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Weekly Briefing

Slovakia Economy briefing:

Macroeconomic situation in Slovakia

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According to most macroeconomic indicators, the economy of the Slovak Republic is doing relatively well. Having weathered the recession after 2008 rather well, the long-term growth is above the EU average. The growth of GDP in 2017 was 3.1% in the first quarter, 3.3% in the second, and is estimated to be 3.4% for the third quarter, signaling that growth seems to be slowing down, although still robust for EU standards. The growth of GDP for the entire year of 2017 is expected to be 3.2-3.3%. This growth was due both to domestic consumption and foreign (mainly European) demand, though as a small and open economy, Slovakia is dependent on the latter. Slovakia tries hard to attract foreign investment, especially from the West, but increasingly also from the East. Expectations of investment are one of the main benefits Slovakia expects from its membership in the 16+1 forum for cooperation between China and Central and Eastern Europe. Slovakia's main selling points are its relatively cheap but highly skilled labor force (although the productivity of labor is among the lowest in the EU) and its membership in the EU (since 2004) and Eurozone (since 2009). It can also rely on its position as a transit country and transportation node in Europe, e.g. due to oil and gas pipelines from Russia to Western Europe and being the switching point between the different gauges of Post-Soviet and Western railroads. Slovakia was most successful in attracting carmakers, whether entire manufacturing and assembly plants, or the production of components, such as tires. As of 2017, Slovakia has 4 major automobile manufacturing plants, making it the world's largest producer of automobiles per capita. There are talks of a fifth carmaker, China's Zhi Dou, building its factory in Slovakia.

Slovakia's main exports are in the areas of the engineering, electronic, metallurgical and chemical industries. In 2016, Slovakia's exports were worth 77.5 bn. USD, making it the world's 32nd largest exporter. The top 5 exports of Slovakia were automobiles (15.5 bn. USD, 20% of all exports), video displays (6.07 bn. USD), vehicle parts (4.44 bn. USD), broadcasting equipment (3.54 bn.

USD) and tires (1.75 bn. USD). The top 5 imports were vehicle parts (7.43 bn. USD), broadcasting equipment (3.73 bn. USD), automobiles (2.07 bn. USD), crude oil (1.83 bn. USD) and natural gas (1.52 bn. USD). This reliance on automobiles and their components raises warnings, since it can become damaging to Slovakia in case of a downturn in demand for automobiles or if other countries start restricting market access.

Also for 2016, the top 3 economic partners of Slovakia are Germany, the Czech Republic and Poland, in that order. Its main sources of imports are Germany, the Czech Republic, Hungary, Poland and Italy. As for its main export markets, these are Germany, the Czech Republic, Poland, France and the United Kingdom. Slovakia's trade is thus strongly oriented towards Western Europe (apart from its neighbors), natural for an EU member. The major exception is Russia, where Slovakia buys 99% of its oil and 95% of its natural gas. Another developing non-EU economic partner is South Korea, due to its investment in the automobile and electronics industries in Slovakia. Notwithstanding, Slovakia's economic dependence on Germany influences many of its policy decisions, such as joining the Eurozone or joining the proposed "EU core". This can have negative consequences if the economy of Germany runs into trouble or if Germany loses its appetite for integration. It would be prudent for Slovakia to seek to diversify its export markets. The government recognizes this, and it is another of the factors behind Slovakia's hopes for the 16+1 platform and the opening of China to business opportunities from Slovakia.

The economic performance of Slovakia is credited to the liberal economic reforms of the center-right governments of the turn of the millennium. These reforms led to rapid growth, and Slovakia was called the "Tatra Tiger" (after the Tatra mountains) before the 2008 recession. The reforms also helped Slovakia's credit rating in recent years after the recession had passed, and Slovakia can now borrow on financial markets at record low interest rates. But this is exacerbating the public debt of Slovakia, which stood at 53.5% of GDP at the start of 2017, although a small fall in the debt level is expected. Slovakia's debt is hovering

between 51-55% of GDP for 3 years. This is better that the EU average of 84.1% of GDP at the start of 2017.

The per capita GDP of Slovakia was at 77% of the EU average, and has been so for 4 years, indicating that Slovakia's ambition to catch up to the EU is stagnating. Yet there was a marked increase over the decade – when Slovakia joined the EU, its per capita GDP was at 60% of the EU in 2005. Nevertheless, catching up to the EU means risking that Slovakia might lose its advantage in its lower costs of labor, due to an increase in wages. The proclaimed solution for this is the continuation of liberal reforms. Some have general acceptance, such as simplifying the administrative load for companies (especially start-ups) or fighting against corruption. Others are more controversial, such as raising the retirement age, revising the tax policy, or decreasing job security for employees in order to create a more flexible job market. Many people distrust liberal capitalist reforms due to the consequences of the post-communist economic transformation, which led to the bankruptcy of many state-owned companies (or to their privatization and subsequent liquidation), and therefore to massive unemployment, which reached 19.2% in 2001. The perceived negative social aspects of these reforms were one of the factors behind the implosion of the economically liberal center-right parties and the dominance of the center-left Smer party (which was critical of these reforms even though it continued implementing many of them), as described in the previous briefing. This means that there is little appetite among Slovakia's political elites for more liberal economic reforms, and any progress on this front will probably be slow.

The unemployment rate in September 2017 is estimated to be at 6.42%, a record low for post-communist Slovakia. Unemployment has been decreasing from a high of 14.78% in January 2013 due to the post-2008 recession. But the growth of employment and the availability of job opportunities are uneven. Regions in the East and South of the country have high unemployment due to poor infrastructure. The disparity in regional growth and wealth is one of the main challenges for the governments of Slovakia. Most major foreign

investment goes to Western Slovakia, where infrastructure is most developed, but where employment is highest. It is precisely the poor infrastructure that prevents foreign companies from investing in the underdeveloped regions. The alternative is to bring the potential employees to the investment sites, but the government is unsuccessful in persuading unemployed people to migrate after jobs. This is mainly because Slovaks are not accustomed to migrate after jobs in general, likely due to being accustomed to having job opportunities near their place of residence, which can be explained by the former Communist regime trying to develop the more backward regions. When these enterprises went bankrupt after the fall of Communism, the preferred response was (and is) to wait for other employment opportunities in their region, or to work abroad for several months (mainly in Western EU countries), while still being based in their home region. This is explained by strong ties to family and home among rural inhabitants. Another reason why Slovaks tend not to migrate after work is the lack of affordable housing in Slovakia. While new housing is being built after the fall of Communism, it tends to be expensive for non-college educated workers or even young professionals. Specifically, there is a shortage of affordable housing for rent. This means most Slovaks own their homes; a major investment that Slovaks do not make lightly. Likewise, certain segments of the population, such as the lowest skilled workers, or members of the Roma ethnic minority (whose poverty levels are among the highest in Slovakia, meaning they are generally not well educated or skilled) have trouble finding work.

On the other hand, due to low unemployment and the number of companies involved in the skilled manufacturing sector, there is now a shortage of labor in the manufacturing industry or the IT sector. The supply of highly skilled labor cannot keep up with demand. One important reason for this is that the secondary educational system does not supply the labor market with workers having the necessary skills. Also, there is pressure for Slovak students to attend university instead of obtaining a vocational education, which further complicates their chances of gaining employment in their specialty and leads to an oversaturation

of the workforce with university students. Many students end up in manufacturing jobs anyway, after re-training and requalification courses. This lack of labor leads companies to hire workers from abroad, mainly from other countries of Central and Eastern Europe such as Serbia and Ukraine. This is controversial due to the existence of unemployed locals as mentioned above. But because of the failure of companies and government to induce unemployed Slovaks to relocate after job opportunities, even the government concedes the necessity of importing foreign workers, although only if companies are not able to find adequate Slovak workers. The government is also developing educational reforms to align the educational process with market requirements. Furthermore, Slovakia suffers from a brain drain of the most educated and skilled workers, professionals and students.

The government must find ways to entice investors to invest in areas that need the jobs. The best way would be to speed up the development of infrastructure, though this raises the question of money. Another way is to offer incentives to companies, though that is politically controversial. Otherwise, Slovakia might have to reconsider the country's strict migration policy and start accepting larger numbers of migrants. This would also alleviate the looming demographic crisis caused by the population aging and the decrease in the number of children born. However, such a solution would face difficult political hurdles, as was alluded to in the previous policy paper. The various governments have been trying to alleviate the demographic trend by gradually raising the retirement age, but this policy can only go so far without a stimulus in natality. The fall in birth rates is proving much harder to tackle, and successive governments have not been able to reverse the trend.