SLOVAKIA: Political instability threatens future prospects

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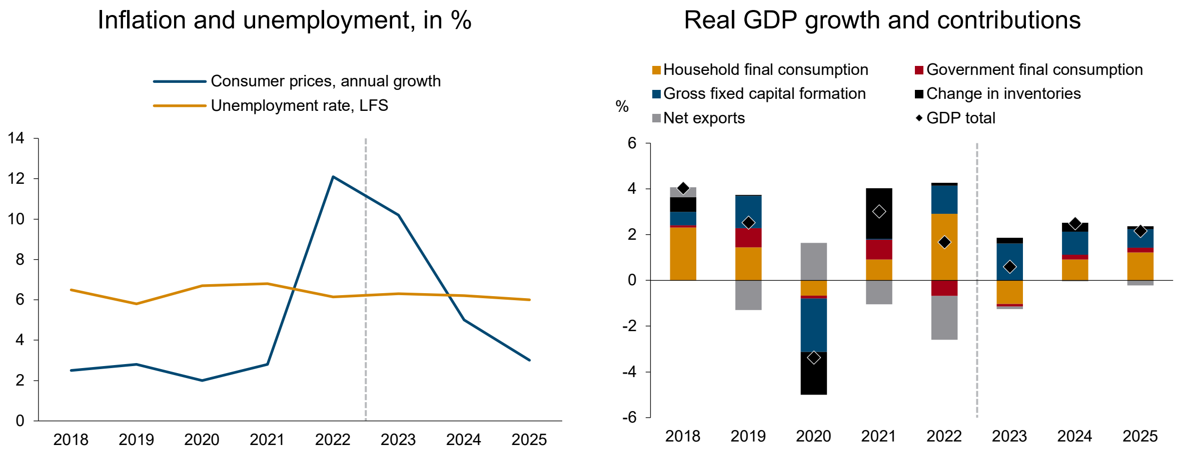
In 2022, Slovakia's GDP growth reached just 1.7%. This year, too, high inflation will continue to prevent stronger economic growth, which is forecast to be 0.6%. Declining household consumption and poor prospects for Germany – the country's main export market – will drag down growth, while the influx of EU funds will provide some growth momentum. The situation should improve in 2024, but domestic political instability resulting from party fragmentation might threaten future prospects in the long run.

Figure 5.20 / Slovakia: Main macroeconomic indicators



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

Slovak GDP grew by a mere 1.7% in 2022, the recovery from the COVID-19 pandemic being hampered by the effects of the Russian invasion of Ukraine on 24 February. Household consumption grew by a surprisingly strong 5.2%, pushed along by pent-up demand after the COVID-19 pandemic – and despite real wages declining quite markedly that year. Gross fixed capital formation also contributed to growth, rising by 6.5%. Gross capital formation was on a par with that, up 6.3%. Overall growth was, however, reduced by two factors in 2022 – first and foremost, negative net exports: while exports of goods and services grew (in real terms) by 1%, imports rose by 3%. Secondly, government consumption declined by 3.2%. Looking at sectoral developments, value added increased in almost all sectors, with trade, transportation, and accommodation and food service activities rising most (by 7.5%). Only in two sectors did it decline: slightly in industry (by 1.2%) and rather more severely in finance and insurance activities (by 20%).

The automotive sector is going electric. This year kicked off with industrial production declining by almost 7% (year on year) in the first two months. The electricity sector, rubber and other non-metallic mineral products, and computer products experienced the strongest fall. However, in the main Slovak industry – the automotive sector – production grew by about 3% in the first two months of 2023, following an increase of 1.1% last year (compared to an overall fall in industrial production of almost 4%), as production in 2022 was affected in the first half of the year by a shortage of semiconductors and by supply-chain problems related to the Russian war in Ukraine. The Slovak production of passenger cars stagnated in 2022 at 1m cars. The automotive sector in the EU-CEE region – and indeed worldwide – is starting the transition to electric vehicles. For Slovakia, new investment announcements have been quite positive in this respect: in July 2022, Volvo Cars announced it was investing more than EUR 1.2bn in building a third production plant in Slovakia that will specialise in electric car production; Porsche will invest more than EUR 1bn in battery modules for electric cars; and VW Bratislava is going to produce the all-electric Porsche Cayenne. During 2023, the Slovak automotive sector will still benefit from the backlog of orders from last year, as well as from the introduction of new models and higher production capacities due this year. On the other hand, the automotive industry will still have to cope with long-term bottlenecks in chips in 2023.

Household consumption will be dampened by still high inflation and a stagnant labour market in 2023. In 2022, the labour market recovered after a two-year strain caused by the COVID-19 pandemic. Employment grew by 1.7%, with more people employed in services and the construction sector, but slightly fewer in industry (-3%). The unemployment rate declined throughout the year and averaged 6.1% in 2022 (compared to 6.8% in 2021). The changes were most pronounced in Trnava region, as well as in the country’s eastern regions (which still record the highest unemployment rates, of more than 9%). Still high inflation for this year and falling real wages will deter consumer spending. The Harmonised Index of Consumer Prices (HICP) increased by 12.1% in 2022 and continued rising in January and February of this year – by 15.1% and 15.4% (year on year); it probably finally peaked in February. One third of this increase was due to rising food prices – up by about 28% in those first two months, year on year. On the other hand, the rise in producer prices was already slowing in February (7%, compared to 21% in January). Overall, inflation will fall in the second half of the year due to the base effect. However, HICP is still forecast to average 10.2% this year, dragging real wages down, before subsiding from 2024 onwards. Households will be supported by government measures to combat rising energy prices this year.

The current account will continue in negative territory in 2023. The trade balance (according to balance of payments (BOP) data) reached a record negative figure last year, with goods exports rising by 19%, but good imports rocketing by 26%. The trade deficit with Russia reached its biggest ever figure. Though exports of services increased by 25% in 2022 and imports of services grew by 28%, the balance was positive last year. As a result, the current account was deeply in red, reaching EUR 9bn (8.3% of GDP). A comparably high figure was last recorded in 2006. The early data for 2023 are contradictory: trade statistics data show an increase in exports of 10.4% for the first two months, while imports increased by only about 7%. Machinery and transport equipment exports (including the important motor vehicle exports) were particularly successful and pulled overall growth, probably due to the reduction in inventories. However, January’s BOP data show a continuation of the pattern in 2022: import growth surpassing export growth and the current account again deep in negative territory. With still high energy prices, this pattern will most probably prevail for the whole of 2023.

Parliamentary elections are due on 30 September. The Slovak government tumbled in December 2022, but was still able to pass the budget for 2023, which was necessary to support households, businesses and municipalities in countering the high energy prices. Overall, the budget deficit will thus be larger, and is planned to reach 6.4% of GDP. The disbursement of EU funds from the 2014-2020 Multiannual Financial Framework is coming to an end this year. Together with the EU's Recovery and Resilience Facility – which encompasses an overall EUR 6.3bn – EU financing should reach its maximum this year. Early parliamentary elections are scheduled for 30 September 2023. The political parties have fragmented over time, making any future government potentially very unstable (as demonstrated by the example of the last quadripartite government). In the most recent poll,[26] Smer (headed by the former prime minister, Robert Fico) was found to enjoy the greatest support, at 22.4%. It is followed by Hlas (led by Peter Pellegrini, who split from Smer in 2020), with 17%. There is a fear that Fico could lead the country in a more pro-Russian and less Ukrainian-friendly direction, probably in the Hungarian mould.

Slow growth is anticipated for this year, but it should speed up in 2024. The wiiw growth forecast for Slovakia remains unchanged for this year, becomes marginally better for next year, and has been revised slightly downwards for 2025. Slovak GDP is expected to grow by just 0.6% in 2023, by 2.5% in 2024 and by about 2.2% in 2025. In 2023, household consumption is expected to decline, due to high inflation and slightly deteriorating conditions on the labour market. For Germany – the main Slovak export market – growth forecasts remain extremely low, and this will also drag down Slovak growth prospects. The drawing of EU funds should bring some growth impetus this year, although the history of low absorption capacity in past years could pose a risk. The situation for Slovakia should improve in 2024, with a revival of both household consumption and export demand. Uncertainties remain manifold on the external side, as well as domestically: the Russian war in Ukraine is continuing, the diversification of energy supplies needs more time, and inflation is still running high. In addition, domestic political instability could threaten future prospects in the long run.

26 Source: NMS Market Research/SME, Date: 28 March – 2 April 2023, https://spectator.sme.sk/c/23155148/ficos-smer-reaches-unshakeable-position-in-the-latest-poll.html

Table 5.20 / Slovakia: Selected economic indicators

	2019	2020	2021	2022 [1)]	2023	2024	2025
						Forecast	
Population, th pers., average	5,454	5,459	5,447	5,432	5,475	5,480	5,480
Gross domestic product, EUR m, nom.	94,438	93,414	98,523	107,730	119,400	128,500	135,200
annual change in % (real)	2.5	-3.4	3.0	1.7	0.6	2.5	2.2
GDP/capita (EUR at PPP)	22,080	21,550	22,510	23,550	.	.	.
Consumption of households, EUR m, nom.	52,363	52,815	55,411	65,457	.	.	.
annual change in % (real)	2.6	-1.2	1.6	5.2	-1.7	1.5	2.0
Gross fixed capital form., EUR m, nom.	20,296	18,225	18,664	21,770	.	.	.
annual change in % (real)	6.7	-10.8	0.2	6.5	8.0	5.0	4.0
Gross industrial production							
annual change in % (real)	0.7	-8.1	10.3	-3.6	-1.0	4.0	3.0
Gross agricultural production							
annual change in % (real)	-4.2	3.4	-3.4	-9.6	.	.	.
Construction industry							
annual change in % (real)	-3.6	-11.3	-2.0	0.0	.	.	.
Employed persons, LFS, th, average [2)]	2,584	2,531	2,561	2,604	2600	2610	2620
annual change in %	0.7	-2.0	-1.7	1.7	0.0	0.3	0.5
Unemployed persons, LFS, th, average [2)]	158	181	188	170	170	170	170
Unemployment rate, LFS, in %, average [2)]	5.8	6.7	6.8	6.1	6.3	6.2	6.0
Reg. unemployment rate, in %, eop	4.9	7.6	6.8	5.9	.	.	.
Average monthly gross wages, EUR	1,092	1,133	1,211	1,304	1420	1480	1560
annual change in % (real, gross)	5.0	1.9	4.5	-4.5	-1.0	-0.5	2.5
Consumer prices (HICP), % p.a.	2.8	2.0	2.8	12.1	10.2	5.0	3.0
Producer prices in industry, % p.a.	1.9	-0.6	6.8	27.8	9.5	7.0	3.3
General governm. budget, EU def., % of GDP							
Revenues	39.3	39.4	40.9	40.5	40.0	39.5	39.3
Expenditures	40.5	44.8	46.3	44.0	46.0	43.9	43.8
Net lending (+) / net borrowing (-)	-1.2	-5.4	-5.5	-3.5	-6.0	-4.4	-4.5
General gov. gross debt, EU def., % of GDP	48.0	58.9	62.2	60.4	60.0	59.4	60.1
Stock of loans of non-fin. private sector, % p.a.	6.6	5.0	7.2	10.8	.	.	.
Non-performing loans (NPL), in %, eop	2.8	2.3	1.9	1.7	.	.	.
Central bank policy rate, % p.a., eop [3)]	0.00	0.00	0.00	2.50	.	.	.
Current account, EUR m	-3,163	526	-2,465	-8,938	-6,000	-4,000	-3,500
Current account, % of GDP	-3.3	0.6	-2.5	-8.3	-5.0	-3.1	-2.6
Exports of goods, BOP, EUR m	75,522	70,011	81,303	96,534	101,400	109,500	115,000
annual change in %	0.5	-7.3	16.1	18.7	5.0	8.0	5.0
Imports of goods, BOP, EUR m	76,658	68,996	81,815	103,163	108,300	114,800	120,500
annual change in %	1.7	-10.0	18.6	26.1	5.0	6.0	5.0
Exports of services, BOP, EUR m	10,981	9,048	9,580	11,931	13,000	14,400	15,600
annual change in %	7.4	-17.6	5.9	24.5	9.0	11.0	8.0
Imports of services, BOP, EUR m	9,763	8,085	9,034	11,552	12,100	13,100	13,600
annual change in %	5.0	-17.2	11.7	27.9	5.0	8.0	4.0
FDI liabilities, EUR m	2,042	-934	818	3,876	.	.	.
FDI assets, EUR m	-162	1,475	1,097	1,528	.	.	.
Gross reserves of CB excl. gold, EUR m	5,002	6,050	6,850	7,915	.	.	.
Gross external debt, EUR m	106,016	111,746	133,051	113,065	110,000	105,000	100,000
Gross external debt, % of GDP	112.3	119.6	135.0	105.0	92.1	81.7	74.0

1) Preliminary and wiiw estimates. - 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.