

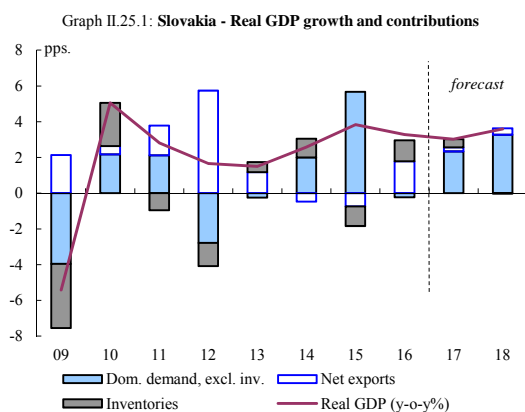
25. SLOVAKIA

Economic growth driven by robust household consumption

Slovakia's economy is set to remain on a solid growth path, with household consumption becoming the main driver of growth. Investment likely bottomed out in late 2016 and a gradual recovery is expected in 2017. Falling unemployment is expected to put upward pressure on nominal wage growth, especially in light of reported labour shortages in some regions and sectors. Buoyant household spending should also contribute to consumer price inflation. The government deficit is projected to decrease steadily.

Household consumption takes the lead

GDP growth in Slovakia is projected to maintain a solid pace of 3% in 2017 and to pick up to 3.6% in 2018, with household spending making the largest contribution to growth in both years. Underpinning the firming trend in household spending are employment gains achieved during the recent years of strong economic growth, as well as solid increases in real wages in a low-inflation environment. Further improvements in labour market conditions are set to buttress household budgets in 2017 against rising consumer prices and their depressing effect on real disposable income. Given historically low interest rates and a favourable economic climate, the saving rate of households is projected to fall in 2017, further contributing to solid household spending growth of around 3% per year over the forecast horizon.



Investment set to recover gradually

Overall investment declined throughout 2016, amounting to a 9.3% fall for the year as a whole after an exceptionally strong 2015. This cyclical investment pattern was linked to the transition between the programming periods of EU funds which affected both public and private investment. The sharp drop in total investment in 2016 suggests that EU-funded projects were a substantial driver of investment activities in

Slovakia, with calls for projects under the new funding period somewhat lagging behind. Total investment is set to recover in 2017 and to accelerate thereafter, driven by private investment in the automotive industry and large infrastructure projects such as the Bratislava ring road. Net trade is likely to make a positive contribution to growth in both years despite a rise in imports for investment purposes. Exports are expected to accelerate in 2018, partly on the back of rising car production in new and upgraded facilities.

The labour market tightens further

Unemployment fell to 9.7% in 2016. In view of the positive outlook for economic growth, unemployment is set to drop below 8% in 2018, accompanied by a gradual rise in the activity rate. Increasingly cited labour shortages in certain regions and sectors suggest a continued tightening of the labour market, which is unlikely to be fully offset by rising labour market participation or accelerating inflows of foreign workers. The shrinking pool of skilled labourers is likely to exert pressure on nominal wage growth, especially in conditions of revived inflation. With already agreed wage increases for 2017 exceeding 6% in some large enterprises, nominal wages are projected to rise by 4% overall in 2017 and to accelerate further thereafter.

Consumer prices recover

Consumer prices are expected to recover in 2017, with the headline inflation rate anticipated to reach 1.4% in 2017, driven mainly by accelerating prices of food and services. Energy prices, meanwhile, continue to depress inflation this year due to a reduction in administrated electricity and gas prices. While the inflation outlook is clouded by transitory factors, including hikes in unprocessed food prices related to poor weather and a methodological change in the pricing of second-hand cars, headline inflation is likely to hold broadly steady at 1.6% in 2018.

Revenue-based consolidation continues

The general government headline deficit in 2016 declined by 1 pp. to 1.7% of GDP. The main drivers of this improvement were robust growth of tax revenues, which were 1.4% of GDP higher than in 2015, higher dividends, and a slump in public investment reflecting a slower drawdown of EU funds. The consolidation effort is projected to slow in 2017, with the headline deficit declining to 1.3% of GDP. A favourable economic environment together with a series of adopted measures, including a higher levy on regulated businesses, higher ceilings on social contributions and their removal on healthcare contributions, are expected to translate into strong tax revenue growth. Meanwhile, the lowering of the corporate income tax rate to 21% and an increase in lump-sum deductions for the self-employed will prevent revenues from growing even faster. The government expenditure ratio is expected to remain stable at around 41½% of GDP.

For 2018, the combined effect on revenues of a new 7% tax on dividends and the scrapping of

healthcare contributions currently paid on dividends, is expected to be positive. The abolition of the minimum corporate income tax and an ad-hoc pension increase for those who retired before 2004 will, on the other hand, slow the consolidation effort. Assuming no other changes in policies, the deficit is projected to decline to 0.6% of GDP in 2018, supported by expenditure restraint and buoyant tax revenues from robust economic activity. Negative risks in 2017 stem from potentially higher-than-budgeted spending by local governments after achieving large surpluses in 2016, and from possible financial operations relating to the state healthcare insurance company.

The structural balance is projected to continue improving following its decline to 1.5% of GDP in 2016. With the output gap projected to turn positive in 2018, the decline in the structural balance will be slower than for the headline deficit. The debt-to-GDP ratio is projected to gradually fall under 50% of GDP in 2018 as the deficit shrinks and nominal GDP growth accelerates.

Table II.25.1:

Main features of country forecast - SLOVAKIA

	2015			97-12	Annual percentage change					
	bn EUR	Curr. prices	% GDP		2013	2014	2015	2016	2017	2018
GDP	78.7		100.0	4.0	1.5	2.6	3.8	3.3	3.0	3.6
Private Consumption	43.2		54.9	3.6	-0.8	1.4	2.2	2.9	3.1	2.9
Public Consumption	15.3		19.5	2.6	2.2	5.3	5.4	1.6	2.4	2.5
Gross fixed capital formation	18.1		23.0	2.0	-0.9	1.2	16.9	-9.3	0.9	5.8
of which: equipment	8.2		10.4	3.5	-9.4	12.1	12.4	-4.4	1.2	5.8
Exports (goods and services)	73.6		93.5	9.3	6.7	3.7	7.0	4.8	6.5	7.0
Imports (goods and services)	71.7		91.1	7.2	5.6	4.4	8.1	2.9	6.6	6.8
GNI (GDP deflator)	77.4		98.4	3.8	2.5	1.7	4.0	3.4	3.1	3.7
Contribution to GDP growth:										
Domestic demand				3.2	-0.2	2.0	5.7	-0.2	2.3	3.3
Inventories				-0.2	0.6	1.1	-1.1	1.2	0.5	0.0
Net exports				1.1	1.2	-0.5	-0.7	1.8	0.2	0.4
Employment				0.2	-0.8	1.4	2.0	2.4	1.4	1.3
Unemployment rate (a)				14.9	14.2	13.2	11.5	9.7	8.6	7.6
Compensation of employees / head				7.6	2.6	1.8	3.1	1.8	4.0	4.7
Unit labour costs whole economy				3.6	0.3	0.7	1.3	0.9	2.3	2.4
Real unit labour cost				0.0	-0.2	0.9	1.5	1.3	1.6	0.9
Saving rate of households (b)				8.3	5.9	7.2	8.8	9.2	8.7	9.0
GDP deflator				3.6	0.5	-0.2	-0.2	-0.4	0.8	1.5
Harmonised index of consumer prices				5.2	1.5	-0.1	-0.3	-0.5	1.4	1.6
Terms of trade goods				-0.6	-0.5	0.2	-0.2	-0.3	-0.8	0.0
Trade balance (goods) (c)				-5.1	3.7	3.4	2.3	3.0	2.5	2.7
Current-account balance (c)				-5.9	1.5	0.6	0.1	0.2	0.1	0.4
Net lending (+) or borrowing (-) vis-a-vis ROW (c)				-5.7	3.1	1.6	2.2	0.7	1.0	1.9
General government balance (c)				-5.3	-2.7	-2.7	-2.7	-1.7	-1.3	-0.6
Cyclically-adjusted budget balance (d)				-5.4	-1.6	-1.8	-2.3	-1.5	-1.4	-0.9
Structural budget balance (d)				-	-1.6	-2.1	-2.3	-1.5	-1.4	-0.9
General government gross debt (c)				39.6	54.7	53.6	52.5	51.9	51.5	49.8

(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.