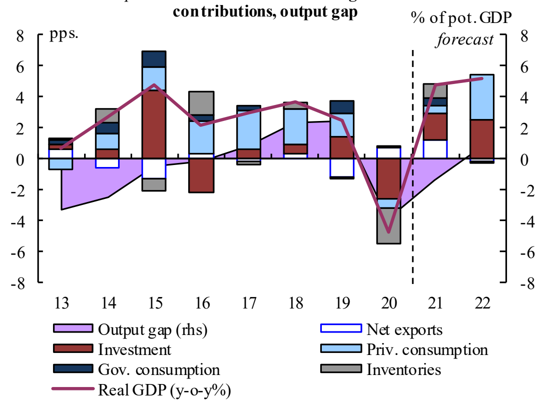
The COVID-19 pandemic pushed Slovakia's economy into a deep recession in 2020. As containment measures are eased, a swift recovery is expected in 2021 and 2022, driven by both domestic spending and foreign demand. After moderating in 2021, inflation is forecast to rise gradually, supported initially by cost-push factors and then by more robust demand. The government budget deficit is expected to remain elevated due to sustained fiscal support. However, the public debt-to-GDP ratio is projected to stay contained as economic growth and low interest rates offset the effect of lower primary balances. RRF-financed investments should help the recovery from 2022 onwards.

Rebounding growth as the economy reopens

After a 4.8% decline in 2020 real output, persisting pandemic-related restrictions in early 2021 continue to weigh on economic activity in Slovakia. Nevertheless, the assumed progress in vaccination and the improving pandemic situation should enable a sharp rebound in the second half of the year, bringing annual GDP growth to 4.8% in 2021. The Slovak economy is forecast to reach its pre-pandemic output level by the end of 2021 and to continue growing at a robust annual rate of 5.2% in 2022, closing its negative output gap.

Prolonged COVID-19 containment measures mainly affect domestic demand. Despite continued fiscal measures cushioning the fall in household incomes, diminished spending opportunities have depressed private consumption, particularly in the service sector, which has led to a rise in forced savings. Private investment has also been held back by uncertainty. However, with the assumed reopening of the economy, a sharp rebound in domestic spending is expected from the second half of 2021, and the household saving rate is forecast to return to near pre-crisis levels in 2022. A boost to public investment by Next Generation EU funds is forecast from 2022 onwards.

Graph II.18.1: **Slovakia- Real GDP growth and contributions, output gap**



Robust foreign demand to help recovery

In contrast to contact-intensive services, industry has proven to be more resilient, as factories were largely shielded from domestic pandemic-related restrictions. This has helped Slovakia's industry-heavy export sector, which is also expected to benefit from robust growth in foreign demand, especially in light of the recent US fiscal stimulus and its spillover effects. Supply-chain disruptions due to ongoing semi-conductor shortages are assumed to have only a temporary effect on Slovakia's automotive industry. Due to a large share of imported intermediate inputs, strong exports should also go along with higher import growth. On balance, net exports are forecast to contribute positively to GDP growth in 2021 and to be broadly neutral in 2022.

Labour market to recover only from 2022

Thanks to public short-time work schemes, the impact of the crisis on the labour market has been mostly reflected in declining hours worked, while employment has been shielded, decreasing only by 1.9% in 2020. However, despite the economic recovery gaining momentum already in 2021, the labour market is expected to strengthen only from 2022 onwards. As fiscal support measures are gradually withdrawn, hours worked should increase first while firms are likely to remain cautious about posting new vacancies. On average, employment is projected to stay 0.6% lower in 2021 compared to last year, with the unemployment rate rising to 7.4%. Gradual improvement is forecast from 2022, with 0.8% employment growth and the unemployment rate falling to 6.6%. Real wage growth is expected to gather pace as labour market slack diminishes, and productivity rebounds.

Inflation to rise as excess capacity shrinks

HICP inflation is projected to moderate from 2% in 2020 to 1.5% in 2021, driven mainly by a reduction in regulated energy prices. Temporary cost-push pressures from supply constraints and rising commodity prices are assumed to be kept in check by still weak domestic demand, which acts as a disinflationary force. But as the Slovak economy moves closer towards its potential, aggregate demand pressures should be pushing inflation higher, mainly in the domestic service sector, to 1.9% next year.

Fiscal policy to remain supportive in 2021

In 2020, the general government deficit widened to 6.2% of GDP, due to both higher expenditures aimed at cushioning the recession and lower tax revenues as a result of the weaker economy. The combination of a sizable deficit and falling output resulted in the public debt-to-GDP ratio jumping to 60.6%. Direct pandemic-related support measures, focusing on employment, social assistance and the healthcare sector, reached 2.2% of GDP.

In 2021, the public budget deficit is expected to increase to 6.5% of GDP, driven by still muted growth in tax revenues, high healthcare expenditures, and the extension of some COVID-19 measures (e.g. nursing allowances). In addition, pension-related subsidies and social transfers are set to increase, despite the government taking steps to contain them (e.g. by freezing the minimum pension at 2020 levels and limiting the number of years worked that can be taken into account for pension calculation).

In 2022, the government budget deficit is forecast to moderate to 4.1% of GDP. As the previous programming period is coming to an end, the use of EU funds is expected to increase in 2022. This forecast also incorporates information about the national RRP as presented in the preliminary version released by the government for public consultation, with RRF-funded expenditure amounting to 0.2% of GDP in 2021, and 1% of GDP in 2022.

The government debt-to-GDP ratio is projected to edge down to 59.5% in 2021, and 59% in 2022. Despite continued primary budget deficits, debt ratios should be contained by strong GDP growth and persistently low interest rates as well as by stock-flow adjustments related to the assumed disbursement profile of RRF funds and cash from last year's borrowings.

Table II.18.1:

Main features of country forecast - SLOVAKIA

	2019			Annual percentage change						
	bn EUR Curr. prices	% GDP	01-16	2017	2018	2019	2020	2021	2022
GDP	93.9	100.0	4.0	3.0	3.7	2.5	**-4.8**	**4.8**	**5.2**
Private Consumption	53.2	56.7	3.2	4.6	4.1	2.7	**-1.0**	**0.8**	**5.2**
Public Consumption	18.5	19.7	2.6	1.3	0.1	4.6	**0.3**	**2.5**	**-0.2**
Gross fixed capital formation	20.2	21.5	3.2	3.0	2.7	6.6	**-12.0**	**8.6**	**12.5**
of which: equipment	9.4	10.0	5.5	-6.0	1.8	13.4	**-19.2**	**9.6**	**16.5**
Exports (goods and services)	86.8	92.4	9.2	3.6	5.2	0.8	**-7.5**	**12.2**	**5.3**
Imports (goods and services)	86.4	92.0	7.9	3.9	5.0	2.1	**-8.3**	**10.9**	**5.6**
GNI (GDP deflator)	92.2	98.2	3.9	3.8	4.2	2.1	**-4.7**	**4.8**	**5.3**
Contribution to GDP growth: Domestic demand			3.1	3.4	2.9	3.8	**-3.1**	**2.7**	**5.4**
Inventories			0.1	-0.3	0.4	0.0	**-2.4**	**0.8**	**0.0**
Net exports			0.9	-0.2	0.3	-1.2	**0.7**	**1.3**	**-0.2**
Employment			0.9	2.2	2.0	1.0	**-1.9**	**-0.6**	**0.8**
Unemployment rate (a)			14.2	8.1	6.5	5.8	**6.7**	**7.4**	**6.6**
Compensation of employees / head			5.3	5.1	5.9	6.8	**3.3**	**4.0**	**4.7**
Unit labour costs whole economy			2.1	4.3	4.3	5.3	**6.4**	**-1.3**	**0.3**
Real unit labour cost			0.1	3.1	2.2	2.7	**3.9**	**-2.8**	**-2.0**
Saving rate of households (b)			7.4	8.1	10.4	10.1	**10.9**	**12.1**	**9.6**
GDP deflator			1.9	1.2	2.0	2.5	**2.4**	**1.5**	**2.3**
Harmonised index of consumer prices			3.1	1.4	2.5	2.8	**2.0**	**1.5**	**1.9**
Terms of trade goods			-0.7	-0.8	-0.9	-0.4	**-0.5**	**0.1**	**0.0**
Trade balance (goods) (c)			-1.2	1.1	1.1	-0.5	**0.0**	**0.8**	**0.4**
Current-account balance (c)			-3.0	-0.9	-0.1	-1.8	**-1.5**	**-0.3**	**-0.4**
Net lending (+) or borrowing (-) vis-a-vis ROW (c)			-2.5	-1.6	-0.1	-1.8	**-1.6**	**-0.4**	**-0.6**
General government balance (c)			-4.2	-1.0	-1.0	-1.3	**-6.2**	**-6.5**	**-4.1**
Cyclically-adjusted budget balance (d)			-4.0	-1.3	-1.9	-2.3	**-4.7**	**-6.0**	**-4.4**
Structural budget balance (d)			-2.5	-1.3	-1.9	-2.3	**-4.7**	**-6.0**	**-4.4**
General government gross debt (c)			43.2	51.5	49.6	48.2	**60.6**	**59.5**	**59.0**

(a) Eurostat definition. (b) gross saving divided by adjusted gross disposable income. (c) as a % of GDP. (d) as a % of potential GDP.