SLOVAK REPUBLIC

Highlights

- **The economy is recovering in 2021, but some supply chain problems are emerging.** Following a gross domestic product (GDP) decline of 4.4 per cent in 2020, the Slovak economy has started to recover, reaching almost 5 per cent year-on-year growth in the first half of 2021. Rising car production is driving growth but supply chains have been disrupted recently by shortages in key inputs.
- **The government's plan for implementing European Union (EU) funds emphasises the green transition.** It is projected that the largest share of the €6.6 billion plan, financed through the Recovery and Resilience Facility (RRF), will be put into raising energy efficiency, encouraging decarbonisation and increasing the share of renewable energy sources.
- **"Kurzarbeit" was approved as a permanent work scheme from 2022.** As a new instrument in labour market policy, it will be available in extraordinary situations, whereby employers will be granted up to 60 per cent of the employee's average earnings. Alongside the continuation of hybrid work schemes due to the Covid-19 pandemic, remote working was further regulated.

Key priorities for 2022

- **The announced tax changes should aim to encourage employment and investment.** The tax changes expected in 2022 should reduce the tax burden on labour to boost employment and increase disposable income. At the same time, tax incentives should be targeted at attracting new investment.
- **Implementation of green transition reforms requires enhanced public administration and greater local capacities.** Steps need to be taken to significantly strengthen administrative capacities and digital skills, also at the local and regional levels, as they can enable the timely implementation of energy-related projects, which will facilitate the country's access to the grid of clean energy sources.
- **Active labour market policies should promote labour market inclusion.** The government should make efforts to address the low participation of women in the labour market through regular upskilling, expanding the childcare system and granting tax allowances and compensation for fathers taking a share of parental leave.

Main macroeconomic indicators %

	2017	2018	2019	2020	2021 proj.
GDP growth	3.0	3.8	2.6	-4.4	4.0
Inflation (average)	1.4	2.5	2.8	2.0	2.4
Government balance/GDP	-1.0	-1.0	-1.3	-5.5	-7.5
Current account balance/GDP	-1.9	-2.2	-3.4	0.1	-0.9
Net FDI/GDP [neg. sign = inflows]	-2.8	-1.3	-2.3	2.1	-1.3
External debt/GDP	108.4	114.9	112.4	121.2	n.a.
Gross reserves/GDP	n.a.	n.a.	n.a.	n.a.	n.a.
Credit to private sector/GDP	60.4	62.7	63.5	68.1	n.a.

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Covid-19: macroeconomic implications

The economic downturn in 2020 was less severe than the EU average. The annual fall in GDP of 4.4 per cent in 2020 was the first decline since 2009. More resilient external demand and the recovery of car production ensured a return to positive growth in late 2020. After intensified containment measures from the end of 2020 and a gradual increase in activities in 2021, in the first half of 2021, GDP grew 4.9 per cent year-on-year. While economic sentiment and retail turnover started to recover from March 2021, the automotive industry and foreign trade have already surpassed figures from the pre-Covid-19 period. However, despite the growth in orders, the latest global chip shortage has resulted in a pause in production at some facilities, such as Jaguar.

Containment measures limited the decline in unemployment, while wages are rising moderately. After the unemployment rate reached 6.7 per cent in 2020, it increased further to 7.0 per cent in the second quarter of 2021, mainly due to the retention of certain restrictions in the services sector. Real wage growth in 2020 amounted to 1.7 per cent, with a rising trend in the industry sector. It also contributed to inflation pressure throughout 2021, with the level of inflation reaching 4 per cent year-on-year in September 2021.

Government spending will continue to support economic recovery. Due to the sizeable fiscal stimulus, worth 5.1 per cent of GDP, the general government deficit in 2020 reached 5.5 per cent of GDP. It interrupted a track record of low deficits. Public debt increased to 59.7 per cent of GDP in 2020, significantly higher than the pre-Covid-19 crisis level of 48.1 per cent in 2019. As the government will continue to use expenditure measures to combat the impact of the Covid-19 pandemic, the fiscal deficit is likely to exceed 6 per cent of GDP in 2021 before declining in 2022. According to the independent Council for Budget Responsibility, the long-term sustainability indicator of public finances continues to stay in the "high-risk zone", which suggests that general government gross debt should be reduced, accompanied by measures to achieve a structural budgetary surplus.

Short-term growth will continue, but the homogenous nature of the Slovak economy is a risk. On the upside, EU funds, including the RRF, of which the first tranche was already distributed in mid-October 2021, are expected to fuel investment, especially in the public sector. GDP growth will, therefore, likely reach 4.0 per cent this year and accelerate further to 5.0 per cent in 2022. However, the dominant automotive sector relies heavily on imports of components and chips, of which shortages are being experienced globally. As a result, disruptions in the supply of subcomponents have already hurt production, which could well lead to renewed job shedding and harm the recovery in household consumption. In addition, only 45 per cent of the population is at least partially vaccinated, creating a risk of sporadic new lockdowns.

Policy response to Covid-19

A broad stimulus package prevented a stronger economic downturn in 2020. With a stimulus package implemented in 2020 that amounted to 5.1 per cent of GDP, the government supported employers and the self-employed through the partial compensation of wages in sectors affected by the Covid-19 pandemic (such as the services sector), allowances and exemptions from social and health payments and extra spending on the social and health sectors. As a eurozone member, the Slovak Republic also took advantage of the quantitative easing policies of the European Central Bank.

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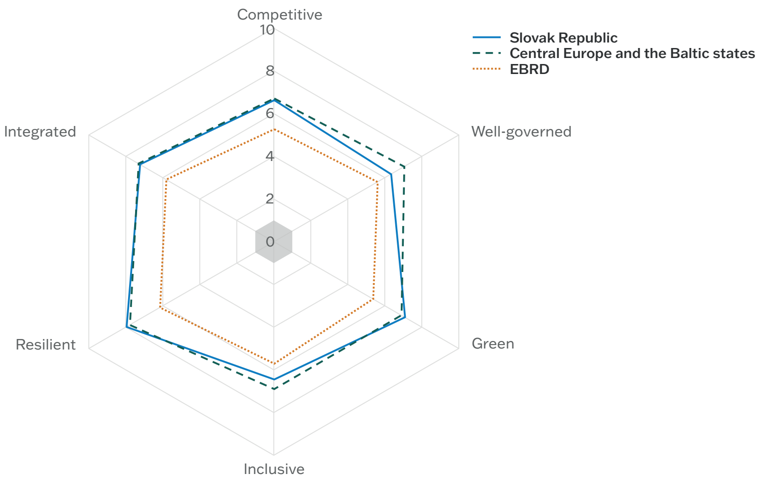
The 2021 budget is marked by increased expenditure for the recovery. Approved in December 2020, the budget provides for increases in expenditure on health, pensions, compensation and family support. Fiscal packages include extended wage compensation and unemployment benefits, along with a prolonged deferral of payroll and corporate tax payments for employers. In addition, the budget assumed a 1.1 per cent of GDP reserve for unforeseen developments related to the Covid-19 pandemic, which was increased with extra budgetary funds in May 2021, raising the target fiscal gap. The most significant change from June 2021 relates to financial aid linked to the so-called "Covid Automat". Under this system, regions are divided into green, orange, red, dark red and black districts, depending on their epidemiological situation. The support system includes four phases. Phase 0 means that at least 40 districts are in the green tier and no financial assistance is paid. In phase three (when most districts are in the dark red or black tiers), employers are able to ask for support amounting to 100 per cent of total labour costs and the self-employed can get up to €870 of assistance.

Assessment of transition qualities (1-10)



Structural reform developments

The implementation of the RRF plan will increase the use of renewable energy sources. The national plan, worth €6.3 billion in grants (6.9 per cent of 2020 GDP) is based on five key components: green economy, education, health, public administration/digitalisation, and research, development and innovation. A significant amount of planned investments is dedicated to the green transition and will include decarbonisation and new investments in renewable and clean energy. The planned investments in the digital area will include strengthening the digital capacities of government services but also improving general digital skills – an area where the Slovak Republic lags the central European and Baltic state average.

Parliament approved the permanent short-time work scheme from 2022. As a new permanent instrument for supporting labour markets, "Kurzarbeit" will be provided to employers and the self-employed in extraordinary circumstances that they cannot prevent, such as a state of emergency or *force majeure* event. The maximum support will be 60 per cent of the employee's average hourly earnings in the calendar month for which the support is provided. The support will be valid for a maximum of six months, to be taken within 24 consecutive months.

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Digitalisation was set as a priority of the government. At the beginning of 2021 the authorities announced that digital reforms worth €1.2 billion would be based on: interconnectedness, cyber security, the digital economy, digital skills, innovations and access to state-related administration via mobile phones. Besides achieving a more effective public administration, a concrete goal is that, by 2025, all schools and, by 2030, all households should be able to access high-speed internet.

A new act on the protection of competition came into force. In May 2021 the Slovak parliament adopted a new competition act, following an EU request to empower the competition authorities. With the new act, the Antimonopoly Office of the Slovak Republic (AMO) will have more control over existing cartels and is likely to discourage the creation of new ones. The AMO will also be authorised to apply measures, fines and penalties in cases of suspected cartels or abuse of a dominant position.

Flagship projects were selected for funding through the Just Transition Fund. In the project implementation period, from 2022 to 2030, the Slovak Republic will have €459 million at its disposal. The highest amount is destined for the coal-dependent Upper Nitra region. Some of the selected projects include the construction or renovation of hospitals, renovation of public buildings and energy-efficient transport to improve living standards and promote the diversification of economic activities.

New investments in the automotive industry are likely to boost economic growth. As a major sector, the automotive industry has maintained its investment plans, despite the Covid-19 crisis. Jaguar Land Rover has announced the employment of 600 workers in the Nitra plant and an additional 300 jobs in the sub-supplier firm. Volkswagen Slovakia is expanding its production by €1 billion and, by 2023, will move production of the Superb model from the Czech Republic and the Passat model from Germany to Bratislava.