

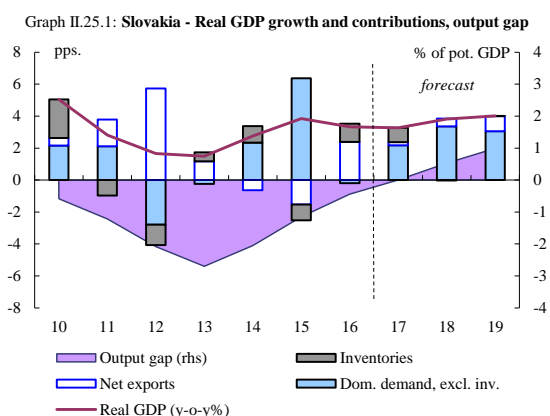
## 25. SLOVAKIA

### Growth strengthens, the labour market tightens

Slovakia's economic expansion is expected to maintain a robust pace in 2017 and to strengthen thereafter, with private consumption as the main contributor to growth. Household spending is set to benefit as the labour market continues to strengthen. Strong labour demand in some regions and sectors is expected to put upward pressure on nominal wages. Inflation is likely to increase further, supported by favourable demand conditions. The government deficit is projected to decrease steadily.

#### Recovery fuelled by household spending

Slovakia's real GDP growth is expected to remain solid at 3.3% in 2017 and to gradually increase to around 4% in 2019. Private consumption is set to become the key driver of growth, supported by higher employment, robust increases in real wages, low credit costs and buoyant consumer sentiment. Economic growth is also expected to benefit from a revival in investment and increasingly positive contributions from net trade over the forecast horizon. Strong economic growth is likely to feed through to all segments of the economy, including the upbeat housing market. At the same time, a shrinking supply of skilled workers, coupled with rising demand for labour, is a potential bottleneck for the Slovak economy.



#### Investment and net exports set to grow

Investment showed a somewhat erratic pattern in 2017, with a swift recovery in the first quarter followed by a substantial fall in the second. On an annual basis investment is projected to return to growth in 2017 and to accelerate thereafter, driven by private investment in the automotive industry and major public investment projects such as the Bratislava ring road. The completion of a new car factory is anticipated to cause investment growth to peak in 2018. At the same time, delays in major

infrastructure projects due to litigation, along with a relatively slow use of EU investment funds, could dampen the investment rebound in the near term. Slovakia's export growth is set to pick up again over the forecast horizon thanks to rising foreign demand and expanded production capacities in the automotive sector. The contribution of net trade to GDP growth is likely to increase until 2019 as import growth, which is partly investment-fuelled, is nonetheless outpaced by exports.

#### Labour demand stimulates wages

As the robust economic recovery bolsters the labour market, the unemployment rate is expected to gradually fall below 7% in 2019. Employment gains are likely to remain strong and broad-based across sectors, contributing to increases in the participation rate as employment prospects for previously inactive persons improve. At the same time, the tightening of the labour market along with increasing labour shortages in some sectors and regions is bound to drive up nominal wage growth, particularly in an environment of rising consumer prices. Nominal wage growth is projected to climb to almost 5% in 2019, allowing real wages to increase by around 3% annually over the forecast horizon.

#### Consumer inflation set to increase

Headline inflation has firmly entered positive territory and is projected to reach 1.3% in 2017, with accelerating food and services prices contributing most to the rebound. By contrast, energy prices are projected to decline throughout 2017, mainly due to a reduction in administered prices for electricity and gas at the beginning of the year. Core inflation (excluding energy and unprocessed food) is expected to pick up significantly to 1.7% in 2017 and to gradually rise thereafter, reflecting vibrant consumer expenditure and wage pressures.

### Headline deficit on a declining path

The general government deficit outcome for 2016 was larger than expected in the spring forecast, having been revised to 2.2% of GDP due to lower-than-anticipated corporate income tax and dividend revenues. Nevertheless, fiscal consolidation is projected to continue in 2017, with the headline deficit forecast to decline to 1.6% of GDP. The adjustment is likely to be supported by strong VAT and labour tax revenues reflecting improving private consumption and labour market conditions, respectively. Tax revenues are also expected to be supported by several policy measures, including a higher levy on regulated businesses and higher ceilings on social and healthcare contributions.

The favourable economic environment is expected to continue to support consolidation in 2018. In addition, a new 7% tax on dividend revenues is projected to contribute positively to public revenues despite a parallel scrapping of healthcare contributions paid on dividends. On the other hand, the abolition of the minimum corporate income tax, introduction of voluntary 13<sup>th</sup> and 14<sup>th</sup>

monthly salary as well as exempting pensioners' who work on contract agreements from paying social security contributions will reduce revenue. The government has further adopted several expenditure-increasing measures, including an ad-hoc pension increase for those who retired before 2004, and extra outlays on public wages and social benefits. A drop in the drawdown of EU funds will reduce co-financing needs and consequently also lower investment financed from the national budget. In the absence of additional measures, the headline deficit is projected to decline to 1% of GDP in 2018. Assuming a strong rebound in the utilisation of EU funds with no other changes in policies, the deficit is projected to decline in 2019 to 0.2% of GDP.

The structural balance is projected to decline to 1½% of GDP in 2017. The improvement in the structural balance in the two following years will be less than that of the headline balance in light of the progressive widening of the positive output gap from 2018 onwards. The debt-to-GDP ratio is projected to decline to 47% in 2019, driven by declining deficits and accelerating nominal GDP growth.

Table II.25.1:

#### Main features of country forecast - SLOVAKIA

|  | 2016   |              |       | Annual percentage change |      |      |      |      |      |      |
|--|--------|--------------|-------|--------------------------|------|------|------|------|------|------|
|  | bn EUR | Curr. prices | % GDP | 98-13                    | 2014 | 2015 | 2016 | 2017 | 2018 | 2019 |
| GDP  | 81.2   | 100.0        |       | 3.7                      | 2.8  | 3.9  | 3.3  | 3.3  | 3.8  | 4.0  |
| Private Consumption                                | 44.3   | 54.5         |       | 3.1                      | 1.4  | 2.2  | 2.7  | 3.3  | 3.3  | 3.3  |
| Public Consumption                                 | 15.7   | 19.4         |       | 2.7                      | 5.2  | 5.4  | 1.6  | 0.8  | 1.8  | 1.8  |
| Gross fixed capital formation                      | 17.2   | 21.2         |       | 1.1                      | 3.0  | 19.8 | -8.3 | 1.0  | 5.9  | 4.5  |
| of which: equipment                                | 8.8    | 10.8         |       | 1.7                      | 20.3 | 13.0 | 2.0  | 5.6  | 6.5  | 4.5  |
| Exports (goods and services)                       | 76.8   | 94.6         |       | 9.1                      | 3.9  | 6.4  | 6.2  | 4.6  | 6.7  | 7.6  |
| Imports (goods and services)                       | 73.9   | 91.1         |       | 6.9                      | 4.8  | 8.4  | 3.7  | 4.6  | 6.5  | 6.9  |
| GNI (GDP deflator)                                 | 80.0   | 98.6         |       | 3.7                      | 2.4  | 3.3  | 3.8  | 3.4  | 3.9  | 4.1  |
| Contribution to GDP growth:                        |        |              |       |                          |      |      |      |      |      |      |
| Domestic demand                                    |        |              |       | 2.6                      | 2.3  | 6.4  | -0.2 | 2.2  | 3.4  | 3.1  |
| Inventories  |        |              |       | 0.0                      | 1.0  | -1.0 | 1.1  | 0.9  | 0.0  | 0.0  |
| Net exports  |        |              |       | 1.2                      | -0.6 | -1.5 | 2.4  | 0.2  | 0.5  | 0.9  |
| Employment   |        |              |       | 0.2                      | 1.4  | 2.0  | 2.4  | 1.3  | 1.2  | 1.2  |
| Unemployment rate (a)                              |        |              |       | 15.1                     | 13.2 | 11.5 | 9.7  | 8.3  | 7.4  | 6.6  |
| Compensation of employees / head                   |        |              |       | 6.7                      | 1.8  | 3.5  | 2.3  | 4.1  | 4.8  | 4.9  |
| Unit labour costs whole economy                    |        |              |       | 3.0                      | 0.5  | 1.6  | 1.4  | 2.0  | 2.2  | 2.0  |
| Real unit labour cost                              |        |              |       | -0.3                     | 0.7  | 1.7  | 1.8  | 0.0  | 0.7  | 0.2  |
| Saving rate of households (b)                      |        |              |       | 7.8                      | 7.2  | 8.9  | 9.5  | 8.8  | 9.2  | 9.6  |
| GDP deflator                                       |        |              |       | 3.3                      | -0.2 | -0.2 | -0.4 | 2.0  | 1.5  | 1.9  |
| Harmonised index of consumer prices                |        |              |       | 4.9                      | -0.1 | -0.3 | -0.5 | 1.3  | 1.7  | 2.0  |
| Terms of trade goods                               |        |              |       | -0.8                     | 0.2  | -0.2 | -0.4 | -0.1 | 0.1  | 0.1  |
| Trade balance (goods) (c)                          |        |              |       | -4.3                     | 3.4  | 1.3  | 2.9  | 3.3  | 3.5  | 4.3  |
| Current-account balance (c)                        |        |              |       | -5.3                     | 1.0  | -1.0 | 0.4  | 0.8  | 0.7  | 1.3  |
| Net lending (+) or borrowing (-) vis-a-vis ROW (c) |        |              |       | -4.9                     | 1.9  | 1.1  | 0.2  | 0.8  | 0.5  | 1.9  |
| General government balance (c)                     |        |              |       | -5.1                     | -2.7 | -2.7 | -2.2 | -1.6 | -1.0 | -0.2 |
| Cyclically-adjusted budget balance (d)             |        |              |       | -5.0                     | -1.9 | -2.3 | -2.0 | -1.6 | -1.2 | -0.6 |
| Structural budget balance (d)                      |        |              |       | -                        | -2.2 | -2.3 | -2.0 | -1.6 | -1.2 | -0.6 |
| General government gross debt (c)                  |        |              |       | 41.0                     | 53.5 | 52.3 | 51.8 | 50.6 | 49.9 | 47.2 |

(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.