SLOVAK REPUBLIC

Robust growth is projected to continue. Significant new capacity in the automotive sector will boost export performance. Labour market buoyancy and solid investment growth, underpinned by favourable financial conditions and increased disbursements of EU funds, will contribute to strong domestic demand. Wage growth will increase and consumer price inflation will reach 3% as the labour market tightens and pressures on production capacity build up.

The government plans to reach a budget balance by 2020, fully in line with EU requirements. Fiscal consolidation is appropriate in the context of intensifying pressures on resources. In the longer term, rapid population ageing will increase public spending significantly. A weakening of the 2012-13 pension reform, currently discussed in the parliament, would make it more difficult to address this challenge.

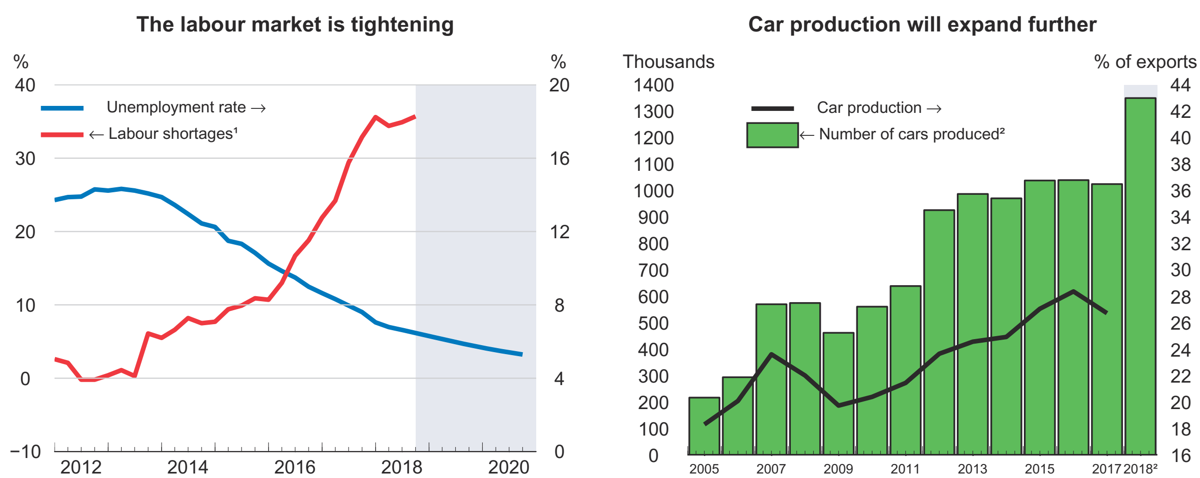
Economic growth is strong

The rapid broad-based economic expansion has continued. New production in the automotive sector has boosted exports. Investment has picked up, thanks to low interest rates, strong business confidence and new foreign investment in the automotive sector. Employment growth has been strong and unemployment has fallen fast. Vacancies are at record levels and labour shortages have intensified, limiting production in some areas. Household debt, particularly mortgage debt, has been growing rapidly. Inflation has risen close to 3% due to rising demand pressures and higher food prices.

Fiscal and macro-prudential policies need to contain credit growth and strong demand

The central bank has been tightening credit standards to contain increasing household indebtedness. This has slowed credit growth but it remains high. Consolidation

Slovak Republic



1. Percentage of manufacturing firms pointing to labour shortages as a factor limiting production.
2. Estimates for 2018 include the launch of new production lines that have started in 2018.

Source: Eurostat, industry database; OECD Trade database; OECD Economic Outlook 104 database; Slovak Investment and Trade Development Agency (SARIO); and Zväz automobilového priemyslu Slovenskej republiky.

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Slovak Republic: **Demand, output and prices**

	2015	2016	2017	2018	2019	2020
	Current prices EUR billion	Percentage changes, volume (2010 prices)				
GDP at market prices	78.9	3.3	3.4	4.1	4.3	3.6
Private consumption	43.2	2.7	3.6	3.0	4.0	4.1
Government consumption	15.3	1.6	0.2	2.3	1.9	2.0
Gross fixed capital formation	18.9	-8.3	3.2	13.2	4.1	4.1
Final domestic demand	77.4	-0.2	2.8	5.2	3.6	3.7
Stockbuilding[1]	0.2	1.1	-0.1	-0.3	0.1	0.0
Total domestic demand	77.6	0.9	2.7	4.7	3.7	3.7
Exports of goods and services	73.3	6.2	4.3	5.8	8.3	6.4
Imports of goods and services	72.1	3.7	3.9	5.9	7.7	6.5
Net exports[1]	1.3	2.4	0.5	0.1	0.8	0.1
Memorandum items						
GDP deflator	_	-0.4	1.3	2.3	2.8	3.0
Harmonised index of consumer prices	_	-0.5	1.4	2.7	2.7	3.0
Harmonised index of core inflation[2]	_	0.9	1.4	2.1	2.5	3.0
Unemployment rate (% of labour force)	_	9.6	8.1	6.7	6.1	5.5
Household saving ratio, net (% of disposable income)	_	3.0	2.4	2.9	2.9	2.9
General government financial balance (% of GDP)	_	-2.2	-0.8	-0.7	-0.4	0.0
General government gross debt (% of GDP)	_	59.8	58.1	57.0	55.1	53.2
General government debt, Maastricht definition (% of GDP)	_	51.8	50.9	49.8	47.9	45.9
Current account balance (% of GDP)	_	-1.5	-2.1	-1.2	0.1	0.0

1. Contributions to changes in real GDP, actual amount in the first column.
2. Harmonised index of consumer prices excluding food, energy, alcohol and tobacco.
Source: OECD Economic Outlook 104 database.

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and strong growth helped to bring the deficit to a historically low level (0.8% of GDP) in 2017. The government's fiscal policy objective is to eliminate the budget deficit by 2020. However, most of this budget improvement will be due to strong cyclical growth, with little structural consolidation. The government plans to increase public sector wages by 10% in each of 2019 and 2020. Given significant demand pressures and low euro area policy interest rates, a tighter fiscal policy would be helpful. More fiscal tightening would also increase the room for action in the event of negative shocks as Slovakia's open economy is very exposed to international trade tensions and volatility. In the long term, spending pressure will rise substantially due to population ageing. In this context, the authorities should not weaken the 2012-13 pension reform and should maintain the link between the statutory pension age and life expectancy.

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 backgrounds. Early childhood education and better-trained and better-paid teachers are necessary parts of this reform. Improving the well-being of Roma, who suffer from social exclusion, will require stronger and better-coordinated efforts across social, housing, education and employment policies.

Growth is projected to remain robust

Growth is projected to be 4.3% in 2019, and then to decline to 3.6% in 2020 in line with the slowdown in the external environment. New production lines in the car industry will boost productive potential, especially in 2019, and fuel gains in export market shares. Labour 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. Inflation will be around 3% by the end of 2020.

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.