



NÁRODNÁ BANKA SLOVENSKA
EUROSYSTEM



Slovak Macroeconomic Outlook

CFA society
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Acceleration of GDP growth in the medium-term due to start of the new productions in the car industry (as expected before). This year the GDP growth slightly higher.

Economy will generate new jobs and labour market overheating is supposed to emerge, it will lead to wage growth pressures, the unemployment rate is assumed to decline towards historically low 7 % at the end of 2019.

Core inflation should accelerate gradually with headline inflation sharply up due to external factors (food prices).



- **Eurozone recovery based on both domestic demand and exports.** Demand up due to the ECB's very accommodative monetary policy. Output gap still negative, should close only in 2019. Euro area exports are also projected to strengthen over the projection horizon (an expected recovery in global trade and the past weakening of the exchange rate of the euro).
- The near-term outlook for **headline inflation** has been revised upwards significantly following the recent rise in oil and food prices. In 2017 energy prices are expected to account for 1.2 percentage points of the strengthening in HICP inflation. After that, the energy component will have a smaller positive contribution to headline inflation in 2018 and 2019. In contrast to energy inflation, the expected pick-up in HICP inflation excluding energy and food is much more gradual, supported by unit labour cost growth.
- The **risks** surrounding the euro area growth outlook have become less pronounced, but **remain tilted to the downside** and relate predominantly to global factors.

March 2017 ECB staff macroeconomic projections for the euro area

(annual percentage changes)	March 2017 MPE				December 2016 BMPE				Revisions since December 2016*			
	2016	2017	2018	2019	2016	2017	2018	2019	2016	2017	2018	2019
Real GDP	1.7	1.8	1.7	1.6	1.7	1.7	1.6	1.6	0.0	0.1	0.1	0.0
HICP	0.2	1.7	1.6	1.7	0.2	1.3	1.5	1.7	0.0	0.4	0.1	0.0
HICP excluding energy and food	0.9	1.1	1.5	1.8	0.9	1.1	1.4	1.7	0.0	0.0	0.1	0.1

*Revisions are calculated from rounded data

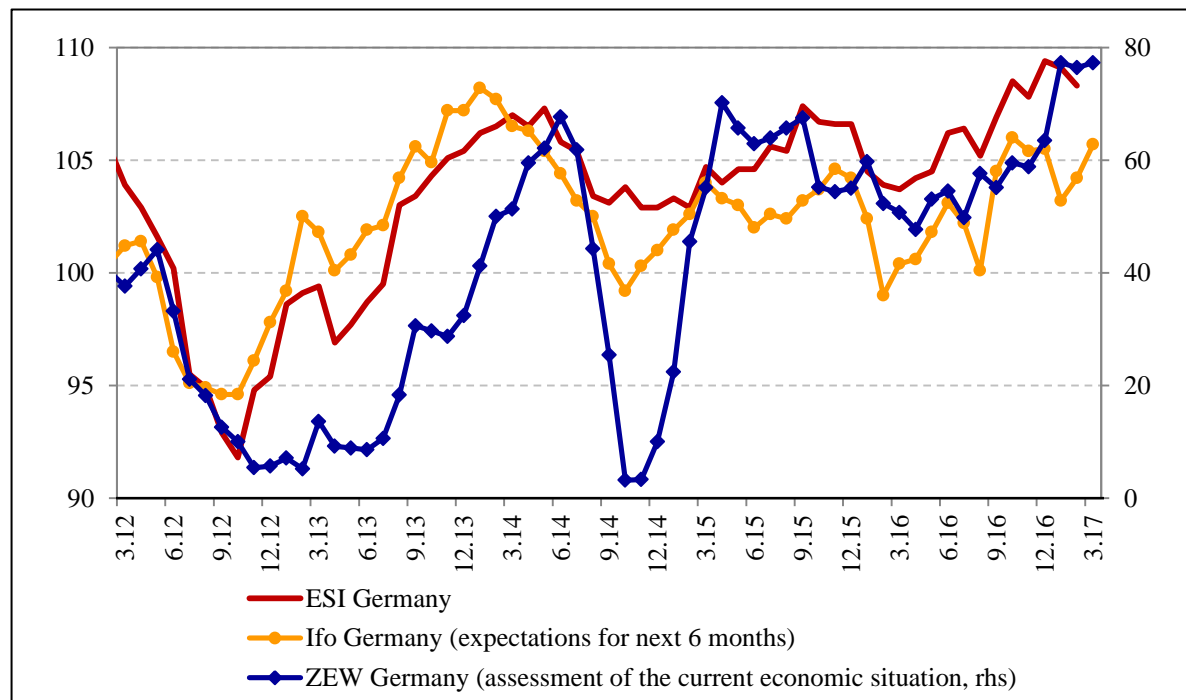
External environment



- Foreign demand growth adjusted up in 2017 and 2018.

	2016	2017	2018	2019
Foreign demand of the S.R. (%)	3.4	3.9	4.2	4.1
Revision (p. p.)	-0.1	0.3	0.1	0.0

Economic sentiment indicators for Germany



Economic development – Growth trajectory confirmed



Keeping the overall economic growth trajectory, but changing the structure of growth.

	2016	2017	2018	2019
GDP (%)	3.3	3.2	4.2	4.6
Revision (p. p.)	0.0	0.1	0.0	0.0

- More favorable external environment and higher employment growth brings **stronger exports and private consumption. Signs of overheating** in the labor market should reinforce the dynamics of nominal wages.
- The effect of weaker investment on GDP is subdued due to import intensity.
- The investments will slowly recover by gradually increasing public investment, including the restoration of drawing EU funds.
- **Export** performance and overall growth will be driven by launch of production at new car factory at the end of the forecast horizon.

Estimated up-to-now Brexit impact incorporated in the baseline prediction



Since 2016Q3, Brexit impacts medium-term forecasts via foreign demand channel.

- Current *aggregate* UK GDP growth affected only mildly so far, but: rebalancing towards domestic demand and openness falling => negative impact on SK foreign demand.
- Other transmission channels (uncertainty, exchange rate) not relevant so far.
- Estimated up-to-now Brexit impact incorporated in the baseline prediction: SK foreign demand down by cumulative 1.18 pp up to 2019 => **SK GDP growth down by cumulative 0.55 pp up to 2019**, approx. 5,500 jobs.

Brexit impact on SK foreign demand and GDP growth

	2016	2017	2018	2019	Cumulative
Impact on SK foreign demand growth (pp)	-0.21	-0.34	-0.33	-0.30	-1.18
Impact on SK GDP growth (pp)	-0.11	-0.17	-0.15	-0.13	-0.55

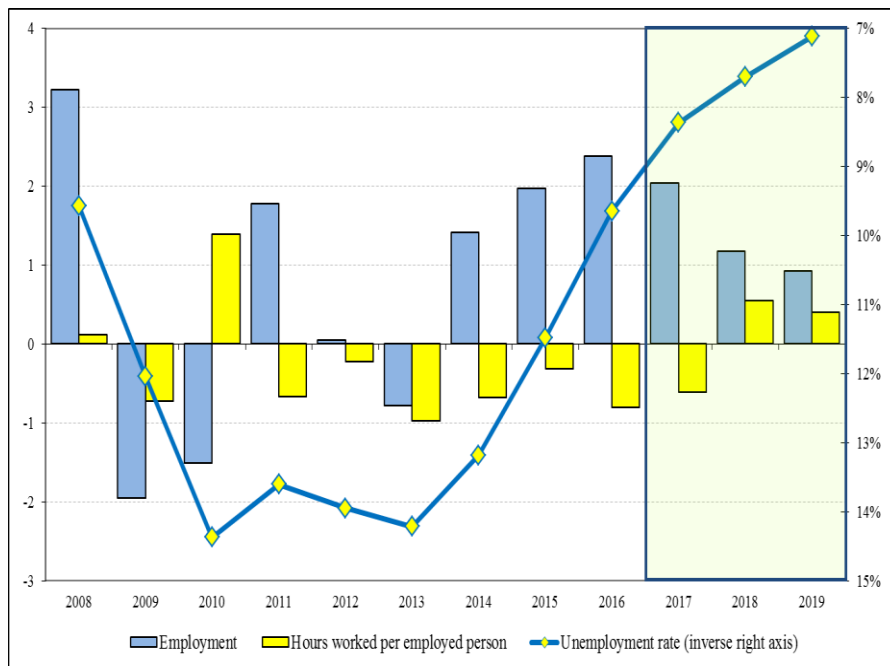
- Brexit, though already incorporated in the baseline, still continues to be a downside risk.

Employment- growing more quickly than expected



	2016	2017	2018	2019
Employment (%)	2.4	2.0	1.2	0.9
Revision (p. p.)	0.1	0.4	0.1	0.0

Employment, hours worked and unemployment rate (annual growth, %, unemployment rate in %)



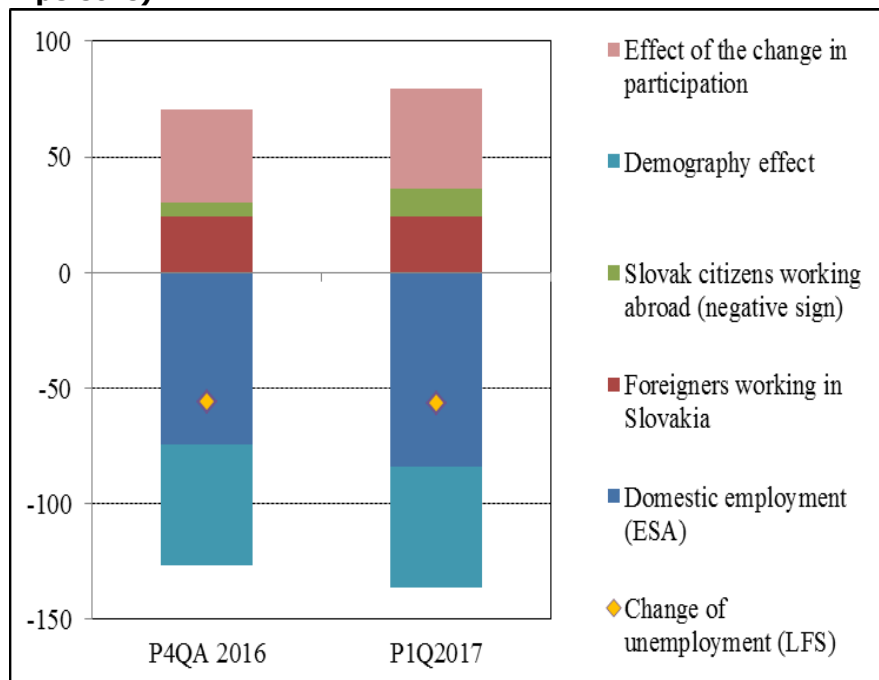
- Current employment developments **exceeded prior expectations.**
- Latest monthly leading indicators suggest faster short-term growth than the P4QA forecast. *At the end of the forecast horizon, employment is by 15 ths. persons higher than P4QA.* Within the forecast horizon (2017Q1 – 2019Q4) **84 ths. jobs will be created cumulatively.**
- In the medium-term, employment growth should moderate, since a **mismatch between labour supply and demand** is building up and new employees are increasingly hard to find.
- Part of the labour demand increase can be saturated by **increasing labour force participation and an increase in hours worked.**

Unemployment- keeps declining towards 7%



	2016	2017	2018	2019
Unemployment rate (%)	9.6	8.4	7.7	7.1
Revision (p. p.)	-0.1	-0.4	-0.4	-0.4

Movement in the labour market and its influence on the number of unemployed (within 2017 Q1 – 2019 Q4; ths. persons)



- Improvement in unemployment is **more moderate** compared with the employment upward revision. *Towards the end of the forecast horizon, lower by 11 ths. persons compared with P4QA.*
- Namely, part of the employment growth will be **satisfied by a higher participation rate growth** and **return of part of the Slovak labour force abroad back home.**
- At the same time, we assume that each year approximately 8 ths. new jobs will be **filled by foreigners**, similarly as in the previous forecast.

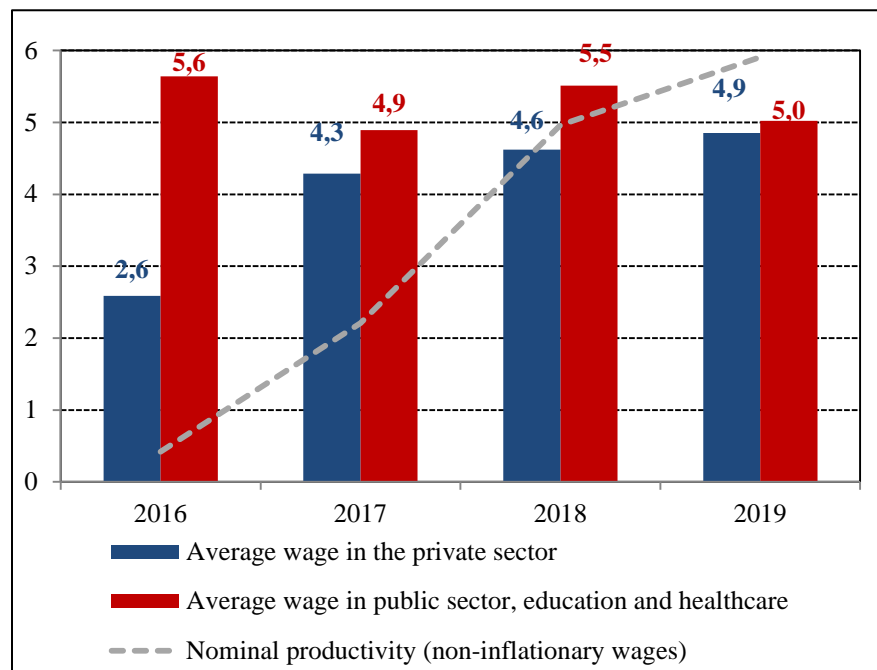
Wages – labour market tightness will support stronger wage growth (reflation)



	2016	2017	2018	2019
Nominal wage (%)	3.3	4.4	4.8	4.9
Revision (p. p.)	0.0	0.2	0.2	0.3

	2016	2017	2018	2019
Real wage (%)	3.8	3.0	2.7	2.6
Revision (p. p.)	-0.1	0.1	0.1	0.0

Annual wage growth (%)



- **Labour market tightness** due to the lack of available job-seekers should result in an acceleration of wage growth in 2017 and in the medium-term.
- First signs are already visible in form of higher negotiated wage increases in selected large firms.
- Dynamic wage growth in the public sector should continue according to the results of wage negotiations in education and administration.

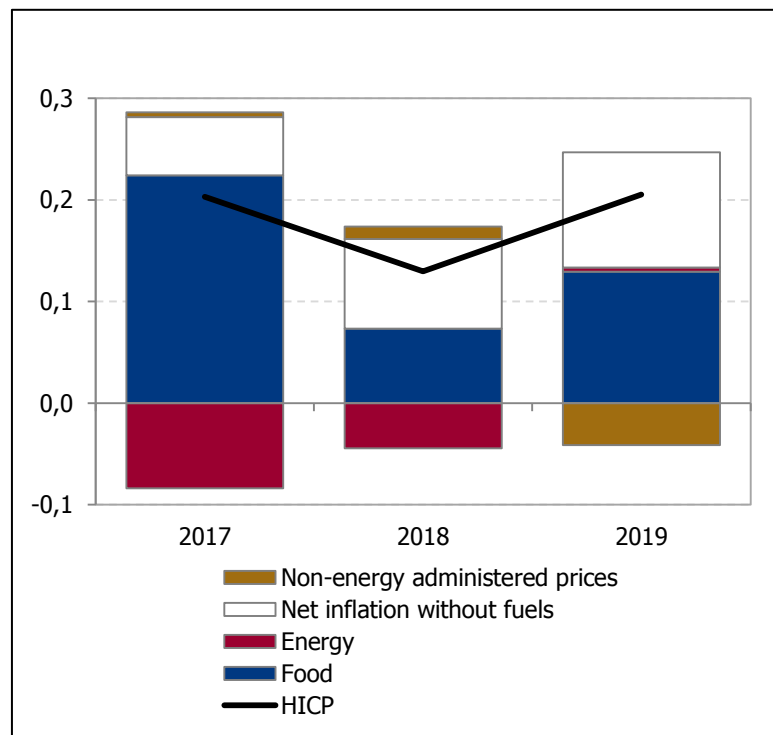
Inflation in Slovakia – step-by-step acceleration due to commodity price increase and demand pull inflation thereafter



	2016	2017	2018	2019
HICP (%)	-0.5	1.4	2.0	2.1
Revision (in p. p.)	0.0	0.2	0.1	0.2

	2016	2017	2018	2019
Demand pull inflation (%)	0.9	1.6	2.3	2.8
Revision (in p. p.)	0.0	0.1	0.2	0.2

Comparison to previous mid-term inflation prediction and revision sources in respect to its structure (in p. p.)



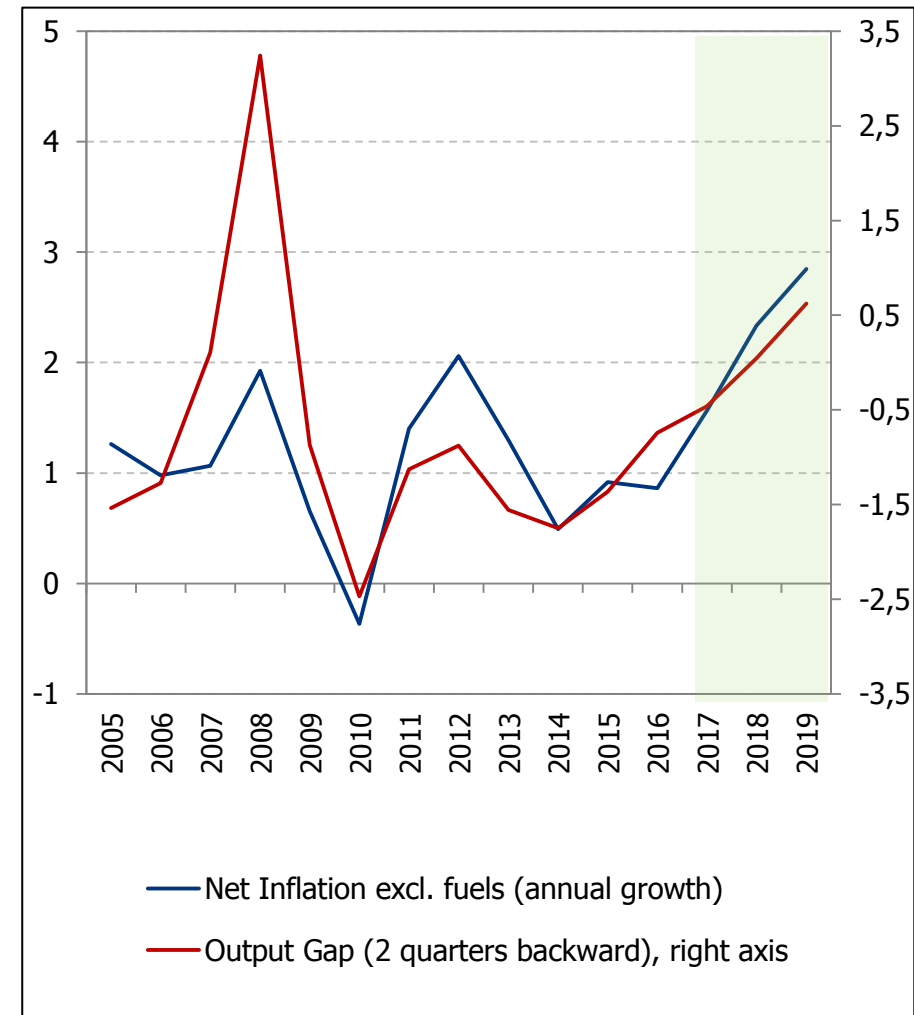
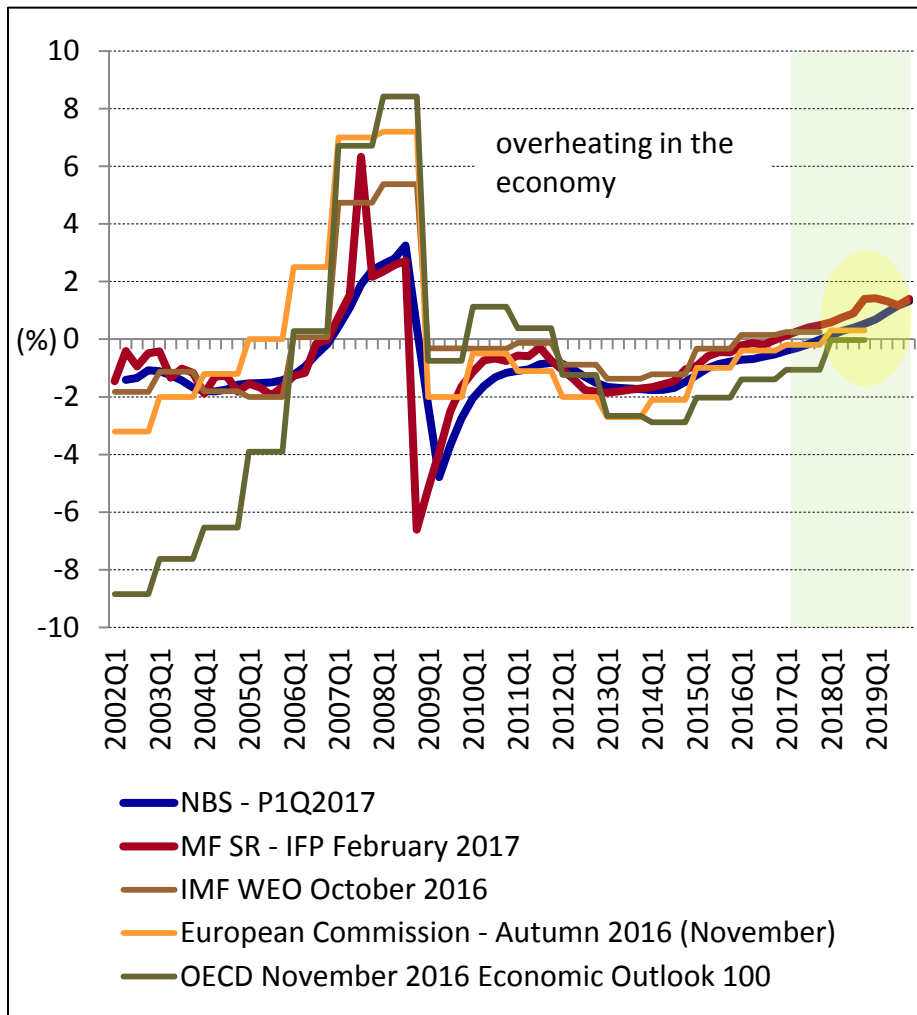
Remark: Demand pull inflation (net inflation without fuels) represent administered prices, energy and food prices adjusted inflation.

- **Slightly higher inflation in year 2017** as a result of recent price development (higher food and non-energy industrial goods prices – due to used cars price measurement methodic change – 0,15 p. p.).
- In consequent years inflation acceleration is influenced by labour market tensions (higher wage increases could pass through into prices).

Slovak Output Gap (Comparison with other institutions)



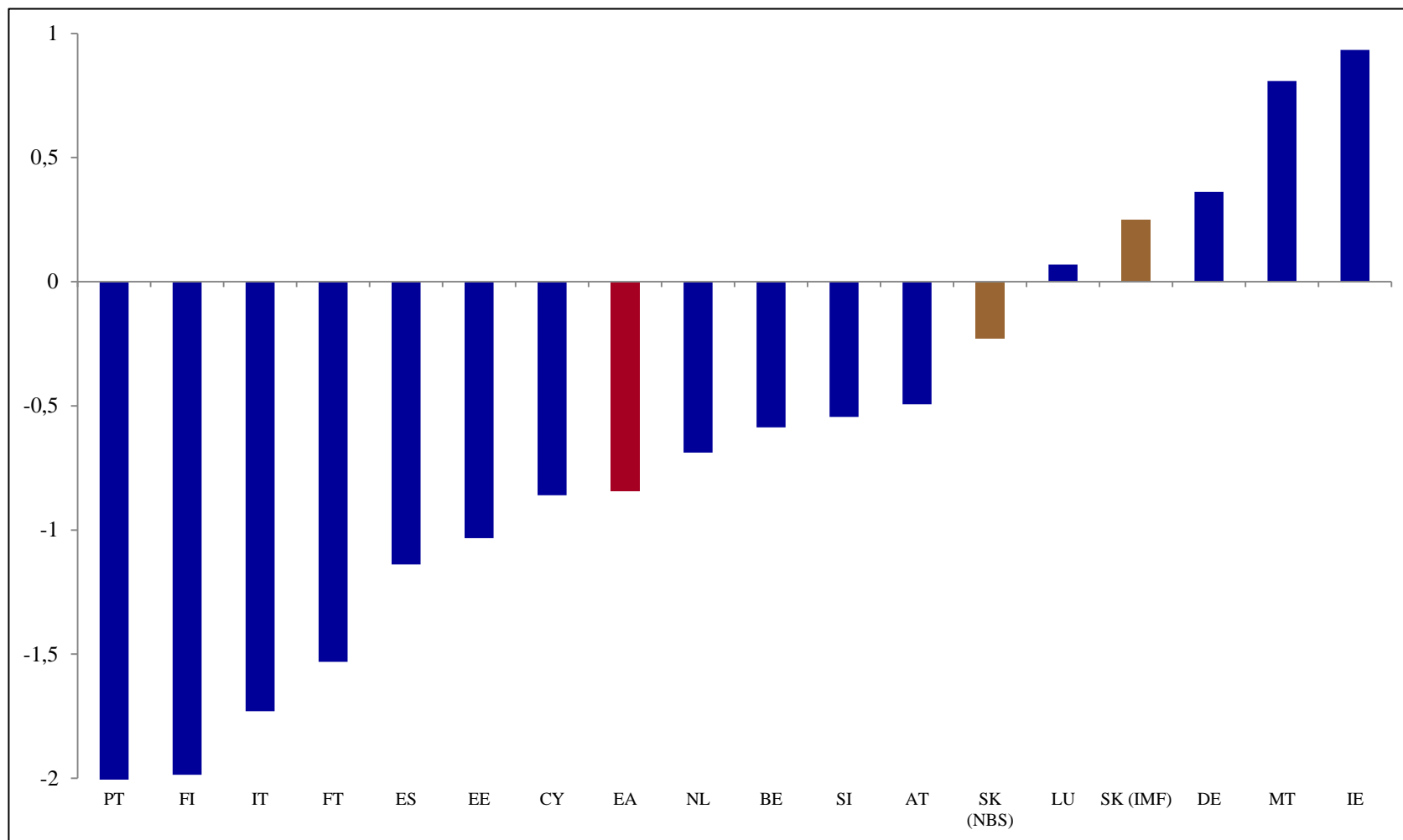
- Economy does not need to be stimulated from 2018, otherwise could show more signs of overheating.



Output gap estimates for euro area countries



IMF - output gap in 2017 (% of potential GDP)

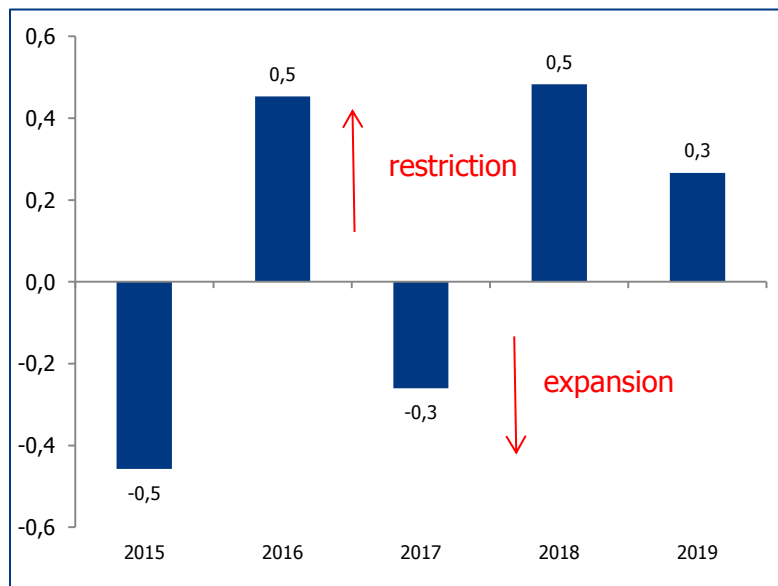




	2016	2017	2018	2019		2016	2017	2018	2019
Deficit (% of GDP)	-1.9	-1.6	-0.8	-0.3	Fiscal stance* (p. p.)	0.5	-0.3	0.5	0.3
Revision (p. p.)	0.4	0.0	0.0	0.0	Revision (p. p.)	0.4	-0.5	0.1	0.0

- Improvement of general government balance outlook for 2016 at 1.9 % of GDP due to lower EU funds co-financing and low level of local government investments.
- Over the rest of the forecast horizon outlook of the fiscal consolidation remains unchanged expecting favourable revenue development and moderate expenditure growth.

Fiscal stance* (y-o-y change in p. p.)



- **Debt** is expected to reach the level of 52.0 % of GDP in 2016, subsequently gradually decreasing to the level of 49.2% of GDP in 2019 as a result of primary balance improvement, low interest expenditures and higher growth of nominal GDP.
- **Fiscal stance:** Following the restrictive influence of fiscal policy in 2016 it is expected a moderate structural expansion this year. In the following years the forecast assumes continuing consolidation of public finances.

*Fiscal stance: y-o-y change of cyclically adjusted primary balance adjusted by influence of PPP projects classified outside general government and net of influence of EU funds outside general government.

Medium-term forecast P1Q-2017

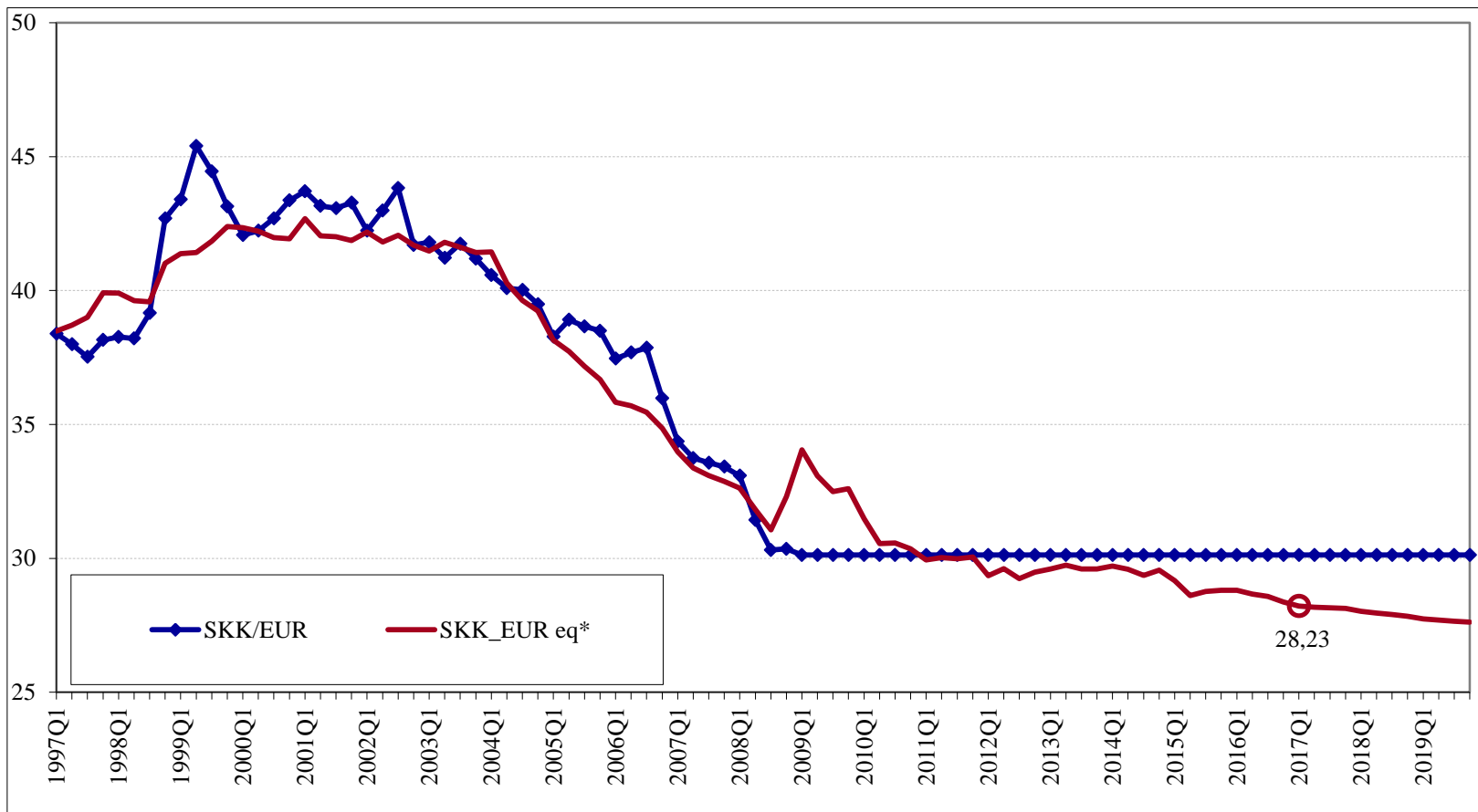


	2016	2017		2018		2019	
	Actual	P1Q-2017	P4QA-2016	P1Q-2017	P4QA-2016	P1Q-2017	P4QA-2016
GDP (constant prices)	3.3	3.2	3.1	4.2	4.2	4.6	4.6
HICP (average)	-0.5	↑ 1.4	1.2	2.0	1.9	↑ 2.1	1.9
Nominal wages	3.3	↑ 4.4	4.2	↑ 4.8	4.6	↑ 4.9	4.6
Real wages	3.8	3.0	2.9	2.7	2.6	2.6	2.6
Employment ESA 2010	2.4	↑ 2.0	1.6	1.2	1.1	0.9	0.9
Unemployment	9.6	↓ 8.4	8.8	↓ 7.7	8.1	↓ 7.1	7.5

Equilibrium exchange rate

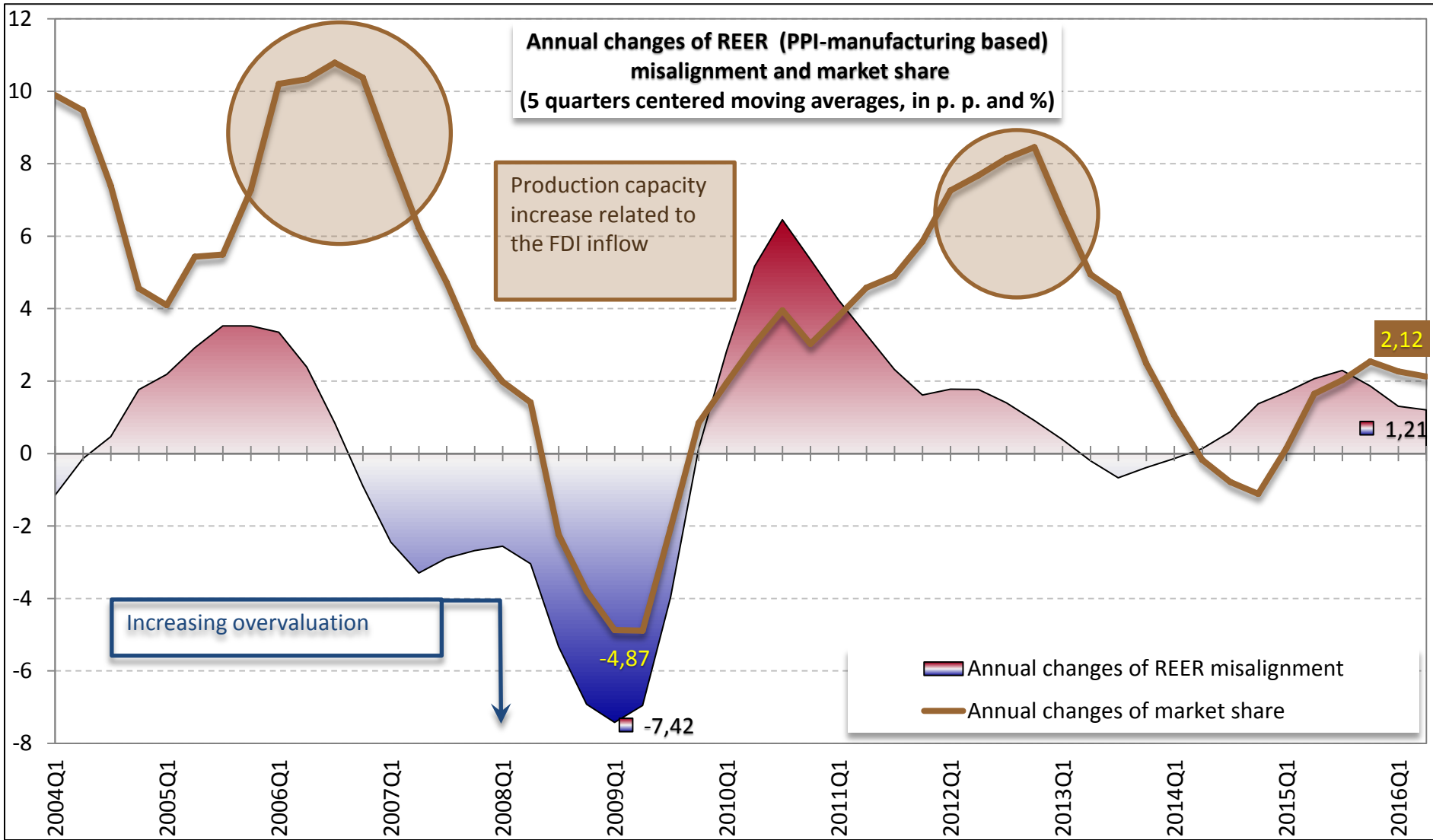


Nominal bilateral exchange rate



* Calculation based on the equilibrium real effective exchange rate under the assumption of homogenous bilateral nominal exchange rates misalignments and an inflation differential resulting from the material Perspektívy dlhodobejšieho vývoja slovenskej ekonomiky.

Market share of Slovakia and REER misalignment





Long-term trends setup (I)

- In the pre-crisis period (2000-2008), the average potential output growth of SR reached **5.2%**, in the forecast horizon (2017-2024), the average growth is expected to be around **3.0%**.

– two factors:

1. Long-term growth of the reference economy (Germany) – lower impact
 - Assumption of gradual slowdown in potential output growth in the long term horizon.
2. The speed of real convergence to the reference country (β - convergence) – higher impact
 - **Moderate long-term growth of the Slovak economy compared to pre-crisis period should be caused primarily due to an increasing degree of convergence of the economy** (higher degree of convergence of the economy results in a slow catching up in the longer term).

	Average potential output growth of SR according to β - convergence (%)	Average potential output growth of SR according to NBS P1Q-2017 (%)	Degree of convergence SK/DE (reality + forecast, GDP in c.p. per head in PPP)
Period	2000 - 2003	4.3	45.3%
	2004 - 2008	3.4	56.3%
	2009 - 2015	3.0	63.2%
	2016 - 2024	2.4	73.3% (72.0%)*

* Figures in brackets represent the values adjusted for the effect of investments in the automotive industry

The macroeconomic outlook to 2024 (III)

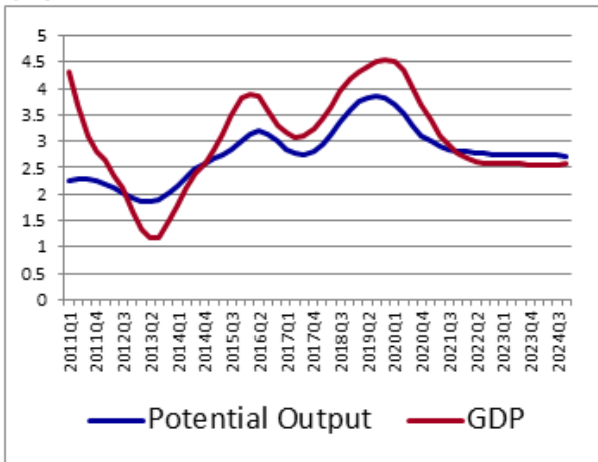


Cyclical position of the economy

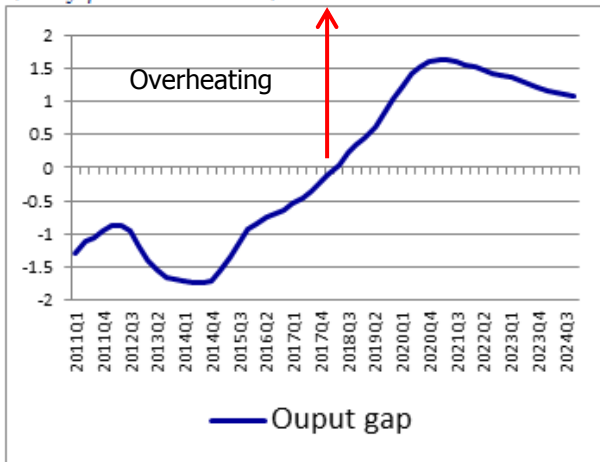
- A negative output gap should be closed by the end of 2017 and consequently the forecast assumes a gradual overheating of the economy. In the years 2020-2021 positive output gap is expected to be around 1.6% with inflation accelerating to 3%.
- In the long term horizon after positive impulses in the economy pass away, in the environment of higher costs of domestic production supporting inflationary pressures the output gap should start to close accompanied by a gradual slowdown of inflation.

	2016	2017	2018	2019	2020	2021	2022	2023	2024
Real GDP growth (%)	3.3	3.2	4.2	4.6	3.7	2.8	2.6	2.6	2.6
Output gap (% of potential GDP)	-0.6	-0.2	0.3	1.0	1.6	1.6	1.4	1.2	1.1
HICP inflation (%)	-0.5	1.4	2.0	2.1	2.5	2.9	2.9	2.8	2.7

Real GDP growth (%)



Output gap (% of potential GDP)



HICP inflation (%)

