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EUROSYSTÉM

Medium-term forecast

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1 Overview

Slovakia's annual GDP growth slowed appreciably in the fourth quarter of 2018, to 3.6% (from 4.6% in the third quarter), owing mainly to the negative contribution of net exports. Year-on-year export growth continued to moderate, although exports were still benefiting from the production of new car models. The domestic demand component included increases in consumer demand, government demand, and investment. The pick-up in investment was supported by the public sector's increasing absorption of European Union funds. Labour market indicators began pointing to a trend shift, with slower growth in both employment and wages.

In this Medium-Term Forecast (MTF-2019Q1), it is assumed that the current business cycle peaked in 2018. Compared with the previous forecast, significant revisions have been made to the macroeconomic outlook. Given lower foreign demand[1] and the related revision of the timing and extent of new production in the car industry, and given the weaker than expected developments in the last quarter of 2018, the projections for GDP growth have been revised down to 3.5% in 2019, 3.4% in 2020, and 2.8% in 2021 (after the impact of new car production capacity has faded). Private consumption is envisaged to continue increasing over the projection period, reflecting labour market developments. After overall investment accelerated significantly in 2018, private sector investment is expected to moderate owing to the base effect and to the cooling of global demand. Since the public sector will be absorbing increasing volumes of European Union funds, it is projected to be supporting investment.

Recent developments and the lowering of employers' expectations, together with the revision of economic growth, have resulted in revisions to the outlook for labour market indicators. Both employment growth and wage growth are expected to moderate. Nevertheless, disposable income growth will provide scope for a relatively robust increase in household consumption. The unemployment rate is expected to fall moderately, and at the projection horizon it should be steady at just below 6%.

The annual HICP inflation rate is expected to be around 2.5% throughout the projection period. Energy inflation is projected to have a strong upward impact on headline inflation in 2019; thereafter, it should moderate, while the impact of demand-pull inflation increases. Besides demand pull-inflation, higher labour costs are also expected to put upward pressure on headline inflation; nevertheless, the headline rate should be lower compared with the previous forecast owing to the economy's weaker cyclical position.

The risks to the GDP growth outlook tilt to the downside. The main downward risks lie in external factors, specifically Brexit and any further slowdown of the global economy. The inflation outlook is subject to balanced risks.

1 *In its March 2018 projection exercise, the European Central Bank (ECB) substantially revised down the projection for euro area economic growth.*

2 Recent developments in the external environment and in Slovakia

Modest euro area GDP growth in the fourth quarter[2]

Euro area GDP increased, quarter on quarter, by 0.2% in the fourth quarter of 2018, slightly surpassing its rate in the previous quarter. All components apart from inventories supported the growth, and net exports had the largest impact. Looking at the geographical breakdown of the growth, only the German and Italian economies failed to expand. Incoming leading indicator data imply that euro area GDP growth will continue easing in the first quarter of 2019. Annual HICP inflation stood at 1.5% in February 2019, reflecting mainly increases in food and energy prices.

The Slovak economy slowed mainly due to net exports[3]

Slovakia's annual GDP growth slowed appreciably in the fourth quarter of 2018, to 3.6% (from 4.6% in the third quarter), owing mainly to the negative contribution of net exports. Year-on-year export growth continued to moderate, although exports were still benefiting from the production of new car models. Consumption demand continued to have a positive impact, thanks largely to stronger growth in government consumption. After falling sharply in the previous quarter, investment rebounded; this was supported by the general government sector, and therefore reflected the positive impact of the higher absorption of EU funds.

Employment increased by 1.7%, year on year, in the fourth quarter of 2018, and its growth rate is gradually decelerating in line with expectations (from 1.9% in the third quarter). This trend is evident mainly in the private sector, which has been affected by ongoing labour shortages and, to a lesser extent, by the current economic slowdown related to weaker foreign demand. Labour market tightness eased slightly, resulting in softer wage growth, particularly in the private sector.

The annual HICP inflation rate decreased to 2.1% in the fourth quarter of 2018 (from 2.7% in the third quarter). Its slowdown was caused mainly by the food prices and partly also by motor fuel prices. As regards demand-pull inflation, the non-energy industrial goods component accelerated on the back of higher imported inflation. By contrast, air fare movements at the end of the year had a dampening effect on demand-pull inflation.

2 For further details, see the "Report on the International Economy – March 2019"

3 For further details, see the "Report on the Slovak Economy – March 2019"

3 Technical assumptions of the forecast[4]

3.1 Commodities and the exchange rate

Between the cut-off dates for the January 2019 forecast and this forecast, the **exchange rate**[5] of the euro against the US dollar followed a depreciation trend underpinned by concerns about future developments in the euro area and by weaker economic data from Germany. The average exchange rate over the period 2019-21 is assumed to be USD 1.14 per euro, which compared with the January forecast, means the exchange rate is 0.4% weaker in 2019 and 0.5% weaker in 2020 and 2021. The nominal effective exchange rate (NEER), calculated with respect to Slovakia's 15 most significant trading partners, is 0.6% lower in this forecast than in the previous forecast.

Oil prices have been on an upward path in recent months, owing to production restraint by OPEC member and non-OPEC oil producers and to the continuation of US sanctions on Iran and Venezuela. Oil prices were further boosted by expectations that the United States and China would strike a trade deal that could have positive impact on global economic growth. Compared with the previous forecast, the euro oil price is markedly higher, by more than 17% in 2019, 14% in 2020 and 9% in 2021.

3.2 Foreign demand

In the ECB's latest projection exercise,[6] the GDP growth forecast has been revised down substantially for 2019 and slightly for 2020. After weakening appreciably in 2019, to 1.1%, annual GDP growth is expected to accelerate to 1.6% in 2020 and to be 1.5% in 2021.

The latest leading indicator readings, as well as the projections of international institutions, show a deterioration in the global economic outlook; this stems from China's economic slowdown, the ongoing trade tensions between the United States and China, and the subdued trends in global industry. The euro area has not yet seen any significant recovery from its weaker performance in the third quarter of 2018, which resulted from the implementation of new emission standards in the car industry. Furthermore, the worsening of economic sentiment indicators across countries and sectors suggest that the impact of adverse factors on the economy is more prolonged. Their impact is evident in the downward revision of euro area growth projections, particularly in 2019. Therefore, compared with the January forecast, the assumptions for growth in Slovakia's foreign demand have been revised down, to 3.4% in 2019 (by 0.5 percentage point), 4.0% in 2020 (by 0.2 percentage point) and 3.8% in 2021 (by 0.1 percentage point).

4 *The technical assumptions of this Medium-Term Forecast are based on the "March 2019 ECB staff macroeconomic projections for the euro area", with a cut-off date of 12 February 2019. The assumptions for the EUR/USD exchange rate, Brent oil prices and Slovakia's foreign demand were updated as at 5 March 2019.*

5 *The bilateral EUR/USD exchange rate is assumed to remain unchanged over the projection period at the average level prevailing in the ten-working day period ending on the cut-off date.*

6 *March 2019 ECB staff macroeconomic projections for the euro area.*

4 Macroeconomic forecast for Slovakia

4.1 Economic growth

Market share gains underpinned by carmakers

After export growth softened temporarily in 2018 amid cooling foreign demand, it is expected to accelerate in 2019 despite a weaker external environment. This is because new production in the car industry will gradually be coming on stream, providing a positive supply shock that should result in the Slovak economy making significant market share gains. Over the rest of the projection period, export growth is expected to decelerate, while still outpacing export market growth due to the Slovak economy's continuing strong price competitiveness.

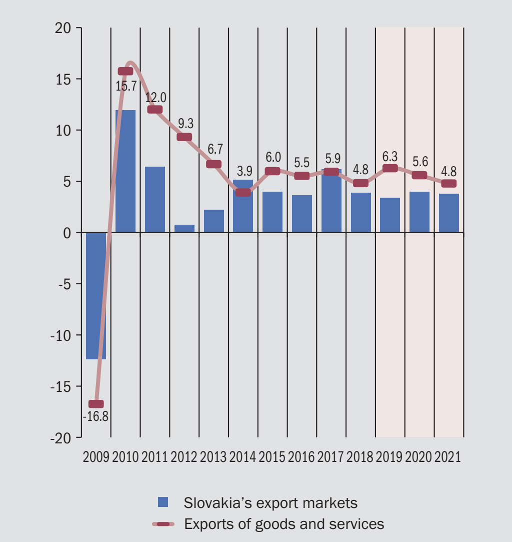
Strong investment growth, particularly in the public sector

The significant acceleration in investment growth in 2018 stemmed from increased investment in the automotive industry and in the public sector. Subsequent years are expected to see investment growth moderate, especially in the private sector as a result of the base effect and the slowdown in GDP growth. In the public sector, however, investment activity is expected to continue gathering pace, due largely to the rising absorption of EU funds and to increasing defence expenditure.

Private consumption to continue growing

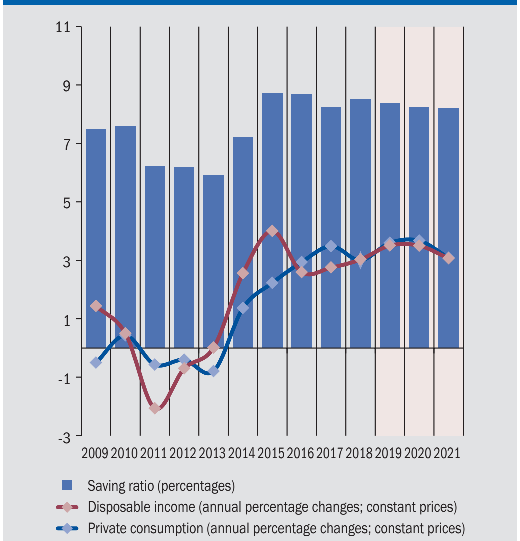
Private consumption is expected to continue increasing over coming years and therefore to reflect the labour market situation. Its growth is expected to be based on increases in real disposable income supported mainly by favourable wage trends and by one-off government measures (including, for example, Christmas benefits, a doubling of the tax credit for children aged up to six, and free school lunches). Wage growth is projected to reflect rising labour productivity, labour market tightness, and increases in public sector salaries. Towards the end of the projection period, consumer demand growth is projected to slow as economic activity growth moderates.

Chart 1 Slovakia's foreign demand and exports of goods and services – trend and forecast (annual percentage changes; constant prices)



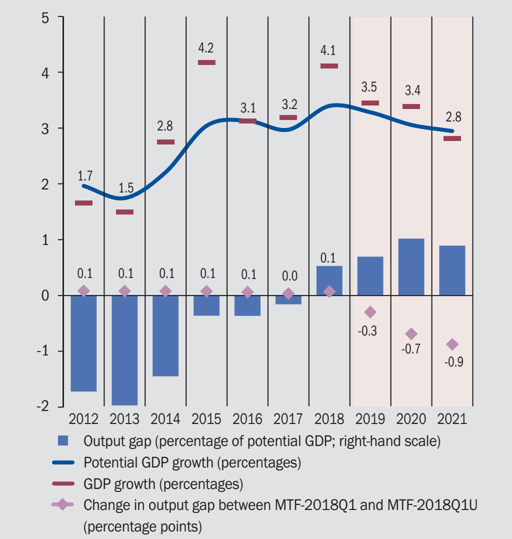
Sources: SO SR, ECB and NBS calculations.

Chart 2 Household income, household consumption and the household saving ratio – trend and forecast (percentages)



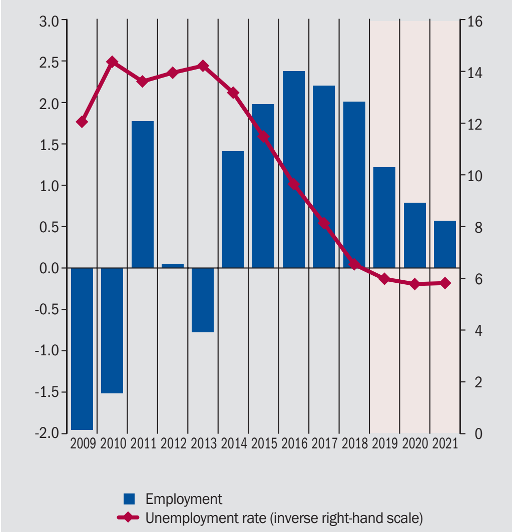
Sources: SO SR and NBS.

Chart 3 GDP and the output gap – trend and forecast (percentages)



Zdroj: ŠÚ SR a výpočty NBS.

Chart 4 Employment and the unemployment rate (annual percentage changes)



Sources: SO SR and NBS.

Economic growth has peaked, now expected to moderate

Supported by expanding production capacities and strong domestic demand, last year's GDP growth is expected to have marked the peak of the current business cycle. Economic activity growth is expected to moderate from this year, with the slowdown somewhat offset by the launch of new production in the car industry. Hence GDP growth in both 2019 and 2020 is expected to remain close to 3.5%, before slowing to 2.8% in 2021. It is still expected, however, that the economy will be operating above potential and this should be reflected in demand-pull inflation.

4.2 LABOUR MARKET

Employment growth gradually moderating

The easing of employment growth seen at the end of 2018 is expected to continue in the next period. This slowdown relates to both external and domestic structural factors. The current global economic cooling is having a dampening effect on employers' expectations for job creation. Even so, labour demand is still exceeding labour supply. Over the projection period, labour supply shortages are expected to become even more pronounced owing to the impact of adverse demographics. The labour market mismatch is expected to be partly mitigated by Slovaks returning from employment abroad, by foreign workers, and by increasing labour force participation. The unemployment rate is expected to fall moderately, and at the projection horizon it should be steady at just below 6%.

Wage growth is expected to remain relatively elevated, supported mainly by the substantial raising of public sector wage scales in 2019 and 2020. Wage growth in the private sector is expected to slow as the labour market becomes less tight.

Table 1 Wages (annual percentage changes)

	2018	2019	2020	2021
Nominal labour productivity	4.4	4.8	5.3	4.8
Whole economy – nominal wages	6.2	6.6	6.3	5.6
Whole economy – real wages	3.6	4.0	3.6	3.0
Private sector – nominal wages	6.0	5.9	5.7	5.5
Private sector – real wages	3.5	3.4	3.1	2.9
Public administration, education and health care – nominal wages	6.7	8.8	8.2	5.9
Public administration, education and health care – real wages	4.1	6.2	5.5	3.3

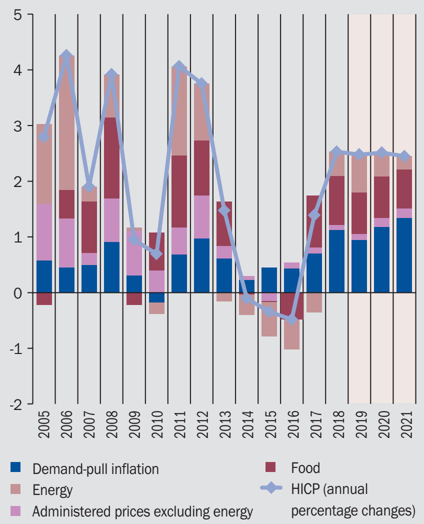
Sources: SO SR and NBS calculations.
Notes: Deflated by the CPI. The sector 'Public administration, education and health care' corresponds to sections O, P and Q of the SK NACE Rev. 2 statistical classification of economic activities. Average nominal wage growth in the general government sector (ESA S.13) is projected to be 9.1% in 2019, 8.4% in 2020, and 5.8% in 2021. Nominal labour productivity – GDP divided by persons in employment according to statistical reporting methodology.

4.3 PRICE DEVELOPMENTS

Inflation to be stable at around 2.5% over the projection horizon

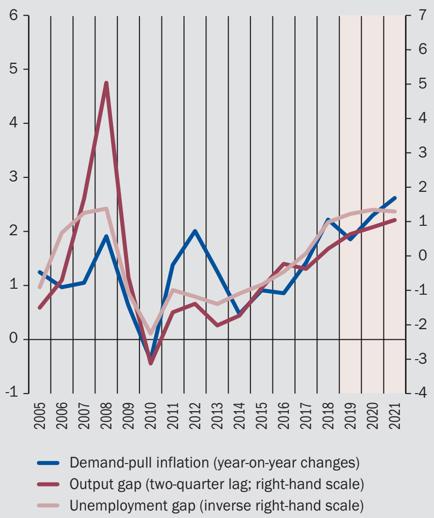
Annual HICP inflation is expected to be around 2.5% throughout the projection period, reflecting upward pressure from all components. Energy inflation is projected to have a strongly positive impact owing to the pass-through of elevated energy commodity prices; thereafter, it should gradually moderate, and the headline inflation rate is expected to reflect cost-push factors to a greater extent. Rising labour costs and consumer demand are expected to be reflected in accelerating services inflation. Non-energy industrial goods prices are projected to increase in line with import prices.

Chart 5 HICP inflation and its components (percentage points, unless otherwise indicated)



Sources: SO SR and NBS.

Chart 6 Demand-pull inflation and the output gap (percentages)



Sources: ŠÚ SR and NBS calculations.
Note: Demand-pull inflation comprises the following: services inflation excluding administered prices; non-energy industrial goods inflation excluding administered prices.

Table 2 Inflation components (annual percentage changes)							
	Average 2004-2008 (pre-crisis period)	Average 2010-2014 (post-crisis period with euro currency)	2017	2018	2019	2020	2021
HICP	**4.1**	**2.0**	**1.4**	**2.5**	**2.5**	**2.5**	**2.4**
Food	3.6	3.1	3.6	3.4	3.1	3.0	2.9
Non-energy industrial goods	0.2	0.3	0.6	1.1	1.1	1.6	1.6
Energy	8.3	2.3	-2.5	3.0	4.4	2.7	1.5
Services	5.3	2.5	2.0	2.8	2.3	2.8	3.4
Demand-pull inflation	1.8	1.0	1.4	2.2	1.9	2.3	2.6

Sources: SO SR and NBS calculations.

5 Fiscal outlook

Doubts about fiscal consolidation

According to the most recent estimate, Slovakia's fiscal deficit for 2018 was 0.7% of GDP. In this Medium-Term Forecast, the deficit is projected to remain close to that level. Compared with the projections in the January update of NBS's December 2018 Medium-Term Forecast, the fiscal deficit projections for 2019, 2020 and 2021 have been revised down by 0.1, 0.1 and 0.3 percentage point respectively. These revisions are a response to a deterioration in the macroeconomic outlook that implies slower growth in tax and social security contribution revenues. Assuming that expenditure continues to increase, such a slowdown means no scope for fiscal consolidation. At the same time, the projections in this forecast do not take into account proposed measures, whose potential impact is examined in more detail in Box 1 and which could further exacerbate the fiscal deficit unless compensatory measures are adopted.

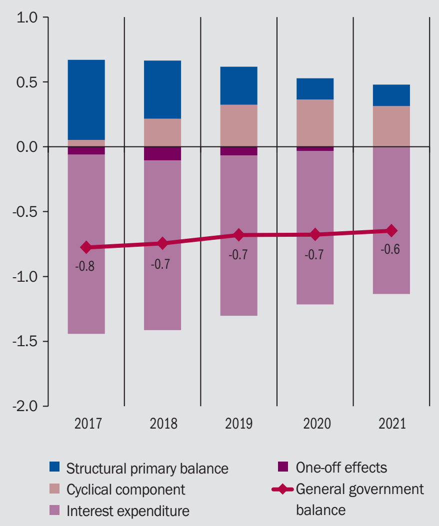
Given the continuing moderately positive impact of the business cycle amid unchanged nominal developments, the domestic fiscal stance is expected to be somewhat expansionary in 2019 and to have ceased to be so by the end of the projection period.

Public debt as a share of GDP is expected to fall gradually, down to 48% in 2019, 46.9% in 2020 and 46.5% in 2021. Compared with the previous forecast, these projections have all been revised up[7] in response to recent developments and in conjunction with deficit revisions and with lower GDP levels (denominator effect).

Expenditure growth remains high

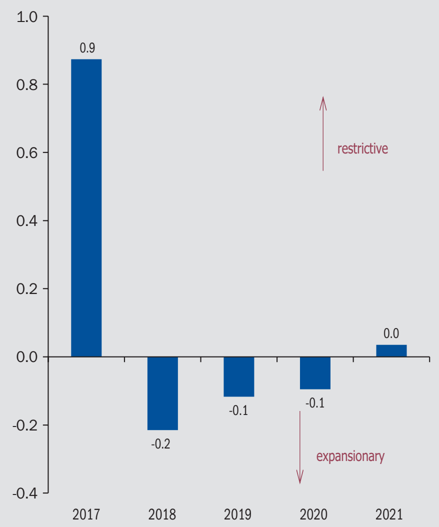
In nominal terms, general government final consumption expenditure is expected to maintain robust growth in 2019, owing mainly to the acceleration of compensation per employee growth and also of healthcare expenditure. Slower growth in expenditure on goods and services, together with stronger price deflator growth, is expected to dampen the increase in

Chart 7 Breakdown of the general government balance (percentages of GDP)



Sources: SO SR and NBS calculations.
Note: One-off factors include non-cyclical effects that have a temporary impact on the general government balance and should be eliminated in the future.

Chart 8 Fiscal stance (percentage points of GDP)



Sources: SO SR and NBS calculations.
Note: Annual rate of change in the cyclically adjusted primary balance, excluding the impact of EU funds.

7 *With the debt brake thresholds to be decreased by 1 percentage point per year during 2018-2027, the general government debt is expected to stay outside the sanctioning zones until 2020. In 2021 the debt is expected to exceed the lower limit (46% in that year) by 0.5 percentage point.*

Table 3 Fiscal developments (annual percentage changes at constant prices, unless otherwise stated)

	2017	2018	2019	2020	2021
General government final consumption expenditure	1.7	1.9	1.6	2.5	3.1
Government investment	2.2	16.2	8.3	8.7	5.8
Contribution of EU funds to rate of change (percentage points)	*-4.2*	*12.1*	*3.4*	*5.8*	*2.6*
General government balance (percentage of GDP)	-0.8	-0.7	-0.7	-0.7	-0.6
Fiscal stance (year-on-year change in percentage points)	0.9	-0.2	-0.1	0.0	0.1
Gross debt (percentage of GDP)	50.9	48.9	48.0	46.9	46.5

Sources: SO SR and NBS calculations.

real final consumption expenditure in 2019. Government consumption growth is expected to accelerate gradually over the projection period, as expenditure on goods and services gathers pace (reflecting payments to concessionaires in relation to new public-private partnership (PPP) projects). As for government investment activity, both domestically sourced investment and EU-funded investment are projected to maintain relatively elevated growth in 2019 and 2020.

Box 1

SCENARIO OF THE IMPACT OF PROPOSED FISCAL MEASURES

Before the Slovak Parliament convened for its March 2019 session, publicity was given to a number of draft bills that have significant implications for fiscal performance. But since these measures were at an early stage of the legislative process, they were not taken into account in this forecast's projections and are quantified only in the form of a scenario.

Most of the proposed measures concern the revenue side of the budget – income and corporate taxes, value-added tax, end-user charges, and social security contributions (specified in Table A). The different measures would enter into force between 1 November 2019 and 1 January 2021.

The resulting negative impact of the scenario on the fiscal deficit is estimated at €1.5 billion in 2020 and €1.6 billion in 2021, i.e. 1.5 % of GDP. This estimation takes into account the impact of the VAT increase (a cu-

Table A Summary of proposed measures incorporated in the scenario

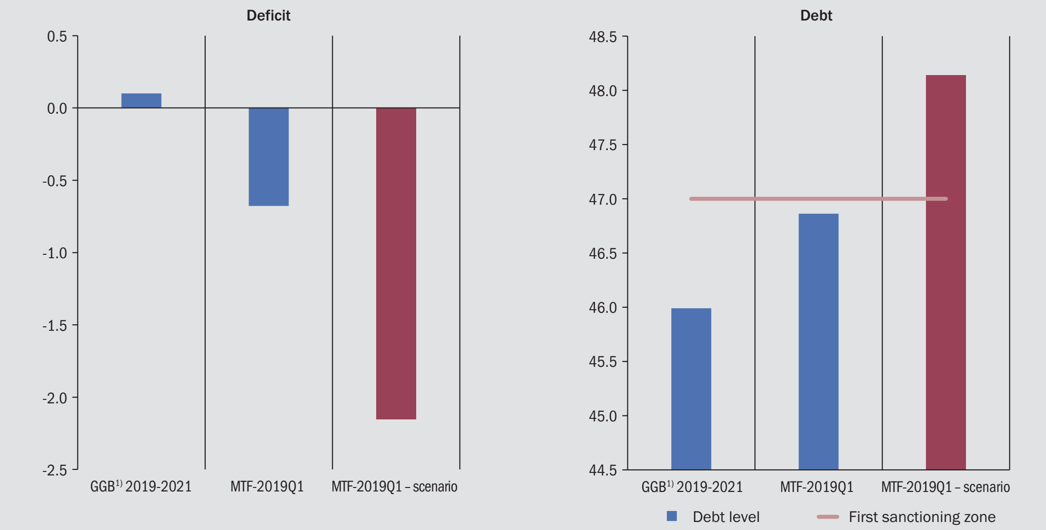
Measure	Entry into force
Reduction of the corporate tax rate from 21% to 15%	1 January 2020
Reduction of social security contributions[1]	1 January 2020
10% VAT on selected food items	1 January 2020
Increase in the non-taxable part of the tax base, from 19.2 times the minimum subsistence amount to 22.7 times	1 January 2020 (partial increase), 1 January 2021
Cancellation of end-user charges for selected	1 January 2020
10% VAT on print media	1 January 2020
Increase in salaries of Armed Forces personnel by an average of €300[2]	1 January 2019

Source: NBS calculations.
1) And at the same time their regrouping to the benefit of old-age insurance.
2) Positive impact of the shift in expenditure from consumption to the compensation of Armed Forces personnel, together with other proposed amendments to the Act on the civil service of professional soldiers of the Armed Forces of the Slovak Republic.

mulative 0.9% over the three years from 2019 to 2021).

Absent the adoption of compensatory measures, such a procyclical fiscal expansion would result in a significant increase in the deficit in 2020, which would represent a **risk in regard to assessing compliance with national and international fiscal rules** (the balanced budget provision under the Fiscal Compact, and the Growth and Stability Pact rules). Furthermore, it would increase the public debt to the point that the debt falls within the first sanctioning zone under the debt brake by as early as 2020.

Chart A Fiscal deficit and public debt in 2020 after taking into account proposed measures (percentages of GDP)



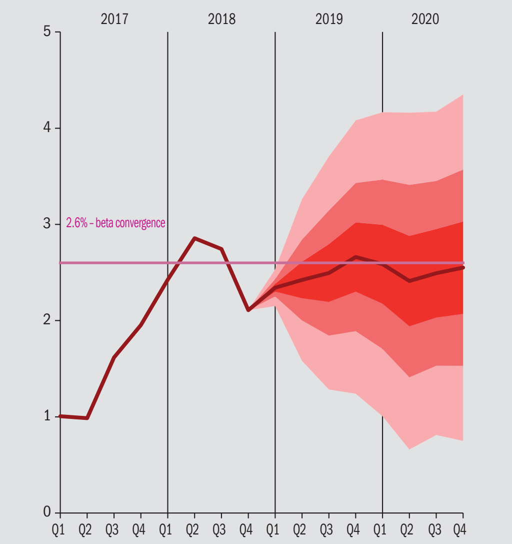
Source: NBS calculations.
1) General Government Budget

6 Risks to the forecast

The risks to the GDP growth outlook over the projection period tilt to the downside. The main downward risks lie in external factors, specifically Brexit and any further slowdown of the global economy. The upward risks include a higher than projected absorption of EU funds and a stronger recovery in the automotive industry.

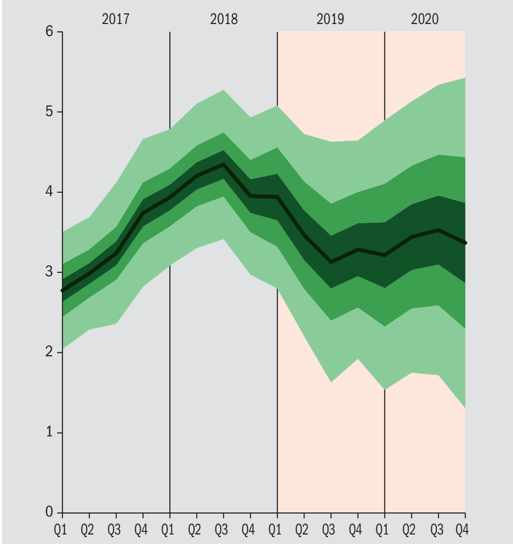
The inflation outlook is subject to balanced risks.

Chart 9 HICP inflation forecast (percentages)



Sources: SO SR and NBS calculations.
Notes: The NBS forecast provides probabilistic best-estimate projections. The projection intervals in the chart (representing coverage probabilities of 30%, 60% and 90%) are calculated using expected quantiles of historical inflation forecast errors (using sieve bootstrap methods). For further details on the construction of the charts, see the Analytical Commentary entitled "Putting new fan-charts into use".
Beta convergence – the situation where countries with lower GDP (per capita) tend to have stronger economic growth than do countries with higher GDP, thereby giving rise to a process of catch-up with advanced economies. The same applies to price level catch-up. Further information is available in the following Slovak-only Analytical Commentary:
"Perspektívy dlhodobejšieho vývoja slovenskej ekonomiky (do roku 2020)" (Longer-term outlooks for the Slovak economy – up to 2020).

Chart 10 GDP growth forecast (percentages)



Sources: SO SR and NBS calculations.
Notes: The NBS forecast provides probabilistic best-estimate projections. The projection intervals in the chart (representing coverage probabilities of 30%, 60% and 90%) are calculated using expected quantiles of historical inflation forecast errors (using sieve bootstrap methods). For further details on the construction of the charts, see the Analytical Commentary entitled "Putting new fan-charts into use".
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Box 2

UNCERTAINTY STILL SURROUNDING THE UK'S WITHDRAWAL FROM THE EU

One of the most significant risks to the NBS Medium-Term Forecast projections remains the uncertainty surrounding the future arrangement of economic relations between the United Kingdom and the European Union. Although the original date for the UK's withdrawal from the EU (29 March 2019) has almost passed, the final form of the arrangement remains in question.

UK lawmakers have repeatedly refused to approve the EU Withdrawal Agreement which sets terms for Brexit. The main obstacle to approval has been the 'Irish backstop' (a guarantee against the establishment of any hard border between Ireland and Northern Ireland even in the case that the UK and EU fail to agree on a future regime under which to conduct their relations after the end of the proposed transition period, i.e. by the end of 2020).[8] UK representatives sought, however, to delay the Brexit date for a short period, until 30 June 2019.

At a summit held on 21 March 2019, the European Council addressed the issue of delaying the Brexit date and agreed that:

- the Brexit deadline would be extended until 22 May 2019, provided the Withdrawal Agreement was approved by the UK Parliament in the last week of March;
- if the Withdrawal Agreement was not approved by the end of March, the Brexit deadline would be extended until 12 April 2019; at the same time, the European Council would expect the UK to indicate a way forward before that date for consideration by the Council.

The 12 April date was chosen because it is the country's deadline for triggering elections to the European Parliament.

It remains to be seen how Brexit will unfold — whether on the basis of an approved joint agreement or not (a no-deal or 'hard' Brexit). The probability of a no-deal Brexit still remains high. Such a variant would have adverse economic repercussions for all EU countries.

Brexit's economic effects operate through several channels, as examined in various studies. Besides the direct impact of international trade (total trade between the UK and EU constitutes around 6% of euro area GDP), many other factors come into play. Integration in global value chains may amplify the impact of the shocks. Disruptions related to the labour market, or to the free movement of labour (changes in migration flows) or capital, may heighten losses on both sides. Other indirect impacts on international trade arise, for example, from uncertainty and its impact on asset pricing or investment planning and from changes in the financial market. In addition to these direct and indirect effects, there are other factors which are subject to ad hoc decisions, such as the impact of the relocation of parts of multinational corporations to other countries and the decentralisation of financial operations from London to local centres.

External studies have been relatively consistent in assessing the impact of Brexit on the EU economy at 0.5% of GDP; if account is taken of the production and services linkages of transmission channels other than international trade, the impact rises to 1.5% of GDP by 2025.[9]

According to the Bank of England's calculations (November 2018), a hard Brexit (the UK leaving the EU with no deal and no transition period) would have a cumulative negative impact on UK GDP of between 4% and 7% by the end of 2023.[10]

Studies on the negative impact of Brexit on the Slovak economy over the period up to end-2025 put it at between 0.5% and 0.7%. NBS's more comprehensive model simulation, which takes account of the latest higher estimates of the effects on the UK economy, indicates that the cumulative negative impact of a hard Brexit on Slovakia's GDP could be between 0.7% and 1.1% by end-2023.[11]

8 In practice, according to the Protocol on Ireland and Northern Ireland, it would mean Northern Ireland remaining part of the EU Customs Union, which would mean having to establish customs controls between Northern Ireland and the rest of the United Kingdom.

9 The highest estimated impacts (up to 1.5% of GDP) are based on econometric models that take into account a comprehensive map of inter-sectoral flows (input-output) in a general equilibrium trade model (for example, Connel, W. et al., Global value chains, trade shocks and jobs: an application to Brexit, Discussion Paper Series, No 17.13, KU Leuven, September 2017; or IMF Country Report No.18/317, November 2018).

10 Compared with the 'Less Close Economic Partnership Scenario', as defined in the Bank of England publication entitled "EU withdrawal scenarios and monetary and financial stability", published in November 2018.

11 See the January 2019 update of NBS's December 2018 Medium-Term Forecast, Box 1 "Estimated impact of a hard Brexit on the Slovak economy", which can be found at: https://www.nbs.sk/_img/Documents/_Publikacie/PREDIK/2018/protected/P4QA-2018.pdf

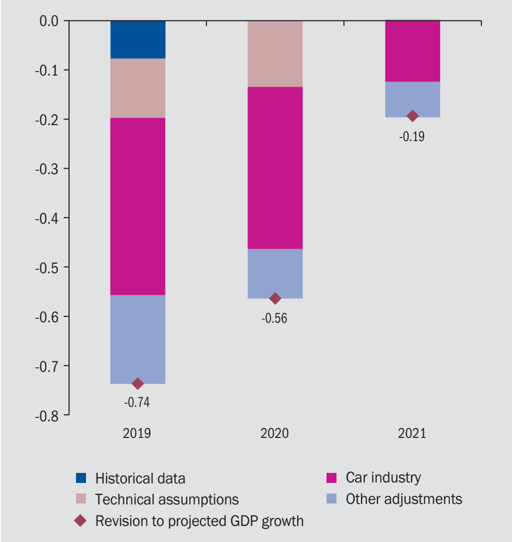
7 Comparison with the previous forecast

Compared with the MTF-2018Q4U forecast (the January 2019 update of NBS's December 2018 Medium-Term Forecast), the most notable change is a significant decline in foreign demand growth over the projection period, the cumulative decrease amounting to 0.6 percentage point.

Weaker economic growth

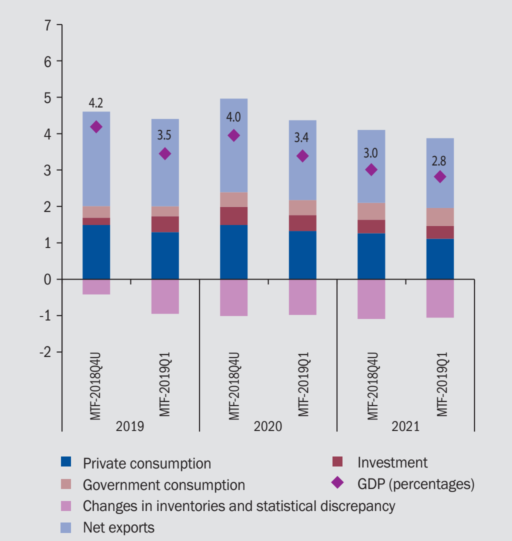
Owing to the cumulation of several factors, this forecast includes significant revisions to the economic growth projections over the medium term. With demand for cars declining in the context of a global economic slowdown, projections for new production in the car industry were revised. The weakening of foreign demand further weighed on economic growth through lower overall export performance. Meanwhile, the GDP growth data for the fourth quarter of 2018 were notably weaker than expected. The relationship between income from work and disposable income, which has been diverging over an extended period, was further reviewed, resulting in a downward revision of projected private consumption growth. By contrast, the recent acceleration of growth in investment and government consumption implies that their impact will be more expansionary than projected in the previous forecast.

Chart 12 Shift in the projection vis-à-vis the MTF-2018Q4U forecast (percentage point contributions)



Sources: SO SR and NBS.

Chart 11 GDP and its components[12] (annual percentage changes; percentage point contributions)



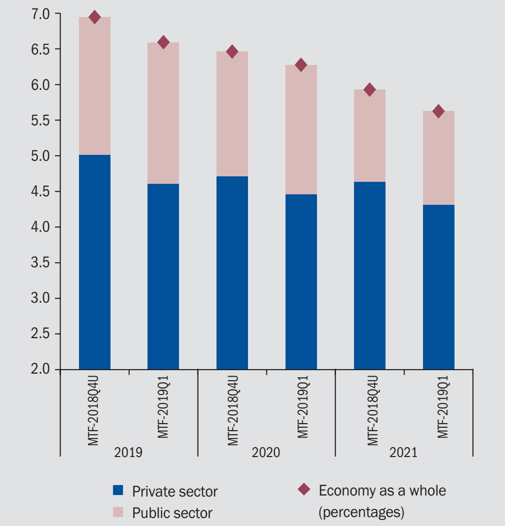
Sources: SO SR and NBS.
Note: The item 'Changes in inventories and statistical discrepancy' includes uncategorised imports that remained after the calculation of import intensity.

Less optimistic labour market outlook

The latest labour market data are in line with expectations. The deterioration in the labour market outlook is largely based on leading indicators. The weakening of employers' expectations has resulted in a downward revision of projected employment growth in the near term, and with economic activity growth now expected to be lower over the whole forecast period, projected job growth over the rest of the period has also been revised down. As labour market tightness is easing, projections for wage growth, particularly in the private sector, have been revised down. This change is also related to lower labour productivity growth and a slowdown in inflation.

12 The composition of GDP growth is calculated as the contributions of components to GDP growth after deducting their import intensity. In this case the calculation uses the constant import intensity of the different GDP components (household final consumption – 30%, government consumption – 7%, investment – 50%, and exports – 62.5%). Remaining imports were included under changes in inventories and the statistical discrepancy.

Chart 13 Average wage broken down by public sector and private sector contributions to its rate of change (annual percentage changes; percentage points)

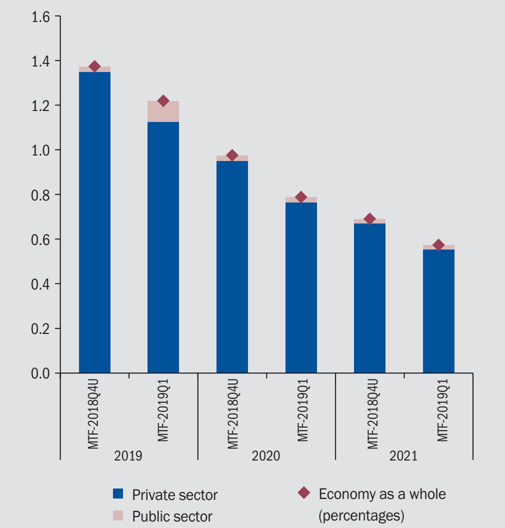


Sources: SO SR and NBS.
Note: The public sector comprises sections O, P and Q of the SK NACE Rev. 2 statistical classification of economic activities.

Inflation projections revised down throughout the forecast period

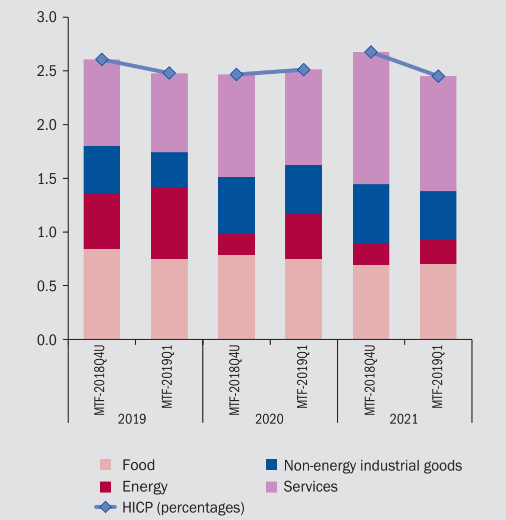
Incoming data show inflation to be accelerating more slowly than projected. This has been reflected in inflation projections for this year, most notably in a downward revision of demand-pull inflation which reflected not only fundamentals (wage developments and import prices), but also other factors (the higher weighting of food services and consequent larger negative contribution of recently introduced 'free school lunches'; the lower weighting of air fares). The revision of the economy's cyclical position has had a downward impact on demand-pull inflation projections over the rest of the forecast period, but that impact is partly offset by higher oil prices and their pass-through to motor fuel prices and administered energy prices.

Chart 14 Employment broken down by public sector and private sector contributions to its rate of change (annual percentage changes; percentage points)



Sources: SO SR and NBS.
Note: The public sector comprises sections O, P and Q of the SK NACE Rev. 2 statistical classification of economic activities.

Chart 15 Comparison of projections for headline inflation and its components (annual percentage changes; percentage point contributions)



Sources: SO SR and NBS calculations.

Table 4 Medium-Term Forecast (MTF-2019Q1) for key macroeconomic indicators

Indicator	Unit	Actual data	MTF-2019Q1			Difference versus MTF-2018Q4U			
		2018	2019	2020	2021	2018	2019	2020	2021
Prices									
HICP inflation	annual percentage change	2.5	2.5	2.5	2.4	0.0	-0.1	0.0	-0.3
CPI inflation	annual percentage change	2.5	2.5	2.5	2.5	0.0	-0.2	0.1	-0.2
GDP deflator	annual percentage change	2.1	2.4	2.6	2.5	-0.2	-0.5	-0.4	-0.5
Economic activity									
Gross domestic product	annual percentage change, constant prices	4.1	3.5	3.4	2.8	-0.1	-0.7	-0.6	-0.2
Private consumption	annual percentage change, constant prices	3.0	3.6	3.7	3.1	0.0	-0.5	-0.5	-0.4
Final consumption of general government	annual percentage change, constant prices	1.9	1.6	2.5	3.1	0.5	-0.3	0.0	0.2
Gross fixed capital formation	annual percentage change, constant prices	6.8	3.9	3.9	3.1	0.8	2.1	-0.7	-0.3
Exports of goods and services	annual percentage change, constant prices	4.8	6.3	5.6	4.8	0.5	-0.5	-1.0	-0.2
Imports of goods and services	annual percentage change, constant prices	5.3	6.9	5.8	5.1	0.8	0.2	-0.9	-0.3
Net exports	EUR millions at constant prices	5,814	5,624	5,782	5,775	-177.4	-894.1	-1093.0	-1064.7
Output gap	percentage of potential output	0.5	0.7	1.0	0.9	0.0	-0.3	-0.7	-0.9
Gross domestic product	EUR millions at current prices	90,202	95,593	101,429	106,931	-271.5	-1384.0	-2358.2	-3186.8
Labour market									
Employment	thousands of persons ESA 2010	2,420	2,449	2,469	2,483	-0.7	-4.5	-9.1	-12.1
Employment (dynamics)	annual percentage change ESA 2010	2.0	1.2	0.8	0.6	0.0	-0.2	-0.2	-0.1
Number of unemployed	thousands of persons[1)]	180	164	158	159	-2.2	-0.8	4.1	8.0
Unemployment rate	percentage	6.5	6.0	5.8	5.8	-0.1	0.0	0.2	0.3
NAIRU estimate[2)]	percentage	7.5	7.2	7.1	7.1	-0.1	-0.1	-0.1	0.0
Labour productivity[3)]	annual percentage change	2.1	2.2	2.6	2.2	-0.1	-0.6	-0.3	-0.1
Nominal labour productivity[4)]	annual percentage change	4.4	4.8	5.3	4.8	-0.3	-1.0	-0.7	-0.6
Nominal compensation per employee	annual percentage change ESA 2010	5.4	6.7	6.3	5.4	-0.1	-0.4	-0.2	-0.3
Nominal wages[5)]	annual percentage change	6.2	6.6	6.3	5.6	-0.1	-0.3	-0.2	-0.3
Real wages[6)]	annual percentage change	3.6	4.0	3.6	3.0	-0.1	-0.2	-0.3	-0.1
Households and non-profit institutions serving households									
Disposable income	annual percentage change, constant prices	3.0	3.5	3.5	3.1	-0.3	-1.0	-0.5	-0.4
Saving ratio[7)]	percentage of disposable income	8.5	8.4	8.2	8.2	-0.6	-1.0	-1.1	-1.1
General government sector[8)]									
Total revenue	percentage of GDP	39.7	39.8	39.8	39.6	-0.1	0.4	0.7	0.8
Total expenditure	percentage of GDP	40.4	40.5	40.5	40.3	-0.1	0.5	0.8	1.1
General government balance[9)]	percentage of GDP	-0.7	-0.7	-0.7	-0.6	0.0	-0.1	-0.1	-0.3
Cyclical component	percentage of trend GDP	0.2	0.3	0.4	0.3	0.1	0.0	0.0	-0.1
Structural balance	percentage of trend GDP	-0.9	-0.9	-1.0	-1.0	-0.2	0.0	0.0	-0.2
Cyclically adjusted primary balance	percentage of trend GDP	0.3	0.2	0.1	0.2	-0.2	0.0	0.0	-0.1
Fiscal stance[10)]	year-on-year change in p. p.	-0.2	-0.1	-0.1	0.0	0.0	0.1	0.0	-0.2
General government gross debt	percentage of GDP	48.9	48.0	46.9	46.5	0.3	0.9	1.4	1.7

Table 4 Medium-Term Forecast (MTF-2019Q1) for key macroeconomic indicators (continued)

Indicator	Unit	Actual data	MTF-2019Q1			Difference versus MTF-2018Q4U			
		2018	2019	2020	2021	2018	2019	2020	2021
Balance of Payments									
Goods balance	percentage of GDP	0.1	-0.5	-0.7	-0.9	-0.7	-2.0	-2.2	-2.0
Current acount	percentage of GDP	-2.5	-2.9	-3.1	-3.2	-0.5	-1.8	-2.1	-1.9
External environment and technical assumptions									
Slovakia's foreign demand	annual percentage change	3.9	3.4	4.0	3.8	-0.1	-0.5	-0.2	-0.1
Exchange rate (EUR/USD)[11),12)]	level	1.18	1.14	1.14	1.14	0.0	-0.4	-0.5	-0.5
Oil price in USD[11),12)]	level	71.1	65.2	64.7	62.9	-0.3	16.3	13.4	8.5
Oil price in USD[11)]	annual percentage change	30.7	-8.3	-0.8	-2.8	-0.4	13.1	-2.5	-4.4
Oil price in EUR[11)]	annual percentage change	25.0	-4.7	-0.8	-2.8	-0.4	14.0	-2.5	-4.4
Non-energy commodity prices in USD	annual percentage change	3.9	1.2	4.3	4.3	0.9	2.6	-0.1	0.0
Three-month EURIBOR	percentage per annum	-0.3	-0.3	-0.2	0.0	0.0	0.0	-0.2	-0.3
Ten-year Slovak government bond yields	percentage	0.9	0.9	1.0	1.2	0.0	-0.3	-0.3	-0.3

Sources: NBS, ECB a SO SR.
Notes:
1) *Labour Force Survey.*
2) *Non-accelerating inflation rate of unemployment.*
3) *GDP at constant prices / employment – ESA 2010.*
4) *Nominal GDP divided by persons in employment (according to SO SR quarterly statistical reporting).*
5) *Average monthly wages (according to SO SR statistical reporting).*
6) *Wages according to SO SR statistical reporting, deflated by CPI inflation.*
7) *Saving ratio = gross savings / (gross disposable income + adjustments for any pension entitlement change) *100; Gross savings = gross disposable income + adjustments for any pension entitlement change – private consumption.*
8) *Sector S.13; fiscal outlook.*
9) *B9n – Net lending (+) / net borrowing (-).*
10) *Year-on-year change in cyclically adjusted primary balance; a positive value denotes a restrictive stance.*
11) *Year-on-year percentage changes and changes vis-à-vis the previous forecast are calculated from unrounded figures.*
12) *Changes vis-à-vis the previous forecast (percentages).*

More detailed time series of selected macroeconomic indicators can be found on the NBS website at:
http://www.nbs.sk/_img/Documents/_Publikacie/PREDIK/2019/protected/P1Q-2019.xls