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Slovakia economy briefing:

Slovak Economy Outlook for 2019

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Slovak Economy Outlook for 2019

In 2019, it is expected that the Slovak economy will strengthen its position. According to the report of the Slovak Central Bank, in the third quarter of 2018 the growth of the GDP accelerated to 4.6% per annum. Moreover, the GDP growth accelerated in 2018, which promises a continuing trend in the upcoming period. Again, private consumption is expected to be the main driver of overall growth of the country's wealth. Further increases on the labor market are likely to make private consumption a key factor of GDP growth in 2019. Since the global economic growth is gradually slowing down, the central bank has also revised the estimated growth of GDP for 2019. The GDP growth should amount to 4.3% in 2019, even though in its previous prognosis the central bank predicted the economy to grow by almost 4.5%. On the other hand, Focus Economics panelists projected that GDP should go up to 3.8% in 2019, which represents an increase of 0.1 percentage points from last month's forecast, and 3.2% in 2020.

Moreover, a responsible fiscal stance should lead into another fall in the public debt-to-GDP ratio. The general government debt-to-GDP ratio is expected to decline to 46.4% of GDP by 2019 and to 44.2% of GDP in 2020, driven by expected primary surpluses and robust nominal GDP growth. The Slovak Central Bank has also been making changes in credit standards in order to ensure an increase in household indebtedness. This has slowed down credit growth, which still remains on a quite high level. According to local property experts, property demand will continue to rise both from local homebuyers and foreign investors.[1] On the contrary, there are some risks to economic growth, such as the Brexit negotiations, EU politics (particularly Italy) and protectionism, which still persist.

Contrary to the growth of GDP, the employment growth slowed down to 1.9% year-on-year in the third quarter. According to the data of the central bank, the decline in employment has been visible in each sector, with the exception of services. However, in average wages increased by 6.1 percentage point. Improvements on the labor market and solid investment growth supported by positive financial conditions and increased disbursements of the European Union funds will contribute to strengthen domestic demand in the country. At the same time, also the continuing labor shortage situation caused by uneven geographical development is

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[1] --, "Analytici: Ekonomike by mala v roku 2019 pomôcť najmä nová automobilka," *Trend*, 31 December 2018, <https://www.etrend.sk/ekonomika/analytici-ekonomike-by-mala-v-roku-2019-pomoct-najma-nova-automobilka.html>.

expected to push wage growth above productivity growth. This will most likely deteriorate the economy's external competitiveness and pose a risk towards further expansion in some sectors of the economy. Due to labor market improvements in 2018 the unemployment falls to a historical level resulting in labor shortages, which become more acute in many sectors. The unemployment rate decreased to 6.4% in the third quarter of 2018 and employment growth rose by 1.4% per annum. The unemployment rate is expected to reach 6.2% in 2019 and fall to 5.7% in the following year. Considering low unemployment risk and supportive financial conditions, consumers are likely to keep spending and invest in the real estate market. Nominal wage growth is likely to average 6.4% in 2019 and remain at about 6% in 2020.[2]

Despite the reported data regarding the Eurozone and its growth slowing down, Slovak exports should benefit from production in the automotive industry. Also, taking into consideration the new Jaguar Land Rover car plant in Nitra, which is expanding export capacities in the large automotive sector, will help significantly accelerate export growth from 2019 onwards. According to analysts, exports are expected to replace investment in the next period. The arrival of Jaguar Land Rover is impacting not only the industrial but also the residential real estate market. The automotive industry and its suppliers should continue to fuel the current demand for new industrial premises, while the positive development in the labor market drives demand for office space. Growing wages drive retail sales and make the retail real estate sector more interesting for investors.[3]

The inflation rate slowed down to 2.1% at the very end of last year and is expected to reach overall 2.6% in 2018. As for 2019, experts estimate the inflation on 2.5 percentage points. The main influencers should be raw materials. Higher oil prices should also lead to an increase in energy consumption and regulated energy prices in the upcoming period. Food prices are expected to continue growing. However, the rise of prices of food should remain at recent trend rates of around 2.5%. Wage growth, higher food prices, pressures on production capacity as well as robust private demand are projected to lead also to consumer price inflation increase.

Revenues from individual income taxes and social contributions are expected to expand significantly. While revenues from corporate income taxes should be affected and are expected to increase due to the growing profitability of companies, revenues from value-added taxes are

[2] --, "Slovak Republic - Economic forecast summary (November 2018)," *OECD – Better Policies for Better Lives*, November 2018, <http://www.oecd.org/eco/outlook/slovak-republic-economic-forecast-summary.htm>.

[3] --, "Car industry alters Slovakia's GDP estimate for next year," *The Slovak Spectator*, 18 December 2018, <https://spectator.sme.sk/c/22011872/car-industry-alters-slovakias-gdp-estimate-for-next-year.html>.

most likely anticipated to benefit from improved tax collection. In line with significant real GDP growth and a strong labor market, tax revenues are expected to continue growing. Public expenditures are expected to go up by 0.2 percentage point of GDP more than revenues.[4]

The government plans to reach a budget balance by 2020, which is fully in line with the standard requirements of the European Union. In December 2018, Slovakia's parliament approved a 2019 budget that sees the deficit falling to zero for the first time in Slovakia's modern history. The government's fiscal policy objective is to eliminate the budget deficit by 2020. The general government deficit is foreseen at 0.1% of GDP in 2019, a balanced in 2020 and a surplus of 0.2% of GDP in 2021.

However, it needs to be considered that most of the budget improvement for the upcoming period should result from strong cyclical growth, with little structural consolidation. What is more, the government plans to increase public sector wages by 10% in each of the years 2019 and 2020.

Referring to the published draft by the Ministry of Finance, the Slovak economy is expected to grow by 4.5% next year. The state budget is reported to manage next year a cash deficit of €2.138 billion. The total revenues are projected at €15.497 billion; and expenditures should reach €17.635 billion. The expenditures next year should total €420 million, which is up 15.3% from the figure approved for this year. In case of personnel expenditures for the next year, an increase is expected in the amount of €35.1 million compared to the previous year, as the Finance Ministry also reflected the impacts of the Financial Administration's reform in the draft budget. Expenditures on information technologies financed from the state budget should increase to €80.4 million, which would represent a drop to data obtained in 2018.[5]

However, given vulnerability of the country to escalating global protectionism, great demand pressures and low Eurozone policy interest rates, a tighter fiscal policy would be recommended. The government should persist in its efforts to improve tax collection and enhance public-sector efficiency in order to create room to finance much needed structural reforms, particularly in education and for Roma integration. To reverse the decline in educational performance, more must be done to improve the chances of children from poorer

[4] --, "Economic forecast for Slovakia," *European Comission*, November 2018, <https://ec.europa.eu/info/business-economy-euro/economic-performance-and-forecasts/economic-performance-country/slovakia/economic-forecast-slovakia_en>.

[5] --, "Ministerstvo financií zverejnilo návrh rozpočtu na budúci rok," *SME Ekonomika*, 4 October 2018, <https://ekonomika.sme.sk/c/20929736/kazimir-rozpocet-financie-buduci-rok-deficit.html>.

backgrounds. Early childhood education and better-trained and better-paid teachers are a necessary parts of this reform.

Conclusion

Economic growth in Slovakia should remain vibrant in 2019. Tighter labor market conditions, moderate inflation, an inflow of immigrant workers and solid wage gains are expected to reinforce consumer spending. The automotive industry and its suppliers continue to fuel the current demand for new industrial premises, while the positive development in the labor market drives demand for office space. Moreover, the labor market buoyancy and strong consumer confidence will contribute to strong private consumption. Supportive financial conditions, acceleration of the disbursements of EU funds and new public infrastructure projects will boost investment. Growing wages drive retail sales and make the retail real estate sector more interesting for investors. Moreover, with additional production coming from new car factories, industrial output is expected to expand in the upcoming year, contributing to an increase in export rates. There is a risk that rising pressure on capacity could lead to overheating, resulting in higher inflation and undermining competitiveness. Furthermore, the Slovak Republic is vulnerable to escalating global protectionism. Disbursements of EU structural funds could surprise in either direction. If they expand productive capacity faster than expected, strong growth could be sustainable for longer.