25. SLOVAKIA

Solid growth set to continue along with a recovery in investment

Slovakia's economy expanded further in 2016, driven mainly by strong net exports and accelerating household consumption, while falling investment detracted from growth. Economic activity is expected to continue growing at a solid pace over the forecast horizon, providing further support to the labour market through sustained job creation. Inflation is set to turn positive in 2017 after three years of declining consumer prices. The government deficit is projected to decrease steadily.

Investment cycle shapes growth profile

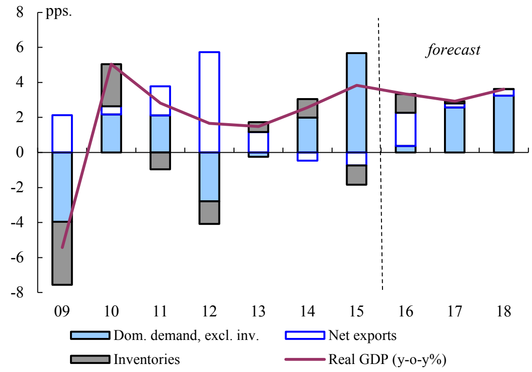
Real GDP is projected to have risen by 3.3% in 2016, slightly less than in 2015. The modest slowing of GDP growth masks a sharp turn in Slovakia's investment cycle in 2016, in which EU-funded investment fell at the start of the new programming period. While public investment contracted particularly sharply in 2016, so too did import growth due to the high import intensity of fixed investment in Slovakia. Coupled with a solid rise in exports, this generated a strong positive contribution of net exports to GDP growth, which was bolstered further by faster growth in household consumption.

Economic growth in Slovakia is projected to remain close to 3% in 2017 and to gather further pace thereafter. Overall investment spending is forecast to return to growth in 2017, accelerating further in 2018. Booming investment in the automotive industry and an expected increase in public investment spending, including large infrastructure projects such as the Bratislava ring road, strengthen the outlook. As investment recovers, import activity is likely to pick up commensurately in 2017. By contrast, export growth is anticipated to accelerate somewhat more gradually, underpinned by rising car production in new and upgraded facilities. Although net trade is likely to prove far less supportive of output growth than in 2016, it is still likely to make a positive contribution throughout the forecast horizon.

Household consumption strengthens

Households benefitted from considerable increases in their real disposable income in 2016 thanks to both nominal income and price developments. Rising employment and solid wage growth supported nominal household incomes, while still-low energy prices and inflation further lifted real incomes. With credit costs low, this pushed household consumption growth to an estimated 2.7% in 2016. The saving rate of households is likely to have peaked in 2016 and is set to decline in 2017, allowing gains in real disposable income to fully feed through to household spending. Growth in private consumption is expected to stay close to 3% over the forecast horizon, reflecting continued growth in employment and wages.

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



Unemployment falls, participation rises

The unemployment rate declined to 9.7% in 2016 and is set to fall further to some 8% in 2018, reflecting the continued economic expansion. The activity rate is also set to gradually increase, as strong labour demand and rising real wages strengthen the incentives for the inactive to join the labour force. Recent increases in the activity rate accompanied with stronger inflows of foreign workers point to a tightening labour market, which should support future wage increases. Taking into account reported labour shortages in specific sectors and regions, nominal wage growth is expected to increase to 4.2% in 2018, lending support to household real disposable income and private consumption.

Consumer prices recover

After three consecutive years of declining consumer prices, inflation is set to turn positive in 2017. An acceleration in food and services prices is set to become the main driver of the overall price recovery, allowing CPI inflation to rise to 0.9% in 2017. Notwithstanding the recent rise in global energy prices, reductions in Slovakia’s administrated electricity and gas prices are projected to act as a drag on overall inflation in 2017. Inflation is set to increase gradually throughout 2018, reflecting robust household demand and renewed growth in energy prices.

Deficit on a downward path

The general government deficit in 2016 is estimated to have declined by 0.5 pps. to 2.2% of GDP. Revenue growth surprised on the upside as labour market improvements drove up growth in revenues from personal income taxes and social contributions, while corporate income tax receipts also increased. Non-budgeted spending (e.g. financial corrections related to EU investment co-financing) and higher-than-budgeted investment and healthcare outlays prevented a faster deficit reduction.

In 2017, the pace of consolidation is projected to accelerate with the deficit declining to 1.4% of GDP. Revenues are anticipated to be the main driver of this adjustment, also due to adopted measures totalling some 0.4% of GDP, which include a higher levy on regulated businesses, higher ceilings on social and healthcare contributions, a new levy on non-life insurance policies, higher fees for the storage of emergency oil stocks, and higher excises on tobacco. Revenue growth will be tempered by a reduction of the corporate income tax rate by 1.0 pp. to 21% and an increase in lump-sum deductions for the self-employed. Expenditure measures adopted by the government will contribute to a higher spending.

In 2018, a 7% tax on dividends will be introduced with a parallel scrapping of healthcare contributions currently paid on dividends. Assuming no other changes in policies, the deficit is set to decline to 0.6% of GDP in 2018, supported by buoyant tax revenues from robust GDP growth.

After an estimated decline to just above 2.0% of GDP in 2016, the structural deficit is projected to continue decreasing in the following two years. The improvement is likely to broadly mirror the decline in the headline deficit, as the economy is expected to operate close to potential. Following a rise in 2016, Slovakia's debt-to-GDP ratio is projected to decline to 50% of GDP in 2018 on the back of an improving primary deficit and accelerating nominal GDP growth.

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	**3.3**	**2.9**	**3.6**
Private Consumption		43.2	54.9	3.6	-0.8	1.4	2.2	**2.7**	**2.9**	**2.8**
Public Consumption		15.3	19.5	2.6	2.2	5.3	5.4	**2.9**	**2.9**	**3.0**
Gross fixed capital formation		18.1	23.0	2.0	-0.9	1.2	16.9	**-7.3**	**2.1**	**5.4**
of which: equipment		8.2	10.4	3.5	-9.4	12.1	12.4	**-2.0**	**3.3**	**5.4**
Exports (goods and services)		73.6	93.5	9.3	6.7	3.7	7.0	**4.1**	**5.1**	**6.6**
Imports (goods and services)		71.7	91.1	7.2	5.6	4.4	8.1	**2.2**	**5.1**	**6.5**
GNI (GDP deflator)		77.4	98.4	3.8	2.5	1.7	4.0	**3.4**	**3.0**	**3.6**
Contribution to GDP growth:	Domestic demand			3.2	-0.2	2.0	5.7	**0.4**	**2.6**	**3.2**
	Inventories			-0.2	0.6	1.1	-1.1	**1.1**	**0.1**	**0.0**
	Net exports			1.1	1.2	-0.5	-0.7	**1.9**	**0.2**	**0.4**
Employment				0.2	-0.8	1.4	2.0	**2.6**	**1.4**	**1.6**
Unemployment rate (a)				14.9	14.2	13.2	11.5	**9.7**	**9.0**	**7.9**
Compensation of employees / head				7.6	2.6	1.8	3.1	**1.5**	**3.8**	**4.2**
Unit labour costs whole economy				3.6	0.3	0.7	1.3	**0.8**	**2.3**	**2.1**
Real unit labour cost				0.0	-0.2	0.9	1.5	**1.1**	**1.3**	**0.6**
Saving rate of households (b)				8.3	5.9	7.2	8.8	**9.6**	**8.7**	**8.6**
GDP deflator				3.6	0.5	-0.2	-0.2	**-0.2**	**0.9**	**1.5**
Harmonised index of consumer prices				5.2	1.5	-0.1	-0.3	**-0.5**	**0.9**	**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	**3.1**	**2.4**	**2.4**
Current-account balance (c)				-5.9	1.5	0.6	0.1	**1.2**	**1.2**	**1.5**
Net lending (+) or borrowing (-) vis-a-vis ROW (c)				-5.7	3.1	1.6	2.2	**1.1**	**1.5**	**1.8**
General government balance (c)				-5.3	-2.7	-2.7	-2.7	**-2.2**	**-1.4**	**-0.6**
Cyclically-adjusted budget balance (d)				-5.4	-1.7	-1.9	-2.3	**-2.1**	**-1.3**	**-0.8**
Structural budget balance (d)				-	-1.7	-2.2	-2.3	**-2.1**	**-1.3**	**-0.8**
General government gross debt (c)				39.5	54.7	53.6	52.5	**52.1**	**51.8**	**50.0**

(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.