Slovak Republic

Highlights

- **The war on Ukraine has held back the economic recovery from Covid-19.** While its direct exposure to trade with Russia and Ukraine is modest, the Slovak Republic is heavily exposed to disruptions in Russian energy imports and mounting import costs, which have already hit the supply side of the economy.
- **Energy supplies have been enhanced by various policy measures.** A government memorandum has sheltered households from heavy electricity price increases until the end of 2024. Industry will be excluded from the mandatory European Union (EU)-wide gas consumption cuts and is exempt from the Russian oil embargo until a fully-fledged alternative can be found.
- **The first EU Recovery and Resilience Facility (RRF) payments have been disbursed.** The payments span 14 partial milestones, including reforms of the judiciary, higher education, energy and transport sectors, digitalisation of the public sector and the fight against corruption.

Key priorities for 2023

- **Administrative capacity needs to improve, especially at local level, to increase EU funds absorption.** The planned investments from the RRF amount to 6.5 per cent of gross domestic product (GDP), but the low absorption rate of the 2014-20 European Structural and Investment Funds highlights the current lack of capacity.
- **Energy security should be enhanced.** The immediate priorities are to bring about greater energy savings in the industry and residential heating sectors and to reduce the country's reliance on fossil-fuel imports.
- **Availability of affordable and quality childcare should be increased.** The gender employment gap is close to the EU average, but is significantly higher for women of childbearing age, in part because of the limited use and availability of formal childcare for children under the age of three.

TABLE Main macroeconomic indicators %

	2018	2019	2020	2021	2022 proj.
GDP growth	4.0	2.5	-3.4	3.0	2.0
Inflation (average)	2.5	2.8	2.0	2.8	12.0
Government balance/GDP	-1.0	-1.2	-5.4	-5.5	-4.0
Current account balance/GDP	-2.2	-3.3	0.4	-1.9	-3.7
Net FDI/GDP [neg. sign = inflows]	-1.3	-2.3	2.0	0.3	0.0
External debt/GDP	114.8	112.2	120.5	137.0	n.a.
Gross reserves/GDP	n.a.	n.a.	n.a.	n.a.	n.a.
Credit to private sector/GDP	62.4	63.2	67.1	68.2	n.a.

Macroeconomic developments and policy response

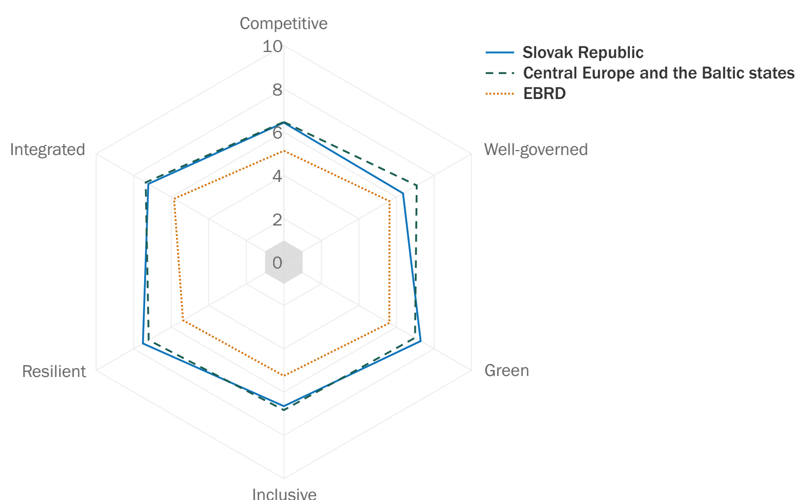
The war on Ukraine has damaged the economy, preventing a full recovery from the Covid-19 pandemic. GDP grew 3.0 per cent in 2021, mostly driven by strong household consumption and government spending. While its direct exposure to trade with Russia and Ukraine is modest, the Slovak Republic is heavily exposed to disruptions in Russian energy imports and the mounting import costs that have adversely affected the supply side of the economy. As a result, GDP growth slowed to 2.1 per cent year on year in the first half of 2022, propped up largely by high household consumption. Despite the slowdown, however, the labour market remains tight, with several sectors facing labour shortages. The unemployment rate dropped to 5.9 per cent in September 2022. But the jobless rate among the low-skilled, at 41.7 per cent in the second quarter of 2022, is the highest in the EU, while the share of long-term unemployed also remains high, at 64.4 per cent in the second quarter of 2022 of all unemployed persons.

High energy and food prices are fuelling inflationary pressures. In the middle of 2022 the harmonised index of consumer prices (HIPC) inflation rate exceeded 12 per cent year on year, not just because of rising food and energy prices, but exacerbated by supply-chain disruptions. Nominal wages are failing to keep up with prices and the resulting decline in households' real incomes is depressing consumption. In June 2022 parliament passed a €1.2 billion anti-inflation package of support, including child benefits and one-off payments to selected vulnerable groups. However, part of this decision overrode a veto by the president who, in July 2022, sent the bill to the Constitutional Court to examine its constitutionality.

Pandemic and war-related spending have led to pressure on public finances. The general government deficit widened from just 1.3 per cent of GDP in 2019 to 6.2 per cent in 2021. At the same time, general government gross debt jumped to 63.1 per cent of GDP. Fiscal buffers are expected to be rebuilt once the economy is on a solid growth path. The anticipated impact of fiscal consolidation on investment is likely to be offset by a higher EU funds inflow, including from the RRF, to be disbursed by the end of 2026.

Disruptions to Russian energy imports, mounting import costs and persistent supply-chain problems will weigh on GDP growth in the short term. On the upside, accelerated investments that engage RRF funding, as well as new capacity investments in the automotive sector, are likely to outweigh the negative factors associated with the war. On balance, therefore, we forecast GDP growth to slow to 2.0 per cent in 2022 and just 1.0 per cent in 2023.

CHART Assessment of transition qualities (1-10)



Structural reform developments

Households are sheltered from large electricity price increases until the end of 2024. The government signed a memorandum with the dominant power utility, Slovenske Elektrarne, in February 2022 to maintain the electricity price for households at €61.21 per megawatt hour, excluding distributional fees, the level when the memorandum was signed. According to the network industries regulator, without such a memorandum, the regulated electricity price for households could increase, on average, by more than 200 per cent in 2023. At the same time, two nuclear reactors in Mochovce are expected to start operating in 2022 and 2024 (on top of two plants already in place). Currently, the share of electricity produced by nuclear power plants is 55 per cent.

Oil supplies from Russia will continue to flow until a fully-fledged alternative is found. While the Slovak Republic supports the EU's June 2022 embargo on imports of crude oil and refined oil products from Russia, it is allowed to use Russian oil until it can be replaced. However, all countries benefiting from this exemption – Hungary, the Czech Republic and the Slovak Republic – will not be able to resell crude oil and petroleum products to other EU Member States or third countries. The Slovak Republic is fully dependent on Russian oil suppliers, and a change to the processing of lighter oil could take three years, according to the government.

Industry will be excluded from mandatory EU-wide gas consumption cuts when activated. The government negotiated several exemptions from the mandatory 15 per cent gas consumption cut regulation passed by the EU Energy Council in July 2022. The mechanism will be triggered when at least five EU countries have declared a state of emergency driven by disruptions to gas supplies from Russia. Industry will be excluded from the reduction in natural gas demand and the country has been granted a more favourable reference period for savings, namely, just the last year rather than the average of the last five years. The EU will also take into account the level of storage facilities, which exceeds the requisite 80 per cent total capacity threshold. In August 2022, 65 per cent of the total natural gas demand of the state-owned gas utility, SPP, was covered by non-Russian sources.

The first RRF payments have been disbursed. The European Commission had disbursed about €460 million to the Slovak Republic as of July 2022, including the pre-financing tranche of October 2021. The payment covers 14 partial milestones, including reforms of the judiciary, higher education, energy and transport sectors, digitalisation of the public sector and the fight against corruption. The overall plan includes 18 thematic milestones and is worth €6.3 billion in grants. In contrast, the absorption of the 2014-20 EU funds is slow, at almost 60 per cent as of the end of June 2022, holding back short-term growth potential.

The poor availability of affordable rental housing is being addressed. In July 2022 the government established a state agency to support rental housing. Four financial groups are considering allocating €6 billion into the construction of about 40,000 rental flats. Rents are expected to be 30 to 40 per cent lower than commercial rents, depending on the region. According to the European Commission, the low availability of affordable rental housing remains a challenge in addressing social exclusion. EU Statistics on Income and Living Conditions data show that the share of households living in rental flats owned by the public sector in the Slovak Republic, at 1.6 per cent, is substantially lower than the EU average of about 11 per cent. However, the overall lack of housing supply still persists and is connected to structural issues, especially institutional drawbacks and red tape.

A new factory is set to be built for the production of electric cars. Swedish car maker Volvo Cars will build a new €1.2 billion plant for the production of electric cars near Kosice. The construction of the plant is scheduled to kick off in 2023, with car production to be launched in 2026. The facility is expected to be in line with the highest global standards of energy and environmental efficiency. It will produce up to 250,000 cars annually and create more than 3,000 jobs in the region. This will be the fifth carmaker in the country, joining Volkswagen Slovakia in Bratislava, Stellantis in Trnava, Kia Motors near Zilina and Jaguar Land Rover in Nitra. The latter plans to expand its production of a new car this year, which is expected to create 700 new jobs. In 2021 there were 184 personal vehicles produced per 1,000 inhabitants in the Slovak Republic, the highest number per capita globally.