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EUROSYSTÉM

Medium-term forecast

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1 Summary[1]

The Slovak economy grew in the third quarter by 0.9%, and, as in the previous quarter, the main driver of growth was domestic demand. This included strong investment demand, which benefited from the **accelerated absorption of EU funds, even beyond what had been expected**. Both private and public consumption expenditure also increased. Domestic demand therefore boosted employment, which increased by 0.4%.

The projection for annual GDP growth in 2015 is 3.3% (up by 0.1 percentage point from the previous forecast). In the light of the temporary growth-supporting impulse from EU funds, **public investment expenditure is expected to fall** next year, **acting as a negative base effect on economic growth.** External demand is expected to have a diminishing impact over the projection horizon, with its growth rate projected to fall by 0.1 percentage point each year. Owing to these two factors, **the forecasts for Slovakia's GDP growth in 2016 and 2017 have been revised down slightly, to 3.1% in 2016** (down by 0.3 p.p.) **and 3.2% in 2017** (0.1 p.p.), which means growth is now expected to accelerate marginally in 2017. The composition of GDP growth is expected to be balanced.

Labour market conditions should continue to improve. Employment growth in 2015 is projected to be 2.0%, with most of the new jobs resulting from increased domestic demand. Employment growth over the rest of the forecast period is expected to slow, owing to lower labour demand, while rising output should be covered by an increase in the number of hours worked. The **labour market outlook is moderately brighter in MTF-2015Q4 than in the previous forecast,** since the downward revision of the inflation projection implies a further increase in real wages.

The annual HICP inflation rate is expected to remain slightly negative this year (-0.3%), owing to a significant fall in energy and food prices. Import prices, too, should have a dampening effect. The current subdued inflation rates in services and in non-energy industrial goods prompted a downward revision of their projected level next year. **Consequently, the headline inflation forecast for 2016 has been revised down by 0.3 percentage point, to 0.7%. An upturn in commodity prices is expected in 2017, and this, together with increasing domestic demand pressures and an assumed acceleration in external prices, was the basis for revising down the HICP inflation forecast for 2017 to 1.7%** (by 0.2 percentage point).

The risks to the GDP growth outlook over the projection horizon are on the upside. **The main risk is the prospective establishment of a new car plant in Slovakia.** The risks to the inflation outlook over the forecast period are upward.

Table 1 GDP and inflation projections (excluding a prospective car plant investment)

	MTF-2015Q4			Difference vis-à-vis MTF-2015Q3		
	2015	2016	2017	2015	2016	2017
GDP	3.3	3.1	3.2	0.1	-0.3	-0.1
HICP	-0.3	0.7	1.7	0.0	-0.3	-0.2
Net inflation excluding automotive fuel	0.9	1.6	2.3	-0.1	-0.4	-0.2

Sources: SO SR and NBS.
Note: Net inflation excluding automotive fuel refers to the HICP inflation rate excluding food, energy and administered prices.

1 *This Medium-Term Forecast (MTF-2015Q4) was produced by NBS as part of the Eurosystem forecasting process. The output of this process is the "Eurosystem Staff Macroeconomic Projections for the Euro Area", which the ECB publishes twice a year (in June and December). The cut-off date for MTF-2015Q4 is therefore the same as that for the Eurosystem projections.*

2 Current developments in the external environment

Euro area growth in the third quarter in line with expectations

According to Eurostat's flash estimate, the euro area economy grew in the third quarter of 2015 by 0.3% quarter-on-quarter (after expanding by 0.4% in the second quarter). Among the larger national economies in the euro area, the highest growth rates were reported by Spain (0.8%), France (0.3%) and Germany (0.3%). By contrast, the Greek and Estonian economies both contracted in the third quarter, after expanding quite strongly in the previous quarter. Leading indicators are at present sending out mixed signals, but for now they still suggest that GDP will continue to grow moderately. The annual HICP inflation rate in October was 0.1% (after registering -0.1% in September and 0.1% in August). Energy price inflation became less negative, while both food price inflation and non-energy industrial goods inflation increased.

Slovak economy maintained strong growth[2]

Slovakia's economic growth in the third quarter was 0.9%, slightly exceeding expectations. Monthly figures suggest that the main driver of that growth was domestic demand, and that exports also made a positive contribution, albeit lower than expected. Within domestic demand there was a marked increase in investment, supported mainly by increased absorption of EU funds available from the 2007-2013 programming period. Another component, besides investment demand, that contributed positively to GDP growth was consumption, with retail sales pointing to continued private consumption growth and with public consumption increasing.

The labour market situation also improved in the third quarter. As firms generated new jobs, employment increased by 0.4%. In consequence, the unemployment rate fell to 11.5% and moved gradually towards the estimated natural rate of unemployment, also known as the non-accelerating inflation rate of unemployment (NAIRU). The rate of job creation is rapid, and vacancies may be difficult to fill in some sectors.

The annual rate of decline in prices moderated temporarily in the third quarter, owing to increases in prices of non-energy industrial goods and unprocessed food. On the other hand, the decrease in energy prices became even more pronounced following reductions in gas prices. October saw energy prices continue to fall amid a marked drop in automotive fuel prices, and there was also a drop in processed food prices. This trend was partially offset by an increase in unprocessed food prices.

2 *For further details, see the "Report on the Slovak Economy – December 2015".*

3 Technical assumptions of the forecast[3]

3.1 COMMODITIES AND THE EXCHANGE RATE

The exchange rate of the euro against the US dollar following the cut-off date for the previous forecast (MTF-2015Q3) was at or above the level projected in that forecast (USD 1.11 per euro). At the end of October and especially in early November, the euro's exchange rate began to depreciate in response to mounting expectations of US monetary policy tightening, as well as a possible reassessment of the ECB's accommodative monetary policy stance. As a result, the assumed exchange rate is weaker in this forecast than in the previous forecast, at USD 1.09 per euro.

The Brent crude oil price in US dollars was relatively stable from the beginning of September. However, an increase in global stocks at the beginning of November caused a significant drop in the oil price. Therefore, in comparison with the previous forecast, the assumed price of a barrel of Brent crude oil has been revised down slightly, to USD 53.8 in 2015, USD 52.2 in 2016 and USD 57.5 in 2017. Since the two forecasts differ more in their assumptions for the exchange rate than in their assumptions for the oil price, the oil price in euro for the next two years is slightly higher in MTF-2015Q4 than in the previous forecast.

3.2 EXTERNAL DEMAND

The recovery in euro area activity is expected to continue. The main driver of this growth should be domestic demand, supported by the ECB's accommodative monetary policy stance, some fiscal easing and low oil prices. The global demand outlook is also expected to improve gradually, coupled with rising export market shares reflecting the comparatively weak effective exchange rate of the euro. Private consumption expenditure is expected to remain the key driver of the recovery. Nominal disposable income should accelerate over the projection horizon, supported by increasing wage income against a background of robust employment growth and rising nominal compensation per employee growth, as well as by accelerating other personal income. Low financing costs and rising household net worth, both reinforced by the asset purchase programme (APP), should support private consumption. Residential investment in the euro area is expected to pick up, albeit from a very low level. Business investment is set to gain momentum gradually, supported by an improvement in financing conditions and by cyclical recovery. The fiscal stance, as measured by the change in the cyclically adjusted primary balance net of government support to the financial sector, is expected to provide a mildly positive contribution to demand over the projection period. Euro area foreign demand is expected to be dampened by weak growth in emerging markets and a low trade intensity of global growth, but is projected to recover gradually over the horizon. The negative output gap is expected to narrow, against the background of moderate potential output growth. Overall, euro area GDP is projected to increase by 0.9% in 2014, 1.5% in 2015, 1.7% in 2016 and 1.9% in 2017. Compared with the ECB's projections published in September, the growth forecast for this year is higher by 0.1 percentage point.[4]

Owing to an assumed global growth slowdown stemming from the weak performance of emerging economies, the projection for Slovakia's **external demand** growth is lower in this forecast than in the previous forecast. Its rate is assumed to be 2.9% in 2015, rising to 4.0% in 2016 and 4.8% in 2017.

3 *The technical assumptions of this Medium-Term Forecast are based on the "September 2015 Eurosystem Staff Macroeconomic Projections for the Euro Area", with a cut-off date of 12 November 2015.*

4 *According to the "December 2015 Eurosystem Staff Macroeconomic Projections for the Euro Area".*

4 Macroeconomic forecast for Slovakia

4.1 ECONOMIC GROWTH

Renewed export growth

Overall export growth in 2015 largely reflects January's exceptionally high export growth, which was attributable to the base effect of weak exports towards the end of 2014. Owing to the base effect of strong exports in 2015, export growth is expected to moderate temporarily in 2016. The projection period is expected to see export growth reflecting external demand for Slovak goods and services, and the acquisition of market shares.

Chart 1 Forecast for external demand and for Slovak exports of goods and services (annual percentage changes; constant prices)

Sources: SO SR, ECB and NBS calculations.

Investment supported mainly by EU funds

The strong growth in investment demand is expected to continue throughout this year. It is caused mainly by the absorption of the remaining EU funds available under the 2007-2013 programming period, which has been even more substantial than expected. Investment activity is projected to slow next year as investment in the public sector weakens. This would happen because the absorption of the remaining 2007-2013 EU funds is a one-off measure and calls under the new programming period will be made only gradually. The drop in this investment should be partly compensated by private investment, which is expected to be supported by low nominal interest rates and lending growth. Residential investment is also expected to grow, based on the number of flats and houses under construction and the number of building permits issued.

Consumer demand to accelerate moderately next year

Monthly figures from the third quarter indicate a slight acceleration in consumer consumption growth, which is expected to buoy growth in real wages and employment. According to leading indicators, sentiment has remained favourable in the last quarter of 2015 and should have a further upward impact on private consumption. Private consumption growth in 2016 is expected to be further boosted by the impact of one-off administrative factors[5] on disposable income growth (estimated to be around 0.4 percentage point).

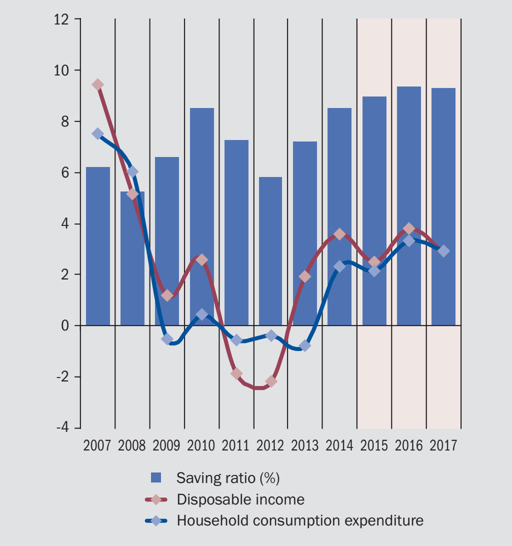
Table 2 Forecast for gross fixed capital formation (annual percentage changes; constant prices)

	2014	2015	2016	2017
Gross fixed capital formation in total	3.5	9.3	2.2	3.2
– private sector[1)]	0.2	5.2	7.7	4.6
– public sector[1)]	22.4	28.9	-19.1	-4.0

Source: SO SR.
1) NBS calculations.

5 An increase in the minimum wage, rebates on household gas bills, and reduction in VAT on selected food products.

Chart 2 Household income and consumption (annual percentage changes; constant prices) and the household saving ratio (%)



Sources: SO SR and NBS.

Chart 3 GDP growth and the output gap (%)

Sources: SO SR and NBS.

Public expenditure[6] growth to decelerate

The growth in government final consumption expenditure is expected to increase slightly in 2015, due largely to increased intermediate consumption stemming from the absorption of the remaining EU funds available under the 2007-2013 programming period. The final consumption growth should slow gradually over the rest of the projection period, owing to the assumed consolidation of public finances.

Economic growth to remain stable at just above 3% over the projection horizon

The conjunction of the euro area's accommodative monetary policy and low energy prices is expected to support growth in external demand for Slovak goods and services. This in turn will boost the export performance of the Slovak economy and, together with the domestic economy, contribute to a stable GDP rate of just above 3%. **GDP growth is therefore expected to be balanced, and its rate is projected to be 3.3% in 2015, 3.1% in 2016 and 3.2% in 2017.** Economic output is expected to be below potential over the production horizon, and the output gap is not expected to close until after the end of that period.

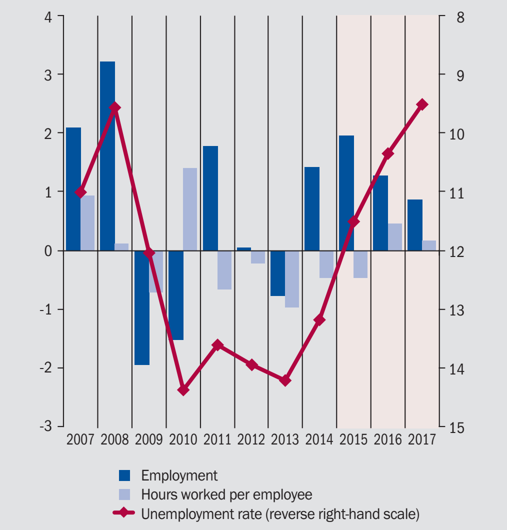
4.2 THE LABOUR MARKET

Strong labour market revival

New jobs are being generated thanks largely to high domestic demand based on the absorption of the remaining EU funds from the 2007-2013 programming period and on low inflation. This trend, together with managers' favourable expectations for the labour market in the period ahead, implies continuing job growth at the end of 2015. Employment growth is expected to ease slightly in subsequent years as it reflects to a greater extent the economy's balanced growth. Employment growth cannot be expected to be as strong as it was in 2015, when business sentiment improved markedly and laid the basis for recruitment. Another factor contributing to this year's job growth was the elevated absorption of EU funds. The number of hours worked is expected to increase over the projec-

6 *Data on general government final consumption, as well as on public investment, have been revised owing mainly to the inclusion of public hospitals in the general government sector. These changes increased final consumption and its components, as well as public investment, throughout the projection horizon.*

Chart 4 Employment, hours worked (annual percentage changes), and the unemployment rate (%)



Sources: SO SR and NBS.

tion horizon. As employment increases, so the unemployment rate is projected to fall gradually, down to 9.5%.

4.3 COSTS AND PRICE DEVELOPMENTS

Marginal costs in the consumer sector expected to rise

After falling in 2014, marginal costs in the consumer sector are expected to have picked up in 2015, owing mainly to increases in domestic value-added prices. These prices are reflecting cost-push pressures in the form of wage cost trends in the domestic economy.

Cost-push pressures are expected to accelerate in 2016 and 2017 amid the assumed acceleration in imported inflation, which may have begun to have an impact even from the beginning of the projection horizon. The composition of marginal cost growth should therefore be evenly split between domestic and imported prices. It is not envisaged, however, that these costs will pass through fully to consumer prices, but that they will have a moderate negative impact on profit margins in the given sector.

Prices to rise only slowly

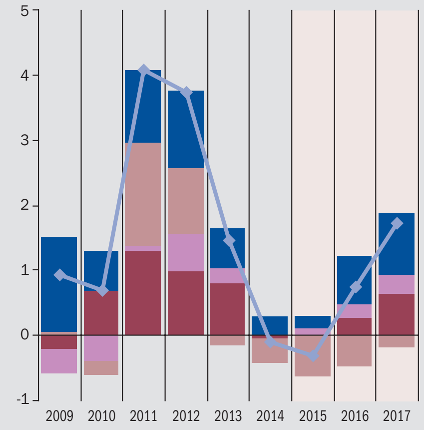
The average annual inflation rate is expected to remain negative in 2015 (at -0.3%). The fall in the overall price level has again been caused by declining energy prices. Moreover, the declining trend in energy prices should continue in the years to come. This assumption is based on expected developments in administered prices, where a lag between prices of future contracts and tariffs set by the Regulatory Office for Network Industries is assumed. On the basis of technical assumptions, food prices are expected to begin rising in 2016, although that increase will be moderated by reductions in VAT on selected food products. The assumed increase in import prices is expected to pass through to prices of non-energy industrial goods, while demand-pull pressures should begin to be reflected in services prices. The inflation rate is projected to accelerate to 0.7% in 2016 and 1.7% in 2017.

Table 3 Wages (annual percentage changes)

	2014	2015	2016	2017
Nominal labour productivity	1.0	0.9	3.1	4.6
Whole economy – nominal	4.1	2.7	3.6	3.8
Whole economy – real	4.2	3.0	2.9	2.0
Private sector – nominal	4.0	2.6	3.3	4.0
Private sector – real	4.1	2.9	2.5	2.2
Public administration, education and health care – nominal	4.6	3.4	5.0	3.2
Public administration, education and health care – real	4.7	3.7	4.3	1.3

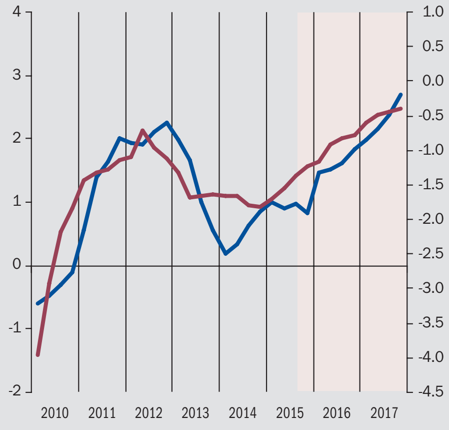
Sources: SO SR and NBS calculations.
Notes: Deflated by the CPI. The sector "Public administration, education and health care" corresponds to sections O, P and Q of the SK NACE Rev. 2 statistical classification of economic activities. Nominal average wage growth in the general government sector (ESA S.13) is assumed to be 3.1% in 2015, 5.4% in 2016 and 3.2% in 2017.

Chart 5 Composition of annual inflation (p.p.)



Sources: SO SR and NBS.

Chart 6 Net inflation excluding automotive fuel and the output gap (%)



Sources: SO SR and NBS calculations.

Table 4 Inflation components (annual percentage changes)

	Average 2004-2008 (pre-crisis period)	Average 2009-2014 (post-crisis period)	2014	2015	2016	2017
HICP	4.1	1.8	-0.1	-0.3	0.7	1.7
Food	3.6	2.5	-0.2	0.0	1.1	2.6
Non-energy industrial goods	0.2	0.1	0.0	0.4	0.7	1.1
Energy	8.3	2.0	-2.2	-3.9	-3.0	-1.1
Services	5.3	2.8	1.0	0.6	2.3	3.0
Net inflation excluding automotive fuel	1.8	0.9	0.5	0.9	1.6	2.3

Sources: SO SR and NBS calculations.

5 Fiscal outlook[7]

The changeover in programming periods for EU funds will dampen demand-side stimuli to the economy

Based on the assumed macroeconomic trends (increasing employment, consumption and inflation) and current developments in public finances (favourable collection of taxes and low interest costs), and taking into account fiscal policy objectives (set out in the General Government Budget), **the general government deficit is expected to ease gradually over the projection horizon**, from 2.8% of GDP in 2015 **to 2.5% of GDP in 2016 and 1.8% of GDP in 2017**. The expected reduction of the deficit is coupled with an increase in budget revenue stemming from continued economic growth and from the moderating impact of adopted measures on expenditure growth. The overall government revenue and expenditure-to-GDP ratio is projected to peak in 2015 and then fall gradually over the rest of the projection period. **The impact on demand of the fiscal stance excluding EU funds is expected to be almost neutral in 2016** and restrictive in 2017 (at 0.4% of GDP). Even more important for the macroeconomic forecast is the outlook for the impact of the fiscal stance after taking into account relations with the EU budget (including EU funds earmarked for the private sector). Since the remaining EU funds from the 2007-2013 programming period are now being absorbed, the forecast assumes that the impact of public finances including EU funds on the economy will be restrictive, by 2% of GDP next year.

In comparison with the General Government Budget (GGB), the fiscal deficit forecast is higher by 0.6% of GDP in 2016 and by 1.4% of GDP in 2017. This fiscal gap is explained by the fact that the GGB does not specify deficit reduction measures, while the likelihood of meeting the stated objectives for substantial reductions in intermediate consumption and capital expenditure appears to be rather low[8].

Government revenue is dominated by the absorption of EU funds.

The general government revenue-to-GDP ratio is expected to increase, year-on-year, in 2015 by 2 percentage points and then to fall gradually in subsequent years (by 1.8 percentage point in 2016 and 0.8 percentage point in 2017).

Of particular significance in 2015 is the annual increase in capital expenditure (up by 1.1 percentage point)[9]. The tax revenue assesment takes into account legislative measures adopted by the government[10], as well as favourable macroeconomic developments. Labour market trends, including the gradual growth already observed in employment and wages, is expected

Table 5 Fiscal assumptions for the NBS forecast and GGB for 2016–2018 (% of GDP)

	2014	2015	2016	2017
General government budget balance	-2.8	-2.8	-2.5	-1.8
General government debt	53.5	52.6	52.6	52.4
Total revenue	38.9	40.8	39.3	38.5
Total expenditure	41.6	43.6	41.8	40.3
Target deficit in the GGB for 2016-2018	-	-2.7 1)	-1.9	-0.4
Fiscal gap (NBS forecast - GGB target deficit for 2016-2018)	-	-0.1	-0.6	-1.4
Fiscal stimulus (-denotes expansion) 2)	-0.3	-0.3	-0.1	0.4
Fiscal stimulus including impact of relations with the EU (- denotes expansion) 3)	-0.3	-2.1	2.0	0.4

Sources: MF SR and NBS calculations (ECB methodology).
1) In the GGB for 2016–2018, the figure for 2015 is the expected deficit.
2) Change in the cyclically-adjusted primary balance.
3) After applying an impact coefficient on the economy (0.66), the demand would be equal to -1.4% of the GDP in 2015, +1.3% in 2016, and 0.2% in 2017.

7 A basic analysis for the medium-term forecast. The Fiscal outlook will be published as part of the Medium-term Forecast on a quarterly basis. The fiscal outlook is similarly published as part of the Eurosystem Staff Macroeconomic Projections for the Euro Area.
8 For a more detailed account of the risks to the budget projections, see the "Analysis of the General Government Budget for 2016–2018".
9 This reflects an acceleration in the absorption of EU funds available under the 2007-2013 programming period, as well as the payment of an instalment of repayable financial assistance provided to the company Cargo.
10 In particular, changes in corporate tax depreciation, the introduction of cash registers and capitalisation limits for closely linked firms, tax advantages for science and research, the introduction of a deductible item for health contributions, amendments to the laws on VAT and on tobacco excise duties, the impact of the 'opening' of the second (fully-funded) pension system pillar, and the increase in rates for the second pillar.

to boost revenues from direct taxes and from social security and health contributions, while rising domestic demand should have an upward impact on indirect tax revenue[11]. By contrast, the introduction of a 'contribution-deductible' item in 2015, albeit with a limited impact in the current year, is expected to have a dampening impact on contribution revenue growth. In 2016, overall revenue is expected to reflect to a large extent the slower onset of the absorption of EU funds under the 2014-2020 programming period, while tax revenue growth should also be depressed by the reduction of the VAT rate on basic foodstuffs (to 10%). The full impact of the new contribution-deductible item is expected to be seen in 2016, which in turn will lower the amount of health contributions. The forecast for 2017 assumes the loss of both revenue from the special levy on businesses in regulated industries and, temporarily, revenue from the special levy on financial institutions.

Government consumption expenditure is benefiting from low inflation and an accommodative monetary policy stance

The general government expenditure-to-GDP ratio is expected to increase in 2015 by 2 percentage points year-on-year. This increase is expected to reflect mainly the assumed trend in the absorption of EU funds and the related upward impact of co-financing on government investment and intermediate consumption. Besides these factors, financial corrections to EU funds are also assumed[12].

Public expenditure is expected to fall year-on-year in 2016 and 2017 by, respectively, 1.8 percentage point and 1.4 percentage point, with this trend reflecting the lower absorption of EU funds in 2016 and a moderate increase in government consumption expenditure in 2017, the year after the general election. Favourable conditions in financial markets, reflecting the current monetary policy stance and low interest rates, are likewise expected to have a gradual downward impact on debt costs. On the other hand, the fall in expenditure in 2016 is expected to be partially moderated by increased wage tariffs for public sector employees and by increasing wages of nurses and other health-care workers, as well as by government measures (with negligible impact).

The social expenditure-to-GDP ratio[13] is projected to increase year-on-year throughout the forecast period, by 0.1 percentage point in 2015, 0.2 percentage point in 2016 and 0.6 percentage point in 2017. The increase in social expenditure stems largely from low inflation, implying a lowered amount of funds for index-linked adjustment to social benefits. Another positive factor should be the continuing fall in unemployment and related moderation in social inclusion expenditure.

The overall risks to the deficit outlook over the projection horizon are balanced[14].

Pace of debt reduction to flatten after extensive use of liquidity

The general government debt is expected to fall to 52.6% of GDP in 2015[15] and remain at that level in 2016, before falling to 52.4% of GDP in 2017.

11 Macroeconomic developments are projected to be more favourable than assumed in the draft budget, with the positive impact on tax and contribution revenue projected to be €199 million.

12 The corrections to EU funds are assumed to amount to 0.4% of GDP. This relates to projects that are not expected to be refunded from the EU under the 2007-2013 programming period because they involved infringements of EU funding rules.

13 Social benefits include old-age pensions, sickness benefits, accident benefits, unemployment benefits, and social inclusion expenditure (emergency benefits, family benefits, and other benefits for individuals).

14 The increased absorption of EU funds in 2015 is expected to increase the need for domestic co-financing, which may have a negative impact on the general government balance. Another downside risk is higher than expected financial corrections to EU funds. The negative risks may be offset by higher than expected VAT revenues, stemming from current trends, as well as by the upside risks to the GDP outlook. Positive risks to the deficit outlook in 2016 and 2017 include further fiscal consolidation measures following the 2016 general election and higher than expected VAT revenues. There remains the downside side risk of higher than projected financial corrections to EU funds related to the 2007-2013 programming period. Another negative risk to the outlook is the impact of the third social package announced by the government. Further risks include the amount of government expenditure related to direct support and land purchase for the prospective Jaguar Land Rover car plant investment, and to preparations for the D4/R7 PPP project. However, the additional consolidation measures that the government will have to adopt in order to meet fiscal targets under the Stability and Growth Pact requirements may further reduce the demand-side stimulus to the economy.

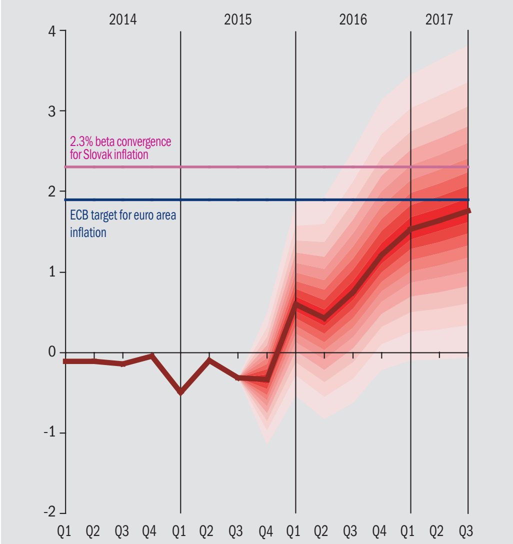
15 A key factor in debt reduction in 2015 was the use of own liquid financial assets to refinance the government's cash deficit (a reserve supplemented with revenues from the privatisation of Slovak Telekom and the opening of the second, fully-funded pension system pillar) and the fall in liabilities under the European Financial Stability Facility (after partial repayment of Greece's borrowings).

6 Risks to the forecast

The risks to the outlook for the real economy over the projection horizon are on the upside. The most significant risk is a prospective new car plant in Slovakia; in particular construction and technological impulses are expected to have an impact over the projection horizon. The car plant, once operating, is not expected to have a significant upward impact on export performance and the domestic economy until after the end of the projection horizon. A downside risk is that external demand will be lower than expected.

The risks to this forecast's inflation projections are on the upside, and include in particular higher than expected oil prices.

Chart 7 HICP inflation forecast (%)



Sources: SO SR and NBS.

Table 6 Risks to the forecast

	2015	2016	2017
GDP	Balanced	↑ Investment (Jaguar Land Rover)	↑ Investment (Jaguar Land Rover)
Inflation	Balanced	↑ Oil price	↑ Oil price

Source: NBS.

Box 1

POTENTIAL IMPACT OF THE EMISSIONS SCANDAL ON THE SLOVAK ECONOMY

The Volkswagen emissions scandal could constitute a negative risk to the outlook for the Slovak economy. Of all the countries in the German carmaker's supply chain, Slovakia is the most exposed to fluctuations in the car industry. This is because of the share of carmakers in the country's overall value added. Volkswagen Slovakia (VS) alone accounts for between 1% and 2% of that value added and, together with its suppliers, for between 2.5% and 3%. A 10% drop in VS's production would be equivalent to the loss of VS's entire exports to the United States, not just the selected brands that have been banned in the US since 2015. A fall in direct US demand for Slovak cars is itself unlikely to cause production to fall by as much as 10%, providing that Volkswagen's efforts to limit the damage to its image have at least some success. Taking into account, however, the drop in Slovak intermediate products destined for the US market via Germany, a decline of 10% may be realistic. Indeed, taking into account the negative impact on global demand for Volkswagen products and the bans imposed by several countries on some of them, a 10% drop in production may be an underestimation.

In the event of VS's production falling by 10%, the direct negative impact on Slovakia's GDP growth is estimated at 0.1-0.12 percentage point or, after full pass-through of the repercussion to VS's suppliers, at 0.25-0.3 percentage point. These effects do not include redundancies resulting from the fall in production and the negative impact of such redundancies on domestic consumption.

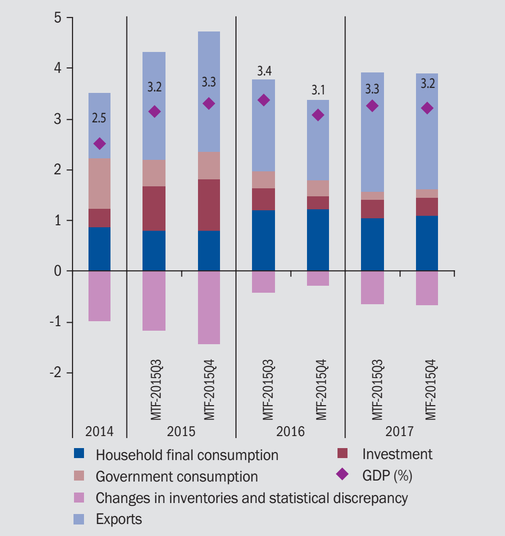
The repercussions of the scandal in Slovakia may be mitigated by the fact that VS has one of the most modern plants in the Volkswagen Group and therefore has the flexibility to shift production to non-diesel cars. In addition, the parent company appears likely to go ahead with its previously announced investments in Slovakia. There may also be an increased incentive to invest in research and development, thereby raising value added in this sector. The fall in Volkswagen's market share may imply the acquisition of market shares by other carmakers in Slovakia (especially of Asian origin), and in this way the country may be able to compensate for some of VS's lost output.

7 Comparison with the previous forecast

Fall in economic growth due to deterioration in global growth outlooks

Compared with the previous forecast (MTF-2015Q3), the projections for global GDP growth in 2016 and 2017 have been revised down in this forecast by a cumulative 0.9 percentage point. External demand will grow, but less than projected in the previous forecast. Export growth will therefore be lower, with negative repercussions for the domestic economy, too. As regards the domestic economy, the impact of investment demand (EU funds) in 2015 is more positive in this forecast than in MTF-2015Q3. However, government investment is expected to have a slightly negative base effect on GDP growth in 2016.

Chart 8 Composition of GDP growth[1] (annual percentage changes; contributions in p.p.)

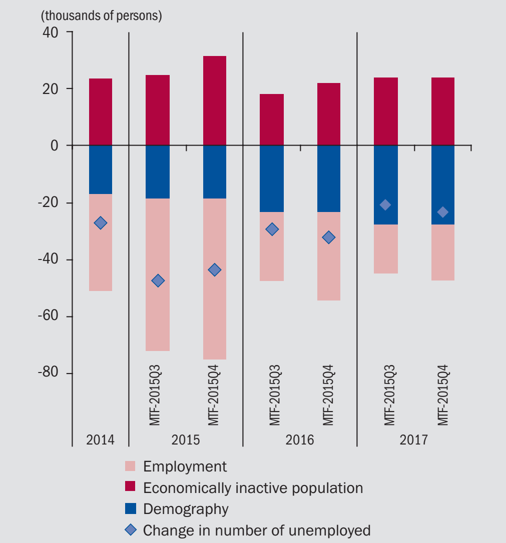


Sources: SO SR and NBS.
Note: The item "Changes in inventories and statistical discrepancy" includes uncategorised imports that remained after the calculation of import intensity.
1) The composition of GDP growth is calculated as the contributions of components to GDP growth after deducting their import intensity. In this case the calculation uses the constant import intensity of the different GDP components (household final consumption – 30%, public consumption – 7%, investment – 50%, and exports – 62.5 %). Remaining imports were included under changes in inventories and the statistical discrepancy.

Labour market situation improving moderately

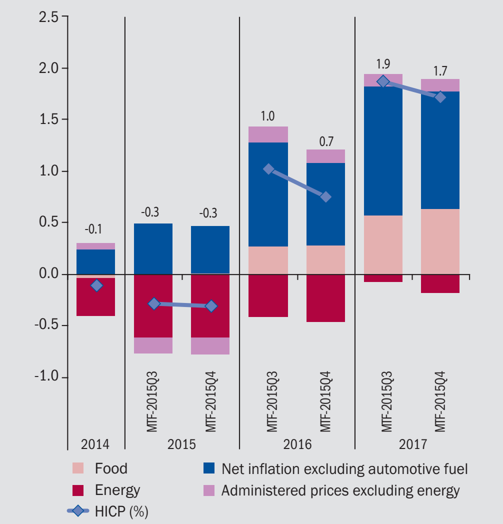
Despite the slight downward revision of economic growth, labour market conditions are improving. An improvement in employers' expectations in the last quarter, together with a drop in the unemployment rate in October, has prompted a slight upward revision of the employment growth forecast. Since the economically-active population has risen slightly there is no significant downward revision of the unemployment rate forecast. The higher number of people reclassified from economically inactive to economically active means that the unemployment rate for this year is not expected to fall by as much as projected in the previous forecast. As for income, the real compensation forecast has been revised slightly up over the projection horizon in response to lower inflation, while downward adjustments have been made to its historical time series.

Chart 9 Comparison of labour market indicators (contributions to unemployment)



Sources: SO SR and NBS.

Chart 10 Comparison of inflation components (annual percentage changes; contributions in p.p.)



Sources: SO SR and NBS.

Inflation forecast over the projection period revised down again

The inflation forecast over the projection horizon has been revised down from the previous forecast. This partly reflects technical assumptions, including a downward revision to the oil price forecast for next year. Due to a time lag, this revision affects energy prices in 2017, too. The downward adjustment to the inflation forecast for 2016 also stems from the current subdued prices of services and non-energy industrial goods.

Table 7 Medium-Term Forecast (MTF-2015Q4) for key macroeconomic indicators								
Indicator	Unit	Actual	MTF-2015Q4			Difference versus MTF-2015Q3		
		2014	2015	2016	2017	2015	2016	2017
Prices								
HICP inflation	annual percentage changes	-0.1	-0.3	0.7	1.7	0.0	-0.3	-0.2
CPI inflation	annual percentage changes	-0.1	-0.3	0.7	1.8	-0.1	-0.4	-0.2
GDP deflator	annual percentage changes	-0.2	-0.2	1.3	2.3	-0.1	-0.2	0.1
Economic activity								
Gross domestic product	annual percentage changes, constant prices	2.5	3.3	3.1	3.2	0.1	-0.3	-0.1
Final consumption of households	annual percentage changes, constant prices	2.3	2.2	3.3	2.9	0.0	0.1	0.1
Final consumption of general government	annual percentage changes, constant prices	5.9	3.3	1.8	0.9	0.2	-0.2	-0.1
Gross fixed capital formation	annual percentage changes, constant prices	3.5	9.3	2.2	3.2	1.2	-1.8	-0.1
Exports of goods and services	annual percentage changes, constant prices	3.6	6.7	4.3	6.1	0.8	-0.6	-0.2
Imports of goods and services	annual percentage changes, constant prices	4.3	8.1	4.1	5.7	1.0	-0.8	-0.1
Net exports	EUR millions at constant prices	4,733	4,111	4,409	5,004	-513	-469	-540
Output gap	% of potential output	-1.7	-1.0	-0.8	-0.5	0.2	-0.1	-0.1
Gross domestic product	EUR millions at current prices	75,560	77,880	81,324	85,839	339	-23	-27
Labour market								
Employment	thousands of persons, ESA 2010	2,223	2,267	2,296	2,316	0.0	1.7	4.3
Employment	annual percentage changes, ESA 2010	1.4	2.0	1.3	0.9	0.0	0.1	0.1
Number of unemployed	thousands of persons [1]	359	315	283	260	3.8	0.9	-1.6
Unemployment rate	%	13.2	11.5	10.4	9.5	0.10	0.0	-0.1
Unemployment gap [2]	p. p.	2.1	1.2	0.6	0.2	0.1	0.1	0.0
Labour productivity [3]	annual percentage changes	1.1	1.3	1.8	2.3	0.1	-0.3	-0.2
Nominal productivity [4]	annual percentage changes	1.0	0.9	3.1	4.6	-0.1	-0.5	-0.2
Nominal compensation per employee	annual percentage changes, ESA 2010	1.8	2.1	3.7	3.8	0.0	0.1	-0.1
Nominal wages [5]	annual percentage changes	4.1	2.7	3.6	3.8	0.0	0.1	-0.1
Real wages [6]	annual percentage changes	4.2	3.0	2.9	2.0	0.0	0.4	0.1
Households								
Disposable income	constant prices	3.6	2.5	3.8	2.9	0.1	0.3	0.2
Saving ratio	% of disposable income	8.5	8.9	9.4	9.3	-0.2	0.0	0.0
General government sector (S.13)								
General government balance [7]	% of GDP	-2.8	-2.8	-2.5	-1.8	-	-	-
General debt	% of GDP	53.5	52.6	52.6	52.4	-	-	-
Total revenue	% of GDP	38.9	40.8	39.3	38.5	-	-	-
Total expenditure	% of GDP	41.6	43.6	41.8	40.3	-	-	-
Balance of payments								
Goods balance	% of GDP	3.8	2.3	1.9	1.9	-0.9	-1.1	-1.2
Current account	% of GDP	0.1	-0.7	-1.8	-1.6	-0.7	-1.3	-1.4

Table 7 Medium-Term Forecast (MTF-2015Q4) for key macroeconomic indicators

Indicator	Unit	Actual	MTF-2015Q4			Difference versus MTF-2015Q3		
		2014	2015	2016	2017	2015	2016	2017
External environment and technical assumptions								
External demand growth for Slovakia	annual percentage changes	4.6	2.9	4.0	4.8	-0.2	-0.3	-0.4
Exchange rate (EUR/USD) [8) 9)]	level	1.33	1.11	1.09	1.09	-0.3	-2.5	-2.5
Oil price in USD [8) 9)]	level	98.9	53.8	52.2	57.5	-0.7	-1.7	-0.3
Oil price in USD	annual percentage changes	-9.1	-45.7	-2.9	10.1	-0.4	-1.1	1.5
Oil price in EUR	annual percentage changes	-9.2	-35.0	-0.7	10.1	-0.2	1.2	1.5
Non-energy commodity prices in USD[9)]	annual percentage changes	-8.6	-18.7	-5.2	4.1	1.0	-0.7	-0.4
EURIBOR 3M [9)]	% p. a.	0.2	0.0	-0.2	-0.1	0.0	-0.2	-0.2
10-Y Slovak government bond yields	%	2.1	0.9	0.9	1.2	0.1	0.3	0.3

Sources: NBS, ECB and SO SR.
1) *Labour Force Survey.*
2) *Difference between the unemployment rate and NAIRU (non-accelerating inflation rate of unemployment). A positive value indicates that the unemployment rate is higher than the NAIRU.*
3) *GDP at constant prices / employment – ESA 2010.*
4) *Nominal GDP divided by persons in employment (according to SO SR quarterly statistical reporting).*
5) *Average monthly wages (according to SO SR statistical reporting).*
6) *Wages according to SO SR statistical reporting, deflated by CPI inflation.*
7) *B9n: Net lending (+) / borrowing (-)*
8) *Changes vis-à-vis the previous forecast (in per cent).*
9) *The technical assumptions of this Medium-Term Forecast are based on the "December 2015 Eurosystem Staff Macroeconomic Projections for the Euro Area", with a cut-off date of 12 November 2015.*

Time series of selected macroeconomic indicators can be found on the NBS website at
http://www.nbs.sk/_img/Documents/_Publikacie/PREDIK/2015/protected/P4Q-2015.xls