



NÁRODNÁ BANKA SLOVENSKA
EUROSYSTEM



REPORT ON THE SLOVAK ECONOMY

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ABBREVIATIONS

CPI	Consumer Price Index
EA	euro area
ECB	European Central Bank
EC	European Commission
EIA	Energy Information Administration
EMU	Economic and Monetary Union
EONIA	euro overnight index average
ESA 95	European System of National Accounts 1995
EU	European Union
Eurostat	Statistical Office of the European Communities
FDI	foreign direct investment
Fed	Federal Reserve System
EMU	Economic and Monetary Union
EURIBOR	euro interbank offered rate
FNM	Fond národného majetku – National Property Fund
GDP	gross domestic product
GNDI	gross national disposable income
GNI	gross national income
HICP	Harmonised Index of Consumer Prices
IMF	International Monetary Fund
IPI	industrial production index
IRF	initial rate fixation
MFI	monetary financial institutions
MF SR	Ministry of Finance of the Slovak Republic
MMF	money market fund
NARKS	National Association of Real Estate Offices of Slovakia
NBS	Národná banka Slovenska
NEER	nominal effective exchange rate
NPISHs	Non-profit Institutions serving households
OIF	open-end investment fund
p.a.	per annum
p.p.	percentage points
qoq	quarter-on-quarter
PPI	Producer Price Index
REER	real effective exchange rate
SASS	Slovenská asociácia správcovských spoločností – Slovak Association of Asset Management Companies
SO SR	Statistical Office of the Slovak Republic
SR	Slovenská republika – Slovak Republic
ULC	unit labour costs
VAT	value-added tax
yoy	year-on-year

Symbols used in the tables

- . – Data are not yet available.
- – Data do not exist / data are not applicable.
- (p) – Preliminary data



1 SUMMARY

The Slovak economy continued to grow in the first quarter of 2016, by 0.8% quarter-on-quarter (compared with 1.0% in the previous quarter). The slowdown in the rate of economic growth was due to slower growth in investment following the end of the absorption of EU funds. Nonetheless, investment, combined with consumption, remained the main driver of economic growth.

Despite the moderate slowdown in economic activity, the favourable trend in the labour market continued in the quarter under review. Employment continued to grow by 2.2% year-on-year, compared with 2.0% in the last quarter of 2015. The number of people employed increased in

the public sector in particular, while the private sector recorded a smaller increase in this area. Unemployment fell significantly, owing to an increase in the number of people involved in labour activation schemes and an increase in the number of Slovak residents working abroad. The annual rate of wage growth slowed. Wages in the private sector grew at a slower pace, while those in the public sector accelerated.

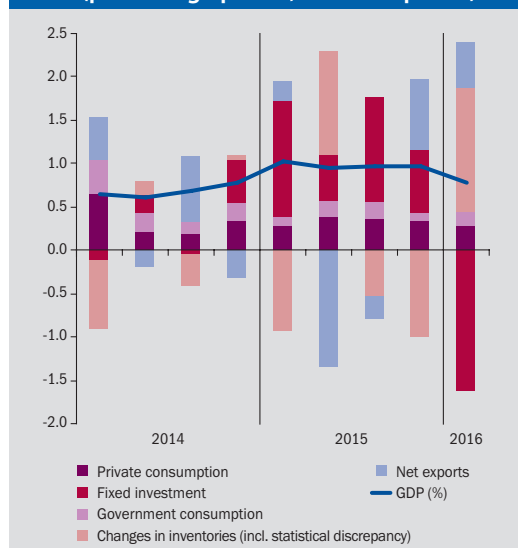
Price levels continued to fall in the first quarter (by 0.5% year-on-year), mainly as a result of a further fall in energy prices accompanied by a deepening decline in processed food prices. The rise in services prices accelerated in year-on-year terms.

2 GROSS DOMESTIC PRODUCT

The Slovak economy grew in the first quarter of this year by 0.8% quarter-on-quarter. Although its annual growth rate slowed from 4.3% at the end of last year to 3.4% (non-seasonally adjusted data), the Slovak economy is still one of the most rapidly growing economies in the European Union (it ranks sixth).

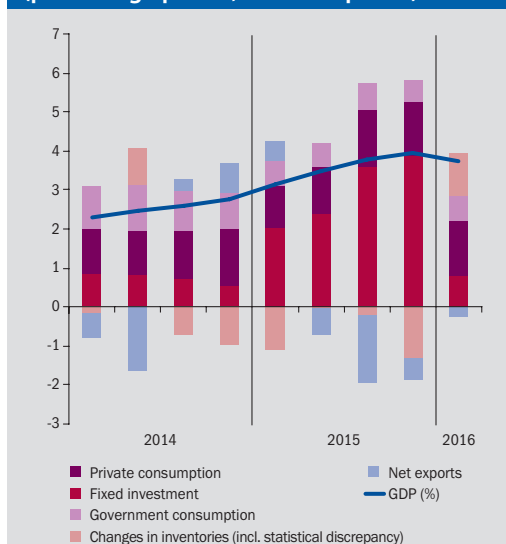
The slowdown in economic growth was caused by the widely expected downturn in investment activity following the end of the absorption of EU funds. Since net exports had a negative effect, economic growth continued to be driven by

Chart 1 Quarterly GDP growth by component (percentage points; constant prices)



Sources: SO SR and NBS calculations.

Chart 2 Annual GDP growth by component (percentage points; constant prices)



Sources: SO SR and NBS calculations.

the stable level of consumption and by a marked increase in inventories.

The increase in inventories partly compensated for the downturn in investment. At the end of last year, however, the volume of inventories decreased, while that of investment increased significantly. This can be explained by the fact that investments financed from EU funds were recorded on the expenditure and income sides of GDP at different points in time. In addition, inventories were probably affected by the changes in foreign demand, too. Its fall at the beginning

Table 1 GDP by expenditure (annual percentage changes; constant prices)

	2015					2016
	Q1	Q2	Q3	Q4	Year	Q1
Gross domestic product	2.9	3.4	3.7	4.3	3.6	3.4
Final consumption						
Households and non-profit institutions	1.5	2.3	2.8	2.8	2.4	2.5
General government	1.8	3.6	5.2	3.2	3.4	3.1
Gross fixed capital formation	6.7	9.5	17.3	19.4	14.0	1.5
Exports of goods and services	5.4	6.1	7.3	9.1	7.0	0.2
Imports of good and services	5.2	7.3	9.9	10.5	8.2	0.4

Source: SO SR.

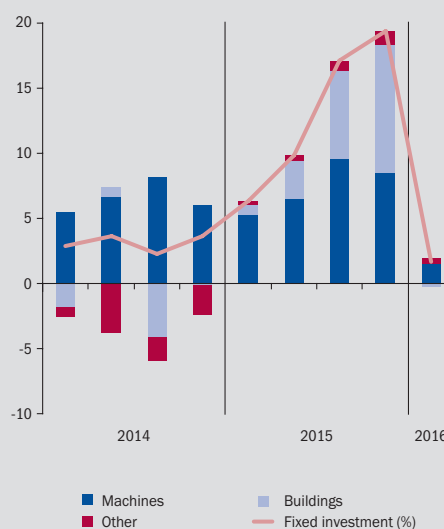
of this year caused an increase in the inventories of goods that were not exported. By contrast, the growing foreign demand at the end of last year absorbed part of the inventories.

The economy, however, was driven primarily by investment, rather than by foreign demand. After rising by 3% in the last quarter of 2015, investment fell by 6.7% quarter-on-quarter at the beginning of 2016. Investment activity was dampened by the public sector in particular. Investment in this sector dropped by 23% quarter-on-quarter, but did not fully offset the effects of the previous successful quarters (an increase of 25% in the third quarter, followed by 8% in the fourth quarter of 2015). Investments financed from EU funds under the previous programming period were probably recorded in the national accounts at the beginning of this year, too. Public investment in the quarter under review still exceeded its pre-crisis level by 80%, which was more than the figure for the first half of 2015 (at the end of 2015, the pre-crisis level was exceeded by 125%).

Private investment fell by 0.9% quarter-on-quarter, after growing by 1.4% in the previous quarter. A sharper fall in private investment was hindered by homeowners' imputed rents (accounting for one-quarter of the volume of investment), followed by investments in transport and the power industry.

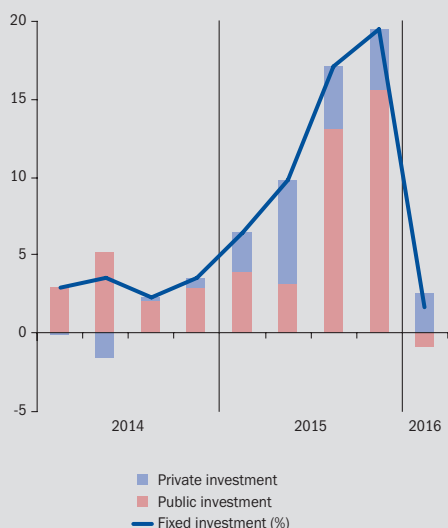
Despite a correction in the first quarter, investment did not fall below its pre-crisis level and remained in the range of sustainable investment. The total volume of investment in the quarter under review remained 2.3% above the quarterly average of 2008 (this was exceeded by almost 10% at the end of 2015).

Chart 4 Annual changes in fixed investment by type of assets (percentage points, current prices)



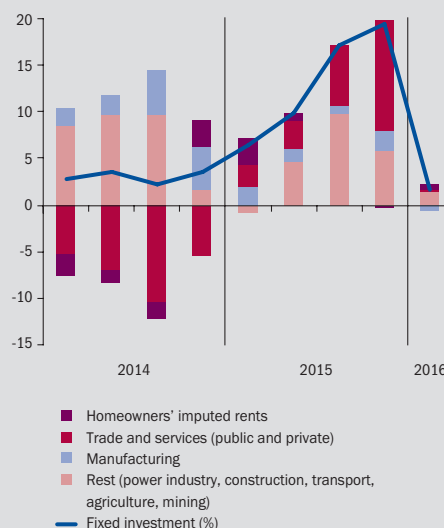
Sources: SO SR and NBS calculations.

Chart 3 Annual changes in fixed investment by form of investment (percentage points; current prices)



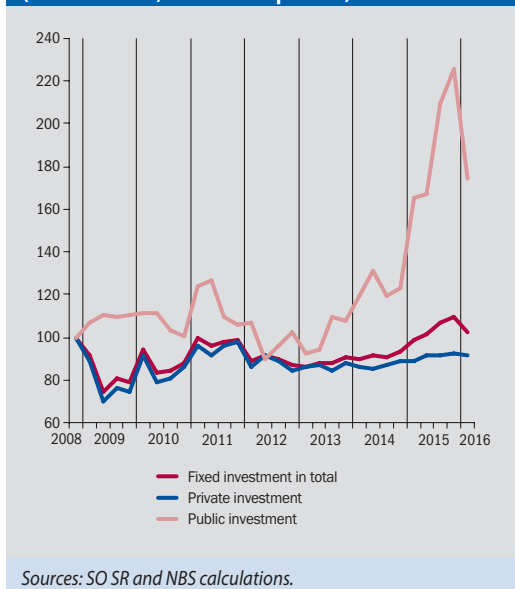
Sources: SO SR and NBS calculations.

Chart 5 Annual changes in fixed investment by sector (percentage points; current prices)



Sources: SO SR and NBS calculations.

Chart 6 Changes in investment by sector compared with the pre-crisis level (2008 = 100; constant prices)



A sustainable trend can be observed in the volume of fixed investment in relation to the volume of GDP. The upper limit of this trend is given by the long-term ratio of investment to GDP (25%) and its lower limit is given by the post-crisis value of the same ratio (22%). Investment has been on a sustainable growth path

since the middle of 2015, owing to the effects of EU funding and of the revival in the corporate loan market. Investment also remained sustainable after the increased absorption of EU funds had ended.

Public consumption grew by 0.8% in the first quarter (compared with 0.6% in the last quarter of 2015) and thus exceeded the growth of private consumption. Public consumption growth was driven by social transfers in the form of social benefits and products the public sector had purchased from market participants (education, health service).

Private consumption grew by 0.6% quarter-on-quarter (as at the end of last year). The rate of growth has been hovering around this level for 1.5 years. Household consumption growth has not accelerated, though labour market developments have enabled households to spend more on consumption for a longer period. Wage levels are on the increase according to both the monthly reports of the SO SR and the statistics of the Social Insurance Agency. This increase, however, is not fully reflected in the disposable income of households (a smaller wage increase was recorded in the disposable income account). Hence the generation of disposable income weakened in the first quarter of 2016.

Chart 7 Comparison of investment with its sustainable long-term trend (average for Q4 in EUR millions; constant prices)

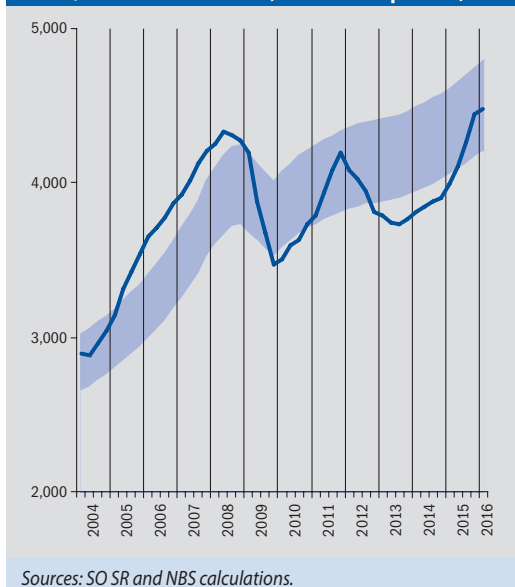


Chart 8 Cumulative growth in resources from the labour market and in household consumption (2012 = 100; current prices)

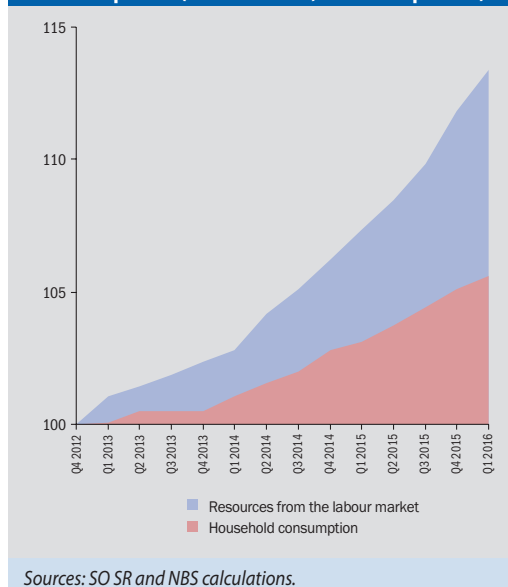
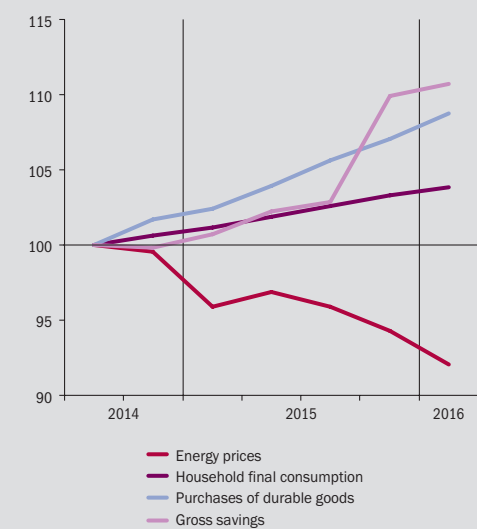


Chart 9 Relationship between the saving ratio and large purchases planned by households



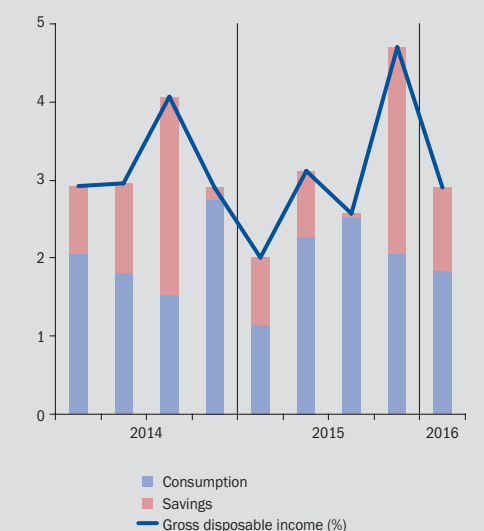
Sources: SO SR and NBS calculations.

Chart 11 Utilisation of lower energy prices for household consumption and savings (2014 Q3 = 100; constant prices)



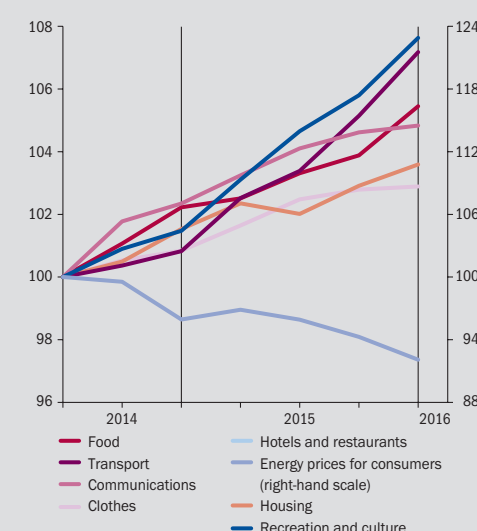
Sources: SO SR and NBS calculations.

Chart 10 Division of annual changes in disposable household income (percentage points; constant prices, non-seasonally adjusted)



Sources: SO SR and NBS calculations.

Chart 12 Segments benefiting from the increased purchasing power of households (2014 Q3 = 100; constant prices)



Sources: SO SR and NBS calculations.

Resources at current prices in the national accounts did not form a sound basis for accelerated growth in consumption. Real consumption grew as a result of a marked fall in consumer prices. The increased purchasing power of households (resulting from savings on energy bills over the last 1.5 years) led to growth in spending on recre-

ation, culture and transport. Spending on transport included mainly car purchases, which, along with the purchase of other durable goods, led to a marked excess of durable goods purchases over consumption in general. Savings from the reduced energy prices were used for the purchase of new durable goods. Households also

Chart 13 Quarterly GDP growth by contributions of selected sectors (percentage points; constant prices)

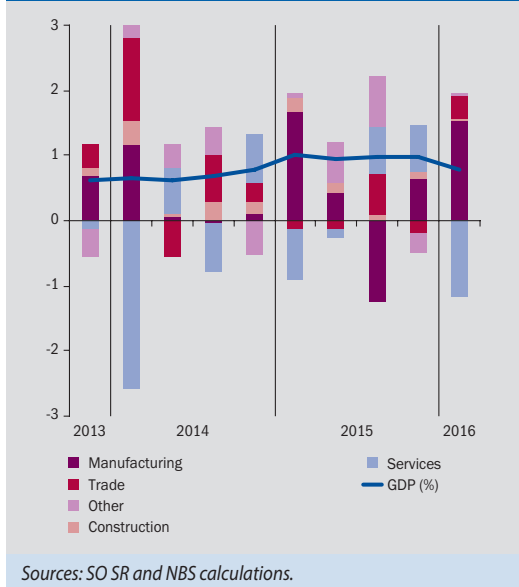


Chart 15 Structure of exports in the ESA 10 methodology (quarterly changes by country of destination in percentage points; constant prices)

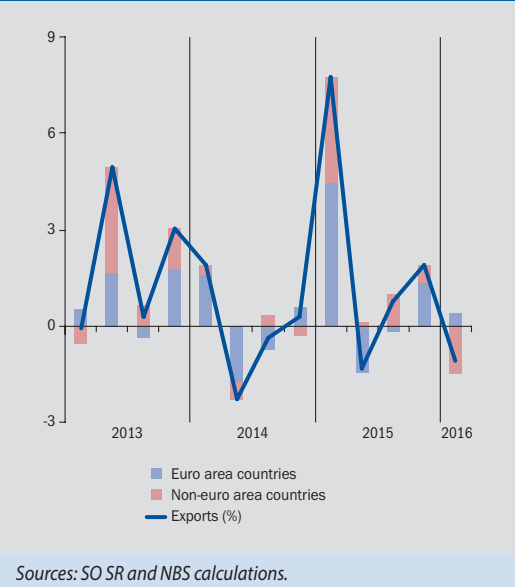


Chart 14 Annual GDP growth by contributions of selected sectors (percentage points; constant prices)

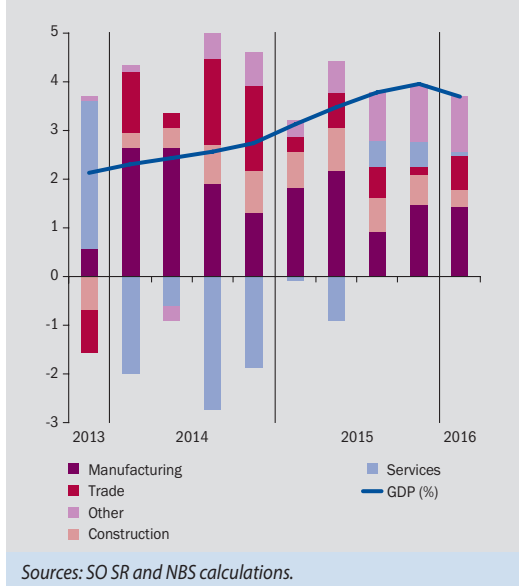
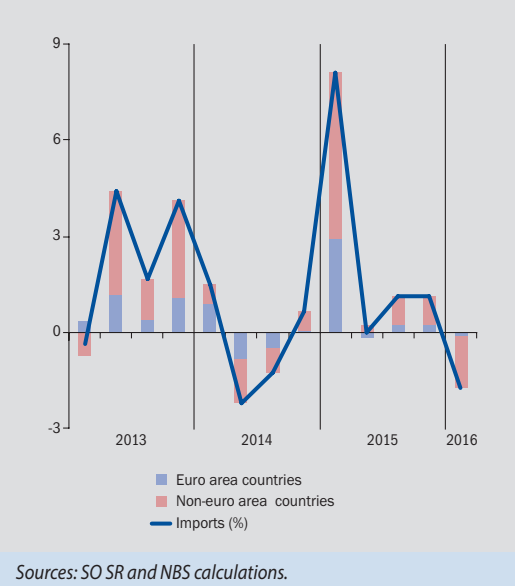


Chart 16 Structure of imports in the ESA 10 methodology (quarterly changes by country of origin in percentage points; constant prices)



spent more on food, communications, housing and clothes (spending on beverages, furniture, health and education grew at a slower pace).

Imports decreased in the first quarter by 1.7% quarter-on-quarter, in line with the significant

fall in investment demand in the domestic economy. Net exports contributed positively to the quarterly rate of economic growth for the second quarter in a row.



3 THE LABOUR MARKET

3.1 WAGES AND LABOUR PRODUCTIVITY

Employment continued to grow in the first quarter of 2016, though the rate of growth in the private sector moderated in comparison with the end of 2015. Unemployment fell significantly as a result of increased participation in labour activation schemes and employment abroad. Compared with the end of last year, the workload of employees decreased in the quarter under review. Hence, the rate of average wage growth moderated somewhat.

The annual rate of average wage growth slowed in the first quarter to 3.3%, from 4.1% in the previous quarter. Developments in the private and public sectors followed divergent trends. While the private sector recorded a slowdown in the annual rate of wage growth (from 4% to 2.5%), wage growth in the public sector accelerated to 6.6%. In the private sector, both bonuses and basic wages experienced decelerating growth. This may be a consequence of increased activity related, inter alia, to the drawdown of EU funds at the end of last year, which moderated in the first quarter. Hence bonuses and extra hours worked decreased somewhat, which is reflected in the shortening average length of a working week

in the private sector. This development in the private sector was supported by changes in the wage categories of health service workers and by the regular increases in the salaries of medical doctors. As a result, wages in health services rose by 7.1% in the quarter under review. In public administration, however, wages increased by as much as 9.1%.

Within the private sector, the rate of wage growth slowed mainly in trade, services and construction. In manufacturing, by contrast, it accelerated moderately from 4.2% to 5%. This may be related to the fact that employers in manufacturing often complain about the shortage of suitable employees, which is also reflected in the structure, by the type of job, of job applicants and vacancies registered in the Central Office of Labour, Social Affairs and Family (ÚPSVAR). There is a relatively great demand in the market for machine/equipment operators and assemblers. At the same time, there is sufficient labour supply for other types of jobs. In construction, the average wage growth slowed at the beginning of this year, but employment increased to a significant extent.

The average wage growth in the economy was moderated by wage developments in smaller

Table 2 Wages and labour productivity (annual percentage changes)

	2015					2016
	Q1	Q2	Q3	Q4	Year	Q1
Average wage (headline)	2.2	2.3	2.9	4.1	2.9	3.3
Consumer price inflation	-0.4	-0.1	-0.3	-0.5	-0.3	-0.5
Average real wage (headline)	2.6	2.4	3.2	4.6	3.2	3.8
Average wage (ESA 2010)	1.8	2.2	2.2	4.0	2.6	2.6
Compensation per employee (ESA 2010)	1.9	1.5	2.1	3.9	2.4	2.8
Nominal labour productivity (non-inflationary wages)	0.7	0.8	1.0	2.1	1.2	0.7
Real labour productivity (non-inflationary wages)	1.1	1.1	1.3	2.2	1.4	1.1
Nominal labour productivity ESA 2010	0.8	1.0	1.2	2.2	1.3	0.8
Real labour productivity ESA 2010	1.2	1.3	1.5	2.3	1.6	1.2

Sources: SO SR and NBS calculations.

Note: Average wages (headline) are based on data from the statistical reports of SO SR. Average real wages were calculated on the basis of CPI inflation. Labour productivity (non-inflationary wages) was calculated as the ratio of real GDP to employment as defined in the methodology of statistical reporting (SO SR). Labour productivity ESA 2010 was calculated as the ratio of real GDP to employment as defined in the ESA 2010 methodology.

firms, which are covered in the quarterly statistics more comprehensively than in the monthly statistics. The monthly average wages in selected segments of the private sector implied an annual growth rate of 5.4% for the first quarter. Quarter-

ly wages in the economy were influenced by an annual wage decrease of 3.8% in smaller firms with up to 20 employees. Average wages in organisations with more than 20 employees in the quarterly methodology rose by as much as 4.9%. Relatively strong wage growth was also indicated in the first quarter by social transfers per employee, which increased by approximately 5.5%¹ year-on-year.

Chart 17 Bonuses and other wage components (annual percentage changes; contributions in percentage points)

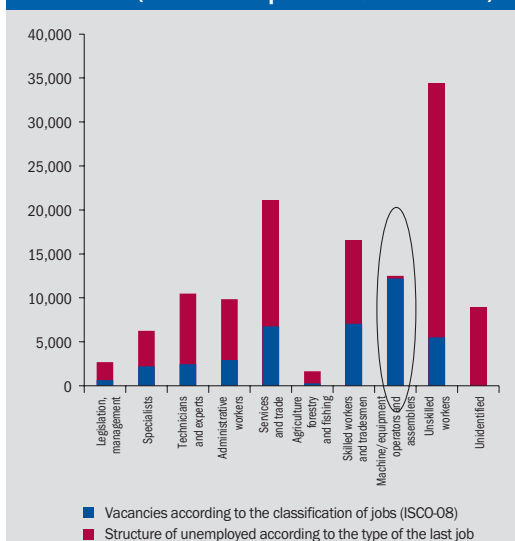


Source: SO SR.

Note: Statistics on companies with 20 or more employees (public administration and financial intermedation, irrespective of the number of employees).

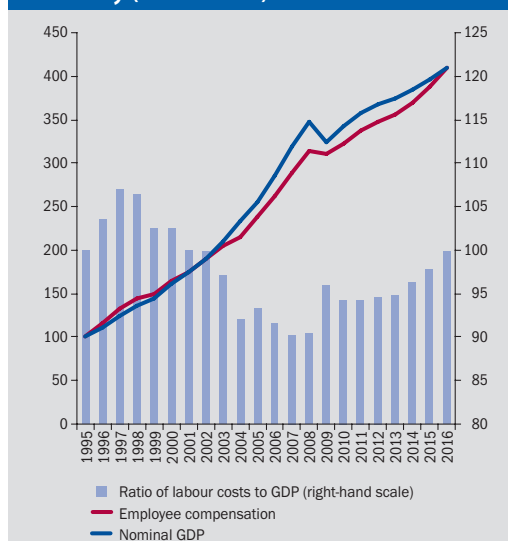
Wages continued to grow at a faster pace than labour productivity, as in the previous two years. In the long term, employee compensation has increased over the last 20 years to a similar extent as the volume of GDP created. If employee compensation continues growing at a faster pace in the coming years, they may exert pressure for a price increase, because employers cannot accept to have decreasing profit margins in the long term. As regards the individual determinants of wage developments, the annual wage growth is currently supported by the growing demand for labour and the perceived shortage of labour. A slight positive effect is also exerted by labour productivity growth or by profitability growth (if profitability per employee is used in the analysis instead of labour productivity, profitability is expected to make a similar contribution as labour productivity).

Chart 18 Structure of job applications and vacancies (number of persons / vacancies)



Source: Central Office of Labour, Social Affairs and Family (ÚPSVR).

Chart 19 Changes in labour costs in the economy (1995 = 100)

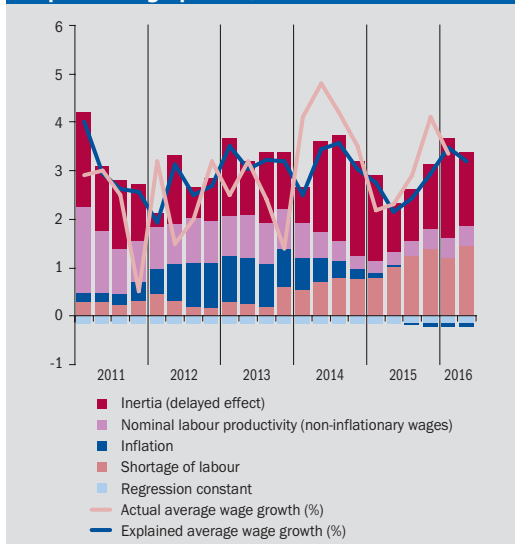


Sources: SO SR and NBS calculations.

Note: Data for 2016 are from the MTF-2016Q2 forecast.

¹ Sources: NBS calculations, data from the Social Insurance Agency and SO SR.

Chart 20 Factors determining wage growth (annual percentage changes; contributions in percentage points)



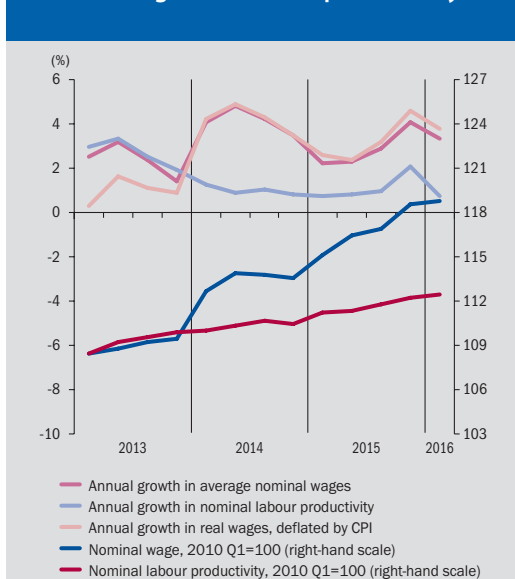
Source: NBS calculations based on a regression analysis.
Note: Transformation of the variables applied: 4-quarter moving average of labour productivity growth, 4-quarter moving average of CPI inflation recorded 3 quarters ago. The shortage of labour was revealed by a business trend research carried out by the European Commission; the sectors are weighted by developments in employment. Productivity and the CPI for the second quarter are based on data from the NBS forecast MTF-2016Q2.

3.2 EMPLOYMENT AND UNEMPLOYMENT

Employment continued to grow in the quarter under review, by 0.53% quarter-on-quarter (compared with 0.49% in the fourth quarter of last year). Its annual growth rate reached 2.2%. In the private sector, however, the rate of employment growth slowed somewhat in comparison with the end of last year. Employment in trade grew at a slower pace, while that in manufacturing rose only slightly. By contrast, employment in services and construction experienced faster growth than in the previous quarter. Employment in construction grew for the third consecutive quarter (after a longer period of post-crisis decline or stagnation). In the public sector and related activities, employment increased to a significant extent, by almost 5,000 persons (1%). This increase was driven by the subsidised employment of disadvantaged persons in self-governments and by the growing number of people employed in health services. Data from business trend surveys and other monthly indicators imply that the positive rate of change in employment will continue in the period ahead.

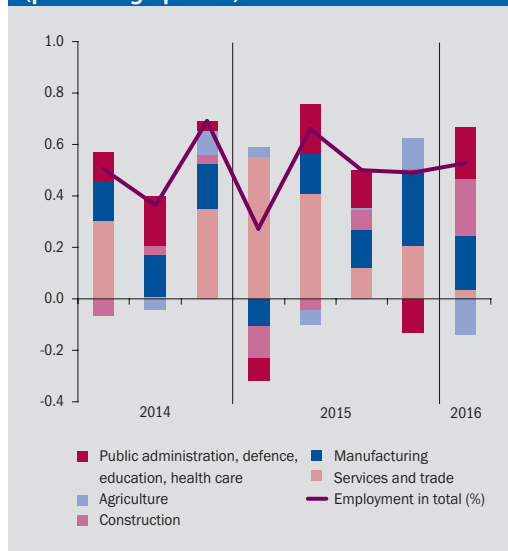
Employment growth was driven by growth in the number of employees, though the number of self-employed persons grew at the same pace

Chart 21 Wages and labour productivity



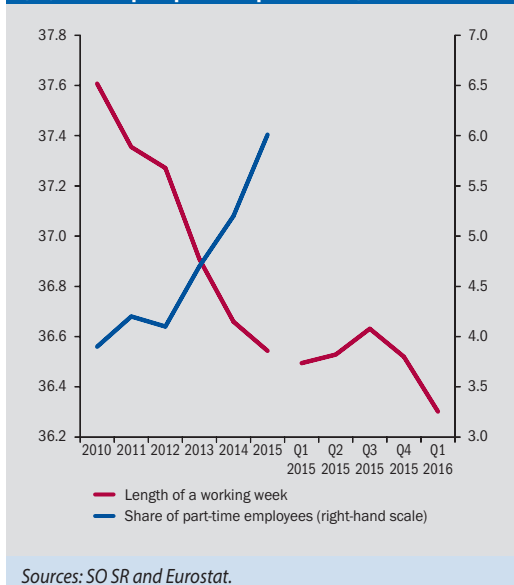
Source: SO SR.
Note: Wages are based on data from the statistical reports of the SO SR. Nominal labour productivity was calculated from employment according to the statistical reports of the SO SR. Base indices are based on seasonally adjusted data.

Chart 22 Quarterly changes in employment by contributions of selected sectors (percentage points)



Source: SO SR.

Chart 23 Part-time employment and the average length of a working week (%; hours per person per week)



Sources: SO SR and Eurostat.

(0.5% quarter-on-quarter). Thus, self-employment ceased to decline in the period under review.

The number of hours worked per person and the length of a working week continued to decrease in the economy. After increasing at the end of last year, the number of hours worked decreased in the period under review by 0.1% quarter-on-quarter. This was due mainly to developments in trade, services, and in the public sector. This indicator also followed a negative trend in manufacturing and construction. The decreasing number of hours worked per person can be attributed to the growing number of part-time workers. In addition, it is likely that less extra hours were worked in the first quarter than in

the previous quarter, which was also reflected in the amount of wages paid. Despite this, the contribution to overall employment growth² of full-time employment and permanent employment has increased in the recent quarters. This shows that employment growth is driven primarily by standard employment.

The number of unemployed according to the latest Labour Force Survey decreased markedly in the quarter under review by 6.4%, representing approximately 19,000 persons. As a result, the seasonally adjusted unemployment rate fell in quarter-on-quarter terms, from 10.8% to 10.1%. The sharper than expected fall (implied by the aforementioned increase in the number of people employed) was due to several reasons. The number of people employed abroad, which is not reflected in the level of employment according to the ESA methodology, continued to increase. In addition, the number of persons involved in labour activation schemes increased, too. This is also left out of consideration in employment based on the ESA methodology. Labour activation schemes may be rather volatile in time, so the possibility of a backward correction in the future is not excluded. The dynamically growing trend in labour force participation moderated in the first quarter, but the recovery of this growth may moderate the decline in unemployment.

The unemployment rate calculated from the total number of job applicants registered with the Central Office of Labour, Social Affairs and Family (ÚPSVR) dropped in the first quarter by 0.77 percentage point, to 11.73%. The non-seasonally adjusted average rate of registered unemployment reached 10.12%, representing a year-on-year fall of 2.1 percentage points.

² Data on employment broken down according to the length and type of employment is available only until the fourth quarter of 2015.



4 PRICE DEVELOPMENTS

Price levels fell in the first quarter of this year by 0.5% (as in the fourth quarter of last year). Within the structure of HICP inflation, the year-on-year decline in processed food prices continued to deepen. The rate of change in unprocessed food prices slowed and the first quarter saw a year-on-year fall in these prices. On the other hand, the rate of change in services prices accelerated, while the annual rate of decline in energy prices slowed.

The general price level has shown a negative rate of change for the ninth consecutive quarter. The main factors behind deflation were still energy

prices and food prices. The impact of the negative rate of change in energy prices weakened somewhat in the quarter under review. Despite this, energy prices contribute most significantly to the year-on-year decline in price levels in Slovakia. A contribution was also made by the deepening year-on-year decline in processed food prices, owing to the effect of commodity prices fluctuating around their all-time low. The continuing price decline was also supported by an administrative measure in the form of a VAT rate reduction for selected processed and unprocessed food. The accelerating rate of change in services prices (and the increase in their posi-

Chart 24 Overall annual inflation by component (percentage points)

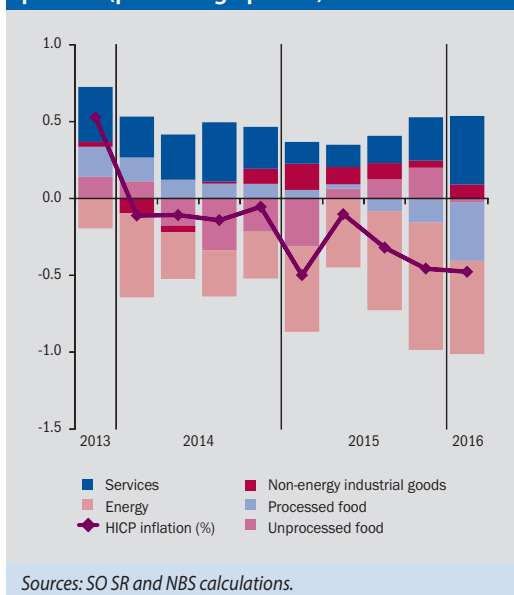


Chart 25 Annual percentage changes in inflation by component

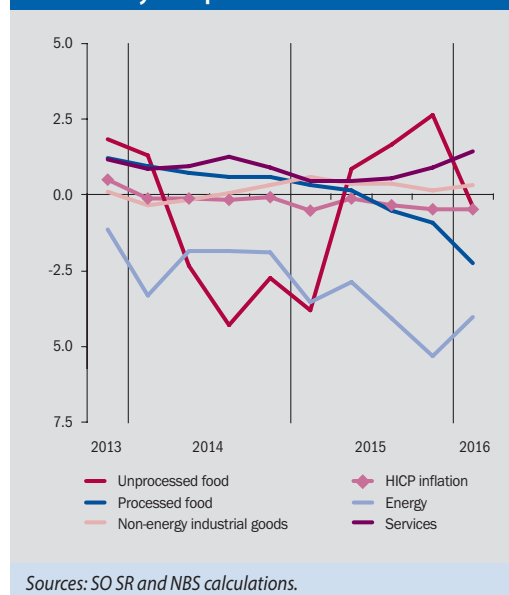


Table 3 Annual percentage changes in inflation by component

	2015					2016
	Q1	Q2	Q3	Q4	Year	Q1
HICP inflation	-0.5	-0.1	-0.3	-0.5	-0.3	-0.5
Unprocessed food	-3.8	0.9	1.6	2.6	0.3	-0.4
Processed food	0.3	0.2	-0.5	-0.9	-0.2	-2.2
Non-energy industrial goods	0.6	0.4	0.4	0.2	0.4	0.3
Energy	-3.5	-2.9	-4.1	-5.3	-3.9	-4.0
Services	0.5	0.5	0.6	0.9	0.6	1.4

Sources: SO SR and NBS calculations.



tive contribution) was a result of the diminishing effect of rail fare reductions. This factor had been responsible for their lower rate of change until the last quarter of 2015.

Despite the favourable labour market developments, the year-on-year rise in services prices

remained slow in the quarter under review. This indicates that a steeper price increase is still dampened by the secondary effects of the energy price shock. Non-energy industrial goods prices influenced by the negative rate of change in import prices continued to rise only slowly.