25. SLOVAKIA

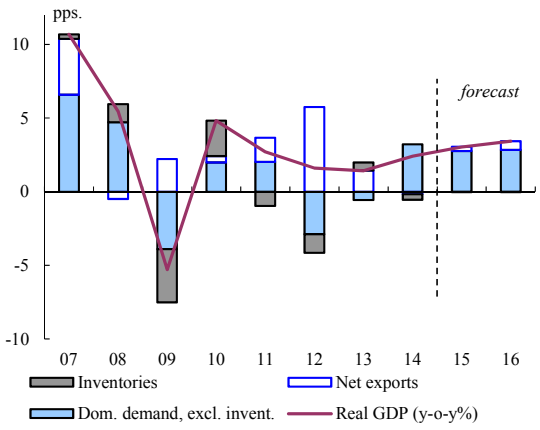
Recovery strengthens fuelled by steady domestic demand

Growth picked up in 2014 and is forecast to further strengthen on the back of a recovery in domestic demand. Labour market conditions are expected to continue improving, in line with the upturn in economic activity. Inflation was slightly negative in 2014 and is projected to recover only slowly. Slovakia's fiscal situation is expected to improve gradually, also thanks to its increasingly tax-rich growth structure.

Growth strengthens…

After slowing down in 2013, growth picked up in 2014 on the back of a strong recovery in private consumption and investment. Domestic demand is expected to continue strengthening and to remain the main motor of growth. Real GDP increased by 2.4% in 2014 and is projected to expand by 3.0% in 2015 and 3.4% in 2016. Labour market conditions improved in 2014 and are expected to further ameliorate in line with the pickup in economic activity. HICP inflation was slightly negative in 2014 and is forecast to increase only slowly.

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



…as domestic demand recovers.

After three consecutive years of decline, private consumption rebounded in 2014 to expand by 2.2% in real terms, driven by growing real disposable income, higher employment and improving consumer confidence. These factors are expected to continue to sustain private consumption growth, which could also be bolstered by a series of labour market reforms that have taken effect in 2015, including a rise in the minimum wage and a reduction in the social contributions paid by low-income workers. Private consumption is therefore expected to grow by 2.4% in 2015 and 2.7% in 2016.

Investment rebounded strongly after two years of decline and grew by 5.7% in real terms. Equipment investment and non-residential construction were the main drivers of investment growth, while housing construction contracted. Planned expansions in the automotive and telecommunications industries and ongoing motorway construction are expected to further support investment, which is projected to increase by 4.6% in 2015 and by 3.7% in 2016.

No boost from the external sector

Export growth slowed down in 2014, reflecting weak demand from Slovakia's main trading partners, and is only expected to recover in 2016. Imports increased faster than exports in 2014, reflecting the pick-up in investment and private consumption, and net exports acted as a drag on growth. Going forward, imports are forecast to evolve more in line with exports and Slovakia is projected to continue running a current-account surplus.

Labour market conditions improve

Growth in employment was strong throughout 2014 and labour market conditions are expected to further improve, in line with the upturn in economic activity. The unemployment rate fell from 14.2% in 2013 to 13.2% in 2014 and is expected to continue declining. The labour market reforms that came into force in 2015, including a reduction in the healthcare contributions of low-income workers and an expansion of in-work benefits, should further support the labour market's recovery.

Inflation slowly resurfaces

Inflation declined sharply in 2014 and was slightly negative for the year as a whole. The fall in inflation was caused mainly by declining energy and unprocessed food prices. Core inflation, however, remained well above zero. Inflation is expected to slowly increase as energy prices

recover and the rebound in domestic demand puts upward pressure on the price of services.

Gradual budgetary consolidation continues

In 2014, the general government deficit deteriorated to 2.9% of GDP from 2.6% of GDP a year earlier. Stronger-than-budgeted tax revenues, expenditure freezes triggered by the first stage of the public debt brake and lower co-financing of EU-related projects were not sufficient to counterbalance the negative impact stemming primarily from dividend shortfalls, lower capital revenues and higher spending on public healthcare.

In 2015, the deficit is projected to decline to 2.7% of GDP. Strengthening private consumption and further compliance improvements are expected to lead to higher VAT collection. Higher corporate income tax revenue will be driven by rising profitability of companies and the broadening of the tax base. Support for R&D investment and the introduction of a healthcare contribution allowance for low-paid workers will, however, dampen the rise in tax revenues. On the expenditure side, the forecast pencils in the planned increase in spending on active labour market policies and education. The government has also announced the 'second social package', of which only the introduction of a minimum pension has been approved and quantified and is thus reflected in the forecast. Moreover, the forecast assumes and recent data corroborates a larger-than-budgeted drawing of EU funds and ensuing higher national co-financing of these expenditures, as 2015 is the last year to use available resources from the 2007-13 programming period. Tightening budget lines and expenditure freezes in the previous year have led to the build-up of some tension in public finances that may prove difficult to contain, especially in view of some additional pressure for social spending. Under an assumption of unchanged policies, the deficit is projected to decline to 2.5% of GDP in 2016, driven by improving macroeconomic environment.

The structural balance deteriorated by about ½ pp. in 2014 to -2% of GDP. The structural position is projected to slightly improve in the following years with the structural deficit reaching 1¾% of GDP in 2016. Public debt is expected to decline to 53.4% of GDP in 2015 and remain broadly at that level in 2016.

Table II.25.1:

Main features of country forecast - SLOVAKIA

	2013			Annual percentage change					
	bn EUR	Curr. prices	% GDP	95-10	2011	2012	2013	2014	2015	2016
GDP		73.6	100.0	4.5	2.7	1.6	1.4	**2.4**	**3.0**	**3.4**
Private Consumption		41.7	56.7	4.6	-0.7	-0.4	-0.7	**2.2**	**2.4**	**2.7**
Public Consumption		13.3	18.1	3.6	-2.1	-2.0	2.4	**4.4**	**2.4**	**2.8**
Gross fixed capital formation		15.0	20.4	3.4	12.7	-9.3	-2.7	**5.7**	**4.6**	**3.7**
of which: equipment		7.3	9.9	3.8	34.5	-10.9	-1.3	**8.0**	**8.3**	**6.7**
Exports (goods and services)		68.4	93.0	8.1	12.0	9.3	5.2	**4.6**	**4.2**	**5.6**
Imports (goods and services)		65.1	88.4	8.2	9.7	2.6	3.8	**5.0**	**4.1**	**5.2**
GNI (GDP deflator)		72.1	98.0	4.4	3.1	1.5	1.5	**2.6**	**3.0**	**3.4**
Contribution to GDP growth:		Domestic demand		4.3	2.0	-2.9	-0.6	**3.2**	**2.8**	**2.8**
		Inventories		0.5	-1.0	-1.3	0.5	**-0.4**	**0.0**	**0.0**
		Net exports		-0.2	1.7	5.8	1.4	**-0.2**	**0.3**	**0.6**
Employment				-	1.8	0.1	-0.8	**1.4**	**1.3**	**1.5**
Unemployment rate (a)				14.8	13.7	14.0	14.2	**13.2**	**12.1**	**10.8**
Compensation of employees / head				-	2.0	2.6	2.6	**3.4**	**2.4**	**3.2**
Unit labour costs whole economy				-	1.1	1.0	0.3	**2.3**	**0.6**	**1.2**
Real unit labour cost				-	-0.6	-0.2	-0.2	**2.6**	**0.5**	**-0.1**
Saving rate of households (b)				9.1	8.5	7.2	8.5	**8.7**	**8.6**	**8.5**
GDP deflator				4.3	1.6	1.3	0.5	**-0.2**	**0.1**	**1.3**
Harmonised index of consumer prices				-	4.1	3.7	1.5	**-0.1**	**-0.2**	**1.4**
Terms of trade goods				-0.7	-1.5	-1.3	-0.5	**0.0**	**0.0**	**0.0**
Trade balance (goods) (c)				-6.1	-0.6	3.1	4.3	**4.0**	**4.0**	**4.5**
Current-account balance (c)				-6.0	-3.8	0.3	0.8	**1.9**	**1.8**	**0.7**
Net lending (+) or borrowing (-) vis-a-vis ROW (c)				-6.0	-2.2	1.8	2.3	**2.8**	**2.6**	**1.5**
General government balance (c)				-5.6	-4.1	-4.2	-2.6	**-2.9**	**-2.7**	**-2.5**
Cyclically-adjusted budget balance (d)				-	-3.6	-3.3	-1.4	**-1.7**	**-1.8**	**-1.8**
Structural budget balance (d)				-	-4.0	-3.4	-1.4	**-2.0**	**-1.9**	**-1.8**
General government gross debt (c)				36.8	43.4	52.1	54.6	**53.6**	**53.4**	**53.5**

(a) as % of total labour force. (b) gross saving divided by gross disposable income. (c) as a % of GDP. (d) as a % of potential GDP.