Economic and Monetary Developments

Winter 2024

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Abbreviations

BIS	Bank for International Settlements
bp	basis point(s)
CEE	central and eastern Europe(an)
CPI	Consumer Price Index
DSA	debt sustainability analysis
EA	euro area
ECB	European Central Bank
EC	European Commission
ESA 2010	European System of Accounts 2010
ESCB	European System of Central Banks
EU	European Union
EUR	euro
EURIBOR	euro interbank offered rate
Eurostat	statistical office of the European Union
GDP	gross domestic product
HAI	housing affordability index
HICP	Harmonised Index of Consumer Prices
ICT	information and communication technology
LFS	Labour Force Survey
MFF	multiannual financial framework
MF SR	Ministry of Finance of the Slovak Republic
MTF	medium-term forecast (of NBS)
NACE	Statistical Classification of Economic Activities in the European Community (Rev. 2)
NARKS	Slovak National Association of Real Estate Agencies / Národná asociácia realitných kancelárií Slovenska
NBS	Národná banka Slovenska
NGEU	NextGenerationEU
NPISHs	non-profit institutions serving households
OECD	Organisation for Economic Co-operation and Development
OPEC	Organization of the Petroleum Exporting Countries
p.a.	per annum
PMI	Purchasing Managers' Index
pp	percentage point(s)
PP	programming period (of the European Union)
RRF	Recovery and Resilience Facility (of the European Union)
RRP	recovery and resilience plan (of the Slovak Republic)
SK	Slovakia
SO SR	Statistical Office of the Slovak Republic

ÚPSVaR SR	Central Office of Labour, Social Affairs and Family of the Slovak Republic / Ústredie práce, sociálnych vecí a rodiny Slovenskej republiky
US	United States
USD	US dollar
VAT	value-added tax

Conventions used in the tables

- \- data do not exist/data are not applicable
- . data are not yet available
- ... nil or negligible
- (p) provisional

Special annex

Winter forecast update

The current forecast was prepared as part of the latest Eurosystem staff macroeconomic projection exercise for the whole euro area, with a cut-off date of 25 November 2024.

After that date, Slovakia implemented a major policy reversal concerning administered energy prices, necessitating an update to our forecast.

This special annex summarises the main implications of freezing gas and heat prices for 2025. The main text of the report continues to present our forecast based on the assumption that gas and heat prices for households would be gradually aligned with market prices.

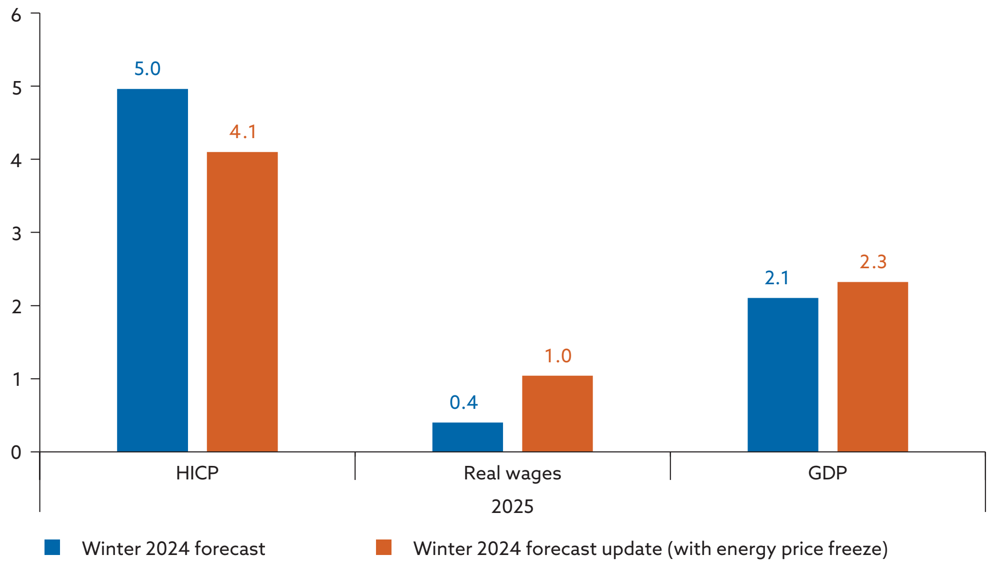
Compared with the original forecast, we now expect annual inflation to be lower in 2025, at 4.1% instead of the previously projected 5%. The policy change has a significant impact on inflation, as administered energy prices constitute a substantial part of the consumption basket.

Real household income growth is projected to be higher, providing a boost to the economy. In 2025 economic growth is now forecast to be 2.3%, slightly higher than under the scenario without an energy price freeze. Real wage growth is estimated to average 1%.

We observe sufficient fiscal space to fund energy price subsidies without jeopardising key fiscal targets. However, freezing energy prices entails financial costs, including reduced efficiency in energy consumption, which adds to environmental strain. Setting priorities on these issues remains a matter for the government.

Chart 1

Winter forecast update with energy price freeze (annual percentage changes)



Source: NBS.

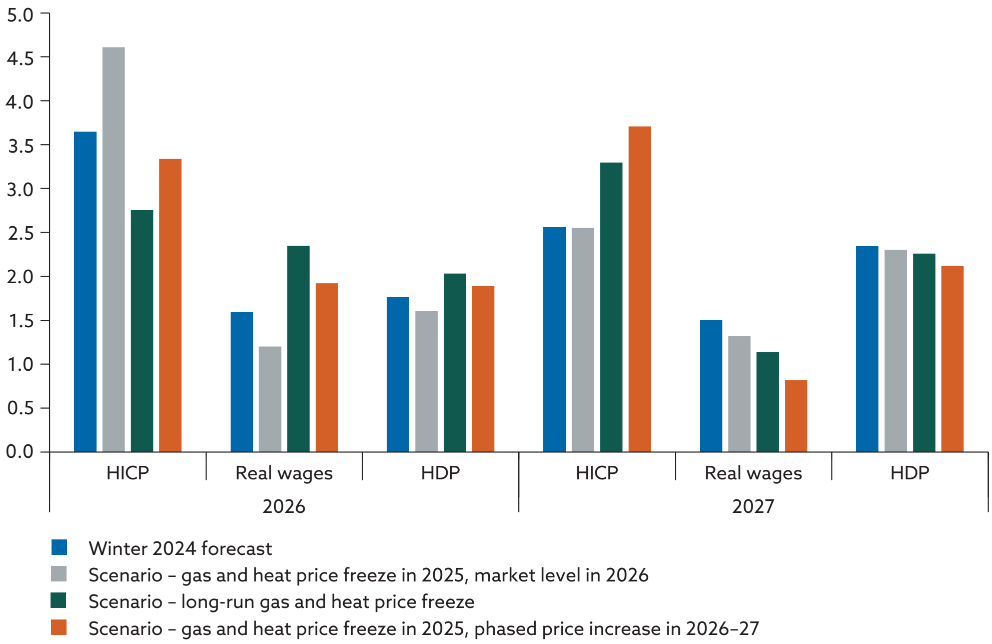
Administered energy pricing is the major source of uncertainty in macroeconomic developments in the period ahead. There continues to be uncertainty as to whether and when administered prices will align with market levels.

We are considering multiple scenarios. The first assumes that energy prices remain fixed until 2027. The second features a gradual adjustment to market prices in 2026–2027. The third scenario has administered energy prices aligning with market levels in 2026.

Lower inflation results in greater purchasing power for households, leading to faster growth in private consumption and the economy. Conversely, higher inflation dampens real income growth and economic performance. The economic growth projections range between 1.6% and 2.0% for 2026 and between 2.1% and 2.3% for 2027.

As in 2025, any energy price subsidies will entail fiscal costs in subsequent years. The consolidation of public finances must continue, and household energy price subsidies must be evaluated in this context. The consolidation effort will need to be all the more ambitious if the government is to achieve its fiscal targets in terms of the general government deficit and long-term sustainability of public debt.

Chart 2
Comparison of scenarios (annual percentage changes)



Source: NBS.

Table 1 Key economic indicators

	Actual data	Winter 2024 medium-term forecast update (MTF-2024Q4)			
	2023	2024	2025	2026	2027
GDP (annual percentage change)	1.4	2.1	2.3	1.6–2.0	2.1–2.3
HICP (annual percentage change)	11.0	3.2	4.1	2.8–4.6	2.6–3.7
Average nominal wage (annual percentage change)	9.6	5.7	5.5	5.0–5.7	4.0–4.7
Average real wage (annual percentage change)	-0.7	2.8	1.0	1.2–2.4	0.8–1.5
Employment (annual percentage change; ESA 2010)	0.3	-0.1	0.1	0.0–0.1	0.1–0.2
Unemployment rate (percentage; Labour Force Survey)	5.8	5.3	5.4	5.7–5.8	5.5–5.7

Source: NBS.
Note: Real wages deflated by CPI inflation.

1 Summary

Slovakia is struggling to accelerate its economic growth. The economic growth outlook has deteriorated further. The economy is still temporarily benefiting from factors such as the expansion of production capacity in the automotive industry and the uptake of EU funds from the Recovery and Resilience Facility (through the implementation of Slovakia's recovery and resilience plan) over the next two years. As a result, the Slovak economy's growth in the coming years is projected to be similar to this year's level of around 2%; however, its growth potential in those years is expected to be less than 2%.

Competitiveness is a challenge for both Slovakia and the euro area as a whole. The domestic economy is feeling the effects of its strong links with, and dependence on, the faltering German economy. Our outlook incorporates weaker projected developments in Germany. In the summer and autumn, it was still unclear to what extent the surprisingly adverse signals from industry in the first half of the year were only temporary. Incoming data and business sentiment from both domestic and external sources have confirmed concerns that weak industrial performance is more persistent in nature.

Inflation is forecast to pick up again temporarily. This shift is primarily due to the gradual return of household energy prices to market levels. Annual headline inflation is projected to average 5% in 2025, before easing to 4% in the following year and then falling to 3%. We envisage such a decline even though, starting in 2027, another measure to combat climate change—the introduction of emission allowances in the transport and housing sectors—will affect prices of energy and automotive fuel in particular. Nevertheless, inflation is expected to return to the 3% level.

In 2025, the general government deficit is expected to narrow to 4.5% of GDP due to the new fiscal consolidation package. In that year, the announced consolidation measures are expected to lock in a permanent improvement in fiscal performance, but without a further consolidation effort, the deficit will not improve in subsequent years. Public debt is estimated to reach 59.7% of GDP in 2024 and to surpass the 60% of GDP threshold in 2025. The deteriorating trend is due mainly to persistently high deficits, while slower economic growth will also negatively affect the debt-to-GDP ratio.

The labour market situation remains stable. Labour shortages related to population ageing and rising early retirements are being temporarily addressed mainly by inflows of foreign workers. This could be sufficient to stabilise employment in the coming years. As labour shortages may push up wage demands, wage growth is projected to exceed 5%. As a result, households should see their financial situation improve even after accounting for inflation.

The risks going forward remain significant. For both the economic and inflation outlooks, risks include the impact of the fiscal consolidation package on the domestic side of the economy and the impact of potential protectionism in global trade. If these risks materialise, economic growth could be lower than projected. As regards the inflation outlook, the principal risk lies in administered energy prices. It remains uncertain to what extent they will be subsidised in the period ahead and when they will be fully aligned with market prices. Another notable uncertainty is the pass-through of VAT changes to final consumer prices.

Table 1 Key economic indicators

	Actual data	Winter 2024 medium-term forecast (MTF-2024Q4)				Difference vis-à-vis the autumn 2024 forecast (MTF-2024Q3)		
	2023	2024	2025	2026	2027	2024	2025	2026
GDP (annual percentage change)	1.4	2.1	2.1	1.8	2.3	-0.4	-0.4	-0.1
HICP (annual percentage change)	11.0	3.2	5.0	3.6	2.6	0.2	0.0	0.9
Average nominal wage (annual percentage change)	9.6	5.7	5.5	5.2	4.2	-0.9	0.2	1.1
Average real wage (annual percentage change)	-0.7	2.8	0.4	1.6	1.5	**-1.0**	**0.2**	**0.2**
Employment (annual percentage change; ESA 2010)	0.3	-0.1	0.1	0.0	0.1	0.1	-0.1	0.0
Unemployment rate (percentage; Labour Force Survey)	5.8	5.3	5.4	5.8	5.7	0.0	0.0	0.2

Source: NBS.
Note: Real wages deflated by CPI inflation.

This report takes a closer look at the following topics:

- *Protectionist measures could hinder global economic growth*
  The impact of protectionist measures on global trade could hurt Slovakia's economy.
- *How the fiscal consolidation announcement pushed up inflation expectations and damaged consumers' confidence regarding the economy and their financial situation going forward*

In October, expectations for the future price developments shifted significantly upwards. People started to lower their previously promising expectations for the economy and their financial situation.

- *Uncertainty is directly impacting price-setting*
  The rise in food prices in October surprised everyone, standing as an outlier compared with other countries. We attribute this to uncertainty and the anticipated tax changes in the coming year.
- *The convergence of living standards in Slovakia towards those of advanced economies is expected to slow*
  Slovakia's economy is closely linked to Germany, the destination for around 20% of Slovak goods exports. However, the German economy has long been facing structural challenges. Industrially oriented economies may struggle to stay competitive at the global level. Without an adjustment to its economic model, Slovakia will experience slower growth in living standards.

2 Current macroeconomic developments in the external environment and Slovakia

2.1 External environment

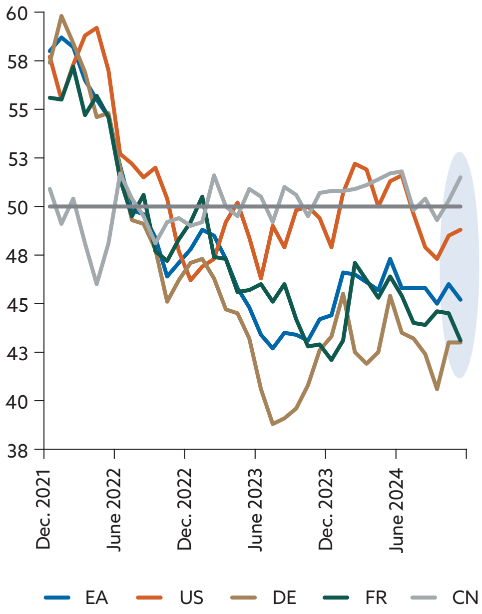
Global economic growth in the third quarter was primarily driven by services. By contrast, industrial stagnation became slightly more pronounced. Leading indicators suggest that industrial activity will remain weak through the end of the year. The industrial slowdown is most evident in the euro area, especially in Germany (Chart 1).

The Chinese economy has benefited from a pick-up in private consumption, supported by measures to boost home appliance trade-ins. The economy has further benefited from the recent easing of monetary policy and the expansion of fiscal stimulus. These factors should add momentum to the economy towards the end of the year or in the coming quarters. However, the effects of the country's real estate crisis and weak consumer confidence continue to weigh on the economy.

In the United States, strong consumer demand has been central to economic growth. Non-residential investment has also had a positive impact. There are, however, emerging signs that the labour market may be gradually cooling. Together with slower growth in wages and disposable income, this is likely to dampen consumer demand. On the other hand, the gradual reduction in interest rates and easing of credit standards are expected to bolster investment demand.

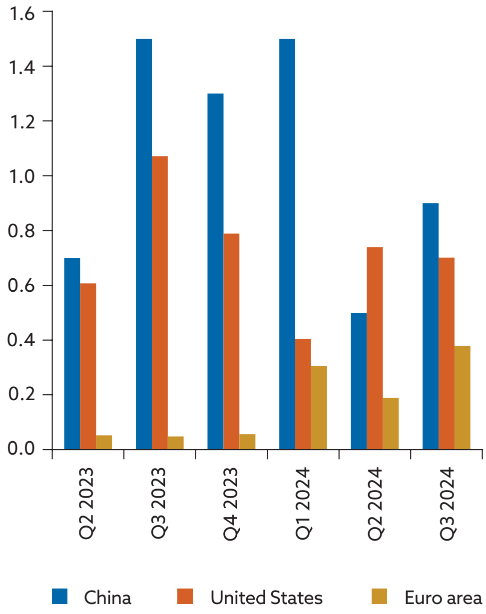
Despite negative signals from leading indicators, the euro area economy's growth over the previous quarter accelerated to 0.4% in the third quarter of 2024 (from 0.2% in the second quarter) (Chart 2). The stronger economic momentum was underpinned by recovering private consumption, reflecting renewed growth in real incomes due to a sharp drop in inflation and stronger wage growth.

Chart 1
Global Manufacturing Purchasing Managers' Index



Source: Macrobond.
Note: PMI readings above 50 indicate an expansion of economic activity, while readings of below 50 indicate a contraction.

Chart 2
GDP (quarter-on-quarter percentage changes)



Source: Macrobond.

At the start of the fourth quarter, leading indicators were signalling weak economic performance. The composite Purchasing Managers' Index (PMI) declined in November to a level that may indicate a slight economic downturn (Chart 3). The deterioration in the economic outlook stemmed mainly from a slump in services, which had been the main driver of growth in previous quarters. Manufacturing industry also, however, continues to struggle with weak performance. According to survey data, manufacturing firms are experiencing an ongoing decline in new orders and a deteriorating competitive position (Chart 4).

Looking ahead, the euro area economy—including Slovakia—faces uncertainty related to a potential increase in protectionist measures globally (Box 1). Given that the euro area is already struggling with weak competitiveness, any raising of trade barriers and tariffs could adversely affect its economic growth and likely entail modest inflationary effects. Other risks to the outlook relate to the global geopolitical situation.

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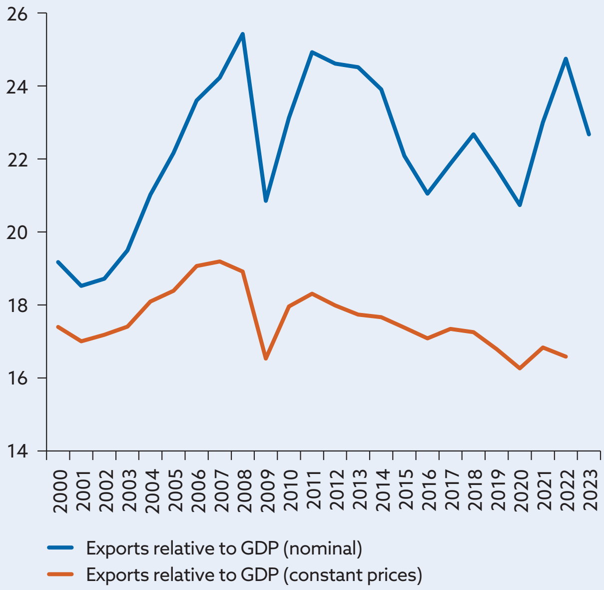
Box 1

Quantifying the impact of a deterioration in EU–US trade relations on the Slovak economy

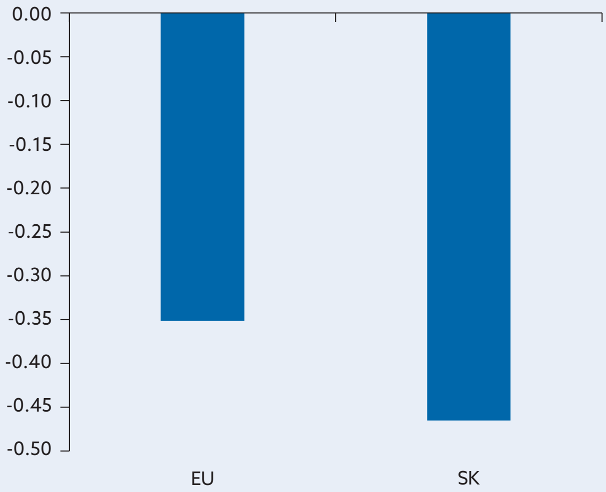
The volume of global trade as a share of global GDP has largely stagnated in recent years, with some indicators suggesting it has even declined (Chart A). For example, in nominal terms, global trade was lower in 2023 than it was a decade earlier. This trend may be influenced by the level of tariffs and other barriers to world trade, just as their removal in earlier decades translated into an increase in global trade volume. In this context, it is important to monitor the risk of deteriorating trade relations between the EU and its main trading partners. In this box, we focus on the United States.

Chart A
Indicators of global goods trade volume relative to GDP (percentage)



Sources: OECD, and BIS.
Notes: The chart shows the volume of global exports relative to GDP, both in nominal terms and at constant prices (the latter, available up to 2022, account for differential price developments in export goods and overall GDP). Trade in goods still constitutes the bulk of global trade, even though trade in services has increased slightly in recent years.

Chart B
Impact of the introduction of reciprocal import tariffs between the EU and the US on the GDP of the EU and Slovakia (percentage changes)



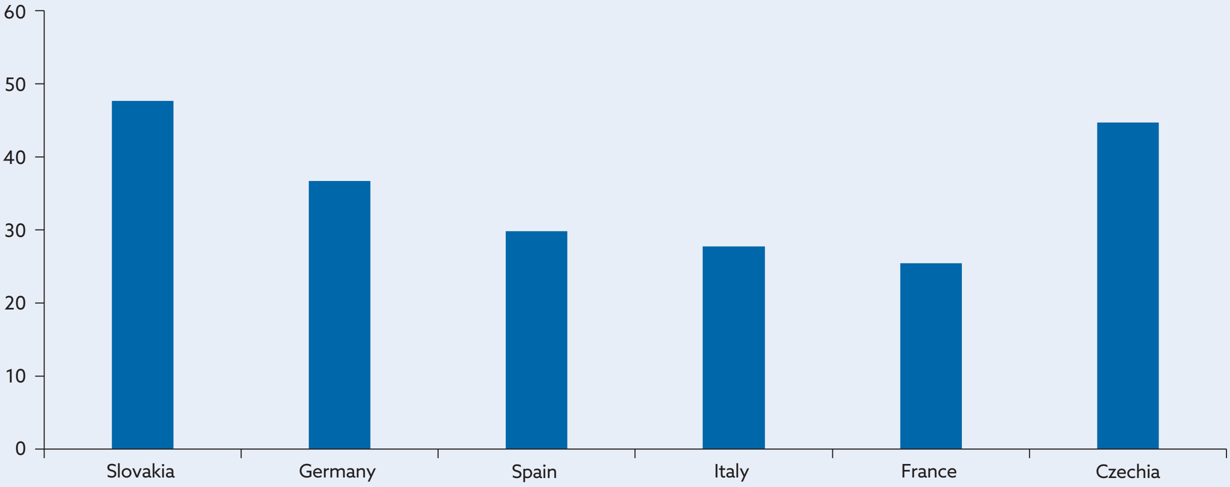
Source: NBS calculations based on Oxford Economics' Global Economic Model.
Note: The chart shows the estimated difference in the GDP figures for the EU and Slovakia between their level under a scenario where reciprocal import tariffs between the EU and the United States undergo a phased 10% increase by the end of 2028 and their level under a baseline scenario with no such increase.

Any introduction of reciprocal import tariffs between the EU and the United States would have a greater impact on the Slovak economy than on the EU economy as a whole (Chart B). Under such a scenario, the overall negative impact of such measures on the Slovak economy in the medium term is estimated to be 0.5% in the case of tariffs being gradually tightened by up to 10%. While this scenario assumes a broad-based tariff increase, those goods that are more sensitive to tariffs could be disproportionately affected if trade relations deteriorate. For example, tariffs may be higher in the automotive sector, further amplifying the impact on the Slovak economy. The main reason for the greater impact on Slovakia is the high openness of its economy. Overall, the United States' position as a crucial trading partner of the EU affects the magnitude of the estimates.

The adverse effect of trade barriers on Slovakia is accentuated by the relatively high share of net exports in its GDP (Chart C). Specifically, Slovak exports net of imported components amounted to nearly 50% of GDP in 2023. In Czechia, the share was similar, while in Germany it was around 35% of GDP. These figures highlight the critical role that tradable goods play in the Slovak economy and the economic cost of taxing them through tariffs.

Chart C

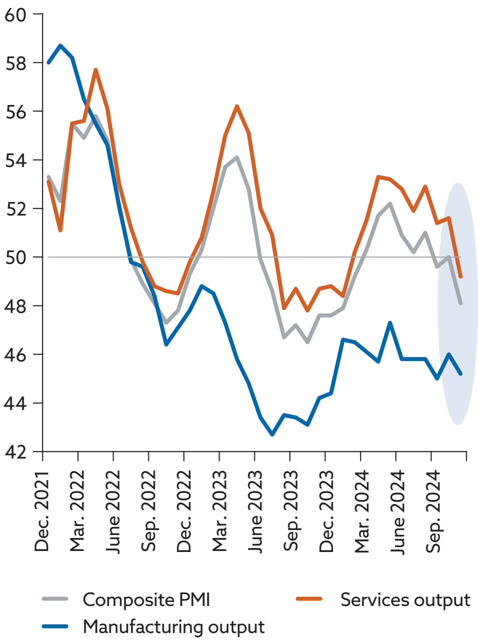
Net exports of Slovakia and selected EU countries relative to GDP (percentages)



Source: OECD Input-Output Database.
Notes: The chart shows net exports (exports adjusted for the share of imports in exports relative to GDP). The export data are from 2023; however, in the current 2023 inpute-output tables, the most recent available share of imports in exports is for 2020.

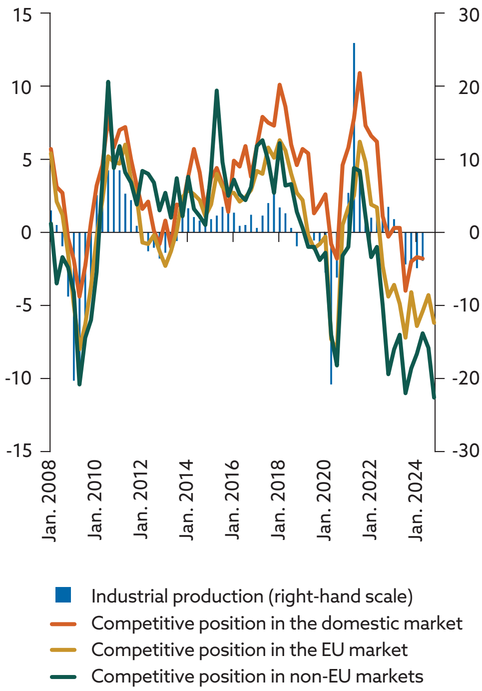
The United States is the principal destination for the EU's exports and its significance in this regard has grown in recent years (Chart D). In 2023, around one-fifth of the EU's total exports went to the United States. Compared with other EU countries, Slovakia is less directly linked to the US economy, with around 5% of its total exports going to the United States. What is important from Slovakia's point of view, however, is the high indirect linkage of production chains through the exports of Slovakia's trading partners to the United States. This channel significantly amplifies the overall impact of any trade barriers and could make Slovakia one of the more vulnerable economies.

Chart 3
Euro area: Purchasing Managers' Index



Source: Macrobond.

Chart 4
Euro area: Industrial production and industrial competitiveness assessments (annual percentage changes; percentage balances)

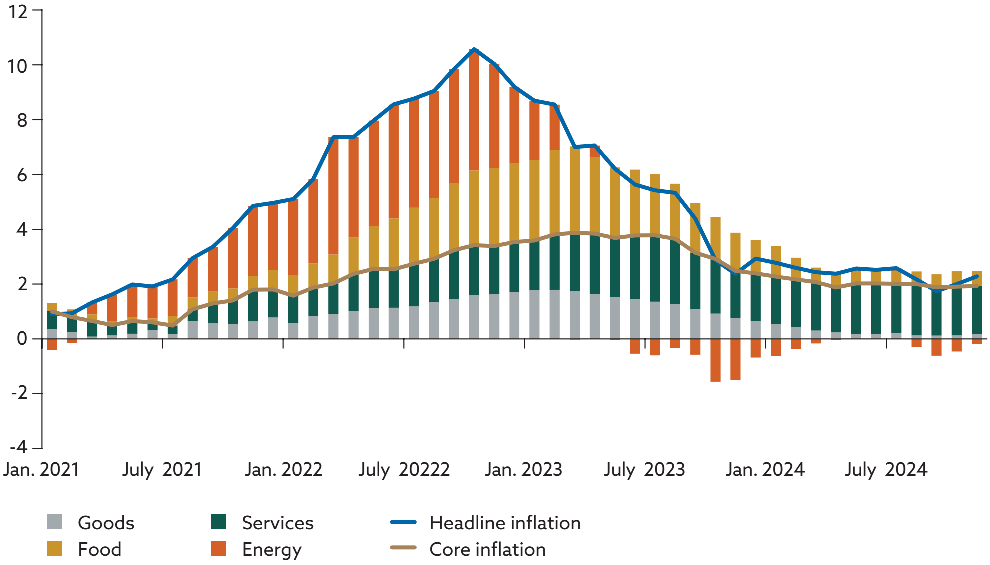


Source: Macrobond.

The gradual easing of euro area inflation during 2024, to levels close to the 2% target, has been largely driven by prices of goods and energy (Chart 5). Goods inflation (excluding energy) has slowed amid a decline in import prices, reflecting improvements in supply chain functioning as well as a relatively significant decrease in China's export prices. Inflation in the energy component of the consumption basket has been tempered by the fading of the energy price shock and stabilisation of the energy commodity market. Indeed, energy inflation has gradually moved into negative territory, owing partly to the base effect of the previous year's elevated energy prices. However, the impact of this base effect has started to fade, and the year-on-year decline in energy prices has moderated. By contrast, food inflation has been accelerating in recent months. With services inflation still relatively high (at around 4% for a year), core inflation has not slowed as much as it might have, fluctuating below 3% since March of this year (2.7% in November). Services prices remain subject to the pass-through of elevated past costs, including wages. However, with the labour market showing signs of cooling, services inflation is also expected to moderate.

Chart 5

Euro area: HICP inflation and its components (annual percentage changes; percentage point contributions)



Source: Macrobond.

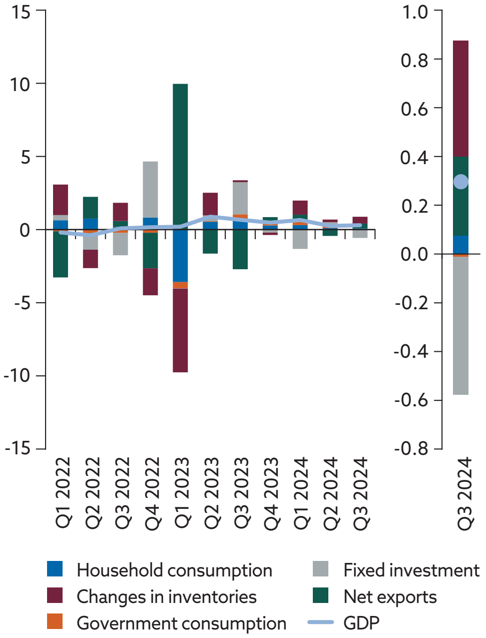
2.2 Slovakia

2.2.1 Economic growth

The economy continued to grow sluggishly during the summer, with GDP increasing by 0.4% compared with the second quarter (Chart 6). The positive impact of domestic consumption is gradually fading, while industrial performance remains subdued. Although the situation in the euro area has improved, partly due to the Paris 2024 Olympics in August, Slovak producers appear not to have benefited from the recovery. Weak demand was particularly evident in the automotive industry, where the launch of new production has also fallen short of expectations. Investment activity has continued to stagnate after the strong absorption of EU funds in the previous year.

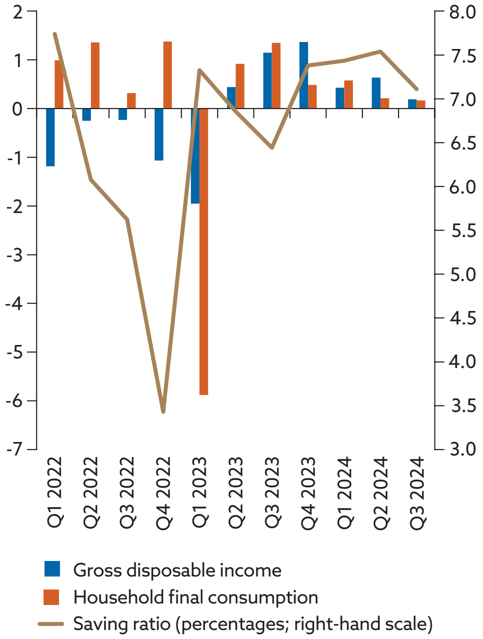
Household spending was weaker in the third quarter than earlier in the year, with household incomes increasing only moderately (Chart 7). The slowdown in inflation has stalled, and, by extension, so has real income growth. Consumption remained restrained over the summer, with households spending only slightly more than in the previous quarter. During the holiday season, they primarily purchased everyday items and services (Chart 8). Although consumption growth was modest, household budgets left little room for increasing savings, and the saving rate declined. Household sentiment started to worsen sharply after the autumn announcement of the government's fiscal consolidation package. At the same time, inflation expectations began to rise, and while this shift could temporarily stimulate consumption, such an effect has yet to be observed in surveys or incoming data (Box 2).

Chart 6
GDP and its components (quarter-on-quarter percentage changes; percentage point contributions)



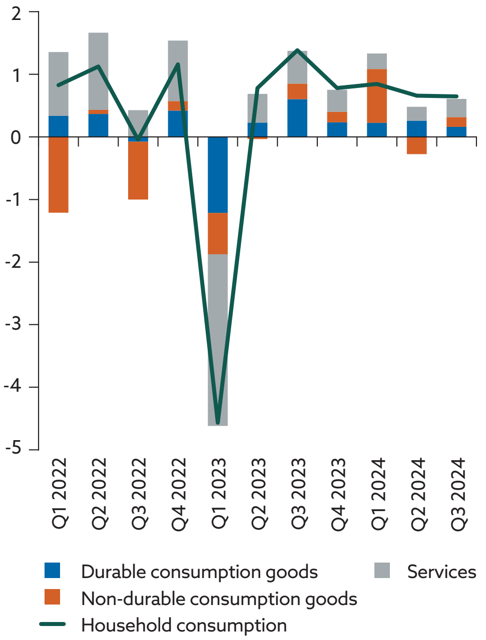
Sources: SO SR, and NBS.

Chart 7
Households' income, consumption and savings (quarter-on-quarter percentage changes; percentages)



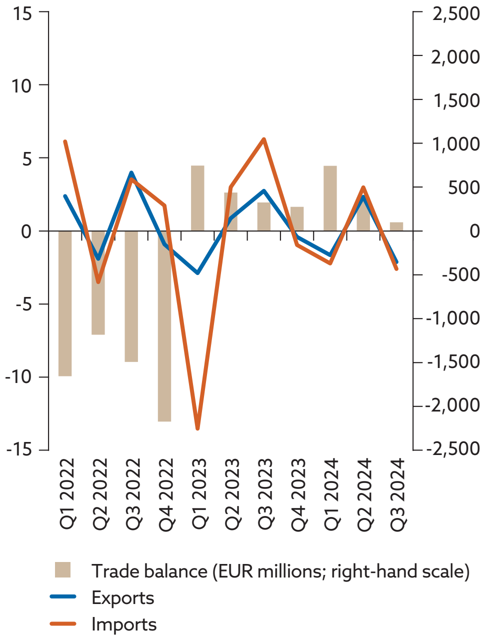
Sources: SO SR, and NBS.

Chart 8
Household consumption (quarter-on-quarter percentage changes; percentage point contributions)



Sources: SO SR, and NBS.

Chart 9
Trade balance (quarter-on-quarter percentage changes)



Source: SO SR, and NBS.

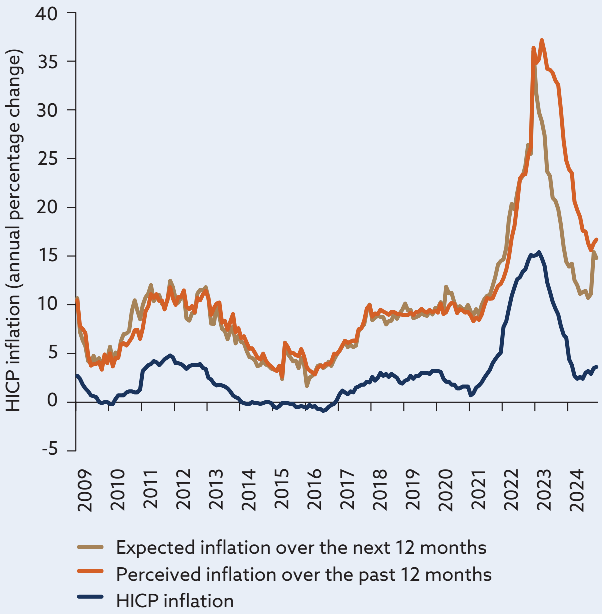
Box 2

Slovak households once again expect inflation to rise

The recently announced fiscal consolidation package has shaken people's expectations about price developments over the next 12 months, raising them significantly. At the same time, households have lowered their expectations for both their financial situation and the general economic situation over the next year. As a result, the higher inflation expectations for next year have not yet translated into an increase in households' propensity to make large purchases ahead of price increases.

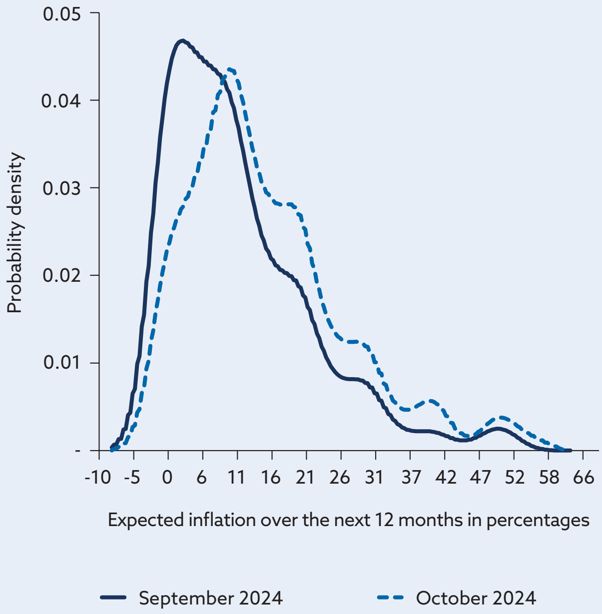
The announced changes to VAT and energy prices, as well as other components of the September 2024 consolidation package, have had an upward impact on Slovak households' inflation expectations.[1] Between September and October 2024, the average expected inflation rate surged from 11% to 15% (Chart A),[2] and it remained elevated in November (at 14.8%). The expected rate is therefore increasing faster than the actual rate. In the past, expectations tended to reflect recent experience.

Chart A
Perceived, expected and actual inflation



Sources: SO SR, and NBS calculations.

Chart B
Distribution of inflation expectations in September and October 2024



Sources: SO SR, and NBS calculations.

[1] Data sources: Statistical Office of the Slovak Republic, and the harmonised consumer survey of the European Commission.

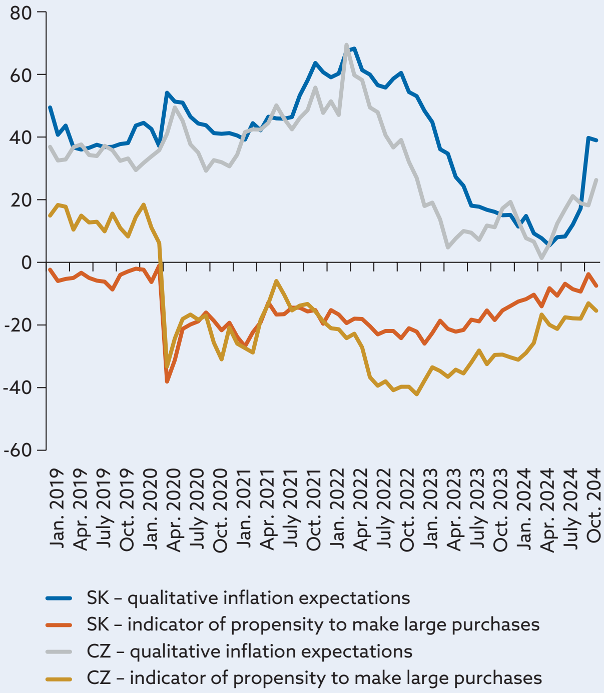
[2] The average expected inflation rate for the next 12 months and the average perceived inflation for the past 12 months are calculated from data adjusted to exclude the lowest 2.5% and highest 2.5% of inflation expectations for the given month.

The share of people expecting inflation to be higher than the average expected rate has increased.

The share of people expecting inflation to be higher than the average expected rate has increased. The consolidation package shifted the distribution of expectations to the right between September and October 2024 (Chart B). Not only are more people expecting higher inflation on average, but the share of people expecting inflation to be significantly higher than in September has also increased.

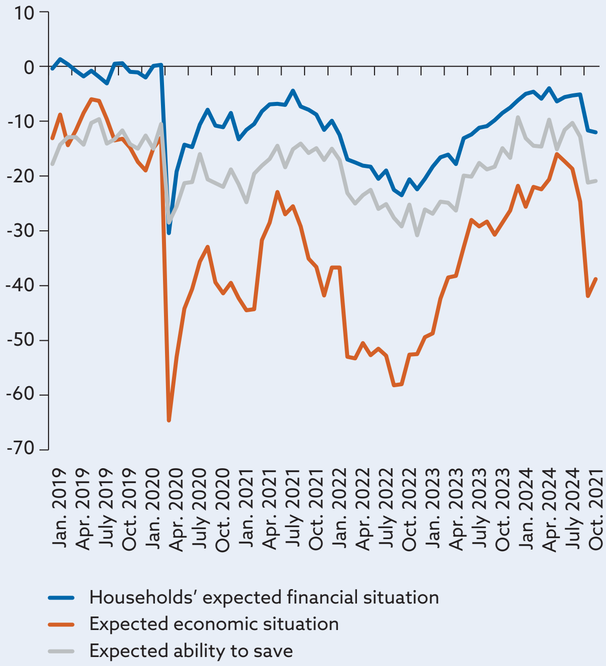
Higher inflation expectations have not yet resulted in households being more inclined to make large purchases. The surveyed households were also asked whether, considering the general economic situation in Slovakia, they think now is the right time to make large purchases (furniture, electrical appliances, electronics, etc.). While inflation expectations in Slovakia rose rapidly in October and stayed elevated in November, the same did not occur in Czechia. Nevertheless, the propensity to spend has evolved similarly in both countries (Chart C).

Chart C
Comparison of inflation expectations and the propensity to make large purchases in Slovakia and Czechia (weighted average of the balance of responses)



Source: European Commission.

Chart D
Consumer confidence in Slovakia (weighted average of the balance of responses)



Source: European Commission.

The disinclination to make large purchases before the VAT increase may be related to the overall outlook for next year, leading to caution and reduced expected purchasing power. Compared with September, households' expectations for their financial situation and the general economic situation in Slovakia over the next 12 months have deteriorated (Chart D). Among households that still believe now is the right time to make large purchases, 40% expect higher inflation. Thus, the positive impact of higher inflation expectations may partly offset the decline in consumer confidence. Without rising inflation expectations, the propensity to make large purchases could have fallen even further behind the level in Czechia (Chart C).

Exports have continued to weaken, and low foreign demand has constrained the launch of new production (Chart 9). While the euro area's economic performance picked up during the summer, Slovak exporters did not benefit. The improvement in European countries was primarily due to the services sector, partly supported by the Paris 2024 Olympics in August. However, the industrial sector of the euro area economy continues to struggle, and consequently so does Slovak industry. As a result of weak demand, the launch of new production in the domestic automotive industry has not gone as planned. The decline in imports has become more pronounced because of weak exports coupled with faltering domestic consumption.

Government consumption growth has gradually slowed from the high levels seen in early 2024, according to preliminary data. Wages remain the primary driver of consumption growth, followed by spending on goods, services and healthcare. While wage growth has slowed because of the fading effect of September 2023 indexation increases, the slight easing of the high growth in current expenditure is due mainly to savings on energy costs.

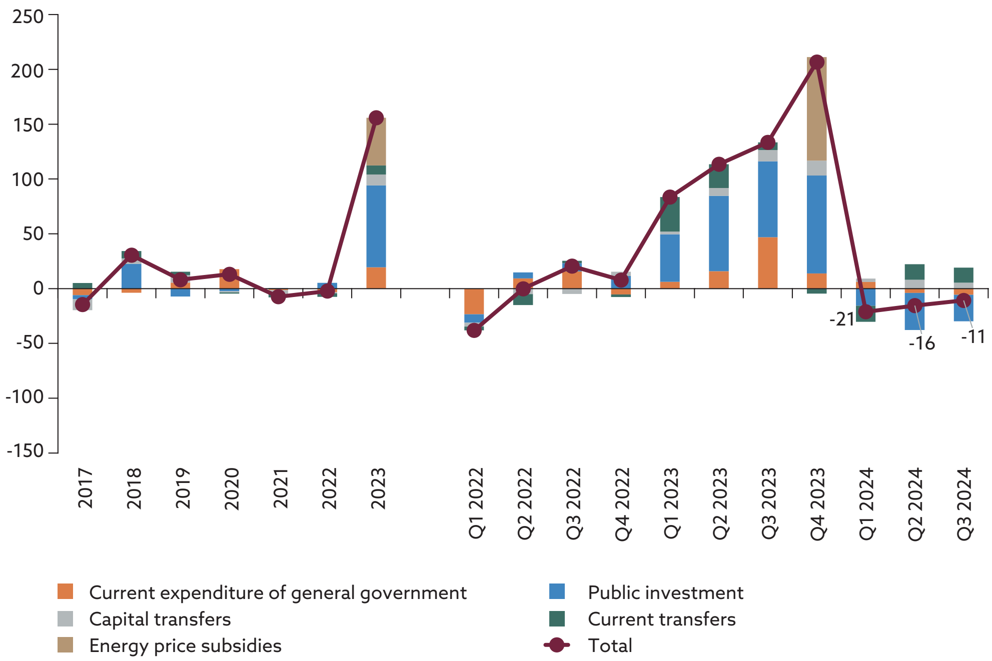
Investment activity has declined in all sectors. Firms have scaled back machinery purchases, investing slightly more only in transport equipment and intellectual property products. Tighter monetary policy continues to constrain households, with their property market activity remaining subdued over the summer. While public investment was expected to pick up in the second half of 2024, it has not done so. Compared with 2023, the most notable slowdown has been in investment in military and special equipment, as well as in civil automotive and rail transport. There has also been a slowdown in building renovation and modernisation. Lower investment spending is due not only to more subdued absorption of EU funds, but also to domestic cost-saving measures.

The slowdown in the absorption of EU funds (including RRF funding via the implementation of Slovakia's recovery and resilience plan) became

less pronounced in the second and third quarters. Following a surge in EU funds in 2023 (when Slovakia had to complete the disbursement of funds allocated under the 2014–2020 EU programming period), the base effect of that influx has been most apparent in the year-on-year decline in public investment funding. By contrast, transfers outside the public sector have increased, amid the completion of payments from the 2014–2020 programming period (Chart 10). The uptake of funds under the current EU budget is barely underway, with only one per cent of the cohesion policy allocation having been disbursed by the end of the third quarter of 2024. The investment pillar of the RRF funding is being implemented slowly, indeed more slowly compared with the previous year. These funds have been used for healthcare, education and transport. Funding related to green transition initiatives has been notably below last year's higher level. Overall, around 13% of the RRF funding allocated to Slovakia has so far been disbursed.

Chart 10

Absorption of EU funds (annual percentage changes) [1)]



Sources: MF SR, and NBS.
1) Adjusted for spending on financial instruments.

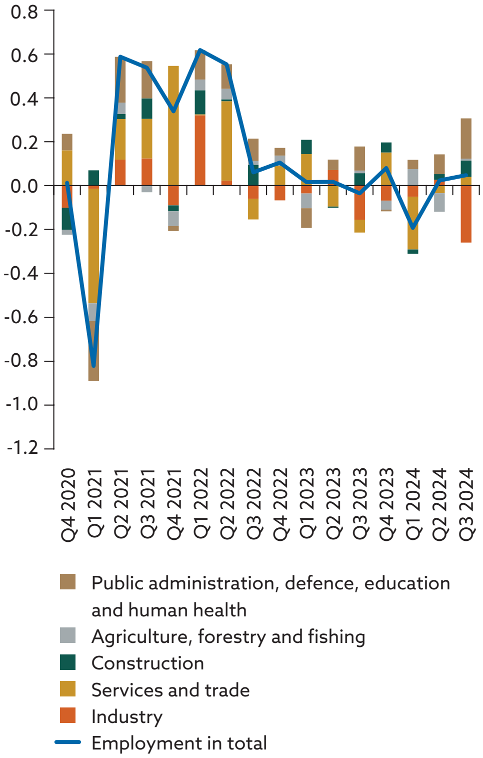
2.2.2 Labour market

Total employment remained unchanged in the third quarter of 2024 (Chart 11). In industry, the adverse trend continued, as weaker performance translated into lay-offs and rationalisation measures. More concerning signals, however, are coming from the services sector, where employment is declining in some sub-sectors. Sectors experiencing upward employment trends include trade, construction, and public administration. Since early

2024, the labour market has seen opposing trends in employment and the unemployment rate. The vacancies left by an increasing number of early retirements are being filled from the ranks of the unemployed and by foreign workers. Hence, the unemployment rate is falling while the number of people in employment remains flat. The number of job vacancies is declining, indicating a shrinking demand for labour (Chart 12).

Chart 11

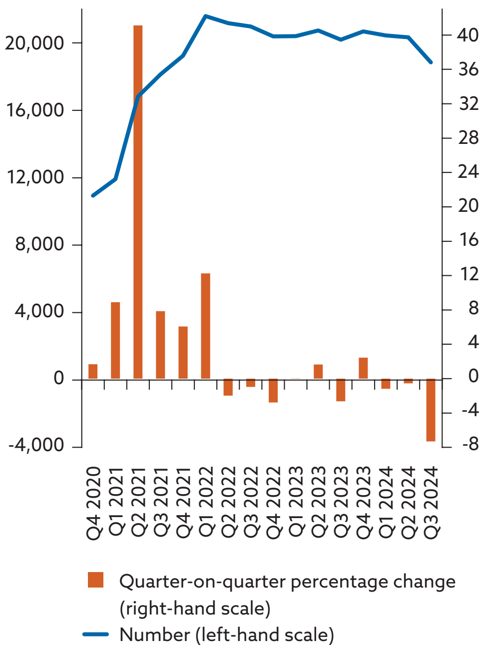
Employment by sector (quarter-on-quarter percentage changes; percentage point contributions)



Sources: SO SR, and NBS.

Chart 12

Number of job vacancies (number; annual percentage changes)

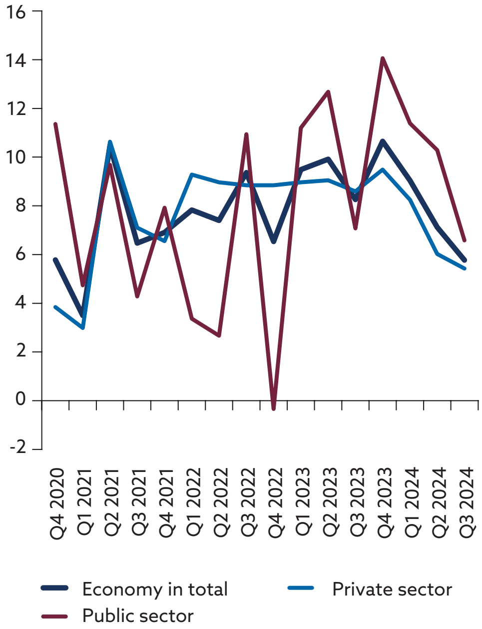


Sources: Profesia online job portal (www.profesia.sk), and NBS.

Wage growth continues to moderate. The slowdown has been more moderate in the private sector—where skilled labour shortages are more pronounced—than in the public sector (Chart 13). In the public sector, the impact on wage growth of the previous year's high indexation-based wage increases has faded. With inflation accelerating again, the recovery of households' purchasing power has moderated. It is worth noting the situation in industry, where long-term employment decline co-exists with persistent labour shortages. Employees are working longer hours, pushing average wages higher.

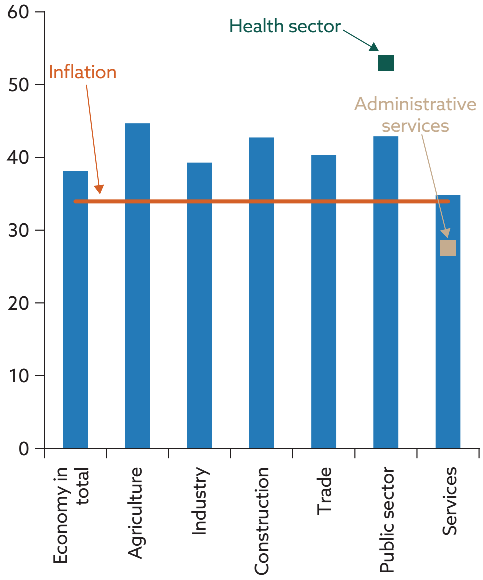
From a sectoral perspective, agriculture, the public sector and construction have experienced strong real wage growth during the period of uncertainty that began with the pandemic and continued through the energy crisis and rising inflation. In the services sector, by contrast, nominal wage growth has barely kept pace with inflation. The biggest winners in terms of real wage growth over this period have been health and social services workers (Chart 14).

Chart 13
Nominal wages by sector (annual percentage changes)



Sources: SO SR, and NBS.

Chart 14
Real wages by sector (index: Q4 2019 = 100)

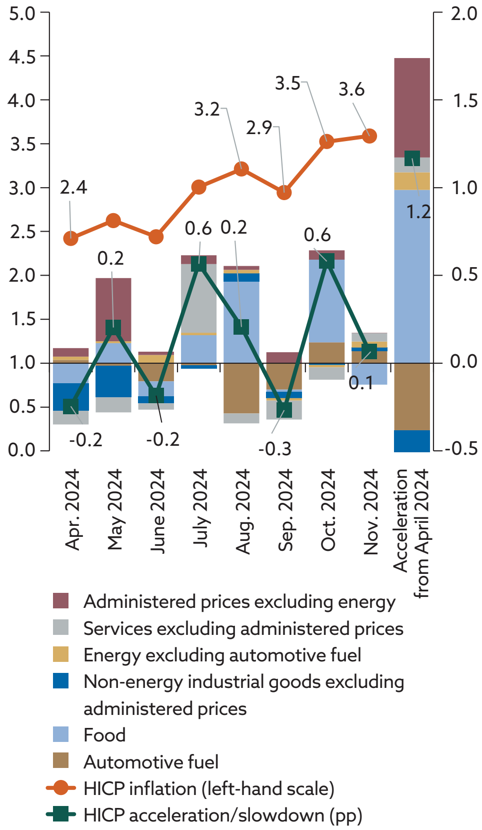


Sources: SO SR, and NBS.

2.2.3 Consumer prices

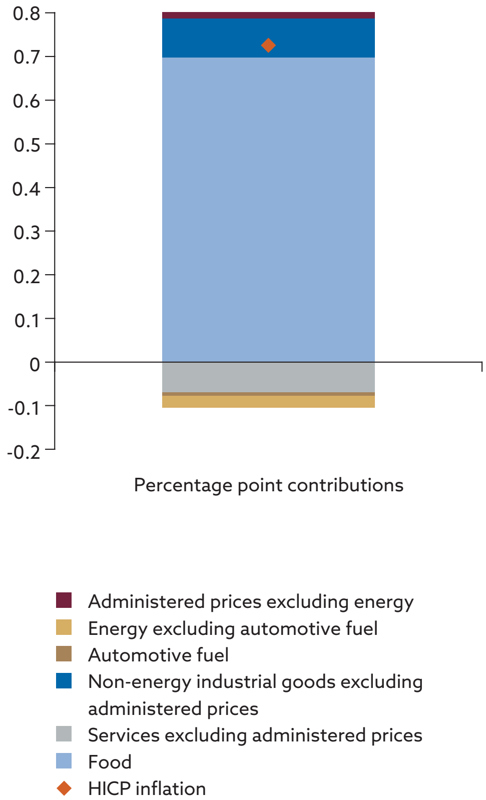
Slovakia's annual inflation rate accelerated to 3.6% in November. Since falling to a short-term low in April 2024, the headline rate has increased by 1.2 pp (Chart 15). This upturn has been primarily driven by food prices and by the fading impact of one-off measures implemented in 2023 (the scrapping of television licence fees and free school meals). Without downward pressure from oil and automotive fuel prices, inflation would have been even higher. November's annual inflation rate was 0.7 pp higher than projected in the autumn forecast (Chart 16), with food prices rising more sharply than envisaged.

Chart 15
HICP inflation and its components (annual percentage changes; percentage point contributions)



Sources: SO SR, and NBS.

Chart 16
Decomposition of the difference between the actual inflation rate and the rate projected in the autumn 2024 forecast (percentage point contributions)



Sources: SO SR, and NBS.

Annual food inflation (including tobacco and alcohol prices) stood at 4.7% in November (Chart 17), slightly slower than in October. The month-on-month increase in food prices in October was unusually fast compared with neighbouring countries and historical trends (Box 3). Part of this increase was due to an October increase in food producer prices for the domestic market. The greater part is for now only attributable to the prevalent uncertainty about future economic developments.

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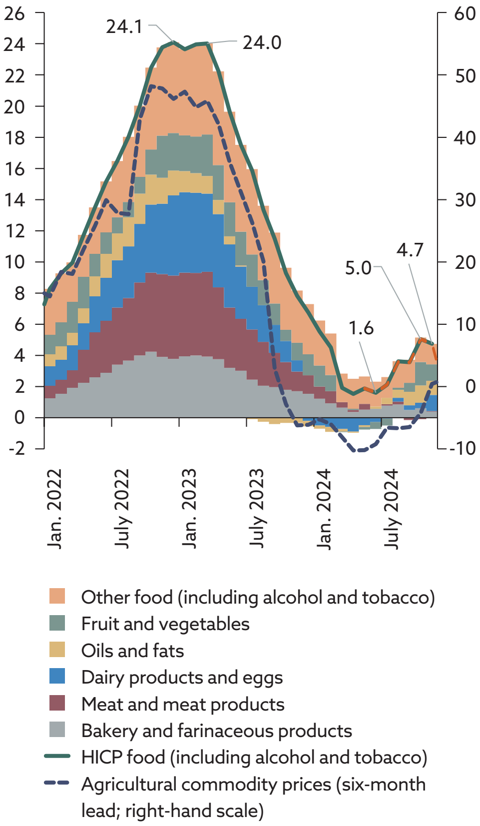
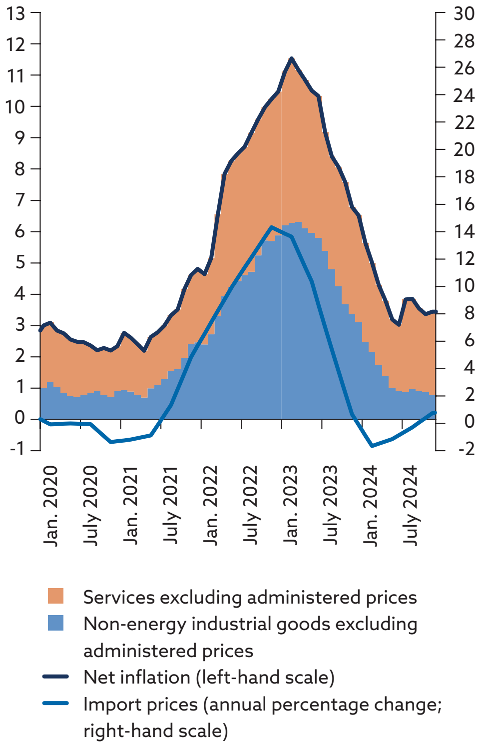
Chart 17
HICP food prices (annual percentage changes; percentage point contributions)



Sources: SO SR, and NBS.

Chart 18
HICP net inflation (annual percentage changes; percentage point contributions)



Sources: SO SR, and NBS.

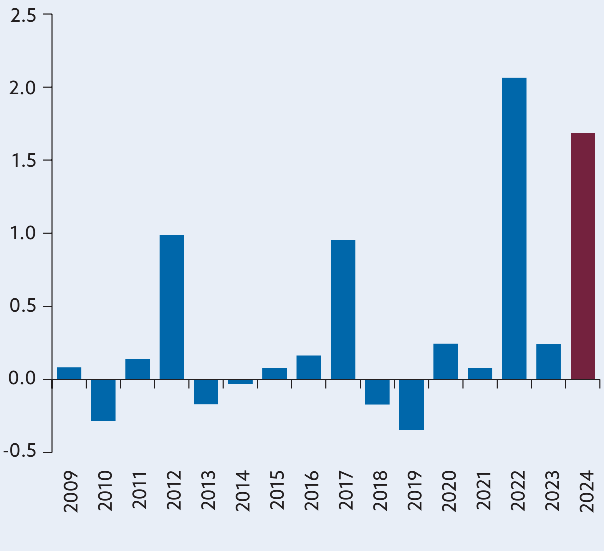
Net inflation (the headline rate excluding automotive fuel) stabilised at 3.4% in November (Chart 18), after accelerating temporarily in July due to the fading of the impact of the abolition of television licence fees a year earlier. In the absence of excessive demand pressures, the environment of low import inflation and moderating wage growth are having a stabilising impact. As a result, the annual rate of non-energy goods inflation dropped to 1.5% in November.

On the other hand, the year-on-year increase in non-administered prices of services (5.7%) remained relatively high, despite easing wage pressures. In this area of services prices, the highest increases are currently observed in education, personal care, holidays, air fares, insurance, and restaurant dining. However, inflation is even higher (9.7%) across services subject to price regulation. In particular, administered prices of public transportation, postal and communication services, and waste disposal recorded a significant year-on-year increase in November.

Box 3
Food prices back in the spotlight

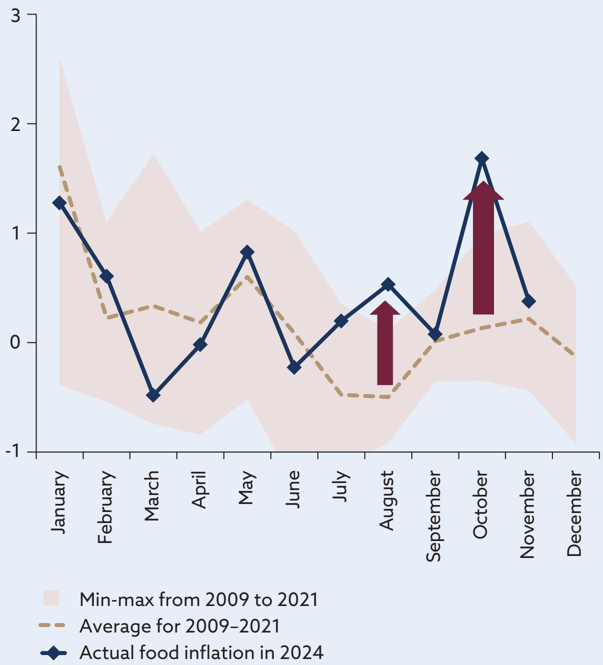
Uncertainty and expected cost increases accounted for an unexpectedly high food inflation print in October. Historically, October tends not to be a month of significant food price changes, except in 2022 (Chart A), when food inflation peaked due to a cost shock. This time, the increase was even more surprising because all cost factors had already subsided and input prices in the food supply chain had stabilised. Food prices surprised on the upside in other countries as well, but nowhere more markedly than in Slovakia, suggesting that other factors were at play. One explanation is that, during times of uncertainty and higher cost expectations, firms raise prices beyond the levels implied by fundamentals.

Chart A
Food prices in October (annual percentage changes)



Sources: SO SR, and NBS.

Chart B
Food prices in retrospect (annual percentage changes)



Sources: SO SR, and NBS.

October's increase in food prices was not driven by a specific part of the food basket, but was broad-based across nearly all items (Chart C). We also analysed price developments in the food basket on an item-by-item basis, both in October (Table A) and over a longer period.

Chart C
Food price sub-components in October 2024 (month-on-month percentage changes)

Sources: SO SR, and NBS.

Table A
Food price sub-components in October 2024 (adjusted for taxes; month-on-month percentage changes)

Food price sub-component	CZ	DE	HU	AU	PL	SK
Food excluding alcohol and tobacco	0.2	0.7	0.9	0.6	0.7	2.1
Bakery and farinaceous products	0.6	0.3	-0.2	0.4	0.6	1.2
Meat	-1.1	-0.3	0.0	0.3	0.1	0.2
Fish and seafood	0.6	-0.2	-0.1	0.2	0.1	0.3
Milk, cheese and eggs	0.2	1.0	2.1	0.8	0.3	1.4
Oils and fats	2.6	6.0	1.8	2.5	2.1	6.4
Fruit	5.9	1.2	1.5	0.3	2.1	4.9
Vegetables	-1.5	2.0	3.7	1.6	2.8	8.2
Sugar, confectionary and chocolate	0.1	-0.9	0.7	0.5	-0.2	2.0
Not elsewhere specified	0.0	0.5	-1.1	0.7	-0.2	0.4
Coffee, tea and cocoa	-1.8	1.1	0.9	-1.7	0.1	-0.1
Mineral waters, juices and soft drinks	0.1	1.2	0.2	0.4	0.8	2.5

Sources: SO SR, and NBS.

Rising food prices are not an issue particular to October 2024. Since the cost shock started, food inflation has been higher in Slovakia than in any other country apart from Hungary (Table B). The cost shock contributed significantly to the recent double-digit headline inflation rate in Slovakia, with the food component playing a major role due to having the largest weight in consumption basket. It may be expected that after the food crisis receded, the impact of cost factors (culminating in late 2022) would fade most markedly in the country with the highest food inflation. Considering Slovakia's links and common market with Czechia and Germany, there was clear potential for a moderation of food inflation (Table C). However, as the latest data from October and November indicate, firms did not capitalise on favourable trends of recent months; instead, Slovakia reported the highest level of food inflation.

Table B
Cumulative change in food prices excluding alcohol and tobacco since February 2022 (adjusted for taxes; percentages)

Food price sub-component	CZ	DE	HU	AU	PL	SK
Food excluding alcohol and tobacco	22.5	24.8	44.7	20.0	24.1	33.4
Bakery and farinaceous products	24.0	29.0	49.8	20.0	29.1	34.8
Meat	21.3	21.3	37.9	21.1	21.9	34.1
Fish and seafood	15.1	22.0	35.3	24.7	20.8	26.5
Milk, cheese and eggs	19.9	30.8	52.8	19.4	24.4	32.9
Oils and fats	33.3	43.9	30.3	29.6	13.0	57.3
Fruit	17.1	17.4	42.7	5.9	9.2	27.8
Vegetables	21.3	11.8	20.5	18.7	11.9	26.0
Sugar, confectionary and chocolate	37.8	29.3	56.1	22.4	36.6	43.7
Not elsewhere specified	22.5	30.4	45.4	17.8	31.8	32.8
Coffee, tea and cocoa	13.9	16.1	44.9	21.4	29.1	21.7
Mineral waters, juices and soft drinks	18.8	31.6	55.3	26.6	28.2	26.4

Sources: SO SR, and NBS.

Table C
Cumulative change in food prices excluding alcohol and tobacco since November 2022 (adjusted for taxes; percentages)

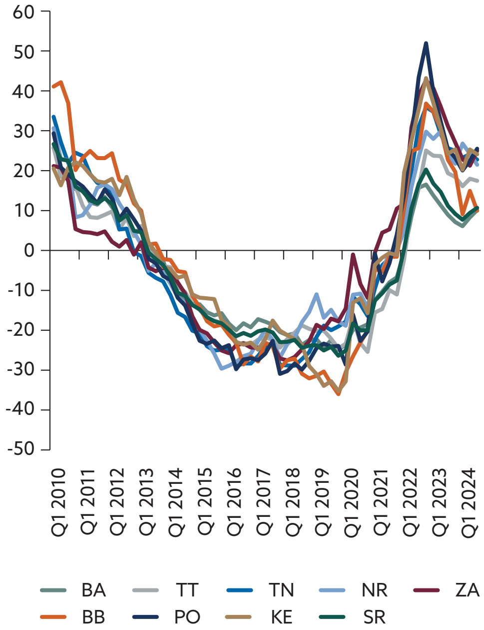
Food price sub-component	CZ	DE	HU	AU	PL	SK
Food excluding alcohol and tobacco	3.9	8.7	7.7	9.0	8.5	12.4
Bakery and farinaceous products	2.9	10.5	0.6	9.3	10.1	14.3
Meat	-1.3	3.6	6.1	7.5	3.7	6.9
Fish and seafood	5.0	6.4	5.6	9.1	3.9	11.4
Milk, cheese and eggs	-3.6	1.1	-2.3	3.9	0.4	6.1
Oils and fats	3.0	10.0	0.4	9.6	-9.0	17.8
Fruit	14.1	15.7	13.4	5.0	8.6	20.4
Vegetables	18.7	7.0	10.4	10.9	8.3	19.0
Sugar, confectionary and chocolate	10.9	16.8	27.3	13.1	13.5	21.9
Not elsewhere specified	8.1	11.0	11.4	10.8	15.7	11.7
Coffee, tea and cocoa	6.6	4.6	16.7	10.5	15.7	11.2
Mineral waters, juices and soft drinks	9.5	20.2	22.4	18.9	15.7	16.5

Sources: SO SR, and NBS.

2.2.4 Residential property prices

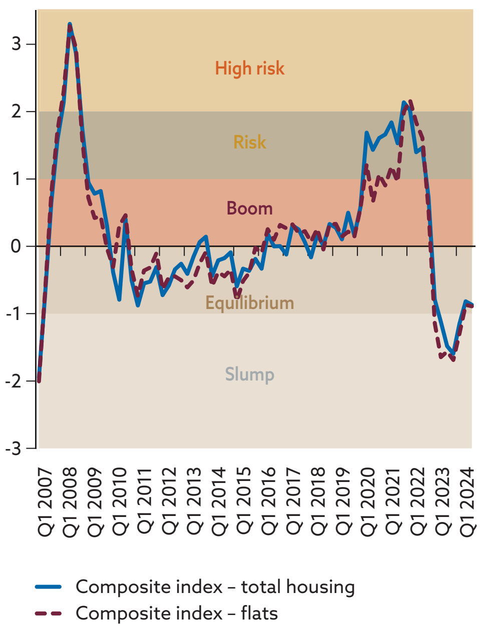
Housing prices in Slovakia continued to rise in the third quarter of 2024, increasing by 2.4% over the previous quarter. Their annual growth rate turned positive, climbing to 3.4%. The regions with highest housing price growth were Prešov, Žilina, and Bratislava, with rising prices of flats in Bratislava being the primary driver of the overall increase in the average housing price. In Nitra and Banská Bystrica regions, by contrast, housing prices declined slightly.

Chart 19
Housing affordability index (HAI) value as a ratio of its historical average (percentages)



Sources: NARKS, SO SR, United Classifieds, and NBS.

Chart 20
Composite index to assess housing price developments



Sources: NARKS, SO SR, United Classifieds, and NBS.

Housing affordability continued to deteriorate slightly in the third quarter (Chart 19). Interest rates on new mortgages peaked in the second quarter and were edging down during the summer months. This trend, however, even combined with wage growth, has not been sufficient to outweigh the impact of rising housing prices. The housing affordability index (HAI)[3] increased (worsened) by 1.3 points in the third quarter. The deterioration was most pronounced in those regions with the fastest-rising housing prices: Prešov, Žilina and Bratislava. In Slovakia's five other regions, the HAI fell slightly.

The composite index[4] does not indicate any significant changes in the assessment of housing price developments **(Chart 20).** Upward pressure on the index is coming from the sub-indicators of disposable income,

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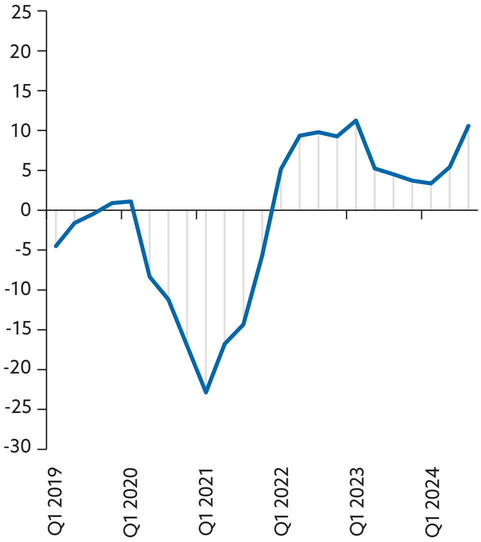
[3] The HAI calculation is based on a so-called adequate income derived from the current average cost of mortgage loan servicing (taking into account current housing prices and interest rates). The adequate income is compared with the wage level on a region-by-region basis. The final ratio is then interpreted in relation to the long-run average.

[4] In order to assess the impact of housing prices on financial and economic stability, we compare their evolution with the evolution of their underlying theoretical fundamentals. We do so using a composite index based on ratio indicators (the real housing price; price/income; price/rent; mortgage loans/households' gross disposable income; amount of residential construction/GDP). Further information on the composite index's compilation is provided in Cár, M. and Vrbovský, R., 'Composite index to assess housing price development in Slovakia', Biatec, Vol. 27, No 3, Národná banka Slovenska, Bratislava, 2019.

inflation and, in particular, mortgage lending. Residential asking prices are rising faster than mortgage originations, implying overvaluation. The index is under downward pressure from subdued residential construction and, even more so, rental prices. Rental prices are rising at an accelerating pace, already 10% higher in the third quarter of 2024 than in the same period of the previous year (Chart 21). This indicates that housing price growth may also accelerate.

Chart 21

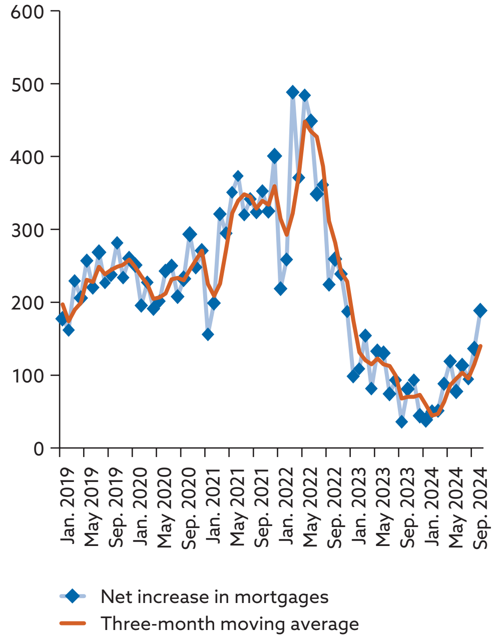
Average housing rental price (annual percentage changes)



Source: ECB.

Chart 22

Net increase in mortgages (EUR millions)



Sources: ECB, and NBS.

The credit market has been slowly picking up in recent months (Chart 22). Monetary policy easing started to pass through to retail interest rates towards the end of the third quarter of 2024. Interest rates on new mortgages (excluding refinancing and top-up loans) fell from a peak of 4.6% in June 2024 to 4.25% in October. Consequently, mortgage borrowing has been gradually increasing, particularly in September and October, when the year-on-year growth rate reached up to 40%.

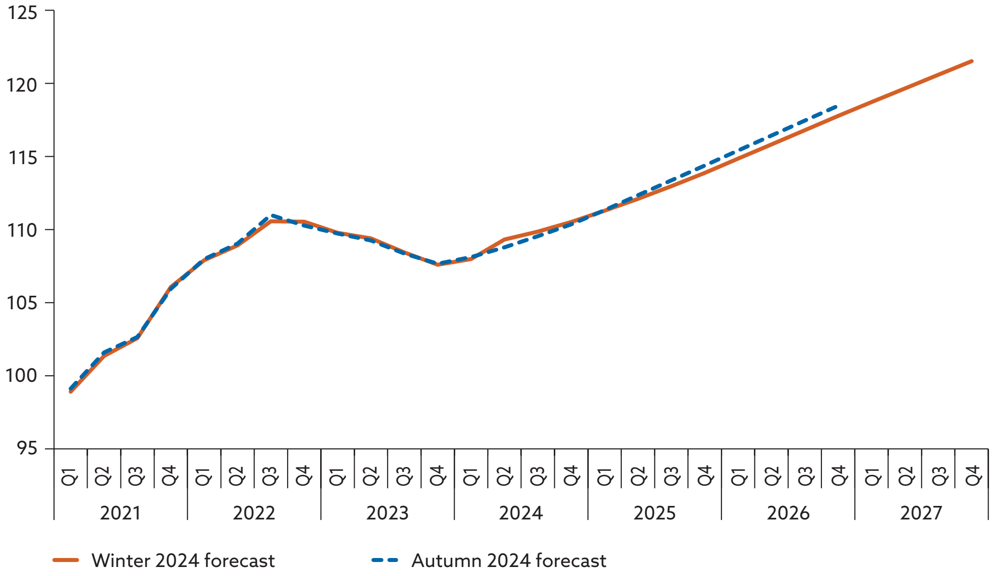
Residential construction remains subdued. As regards the construction of flats, the third quarter saw the number of construction starts fall to its lowest level since 2013 (declining by 22% year-on-year) and a similar drop in the number of building permits issued. The number of construction completions was 0.5% higher year-on-year. Thus, the number of residential properties under construction continues its gradual decline.

3 Medium-term forecast[5]

3.1 Global outlook and technical assumptions of the forecast[6]

The outlook for foreign demand for Slovak products continues to deteriorate (Chart 23). The ongoing struggles of German industrial production are gradually reducing the assumptions for foreign demand growth, especially in 2025. Compared with the autumn 2024 forecast, the assumption for the level of foreign demand at the end of 2026 has been revised down by 0.6%.

Chart 23
Foreign demand (index: Q4 2019 = 100)



Source: NBS.

We currently foresee favourable oil price developments, with the average price per barrel assumed to be just under USD 72 in 2025, falling to around USD 70 in 2026 and 2027. The assumption for the euro's exchange rate against the US dollar is more than 4% weaker in this forecast than in the previous edition, revised down from 1.11 to 1.06 dollars per euro over the projection horizon.

Markets expect a sharper reduction in short-term interest rates. Compared with the autumn forecast, the assumption for these rates' average level in

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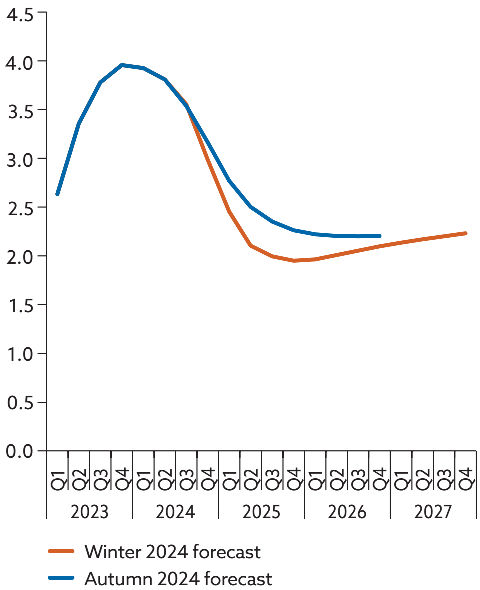
5 We produced the forecast based on the available national accounts data for the second quarter of 2024 and on the flash estimate for the third quarter.

6 The technical assumptions of this medium-term forecast are based on the December 2024 Eurosystem staff macroeconomic projections for the euro area.

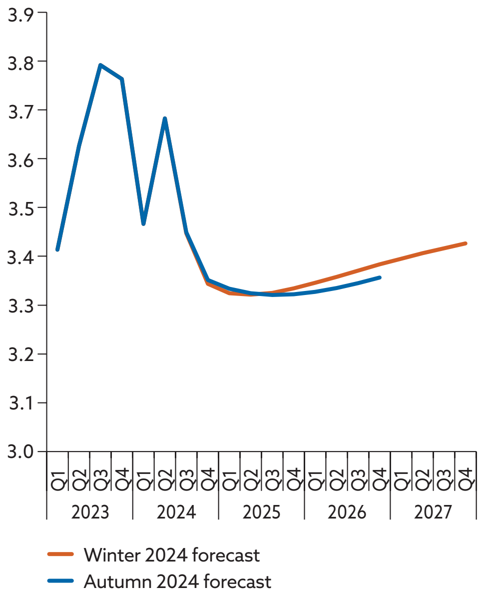
2025 has been revised down by around 30 basis points. Long-term interest rates are assumed to follow a moderate upward trend, from 3.3% at the end of 2024 to 3.4% in 2027 (Charts 24 and 25).

Chart 24
Three-month EURIBOR



Sources: European Commission, and NBS.

Chart 25
Ten-year Slovak government bond yield



Sources: SO SR, and NBS.

Table 2 External environment and technical assumptions (annual percentage changes, unless otherwise indicated)

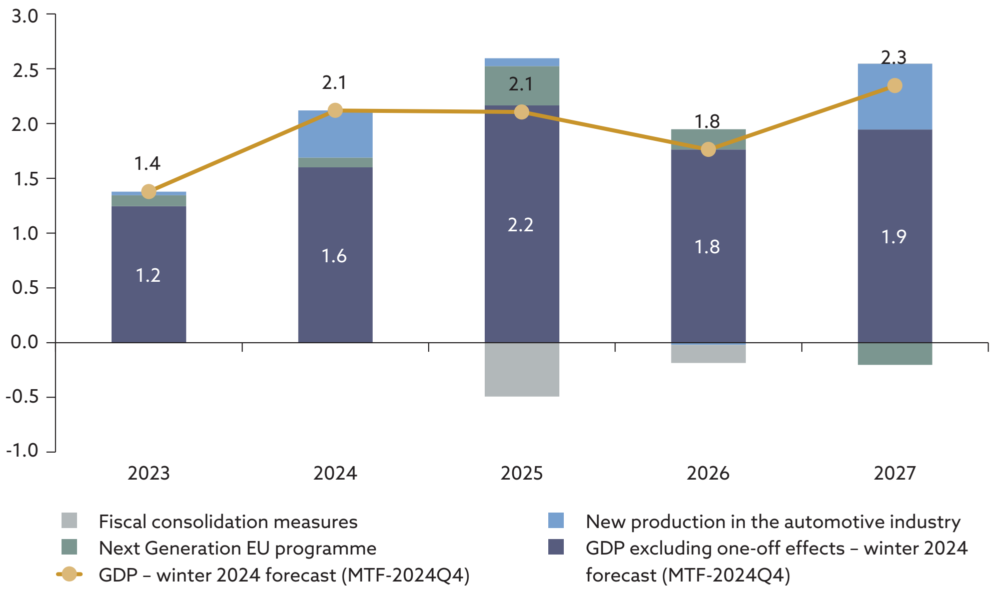
	Actual data	Winter 2024 forecast (MTF-2024Q4)			Difference vis-à-vis the autumn 2024 forecast (MTF-2024Q3) in pp		
	2023	2024	2025	2026	2024	2025	2026
Slovakia's foreign demand	-0.6	0.6	2.9	3.3	0.2	-0.5	-0.3
USD/EUR exchange rate 1) (level)	1.08	1.08	1.06	1.06	-0.8	-4.2	-4.2
Oil price in USD 1) (level)	83.7	81.8	71.8	70.1	-0.3	-3.5	-2.7
Oil price in USD	-19.2	-2.3	-12.3	-2.3	-0.3	-2.9	0.8
Oil price in EUR	-21.3	-2.5	-10.5	-2.3	0.5	0.2	0.8
Non-energy commodity prices	-12.5	8.9	5.8	-0.4	1.6	4.5	-2.9
Electricity price (EUR/MWh)	-59.9	-25.9	17.3	-11.6	-0.6	-3.4	0.3
Gas price (EUR/MWh)	-67.0	-15.5	24.8	-18.5	0.3	4.8	-4.5
Three-month EURIBOR (percentage per annum)	3.4	3.6	2.1	2.0	0.0	-0.3	-0.2
Ten-year Slovak government bond yield (percentage)	3.6	3.5	3.3	3.4	0.0	0.0	0.0

Sources: ECB, SO SR, and NBS.
Note: Annual percentage changes and changes vis-à-vis the previous forecast are calculated from unrounded figures.
1) Differences vis-à-vis the previous forecast are in percentages.

3.2 Macroeconomic forecast for Slovakia

The Slovak economy is expected to maintain growth of around 2% in 2025 (Chart 26). Its expansion should be primarily driven by investment, which will largely depend on the effective absorption of EU funds. A further boost is envisaged from improved export performance, as Slovak firms benefit from a strengthening recovery of foreign demand. The recently approved fiscal consolidation package will weigh on both firms and households. Inflation will erode incomes, compelling households to retrench. The inflation projection for next year is unchanged from the autumn forecast. Any relief that households might expect from the slower raising of gas prices to market levels—to be phased over 2025 and 2026—is cancelled out by the current sharp rise in food prices.

Chart 26
GDP adjusted for one-off effects (annual percentage changes; percentage point contributions)



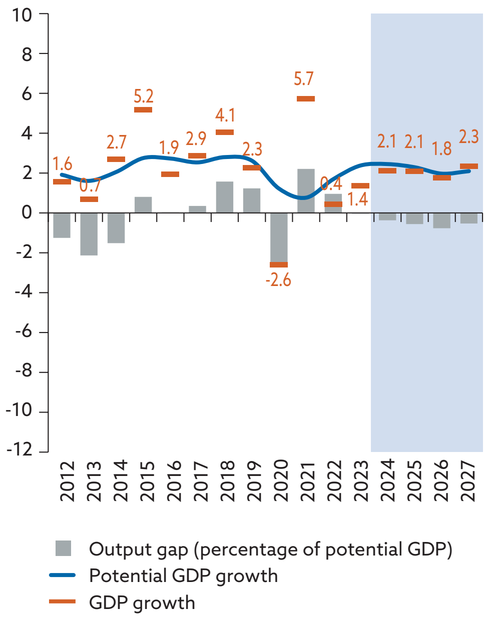
Sources: SO SR, and NBS.

What is worse is that the outlook for the economy's performance over the whole projection horizon has deteriorated. The difficulties now facing industry in Europe, including Slovakia, have deeper roots that extend beyond the effects of recent crises. In the autumn, it was still unclear how much of the weak performance could be attributed to temporary factors—such as the car industry's transition to the production of new models—and how much to structural underperformance.

In Germany, longer-term structural challenges are hampering economic growth more than previously expected. The implications for Slovakia are serious, given its strong economic ties to Germany (Box 4). Consequently, the long-term growth outlook for the domestic economy has been revised down. Slovakia's market share may be temporarily boosted by the planned launch of new production in the automotive industry, but without more significant investment in innovation and the knowledge economy, the scope for faster economic growth is limited (see Chapter 2 of NBS's 2024 Structural Challenges report and Chapter 3 of NBS's 2023 Structural Challenges report).

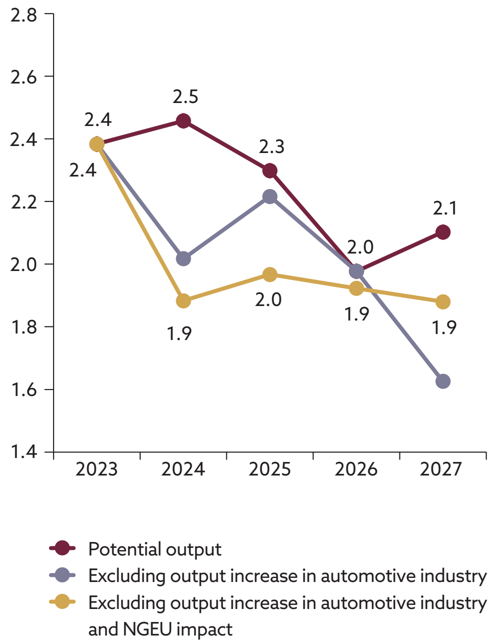
The outlook for the economy's cyclical position is not favourable. Weaker demand from Slovak households, whose propensity to save has been higher recently than in the previous two years, is contributing to the economy's negative cyclical position (Chart 27). In addition to the growth constraints imposed by the new fiscal consolidation measures, the economy is also facing a further deterioration in foreign demand and consequently reduction in export performance. The cyclical position is not expected to improve until later in the projection horizon, when new car production is due to come on stream and help Slovakia increase its market share (Chart 28).

Chart 27
GDP and the output gap
(percentages)



Sources: SO SR, and NBS.

Chart 28
Potential output and one-off effects
(annual percentage changes)



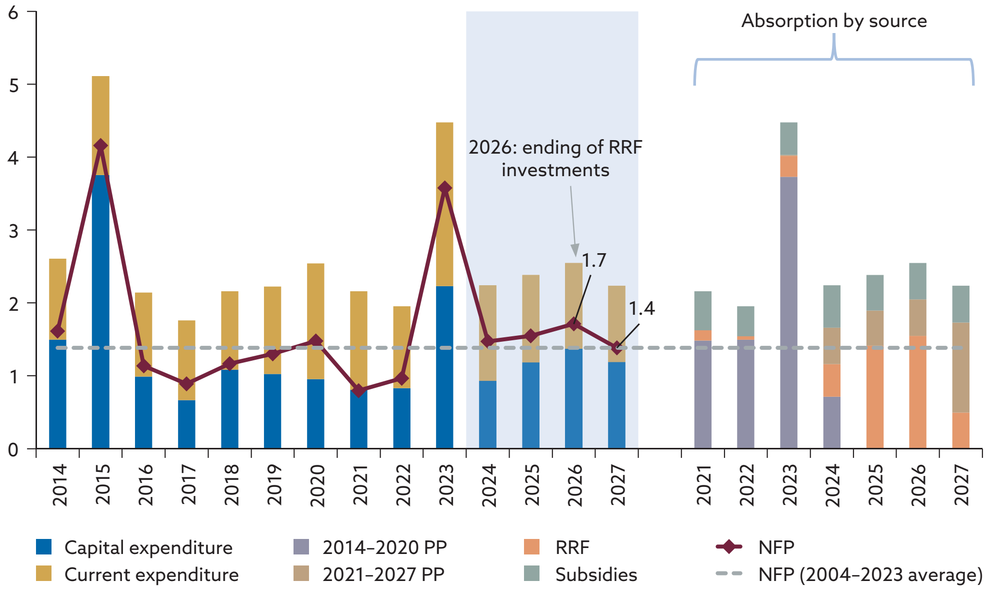
Source: NBS.

Investment will be the major determinant of economic performance in the coming quarters (Chart 31). A large part of the economic growth projected for 2025 is predicated on investment in new production capacity in the automotive industry and on a significant improvement in the absorption of EU funds, especially funding from the Recovery and Resilience Facility (RRF). At the same time, business investment projections have been revised up, as the decline in interest rates has been more pronounced than projected in the autumn forecast.

Slovakia's net receipts from the EU budget[7] are expected to gradually increase on the back of the accelerating disbursement of RRF funds via the implementation of the national recovery and resilience plan (RRP). In 2024, the completion of fund disbursements under the 2014–2020 EU programming period has coincided with the initial absorption of new EU cohesion funds and RRF funds. As the RRP nears completion, RRF investment is expected to accelerate over the next two years (Chart 2). The impact of the subsequent decline in RRF investment should be eased by the expected acceleration of disbursements under the 2021–2027 EU budget.

Chart 29

Slovakia's absorption of EU funds and net financial position (percentages of GDP)



Source: NBS.
Note: NFP – net financial position; PP – programming period.

Exports continue to struggle, hindered mainly by weak demand. Although Europe is showing the first signs of a recovery in private consumption, including stronger demand for cars, the weak demand for other products continues to weigh on domestic firms. The stalled European economy is expected to see some improvement in export performance in 2025, but although domestic firms could benefit from this upturn, they are unlikely to regain their lost market shares any time soon.

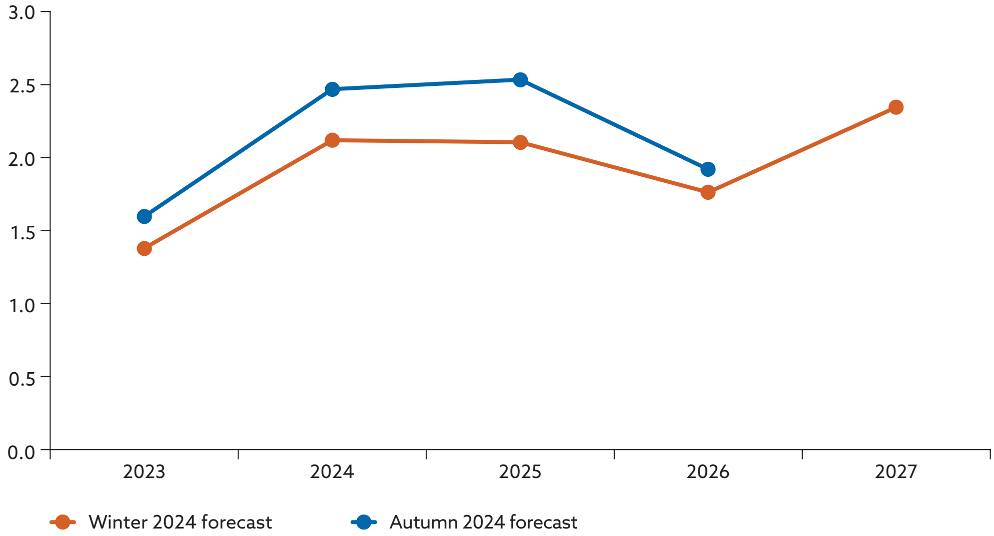
This forecast incorporates the risk of the European economy continuing to lag behind global economic developments (Chart 29). Slovak exports

7 Receipts here include funding from the Recovery and Resilience Facility (RRF). Net receipts from the EU budget are total receipts less payments to the EU budget.

are projected to grow slightly more slowly than Slovakia's foreign markets, leading to a moderate decline in market share.

Chart 30

Economic growth (annual percentage changes)



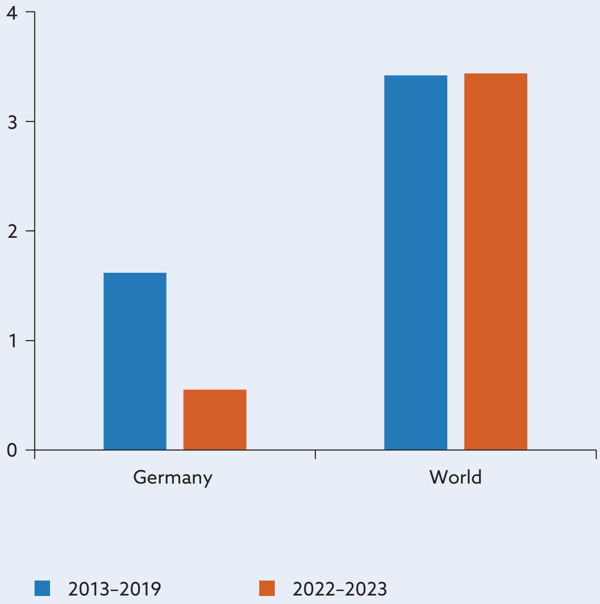
Sources: SO SR, and NBS.

Box 4
Germany's worsening export performance is jeopardising Slovakia's economy

The German economy faces prolonged challenges and its performance is declining. While global economic growth averaged a similar rate in the post-pandemic years of 2022 and 2023 as it did in the post-financial crisis period of 2013–19, Germany's already halved growth rate slowed even further (Chart A). The German economy is clearly suffering from the energy crisis, heightened uncertainty related to the war in Ukraine, and intensifying competition from abroad.

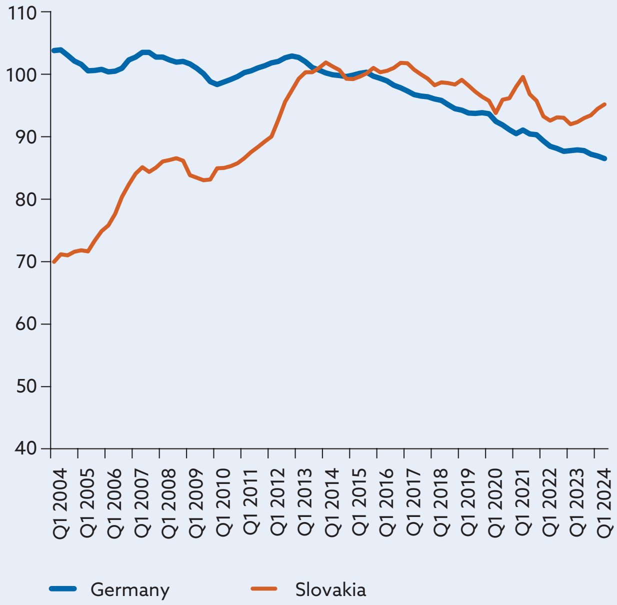
Germany's declining competitiveness is reflected in the long-term deterioration of its export performance. After 2015, Germany's share of exports in foreign demand started to decline at a rate of more than 1% per year from what had until then been a relatively stable level (Chart B). By contrast, Slovakia initially experienced market share growth. Driven by accelerating economic transformation, accession to the European Union and the euro area, and an influx of foreign direct investment, Slovakia's exports grew faster than foreign demand. However, structural challenges similar to those in the German economy have started to emerge in Slovakia. Export growth has moderated as a result of weak investment in modern technology, skilled labour shortages, and energy supply vulnerability.

Chart A
Average annual economic growth (percentages)



Sources: IMF World Economic Outlook, and Macrobond.

Chart B
Market shares (index: 2015 = 100; annual moving averages)



Sources: Oxford Economics, and NBS calculations.

The German economy's difficulties may also have a significant impact on the Slovak economy. Germany has long been Slovakia's most important trading partner, with more than 20% of Slovak goods and services exports destined for the German market.

The underperformance of the German economy affects Slovakia both directly, through a reduction in exports to Germany, and indirectly, through the strong links of Slovakia's other trading partners with Germany. This results in a significant decline in demand for Slovak products in other countries, especially in the CEE region. In order to capture also these indirect effects, we used Oxford Economics' Global Economic Model.[8]

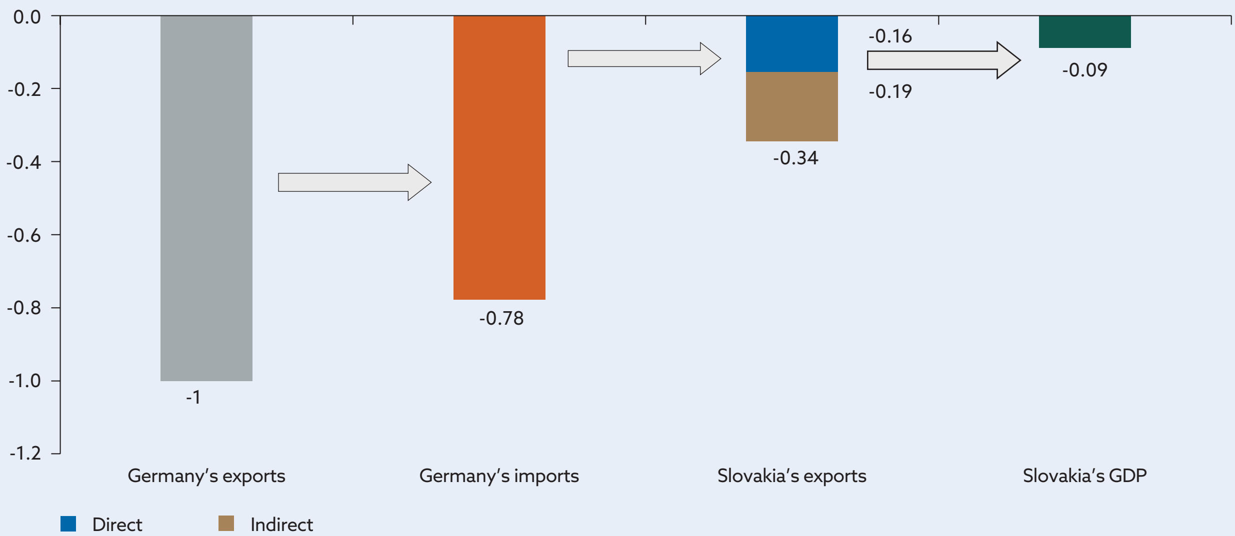
We simulated a trend decline in Germany's market share (about 0.9% per year) by reducing its export performance by 1% per year. In consequence, there is also a 0.78 pp decline in Germany's import growth (Chart C).

The overall impact of Germany's faltering export performance on the Slovak economy is twice as high as the direct reduction in Slovak exports to Germany. In this scenario, Slovak export growth is estimated to fall by 0.34 pp. The direct negative impact on export growth—through Germany's share in Slovak exports—accounts for 0.16 pp. Additionally, Germany's

[8] Global Economic Model (Oxford Economics) – a semi-structural model covering 85 countries, including Slovakia and Slovakia's main trading partners. The model captures global trade, capital and financial linkages.

weaker economic activity affects other countries worldwide, and the resulting slowdown in their demand reduces Slovakia's export growth by a further 0.19 pp.

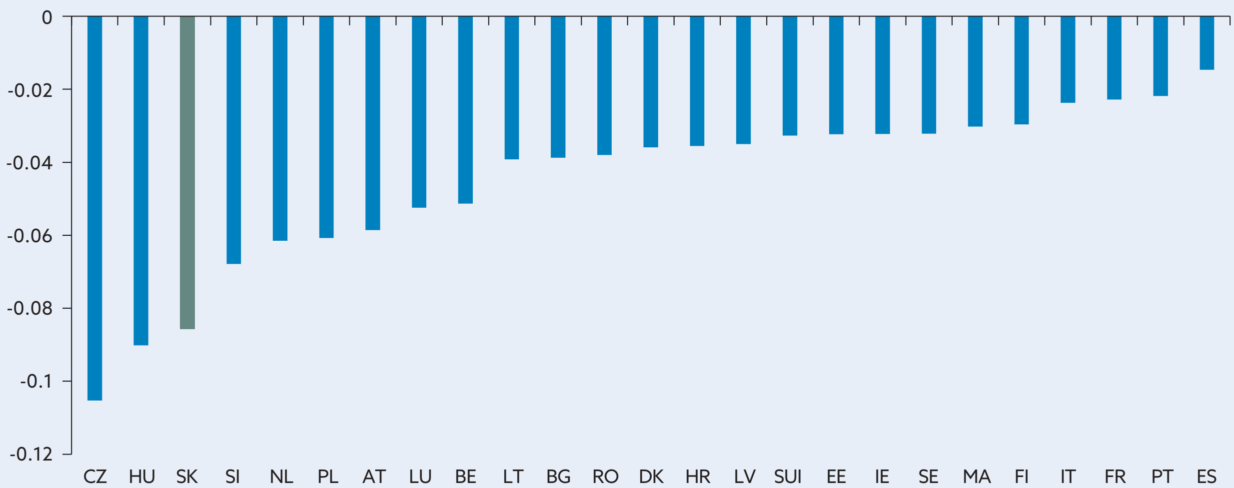
Chart C
Impact of slowdown in Germany's exports (percentage points)



Sources: Oxford Economics, and NBS calculations.

The CEE region's strong interlinkage with the German economy is also seen in the impact on the economic growth of CEE countries, with the reduction in Slovakia's growth estimated to be 0.09 pp (Chart D). By contrast, the impact on other large EU economies is low.

Chart D
Impact of a 1 pp slowdown in Germany's exports on other economies' growth rates (percentage points)



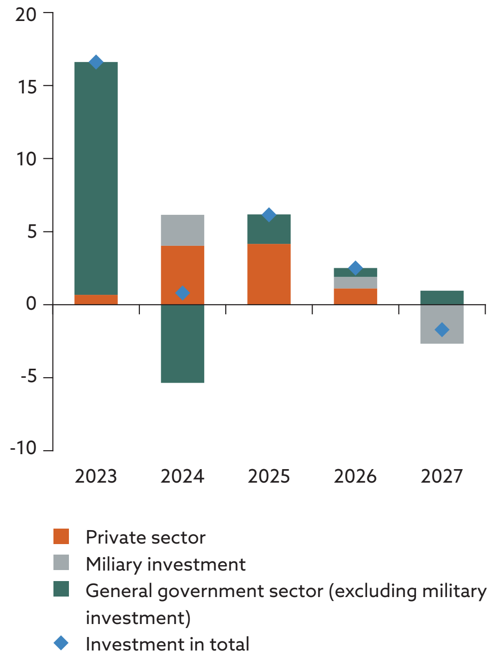
Sources: Oxford Economics, and NBS calculations.

Households will have to temporarily retrench next year, with high inflation wiping out nearly all their income growth (Chart 30). As inflation subsides, the following years should see a noticeable improvement. As their financial situation continued to rebound in 2024, households started to consume more. In the latter part of the year, households will be looking to take advantage of lower VAT rates, before facing the burden of fiscal consolidation measures in 2025. Although much of the consolidation effort is directed at the corporate sector, uncertainty and expected cost increases are already having an upward impact on prices. While nominal incomes will increase quite substantially, the counteraction of high inflation will leave households only slightly better off. The recently approved consolidation package has already severely dented households' expectations for their future financial situation, according to the latest surveys. We therefore expect a moderate increase in households' propensity to save next year.

Chart 31
Private consumption (index: Q4 2019 = 100)

Sources: SO SR, and NBS.

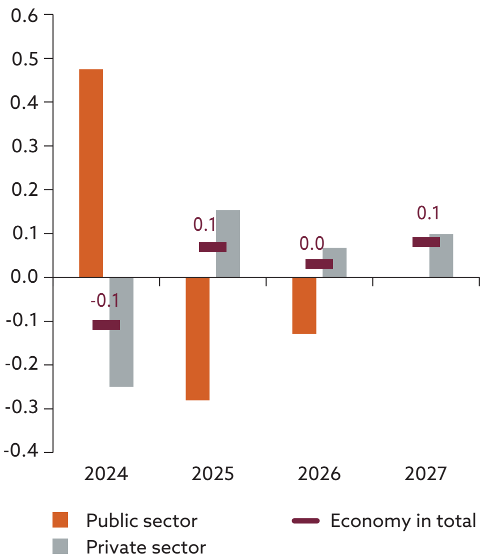
Chart 32
Investment (annual percentage changes; percentage point contributions)



Sources: SO SR, and NBS.

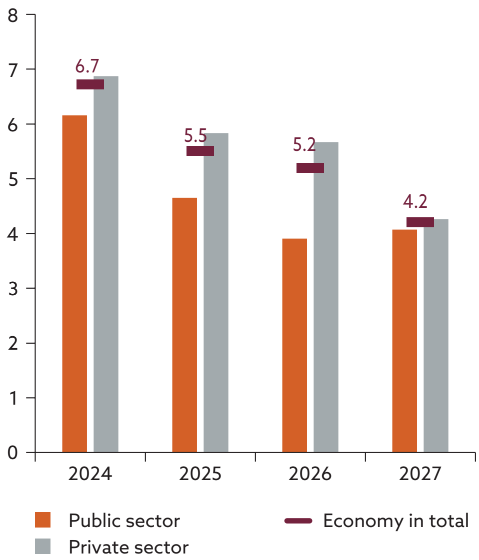
The labour market situation is expected to remain stable (Chart 33). Despite a weaker outlook for the Slovak economy, our projections for the labour market are unchanged. Slovakia is confronted by structural challenges and an ageing population. Notwithstanding the worsening economic outlook, the projections for the labour market situation remain the same as in the autumn forecast. The difficulties in German manufacturing could even provide a short-term boost to employment in Slovakia, as a result of production relocations.

Chart 33
Employment (annual percentage changes)



Sources: SO SR, and NBS.

Chart 34
Nominal compensation per employee (annual percentage changes)



Sources: SO SR, and NBS.

Labour income is expected to rise sharply (Chart 34). There is no change in the outlook for real incomes. Given the shortage of skilled labour and the persistence of high inflation, nominal wage growth is expected to remain robust in 2025, as projected in the autumn forecast. Although high inflation is expected to subside by 2026, we are revising our outlook due to energy prices. Nominal incomes are expected to adjust to the higher price level and rise faster than anticipated in the autumn.

Table 3 Wages (annual percentage changes)

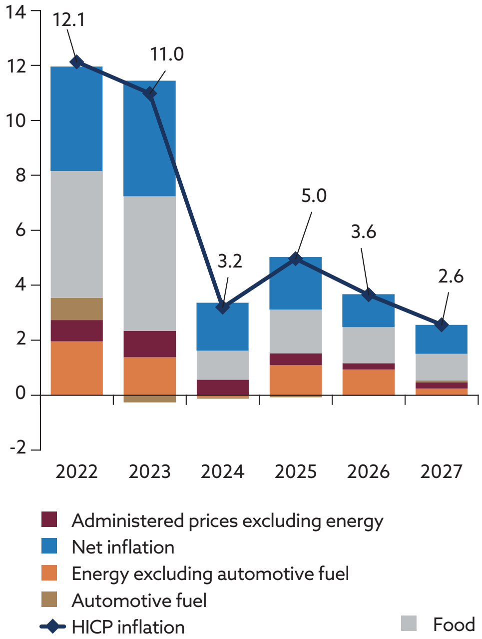
	2023	2024	2025	2026	2027
Nominal labour productivity	11.3	7.2	5.2	4.7	4.7
Whole economy – nominal wages	9.6	5.7	5.5	5.2	4.2
Whole economy – real wages	-0.7	2.8	0.4	1.6	1.5
Private sector – nominal wages	8.1	5.8	5.8	5.5	4.4
Private sector – real wages	-2.1	2.9	0.7	1.9	1.7
Public administration, education and health care – nominal wages	14.3	5.3	4.6	4.3	3.6
Public administration, education and health care – real wages	3.5	2.4	-0.4	0.7	0.9

Sources: SO SR, and NBS.
Notes: Deflated by the CPI. Nominal labour productivity – GDP divided by persons in employment (ESA 2010).

Inflation is likely to remain elevated for longer than previously expected (Chart 35). Compared with the autumn forecast, the projections for price developments have been revised throughout the forecast horizon (Chart 36). The easing of headline inflation is expected to be slower—from 5% in 2025 to below 4% in 2026 and below 3% in 2027—owing mainly to household energy and food prices.

Chart 35

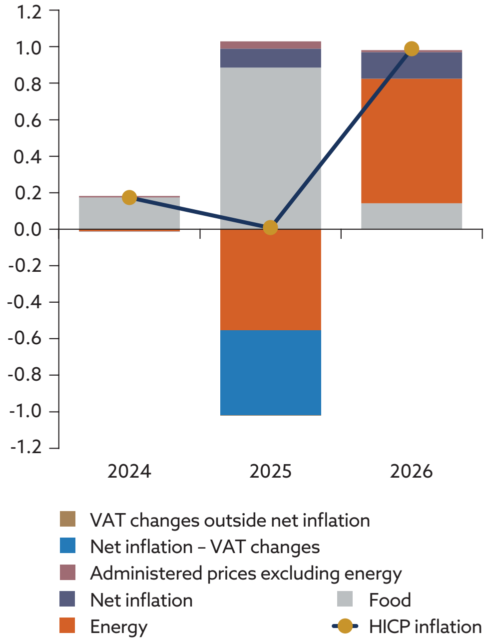
HICP inflation and its components (annual percentage changes; percentage point contributions)



Sources: SO SR, and NBS.

Chart 36

Change in projection vis-à-vis the autumn 2024 forecast (percentage points)



Sources: SO SR, and NBS.

Taking into account commitments made in government policy statements, we revert back to the assumption that energy prices will gradually be brought into alignment with market gas prices by 2026. Hence, compared with the previous forecast, households' energy bills will be lower in 2025 but higher in 2026. Based on the market trend in energy commodity prices, household energy prices are expected to come down in 2027. In 2027, energy prices are expected to rise even while market prices decline. This is because of the introduction, under EU law, of 'ETS2', a market mechanism for the pricing of emission allowances for energy carriers (gas, electricity, heat, automotive fuels).

While the projected inflation rate for 2025 has not been revised, there have been adjustments to the composition of price growth. The faster increase in food prices will be largely offset by administrative measures in the form of a lower VAT impact and a more moderate increase in administered energy prices. We are currently seeing a more pronounced acceleration in food inflation due to uncertainty and the expected increases in firms' costs. Market expectations for agricultural commodity prices have also increased, leading us to revise up food inflation projections across the forecast horizon.

Net inflation will remain elevated next year, driven by VAT changes and, in particular, services prices, which will be pushed up by rising cost factors, including food and energy. Although wage growth is slowing, it should remain strong. The VAT rate on most goods will be raised to 23%, while the impact of VAT changes on services prices will be broadly neutral, as they go both ways.

Table 4 Components of HICP inflation (annual percentage changes)

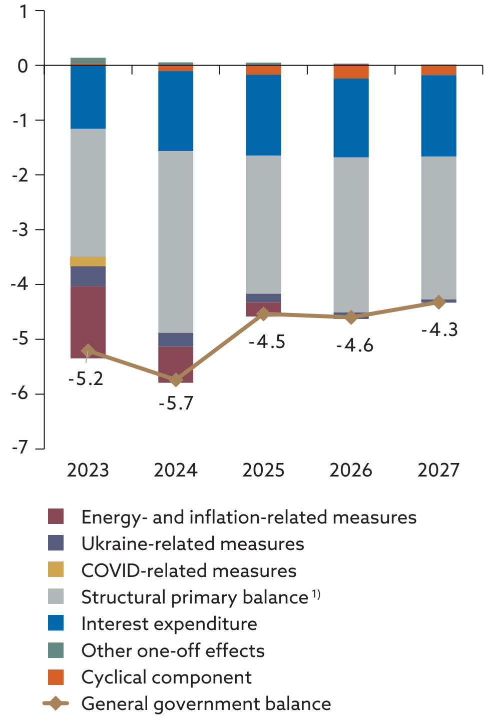
	Average for 2004–08 (pre-crisis period)	Average for 2010–14 (post-crisis period with euro currency)	2023	2024	2025	2026	2027
HICP	**4.1**	**2.0**	**11.0**	**3.2**	**5.0**	**3.6**	**2.6**
Food	3.6	3.1	15.6	3.3	5.1	4.2	3.1
Non-energy industrial goods	0.2	0.3	8.8	2.6	3.6	1.9	1.8
Energy	8.3	2.3	7.4	-1.0	6.9	6.3	2.1
Services	5.3	2.5	10.1	5.9	5.0	3.3	3.0
Net inflation	1.8	1.0	9.3	3.9	4.2	2.7	2.4

Sources: SO SR, and NBS.

3.3 Public finance projections

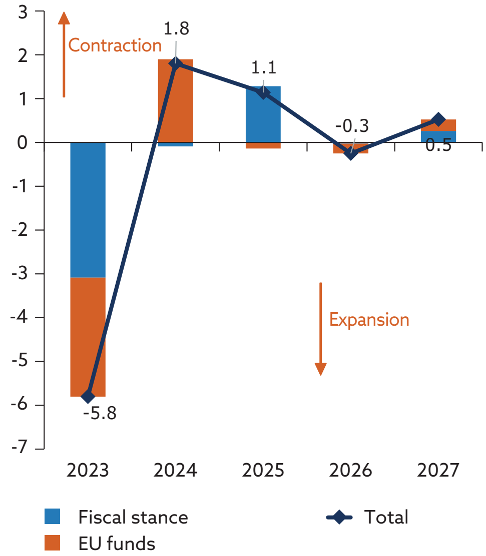
Slovakia's general government deficit for 2025 is projected to narrow to 4.5% of GDP (Chart 37), owing mainly to the recently adopted fiscal consolidation package. The fiscal deficit for 2024 is expected to be 5.7% of GDP, its highest level since 2010. This is partly due to ongoing measures to compensate for high energy prices; however, a considerable part of the deficit is structural in nature. In addition, the business cycle is exerting a slightly negative impact on the deficit throughout the projection horizon. In 2025, the consolidation measures will ensure a sustained improvement in fiscal performance, although this will be partly offset by additional government spending policies and persistently high interest costs. In subsequent years, the deficit will stagnate at around the same level unless further consolidation measures are taken. The projected slight improvement in the fiscal deficit in 2027, to 4.3% of GDP, is primarily due to the expected unwinding of some large capital expenditures (notably deliveries of military equipment). Public debt is expected to reach 59.7% of GDP in 2024 and is forecast to surpass 60% of GDP in 2025. This deteriorating trend is caused mainly by persistently high deficits, while slower economic growth will also have an adverse impact on the debt-to-GDP ratio.

Chart 37
Decomposition of the general government balance (percentages of GDP)



Sources: SO SR, and NBS.
1) Excluding pandemic-, Ukraine- and energy-related measures.
Notes: One-off factors include non-cyclical effects that have a temporary impact on the general government balance and are supposed to be eliminated in the future. Additional government spending from 2025 should include targeted social assistance for vulnerable groups at risk from rising gas prices. Given, however, that the form and size of these expenditures is still unclear, they are classified within the structural primary balance.

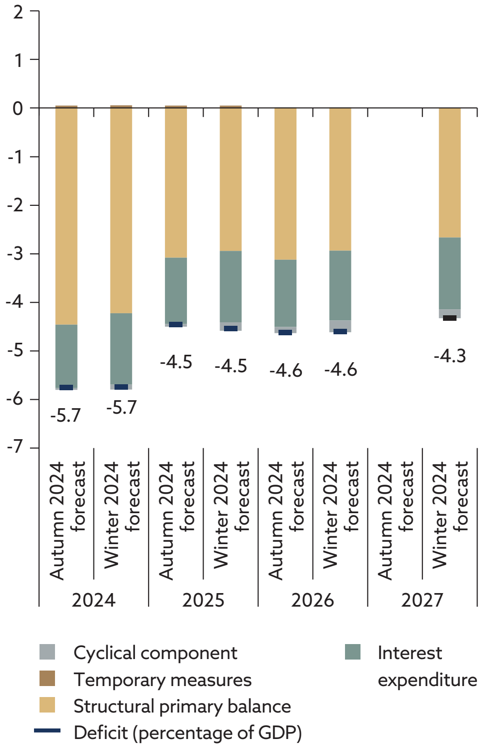
Chart 38
Fiscal stance (percentage points of GDP)



Sources: SO SR, and NBS.
Note: Fiscal stance – annual rate of change in the cyclically adjusted primary balance.

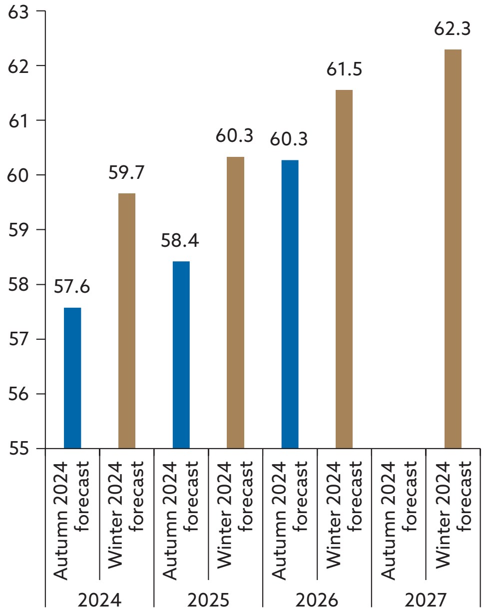
Compared with the autumn 2024 forecast, the fiscal deficit projections for 2025 and 2026 are unchanged (Chart 39), despite higher interest costs and a slightly worsened cyclical position. There are, however, changes in the composition of revenue and expenditure. The impact of the consolidation package, especially the increase in corporate income tax, is expected to be more favourable than previously envisaged, following the legislature's amendments to the package. This is partly offset by lower projections for indirect tax revenues and higher projections for expenditure (especially on social benefits and healthcare) and expected higher employee compensation resulting from the current situation in the health sector.

Chart 39
Comparison of projections for the deficit and its decomposition (percentages of GDP; percentage point contributions)



Source: NBS.

Chart 40
Comparison of public debt projections (percentages of GDP)



Source: NBS.

Gross general government debt is envisaged to rise steadily over the projection horizon. It is expected to exceed the 60% threshold in 2025 (Chart 40) and to further diverge from the upper limit of the debt brake.[9] By the end of the forecast horizon, public debt is projected to be 62.3% of GDP, after increasing by more than 6 pp in four years.

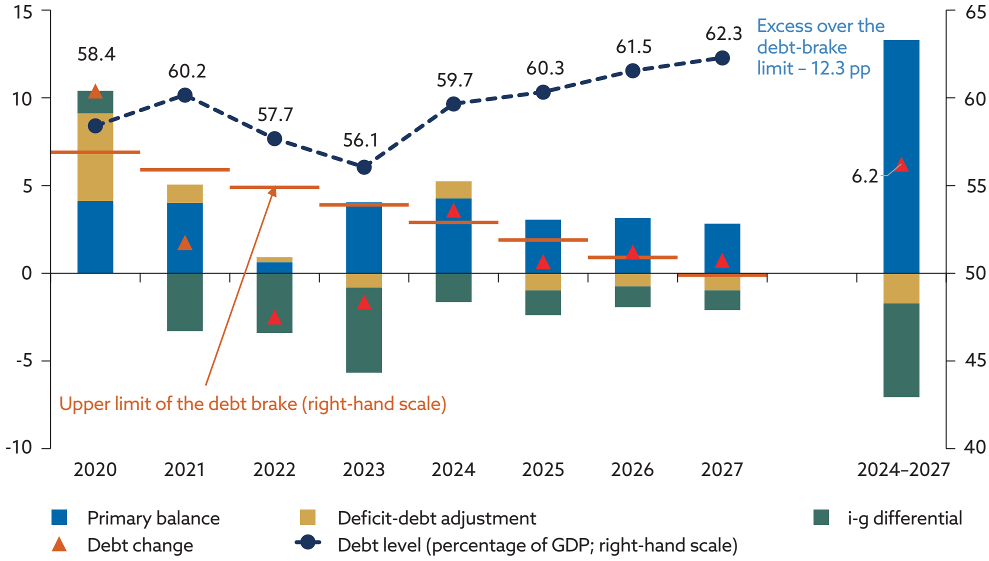
Ongoing deficit budgets are the main cause of the rising debt. Public debt growth is expected to be highest in 2024, when the budget deficit peaks. High funding needs are being covered by new issuance of government bonds. However, the volume of new debt in 2024 is expected to exceed state budget needs and debt rollover requirements, so the state's cash reserves should increase. Public debt is expected to increase more slowly in subsequent years, as fiscal deficits narrow. Partial funding from reserves (the DDA component) is also expected to have a favourable effect, reflected in reduced issuance of government bonds. The combination of

9 For 2024, the upper limit of sanction bands under the debt brake regime was 53% of GDP. Under a transitional provision of the constitutional Fiscal Responsibility Act, the upper limit of general government debt is to be reduced by one percentage point per year from 2018 to 2027, when it will drop to the level of 50% of GDP.

the higher cost of new borrowing and moderate economic growth should lead to a reduction in the interest rate-growth (i-g) differential. While these factors, together with the DDA, curb the increase in public debt, their impact does not outweigh that of the primary deficit, and so debt remains on an upward trajectory over the entire horizon (Chart 41).

Chart 41

Public debt and factors of change (percentages of GDP; percentage points of GDP)



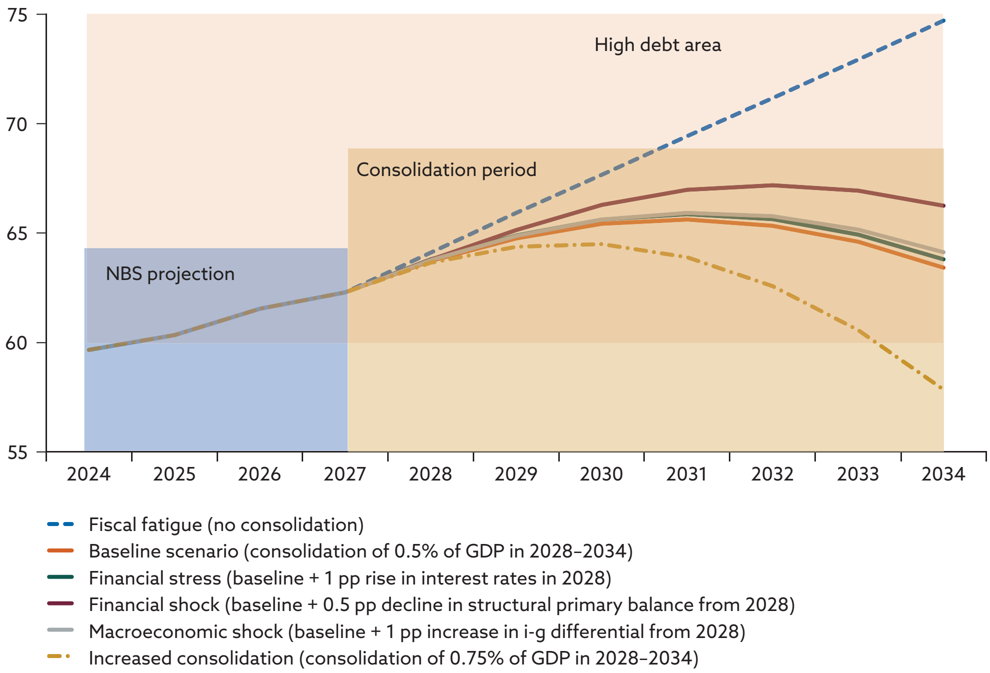
Sources: NBS, and SO SR.
Notes: Debt-deficit adjustment – a factor of consistency between the fiscal deficit and the debt change; i-g differential – a factor taking into account the impact of interest costs and economic growth on the debt change.

The consolidation effort needs to be maintained at a level of at least 0.5 pp of GDP per year beyond 2027. Even in such a scenario, assuming the ongoing repair of public finances, the debt ratio would only start to decline from 2032 onwards. To bring public debt back below 60% of GDP (Chart 42) over a ten-year horizon would require improving the fiscal balance by more than 0.7 pp[10] of GDP per year.

[10] Each additional increase of 0.25 pp of GDP per year shortens by one year the period to bring public debt below 60% of GDP.

Chart 42

General government gross debt under DSA scenarios[11] (percentages of GDP)



Source: NBS.

3.4 Risks to the forecast

The risks to the economic growth outlook are predominantly on the downside. Beyond the ongoing risk posed by fiscal consolidation, risks from the external environment have become more pronounced.

Protectionism in global trade represents the greatest threat to global economic developments. The imposition of tariffs and trade restrictions could stifle prosperity growth for an extended period.

A second area of risk for firms in Slovakia is the underperformance of European industry vis-à-vis the rest of the world, resulting in the loss of market share. Given that domestic firms are deeply embedded in global supply chains, further deterioration in the economies of Slovakia's main trading partners could impair the growth potential of the Slovak economy.

Another risk continues to be the timing and profile of the absorption of EU funds. If the uptake of RRF funding does not pick up pace, economic growth

[11] DSA – debt sustainability analysis. The DSA analyses debt sustainability by simulating possible scenarios of public debt developments under certain assumptions. This approach is suitable for projecting medium to long-term trajectories over a horizon of 3 to 15 years. The DSA's core component includes a set of deterministic projections based on fiscal consolidation scenarios up to 2033 and on assumptions for macroeconomic and financial variables, including the assumption of population ageing.

in 2025 could be slower than projected. Conversely, an improvement in the uptake of EU funds could notably boost economic growth in 2026.

Energy prices are once again posing risks to the inflation outlook. The timeline for the alignment of energy prices with market levels will significantly affect not only inflation, but also consumer behaviour. The inflation expectations of households and firms could become anchored at elevated levels over the long term, delaying the return to price stability. Considerable uncertainty also surrounds the second phase of the introduction of emission allowances.

The outlook for public finances is subject to the upside risks of higher absorption of EU funds and efforts to stabilise public debt by adopting additional consolidation measures in the coming years.

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Table 5 Forecast for key macroeconomic indicators

Winter 2024 medium-term forecast MTF-2024Q4									
Indicator	Unit	Actual data	Winter 2024 forecast (MTF-2024Q4)				Difference vis-à-vis the autumn 2024 forecast (MTF-2024Q3)		
		2023	2024	2025	2026	2027	2024	2025	2026
Price developments									
HICP inflation	annual percentage change	11.0	3.2	5.0	3.6	2.6	0.2	0.0	0.9
CPI inflation	annual percentage change	10.5	2.8	5.1	3.6	2.6	0.1	0.1	0.9
GDP deflator	annual percentage change	10.1	3.7	2.9	2.8	2.0	-0.7	0.0	0.5
Economic activity									
Gross domestic product	annual percentage change, constant prices	1.4	2.1	2.1	1.8	2.3	-0.4	-0.4	-0.1
Private consumption	annual percentage change, constant prices	-3.1	1.9	0.5	1.5	1.5	0.1	-0.3	0.2
General government final consumption	annual percentage change, constant prices	-3.0	3.3	2.2	1.9	1.9	0.0	-0.7	-0.5
Gross fixed capital formation	annual percentage change, constant prices	16.6	0.8	6.1	2.5	-1.7	0.3	0.6	-0.1
Exports of goods and services	annual percentage change, constant prices	-0.2	0.8	3.1	3.0	4.3	-1.2	-1.1	-0.5
Imports of goods and services	annual percentage change, constant prices	-7.0	2.4	3.1	3.1	2.7	-0.8	-1.0	-0.4
Net exports	EUR millions at constant prices	5,378	4,038	4,156	4,172	5,826	-1,947.3	-2,170.2	-2,351.1
Output gap	percentage of potential output	0.0	-0.4	-0.6	-0.8	-0.5	-0.3	-0.4	-0.4
Gross domestic product	EUR millions at current prices	122,919	130,136	136,750	143,006	149,350	-1,289.1	-1,916.2	-1,580.2
Labour market									
Employment	thousands of persons, ESA 2010	2,434	2,431	2,433	2,434	2,436	1.1	-2.3	-0.7
Employment	annual percentage change, ESA 2010	0.3	-0.1	0.1	0.0	0.1	0.1	-0.1	0.0
Number of unemployed	thousands of persons, LFS [1]	162	148	150	158	156	0.0	1.6	4.0
Unemployment rate	percentage	5.8	5.3	5.4	5.8	5.7	0.0	0.0	0.2
NAIRU estimate [2]	percentage	6.2	6.1	6.1	6.1	6.0	0.0	0.0	0.0
Labour productivity [3]	annual percentage change	1.1	2.2	2.0	1.7	2.3	-0.4	-0.3	-0.3
Nominal productivity [4]	annual percentage change	11.3	6.0	5.0	4.5	4.4	-1.2	-0.3	0.2
Nominal compensation per employee	annual percentage change, ESA 2010	9.8	6.7	5.5	5.2	4.2	-0.1	0.1	0.9
Nominal wages [5]	annual percentage change	9.6	5.7	5.5	5.2	4.2	-0.9	0.2	1.1
Real wages [6]	annual percentage change	-0.7	2.8	0.4	1.6	1.5	-1.0	0.2	0.2
Households and non-profit institutions serving households									
Disposable income	annual percentage change, constant prices	-1.9	2.9	0.2	1.3	1.5	0.0	0.0	-0.1
Saving ratio [7]	percentage of disposable income	6.8	7.6	7.3	7.2	7.2	0.2	0.4	0.3
General government sector [8]									
Total revenue	percentage of GDP	43.3	40.9	42.2	42.3	41.7	0.4	0.6	0.7
Total expenditure	percentage of GDP	48.5	46.6	46.8	46.9	46.0	0.5	0.6	0.7
General government balance [9]	percentage of GDP	-5.2	-5.7	-4.5	-4.6	-4.3	-0.1	0.0	0.0
Cyclical component	percentage of trend GDP	0.0	-0.1	-0.2	-0.2	-0.2	-0.1	-0.1	-0.1
Structural balance	percentage of trend GDP	-5.3	-5.7	-4.4	-4.4	-4.1	0.0	0.0	0.1
Cyclically adjusted primary balance	percentage of trend GDP	-4.1	-4.2	-2.9	-2.9	-2.7	0.0	0.1	0.2
Fiscal stance [10]	annual percentage point change	-3.1	-0.1	1.3	0.0	0.3	0.1	0.1	0.0
General government gross debt	percentage of GDP	56.1	59.7	60.3	61.5	62.3	0.7	0.8	0.8

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Table 5 Forecast for key macroeconomic indicators (continued)

Indicator	Unit	Actual data	Winter 2024 forecast (MTF-2024Q4)				Difference vis-à-vis the autumn 2024 forecast (MTF-2024Q3)		
		2023	2024	2025	2026	2027	2024	2025	2026
Balance of payments									
Goods balance	percentage of GDP	0.2	1.0	1.1	0.8	1.9	0.4	0.8	0.7
Current account	percentage of GDP	-1.7	-1.6	-1.4	-1.7	-0.7	-0.1	0.2	0.1
External environment and technical assumptions									
Slovakia's foreign demand	annual percentage change	-0.6	0.6	2.9	3.3	3.3	0.2	-0.4	-0.3
USD/EUR exchange rate [11), 12)]	level	1.08	1.08	1.06	1.06	1.06	-0.8	-4.2	-4.2
Oil price in USD [11), 12)]	level	83.7	81.8	71.8	70.1	69.2	-0.3	-3.5	-2.7
Oil price in USD [11)]	annual percentage change	-19.2	-2.3	-12.3	-2.3	-1.3	-0.3	-2.9	0.8
Oil price in EUR [11)]	annual percentage change	-21.3	-2.5	-10.5	-2.3	-1.3	0.5	0.2	0.8
Non-energy commodity prices in USD	annual percentage change	-12.5	8.9	5.8	-0.4	-1.7	1.6	4.5	-2.9
Three-month EURIBOR	percentage per annum	3.4	3.6	2.1	2.0	2.2	0.0	-0.4	-0.2
Ten-year Slovak government bond yield	percentage	3.6	3.5	3.3	3.4	3.4	0.0	0.0	0.1

Sources: NBS, ECB, and SO SR.
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 (ESA 2010).
6) Wages (ESA 2010) 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.
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:
https://nbs.sk/en/publications/economic-and-monetary-developments/