Economic update on Slovak Republic

Review of the latest public forecasts 2017-2020

In 2017, the Slovak economy is expected grow by 3.3% according to the latest June 2017 forecasts by the Slovak Ministry of Finance. Domestic demand will be the main driver, primarily household consumption and investment. Thanks to an improving labor market, private consumption shows its strongest dynamics since the 2009 crisis and it is expected to expand between 4.5% to 5.1% at current prices towards 2020. Renewed investments mainly stem from the private sector, specifically the automotive industry. The construction of the highway bypass of the D4 / R7 motorway is an additional important driver. In 2017 EU funds are still under-funded and partly offset by their own resources. Between 2018 and 2020, higher growth in storage investments (self-service parcel terminlas) and increasing EU support are expected. Foreign trade is likely to dampen the outlook in 2017 since growth in exports will be lower than the increase in imports due to the higher import intensity of the economy.

In the year 2018, the economy is forecasted to accelerate by 4.2%. The dynamics of household consumption will remain at a high level. Thanks to the launch of new production facilities of automakers (at VW from the beginning of the year and at Jaguar Land Rover by the end of the year) exports gain in dynamics also because of increasing foreign demand. Additionally government consumption is expected to increase by around 2.0% compared to the previous year.

Estimations for the years 2019 and 2020 show a year-on-year **total economic growth by 4.4% and 3.9% respectively**. In 2019, the contribution of new production in the automotive industry will peak. Investments will slow down afterwards due to the completion of Jaguar Land Rover plant. In general, mid-term economic growth will be closer to its potential by the end of the forecast period in 2020.

The labor market is expected to recover continuously, leading to a declining unemployment rate of 8.2%. The trend is likely to continue towards 6.0% until 2020. This will lead to a shortage of skilled workers mainly in the industrial sector. Higher participation of foreign workers on the Slovak labor market will continue and help to satisfy the demand for labor. Average nominal wages should increase by 3.6% in 2017. Wage growth will accelerate because of the expected shortage of qualified labor. The real wage increase should reach 2.2%. In the upcoming years, gradual acceleration of real wage growth is expected to reach the 3.0% mark.

Inflation (CPI) will return to positive figures in 2017 when it will reach an increase by 1.3% compared to the previous year. The price development is influenced by a decline in fuel prices which is offset by price increases like food. On the other hand energy price reductions set by the Regulatory Authority in January 2017 (or maintained 2016 prices) help against a stronger price level increase. Nevertheless increasing inflation will hold on in the next years. Market service prices are expected to rise as well as energy prices. Due to rapid economic growth, inflation growth will exceed a rate of 2.0% at the end of the projected mid-term period (2.1%).

There are several drivers and risks which can influence these forecasts. External negative risks result from the Brexit and the threat of protectionism in world trade as well as from the unstable banking sector in Italy. A positive factor stems from stronger economy dynamics in the Euro area. From a domestic point of view, there is a risk of accelerating wage growth in an overheated labor market due to a lack of qualified labor, which may, however, also limit the profitability of companies.

Table 1: Main economic indicators - June 2017 forecasts

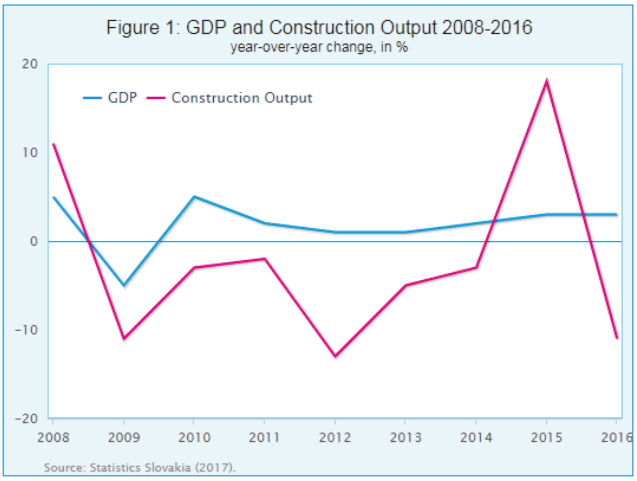
	Real	Forecasts			
	2016	2017	2018	2019	2020
	year over year change, in %				
Gross domestic product	3.3	3.3	4.2	4.4	3.9
Private consumption	2.9	3.1	2.8	2.9	2.9
Public consumption	1.6	1.4	2.0	1.9	1.8
Fixed investment	– 9.3	4.2	3.8	3.1	3.2
Export (goods &services)	4.8	6.0	7.7	7.7	6.3
Import (goods &services)	2.9	6.1	6.8	6.3	5.4

Source: Slovak Ministry of Finance (www.finance.gov.sk/ifp)

GDP and construction output in the recent past

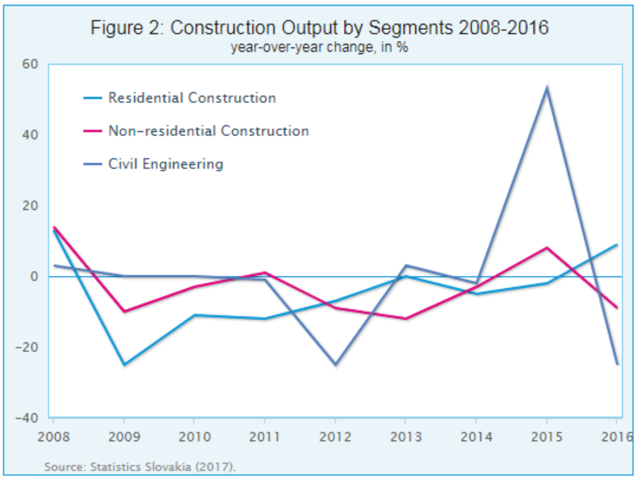
Slovakia shows the lowest construction output in absolute terms within the EUROCONSTRUCT network. Slovak's construction output per GDP at current prices showed the highest value in 2009 with a share of 8.9% and its lowest was recorded in 2014 (5.6%). Latest data for 2016 indicate a value of 5.7%.

Figure 2: GDP and Construction Output 2008-2016



S: Statisitcs Slovakia.

Figure 3: Construction Output by Segments 2008-2016



S: Statisitcs Slovakia.

In 2009, the first year after the crisis, GDP and construction output dropped significantly according to public statistics. At that time GDP at constant prices fell by 5.4% compared to the previous year and construction output declined even stronger by 11.1%.

In the period 2010-2016, annual growth of GDP ranged between 5.0% in 2010 and reaching the lowest value in 2013 (1.5%). Increase of GDP has been influenced since 2010 by exports. Production enhanced by higher labor productivity, better work organization, more working shifts and the use of new machinery and equipment. On the other hand new buildings were only built in small range.

Despite the recent economic growth in Slovakia, it was not possible to revive the pre-crisis level of construction output. Within the period 2009-2016 construction volume has been declining from 2.8% in 2011 (lowest downturn) to 13.8% in 2012 (strongest decline) on a year-on-year comparison. The year 2015 was the only exception, when construction output rose by 18.5% compared to the previous year, due to higher public investments in transport infrastructure and an uptake of EU funds from the programming period 2007-2013. Production growth was partially secured by other measures, such as the construction of new buildings and structures. The general decline in construction output was a response to reduced demand. Weak demand was the result of the low availability of credit and finance (both public and private) and in the private area higher uncertainty on the return of investment which resulted in cautious investment. After 2009, a number of upcoming projects were canceled, stopped, adjusted from the point of scale and their implementation progressed only gradually.

Residential construction was one of the sectors which were hit most by the economic and financial crisis. In 2009 housing output decreased by 25.3%. According to the data of the National Bank of Slovakia, the average real estate price for housing for Slovakia in 2009 was € 1510 per square meter, which was the highest price level. In the following years the price of apartments declined and started to recover slightly from 2015 onwards. In the first quarter of 2017 average house prices were at about € 1330 per square meter. The real estate markets are influenced by the financial sources of private persons (own resources, loans) and also by the business condition of the developers. In past years the demand was limited by high unemployment and higher interest rates and therefore the number of completed dwellings in residential buildings declined. There was also a period when large-sized flats were not always built in a good layout and therefore they became non-redeemable. In course of the current economic recovery, unemployment is decreasing and wages are gradually rising. Also interest rates on loans are favorable (due to a decline in the main interest rate of ECB and the competition of banks) and purchase of an apartment as an investment affects the demand for housing positively. Construction growth is expected to increase in 2017 compared to last year. Negative may be the forthcoming measures by the National Bank of Slovakia in the area of lending restrictions to avoid excessive indebtedness of citizens. Rising housing prices may also reduce the private demand in the long run.

Non-residential investments depend generally on several factors which are evaluated by investors. Measures like suspension, re-evaluation and modification of projects led after the crises to a drop in non-residential construction. Projects were postponed and modified in size. Important factors of recovery were improving investments and the availability of financial resources. Industrial parks and industrial zones were created but not always managed to secure an investor. Several were successfully established but there are also some available industrial parks. These were mainly developed by the automotive, electro-technical and mechanical as well as chemical sectors. In 2017 and partly 2018, the construction of the fourth car factory in Slovakia (by Jaguar Land Rover) and the expansion of production in combination with the arrival of new suppliers for the automotive industry were a major impetus in Slovakia. A new law on providing investment incentives (in line with EU regulative) is in place to encourage further investment.

In commercial construction sales chains gradually began to build their operations in smaller towns. Existing shopping centers are expanding and are partly rebuilt. This can be seen as a response to growing household consumption and hard competition between business chains. Low availability of warehouses and high-quality and well-equipped administrative buildings created a prerequisite for building construction in these sub-segments. Multiple poly-functional complexes are being completed or dismantled. Such objects are mainly established in the capital Bratislava. One of the latest trends shows that several large corporations based in the capital prefer renting space in new buildings prior to their purchase.

In the case of public non-residential investments funds are mainly led into repairs and maintenance of existing buildings (like heating system) and also into the completion and reconstruction but only to a small extent into new construction projects. The public budget benefitted in the recent past by improved tax collection on income and value added tax. Income tax revenues were reallocated to municipalities. It is expected that this will lead to more stable and higher financial means for municipalities and cities which should drive investment along with the use of EU funds. Public funds are also used to co-finance non-repayable contributions from EU funds. Nevertheless the bigger growth potential stems from the possibility of using EU funds.

In **civil engineering**, especially the area of transport infrastructure construction is mainly supported and financed by EU funds which were co-financed by the national budget. In 2015, transport infrastructure construction grew significantly because of higher public expenditures (to complete the use of funds from the EU 2007-2013 programming period). Due to further financial needs additional resources and projects schemes are sought like funds or PPP projects. On the state level, cancellation of the law on the public debt break is additionally considered.

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