Slovakia: March 2009

Changes over previous version

Recent industrial production figures along with the economic sentiment point to further slowdown of economic activity in the first quarter 2009, posing downside risk to our 2.7% growth forecast for the full 2009. Nevertheless, we need to see at least the GDP growth structure from 4Q08 before we make any revision to the 2009 growth forecast. Monetary policy easing of the ECB is likely to continue with the interest rates bottoming at 1.00-1.25%, in our view. The Statistical Office revised sector classification NACE, which has slightly changed some past growth rates and implies different growth dynamics for future (i.e. retail sales now include also sales of gasoline). We revised downwards PPI growth rate for this year (high growth of energy prices such as the one seen in 2008 will likely not repeat this year).

		2004	2005	2006	2007	2008f	2009f	2010f	2011f
Real economy									
Real GDP	% y/y	5.2	6.6	8.5	10.4	**6.4**	2.5	4.1	5.1
Nominal GDP	fixed EUR m*	45.2	49.3	55.1	61.5	**67.3**	70.9	76.2	82.7
GDP per capita	EUR	6315	7140	8261	10149	**11980**	13094	14067	15245
Household consumption (real)	% y/y	4.2	6.5	5.9	7.1	**6.3**	4.4	4.4	5.0
Gross investments (real)	% y/y	13.6	16.3	5.5	10.4	**6.9**	0.4	2.7	5.1
Industrial output	% y/y	4.0	3.8	9.9	12.8	**2.0**	0.0	4.0	5.0
Retail sales (real)	% y/y	6.2	9.7	8.3	4.8	**6.8**	4.5	5.5	5.0
External balance									
Import	% y/y	13.8	13.1	22.9	10.2	**4.9**	-3.8	8.2	12.3
Export	% y/y	10.9	11.1	24.5	15.2	**5.1**	-4.9	8.2	13.0
Merchandise foreign trade balance	EUR m	-1.6	-2.5	-2.5	-0.7	**-0.7**	-1.2	-1.3	-1.1
	% of GDP	-3.6	-5.0	-4.5	-1.2	**-1.0**	-1.7	-1.7	-1.3
C/A (since 2005 incl. reinv. earnings)	% of GDP	-3.6	-8.4	-7.2	-5.3	**-5.6**	-6.0	-5.8	-5.2
Net FDI inflow (equity capital)	USD bn	1.1	0.7	2.1	1.1	**1.2**	1.4	1.5	1.8
	% of GDP	2.5	1.5	3.7	1.5	**1.3**	1.4	1.4	1.6
Prices									
CPI inflation	% y/y, Dec	5.9	3.7	4.2	3.4	**4.4**	3.0	3.9	3.9
	% y/y, avg	7.5	2.7	4.5	2.8	**4.6**	3.0	3.9	3.9
Core inflation (CPI ex-reg. prices and taxes)	% y/y, Dec	1.5	1.7	2.7	4.2	**3.3**	3.5	3.9	3.9
Harmonized inflation	% y/y, Dec	5.8	3.9	3.7	2.5	**3.5**	2.4	3.7	3.8
	% y/y, avg	7.5	2.8	4.3	1.9	**3.9**	2.3	3.7	3.8
Producer prices	% y/y, Dec	4.3	7.0	5.4	2.8	**6.0**	2.0	2.5	2.0
Labour market									
Unemployment rate (ILO methodology)	%	18.1	16.2	13.3	11.0	**9.8**	10.9	10.7	10.0
Employment (domestic concept)	thousands	2170	2216	2301	2357	**2429**	2429	2449	2478
	% y/y	0.3	2.1	3.8	2.4	**3.1**	0.0	0.8	1.2
Average wage	fixed EUR*	525	573	623	669	**729**	770	824	890
Average real wage	% y/y	2.5	6.3	3.3	4.3	**4.2**	2.5	3.0	4.0
Public sector									
Fiscal balance (ESA-95, ex pension reform)	% of GDP	-2.3	-2.2	-2.4	-0.7	**-0.7**	-1.6	-1.5	-1.0
Fiscal balance (ESA-95, with pension reform)	% of GDP	-2.3	-2.8	-3.5	-2.0	**-2.2**	-3.0	-2.9	-2.4
Public debt	% of GDP	41.4	34.2	30.4	29.4	**29.0**	30.6	31.3	31.3
Interest rates									
Central bank's policy rate	Dec	4.0	3.0	4.8	4.3	2.50	**1.25**	3.25	3.50
3M BRIBOR	Dec	3.7	3.2	4.7	4.3	2.98	**1.60**	3.65	3.90
	avg	4.7	2.9	4.3	4.3	4.15	**1.55**	2.70	3.70
1Y BRIBOR	Dec	3.5	3.4	4.6	4.4	3.28	**1.80**	3.90	4.35
	avg	4.4	2.9	4.6	4.4	4.61	**1.75**	2.90	4.15
5Y yield (zero curve)	Dec	4.0	3.6	4.3	4.6	3.20	**3.50**	4.50	4.50
	avg	4.6	3.3	4.5	4.5	4.30	**3.15**	4.00	4.50
10Y yield (zero curve)	Dec	4.5	3.7	4.3	4.8	3.75	**4.30**	5.00	5.00
	avg	5.1	3.9	4.5	4.6	4.52	**4.00**	4.70	5.00
Exchange rates									
USDEUR	Dec	1.36	1.18	1.32	1.47	1.41	**1.50**	1.40	1.30
	avg	1.24	1.24	1.25	1.37	1.47	**1.45**	1.43	1.35

Note:* euro-fixed time series is a series in SKK multiplied by the conversion rate of 30.1260 SKK/EUR.

Source: Štatistical Office, Eurostat, NBS, SLSP, Erste Research

Real economy

After reaching the peak at the record 10.4% in 2007, the Slovak economy started to slow down; in 2008 the growth rate reached 6.4% and in 2009 we expect sharp slow-down to around 2.5%. In past few years economy benefited from established foreign direct investments, placed mainly in the automotive and electronic industries. The pace of potential output growth has slowed down since 2008 as the car factories did not deliver such one-off boost as was seen in 2007. More sever impact on this-year growth comes from ongoing recession in the Euro zone, dampening Slovak exports especially in the cyclically sensitive industries. Cautiousness of financial institutions by loans provisions, resulting from financial crises, will hit corporate business and investment growth. Private consumption will likely be effected in lesser extent than the corporate sphere and should continue provide a support to the economy.

External balance

The foreign trade deficit narrowed significantly in 2007 to 1.2% of GDP, due to sustained growth of car exports, slowdown of investment-related imports and smaller increase in oil prices than in 2006. Along with the trade balance, the current account deficit narrowed as well to 5.3% of GDP last year. We expect the trade balance to end 2008 with a deficit of 1% of GDP and expect widening of the trade gap to 1.7% of GDP in 2009 (due to decline in exports). While slowdown in the Europe has already brought lower demand for Slovak products in late 2008, imports slowed down as well due to lower material imports of key Slovak exporters and decline of oil prices since mid-2008. We expect sluggish trade dynamics at least in the first half of 2009, while gradual improvement in the second half of 2009 could occur.

Prices

Inflation was gradually increasing since the second half of 2007 until September 2008, particularly on the back of high food and oil price growth (harmonised inflation reached its peak in September at 4.5% y/y and headline CPI peaked at 5.3%). Despite higher inflation, Slovakia was meeting Maastricht inflation criterion since the second half of 2007. Harmonized consumer inflation has gradually declined since September to 3.5% by the year-end and we expect it to stay below 3.5% in 2009. Deceleration of annual price growth was due to the higher base (last year’s food prices increase has not repeated). At the same time, oil price decline in second half of 2008 eased the pressure on energy prices (the government also exerted significant pressure to prevent a gas price hike), which were previously regarded as the biggest inflation risk by us. On the other hand, higher prices of cigarettes fuelled inflation in the last quarter of 2008. In 2009, average inflation should stay at around 2.3%.

Labour market

While the labour market continued to experience favourable tendencies until the third quarter 2008, the economic slowdown will likely lead to deterioration of the situation. In recent years improved possibilities to work abroad after the EU entry contributed to the employment growth in Slovakia. Some of this people will likely lose jobs and return home, as EU is hit hard by the recession. At the same time, lower demand for Slovak export goods means some domestic firms have already announced layoffs and others are less eager to hire new workers, as expanding plans are put on hold. As a result of slower economic growth, we expect employment to stagnate in 2009. Due to growing labour force, the unemployment rate should nevertheless increase. In 2009, we also expect slowdown of real wage growth to around 2.5% y/y.

Public sector

The worsened economic forecasts for Slovakia lead to worse outlook for fiscal deficit. While the original budgeted target for 2009 was planned at 1.7% of GDP, lower economic growth means lower tax revenues and higher social spending even if no new fiscal initiatives were undertaken. Moreover, we see further risks that the budget overestimated the number of people leaving the second pension pillar and that the state might fall short of its objective to save money in order to finance some new anti-crisis measures. We expect fiscal deficit close to 3% of GDP in both 2009 and 2010 (it could be higher in case of new spending initiatives). But eventual breaching of the 3% Maastricht threshold in 2009 should be looked upon less strictly by the EU, since it will be a common case for EU countries this year due to the recession.

Interest rates

Slovakia entered the Euro area on January 1, 2009 and along with the single currency Slovakia adopted also Eurozone interest rates. Effectively, the NBS followed the steps of the ECB already since mid-2008. The ECB cut its interest rates by February to 2.0% due to financial crisis and recession in the countries of Euro area. We expect the ECB to cut interest rates further in March, by 50bp to 1.50% and in April to 1.00-1.25% (depending on coming data). Money market rates declined along with the lower official rates; 3M Euribor ended the year 2008 slightly below 3% and is expected to decline further this year to 1.6% by December. The financial crisis also widened spreads on Slovak government bonds. In normal conditions, we see a 20-30bp yield differential over the Eurozone as reasonable after EMU entry due to differences in liquidity and the credit risk. But due to financial crisis, the convergence to these levels might be rather a medium-term story.

Contact list

Head of Research	Juraj Barta	+421 (2) 4862 4166
Research	Michal Mušák	+421 (2) 4862 4512
	Mária Valachyová	+421 (2) 4862 4185
Sales	Treasury Sales	+421 (2) 4862 6666