Slovak Republic

Highlights

- **Gross domestic product (GDP) growth has slowed further in 2023.** Household disposable income has fallen, investment remains subdued amid high financing costs, and the use of European Union (EU) funds has been sluggish.
- **The country's Recovery and Resilience Plan (RRP) has been revised.** In July 2023 the EU Economic and Financial Affairs Council (ECOFIN) approved an amended RRP for the Slovak Republic, worth €6.4 billion in grants. The revised plan includes reforms and investments linked to REPowerEU, aimed at reducing the country's energy dependence on Russia and supporting the transition to a green economy.
- **Energy security has increased.** The third unit of the Mochovce nuclear power plant is expected to be running at 100 per cent by autumn 2023 and will cover nearly 13 per cent of the country's total electricity needs.

Key priorities for 2024

- **Energy price subsidies should be provided to vulnerable groups only.** Any extension of existing support schemes, which have kept energy price increases low, should be targeted at those most in need, in order to protect public finances and encourage the switch to more efficient and green energy production.
- **Reforms to support economic convergence with the EU need to be relaunched.** According to the latest central bank report, in addition to improving the business environment, reducing red tape and speeding up the digitalisation of the economy, the management of EU funds needs to be improved, as it has constituted a major constraint on economic development.
- **Investments in e-mobility need to be accelerated.** Amid growing technological competition from China, rapidly stepping up concentration on electric vehicle and battery production will help the Slovak Republic to maintain international competitiveness and employment in the automotive industry.

Main macroeconomic indicators (per cent)

	2019	2020	2021	2022	2023 proj.
GDP growth	2.5	-3.3	4.8	1.8	1.0
Inflation (average)	2.8	2.0	2.8	12.1	11.0
Government balance/GDP	-1.2	-5.4	-5.2	-2.0	-5.0
Current account balance/GDP	-3.3	0.6	-4.0	-7.3	-2.7
Net FDI/GDP [neg. sign = inflows]	-2.3	2.6	-1.3	-2.1	-1.0
External debt/GDP	112.3	119.6	134.1	103.1	n.a.
Gross reserves/GDP	n.a.	n.a.	n.a.	n.a.	n.a.
Credit to private sector/GDP	63.2	67.1	67.0	67.9	n.a.

Macroeconomic developments and policy response

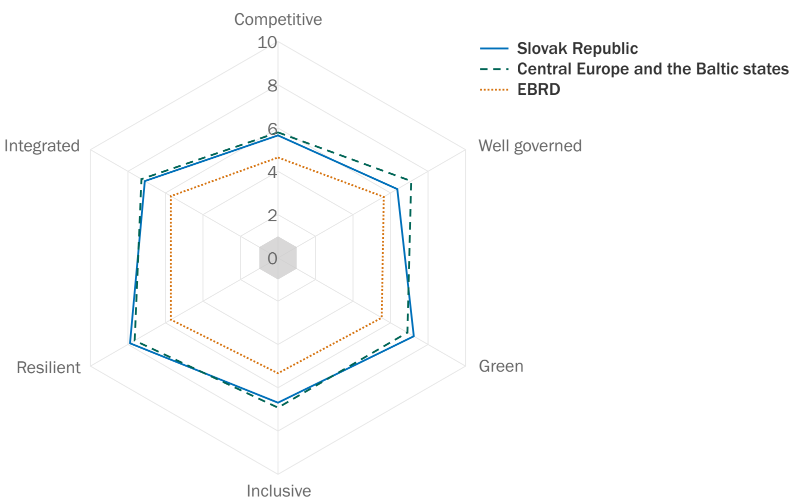
GDP growth has decelerated. After an impressive recovery in GDP growth to 4.8 per cent in 2021, economic growth slowed to 1.8 per cent in 2022 and 1 per cent year on year in the first half of 2023. High inflation rates have weighed on household disposable income, while elevated prices for imported energy have negatively affected the terms of trade. Increased financing costs, triggered by higher policy rates and an increased risk premium amid regional uncertainty related to the war on Ukraine, together with the slow use of EU funds, have held back domestic investment, although new investments in e-mobility are under way.

High inflation and rising indebtedness have triggered a surge in personal bankruptcies. In 2022 the number of personal bankruptcies increased almost 12 per cent from 2021 to 9,674 individuals, according to the Slovak Credit Bureau. At the same time, about 63 per cent of Slovaks are having difficulty making ends meet, with only 35 per cent living comfortably compared with the EU average of 54 per cent, according to the latest Eurobarometer survey. Inflation peaked at 15.4 per cent in February 2023 and has fallen since then, coming in at 9 per cent in September 2023.

Fiscal consolidation is needed amid widening budget deficits. Following a low budget deficit of 2 per cent of GDP in 2022, the European Commission expects the general government deficit to widen to more than 6 per cent of GDP in 2023, partly because of new measures to mitigate the effects of high energy bills. It forecasts public debt to increase to 58.3 per cent of GDP by the end of 2023. Fiscal consolidation will be a task for the new government to be formed after the September 2023 elections.

Economic activity is likely to pick up from current low levels in 2024. We forecast GDP growth of just 1 per cent in 2023, rising to 2.2 per cent in 2024, when households' purchasing power starts to improve (as inflation continues to fall) and external demand picks up. Key risks to the outlook include the persistently slow use of EU funds and potential political instability, which would hold back public investment. The labour market is expected to remain tight, with unemployment rates at historically low levels, but skills mismatches, a deteriorating demographic profile and high structural unemployment rates will all weigh on the country's medium- and long-term growth potential.

Assessment of transition qualities (1-10)



Structural reform developments

The country's RRP has been revised. In July 2023 ECOFIN approved an amended RRP for the Slovak Republic, worth €6.4 billion in grants. The revised plan includes reforms and investments linked to REPowerEU, aimed at reducing the country's energy dependence on Russia and supporting the green economy transition. In March 2023 the Slovak Republic received the second tranche of its Recovery and Resilience Facility (RRF) grants, amounting to one-third of the total package that needs to be used by the end of 2026. Moreover, as of the end of July 2023 the Slovak Republic had only absorbed about 75 per cent of the €14.5 billion in EU funds allocated to it in the 2014-20 programming period, which concludes at the end of 2023. In January 2023 the government started to draw down funds from its new EU allocation for the 2021-27 programming period, which totals close to €13 billion, following the European Commission's approval of the country's Operational Programme in November 2022. The new programme focuses on enhancing energy security, digitalisation, green investment and improving the quality of people's lives.

Government measures have kept household energy prices in check. According to Ministry of Finance estimates, consumers in the Slovak Republic experienced one of the smallest increases in electricity and gas prices in the EU in the second half of 2022. Prices have been held down by a combination of price caps, financial compensation schemes for the business sector and exceptional agreements with utility companies. In March 2023 the government approved electricity prices for 2024. These are expected to remain the same as in 2023, thanks to a memorandum of understanding with power utility Slovenske Elektrarne. In line with European Commission recommendations, however, the government is working on an energy support scheme that targets vulnerable groups only, rather than applying across-the-board assistance. Vulnerable households will be eligible for a subsidy covering the difference between market prices and a limit set by government.

The Ministry of Agriculture proposed seven measures for reducing food inflation, excluding any potential value-added tax (VAT) cuts or price caps. In June 2023, in response to a request from parliament, the Ministry of Agriculture announced one-off financial transfers to the most vulnerable households, as well as measures to increase food-chain efficiency, improve food-industry competition and trade, and improve the transparency of companies' economic results. At the same time, parliament approved a waiver of social contributions for employees of food producers and farmers for a six-month period to end 2023. Labour costs per employee are expected to be reduced by 24 per cent and capped at the level of the minimum wage of €700. The gap in social contributions should be covered by the state budget.

New energy windfall taxes were introduced. In April 2023 the president signed into law an increase in the windfall tax on refineries from 55 to 70 per cent until the end of 2023, with coal mining remaining exempt. In addition, in January 2023 the government approved a 90 per cent windfall tax on power producers' excess revenues, effective December 2022 for a period of two years. According to some market estimates, the two windfall taxes are likely to generate additional budget revenues of €435 million in 2023.

Energy security has increased. In February 2023 the third unit of the Mochovce nuclear power plant came into operation. It is expected to be running at 100 per cent by autumn 2023, covering about 13 per cent of the country's total electricity consumption, and has an expected service life of 60 years. The Slovak Republic is now electricity self-sufficient. In addition, by the middle of 2023 state-owned gas company SPP had secured more than 70 per cent of its gas supply needs from sources other than Russia. This includes access to LNG terminals and regasification facilities by signing memoranda of understanding with key partners, such as Italy's Edison in June 2023, and other countries earlier this year. In the middle of 2023 gas reservoirs had already been 76 per cent filled, thus exceeding the EU average of 73 per cent.

A proposed EU ban on combustion engines is meeting resistance. In May 2023 parliament approved a resolution on the EU's proposed ban on the production of new combustion engines after 2035. The resolution urges the government to oppose any EU-wide regulation that would disadvantage, overprice or ban internal combustion engines. Rather, the government should actively support the principle of "technological neutrality". At the same time, electric vehicle production is on the rise in the Slovak Republic. German company VW is planning to increase its share of electric and hybrid car production in the country to 17 per cent from 2025, while Swedish company Volvo is expected to launch the production of electric vehicles only near Košice from 2027. The country's car sector accounts for more than 50 per cent of domestic industrial production and 42 per cent of total exports.

The government is encouraging the development of rental apartments. In December 2022 the government approved pilot contracts with several large investors to build 9,000 rental flats worth some €1.5 billion. These apartments are intended for lifelong living and will be partially subsidised by the state to the tune of 30-40 per cent of market prices. The availability of rental and social housing remains a key challenge in addressing social exclusion.