SLOVAKIA: Domestic demand driving growth

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Domestic demand replaced exports as the main engine of growth in 2014. This pattern will be maintained in the years to come. A major contributory factor is a number of substantial social measures taken by the government in the run-up to parliamentary elections. Stronger household consumption will also encourage import growth. Exports will remain sluggish in 2015, as low growth will prevail in the euro area and regional uncertainties persist. Growth should pick up thereafter, although risks will remain.

GDP growth in Slovakia reached 2.4% in 2014. While in the past net exports were the main drivers of growth it is now domestic demand. Household consumption recovered after five years of stagnation and grew by about 2.3% in the first three quarters thanks to improving conditions on the labour market and rising real wages. There was deflation in 2014 (-0.1% on annual average). Government consumption rose by nearly 5% as did investment. The latter showed an exceptionally improving trend over the first three quarters. On the other hand, export and import growth slowed down significantly during the year. Goods exports to Slovakia’s main export partner Germany grew by 7% (January to November), exports to its second most important export partner, the Czech Republic, dropped by 5%. Exports to other markets, such as Russia or China, dropped by as much as 19% and 15%, respectively.

With regard to sectoral trends, industrial production increased by 3.6% in 2014 – the smallest increase since 2009. The automotive industry, which is the largest sector of the Slovak economy and has led growth in the recent years, lost momentum in the second half of 2014: it even declined from August. Overall, it grew just by 2.4%. While the record number of 980,000 cars produced in 2013 was probably not reached in 2014, two of the main car manufacturers, PSA Peugeot-Citroën and KIA Motors, still reported production increases. The major sectors contributing to growth were basic metals and fabricated metal products, and electrical engineering, followed only on third place by the automotive sector. The construction sector still did not recover in 2014 and declined again by 4% – the sixth year in a row. Value added of services continued growing.

On the labour market, trends were fairly favourable in 2014: Employment rose by about 1% and the unemployment rate (LFS) fell from 14.2% to about 13.4%. Still, this figure is quite high and the situation is aggravated by high long-term and youth unemployment – both represent a major problem in Slovakia. Regional disparities are wide, with low unemployment rates prevailing in the capital Bratislava, but high ones in the central and eastern part of the country. Unemployment among the Roma minority, mainly located in the east, is very high as well.

The Slovak budget deficit and debt to GDP ratio for the year 2013 decreased slightly thanks to revisions in GDP data (but increased due to ESA 10 implementation in 2014), thus reaching -2.6% and 54.6% of GDP in 2013. This is important as Slovakia introduced a 'Fiscal Responsibility Act' in 2011 which incorporates certain thresholds for the debt level and sanctions if surpassed. Thus, the debt to GDP level fell again below the '55%-threshold'. This, together with a pre-election period (the next parliamentary elections are to take place in 2016) and the end of the drawing of structural funds for the period 2007-2013 (absorption of EU funds has been the third lowest and payments will finish at the end of 2015), seems to have spurred the spending mood in 2014/15: The government announced a set of social measures which include free rail transport for students and pensioners since November 2014. The 2015 budget stipulates an increase in salaries of teachers and public and state administration employees, support for kindergartens and new rules for health insurance for low-income employees. At the beginning of 2015, the minimum wage was raised by 8% to EUR 380; also, the introduction of a minimum pension of EUR 270 is planned in 2015. Further on, the government, owner of the Slovak gas utility SPP since 2014, promised to cut household gas prices by a double-digit number until 2016. Considering these measures, the official 2015 budget deficit target of 2.5% seems unrealistic, while the debt to GDP level should remain at about 55% in the coming years.

The Slovak banking sector is in good shape, as confirmed by the ECB's comprehensive assessment of banks which took place in October 2014 (consisting of an asset quality review and stress tests of banks). Slovakia's three largest banks were included: Slovenská sporiteľňa (Erste Bank), Všeobecná úverová banka (Intesa), and Tatra banka (Raiffeisen). On 4 November 2014, the Single Supervisory Mechanism became effective and the ECB has now direct oversight in Slovakia over the above three banks as well as over Československá obchodná banka (KBC), ČSOB Stavebná sporiteľňa and Sberbank Slovensko, as their parent groups are deemed significant. A specific feature of Slovakia is its high growth of loans to households (10% annually between 2009 and 2013), which is among the highest in the EU, and which even accelerated further to 12% in the third quarter of 2014. As a precautionary measure, the Slovak National Bank issued a recommendation in October 2014 which specified conditions under which retail loans are given (e.g. checking of customers, more prudency requirements). Growth of loans to non-financial corporations is lower but also picked up and reached close to 4% in the third quarter of 2014. Here it was primarily loans to state-owned enterprises that surged.

Domestic demand replaced exports as the main engine of growth in 2014, and this pattern will be maintained in 2015 as well. As 2015 is a pre-election year, government spending will be more favourable and contribute to rising household income (e.g. minimum wages, pensions). Stronger household consumption will in turn encourage import growth. Export growth will remain sluggish as low growth will prevail in the euro area and regional uncertainties (Russia, Ukraine) will persist. The economic sentiment indicator has been quite stable since July 2014; in January 2015 it was six points higher than a year earlier. While confidence in the construction sector has increased most since July, confidence in services has registered the strongest relative decline. Other components of the economic sentiment indicator – confidence in industry, in retail trade and consumer confidence – remained at their previous level. For the coming two years we have marginally increased our growth forecast (+0.1pp due to better forecasts for Slovakia's main trading partner Germany); household consumption will again be the main driving force. Prospects for export growth are more favourable for 2016 and 2017. Still, downward risks remain as regional tensions (Russia, Ukraine) persist and certain risks within the euro area prevail (Greece). On the other hand, upward risks may bring faster export growth as oil prices are low and the weak euro may encourage exports to countries outside the European Union. However, previously promising markets (Russia, China) saw decreasing market shares last year. Thus our forecast for 2015 remains at 2.5% for this year and lies at 2.7% for 2016 and 3% for 2017.

Table 1 / Slovakia: Selected Economic Indicators

	2010	2011	2012	2013	2014 [1]	2015	2016 Forecast	2017
Population, th pers., average [2]	5,391	5,398	5,408	5,413	5,420	5,430	5,440	5,450
Gross domestic product, EUR mn, nom. [3]	67,204	70,160	72,185	73,593	75,300	77,500	80,700	84,500
annual change in % (real) [3]	4.8	2.7	1.6	1.4	2.4	2.5	2.7	3.0
GDP/capita (EUR at exchange rate)	12,500	13,000	13,300	13,600	13,900	13,900	14,800	15,500
GDP/capita (EUR at PPP)	18,600	19,200	19,700	20,000	20,600	.	.	.
Consumption of households, EUR mn, nom. [3]	38,354	39,583	40,770	40,995	41,800	43,000	44,800	46,800
annual change in % (real) [3]	0.1	-0.7	-0.5	-0.8	2.0	2.5	2.7	2.7
Gross fixed capital form., EUR mn, nom. [3]	14,910	16,946	15,393	15,045	15,600	16,300	17,300	18,400
annual change in % (real) [3]	7.2	12.7	-9.3	-2.7	4.0	4.0	4.5	4.5
Gross industrial production								
annual change in % (real)	8.2	5.3	7.9	4.9	3.6	3.0	4.0	4.0
Gross agricultural production								
annual change in % (real)	-8.2	8.7	-5.7	6.7	0.9	.	.	.
Construction industry								
annual change in % (real)	-4.6	-1.8	-12.6	-5.2	-4.2	.	.	.
Employed persons, LFS, th, average [4]	2,318	2,351	2,329	2,329	2,352	2360	2380	2400
annual change in %	-2.1	1.5	0.6	0.0	1.0	0.5	0.7	0.7
Unemployed persons, LFS, th, average [4]	389	368	378	386	365	.	.	.
Unemployment rate, LFS, in %, average [4]	14.4	13.5	14.0	14.2	13.4	13.0	12.5	12.0
Reg. unemployment rate, in %, end of period	12.5	13.6	14.4	13.5	12.3	12.0	11.5	11.0
Average monthly gross wages, EUR	769	786	805	824	840	.	.	.
annual change in % (real, gross)	2.2	-1.6	-1.2	1.0	4.5	.	.	.
Consumer prices (HICP), % p.a.	0.7	4.1	3.7	1.5	-0.1	0.4	1.4	1.7
Producer prices in industry, % p.a.	0.4	4.5	1.9	-1.0	-3.5	1.0	1.5	2.0
General governm.budget, EU-def., % of GDP								
Revenues	34.5	36.4	36.0	38.4	38.0	.	.	.
Expenditures	42.0	40.6	40.2	41.0	40.9	.	.	.
Net lending (+) / net borrowing (-)	-7.5	-4.1	-4.2	-2.6	-3.0	-2.8	-2.6	-2.3
Public debt, EU-def., % of GDP	41.1	43.5	52.1	54.6	54.1	54.9	55.2	55.0
Central bank policy rate, % p.a., end of period [5]	1.00	1.00	0.75	0.25	0.05	.	.	.
Current account, EUR mn [6]	-3,184	-3,497	684	1,341	530	460	250	350
Current account, % of GDP	-4.7	-5.0	0.9	1.8	0.7	0.6	0.3	0.4
Exports of goods, BOP, EUR mn [6]	46,501	54,673	60,159	62,815	63,500	64,000	65,000	68,000
annual change in %	21.3	17.6	10.0	4.4	1.1	1.1	2.2	4.8
Imports of goods, BOP, EUR mn [6]	46,581	54,709	57,653	59,384	59,600	60,000	62,000	65,000
annual change in %	22.3	17.4	5.4	3.0	0.4	1.5	2.8	4.9
Exports of services, BOP, EUR mn [6]	4,836	5,228	6,049	7,197	6,500	6,800	7,300	7,800
annual change in %	2.1	8.1	15.7	19.0	-9.7	5.0	7.0	7.0
Imports of services, BOP, EUR mn [6]	5,488	5,498	5,628	6,612	6,300	6,600	7,300	8,000
annual change in %	-2.7	0.2	2.4	17.5	-4.7	5.0	10.0	10.0
FDI inflow (liabilities), EUR mn [6]	1,561	3,961	1,356	1,610	1,200	.	.	.
FDI outflow (assets), EUR mn [6]	939	1,962	-958	847	1,000	.	.	.
Gross reserves of NB excl. gold, EUR mn	541	659	620	670	1,165	.	.	.
Gross external debt, EUR mn	49,262	52,934	53,755	59,684	66,500	.	.	.
Gross external debt, % of GDP	73.3	75.4	74.5	81.1	88.3	.	.	.
Purchasing power parity EUR/EUR	0.6691	0.6758	0.6776	0.6794	0.6748	.	.	.

1) Preliminary and wiiw estimates. - 2) According to census May 2011. - 3) According to ESA 2010. - 4) From 2012 data according to census May 2011. - 5) Official refinancing operation rates for euro area (ECB). - 6) BOP 6th edition.
Source: wiiw Databases incorporating Eurostat and national statistics.