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Macroeconomic developments

5.2%
contraction
of the Slovak
economy

investment
down by
11.9%

around
52,000
jobs lost





Macroeconomic developments

Macroeconomic developments in 2020 include information about developments in the global economy and in Slovakia's underlying macroeconomic indicators during the year



External economic environment

1.1.1 Global economy struck by the pandemic crisis

Efforts to contain the spread of the coronavirus (COVID-19) pandemic by enforcing social distancing resulted in the economies being shut down in part of the first half of 2020. The economic sector worst affected was services, but the pandemic also caused serious supply chain disruptions and bottlenecks in several sectors, notably in the car industry. The downturn in economic activity mirrored the stringency of pandemic containment measures. The decline in activity was most pronounced between February and April 2020.

As the restrictions were gradually eased, the global economy began to pick up slowly. Its recovery was supported by significant fiscal stimuli and monetary policy loosening in the major economies. But with a resurgence in new infections in the last quarter of the year and the resulting tightening of containment measures, the recovery was curbed. According to the IMF's estimates, the global economy contracted by 3.5% in 2020. The pandemic's impact was uneven across countries. While the recovery in China was stronger than expected, the return to pre-pandemic levels proceeded only slowly in most other economies.

The pandemic crisis and related economic lockdowns also affected price developments. The economic downturn was reflected in lower demand for oil. In the midst of this situation, in March, Saudi Arabia initiated an oil price war that brought the price per barrel of oil down to USD 20. The average oil price for the whole of 2020 fell more than 30% year on year. Commod-

ity prices passed through to consumer energy prices, which contributed significantly to the decline in headline inflation. However, the weakening of economic activity and consumer demand also dampened inflation in other sectors, services in particular.

1.1.2 The adverse health situation had a major impact on the euro area economy

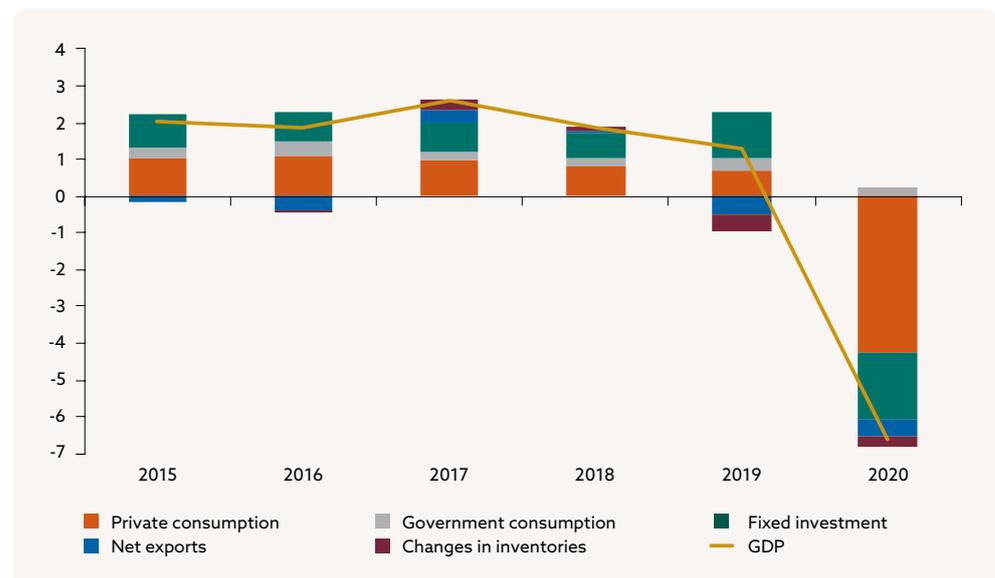
Pandemic containment measures included severe economic lockdowns, particularly in late March and early April. As a result, the euro area economy contracted by around 15% in the first half of the year. As the incidence of new infections dropped, the economy quickly regained momentum. In the latter part of the year, however, containment measures had to be tightened again and the economy again declined, albeit moderately.

The euro area's annual GDP decreased by 6.6% in 2020, after increasing slightly in the previous year (Chart 1). The largest contribution to that decline came from private consumption, which was hard hit by social distancing measures as well as by the deteriorating labour market situation and large rise in uncertainty. In an environment of worsening economic outlooks, investment demand also fell. Only government consumption had a positive impact on economic growth.



Chart 1:
Euro area GDP
and its components
(annual percentage
changes;
percentage point
contributions)

Source: Eurostat.



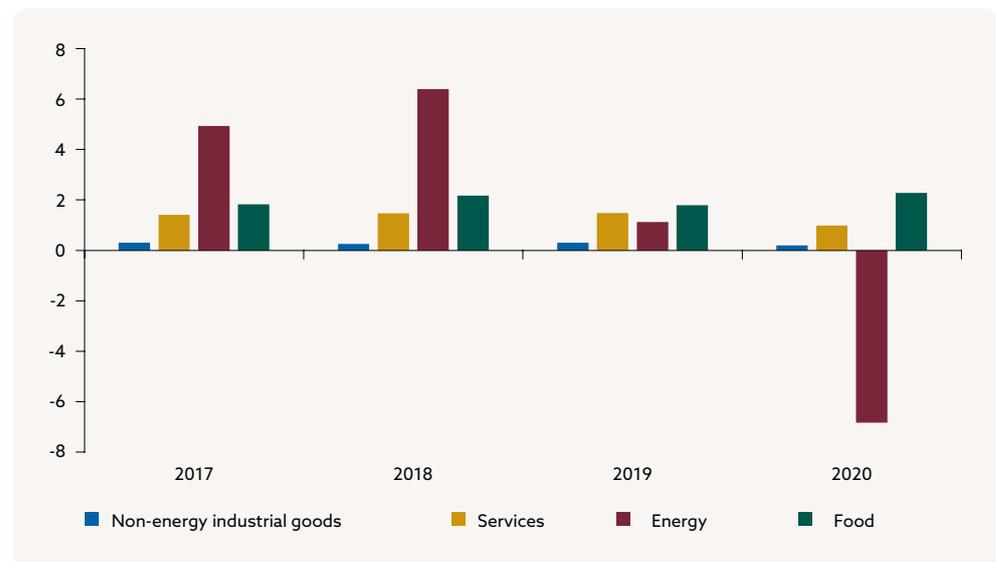
The adverse economic situation was reflected in the labour market, as employment in the euro area declined by 1.6% in 2020. Compared with the economy's contraction, however, that figure was relatively moderate and resulted from the support given to the labour market through various government job retention schemes.

The pandemic crisis also had a downward impact on euro area headline inflation in 2020, which fell by 1.0 percentage point, to 0.2%. This significant slowdown reflected the pass-through of falling oil prices to consumer energy prices (Chart 2). Inflation was further affected by the economic downturn and declining demand, as well as by the impact of pandemic-related shifts in consumer behaviour on price developments in the service industries hardest hit by the containment measures. Prices of transportation and trips decreased year on year, while inflation in the hotel and restaurant industry decelerated. By contrast, food inflation increased slightly. Core inflation (the headline rate excluding food and energy prices) slowed by 0.3 percentage point, to 0.7%.



Chart 2:
Components
of HICP inflation
(annual
percentage
changes)

Source: Eurostat.



1.2

Macroeconomic developments in Slovakia

Owing to the effect of the pandemic crisis and strict lockdown measures, Slovakia's economy contracted by 5.2% in 2020. All GDP components apart from net exports had a negative impact on growth.

Employment declined amid a recession-hit labour market. Its decline was most severe in the first half of the year and resulted in an increase in the number of unemployed. Jobs were lost mainly in the industry and services sectors. Government measures aimed at retaining jobs supported employment to a large extent and mitigated the decline in household income. Wages across the economy increased, though mainly because of index-linked wage rises in the public sector.

Annual HICP inflation decelerated to 2.0% in 2020, with the slowdown caused mainly by lower prices of energy and food.

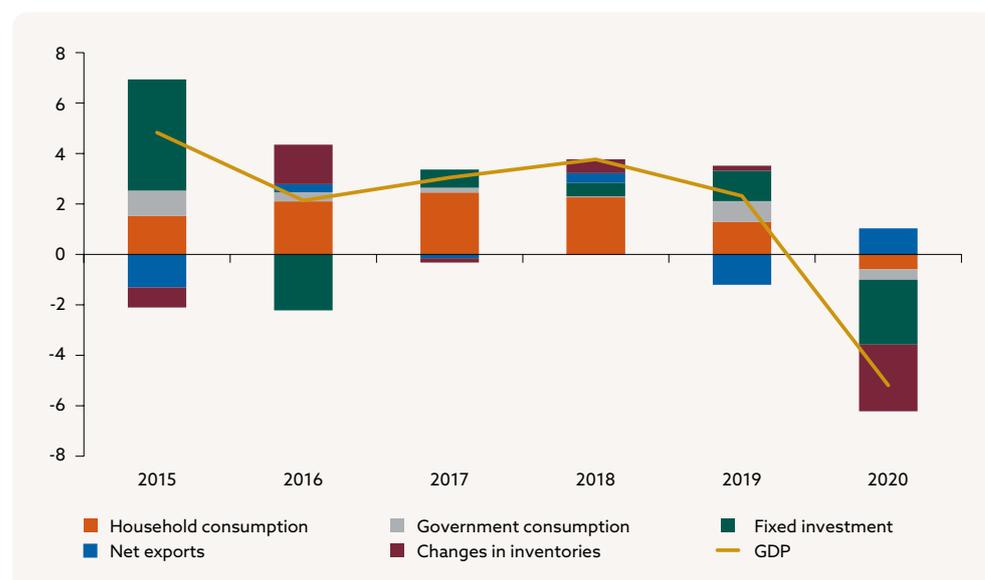
1.2.1 Real economy affected by pandemic measures

In Slovakia, like other countries, the economy was unexpectedly affected by the onset of the COVID-19 pandemic in early 2020. The containment measures adopted in response to the crisis resulted in economic activity contracting by 5.2% in 2020 (after increasing by 2.3% in 2019). The domestic side of the economy was worse affected. While households reined in their consumption only slightly, firms were to a considerable extent deferring their investment plans. Exports fell in 2020, but net trade nevertheless made a positive contribution to economic growth. This was because imports declined amid lower domestic demand and significant destocking (Chart 3).



Chart 3:
Real GDP and its
components
(annual percentage
changes;
percentage point
contributions)

Source: SO SR.



Business lockdowns and movement restrictions had an impact on household consumption, which fell by 1.1% in 2020. With pandemic containment measures in place, consumers were not able to spend their money as they might have wanted. The effect was most evident in revenues in those services hardest hit by the crisis. On the other hand, as remote working proliferated, spending on food and housing increased (Chart 4). The drop in household consumption stemmed partly from consumers' caution about the future. The various pandemic containment measures during the year were reflected in the labour market's deteriorating situation. The increase in unemployment and the halting of production during the pandemic's first wave caused a decline in labour income. Government measures, including a short-term work scheme ("kurzarbeit") and pandemic-related sickness allowance and

carer's allowance payments, mitigated the decline in household disposable income (Chart 5). The savings rate climbed in 2020, though not as much as savings rates in other European countries.



Chart 4:
Household
consumption
and its components
(constant prices;
annual percentage
changes;
percentage point
contributions)

Sources: SO SR,
and NBS calculations.

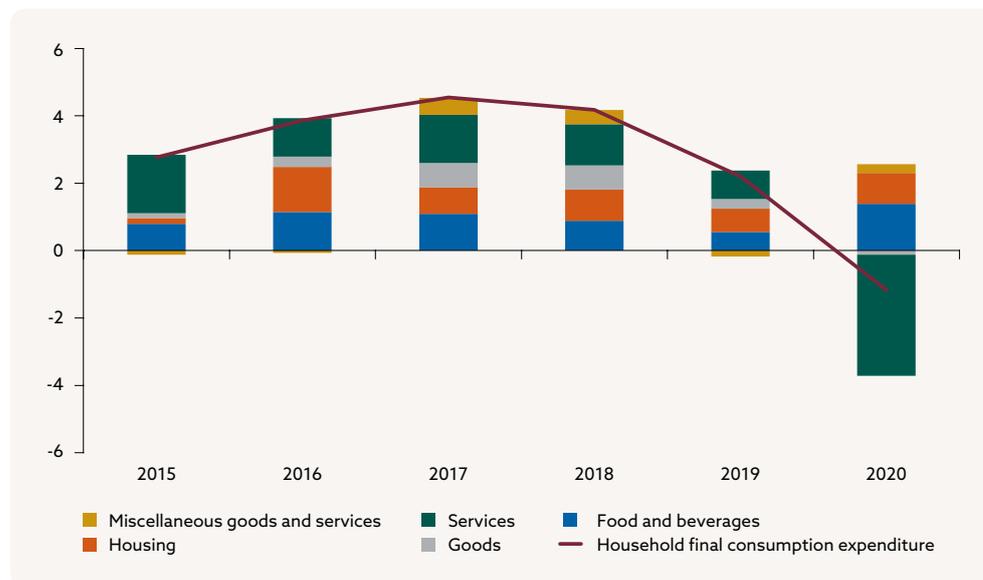
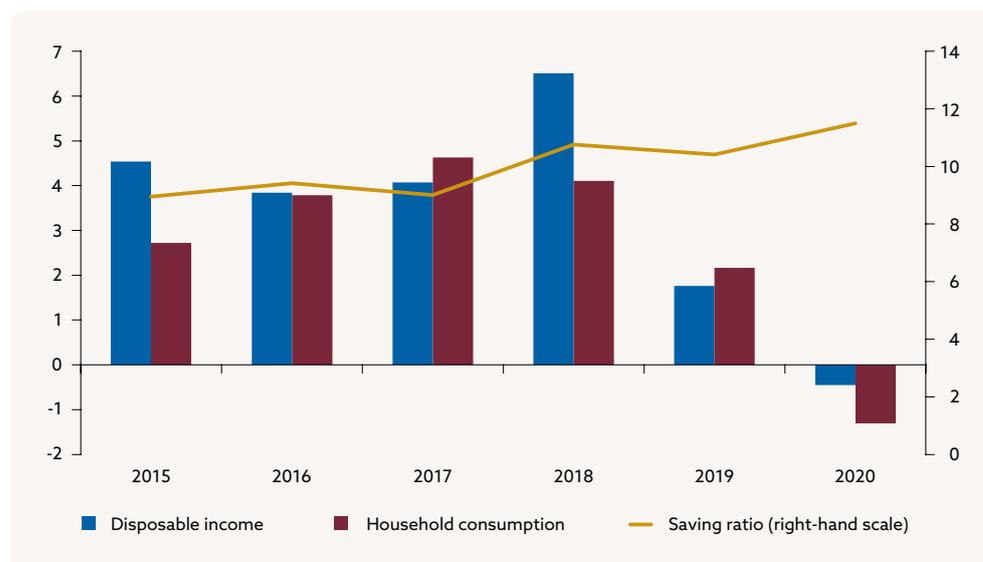


Chart 5:
Household
consumption
and disposable
income (constant
prices; annual per-
centage changes)

Sources: SO SR,
and NBS calculations.



Firms' investment activity in 2020 was greatly curtailed because of the pandemic, and gross fixed capital formation decreased by 11.9%. The halting of production and consequent drop in revenues diminished firms' liquidity. Seeking to improve their financial situation, firms cut costs and became more cautious about their investment plans in the light of concerns about future developments. Capital formation fell in all sectors of the economy, in particular however among financial and non-financial corporations. Looking at its breakdown by asset type, only investment in residential construction managed to maintain growth.

Slovakia's exports decreased in 2020 owing to lower foreign demand (Chart 6) and to the specific problems caused by the pandemic. During the first wave of the virus, the government enforced a hard lockdown, which for a certain time included shutting down production at industrial firms. At the same time, firms were having to deal with global supply chain disruptions and reduced competitiveness (Chart 7). The volume of exports during this period slumped by almost one-third. The subsequent easing of measures and gradual pick-up in production resulted in rapid recouping of losses, and therefore exports for the year as a whole fell, year on year, by a much more modest 7.4%.



Chart 6:
Exports and foreign demand (index: 2015 = 100; constant prices)

Sources: SO SR, and NBS calculations.

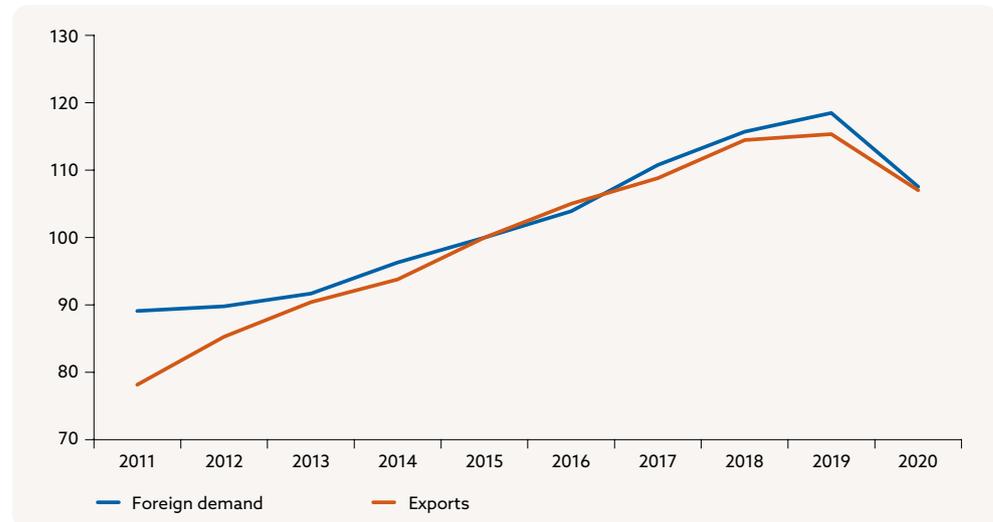
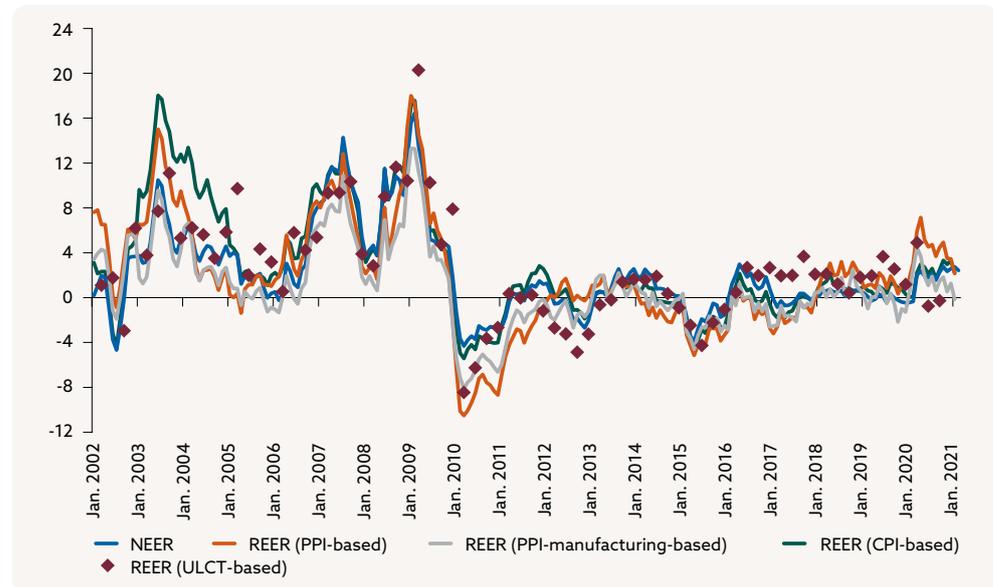


Chart 7:
NEER and REER indices (calculated with respect to 15 trading partners; annual percentage changes)

Source: NBS calculations.



Note: Appreciation and depreciation of the NEER and REER indices are denoted by positive figures and negative figures respectively.

The difficult situation in the domestic side of the economy, together with firms' caution in the face of uncertain future developments, had a significant downward impact on imports of goods and services. Both industrial firms and retail businesses were running down inventories of intermediate and

finished goods respectively. In the context of uncertainty about future demand (domestic and foreign), they were importing lower volume of goods and services throughout the year. The trade balance for the year showed a strong surplus, and net exports made the only positive contribution to economic growth.

As regards GDP calculated by the production approach, its decline in 2020 was due largely to decreases in value added in the trade sector and in accommodation and restaurant services. The industry sector also had negative impact, albeit confined mainly to the first wave of the pandemic. Because of the unfavourable economic situation, tax receipts were also lower.



Table 1:
GDP based on
the expenditure
approach (annual
percentage changes;
constant prices)

Source: SO SR.

	2019	2020				
	Q1-Q4	Q1	Q2	Q3	Q4	Q1-Q4
Gross domestic product	2.3	-3.6	-12.1	-2.4	-2.7	-5.2
Final consumption of households and non-profit institutions serving households	2.3	1.1	-4.1	1.1	-2.2	-1.3
Final consumption of general government	4.7	1.2	-10.4	-0.3	0.1	-2.3
Gross fixed capital formation	5.8	-7.5	-15.1	-8.2	-15.4	-11.9
Exports of goods and services	0.8	-5.6	-26.0	0.7	1.8	-7.4
Imports of goods and services	2.1	-2.3	-26.8	-6.0	0.6	-8.7

1.2.2 Labour market deterioration reflected a sharp decline in economic activity

Employment fell and the unemployment rate increased in 2020. Average wage growth decelerated, with the growth being largely accounted for by the public sector through increases in contractual wages in the public and civil services. Wages in the private sector increased slowly.



Table 2:
Labour
market
indicators

Sources: SO SR,
and NBS calculations.

	2019	2020				
	Q1-Q4	Q1	Q2	Q3	Q4	Q1-Q4
Nominal wages (index)	7.8	6.2	-1.2	4.2	5.8	3.8
Real wages (index)	5.0	3.3	-3.0	2.7	4.2	3.2
Nominal compensation per employee - ESA 2010 (index)	6.6	5.6	-3.7	2.2	3.8	1.9
Labour productivity - GDP per person (index; current prices)	3.8	-0.2	-8.0	2.2	1.7	-1.1
Labour productivity - GDP per person (index; constant prices)	1.3	-3.2	-9.8	0.1	-0.6	-3.4
Employment - ESA 2010 (index)	1.0	-0.5	-2.6	-2.5	-2.0	-1.9
Unemployment rate - LFS ¹⁾ (percentage)	5.8	6.0	6.6	7.2	7.0	6.7
Nominal unit labour costs (ULCs) ²⁾	5.3	9.1	6.7	2.1	4.5	5.5

Note: 1) Labour Force Survey. 2) Ratio of compensation per employee at current prices to labour productivity growth (ESA 2010) at constant prices.

Employment fell by 1.9% and roughly 52 thousand jobs were lost in 2020 (after employment rose by 1.0% in 2019). The decline would have been greater but for the timely introduction of government job retention schemes. By compensating employers for part of their wage costs, the government tempered the blow of revenue losses resulting from the pandemic crisis. Almost all sectors reported net job losses, and those contributing most to the overall decline in employment were industry, trade, and services (in particular accommodation and recreation services). The pandemic crisis did not affect employment in the public sector and the information and communication sector. The downtrend in the number of residents working abroad continued for a fourth successive year, with the number dropping by 6.7 thousand year on year. On the other hand, the number of foreigners working in Slovakia remained flat for 2020 as a whole and it was already recording a notable year-on-year decline in the latter part of the year.

The number of unemployed increased in 2020 after decreasing for the previous six years. According to the Labour Force Survey, the number of unemployed increased by 24 thousand. The unemployment rate rose by 0.9 percentage point year on year, to 6.7%.

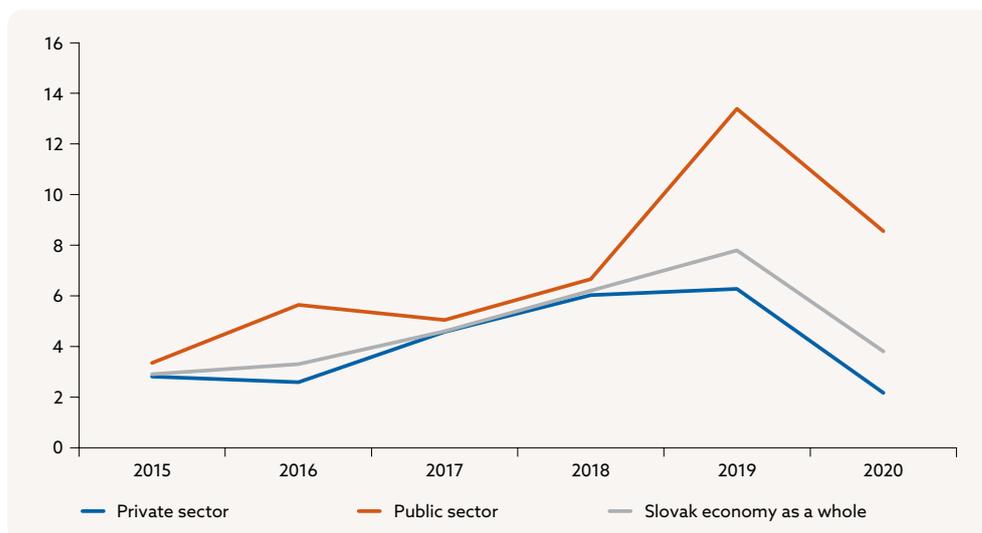
Average annual wage growth in 2020 stood at 3.8% (Chart 8), four percentage points below its level of the previous year. The main driver of wage growth was the public sector, specifically increases in contractual wages in the public and civil services. Private sector wage growth decelerated more sharply, while also being supported by government measures. Revenue losses and falling profitability were reflected in wage developments. In the private sector, there were notable declines in wages in accommodation and food services activities, the sectors that were most restricted for much of the year. At the same time, however, wages slowed in industry, which recovered very quickly from the initial shock of the crisis.

Owing to weak demand, labour market tightness was more moderate in 2020 than in the previous year and the upward pressure on wages weakened. With the decline in the economy being significantly greater than the decline in employment, nominal labour productivity decreased in 2020 and continued to lag behind wage growth.



Chart 8:
Average nominal wage (annual percentage changes)

Sources: SO SR, and NBS calculations.



1.2.3 Price developments were greatly affected by global factors

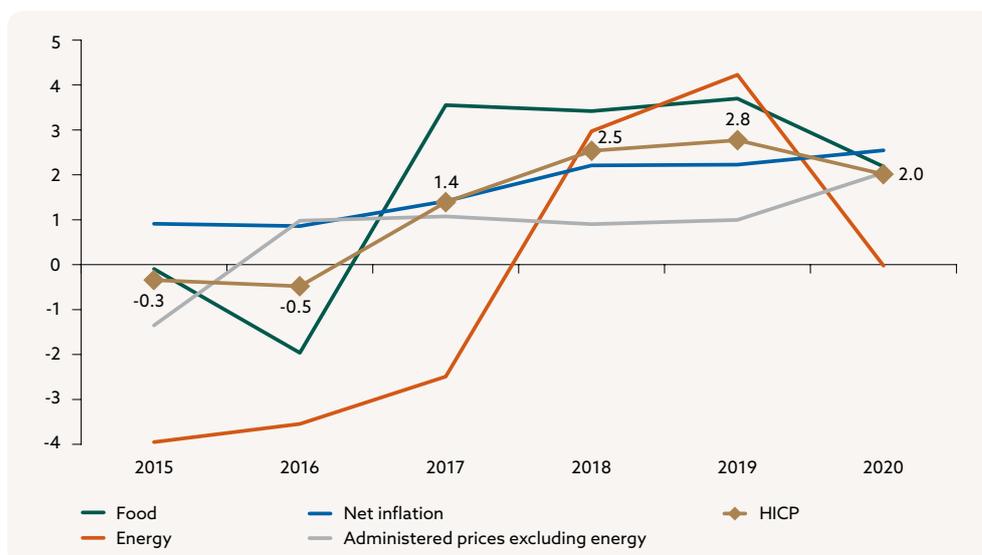
Slovakia's annual average HICP inflation slowed to 2.0% in 2020 (Chart 9). Compared with other euro area countries, Slovakia had one of the highest inflation rates.

Just after a sharp rise in negative economic expectations, oil prices plunged in March 2020. Because there was no significant lag between the two developments, the pass-through of lower oil prices to inflation was seen as early as April.



Chart 9:
HICP inflation and components (annual percentage changes)

Sources: SO SR, and NBS calculations.



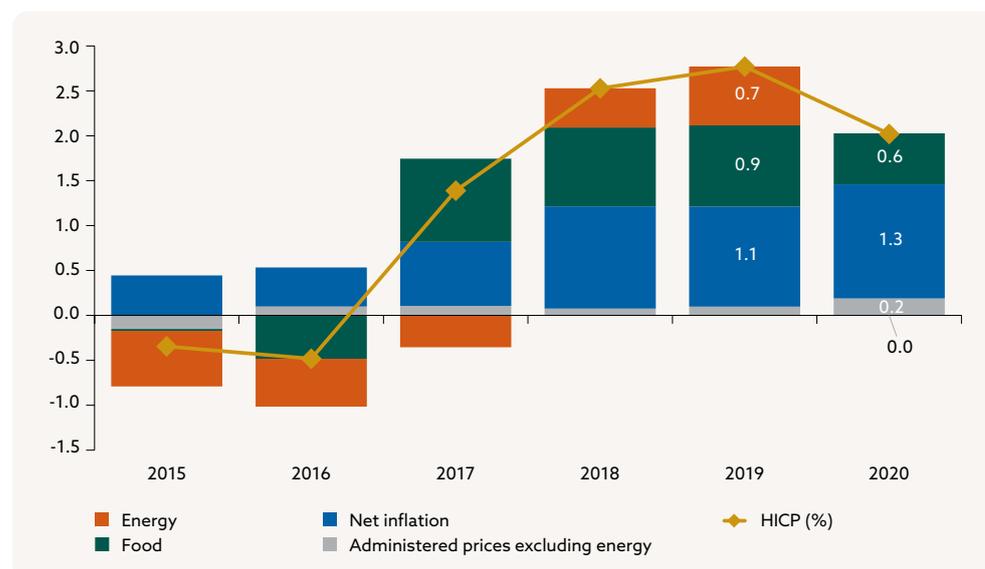
After the initial energy price shock, agricultural commodity prices also declined. The slightly lagged pass-through to consumer food prices began in June. Their level remained on a downtrend until the end of the year and their annual rate of increase decelerated, the trend being driven by prices of meat and unprocessed food. From when the pandemic appeared in Slovakia, the most significant inflationary developments were in prices of automotive fuel and food.

Net inflation remained elevated in 2020 (Chart 10). The economic lockdown and other pandemic-related restrictions caused a decline in domestic consumption. The greater difficulty in collecting price data and resulting estimations of prices may have had an impact on the calculation of inflation during the pandemic. Sellers of goods and providers of services struggled with revenue losses throughout the year, yet still had to cover their fixed costs. Hence there was a paradoxical situation in which prices remained relatively high amid weak consumer demand.



Chart 10:
HICP inflation
and components
(annual percentage
changes; percentage
point contributions)

Sources: SO SR,
and NBS calculations.



Compared with the previous year, administered energy prices increased more moderately. The prices were adjusted in January 2020, so the pandemic was not a dampening factor in their resetting. The lower increase was rather caused largely by a base effect in heat prices.

1.2.4 Reduced current account deficit

In Slovakia's balance of payments for 2020, the current account deficit moderated on the back of an improvement in the trade deficit (Chart 11). The slump in global trade in the first half of the year was reflected in Slovakia's foreign

trade, with both exports and imports declining. In the second half of the year, exports recovered more strongly than imports, resulting in a notably improved balance of foreign trade in goods.

Other components of the current account remained largely unchanged (Chart 11). The balance of services surplus was trimmed by the impact of the pandemic crisis, while there were slight deficit reductions in the primary and secondary income balances.

The financial account deficit increased slightly in 2020. The largest inflow, recorded in the other investment balance, was related to an increase in deposits in the central bank's accounts. The financial account developments were also affected by purchases of foreign debt securities by Slovak residents. Another factor was the outflow of debt capital resulting from the economic activity of firms under the balance of direct investment abroad.



Chart 11:
Current account
balance and trade
balance (EUR millions;
percentages)

Sources: SO SR,
and NBS calculations.

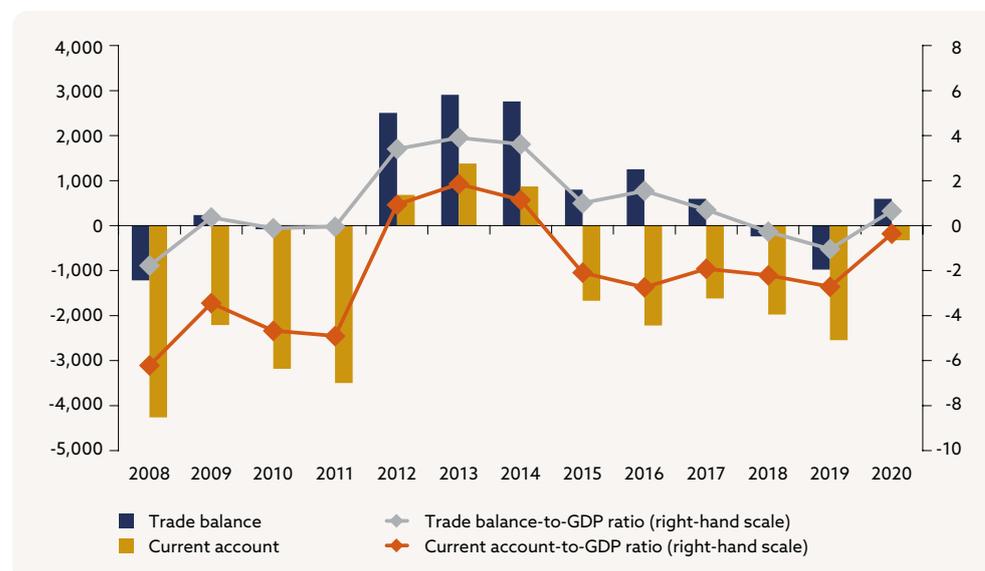


Table 3:
Current account
and capital account
balances (EUR
billions, unless
otherwise indicated)

Sources: SO SR,
and NBS calculations.

	2019	2020
Goods	-1.0	0.6
Exports	75.7	69.7
Imports	76.6	69.1
Services	1.2	1.1
Primary income balance	-1.9	-1.5
Secondary income balance	-0.8	-0.5
Current account	-2.5	-0.3
Current account-to-GDP ratio (percentage)	-2.7	-0.4
Capital account	0.7	1.1



Table 4:
Financial
account balance
(EUR billions)

Sources: SO SR,
and NBS calculations.

	2019	2020
Direct investment	2.1	1.9
Portfolio investment and financial derivatives	0.4	2.7
Other investment	0.9	4.8
Reserve assets	1.5	1.4
Financial account	1.1	1.2

Note: The figures for the financial account balances are shown in net terms (assets minus liabilities), with a positive value denoting a net outflow and a negative value denoting a net inflow.