SLOVAKIA: Heavy reliance on Russian energy renders the economy vulnerable

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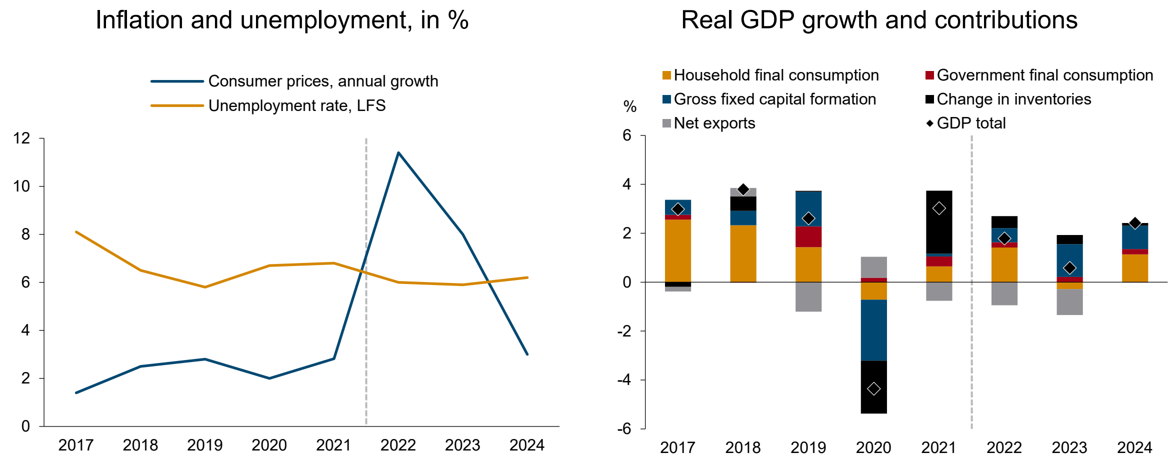
The adverse impact of the Russian war in Ukraine, high inflation and the energy crisis are all taking their toll on the Slovak economy. We estimate real GDP growth of 1.8% in 2022, driven by private consumption. While household consumption will fall back in the face of soaring inflation, the inflow of EU funds could provide some growth impetus in 2023 and beyond.

Figure 6.20 / Slovakia: Main macroeconomic indicators



Source: wiiw Annual Database incorporating national and Eurostat statistics, own calculation. Forecasts by wiiw.

Slovak growth in the first half of 2022 reached 2.4%, but showed a downward trend. In Q1, GDP grew by 3.1% compared to the previous year, but in Q2 the figure was only 1.8%, on account of declining household consumption. The Russian invasion of Ukraine on 24 February sent shockwaves throughout Europe and led to inflation and an energy crisis, which has been affecting all parts of the Slovak economy during the second half of the year. Also, the important automotive industry has been exposed to further trade-link disruption by the war, which comes on top of the ongoing semiconductor shortages and the zero-COVID strategy in China that has led to supply-chain disruption. Meanwhile, for the Slovak people and policy makers, the COVID-19 pandemic has faded into the background.

Growth in the first half of the year was founded on household consumption and investment. Household consumption was up 7% in the first half of 2022, spurred by pent-up demand after the COVID-19-related lockdowns. Gross capital formation grew by 6%, but gross fixed capital formation by a disappointing 3%. Construction output was practically flat year on year, which is disappointing, as that sector's output had been falling for the previous three years; however, the promised EU funds have been slow to arrive. In addition, net exports made a negative contribution to GDP growth: while exports of goods and services (in real prices) declined by 2.4%, imports fell by only 0.7%.

Industry and automotive production have been badly affected and are in decline. Industrial production fell by almost 4% in the first seven months of 2022. The main manufacturing industry in Slovakia – the automotive sector – fared even worse, suffering a 6.3% decline in the same period. It is troubled by the continuing shortage of chips and the disruption of its supply chains: the Russian invasion of Ukraine has affected supply chains since March, and there were extensive lockdowns in China (e.g. in Shanghai) in April and May. In addition to the four major existing automotive companies – Volkswagen Slovakia, KIA Motors Slovakia, Stellantis (previously PSA Peugeot-Citroen) and Jaguar Land Rover, all based in the west of the country – a fifth producer is shortly to arrive in Slovakia, which is a positive development. In July 2022, Volvo Cars[26] announced that it is to build its third European production plant near Košice, in eastern Slovakia (it already has factories in Belgium and Sweden) and will focus on electric car production. It will manufacture about 250,000 vehicles a year and will employ 3,300 workers. The investment will amount to EUR 1.2bn.[27]

The labour market is recovering from the COVID-19 shock, but inflation will deter household consumption in the near future. In the first half of 2022, there was a big improvement in the labour market: employment increased by 2.8%, with a continuing favourable trend; and the unemployment rate fell to 6.2%. Those sectors that suffered most from the COVID-19 pandemic registered the largest relative increases in the number of employees: accommodation and catering services, professional, scientific and technical activities, and art, entertainment and recreation. However, a nominal wage increase of 7.7% in the first half year was swallowed up by soaring inflation, which resulted in real wages declining by 3%. This will deter household consumption in the second half of 2022 and next year. Consumer price inflation peaked in August at 13%, while producer price inflation has been even higher, reaching 35% in April. Electricity and gas prices for households and small businesses are regulated by the Regulatory Office for Network Industries. Prices are due to rise in 2023. Large companies have long-term contracts for electricity. Measures proposed by the government to help families with an anti-inflation package worth EUR 1bn led to a political crisis, which culminated at the beginning of September in Richard Sulík's SaS party leaving the four-party governing coalition, which now must operate as a minority government.

With the drop in car exports and with imports soaring due to higher energy prices, the current account has found itself in record negative territory. In nominal terms, exports of goods increased by 14.5% in the first half of the year, while goods imports rose by 23%, resulting in a negative trade balance. While Ukraine is only a minor trade partner for Slovakia, the same cannot be said of Russia – at least in terms of imports. During the first half of 2022, trade with Ukraine expanded (exports 115% up and imports 97% up); meanwhile exports to Russia shrank by 50%, but imports increased by 96% (on account of higher energy prices). Thus, Slovakia recorded its largest ever trade deficit with Russia. In terms of its main products, car exports declined during the first half of the year. Also, in terms of trade in services, imports grew more strongly than exports (30% versus 25%), though the trade in services balance remained positive. Altogether, the current account deficit reached a record 7% of GDP in the first half of 2022.

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26 Volvo Cars was taken over by the Chinese Geely in 2010.

27 https://spectator.sme.sk/c/22951744/volvo-is-coming-slovakia-will-get-the-fifth-carmaker.html published on 1 July 2022.

The country's energy dependence on Russia is still very high, despite measures taken in recent years to diversify its gas suppliers. Slovakia's energy dependence on Russia is the second highest in the EU, with imports from Russia accounting for almost 60% of gross available energy in 2020.[28] Gas is supplied from Russia via the southern branch of the Druzhba pipeline, via Ukraine, and Slovakia is a main gas transit country to Europe. Since the gas crisis in 2009, Slovakia has invested in its gas transmission infrastructure through projects to enable reverse gas flows; also, a Slovak-Hungarian interconnector was launched in 2015 and a Polish-Slovak interconnector opened this August. Since the Russian war in Ukraine, Slovakia has diversified its gas suppliers and now receives gas from Norway, liquefied natural gas from the US, and Algerian gas via Italy. At the time of writing, gas storage was at 85% capacity,[29] and the gas pipeline was still operating. As regards electricity, the third reactor of the Mochovce nuclear power plant has finally been certified after a 10-years delay. It will operate at full capacity from the start of next year. Planned in the 1980s during communist times, the first two units were completed in 1998 and 2000; a fourth reactor will probably be ready in two years' time.

The first effects of the soaring energy prices on the economy are already in evidence. Slovalco, Slovakia's only aluminium producer and its largest consumer of electricity (accounting for a tenth of national electricity consumption), has announced it is switching to crisis mode from the end of the year and is shutting down most of its furnaces. However, alongside the soaring energy prices, emissions restrictions and falling aluminium prices, the company also cites the lack of Slovak legislation on compensation for the cost of emission allowances (legislation that is in place in other European countries). While waiting for the legislation, the company failed to secure its electricity contract in time.[30]

Due to the Russian war in Ukraine and its knock-on effects, wiiw has revised its growth forecast downwards. Slovak GDP is now expected to grow by 1.8% in 2022, by 0.6 % in 2023 and by 2.4% in 2024. This year's growth will still be based on rising household consumption, fuelled by the pent-up demand following the COVID-19 pandemic. However, that will slow during the second half of the year and particularly next year, on account of the growing impact of inflation. Investment should become a pillar of growth from next year, helped by the influx of EU funds, including the Recovery and Resilience Facility. Net exports will act as a drag on growth over the coming two years. Germany's negative economic prospects will also have a significant adverse impact on Slovakia because of the strong trade linkages. Risks are primarily on the downside: the COVID-19 pandemic and the chip shortage are ongoing, and the Russian war in Ukraine is escalating. Its effects pose the most severe risks, with the energy and inflation crisis now in full swing.

28 https://ec.europa.eu/eurostat/statistics-explained/index.php?title=EU_energy_mix_and_import_dependency&stable=1 Data extracted on 4 March 2022.

29 https://www.bruegel.org/dataset/european-natural-gas-imports

30 https://spectator.sme.sk/c/22971453/too-late-for-the-governemnt-to-react-why-slovalco-has-to-lay-people-off.html published on 28 July 2022.

Table 6.20 / Slovakia: Selected economic indicators

	2019	2020	2021 1)	2021 January-June	2022 January-June	2022 Forecast	2023 Forecast	2024 Forecast
Population, th pers., average	5,454	5,459	5,447	.	.	5,470	5,475	5,480
Gross domestic product, EUR m, nom.	94,048	92,079	97,123	45,897	50,330	110,100	119,600	126,200
annual change in % (real)	2.6	-4.4	3.0	4.9	2.4	1.8	0.6	2.4
GDP/capita (EUR at PPP)	21,750	20,940	22,020	.	.	.	.	.
Consumption of households, EUR m, nom.	52,334	52,748	55,075	26,053	31,115	.	.	.
annual change in % (real)	2.6	-1.3	1.1	-0.5	6.6	2.5	-0.5	2.0
Gross fixed capital form., EUR m, nom.	20,296	18,073	18,571	7,965	9,010	.	.	.
annual change in % (real)	6.7	-11.6	0.6	-1.6	3.1	3.0	7.0	5.0
Gross industrial production								
annual change in % (real)	0.4	-9.0	10.4	19.4	-3.2	-3.0	2.0	5.0
Gross agricultural production								
annual change in % (real)	-4.2	3.4	0.3	.	.	.	.	.
Construction industry								
annual change in % (real)	-3.6	-11.3	-2.0	-4.3	-0.1	.	.	.
Employed persons, LFS, th, average 2)	2,584	2,531	2,561	2,519	2,588	2630	2670	2670
annual change in %	0.7	-2.0	-1.7	-3.2	2.8	2.6	1.5	0.0
Unemployed persons, LFS, th, average 2)	158	181	188	190	172	170	170	180
Unemployment rate, LFS, in %, average 2)	5.8	6.7	6.8	7.0	6.3	6.0	5.9	6.2
Reg. unemployment rate, in %, eop	4.9	7.6	6.8	7.8	6.3	.	.	.
Average monthly gross wages, EUR	1,092	1,133	1,211	1,163	1,252	1300	1390	1450
annual change in % (real, gross)	5.0	1.9	3.6	5.3	-3.0	-3.4	-1.0	1.5
Consumer prices (HICP), % p.a.	2.8	2.0	2.8	1.5	10.1	11.4	8.0	3.0
Producer prices in industry, % p.a.	1.9	-0.6	6.8	1.7	27.6	28.0	18.0	6.0
General governm. budget, EU def., % of GDP								
Revenues	39.4	39.9	40.7	.	.	40.0	40.0	39.5
Expenditures	40.7	45.3	46.8	.	.	45.1	44.1	43.0
Net lending (+) / net borrowing (-)	-1.3	-5.5	-6.2	.	.	-5.1	-4.1	-3.5
General gov. gross debt, EU def., % of GDP	48.1	59.7	63.1	.	.	62.2	60.0	58.0
Stock of loans of non-fin. private sector, % p.a.	6.6	5.0	7.2	5.1	11.3	.	.	.
Non-performing loans (NPL), in %, eop	2.8	2.3	1.9	2.1	1.9	.	.	.
Central bank policy rate, % p.a., eop 3)	0.00	0.00	0.00	0.00	0.00	.	.	.
Current account, EUR m	-3,163	330	-1,910	-68	-3,569	-8,100	-10,000	-10,000
Current account, % of GDP	-3.4	0.4	-2.0	-0.1	-7.1	-7.4	-8.4	-7.9
Exports of goods, BOP, EUR m	75,522	70,011	81,464	40,500	46,389	92,100	96,700	101,500
annual change in %	0.5	-7.3	16.4	27.9	14.5	13.0	5.0	5.0
Imports of goods, BOP, EUR m	76,658	68,996	81,539	39,690	48,836	100,300	107,300	112,700
annual change in %	1.7	-10.0	18.2	23.0	23.0	23.0	7.0	5.0
Exports of services, BOP, EUR m	10,981	9,032	9,459	4,220	5,284	11,400	12,300	13,300
annual change in %	7.4	-17.8	4.7	-3.4	25.2	20.0	8.0	8.0
Imports of services, BOP, EUR m	9,763	7,944	8,663	3,913	5,082	10,800	11,200	11,600
annual change in %	5.0	-18.6	9.0	2.6	29.9	25.0	4.0	4.0
FDI liabilities, EUR m	2,042	-214	818	616	2,919	500	.	.
FDI assets, EUR m	-162	1,683	1,097	1,043	1,906	200	.	.
Gross reserves of CB excl. gold, EUR m	5,002	6,050	6,850	6,160	8,094	.	.	.
Gross external debt, EUR m	106,016	111,746	133,051	111,445	132,676	135,000	140,000	145,000
Gross external debt, % of GDP	112.7	121.4	137.0	114.7	120.5	122.6	117.1	114.9

1) Preliminary. - 2) From 2021 the new LFS methodology is applied in line with the Integrated European Social Statistics Regulation (IESS). - 3) Official refinancing operation rates for euro area (ECB).

Source: wiiw Databases incorporating Eurostat and national statistics. Forecasts by wiiw.