1 Macroeconomic developments

1.1 The external economic environment

1.1.1 Global trends in output and prices

Global economic growth slowed to 3.1% in 2015, its lowest rate for six years and down from 3.4% in 2014. As in the previous year, GDP growth trended upwards across advanced economies and downwards across emerging market economies (EMEs).

The 2015 trends stemmed from several factors, the most important being the continuing slowdown of the Chinese economy. China's transitioning away from investment-led economic growth (accompanied by excess capacity) and towards private consumption-led growth had an impact on global demand. In addition, amid mounting fears in mid-year that China's economy could face a ,hard landing', equity prices in Chinese stock markets underwent a sharp correction, resulting in spillover effects in global financial markets. The downside risks to China's growth outlook were further heightened by the volatility of the Chinese currency, with the renminbi being devalued to support export performance and capital flight ensuing. Owing to the continuation of monetary and fiscal policy stimulus measures aimed at stabilising the economy, China's GDP growth was only slightly below target; nevertheless, the build-up of imbalances poses risks going forward. Another key factor in the global economic situation in 2015 was the continuing decline in commodity prices in general and oil prices in particular. The average oil average slumped to almost half of its 2014 level, with major repercussions for those economies most dependent on oil exports. In an environment of low oil prices, currency depreciation, ebbing confidence and rising geopolitical tensions, Russia fell furthest into deep recession. Brazil, too, experienced significant GDP contraction, its largest for 25 years, as the economy was buffeted by declining commodity prices, subdued global growth and economic slowdown in China, Brazil's main trading partner. On the other hand, lower oil prices benefited India, which thanks to continuing reforms and an accommodative monetary policy stance became the fastest-growing large economy in the world in 2015. Generally, however, EMEs exerted a significant drag on global growth for a fifth successive year, and also contributed to the slowdown in world trade growth, from 3.4% in 2014 to 2.6% in 2015.

Advanced economies, supported by the continuance of monetary policy accommodation, had a positive impact on global GDP growth. The recovery in the advanced world did not have such momentum as in the previous year, and there was significant heterogeneity across countries. The euro area recorded the strongest growth, which was driven by both consumer and investment demand, as well as by export growth (despite a slowdown in global demand). Japan's economy also picked up in 2015, after stagnating in the previous year, but its growth was entirely export-driven, with government demand compensating for a slight drop in private sector demand. In the United States, GDP growth maintained its pace of the previous year, with higher contributions from private and government consumption expenditure, a less positive contribution from gross fixed capital formation and a negative contribution from net exports. The labour market upturn supported expectations for the normalisation of US monetary policy in 2015, but it was not until December that the Federal Reserve increased the target range for the federal funds rate. The UK economy's performance in 2015 had a dampening effect on global growth, as the upward impact of private consumption growth was offset by strong import growth.

Global headline inflation continued to fall in 2015, reflecting mainly the impact of a slump in energy prices in response to falling energy commodity prices. The average inflation rate across advanced economies fell to 0.3%, from 1.4% in 2014, and core inflation (excluding food and energy) also continued to decline, possibly implying future deflationary impulses. Although China also experienced falling inflation, caused by a drop in food price inflation, average inflation across EMEs accelerated to 5.5% in 2015 (from 5.1% in 2014). The upward pressure on EME inflation came from currency depreciation and higher import prices, as well as from the low credibility of monetary policies.

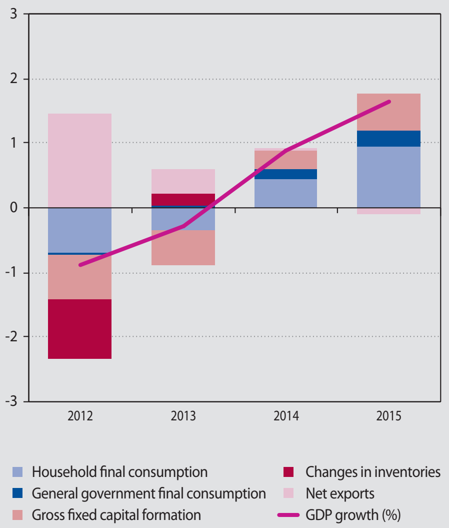
The global oil price slump was a result of an oversupplied market. The supply-side causes of this situation included a production glut, the decision of OPEC countries not to reduce oil output, and the nuclear deal struck with Iran. The downward pressures from the demand side consisted mainly of a drop in Chinese imports amid a slowdown of the Chinese economy. At the same time, however, non-energy commodity prices also fell. Prices of metal and agricultural commodities responded, like oil prices, to persisting oversupply, high stocks and weakening global demand.

1.1.2 Euro area economic developments

The euro area economy's growth accelerated to 1.6% in 2015 (from 0.9% in 2014). The largest contribution to that growth was made by private consumption, with smaller contributions from investment and government consumption. Private consumption and investment were buoyed significantly by the accommodative monetary policy stance and consequent easing of lending conditions. Export growth was higher in 2015 than in 2014, but since import growth was higher still, net exports had a slightly negative impact on GDP growth. The economic recovery remained fragile and buffeted by geopolitical tensions. As the economic recovery began to feed through to the labour market, the unemployment rate gradually declined over the course of the year, from 11.3% in December 2014, to 10.4% in December 2015 (the average rate for 2015 was 10.9%, while for 2014 it was 11.6%).

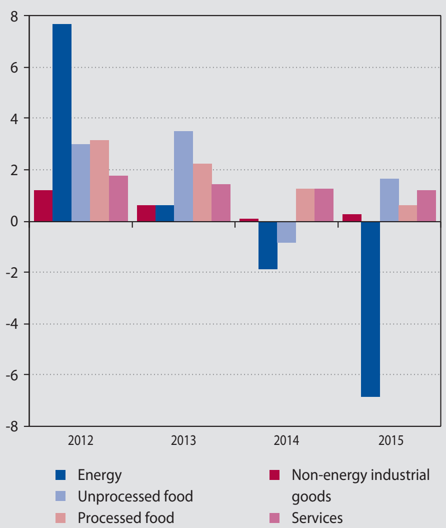
Headline inflation in the euro area, as measured by the Harmonised Index of Consumer Prices (HICP) averaged 0.0% in 2015, which was 0.4 percentage point lower compared with the previous year. Annual inflation remained very low throughout the year, crossing into negative territory in the first three months and in September. In December 2015 the annual inflation rate was slightly positive (at 0.2%) while in December 2014 it had been slightly negative (at -0.2%). The path of inflation during the year was determined mainly be energy commodity prices and their pass-through to energy prices. Food price inflation increased, and so too did non-energy industrial goods inflation, albeit only marginally. Services price inflation was relatively stable, but also remained subdued. Core HICP inflation (excluding energy and unprocessed food) accelerated earlier in the year, but then remained flat from May. It averaged 0.8% in 2015 (0.9% in 2014).

Chart 1 Euro area annual GDP growth and its composition (annual percentages changes and percentage point contributions)



Source: Eurostat.

Chart 2 HICP inflation components (annual percentage changes)



Source: Eurostat.

The euro's exchange rate against the US dollar depreciated sharply at the beginning of 2015, remained broadly unchanged from March, and then weakened again in the last quarter of the year. This pattern reflected different cyclical positions and monetary policy stances in large global economies, as well as downward revisions to outlooks for growth and inflation in the euro area. In its trading against the US dollar, the euro was around 10% weaker at the end of 2015 than at the beginning of year.

As part of its response to current developments, the ECB's Governing Council made one adjustment to its key rates in 2015. Furthermore, the Governing Council decided to expand the ECB's asset purchase programme (APP) at a time when most indicators of actual and expected euro area inflation were gradually decreasing towards historical lows. Given the potentially adverse spillover effects of wage and price formation on the medium-term inflation path, the monetary policy response was necessary. Asset purchases are providing a monetary stimulus to the economy at a time when the ECB's key rates are close to their lower bound.

1.2 MACROECONOMIC DEVELOPMENTS IN SLOVAKIA

Slovakia's economic growth reached a five-year high in 2015, as GDP at constant prices increased by 3.6% year-on-year (up from a rate of 2.5% in 2014). Domestic demand was the main driver of that growth, with its investment component having the largest impact and domestic consumption contributing to a lesser extent. Foreign demand growth was also stronger in 2015 than in 2014. The growth in GDP in the output approach was based largely on an increase in value added in industry, construction, wholesale trade and the general government sector. A major contribution to GDP growth came from the absorption of EU funds under the National Strategic Reference Framework of the Slovak Republic for 2007-2013, with the absorption of the available funds surging from 63% in 2014 90% in 2015.

In the balance of payments, the current account showed a deficit of €1.0 billion for 2015 (after a surplus of €0.1 billion for 2014). This was caused mainly by a decline in the trade surplus that reflected increasing goods imports. Other components of the current income remained broadly unchanged in year-on-year terms.

The labour market situation improved during 2015, supported by solid economic growth and, in the second half of the year, the increased absorption of EU funds. Employment as defined in the ESA 2010 grew by 2.0% year-on-year in 2015 (following a growth rate of 1.4% in 2014). The unemployment rate as measured by the Labour Force Survey fell from an average of 13.2% in 2014 to 11.5% in 2015. While the downward trend was favourable, the unemployment rate still remained above its pre-crisis level. Average nominal wages increased in 2015, but their annual growth rate was lower compared with the previous year.

Average annual inflation moved further into negative territory in 2015, from a rate of -0.1% in 2014 to -0.3%. The energy, food and services components all contributed to the decline in the overall price level.

1.2.1 Price developments

Average annual inflation followed a declining trend in year-on-year terms. The price level's further move into negative territory reflected an acceleration in the decline of energy prices and lower rates of inflation in processed food and services prices. Inflation in 2015 was also under downward pressure from external factors (the continuing slump in prices of oil and other energy commodities) and, to a lesser extent, from administrative measures (rail fare reductions at the end of 2014) and from low imported inflation.

Wholesale gas prices fell in an environment of global oversupply, leading to reductions in regulated household gas prices, mainly in the second half of the year. Electricity prices were pushed down by the pipeline pressure of falling energy commodity prices. Owing to the pass-through of sharply falling oil prices, automotive fuel prices were on a downward trajectory throughout the year, falling by more than 12% on average. The oil price slump was one of the main causes of the persisting low inflation environment in Slovakia and other euro area countries.

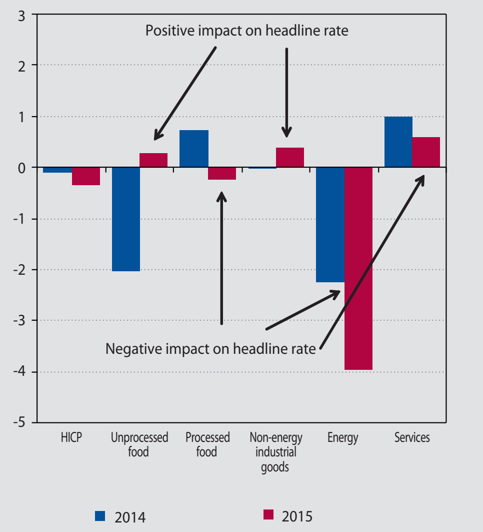
Unprocessed food inflation picked up gradually over the year, reflecting the base effect of the significant drop in unprocessed food prices in the second half of 2014. For the year as a whole, unprocessed food inflation averaged 0.3%. Processed food prices, by contrast, declined slightly in 2015 owing to relatively high stocks of key food commodities.

Despite exchange rate depreciation, the annual rate of inflation in non-energy industrial goods slowed gradually in 2015, from 0.6% at the beginning of the year to 0.1% in December. Its average for the year as a whole, however, was moderately higher compared with the previous year. Looking at the breakdown of non-energy industrial goods inflation, prices of non-durable goods increased and prices of durables were falling throughout the year, albeit more moderately towards the year-end. The price trends in non-energy industrial goods may have continued to be affected by the impact of structural changes (technical advances in manufacturing processes, burgeoning internet sales, and the shortening of product life cycles).

The average rate of services inflation was slightly lower in 2015 than in 2014, owing mainly to administrative measures. In particular, the introduction of zero rail fare for certain groups of consumers at the end of 2014 passed through to services inflation in 2015 (with an impact of -0.19 percentage point on the headline inflation rate). Despite favourable trends in the labour market and in household final consumption, services inflation excluding administered prices was relatively subdued throughout the year.

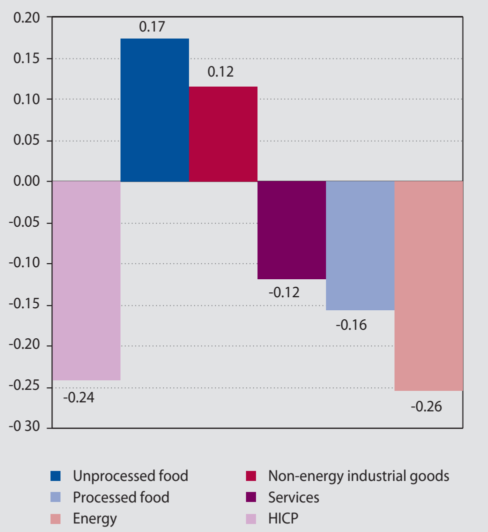
Headline inflation was strongly affected by the impact of external factors in the form of commodity price shocks. The consequent pipeline pressures resulted in negative energy inflation and low food price inflation. Services inflation, too, was affected by the pass-through of these shocks (via reduced energy, fuel and food costs), which served to dampen the upward impact of positive developments in the real economy as well as in the labour market, wages and consumption.

Chart 3 HICP inflation and its components (annual percentage changes)



Sources: SO SR and NBS calculations.

Chart 4 HICP inflation and its contribution by components for 2015 minus the corresponding figures for 2014 (percentage points)

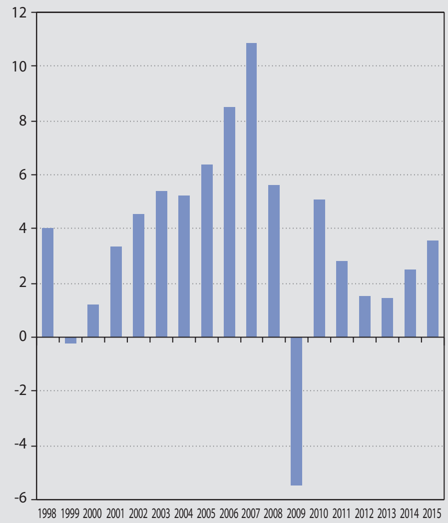


Sources: SO SR and NBS calculations.

1.2.2 Gross domestic product

Slovakia's annual GDP growth at constant prices increased to 3.6% in 2015, from 2.5% in 2014. The acceleration was based on stronger growth in domestic demand. Nominal GDP increased by 3.3% in year-on-year terms, to

Chart 5 Real GDP (annual percentage changes)



Source: SO SR.

€78 billion. The nominal growth was lower than the real growth owing to a decline in the general price level, as measured by the GDP deflator. The GDP deflator fell by 0.3% year-on-year (after falling by 0.2% in 2014) amid the continuing decline in consumer, producer, import and export prices.

GDP on the output measure

The output measure of annual GDP growth reflected an acceleration in real value added growth, to 3.1% (from 2.1% in 2014). The economic sectors reporting the strongest value added growth in 2015 were industry, construction, wholesale trade and the general government sector. In agriculture, by contrast, value fell.

GDP on the expenditure measure

Domestic demand growth was higher in 2015 than in 2014, at 5.0%. The acceleration was based largely on investment growth (elevated absorption of EU funds towards the end of the year) as well as continuing growth in household consumption. Net exports, on the other hand, made a negative contribution, with import growth (8.2% year-on-year) exceeding export growth (7.0%). As in the previous year, import growth

Table 1 GDP on the output measure (index: same period a year earlier = 100; constant prices)

	2014	2015				
	Q1-Q4	Q1	Q2	Q3	Q4	Q1-Q4
GDP	102.5	102.9	103.4	103.7	104.3	103.6
Gross output	102.2	102.9	104.5	107.1	107.2	105.4
Intermediate consumption	102.3	102.9	105.7	110.1	109.4	107.0
Value added	102.1	103.1	102.6	103.1	103.7	103.1
Net taxes on products[1)]	106.9	101.2	110.9	110.4	109.2	108.2

Source: SO SR.
1) Value added tax, excise tax and import tax, less subsidies.

Table 2 GDP on the expenditure approach (index: same period a year earlier = 100; constant prices)

	2014	2015				
	Q1-Q4	Q1	Q2	Q3	Q4	Q1-Q4
GDP	102.5	102.9	103.4	103.7	104.3	103.6
Final consumption	103.2	101.6	102.6	103.3	102.9	102.6
Final consumption of households and non-profit institutions serving households	102.3	101.5	102.3	102.8	102.8	102.4
Final consumption of general government	105.9	101.8	103.6	105.2	103.2	103.4
Gross fixed capital formation	103.5	106.7	109.5	117.3	119.4	114.0
Goods and services exports	103.6	105.4	106.1	107.3	109.1	107.0
Goods and services imports	104.3	105.2	107.3	109.9	110.5	108.2

Source: SO SR.

was boosted by the strengthening of domestic demand.

All components of domestic demand increased in 2015. Fixed capital investment grew the fastest, by 14.0% year-on-year, and while this growth was broadly-based across the range of sectors, it was strongest in the public sector, driven mainly by investment in *other building construction*. This surge in investment activity is expected to be only temporary, given that it was supported by the final absorption of EU funds available under the previous EU programming period. Consumption demand, too, contributed to economic growth. Private consumption increased by 2.4%, as the improving labour market situation and falling inflation had an upward impact on household disposable income. The pass-through of lower oil prices to inflation was seen mainly in prices of energy and automotive fuel. This enabled households to increase their spending on other, non-essential goods and services (such as recreation and culture). Government consumption growth, at 3.4%, was higher than private consumption growth, and included increases in goods and services expenditure and in compensation of employees.

Export performance was responsive to demand trends in Slovakia's trading partners, with export growth accelerating gradually over 2015 and its average annual growth rate for the year standing at 7.0%. In sectoral terms, export growth was strongest in the car industry, while in the geographical breakdown, exports to EU markets increased the most.

As measured by the export-to-GDP ratio, export performance improved in 2015 by 1.9 percentage points, year-on-year, to stand at 94%. At the same time, import intensity increased by 3.2 percentage points, As for the openness of the Slovak economy, measured by goods and services exports and imports as a percentage of GDP, it rose by 5.1 percentage points, to 185.2%.

1.2.3 The labour market

After picking up in 2014, the labour market situation continued to improve in 2015. This trend reflected the impact of solid GDP growth and, in the second half of the year, the increased absorption of EU funds. Average nominal wage growth was attributable to the still rising demand for labour and labour productivity growth. At the same time, subdued inflation had a dampening effect on nominal wage growth. Unemployment fell quite sharply in 2015, but nevertheless remained in double digits.

Employment

Employment as defined in the ESA 2010 grew by 2.0% year-on-year in 2015 (following a growth rate of 1.4 % in 2014). The number of hours worked increased by 1.7% in year-on-year terms

Table 3 Labour market indicators

	2014	2015				
	Q1-Q4	Q1	Q2	Q3	Q4	Q1-Q4
Nominal wages (index)	104.1	102.2	102.3	102.9	104.1	102.9
Real wages (index)	104.2	102.6	102.4	103.2	104.6	103.2
Nominal compensation per employee – ESA 2010 (index)	101.8	101.9	101.5	102.1	103.9	102.4
Labour productivity – GDP per employee (index; current prices)	100.9	100.8	101.0	101.2	102.2	101.3
Labour productivity – GDP per employee (index; current prices)	101.1	101.2	101.3	101.5	102.3	101.6
Employment – ESA 2010 (index)	101.4	101.8	102.0	102.2	102.0	102.0
Unemployment rate – LFS[1)] (%)	13.2	12.1	11.5	11.4	10.8	11.5
Nominal unit labour costs (ULCs)[2)]	100.7	100.7	100.2	100.5	101.6	100.8

Sources: SO SR and NBS calculations.
1) Labour Force Survey.
2) Ratio of compensation per employee growth at current prices to labour productivity growth (ESA 2010) at constant prices.

(after increasing by 0.7% in 2014). The sectors accounting for most of the employment growth were professional and scientific activities, industry, and the public sector. The construction sector's contribution to overall employment growth remained negative in 2015, but it was the sector's least negative contribution in the post-crisis period. Public sector employment[1] grew by 1.1% (after increasing by 1.8% in 2014), based mainly on job growth in the health-care and, to a lesser extent, administration sectors. According to the Labour Force Survey, the number of Slovak citizens working abroad in 2015 soared by 10.5% (14,000 people) on a year-on-year basis. This was a turnaround from 2014, when the number fell.

Unemployment

As measured by the Labour Force Survey, the number of unemployed fell, year-on-year, by 12.4% (more than 44,000) and the unemployment rate decreased by 1.7 percentage point, to 11.5%. The average registered unemployment rate, based on figures from labour offices, fell by 1.3 percentage point year-on-year, to also stand at 11.5%.

Wages and labour productivity

The average monthly nominal wage in 2015 increased to €883, and its annual growth rate slowed to 2.9% (from 4.1% in 2014). As inflation was lower in 2015 than in 2014, it put downward pressure on nominal wage growth. As firms experienced reduced income in a low inflation environment, they were constrained from more significant wage growth. The sectors reporting the highest nominal wage growth in 2015 were IT and telecommunications (5.3%), transportation and storage (5.0%) and mining and quarrying (4.9%). Wage developments in the construction sector were notable in that the average wage climbed by 5.3% after falling in the previous year. This turnaround was supported by work on the completion of EU-funded projects, which had a greater impact on wage and production growth than on the employment figures in the sector. By contrast, sectors in which the average nominal wage fell included professional and scientific activities (-6.0%) and agriculture (-2.3%). As in 2014, the price level declined in year-on-year terms and, consequently, real wage growth was higher than nominal wage growth. The annual growth rate for labour productivity (GDP per employee) increased in 2015. At the same time, real labour productivity growth was lower than real wage growth. Such a situation may support a pick-up in prices in the following period, but if it were to persist for an extended time and spread to export-oriented sectors, it could weigh on economic competitiveness.

1.2.4 Financial results

The aggregate profit of non-financial and financial corporations in Slovakia increased in 2015 by 13.6% year-on-year, to €11,633.34 million (after falling by 0.9% in 2014), according to the SO SR's preliminary figures. While the non-financial corporations sector increased its overall profit by 21.6% (up from 0.5% in 2014), financial corporations, not including Národná banka Slovenska, saw their aggregate profit slump by 21.1% (after increasing by 18.4% in 2014).

In absolute terms, the overall profit of non-financial corporations increased by €1,834.7 million, to €10,325.5 million. That growth was largely accounted for by manufacturing industry, and in particular by the sectors of pharmaceuticals and refined petroleum products, which made an aggregate profit after reporting a loss in the previous year. Other sectors that contributed positively to the total profit included the following: electricity, gas and steam supply; construction; transportation and storage; and trade.

The total profit of the financial sector (excluding NBS) was lower in 2015 than in 2014 by €347.4 million, at €1,301.0 million.

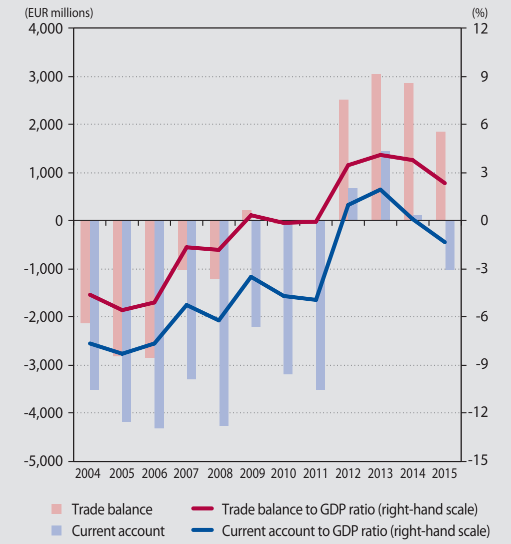
1.2.5 Balance of payments

Current account

In Slovakia's balance of payments for 2015, the current account result deteriorated to a deficit of €1.0 billion, from a moderate surplus in 2014. This result was largely attributable to the trade surplus, which declined owing to increasing imports of investment and consumption goods. The ratio of the current account balance to GDP (at current prices) fell, year-on-year, by 1.4 percentage point, to stand in negative territory at -1.3%.

1 *Including also the health-care and education sectors.*

Chart 6 Current account and trade balance developments



Sources: SO SR and NBS calculations.

Export performance was subdued in the early part of 2015, as it had been in late 2014. Exports began slowly to recover only in the second half of the year, led by export growth in the car industry. Import growth stemming from the import intensity of exports was heightened by growing imports of final consumption goods. As a result, exports grew more slowly than imports, and the trade surplus was therefore lower in 2015 than in the previous year.

Table 4 The b.o.p. current and capital account (EUR billions)

	2014	2015
Goods	2.9	1.8
Exports	62.6	65.9
Imports	59.7	64.1
Services balance	0.1	0.1
Primary income balance	-1.7	-1.8
Secondary income balance	-1.2	-1.1
Current account in total	0.1	-1.0
Current account to GDP ratio (%)	0.1	-1.3
Capital account	0.7	2.8

Sources: SO SR and NBS.

Other components of the current showed only minor changes in year-on-year terms. The services balance surplus was almost unchanged, as increases in the *travel* and *transportation* items were offset by a deterioration in other items of the balance.

In contrast to the current account, the capital account recorded a surplus of €2.8 billion. This significant year-on-year increase was largely attributable to the completion of large infrastructure projects in the latter part of the year. These drew in a record inflow of EU funds, to the extent that almost 50% of the EU fund inflows for 2015 were recorded in the fourth quarter of the year.

Financial account

The surplus in the financial account of the balance of payments was €0.6 billion in 2015, €1.0 billion lower than in 2014.

In the direct investment balance of the financial account, the inflow comprised participating interests of non-residents and resulted in an increase in liabilities vis-à-vis the rest of the world. This impact of that increase was cancelled out by a moderate outflow of debt capital arising from the activity of economic agents. The outflow recorded in the portfolio investment balance was based mainly on NBS's activities in relation to the Eurosystem's asset purchase programme, i.e. the purchase from non-resident counterparties of securities issued in Slovakia. This activity had a downward impact on liabilities. The inflow in the other investment balance was supported

Table 5 The b.o.p. financial account (EUR billions)

	2014	2015
Direct investment	0.2	-0.7
Portfolio investment and financial derivatives	-2.3	1.4
Other investment	0.0	-1.5
Reserve assets	0.5	0.2
Financial account in total	-1.6	-0.6

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

mainly by loans provided to non-residents by Slovak banks.

External debt of Slovakia

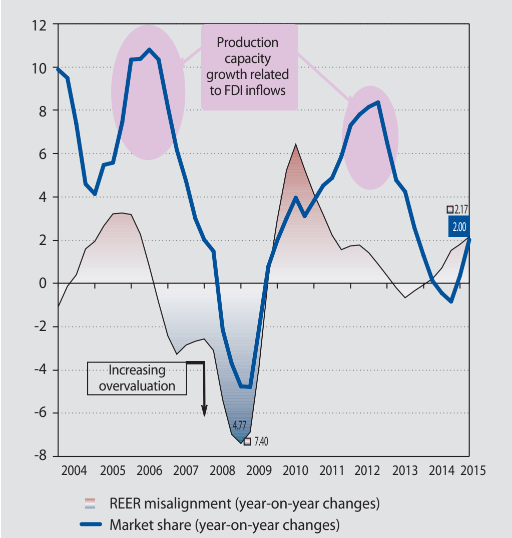
As a result of b.o.p. transactions, Slovakia's external debt denominated in euro decreased in 2015 by €0.5 billion, year-on-year, to €67.2 billion, and the external debt denominated in US dollars fell by $9.1 billion, to $73.2 billion. According to preliminary figures, the ratio of Slovakia's total gross external debt to GDP at current prices was 87.8% as at 31 December 2015, which was 0.3 percentage point lower than the figure for 2014 (88.1%). The ratio of total short-term external debt to total gross external debt increased, year-on-year, by 2.1 percentage points, to 32.2% as at the year-end. Debt per capita was €12,398 as at the end of 2015, which was €136 higher than its level a year earlier.

Nominal and real effective exchange rates[2]

The nominal effective exchange rate (NEER) depreciated in 2015 by an average of 1.9% year-on-year, after appreciating by 1.2% in the previous year. The principal negative contributions to the NEER were made by weakening against the Chinese renminbi (-1.2 percentage points), the South Korean won (-0.6 percentage point), the pound sterling (-0.5 percentage point) and the US dollar (-0.4 percentage point), while the main upward pressure on the index came from appreciation against the Russian rouble (0.9 percentage point). Exchange rates remained relatively stable with the currencies of neighbouring countries that are Slovakia's fellow members of the Visegrad Four group (Poland, the Czech Republic, and Hungary).

The real effective exchange rate (REER) based on the producer price index depreciated by 2.5% in 2015, fully 2.3 percentage points more than it depreciated in 2014. The weakening of the REER was more marked than that of the NEER owing to the negative inflation differential against Slovakia's most significant trading partners. After accounting for the weights of trading partners currencies in the index, the differentials that had the largest negative impact on the REER were those against Germany (-0.6 percentage point) and Russia (-0.5 percentage point). Amid continuing appreciation of the REER's estimated equilibrium trajectory (stemming mainly from the fact that the equilibrium growth of labour productivity was higher in Slovakia than in its trading partners), the depreciation of the index led to increased undervaluation of the REER. The more undervalued REER continued to support the price competitiveness of domestic firms, which may have contributed to the pick-up in the share of Slovak exports in world trade.

Chart 7 Year-on-year changes in the PPI-based REER's misalignment and in market share (centred five-quarter moving average; percentage points; percentages)



Source: ECB, Eurostat and NBS calculations.

2 *The methodology used to calculate the effective exchange is published on the NBS website at: http://www.nbs.sk/_img/Documents/_Statistika/VybrMakroUkaz/EER/NEER_REER_Methodology.pdf*