25. SLOVAKIA

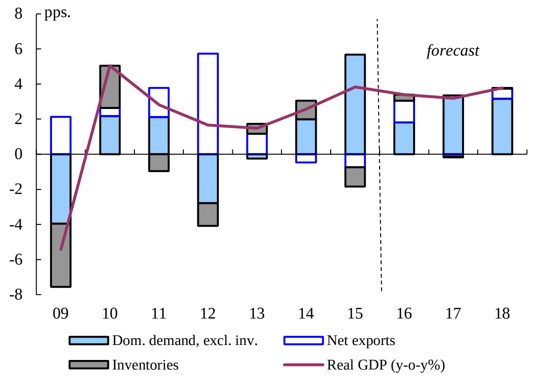
Robust growth to ensure steady labour market improvement

GDP growth this year looks solid, underpinned by strengthening household demand and net exports. Labour market conditions have been improving significantly and sustained job creation should help bring the unemployment rate below 8% in 2018. Consumer prices are expected to continue declining this year before inflation turns positive in 2017.The government deficit is expected to decline to near-balance in 2018 in a revenue-driven consolidation.

Growth to remain solid as composition evolves

After a strong 2015, annual real GDP growth in Slovakia is expected to remain above 3% between 2016 and 2018. While household consumption is expected to provide the largest positive impulse to growth throughout the forecast horizon, the role of investment and net exports looks set to evolve. A pronounced downturn in public investment linked to the cycle of EU investment co-funding is expected to restrain growth in 2016. Although an increase in private investment is unlikely to fully compensate for this drop in 2016, overall investment is forecast to return to solid growth in 2017 and 2018. Buoyant investment in the car industry and a rise in public investment spending, including large infrastructure projects such as the Bratislava ring road, bolster the outlook.

Graph II.25.1: **Slovakia - Real GDP growth and contributions**



Net exports reflect uneven investment pattern

Owing to the high import intensity of Slovak investment (particularly for equipment), the outlook for imports is strongly shaped by fixed investment, whose growth is expected to peak in 2017. In conjunction with the expected gradual rise in exports over the forecast horizon, net exports look set to partly offset this pattern of investment. In 2016, net exports are expected to be the second largest driver of real GDP growth, before exerting a minor drag on growth in 2017. Expanding car production in new and upgraded facilities is expected to boost (net) exports and GDP growth again in 2018.

Robust household spending underpins growth

Private consumption growth is set to rise in 2016 and 2017, benefitting from the continued improvement in the labour market and subdued inflation. The saving rate of households is likely to peak in 2016 and to gradually decline thereafter, allowing gains in real disposable income to feed through to household spending. The low interest rate environment is likely to help accelerate household credit, in turn fuelling consumption expenditure. Growth in household demand is forecast to peak in 2017 at 3.3% and to slow in 2018, as increasing prices start to restrain real disposable income.

The unemployment rate falls well below 10%

Following three years of improvement in the labour market, the unemployment rate is forecast to fall to 9.7% in 2016. Employment is expected to be boosted by buoyant economic activity in the forecast years, pushing the unemployment rate below 8% in 2018. At the same time, the participation rate is set to gradually increase, as incentives to join the labour force for the long-term unemployed and foreign workers increase. Recent significant declines in unemployment and greater inflows of foreign workers point to a tightening labour market, which should drive future wage increases. With regard to emerging labour shortages, especially in the western and central region, nominal wage growth is forecast to steadily increase from 2.3% this year to 4.8% in 2018.

Low price growth even in the medium term

Inflation is forecast to decline to -0.5% in 2016, the third consecutive year of declining consumer prices. The main drags are falling energy and food prices, which are overshadowing rising service prices. Energy prices are expected to continue declining on an annual basis in 2017 due to a reduction in regulated electricity and gas prices. This should be outweighed by rising service prices and a renewed growth in food and fuel prices, thus bringing inflation into positive territory in 2017. Growth in consumer prices is set to increase gradually thereafter.

Fiscal adjustment driven by revenues

The general government deficit for 2015 was revised downwards by 0.3 pps. to 2.7% of GDP mainly on account of higher tax revenues. In 2016, the deficit is projected to decline to 2.2% of GDP. This fall is supported by robust corporate income tax receipts reflecting rising profitability, as well as by steady growth in personal income taxes and social contributions due to favourable labour market developments. A more pronounced deficit reduction will, however, be hindered by non-budgeted spending (e.g. financial corrections related to EU funds) and higher-than-budgeted investments.

The consolidation effort in 2017, which comes exclusively from the revenue side, is expected to reduce the deficit to 1.5 % of GDP. A shortfall in revenue from the reduction of the corporate income tax rate to 21% and increasing lump-sum deductions for the self-employed are more than compensated by other measures including a higher levy on regulated businesses, higher excises on tobacco and a new levy on non-life insurance policies. The bank levy, which had been expected to expire, has also been retained for 2017. The forecast also assumes additional revenue from the changes to social contributions that were approved by the Parliament. Assuming no changes in policies beyond the introduction of a 7% tax on dividends, the deficit is set to decline to 0.5% of GDP in 2018, driven by buoyant tax revenues from strong GDP growth.

The structural deficit is expected to decline to 2% of GDP in 2016, going down more slowly than the headline deficit due to the closing output gap. In the following two years the improvement in the structural balance will broadly mirror the decline in the headline deficit, as the economy is expected to operate at near-potential levels. Following an increase in 2016, the debt-to-GDP ratio is projected to revert to a downward trend falling below 52% in 2018, owing to favourable deficit developments and accelerating nominal GDP.

Table II.25.1:

Main features of country forecast - SLOVAKIA

	2015		Annual percentage change						
	bn EUR Curr. prices	% GDP	97-12	2013	2014	2015	2016	2017	2018
GDP	78.7	100.0	4.0	1.5	2.6	3.8	**3.4**	**3.2**	**3.8**
Private Consumption	43.2	54.9	3.6	-0.8	1.4	2.2	**2.9**	**3.3**	**3.1**
Public Consumption	15.3	19.5	2.6	2.2	5.3	5.4	**2.3**	**2.5**	**2.7**
Gross fixed capital formation	18.1	23.0	2.0	-0.9	1.2	16.9	**-0.9**	**4.9**	**4.3**
of which: equipment	8.2	10.4	3.5	-9.4	12.1	12.4	**0.0**	**5.0**	**4.3**
Exports (goods and services)	73.6	93.5	9.3	6.7	3.7	7.0	**5.2**	**5.2**	**6.4**
Imports (goods and services)	71.7	91.1	7.2	5.6	4.4	8.1	**4.0**	**5.6**	**6.0**
GNI (GDP deflator)	77.4	98.4	3.8	2.5	1.7	4.0	**3.5**	**3.2**	**3.8**
Contribution to GDP growth: Domestic demand			3.2	-0.2	2.0	5.7	**1.8**	**3.4**	**3.2**
Inventories			-0.2	0.6	1.1	-1.1	**0.3**	**0.0**	**0.0**
Net exports			1.1	1.2	-0.5	-0.7	**1.2**	**-0.1**	**0.6**
Employment			0.2	-0.8	1.4	2.0	**2.7**	**1.5**	**1.7**
Unemployment rate (a)			14.9	14.2	13.2	11.5	**9.7**	**8.7**	**7.5**
Compensation of employees / head			7.6	2.6	1.8	3.1	**2.3**	**3.7**	**4.8**
Unit labour costs whole economy			3.6	0.3	0.7	1.3	**1.7**	**2.0**	**2.7**
Real unit labour cost			0.0	-0.2	0.9	1.5	**1.9**	**0.9**	**1.1**
Saving rate of households (b)			8.3	5.9	7.2	8.8	**9.6**	**8.5**	**8.3**
GDP deflator			3.6	0.5	-0.2	-0.2	**-0.2**	**1.0**	**1.5**
Harmonised index of consumer prices			5.2	1.5	-0.1	-0.3	**-0.5**	**0.8**	**1.4**
Terms of trade goods			-0.6	-0.6	0.3	-0.1	**-0.1**	**-0.1**	**-0.1**
Trade balance (goods) (c)			-5.1	3.7	3.4	2.3	**3.0**	**2.7**	**3.0**
Current-account balance (c)			-5.9	1.5	0.6	0.1	**0.6**	**0.1**	**0.6**
Net lending (+) or borrowing (-) vis-a-vis ROW (c)			-5.7	3.1	1.6	2.2	**0.3**	**0.3**	**0.8**
General government balance (c)			-5.3	-2.7	-2.7	-2.7	**-2.2**	**-1.5**	**-0.5**
Cyclically-adjusted budget balance (d)			-5.4	-1.7	-1.9	-2.3	**-2.0**	**-1.4**	**-0.7**
Structural budget balance (d)			-	-1.7	-2.2	-2.3	**-2.0**	**-1.4**	**-0.7**
General government gross debt (c)			39.5	54.7	53.6	52.5	**53.3**	**52.7**	**51.5**

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