SLOVAK REPUBLIC

Highlights

- **The Covid-19 pandemic has led to lower external demand and ruptured supply chains, causing a GDP contraction.** The situation is exacerbated by the homogeneity of the economy and heavy concentration on one industry – car manufacturing – which has been badly affected by the crisis.
- **Crisis response measures have supported employment and business liquidity.** The “First Aid” package, approved by the government in March 2020, amounted to about 1 per cent of annual GDP each month.
- **The bank levy has been removed.** The €1 billion already collected from past payments of the levy will be moved to the Slovak Development Fund to support development programmes, such as investments in healthcare and significant infrastructure projects.

Key priorities for 2021

- **Measures designed to restart the economy should also be targeted at long-term development.** Building an adequate skills base and a better innovation environment can ensure that the economy remains competitive and resilient through further productivity growth and relevance in global value chains, including beyond the automotive industry.
- **Further simplification and legislative amendments are needed to ensure that European Union (EU) funds are used in the most effective way.** This is particularly important as the unused money in the 2014-20 EU budget can still be spent in a more flexible way, especially on activities to fight the effects of Covid-19. Persistent trouble over the years with the investment co-financed with the EU funds have highlighted the need to improve the effectiveness and capacity of the administration at various levels of government.
- **Investments in energy efficiency and the green economy need to be substantially increased.** Greening of the economy should be a priority. So far the country has had limited success in delivering financial instruments to support the greening of small and medium-sized enterprises (SMEs), energy efficiency in the building sector (single-family homes and municipal buildings in particular), renewable energy capacities or waste management.

Main macroeconomic indicators %

	2016	2017	2018	2019	2020 proj.
GDP growth	2.1	3.0	3.9	2.4	-7.0
Inflation (average)	-0.5	1.4	2.5	2.8	1.5
Government balance/GDP	-2.5	-1.0	-1.0	-1.3	-8.8
Current account balance/GDP	-2.7	-1.9	-2.2	-2.7	-3.1
Net FDI/GDP [neg. sign = inflows]	-0.8	-2.8	-1.3	-2.2	0.8
External debt/GDP	92.5	108.3	114.6	112.0	n.a.
Gross reserves/GDP	n.a.	n.a.	n.a.	n.a.	n.a.
Credit to private sector/GDP	57.3	60.4	62.5	63.4	n.a.

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Covid-19: macroeconomic implications

The coronavirus crisis prompted economic activity to plunge. GDP growth in 2019, at 2.4 per cent, was already on a downward path, and the lockdown imposed country-wide in March 2020 and the collapse of external demand pushed the Slovak economy into a deep recession in the first half of 2020. GDP dropped by 8.1 per cent year-on-year in this period, mostly weighed by a double-digit plunge in investment and private and government expenditures. The latter dropped more abruptly than the expenditures of households, reflecting major delays in the provision of support measures by the new government in the second quarter of 2020. The homogeneity of the economy has long been a risk factor, which is currently materialising. Car manufacturing, including smaller domestic suppliers, accounts for almost half of industrial production and 47 per cent of total exports. The country's four car makers stopped production completely in April 2020, but partially re-started a month later.

Car manufacturers' investments are on hold but remain in the pipeline. Despite the cyclical slowdown registered already in 2019, investment grew by 6.8 per cent, mainly because of major infrastructure construction projects and improved absorption of EU funds. The Covid-19 pandemic put the majority of investment projects on hold, as seen by the substantial drop of gross fixed capital expenditures of 10.1 per cent year-on-year in the first half of 2020. On the upside, several car manufacturers are considering new investments. Porsche is planning to build a new production plant for e-cars, worth €250 million, near Piestany in the west of the Slovak Republic. Volkswagen (VW), another German car maker, is planning to invest at least €500 million in the next five years, as a result creating an additional 2,000 jobs while not introducing any Covid-19-related redundancies by 2023. The government pledged to support the construction of residential housing near VW's plant in Bratislava.

The government deficit increased substantially. According to the International Monetary Fund's October 2020 estimates, the general government deficit is expected to rise to 8.8 per cent of GDP in 2020, before falling again in 2021 as the economy rebounds. As elsewhere, the deterioration of public finances is directly linked to the shortfall of tax revenues and government measures to mitigate the negative impact of the coronavirus outbreak on the economy. In June 2020 the government suspended the cap on state expenditures, approved in January 2020, due to the extraordinary circumstances linked to the pandemic. In March 2020 the European Commission invoked the General Escape Clause from the Stability and Growth Pact, so that market access and long-term fiscal sustainability became the only constraints on the size of public spending programmes.

Post-crisis recovery will largely depend on the condition of the automotive sector. GDP will fall sharply in 2020 by 7.0 per cent, according to our current forecasts. However, we anticipate some improvement in external demand next year, which together with improved absorption of EU funds, including the EU recovery package, and significant investments by the automotive industry, should bring a recovery of 5.0 per cent growth in 2021. The high reliance of the economy on the automotive industry remains a key risk factor. Any adverse shock to the industry, such as a drop in demand for cars or any break of supply chains, could delay the recovery.

Policy response to Covid-19

The Covid-19 pandemic-related restrictions triggered rapid crisis protective measures. As an accompaniment to the lockdown imposed in March 2020, the government launched various relief measures to preserve employment, support companies in a state of hibernation and support household incomes. The majority of restrictions were gradually lifted from May 2020, including international travel and a return of production in all car plants.

Crisis response measures have been largely targeted at supporting employment and business liquidity. In March 2020 the outgoing government approved 31 measures to prevent the economy from collapsing. Key measures included the provision of liquidity to businesses through the Slovak Guarantee and Development Bank (SZRB) and the Eximbanka, tax and social security contribution deferrals, wage subsidies, extended sickness benefits, and negotiations with

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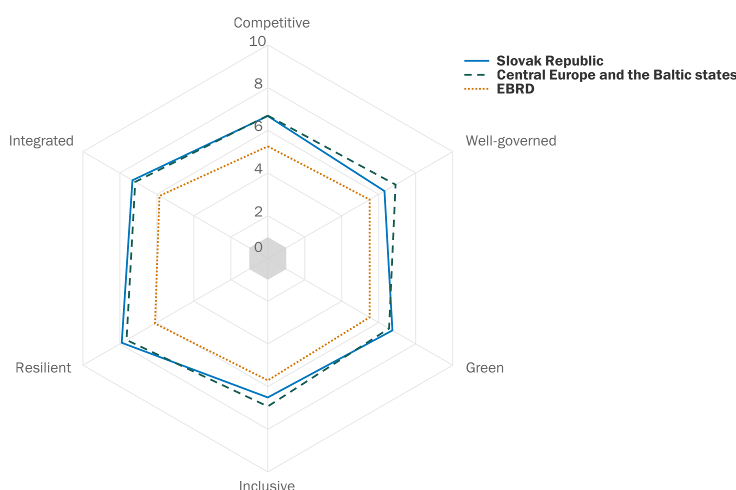
the banking sector on a moratorium on loan repayments. Later in March 2020 the government approved a "First Aid" package, worth about 1 per cent of annual GDP each month, to support businesses, the self-employed and employees. The package consisted of about €1 billion of direct aid and €500 million as bank guarantees. Further, in April 2020, the so-called "Kurzarbeit" – a reduction of working time and salaries as a means to avoid redundancies – and additional aid for entrepreneurs via preferred loans were introduced, followed by state assistance in rent payments to affected small businesses, such as shops or restaurants. In June 2020 the government approved an additional 114 measures, the so-called "Lex Corona", to improve the business environment and revive the economy. As a eurozone member, the Slovak Republic has been eligible for the European Central Bank's Pandemic Emergency Purchase Programme of €750 billion.

Assessment of transition qualities (1-10)



Structural reform developments

The government has set out plans for an employment preservation fund. In August 2020 the government proposed a scheme to preserve employment in future crises, such as the current coronavirus crisis, but also when other local problems emerge, such as floods. According to the proposal, employees who would otherwise be dismissed should receive 80 per cent of their net salary, of which 60 per cent is to be covered by the created employment preservation fund and the remaining 20 per cent by employers. The fund should also be available to the self-employed. According to the labour ministry, the current employment preservation scheme, as a part of the "First Aid" package, saved 500,000 jobs as of mid-August 2020.

The bank levy has been removed. In June 2020 the finance ministry and the Slovak Banking Association signed an agreement to remove the special bank tax on banks' assets, starting from July 2020. In return, banks agreed to boost their core capital, among other things, by not paying dividends. In addition, banks pledged to invest an additional €500 million in loans for households and businesses until 2023. The €1 billion collected from past payments of the levy will be moved to a new Slovak Development Fund, which will be established by the end of 2020 and which will focus on supporting and financing development programmes, such as investments in healthcare and significant infrastructure projects. The special bank levy was introduced in 2012 to create a buffer fund to help cope with potential crises.

Rules for use of EU funds have been simplified. In March 2020 the European Commission approved a request by the Slovak government to move uncontracted money between funds and to simplify the bureaucratic rules. Effectively, 100 per cent of the EU funds can now be used to mitigate

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the impact of the pandemic, without national co-financing. As a result, in April 2020 the government reallocated €1.25 billion of EU funds to five key areas: the healthcare system, jobs, SMEs, the emergency rescue system and education. As of the end of July 2020 the Slovak Republic had absorbed 32.5 per cent of EU funds under the 2014-20 EU budget. The upcoming 2021-27 EU funds will consist of two pillars: the regular multiannual financial framework (MFF) and an extraordinary Covid-19 recovery fund. The Slovak Republic is expected to receive €18.6 billion under the MFF 2021-27, and €7.5 billion in grants under the Covid-19 recovery fund, and it will be eligible to draw soft loans of up to €6.8 billion, repayable by 2058.