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Slovakia economy briefing:

The Slovak Economy in 2018

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The Slovak Economy in 2018

Summary

Slovakia experienced a sustainable growth of the GDP since its integration into the European Union 14 years ago (if not taking into consideration the financial crisis between years 2008-2009 and the Eurozone crisis from 2011 till 2012). In the recent years, the Slovak economy was fueled and boosted by the increase in the internal as well as the European demand. The moderate decline, expected on the basis of monthly indicators, was caused mainly by a sharp drop in the car production, which was related to the industry's slow adaptation to new emission standards released by the EU. This decline, mostly affecting the German carmaker, is assumed to have an impact on the economy.

Based on financial forecasts, in 2018, the Slovak economy should have had a positive development trend. Considering the macroeconomic point of view, real growth of the GDP was expected to increase and the unemployment rate to decline at the end of the year. Referring to the Slovak labor market and the prospering automotive industry, a significant deficit of qualified labor is a big concern for the next year.

Unfavorable Situations

The year 2018, from a financial and economic point of view, was a vivid year for the Slovak economy. The beginning of the year was negatively influenced by the domestic situation - the murder of investigative journalist Ján Kuciak and his fiancée Stanislava Kušnírová and the subsequent mass protests, which led to a temporary political instability. Despite the unsavory situation, the political crisis did not result in any negative implications and the economic policy of the country remained unaffected and with no pronounced impact on the development of the national economy.

According to the Central Bank Report, the increase of debts of Slovak people was the highest in the EU, therefore measures to tackle the situation had to be implemented. Financial stability is ensured through indebting rules based on household income and a limit for the maximum sum of a loan in relation to the real estate's value. The situation in the health care is also not very favorable due to continuous deepening of indebtedness and loss in hospitals, which is not favorably supported by revenues from health insurers. Moreover, the debt is deepened by multiple operation costs.

Another expected negative impact was the imposition of tariffs on imports of steel and aluminum as all the goods sold from the EU to the US would be subject to charge. Even though an ordinary consumer in Slovakia will not discern the measures announced by the US President. Exports of these commodities from Slovakia to the USA make up only a small portion of the total volume, which had no fundamental impact on Slovakia's economy. The only real concern that may affect the Slovak economy are tariffs on cars, as they may increase from 2.5% to 10 %. At present, out of the three carmakers active in Slovakia only one exports cars directly to the US.

Historical Milestones

In the field of foreign economic relations some positive changes were achieved. A Double Taxation Avoidance Agreement was signed with Oman, along with debates over mutual economic cooperation. This was for sure a historical milestone for Slovakia.

Also the finance ministers of the Visegrad Group countries signed a memorandum on financing of the European budget, which is also considered an important milestone for Slovakia. Also, the representatives have discussed the EU's proposal on taxation of digital revenues, which should be applied against transnational companies.

Furthermore, Slovakia has signed a bilateral agreement with the Czech Republic on automatic exchanges of information related to value-added tax, which should help eliminate and fight against tax fraud.

During the year, Slovakia achieved another historical milestone: the 50-year bond is the longest euro bond issued in Central and Eastern Europe over the past decade. The document is the longest bond the Slovak Republic that has ever been issued in its history.

The State Budget

In case of the national budget, statistics were better compared to the same period last year - meaning a lower deficit. The state budget incomes and also expenditures reported growth by the end of the first quarter of 2018. Economic growth reached its highest peak in the last two and a half years. The main drivers to achieve this result were household consumers.

The Ministry of Finance presented a state budget draft for the next three years. Based on the numbers, it should meet historical milestones in the deficit calculation for 2019, or even a surplus of 0.2 % for the end of the period in 2021. The predictions for the gross debt are also positive, as the state owned amount should decline to 47.3% of the GDP. The Ministry of Finance has submitted the draft state budget to the tripartite meeting. Referring to the presented data, Slovakia continues with the revitalization of its public finances in order to achieve sustainability. On the other hand, there is also a negative side of the published budget draft. The numbers calculated by the Ministry of Finance may have a prejudicial impact on the state-owned railway company ŽSR.

Employment

Throughout the year, the Slovak economy repeatedly reported a lowering number of the finance public deficit, an outcome mainly driven by the growth of the national economy and the situation on the labour market. The overall unemployment rate dropped in all regions of Slovakia and the trend of decreasing should continue for the future as well.

On the other hand, employers are concerned about the shortage of qualified labor. In response, employers are (to an increasing extent) hiring people that traditionally have a lower propensity to be economically active, or hiring foreigners and employing people on a part-time basis. Dynamic wage growth was recorded in both the private and public sectors. Employment grew over the quarters of this year at the same or similar pace. On the other hand, companies are continuously reporting shortage of qualified labor while covering these gaps with workforce from abroad, including non-EU citizens.

Paradoxically, while the main long-term problem of the Slovak economy was (and to an extent still is) a high rate of unemployment, it is now coupled with a new phenomenon – a shortage of labor in select sectors and regions. There are two reasons for the shortage of skilled workers in industry. First, the job market in Slovakia has become saturated with foreign companies, which bring investment in the manufacturing sector, mainly the carmakers and manufacturers of automobile components. In this, we can see that to a certain extent Slovakia has become a victim of its own success at attracting foreign investment in manufacturing. The other main reason for the industrial labor shortage is the fact that the Slovak education system does not adequately reflect the needs of the market and does not provide people with the necessary skills. The manufacturing positions require a different skill set than they used to in previous decades, especially with regard to the advances in IT.

The decreasing tendency of the unemployment rate came to an end in June. Analysts reported the situation positively, as a result of a cyclical situation caused by graduates from universities who registered in local labor offices. The increase appeared after three years of an intensive decline. However, specialists in this area pointed out other concerning facts. In terms of unemployment, demographic differences in Slovakia continue to grow. While the western part of the country lacks workforce, the eastern part lacks work opportunities. Also, the low mobility of the unemployed people forces companies to employ foreigners, mostly Serbians, Romanians and Hungarians. The eastern part of Slovakia lost potential investments in the amount of approximately €2 billion as foreign companies chose low cost production in southern Europe.

The situation on the labor market became a bit more competitive since the implementation of a new legislation demanding companies to disclose.

The Main Driver of 2018

The automotive industry is one of the pillars of Slovakia’s economy bringing investment, employment and innovations, with Jaguar Land Rover as the latest example. Slovakia is already home to three big carmakers, Volkswagen Slovakia, PSA Peugeot Citroën Slovakia and Kia Motors Slovakia. This has made Slovakia the biggest per capita car producer in the world. And the importance of the automotive industry for the economy of Slovakia is still increasing.

However, there are concerns over the strong focus on the automotive industry, and warnings against the Detroit-like scenario. Instead, a bigger focus on education and innovations could help save Slovakia from becoming the new Detroit.