



NÁRODNÁ BANKA SLOVENSKA
EUROSYSTEM



REPORT ON THE SLOVAK ECONOMY

SEPTEMBER 2016

Published by:
© Národná banka Slovenska

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Discussed by the NBS Bank Board on 27 September 2016.

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ISSN 1339-9594 (online)



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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 second quarter of 2016, by 0.9% quarter-on-quarter (compared with 0.8% in the previous quarter). In year-on-year terms, the rate of economic growth accelerated to 3.7%, from 3.4% at the beginning of the year. The main driver of this growth was foreign demand. Private consumption also continued to grow, owing to the favourable labour market developments and the low-inflation environment.

Employment rose in the second quarter by 0.6% quarter-on-quarter (as in the first quarter) and by

2.3% year-on-year (compared with 2.2% in the first quarter). The number of people employed increased, especially in services and trade. This increase led to a fall in the rate of unemployment. Wages continued to grow in year-on-year terms at a slower pace. Slower wage growth was recorded in manufacturing and in the public sector, while trade and services experienced faster wage growth.

Price levels continued to fall in the second quarter (by 0.6% year-on-year), mainly due to a deepening decline in unprocessed food prices.

2 GROSS DOMESTIC PRODUCT

The Slovak economy grew in the second quarter of this year by 0.9% quarter-on-quarter, compared with 0.8% in the first quarter. The annual rate of economic growth accelerated to 3.7%, from 3.4% at the beginning of the year (according to non-seasonally adjusted data).

The main driver of this growth was foreign demand. Growth was also stimulated by domestic demand, especially by consumer demand. The burgeoning foreign and domestic demand absorbed part of the inventories, too. The resulting change in inventories was detrimental to GDP growth.

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

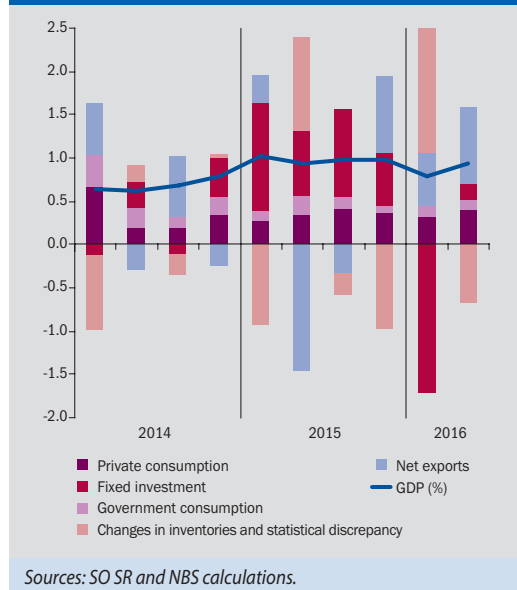
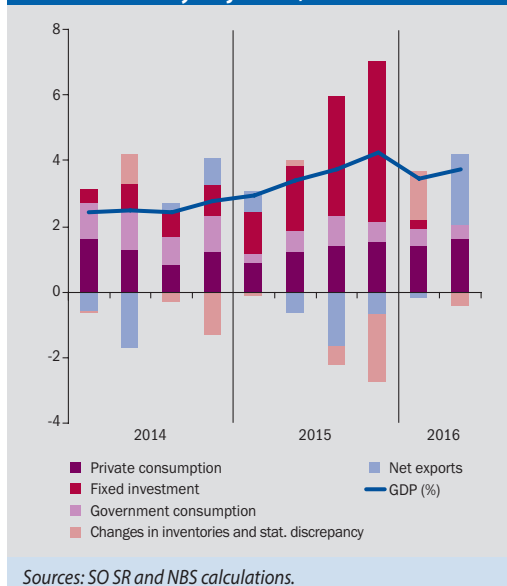


Chart 2 Annual GDP growth by component (percentage points; constant prices; non-seasonally adjusted)



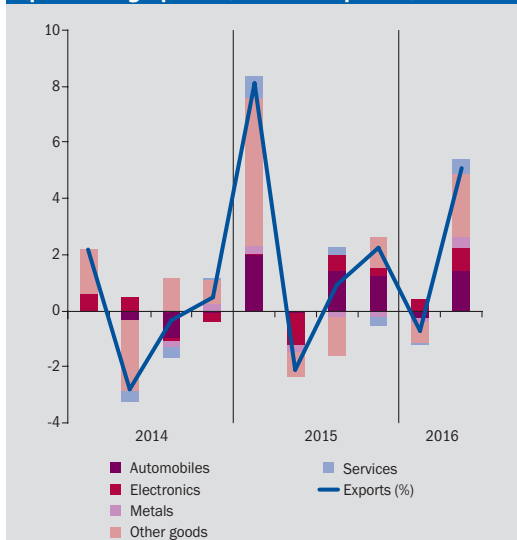
The exports of goods and services grew by 5.1% in the second quarter, after declining by 0.7% in the previous quarter. This growth was driven by car and machine exports, the recovering exports of metal commodities, and by exports of electronic products in connection with major international sporting events. These exports went largely to countries outside the euro area. Besides goods, export activity also increased in services. The growing exports of services (by 5.8%) reflected the increased interest of tourists in Slovakia.

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

	2015					2016	
	Q1	Q2	Q3	Q4	Year	Q1	Q2
Gross domestic product	2.9	3.4	3.7	4.3	3.6	3.4	3.7
Final consumption							
Households and non-profit institutions	1.5	2.3	2.8	2.8	2.4	2.5	3.0
General government	1.8	3.6	5.2	3.2	3.4	3.1	2.2
Gross fixed capital formation	6.7	9.5	17.3	19.4	14.0	1.5	0.0
Exports of goods and services	5.4	6.1	7.3	9.1	7.0	0.2	7.7
Imports of goods and services	5.2	7.3	9.9	10.5	8.2	0.4	5.9

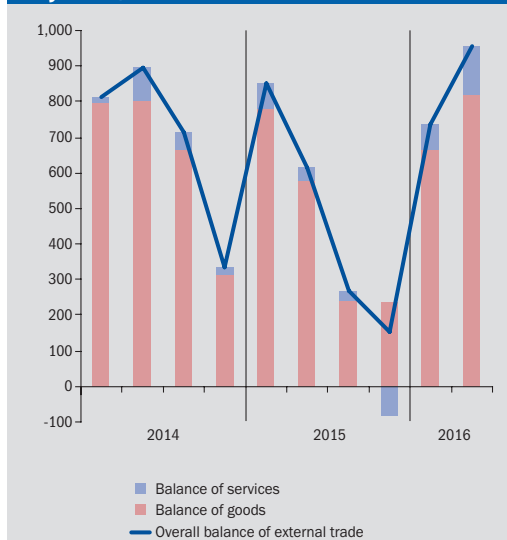
Source: SO SR.

Chart 3 Quarterly changes in exports by contributions of selected commodities (percentage points; constant prices)



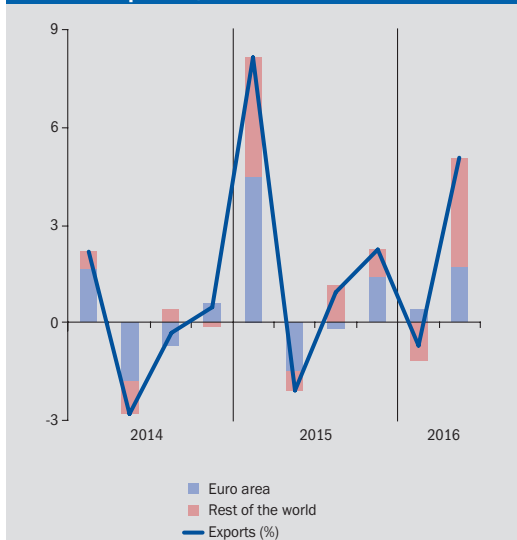
Sources: SO SR and NBS calculations.

Chart 5 Nominal balance of external trade (EUR millions, current prices; non-seasonally adjusted)



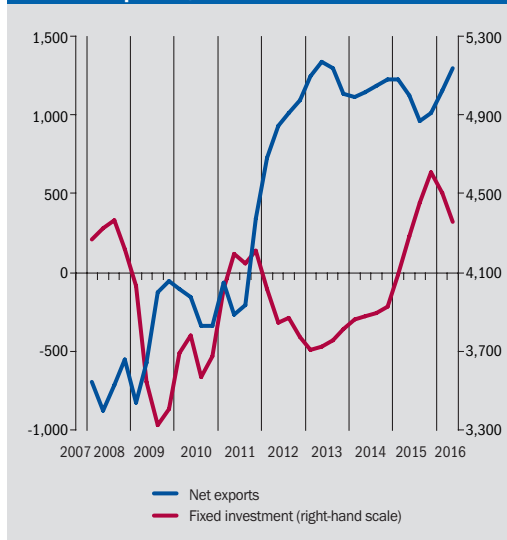
Sources: SO SR and NBS calculations.

Chart 4 Quarterly changes in exports by country of origin (percentage points; constant prices)



Sources: SO SR and NBS calculations.

Chart 6 Decline in investment as reflected in net exports (average for Q2 in EUR millions; constant prices)



Sources: SO SR and NBS calculations.

After falling by 1.4% in the first quarter, the imports of goods and services grew by 4.4% in the second quarter. Since this growth lagged behind the rate of export growth, the net balance

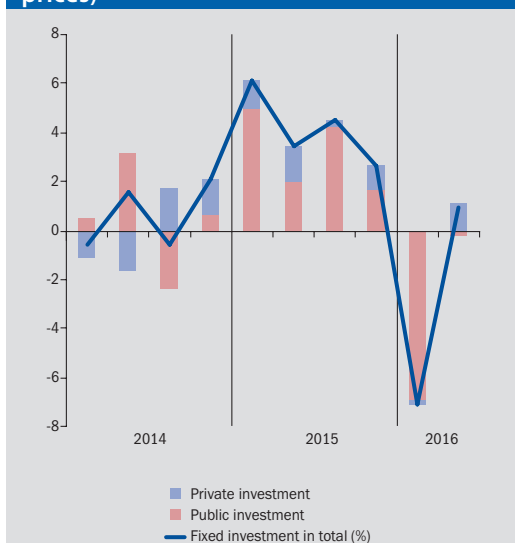
of external trade was highly favourable. Net exports reached a three-year high, which was a natural result of a downturn in investment activity in Slovakia. As almost two-thirds of fixed

investment came from imports, the decline in investment was mirrored in the improving external trade balance.

After a sharp rise last year, investment recorded a fall of 7.1% at the beginning of this year. This

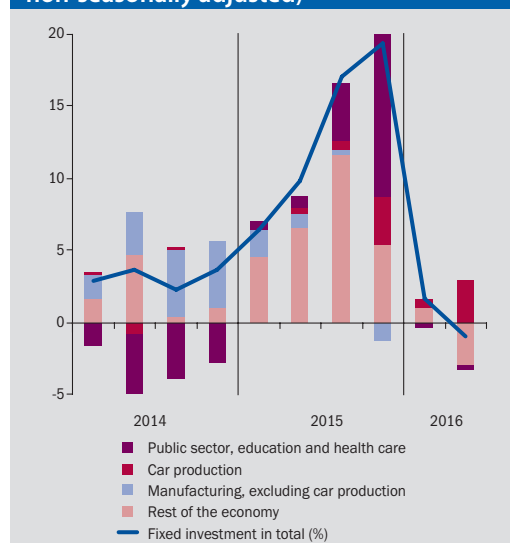
was followed by a quarter-on-quarter increase of 0.9% in the second quarter. Public investment fell somewhat in that period. Private fixed investment was concentrated in the car industry. Investment in machines exceeded that in construction.

Chart 7 Quarterly changes in fixed investment by contributions of groups in real terms (percentage points; constant prices)



Sources: SO SR and NBS calculations.

Chart 9 Annual changes in fixed investment by contributions of segments in nominal terms (percentage points; current prices; non-seasonally adjusted)



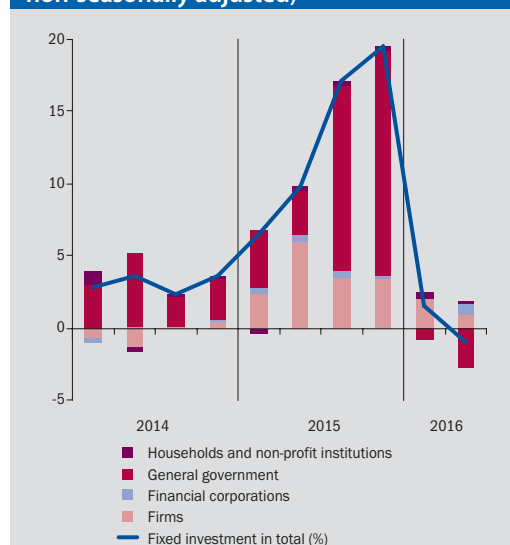
Sources: SO SR and NBS calculations.

Chart 8 Quarterly changes in fixed investment by contributions of assets in real terms (percentage points; constant prices)



Sources: SO SR and NBS calculations.

Chart 10 Annual changes in fixed investment by contributions of sectors in nominal terms (percentage points; current prices; non-seasonally adjusted)

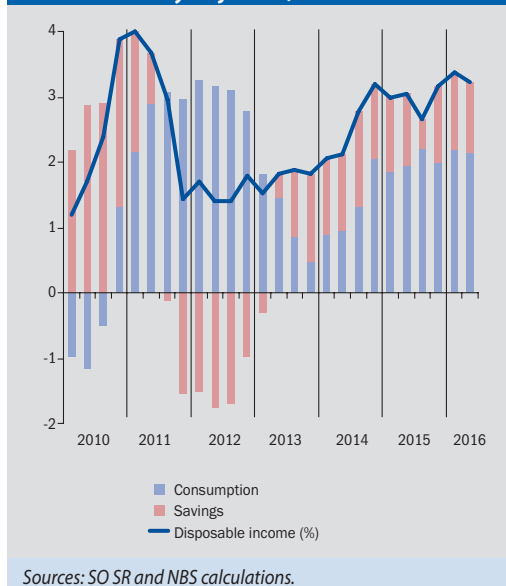


Sources: SO SR and NBS calculations.

Consumer demand grew more rapidly than investment demand. While public consumption continued to grow at a steady pace of 0.6% quarter-on-quarter (as at the beginning of this year), the rate of private consumption growth accelerated from 0.6% at the beginning of the year to 0.8% in the second quarter. Long-term pro-consumption factors, such as the low-inflation environment and the favourable labour market situation, weakened the propensity of households to save and boosted consumer spending in the period under review.

The seasonally adjusted household savings ratio, measured as the ratio of gross savings to gross disposable income (plus the change in the net equity of households in pension funds), dropped to 9.1% in the second quarter, after reaching a five-year high (9.2%) in the first quarter. One of the factors that could reverse the rising trend in the savings ratio of households was a decline in their property income (including interest on deposits). Property income probably forms that part of households' disposable income that is saved, rather than consumed on a day-to-day basis. Hence, its slower growth normally leads to a lower savings ratio.

Chart 12 Income divided into consumption and savings (contributions to annual growth in percentage points; current prices; non-seasonally adjusted)



In the quarter under review, households spent more on food and housing in particular. The main factor stimulating consumption was 'other expenses', rather than spending on durable

Chart 11 Changes in the household savings ratio in relation to changes in property income (%)

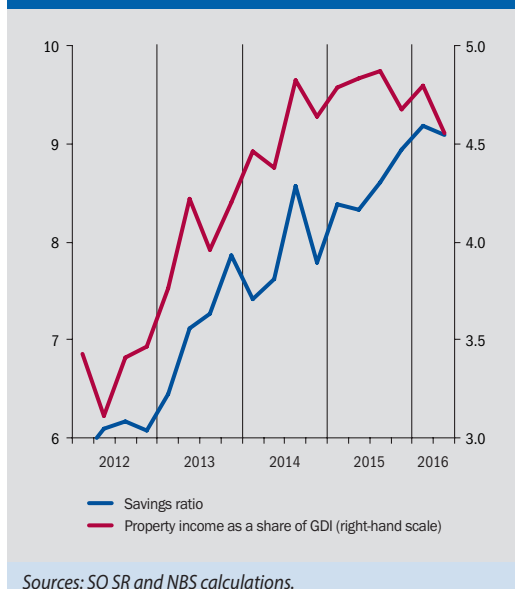


Chart 13 Composition of household expenditure (contributions to annual growth in percentage points; constant prices; non-seasonally adjusted)

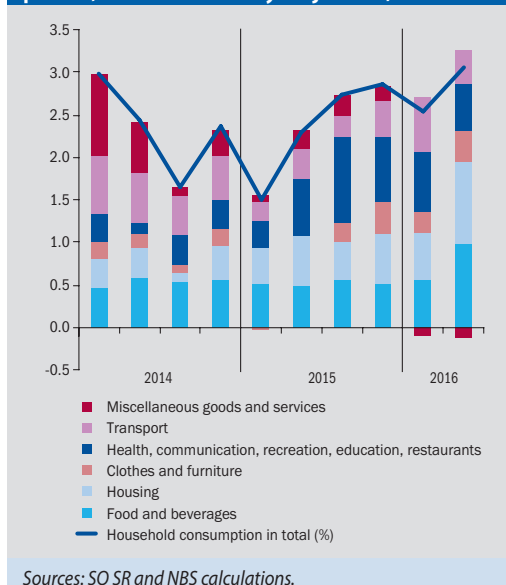
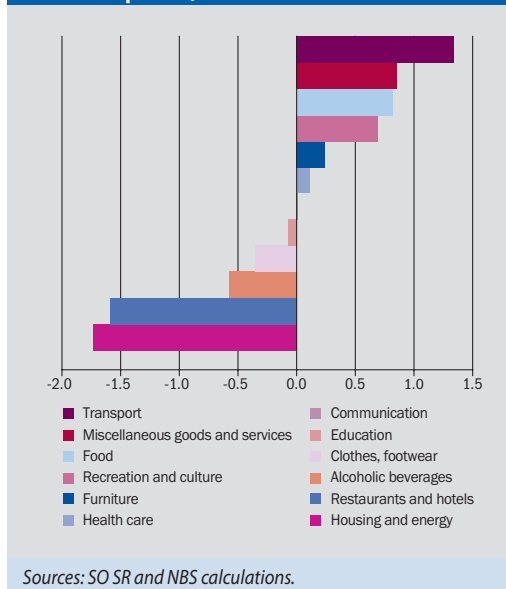


Chart 14 Expenditure on durables and other goods (contributions to quarterly growth in percentage points; constant prices)



Chart 15 Changes in the current consumer basket of households compared with the pre-crisis period (percentage points; constant prices)



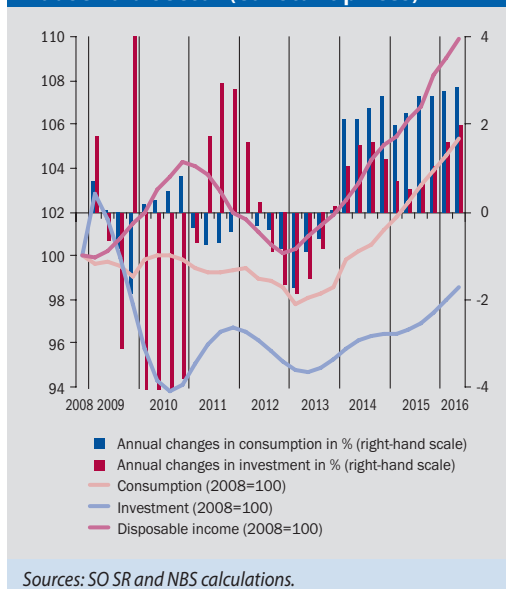
goods. Other expenses act as a key driver of consumption growth for a fifth consecutive quarter.

The increased spending on durable goods in the long term, in particular on car purchases, has modified the structure of households' consumer basket in favour of spending on transport. The current share (in the first half of 2016) of spending on transport is 1.3 percentage points higher than it was in the pre-crisis period (in the first half of 2008). This change can be attributed to the persistently low oil and fuel prices, which tend to reduce the operating costs of car owners.

The depressed oil and energy prices had a completely different effect on housing costs. The share of these costs in consumption decreased by 1.7 percentage points in the period under review. The lower housing costs resulting from the lower energy prices and the employment of cost-cutting measures released resources for spending on other goods and services. Households used these resources to spend more on transport, food consumption, recreation, and furniture purchases.

Non-seasonally adjusted real household consumption grew in the second quarter by 3% year-on-year (compared with 2.5% in the first

Chart 16 Changes in consumption, investment and disposable income in the household sector (constant prices)



quarter), representing the strongest growth since the crisis of 2009. Household consumption exceeded its pre-crisis level by more than 5%. For comparison, real household investment grew at a slower pace than consumption and thus remained, despite the pro-investment environment, below the pre-crisis level.

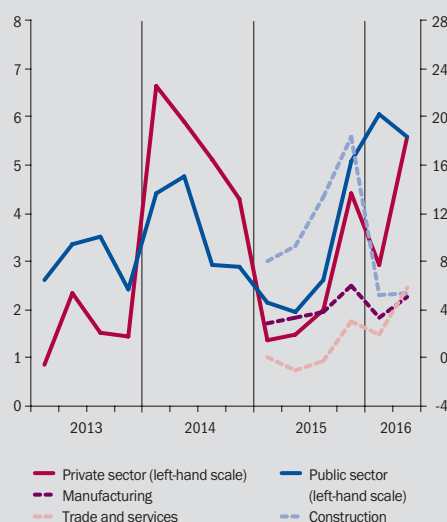
3 THE LABOUR MARKET

3.1 WAGES AND LABOUR PRODUCTIVITY

Wage dynamics continued to weaken in the second quarter as a result of developments in the less stable wage components (remuneration and compensation). At the same time, basic wages adjusted for these effects increased by more than 5%. Compensation per employee grew at a slower pace, owing probably to the lower wages of persons working under an agreement on working activity or on performing certain tasks and to the lower severance payments. Wages continued to grow more rapidly than labour productivity, thus approaching the level of labour productivity in the long run. Employment in the private sector grew at a solid pace, especially in trade and services.

The average annual rate of wage growth in the economy slowed in the second quarter to 2.7%, from 3.3% in the first quarter. This slowdown was reflected in both the private and public sectors. Wage levels were influenced by the volatility of remuneration and wage compensation. Remuneration in the private and public sectors rose at the end of last year in particular. In the first

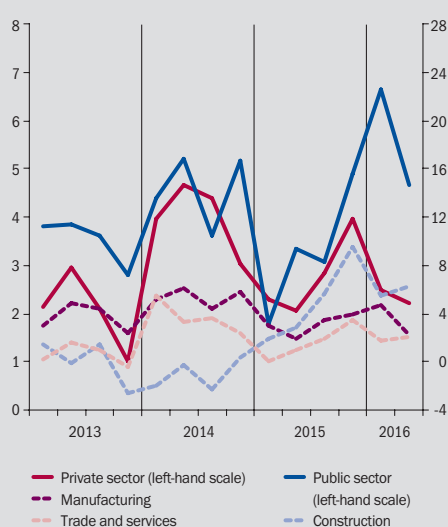
Chart 18 Overview of basic wage developments broken down by sector (average annual basic wage growth in %)



Sources: SO SR and NBS calculations.

Note: Data for the public sector are based on SO SR's classification according to the type of ownership. Basic wage is defined as total gross wage adjusted for the effects of remuneration and wage compensation. Statistics on the firms with 20 or more employees, for the public and financial sectors irrespective of the number of employees.

Chart 17 Overview of wage developments broken down by sector (average annual wage growth in %)



Sources: SO SR and NBS calculations.

Note: Data for the public sector have been calculated on the basis of data from the categories O, P and Q of the NACE classification.

quarter of this year, wage growth was supported to some extent by the effect of increased wage compensation (for the Easter holidays). This effect, however, faded away during the second quarter. An interesting trend was observed in wages adjusted for these one-off effects (such adjustment can only be made to wages in firms with 20 or more employees). These wages rose in the period under review by 5.6% year-on-year in both segments. They were also supported by the higher number of hours worked per person.

These facts point to the presence of relatively strong fundamental wage growth in the economy. In the official statistics, however, wage dynamics are dampened by the aforementioned one-off factors and data from smaller firms, indicating that wages are falling in this segment. The construction sector experiences strong wage growth. Wage dynamics in manufacturing, trade and services still reflect the effect of remuneration and wage compensation. Compensation

Table 2 Wages and labour productivity (annual percentage changes)

	2015					2016	
	Q1	Q2	Q3	Q4	Year	Q1	Q2
Average wage (headline)	2.2	2.3	2.9	4.1	2.9	3.3	2.7
Consumer price inflation	-0.4	-0.1	-0.3	-0.5	-0.3	-0.5	-0.7
Average real wage (headline)	2.6	2.4	3.2	4.6	3.2	3.9	3.4
Average wage (ESA 2010)	1.8	2.2	2.2	4.0	2.6	2.6	1.9
Compensation per employee (ESA 2010)	1.9	1.5	2.1	3.9	2.4	2.8	2.0
Nominal labour productivity (ESA 2010)	0.8	1.0	1.2	2.2	1.3	0.8	0.9
Real labour productivity (ESA 2010)	1.2	1.3	1.5	2.3	1.6	1.2	1.4

Sources: SO SR and NBS calculations.

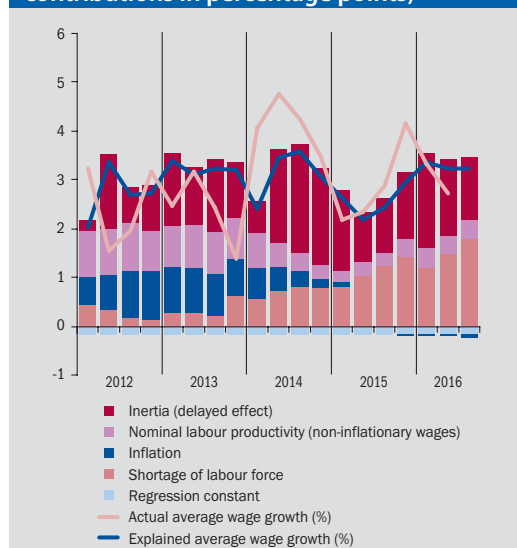
Note: Average wages (headline) are based on data from the statistical reports of SO SR. Average real wages are calculated on the basis of CPI inflation. Labour productivity (ESA 2010) is calculated as the ratio of nominal GDP to employment as defined in the ESA 2010 methodology (real analogy).

per employee (wages, including social security contributions, the remuneration of persons working under an agreement on working activity or on performing certain tasks, and various benefits), like wages, recorded a slowdown in the quarter under review, but its annual growth rate was only 0.7 percentage point slower. This can be partly explained by the smaller amount of severance payments (improving labour market situation) and the zero increase in the costs

paid (includes payments to persons working under an agreement on working activity or on performing certain tasks, whose employment in the economy is decreasing, as well as the number of hours worked per agreement).

Nominal wages are growing at a faster pace than nominal labour productivity. This is likely to eliminate virtually the persistent excess of labour productivity growth over wage growth in

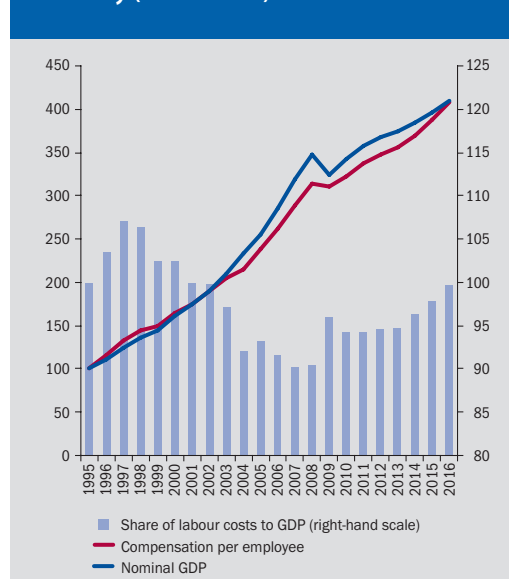
Chart 19 Factors determining the rate of wage growth (annual percentage changes; contributions in percentage points)



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. Labour shortages were revealed by a business trend analysis carried out by the European Commission; the sectors are weighted by developments in employment.

Chart 20 Changes in labour costs in the economy (1995 = 100)



Sources: SO SR and NBS calculations.

Note: The data for 2016 are from the MTF-2016Q3 forecast.

the course of this year. The increased demand for labour force still has a favourable impact on the labour market, while firms experience its acute shortage. On the other hand, wage dynamics are dampened by the current inflation rate. At the same time, nominal labour productivity has only a modest pro-growth effect, because more and more less productive workers are hired and economic performance is dampened by the lower level of producer prices, too.

3.2 EMPLOYMENT AND UNEMPLOYMENT

Employment grew in the second quarter by 0.63% quarter-on-quarter, compared with 0.55% in the first quarter. In year-on-year terms, employment rose by 2.3%. This robust growth was stimulated mainly by the creation of new jobs in services and trade. Employment in manufacturing grew at a slower pace. The construction sector, by contrast, faced a shortage of new orders in the wake of a short-lived revival sparked by projects financed from EU funds, which was reflected in the sector's lower output and employment. The level of employment was, to some extent, supported by the public sector (specifically by health and social services, and by other subsectors). Selected job applicants continued to be hired in the public sector within the framework of national projects. The rate of employment growth in the private sector approached the pre-crisis figure. The monthly indicators of employment in Slovakia for the third quarter are still relatively favourable; they reflect no signs of the uncertainty surrounding 'Brexit', which are already present in other leading indicators.

Employment growth was boosted mostly by the segment of employees, while the number of self-employed persons dropped on a quarter-on-quarter basis. However, the current monthly indicators for the third quarter indicate a certain improvement in the latter segment, too.

Chart 21 Quarterly changes in employment by contributions of selected sectors (percentage points)

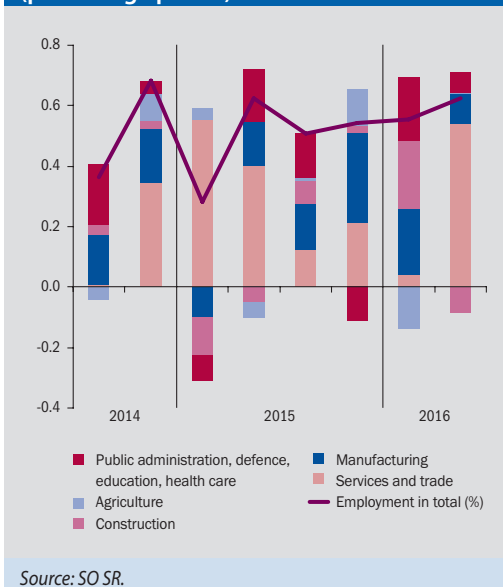
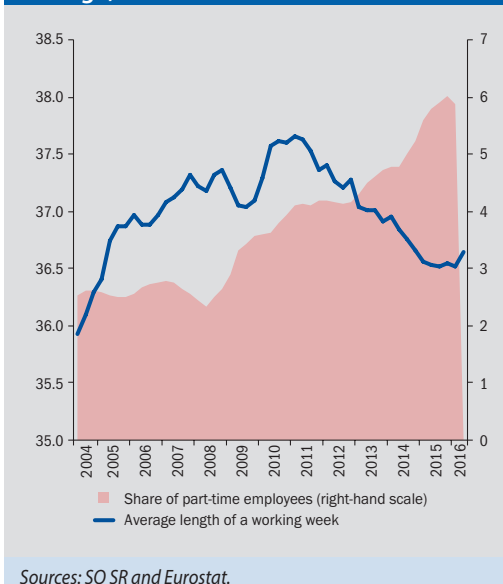


Chart 22 Part-time employment and the average length of a working week (%; hours per person per week; 4-quarter moving average)





The number of hours worked in the economy increased considerably in the second quarter. This applies to all the key segments. At the same time, the strong demand for labour led to an increase in the average length of a working week. This indicator rose in the majority of segments. Services and trade recorded only a slight rise in this indicator, because the staff numbers of firms in these segments were increased to a significant extent. Thus, the decreasing trend in the length of a working week, probably related to an increase in the share of part-time employees, came to a halt.

The number of unemployed continued to fall in the second quarter, though at a slower pace than in the previous two quarters. This fall accounted for 3,900 persons, representing a seasonally adjusted unemployment rate of 0.2 percentage

point. According to the Labour Force Survey, the rate of unemployment dropped to 10%. The share of persons participating actively in the labour market at early or full retirement age increased, as well as the share of younger persons, mainly women aged 25-39. This phenomenon explains why the fall in unemployment was smaller than the rise in employment. The number of persons working abroad continued to grow, as well as the number of persons involved in labour activation schemes. 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 second quarter by 0.39 percentage point, to 11.32%. The non-seasonally adjusted average rate of registered unemployment reached 9.51%, representing a year-on-year fall of 2.1 percentage points.

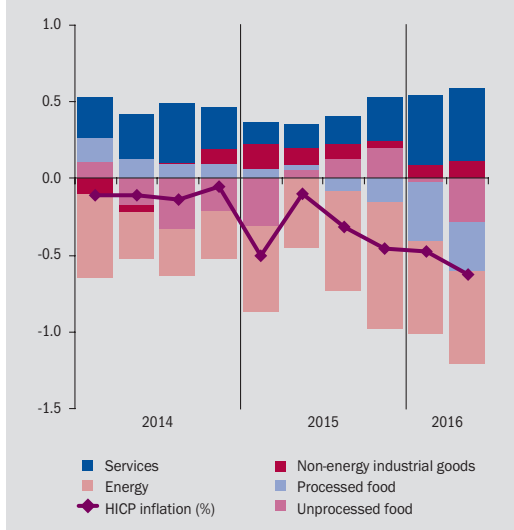
4 PRICE DEVELOPMENTS

Price levels dropped by 0.6% year-on-year in the second quarter, compared with 0.5% in the first quarter. Within the structure of HICP inflation, the year-on-year decline in unprocessed food prices continued to deepen. The other basic components of inflation experienced a gradual revival.

The general price level continued to show a negative rate of change for a tenth consecutive quarter. The price deflation was caused primarily by external factors. The low energy and food commodity prices, fluctuating

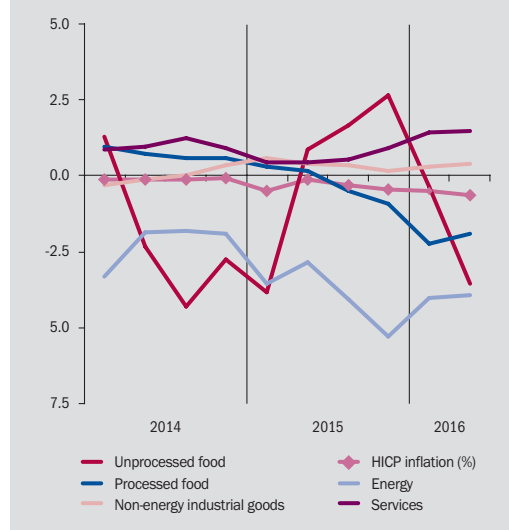
around their long-term lows, were reflected in the negative rates of change in consumer energy and food prices in Slovakia. Among the factors contributing to the year-on-year fall in the general price level, only unprocessed food prices (fruit and vegetable prices in particular) made such a contribution in the quarter under review. The slight acceleration in the rate of change in services prices was still inconsistent with the steady and relatively strong labour market growth. Demand pressures are expected to build up gradually by the turn of 2016/2017.

Chart 23 Overall annual inflation by component (percentage points)



Sources: SO SR and NBS calculations.

Chart 24 Annual percentage changes in inflation by component



Sources: SO SR and NBS calculations.

Table 3 Annual percentage changes in inflation by component

	2015					2016	
	Q1	Q2	Q3	Q4	Year	Q1	Q2
HICP inflation	-0.5	-0.1	-0.3	-0.5	-0.3	-0.5	-0.6
Unprocessed food	-3.8	0.9	1.6	2.6	0.3	-0.4	-3.5
Processed food	0.3	0.2	-0.5	-0.9	-0.2	-2.2	-1.9
Non-energy industrial goods	0.6	0.4	0.4	0.2	0.4	0.3	0.4
Energy	-3.5	-2.9	-4.1	-5.3	-3.9	-4.0	-3.9
Services	0.5	0.5	0.6	0.9	0.6	1.4	1.5

Sources: SO SR and NBS calculations.



Non-energy industrial goods prices continued to rise only moderately, owing partly to the negative rate of change in import prices. Our technical assumptions and developments in the country's basic macroeconomic fundamentals suggest that the negative inflation rate reached its bottom in the second quarter.