Economic and Monetary Developments

Spring 2024

NÁRODNÁ BANKA SLOVENSKA
EUROSYSTÉM

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Abbreviations

bp	basis point(s)
CPI	Consumer Price Index
DDA	debt-deficit adjustment
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
OECD	Organisation for Economic Co-operation and Development
OPEC	Organization of the Petroleum Exporting Countries
pp	percentage point(s)
PMI	Purchasing Managers' Index
PPI	producer price index
RRF	Recovery and Resilience Facility (of the European Union)
RRP	recovery and resilience plan (of the Slovak Republic)
SO SR	Statistical Office of the Slovak Republic
SPB	structural primary balance
TFP	total factor productivity
ÚPSVaR SR	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

1 Summary

The period of high inflation is fading, owing to falling prices in commodity markets and tighter monetary policy. This year in particular should see an improvement in households' financial situation, thanks in part to energy prices remaining frozen.

Households are opting to save more at the expense of spending. We expect that households will in the short term continue using real income growth to build up savings at an increasing pace. The cautious spending that was a feature of last year will continue into the current year. We do not see consumer demand picking up strongly again until the second half of the year.

Foreign demand will continue to dampen Slovakia's export performance. The euro area's teetering on the brink of recession is having an impact on firms in Slovakia. It appears for now that the euro area economy will only slowly recover from the effects of the energy shock, hence a downward revision in our projection for Slovak export growth.

Because of weak domestic and foreign demand, Slovakia's economy will grow more slowly in the short term than was projected in our winter forecast. Almost all of the lost ground is expected to be recouped in subsequent years. Looking ahead, we continue to expect consumer demand to rally, investment to rebound, and the performance of export-oriented firms to improve.

As regards the labour market, it should remain robust. A temporary decline in employment due to an upsurge in people retiring early is expected to be made up in the future, supported by both domestic and foreign pools of labour. The favourable trend observed in late 2023 is envisaged to continue this year. More inactive people have been brought into jobs, and a large number of foreigners have been filling job vacancies.

This positive trend is due in part to wage growth. Nominal wage growth is projected to outpace inflation in the years ahead, supporting further growth in household purchasing power.

The general government deficit in 2024 is now estimated to reach 6.1% of GDP, lower than projected in the winter forecast but still its highest level in 14 years. A large increase in total expenditure and outlays on military equipment will exceed tax revenue growth and cause the fiscal deficit to deteriorate by 0.8 pp in 2024. Consolidation efforts announced in December 2023 are projected to result in the deficit narrowing to 4.9% of GDP in 2026.

Public debt is expected to reach almost 58% of GDP in 2024, and without additional consolidation, it would surpass 60% in subsequent years.

The biggest risk to the economic outlook is that fiscal consolidation goes beyond the measures already announced. Any robust measures that stabilise the debt ratio at around its current level would dent economic growth by an appreciable, albeit manageable, half a percentage point per year. Among other risks still present are the European economy's competitiveness in the wake of the energy crisis and the strength of the residual impact of monetary policy.

The risks to the inflation outlook are on the upside. Although an increase in energy prices could push inflation higher, household energy prices will have to be raised up to market levels. The current forecast already sees energy prices being aligned with market rates at an even pace over 2025 and 2026. Should this convergence be spread over a different time frame, it could mean that inflation is lower than projected in one year and higher in another year. The more significant risk, however, is that energy prices will have to be brought up to market levels that are higher than currently envisaged. Another upward risk is the inflationary impact of any additional fiscal consolidation that includes an increase in excise duties. On the other hand, its downward impact on consumer and investment demand could have a dampening effect on inflation.

Table 1 Key economic indicators

	Actual data	Spring 2024 medium-term forecast (MTF-2024Q1)			Difference vis-à-vis the winter 2023 forecast (MTF-2023Q4)		
	2023	2024	2025	2026	2024	2025	2026
GDP (annual percentage change)	1.1	2.3	3.2	2.0	-0.5	0.2	0.2
HICP (annual percentage change)	11.0	2.8	3.7	3.7	0.3	-0.9	-0.2
Average nominal wage (annual percentage change)	9.1	7.2	5.3	5.1	0.3	-0.6	-0.1
Average real wage (annual percentage change)	-1.3	4.3	1.5	1.4	**0.3**	**0.4**	**0.0**
Employment (annual percentage change; ESA 2010)	0.3	0.3	0.4	0.0	-0.1	0.1	0.0
Unemployment rate (percentage; Labour Force Survey)	5.8	5.5	5.3	5.3	0.0	0.1	0.1

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

The boxes in this report address the following topical issues:

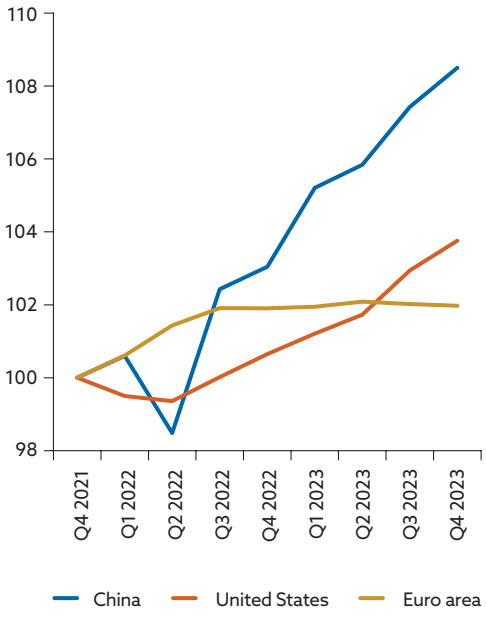
- Referring to the Household Finance and Consumption Survey, we found that it was mainly wealthier and older people who built up savings during the pandemic.
- Capital stock in the Slovak economy is diminishing more quickly than in previous years, as firms are depreciating it more rapidly. The trend increase in the overall rate of depreciation in recent years is related to an increase in the share of assets with faster obsolescence in the total capital stock. This may have implications for the economy's potential output in the longer term.
- Potential GDP growth is expected over the forecast horizon to converge towards levels seen in the pre-pandemic decade. Projected growth in productive capacity should be significantly lower than it was before the global financial crisis, when foreign investment inflows were stronger and economic reforms were being implemented. The contribution of total factor productivity is envisaged to be lower and may be dampened by unfavourable demographic developments.
- The government's more ambitious public finance targets are estimated to take around 0.5 percentage point off economic growth in the coming years. Such a reduction would be manageable and would stabilise public debt at its current level.

2 Current macroeconomic developments in the external environment and Slovakia

2.1 External environment

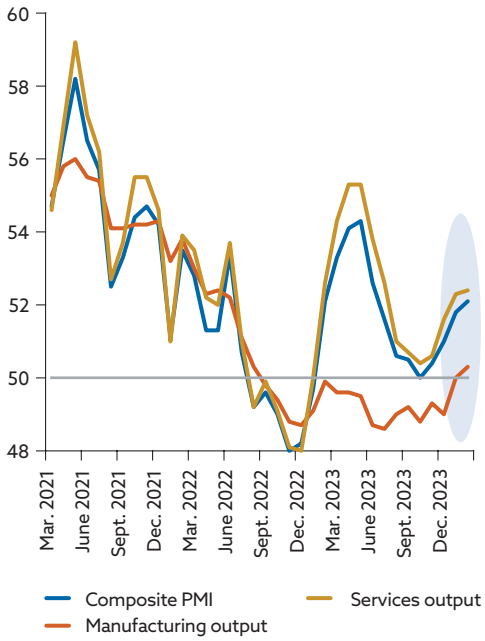
Global trade strengthened towards the end of 2023. The world economy's performance weakened in the latter part of the year, owing to the previous sharp tightening of monetary policy. The economy did, however, benefit from an improvement in the functioning of supply chains. Despite slowing down, the US economy performed solidly in the fourth quarter of 2023 (Chart 1), supported mainly by the ongoing strength of consumer demand. China's economy also slowed in that period, and although receiving a boost from economic policy measures, it continued to face difficulties in the real estate sector.

Chart 1
GDP (index: Q4 2021 = 100)



Source: Macrobond.

Chart 2
Global Purchasing Managers' Index (PMI)



Source: Macrobond.

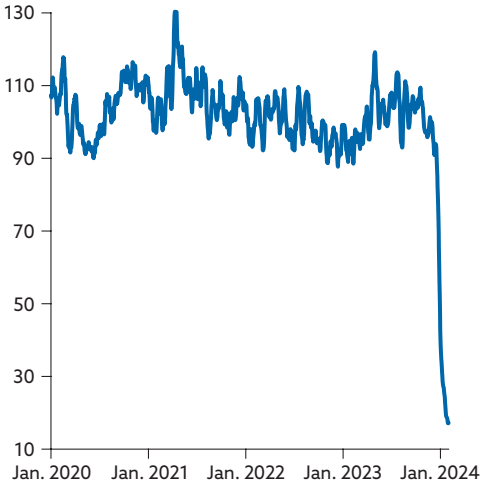
The euro area continues to struggle. After contracting in the third quarter of 2023, the euro area economy stagnated in the last quarter of the year. Investment demand was subdued by previous monetary policy tightening.

By contrast, private consumption rose marginally on the back of real income growth.

The world economy is expected to pick up moderately in the first quarter of 2024. The Purchasing Managers' Index (PMI) pointed to a slight acceleration in economic activity in the first two months of 2024, particularly in the services sector. Meanwhile, according to the PMI, manufacturing activity stopped declining, which may indicate that this sector is turning the corner (Chart 2).

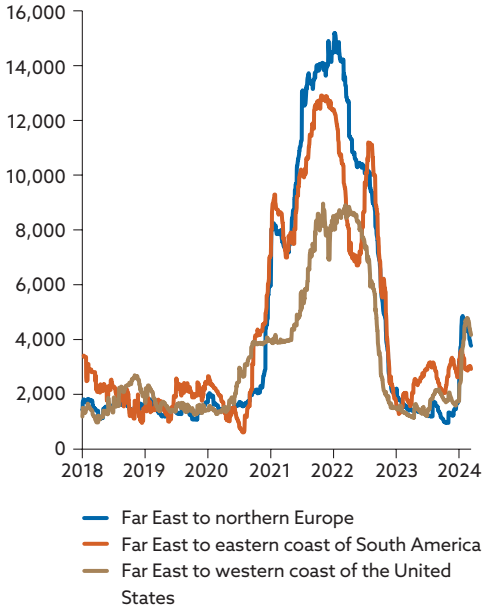
The last quarter of 2023 saw increased uncertainty related to the escalation of conflict in the Middle East. This was temporarily reflected in rising energy commodity prices. The situation gradually stabilised, and both oil and gas prices steadily came down. The supply of energy commodities was not notably affected by the conflict in Gaza, and by the end of the year there was greater concern about weakening demand for these commodities. In early 2024 the oil price started rising in response to brighter outlooks for the Chinese economy, supported by government stimulus, dwindling oil inventories, and ongoing supply constraints from OPEC+. By contrast, gas prices continued to fall amid ample production, relatively low consumption and high inventories.

Chart 3
Container ships in the Red Sea (index: 2023 = 100)



Source: Macrobond.

Chart 4
Container shipping rates (index)



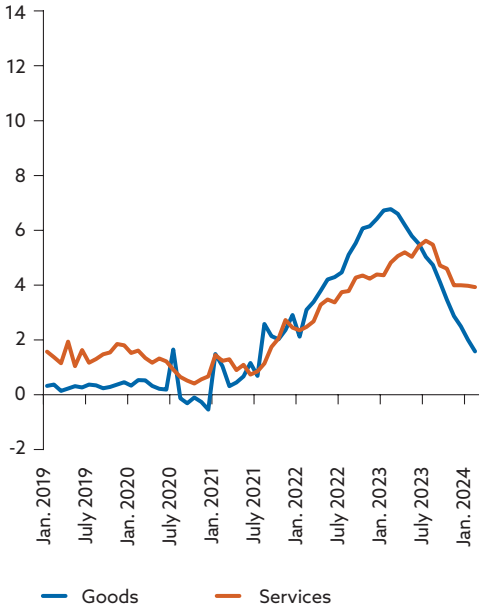
Source: Macrobond.

In the context of the Gaza conflict, attacks on ships in the southern Red Sea have gradually increased, resulting in a sharp drop in shipping traffic through the Suez Canal (Chart 3) and the redirection of shipping around the Cape of

Good Hope. As the alternative route is significantly longer, there has been an increase in shipping costs, especially between China and Europe, as well as increased risk of longer delivery times. However, shipping costs (Chart 4) have recently stabilised and should not pose a significant inflation risk.

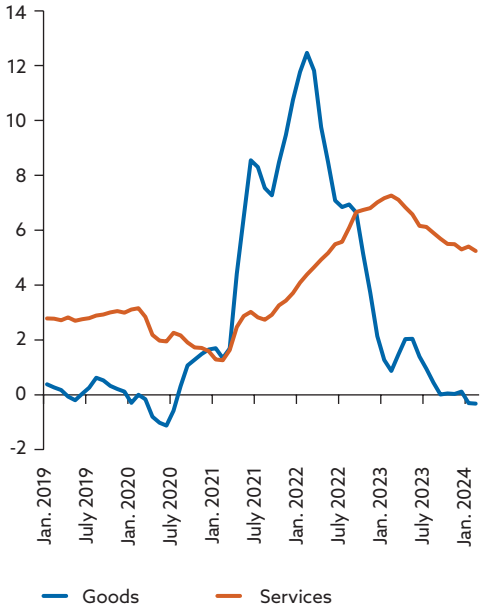
The disinflationary trend slowed in both the euro area and the United States in late 2023/early 2024 (Charts 5 and 6). This reflected a gradual fading of the base effect of past high energy inflation and the only slow deceleration in core inflation. Goods inflation has continued to moderate, thanks to the improved functioning of supply chains as well as to tight monetary policy and its downward impact on global demand. Goods inflation has also been dampened by falling export prices in China. Services inflation has eased more moderately, as demand in this sector remains elevated and also because labour markets are tight and wage growth is relatively strong. In this context, both the ECB and the US Federal Reserve are postponing a further reduction in monetary policy rates until incoming data provide stronger evidence that inflation is making a sustainable return to target.

Chart 5
Euro area – core inflation components (annual percentage changes)



Source: Macrobond.

Chart 6
United States – core inflation components (annual percentage changes)



Source: Macrobond.

2.2 Slovakia

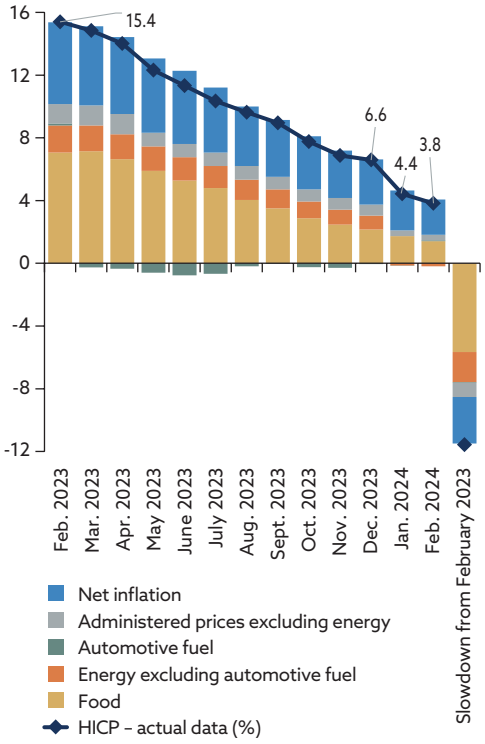
2.2.1 Consumer prices

Prices continue to rise, but far more slowly compared with the previous year. With the fading of the direct effects of input costs, headline inflation

fell to 3.8% in February of this year (Chart 7), representing a cumulative slowdown of 11.6 pp since February 2023. Food inflation contributed most to this deceleration. In recent months, however, headline inflation has been higher than projected, with food prices in particular surprising on the upside (Chart 8).

Chart 7

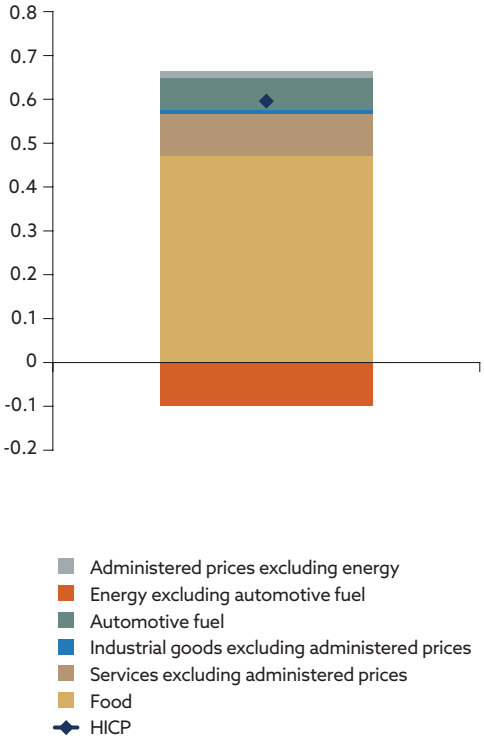
HICP inflation and its components (annual percentage changes; percentage point contributions)



Sources: SO SR, and NBS.

Chart 8

Decomposition of the difference between the actual inflation rate in February 2024 and the rate projected in the winter 2023 forecast (percentage point contributions)

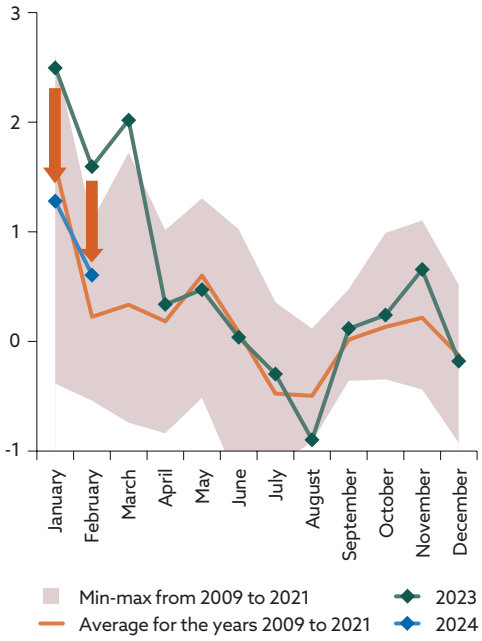


Sources: SO SR, and NBS.

Food prices have risen faster than projected in the winter forecast, driven up mainly by higher-than-projected agricultural commodity prices. In these months, however, food prices are rising far more slowly than they were a year ago, hence food inflation is moderating on a year-on-year basis (Chart 9). This trend is observed across all food products (Chart 10).

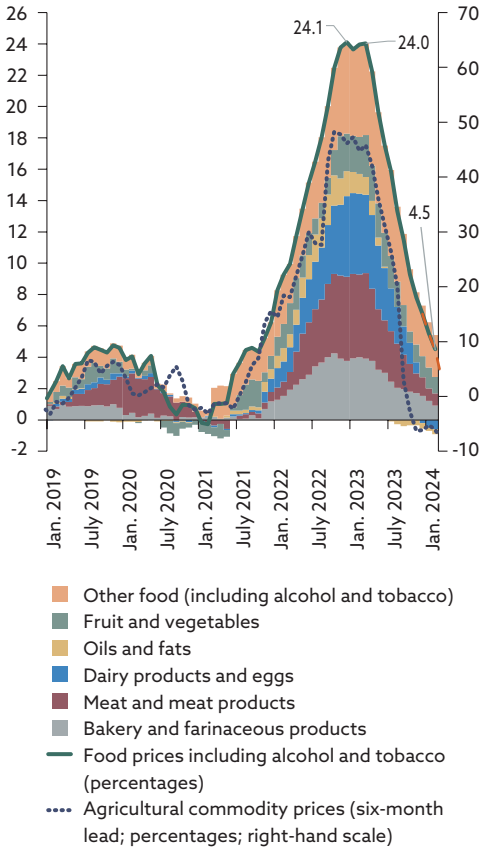
Net inflation is slowing but, as in other countries, it remains relatively high. Services prices are still rising quite sharply, stoked by the labour market situation and consequent high wage demands. Goods prices are rising at their slowest pace in two years, as supply chains have normalised. Another factor restraining goods inflation, besides the improvement in supply chains, is weaker consumer demand.

Chart 9
Food price evolution and the base effect (month-on-month percentage changes)



Sources: SO SR, and NBS.

Chart 10
Food inflation and its components (annual percentage changes; percentage point contributions)



Sources: SO SR, and NBS.

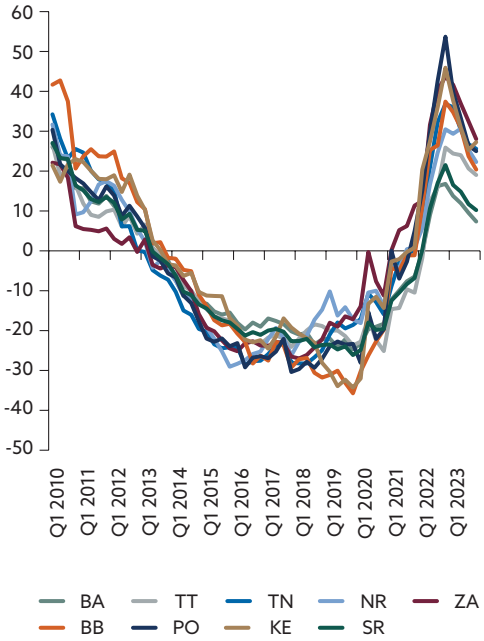
As administered energy prices have remained unchanged this year, they have had a downward impact on headline inflation. Heat prices for household consumers even fell in January. Without the adoption of energy price compensation measures, gas prices for households would have been significantly higher, since the commodity prices included in the calculation of administered prices remain elevated compared with their level before the war in Ukraine.

2.2.2 Residential property prices

The housing market is stabilising, as is apparent from all monitored indicators. The quarter-on-quarter decline in housing prices eased significantly in the fourth quarter of 2023, to -0.2%. Over the year as a whole, they dropped by an average of 6%. In month-on-month terms, housing prices increased gradually from October to December, but not to an extent that would outpace the previous quarter's level. Only new incoming data will confirm whether we are seeing a change in trend or simply a temporary uptick in optimism. The ambiguity of the situation is also underlined by

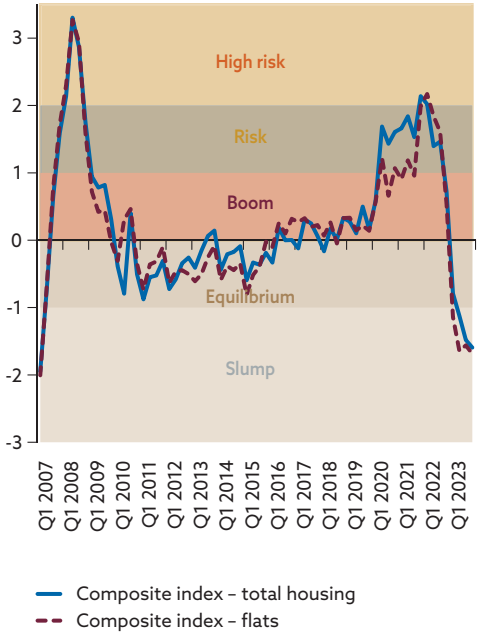
what is happening in Slovakia's regions, as housing prices decreased in five regions in the fourth quarter (by the highest margin in Nitra Region) and rose in three regions (most of all in Košice Region).

Chart 11
Housing affordability index (HAI) value as a ratio of its historical average (percentages)



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

Chart 12
Composite index to assess housing price developments



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

Housing affordability improved only marginally in the fourth quarter of 2023, staying below its long-term average (Chart 11). Both housing prices and interest rates remained around the previous quarter's level. Nominal wage growth was therefore the only indicator that had a positive impact on housing affordability, as measured by the housing affordability index[1] (HAI). Most regions saw an improvement in the HAI, the only exception being Košice Region. On current wage growth projections, housing prices would need to fall by a further 7% for the HAI to reach its long-term average.

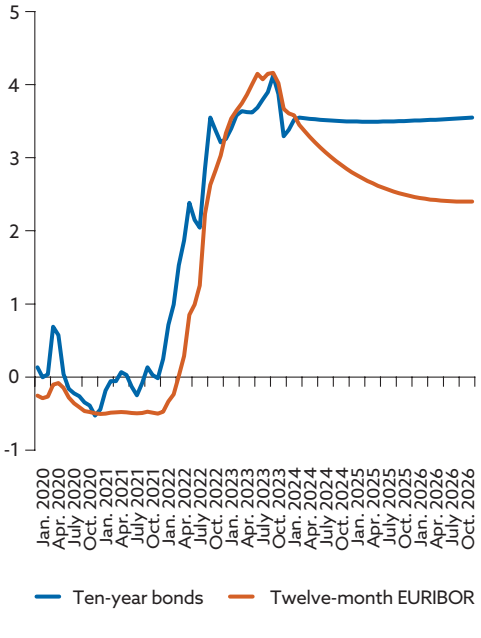
The decline in real housing prices slowed towards the end of the year, so the composite index[2] capturing the possibility of a turnaround in price

[1] 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.

[2] 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.

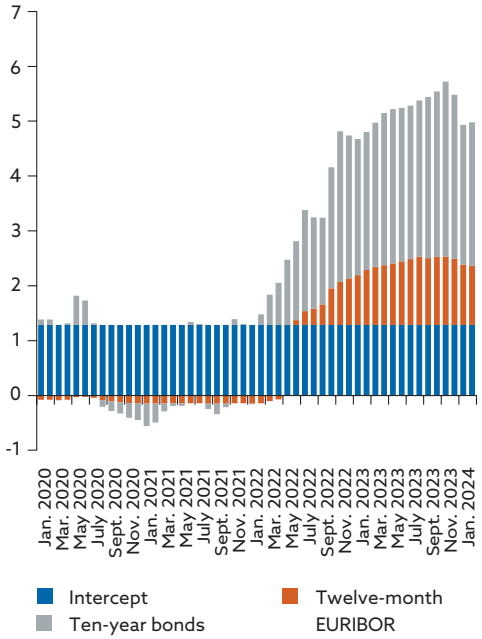
developments remained virtually unchanged (Chart 12). The ongoing divergence from the price equilibrium band stemmed mainly from the price-to-income and price-to-rent ratios. Disposable income growth turned positive in the last quarter, even when adjusted for inflation. The rental housing market continues to benefit from low housing affordability

Chart 13
Market expectations for interest rates (percentages)



Source: ECB.

Chart 14
Decomposition of mortgage rates (percentage points)



Sources: ECB, and NBS.

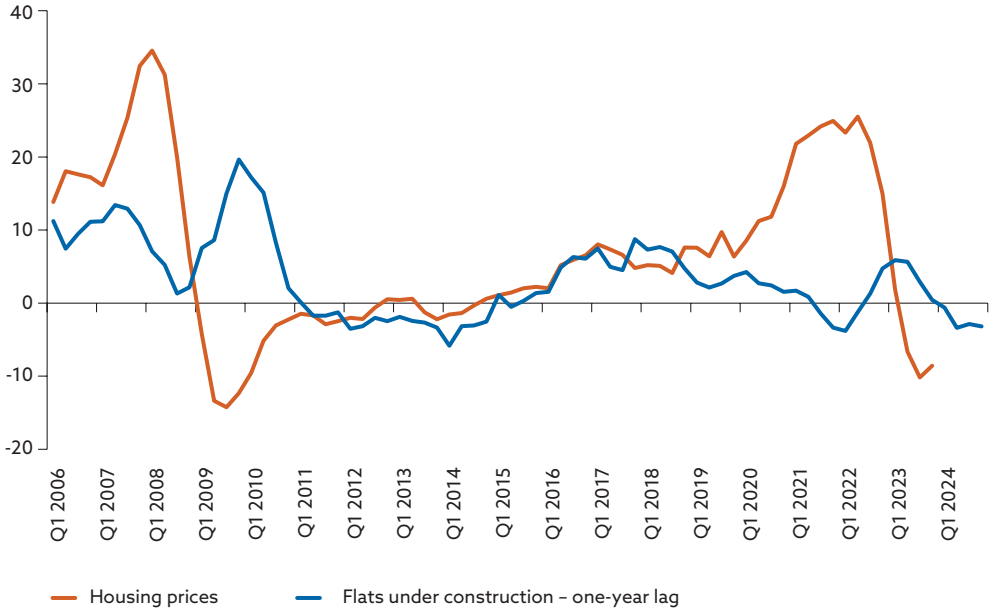
Market expectations are tempering optimism about mortgage rate reductions. Financial markets are, on the one hand, anticipating a reduction in short-term interest rates, while on the other hand, long-term rates are heavily affected by the outlook for public finances (Chart 13). The contribution of government bonds is also playing a key role in mortgage rate forecasting models (Chart 14). Even if market expectations were met and short-term rates did indeed fall, it may not automatically imply lower mortgage costs.

As regards the construction of flats, the number of completions was higher in the fourth quarter of 2023 than in any quarter since 2010. And for the first time in six quarters, the number of construction starts

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.

increased year-on-year. Even so, the resulting impact on the current number of flats under construction remained negative (Chart 15).

Chart 15
Housing prices and the number of flats under construction (annual percentage changes)



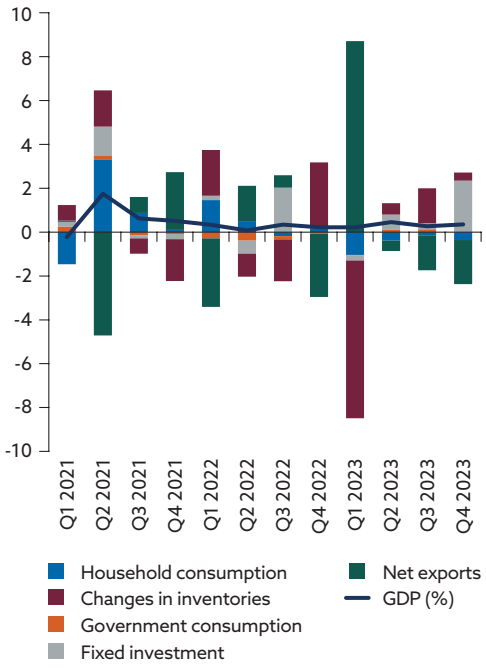
Sources: NARKS, SO SR, and United Classifieds.

2.2.3 Economic growth

The Slovak economy continued growing in the last quarter of 2023, with GDP increasing by 0.3% over the previous quarter. Only investment growth made a positive contribution to GDP growth, thanks to the final disbursements of funds allocated to Slovakia under the previous EU budget. Households remained cautious and focused on building up their savings. Amid weakening external demand, industry in general continued reducing output, and this time so did the automotive industry, which had previously been resilient to the situation.

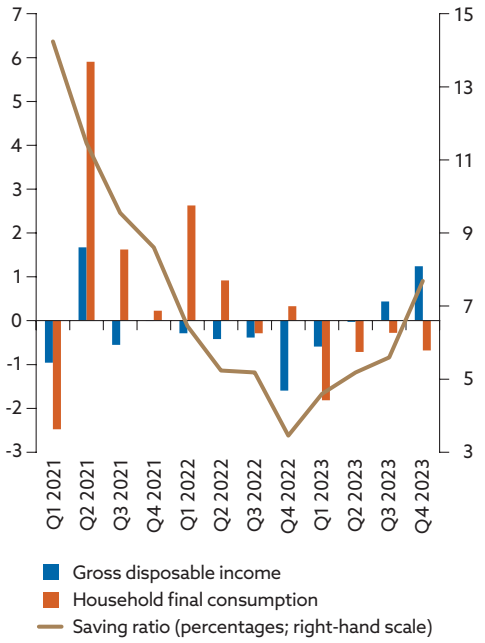
Declining inflation and government measures for selected groups supported real income growth in the fourth quarter. Even so, consumers remained cautious and preferred to continue building up depleted savings (Chart 17). Throughout the year, households saved mainly on durable goods and on the use of services (Chart 18). The strains on household budgets resulting from higher prices eased somewhat towards the end of the year. Besides increasing their saving rate, consumers were also slowly starting to spend more on purchases of everyday goods.

Chart 16
GDP and its components (quarter-on-quarter percentage changes; percentage point contributions)



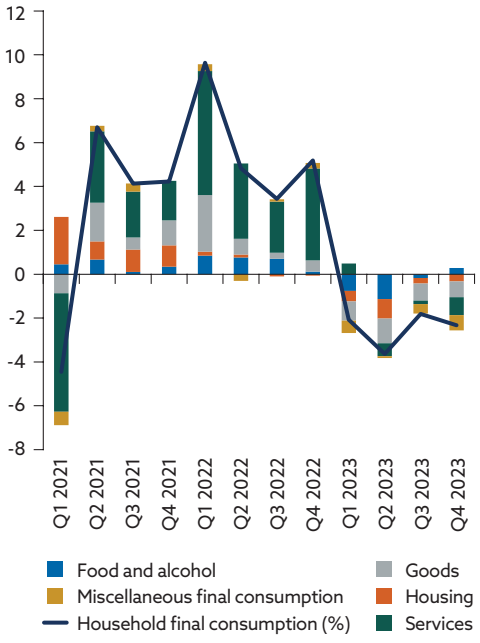
Sources: SO SR, and NBS.

Chart 17
Households' income, consumption and savings (quarter-on-quarter percentage changes; percentages)



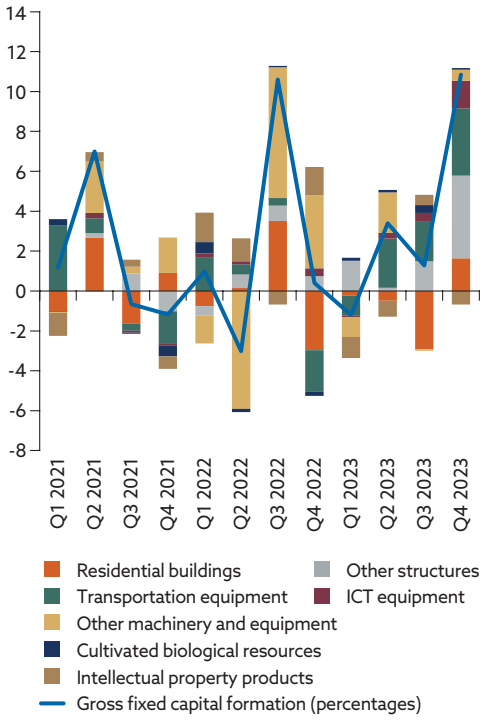
Sources: SO SR, and NBS.

Chart 18
Household consumption (annual percentage changes; percentage point contributions)



Sources: SO SR, and NBS.

Chart 19
Gross fixed capital formation (quarter-on-quarter percentage changes; percentage point contributions)

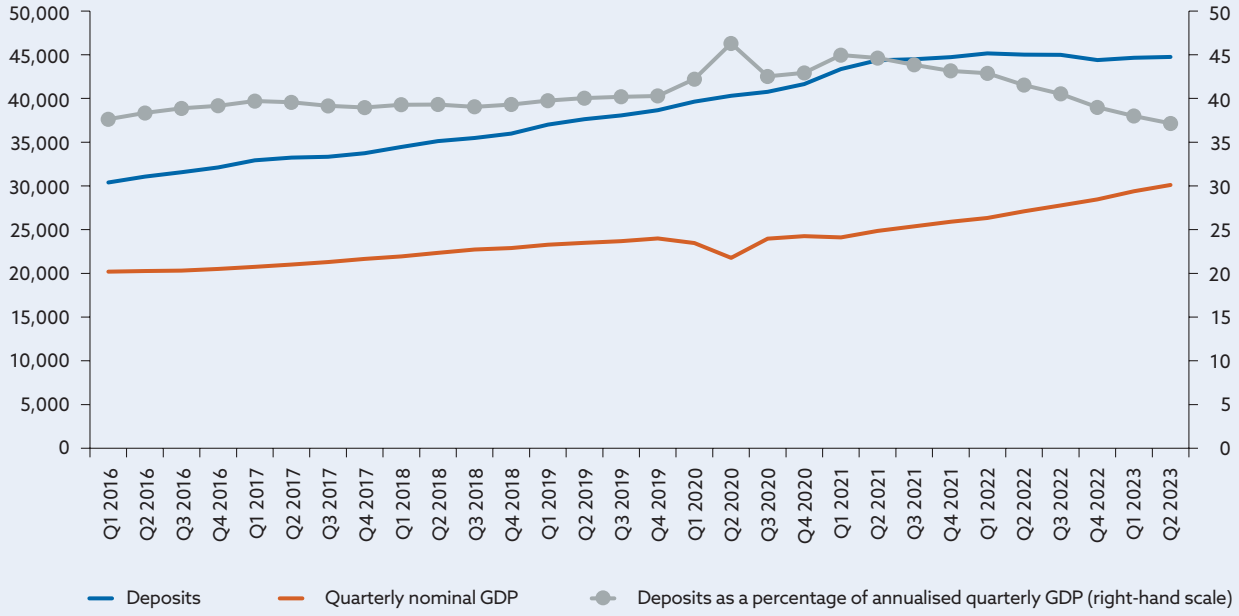


Sources: SO SR, and NBS.

Box 1
Excess savings from the pandemic period are concentrated among wealthier and, to a lesser extent, older households

Recent years have been turbulent for household savings in Slovakia (Chart A). Their growth in the period before the COVID-19 pandemic was similar to that of nominal GDP. During the pandemic, however, the accumulation of savings accelerated. Both the amount of household savings and their share in nominal GDP increased above the long-run average.

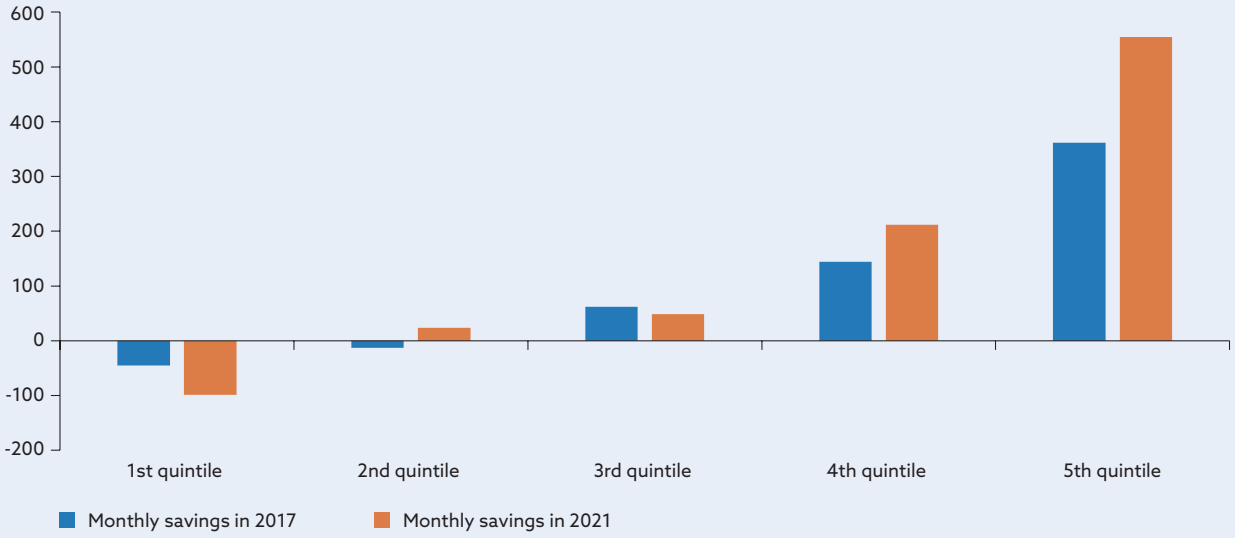
Chart A
Deposits and GDP (EUR millions; percentages)



Source: SO SR, and NBS.

Another important issue, however, besides the evolution of the total amount of savings, is the distribution of additionally accumulated savings – what are called 'excess savings' – across households. One reason why this is so is that 'pandemic savings' may have eased households' financial situation, for example in regard to elevated inflation in the following years. More granular, household-level data on savings is provided by the Household Finance and Consumption Survey (HFCS), which reveals an uneven distribution of savings across households (Chart B). Higher-income households were able to save a greater amount.

Chart B
Average monthly saved amount by household income (EUR)



Source: HFCS.
Notes: The horizontal axis shows household income quintiles, with each quintile representing 20% of households. The first quintile denotes households with the lowest income, while the fifth quintile denotes those with the highest income.

This result may be explained by the fact that the consumption of items more frequently purchased by higher-income households was limited during the pandemic. This is also evident from the fact that households which differ on other dimensions, such as number of members or education, did not show significant differences in their saving behaviour. The only exception was in the dimension of 'age of the household head', which correlated with an increased saving rate during the pandemic period, albeit to a lesser extent than the correlation observed with household income.

Moreover, the HFCS data correspond well with the overall picture of savings trends. In particular, the total reported savings represent around 90% of the value of the increase in households' total bank deposits. This is consistent with the tendency of Slovak households' to place their savings in bank deposits.

The latter part of 2023 saw adverse developments abroad start to affect the domestic automotive industry, hitherto the main driver of export growth. Besides a softening of demand, firms were starting to experience a return of supply difficulties, this time related to shipping disruptions in the Red Sea. Imports remained at a low level owing to subdued exports, weaker consumption, and increasing use of inventories in production.

Towards the end of the year, however, as colder weather set in, energy imports increased and net exports consequently had a negative impact on GDP growth in the fourth quarter.

Investment activity increased significantly in the fourth quarter of 2023, since, as expected, the absorption of funds allocated to Slovakia under the 2014–2020 EU budget was completed. The general government sector, in particular local authorities, invested EU funds mainly in infrastructure projects and transportation (Chart 19). Private business investment also increased towards the end of the year, and to a modest extent so did household residential investment. The private sector was probably also absorbing EU funds. Moreover, firms facing a shortage of skilled labour appear to be increasingly investing in machinery, equipment and facilities in an effort to maintain or increase output. At the same time, we have seen firms investing more in transport equipment, which may be related to automotive industry investment in the transition to electric vehicles.

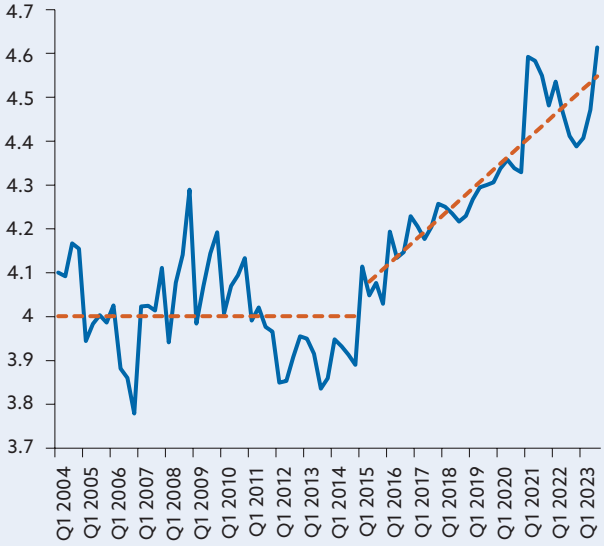
In recent years we have identified a decline in capital in the economy. This may reflect a structural change, as firms increase their investment in intellectual property, machinery and equipment, which depreciate more quickly. However, the impact of this situation on the supply side of the economy, particularly through total factor productivity, remains unclear.

Box 2
Faster obsolescence stems from a change in capital structure

The rate of depreciation/amortisation of accumulated capital has gradually accelerated to 4.6% per annum since 2014, from a previously stable level of around 4% per annum (Chart A). The increase in the overall depreciation rate is related to the total capital stock containing an increasing share of assets with faster obsolescence, in particular machinery and equipment but also intellectual property products.

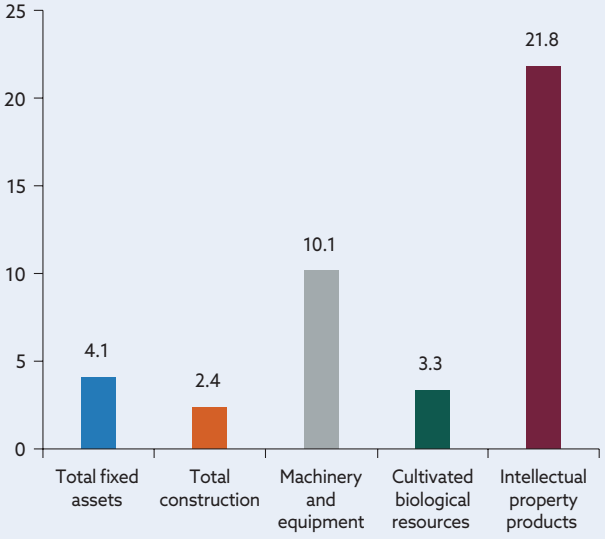
The depreciation rate represents the gradual depreciation of capital through physical wear and tear or moral obsolescence. It applies to all types of assets, including constructions, machinery and equipment, and intellectual property products.

Chart A
Depreciation rate (percentages per annum)



Sources: Eurostat, and NBS.

Chart B
Average depreciation rates for the period 2004–2022 (percentages per annum)



Sources: Eurostat, and NBS.

Capital accumulation depends on the formation and consumption of fixed capital. **A faster depreciation rate denotes higher capital consumption. Increased capital consumption reduces the capital stock.** Gross fixed capital formation has been dampening capital accumulation, in particular during the financial crisis from 2009 and during the pandemic crisis in 2020. At times of crisis, firms are less willing to invest owing to heightened uncertainty. Moreover, with profits down, they also have less capacity to finance investment from their own resources. External funding also becomes less accessible, as banks are less willing to lend during riskier periods.

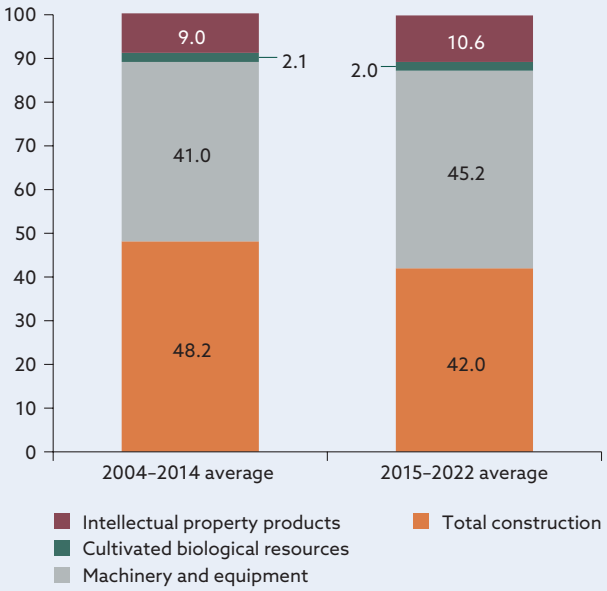
The upward trend in the overall depreciation rate in recent years is related to an increase in the share of assets with faster obsolescence in the total capital stock. The assets experiencing the most rapid obsolescence are intellectual property products (Chart B). By contrast, constructions have a significantly longer lifespan. They account for more than three-quarters of the capital stock, but compared with the 2004–2014 period, when the overall depreciation rate was lower, their share of the stock has fallen in favour of machinery, equipment and intellectual property products, which have a higher rate of obsolescence (Chart C).

The changes in capital stock structure are due to the share of investment in machinery, equipment and intellectual property products increasing at the expense of the share of total construction during a period of depreciation rate acceleration (Chart D).

Chart C
Shares of fixed asset types in capital stock (percentages)

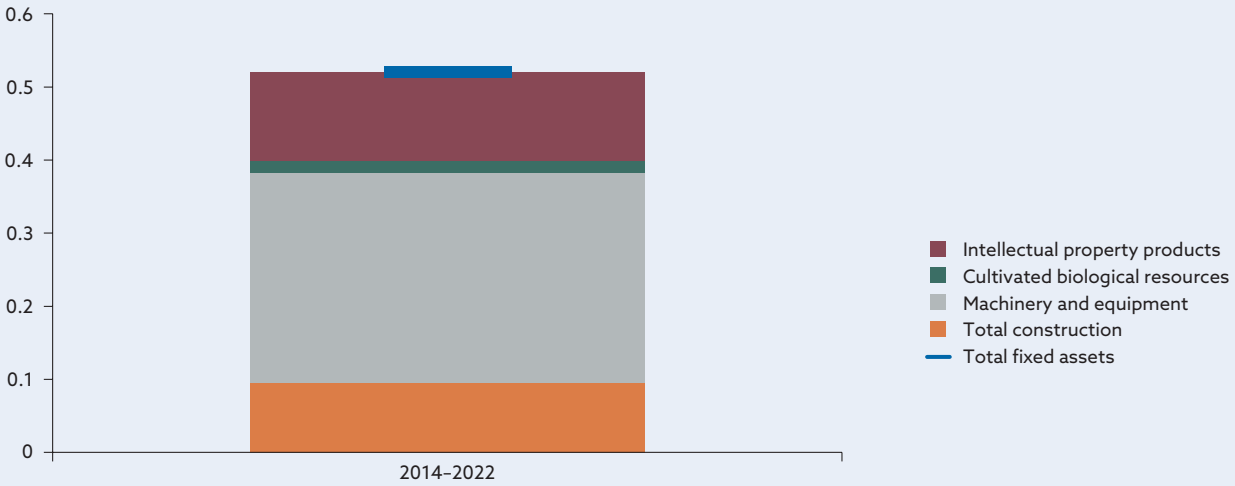
Sources: Eurostat, and NBS.

Chart D
Shares of fixed asset types in gross fixed capital formation (percentages)



Sources: Eurostat, and NBS.

Chart E
Contributions to the cumulative change in the depreciation rate since 2014 (percentages points)



Sources: Eurostat, and NBS.

Hence, the main contributor to the accelerating depreciation rate has been machinery and equipment, followed by intellectual property products and, to a lesser extent, total construction (Chart E). The weight of machinery and equipment, with its relatively high rate of obsolescence, has increased. Moreover, the depreciation rate of this component has

increased slightly. The positive contribution of intellectual property products, which have the fastest rate of obsolescence, stems from an increase in their share of the total capital stock. Although the weight of total construction in the capital stock has decreased, the shortening of the useful life of buildings and other structures has resulted in an increase in the overall depreciation rate. The declining share of total construction in favour of assets with faster obsolescence is indirectly accelerating capital stock depreciation.

The depreciation rate's acceleration is a natural consequence of the economy's structure moving away from long-lived assets and towards assets with shorter lifespans, specifically machinery, equipment and intellectual property products. Faster capital replacement can create conditions for the introduction of more modern and productive technologies. To foster productivity growth, investment must sufficiently replace the capital consumed and, importantly, must do so efficiently. The result can then be a gradual transition towards an innovation-based economy.

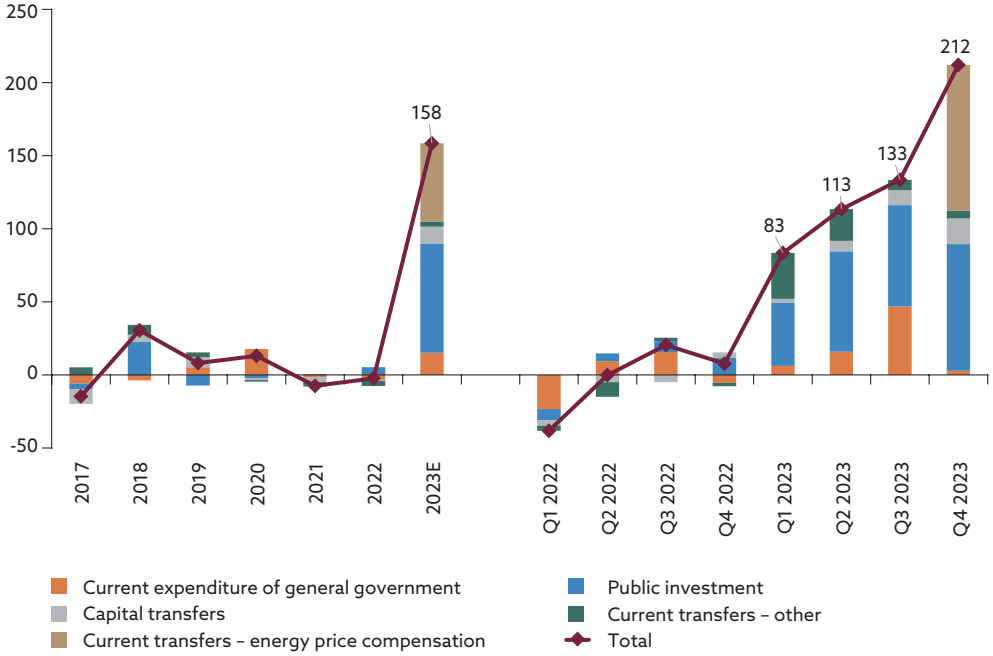
With Slovakia having until the end of 2023 to disburse unspent funds under its 2014–2020 EU budget[3] allocation, its absorption of EU funds accelerated sharply in the latter part of the year (Chart 20). According to a preliminary estimate, total disbursements of EU funds increased in the fourth quarter by more than two and a half times year-on- year, to €5.9 billion. This figure included €360 million received from the Recovery and Resilience Facility (through the implementation of Slovakia's recovery and resilience plan) and €340 million in transfers to financial instruments. The late-year surge in EU fund disbursements was supported by capital expenditure on transportation projects, such as the development of urban public transport (modernisation of rolling stock and transport infrastructure), the regional road network, and railways. The spending of EU funds in the private sector was focused on projects supporting production and product innovation, technology modernisation, energy efficiency improvements and the expansion of environmental services (waste and water management).

Some €990 million of EU funds has been allocated to compensating households for higher energy prices, and more than half of that amount has already been disbursed. The part that remains to be disbursed will still be recorded in 2023, on an accrual basis. As a result, energy compensation measures are expected to account for half of the year-on-year increase in EU

[3] The Multiannual Financial Framework for 2014–2020.

fund disbursements in the fourth quarter of 2024. However, like the part of EU funds previously allocated to pandemic relief measures (in particular job retention grants), these resources represent a sacrificed opportunity, at the cost of current spending, to use EU funds to modernise the economy and regions.

Chart 20
Absorption of EU funds (annual percentage changes)[1)]



Sources: State Treasury, and NBS.
1) Adjusted for spending on financial instruments.

Government consumption growth in the fourth quarter of 2023 was among the highest in recent periods, owing largely to a sharp increase in standardised public sector wages as well as to a one-off increase in bonuses, severance payments and overtime premia. These developments were partly offset by a relatively strong rise in revenue from sales.

2.2.4 Labour market

Employment increased slightly in the last quarter of 2023, with strong demand for experienced workers remaining prevalent. Recruitment was highest in the trade and services sectors. Construction firms benefited from the increased absorption of EU funds and were therefore taking on more workers (Chart 21). The second half of last year saw a pronounced trend towards hiring people on a self-employed basis, while the number of employees increased only slightly (Chart 22).

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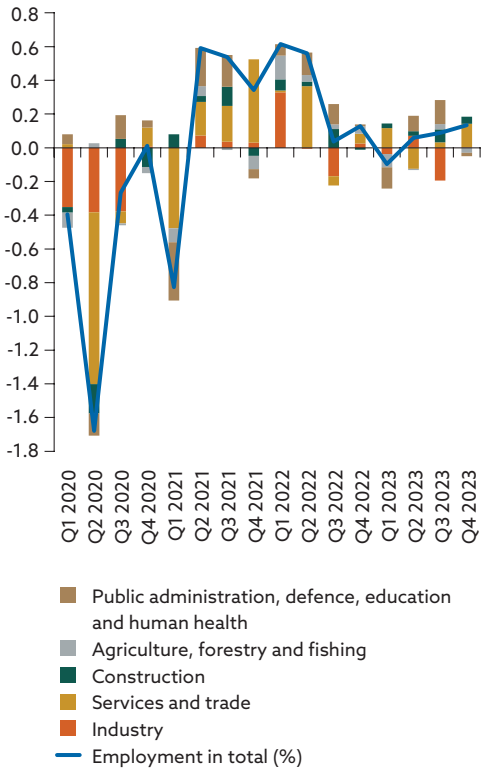
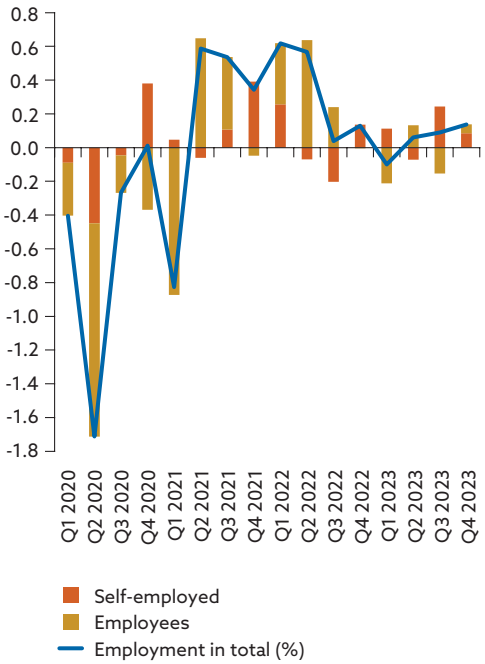
Chart 21
Employment by sector (quarter-on-quarter percentage changes; percentage point contributions)



Sources: SO SR, and NBS.

Chart 22
Employment (quarter-on-quarter percentage changes; percentage point contributions)

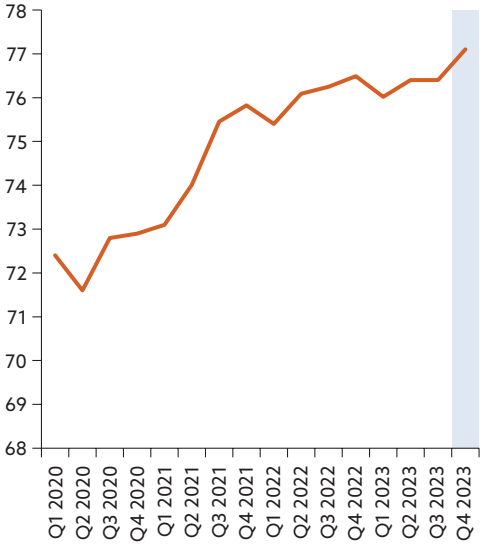


Sources: SO SR, and NBS.

Labour shortages persist even as labour supply is growing through the increasing number of foreign workers and rising participation rates. The main sources of employment growth in the fourth quarter were unemployed finding jobs, an upturn in the movement of people from inactivity to activity (and hence a rising labour participation rate, see Chart 23), and labour immigration. Unemployment fell to an all-time low. The number of foreign workers in the labour market continued to increase, and by the end of 2023 it had surpassed one hundred thousand.

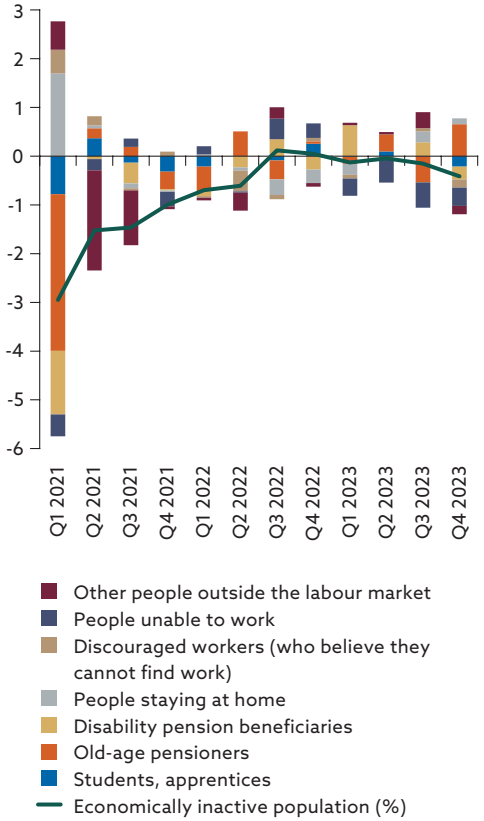
The economically inactive population continues to decline, while activity increases. The number of older people in the labour force is increasing. Discouraged workers (people who stopped looking for work because they believe none is available) are returning to the labour market, as are people who were previously staying at home for family reasons (Chart 24). But despite these inflows, labour market tightness remains high. This is particularly evident from the business survey–based indicator of reported labour shortages, which reached a historical high in the fourth quarter.

Chart 23
Labour force participation rate (percentages)



Sources: SO SR, EC, and NBS.

Chart 24
Economically inactive population (quarter-on-quarter percentage changes; percentage point contributions)



Sources: ÚPSVaR, and NBS.

Real wage growth picked up in the fourth quarter of 2023 (Chart 25). As for nominal wages, their year-on-year growth exceeded 10%. After two years, household purchasing power started rising again. The main driver of annual wage growth was strong wage developments in the public sector, where one-off bonuses were paid. Private sector wage growth increased slightly, though its rate has been stable at around 9% for several quarters now (Chart 26).

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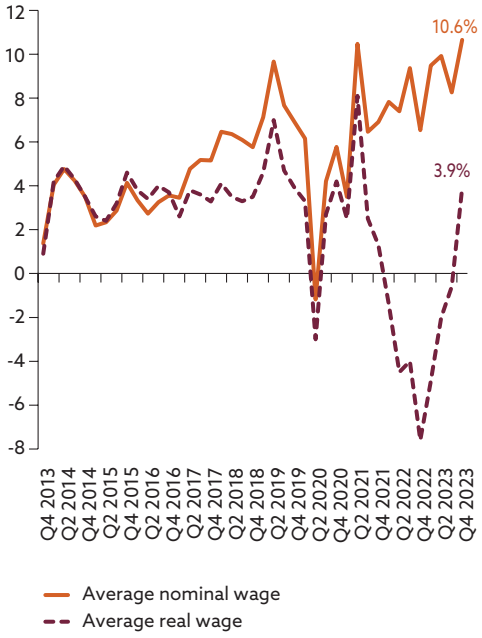
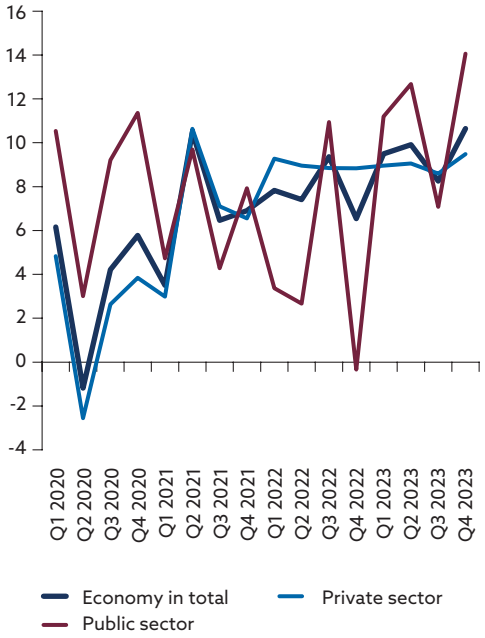
Chart 25
Nominal and real wages (annual percentage changes)



Sources: SO SR, and NBS.

Chart 26
Wages by economic sector (annual percentage changes)



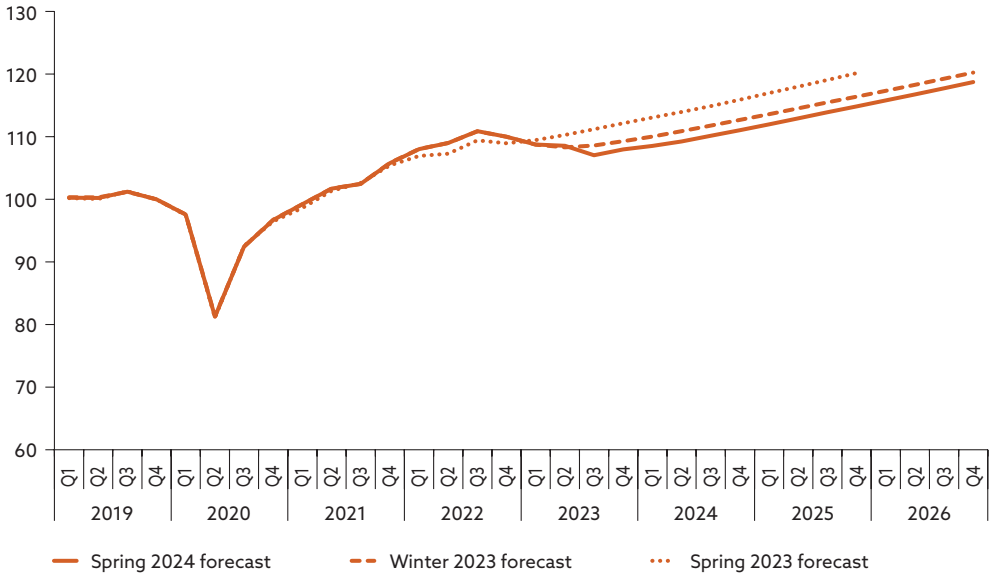
Sources: SO SR, and NBS.

3 Medium-term forecast

3.1 Global outlook and technical assumptions of the forecast[4]

The outlook for foreign demand for Slovak products has deteriorated further (Chart 27). The demand is again lower than expected, owing to a weakening of import developments in several of Slovakia's key trading partners, in particular France, Germany and Italy. Compared with the winter 2023 forecast, the assumption for foreign demand at the end of 2026 has been revised down by 1.2%.

Chart 27
Foreign demand (index: Q4 2019 = 100)



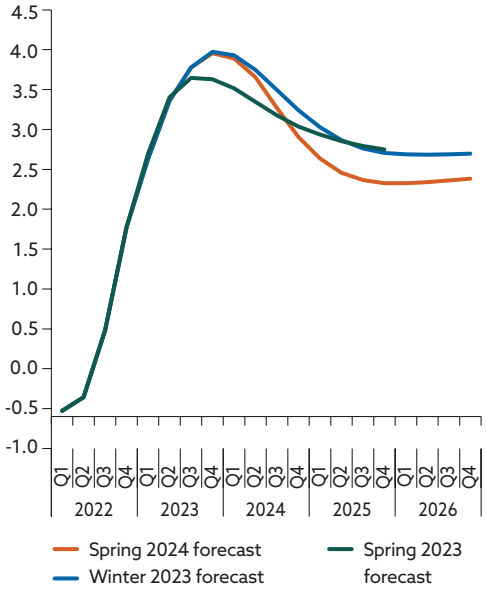
Source: NBS.

The barrel price of oil is assumed to decline gradually over the projection horizon, from USD 86 at the end of 2023 to USD 73 at the end of 2026. The euro's exchange rate against the US dollar is assumed to remain stable until the end of the projection period, at just above 1.08 US dollars per euro.

As markets are expecting sharper cuts in short-term interest rates (Chart 28), the assumptions for the level of these rates up to the end of 2025 have been revised down by around 40 basis points, compared with the winter forecast. In the baseline assumptions, long-term rates are 26 basis points lower at the end of 2025 than they were in the winter forecast (Chart 29).

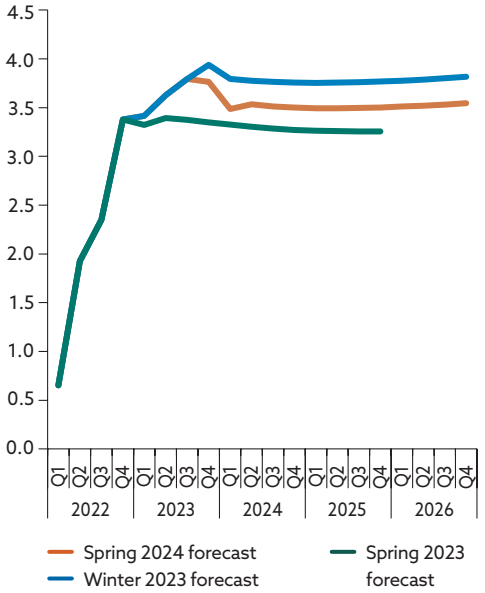
[4] The technical assumptions of this medium-term forecast are based on the March 2024 ECB staff macroeconomic projections for the euro area.

Chart 28
Three-month EURIBOR



Sources: European Commission, and NBS.

Chart 29
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	Spring 2024 forecast (MTF-2024Q1)			Difference vis-à-vis the winter 2023 forecast (MTF-2023Q4)		
	2023	2024	2025	2026	2024	2025	2026
Slovakia's foreign demand	-1.3	1.5	3.4	3.4	-0.9	0.1	0.1
USD/EUR exchange rate [1), 2)] (level)	1.08	1.08	1.08	1.08	0.1	0.1	0.1
Oil price in USD [1), 2)] (level)	83.7	81.4	76.0	72.8	1.6	-0.8	-1.1
Oil price in USD [1)]	-19.2	-2.8	-6.6	-4.1	1.8	-2.2	-0.3
Oil price in EUR [1)]	-21.3	-3.2	-6.6	-4.1	1.8	-2.2	-0.3
Non-energy commodity prices [1)]	-12.5	0.6	2.0	0.1	2.9	-0.4	-1.6
Three-month EURIBOR (percentage per annum)	3.4	3.4	2.4	2.4	-0.2	-0.4	-0.3
Ten-year Slovak government bond yield (percentage)	3.6	3.5	3.5	3.5	-0.3	-0.3	-0.3

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

3.2 Macroeconomic forecast for Slovakia

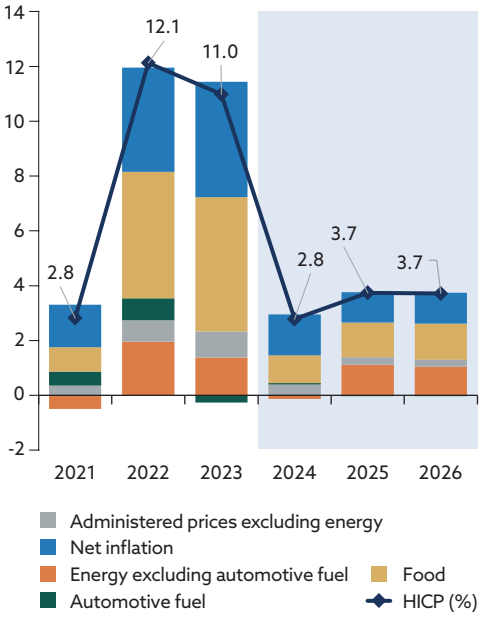
Weaker foreign demand and households' increasing propensity to save are delaying the economy's recovery. The euro area is affected by tighter monetary policy and by competitiveness problems stemming from the energy crisis. As a result, outlooks for euro area growth in the months

ahead have deteriorated, which implies lower growth in foreign demand for Slovak goods and services.

Consumer demand has slumped, and despite growth in real incomes, we do not yet see signs of it making any significant recovery. Households are likely to build up their savings and will venture to increase their spending as their lost purchasing power is gradually recouped.

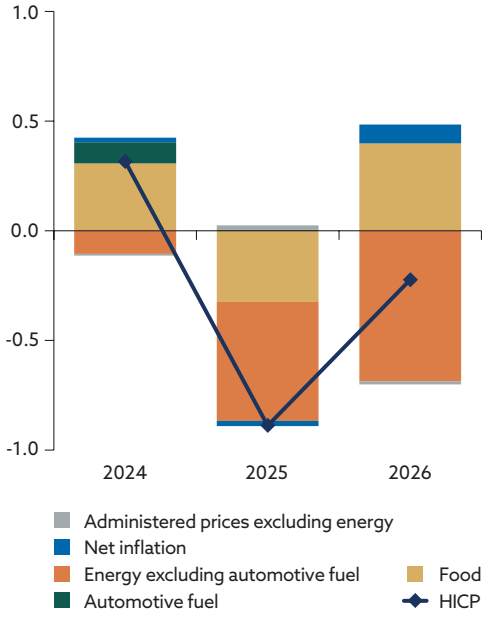
Compared with the winter 2023 forecast, our outlook for Slovakia's economic growth in 2024 has deteriorated. The economy is expected to operate below potential, owing to weaker domestic and foreign demand. The following two years should see the economy pick up momentum. Lower energy market prices have opened the way for faster real wage growth, adding impetus to private consumption. The economy is therefore envisaged to gather significant momentum and to start overheating. The economy's performance in 2026 should be similar to what was projected in the winter forecast.

Chart 30
HICP inflation and its components (annual percentage changes; percentage point contributions)



Source: SO SR, and NBS.

Chart 31
Change in projection vis-à-vis the winter 2023 forecast (percentage point contributions)



Sources: SO SR, and NBS.

Inflation is set to fall markedly this year as the impact of cost factors fades (Chart 30). In the following years it will accelerate to just below 4%, as administered energy prices are brought up to market levels. Although headline inflation is now slowing sharply, food prices have not met our expectations, rising slightly faster than forecast. Hence the projection for average headline inflation in 2024 has been revised up slightly. There is

good news in commodity market developments, with energy commodity prices having returned almost to the level they were at before the start of the war in Ukraine. As a result, consumer energy prices are expected to rise more slowly than was projected in the winter forecast (Chart 31).

All factors are playing in favour of downward pressure on inflation. Imported inflation has fallen, particularly in the food and goods segments, owing to the easing of supply chain and logistics problems and to a decline in commodity prices.

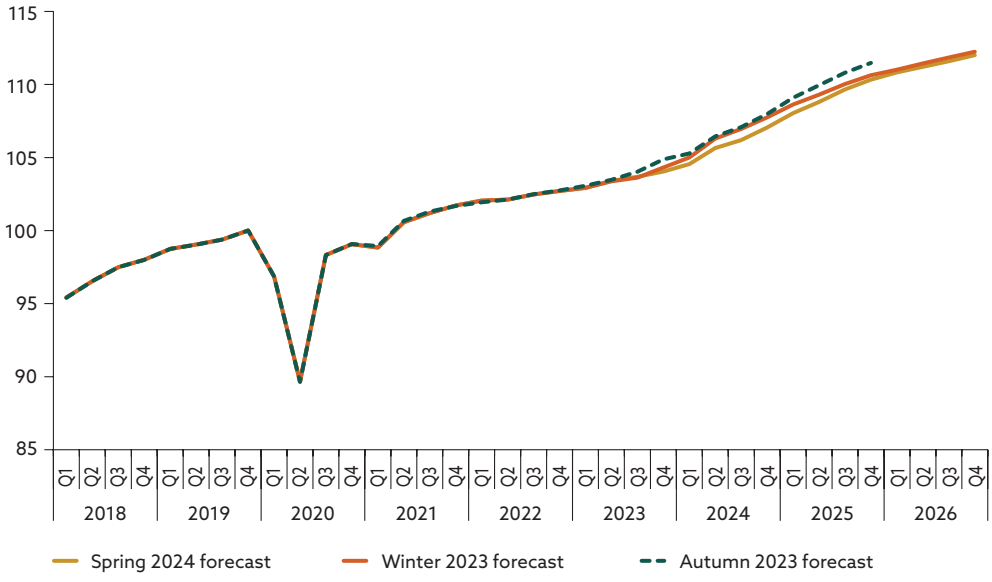
Inflationary pressures from the domestic economy, both from the cost side and from dampened demand, are also gradually moderating. Consumer demand is lagging behind, domestic cost drivers are fading, and services prices are rising more moderately than in previous years. Net inflation is projected to stabilise at around 2.5% in 2025 and 2026, with wage growth having a greater impact than other cost factors.

Table 3 Components of HICP inflation (annual percentage changes)

	Average for 2004–08 (pre-crisis period)	Average for 2010–14 (post-crisis period with euro currency)	2022	2023	2024	2025	2026
HICP	**4.1**	**2.0**	**12.1**	**11.0**	**2.8**	**3.7**	**3.7**
Food	3.6	3.1	16.1	15.6	3.2	4.0	4.1
Non-energy industrial goods	0.2	0.3	7.3	8.8	2.5	2.1	1.9
Energy	8.3	2.3	18.8	7.5	-0.6	7.4	7.0
Services	5.3	2.5	9.3	10.2	4.4	3.1	3.3
Net inflation	1.8	1.0	8.3	9.3	3.3	2.5	2.5

Sources: SO SR, and NBS.

Chart 32
GDP (index: Q4 2019 = 100)



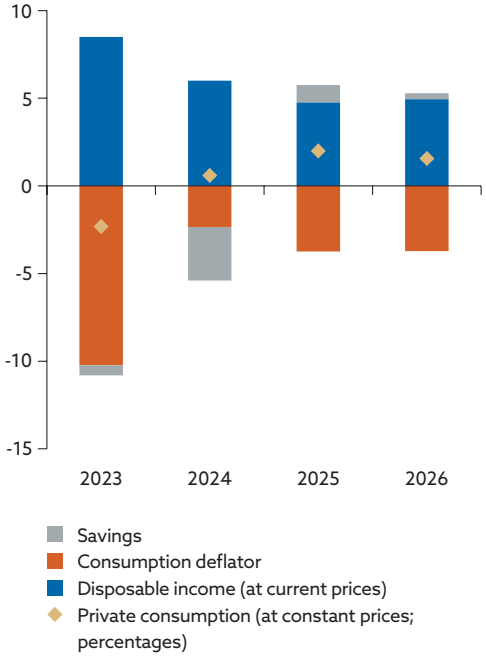
Source: NBS.

Compared with the winter forecast, the economy is expected to perform worse in the short term, before rebounding back to the level previously projected. GDP growth projections for coming quarters have been revised down (Chart 32) on grounds of weaker foreign demand and households' greater propensity to save in the near term.

The export-oriented side of Slovak industry will perform less well in the short term than was previously forecast. The euro area economy is teetering on the brink of recession and is not as yet showing any signs of improvement. We expect that it may start to turn the corner in the second half of this year. Energy prices have fallen to low levels that could support Europe's competitiveness. Favourable labour market developments, coupled with a gradual increase in real incomes, are expected to boost Slovak exports.

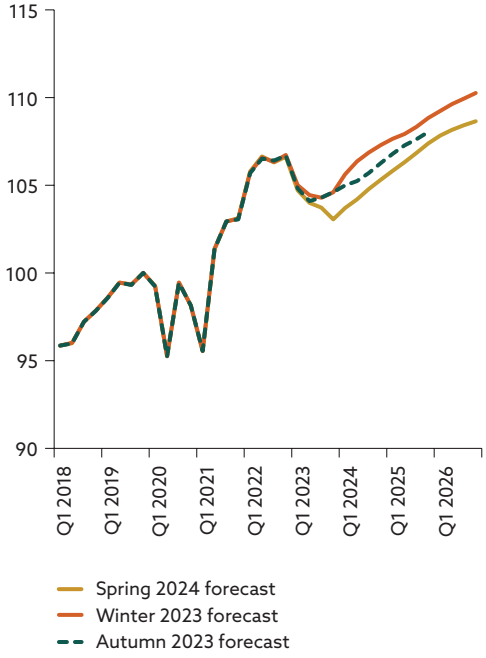
Consumer demand has slumped and households are showing an increasing propensity to save (Chart 33), with the result that private consumption has not recovered as strongly as expected. In late 2023 growth in real incomes was still not having the desired upward impact on consumer spending. In the first months of this year, however, there were signs of spending starting to pick up again, though households remained cautious. Subsequent years should see a notable acceleration in consumer spending (Chart 34), with households allocating somewhat less of their income to savings.

Chart 33
Decomposition of private consumption (annual percentage changes; percentage point contributions)



Source: NBS.

Chart 34
Private consumption (index: Q4 2019 = 100)

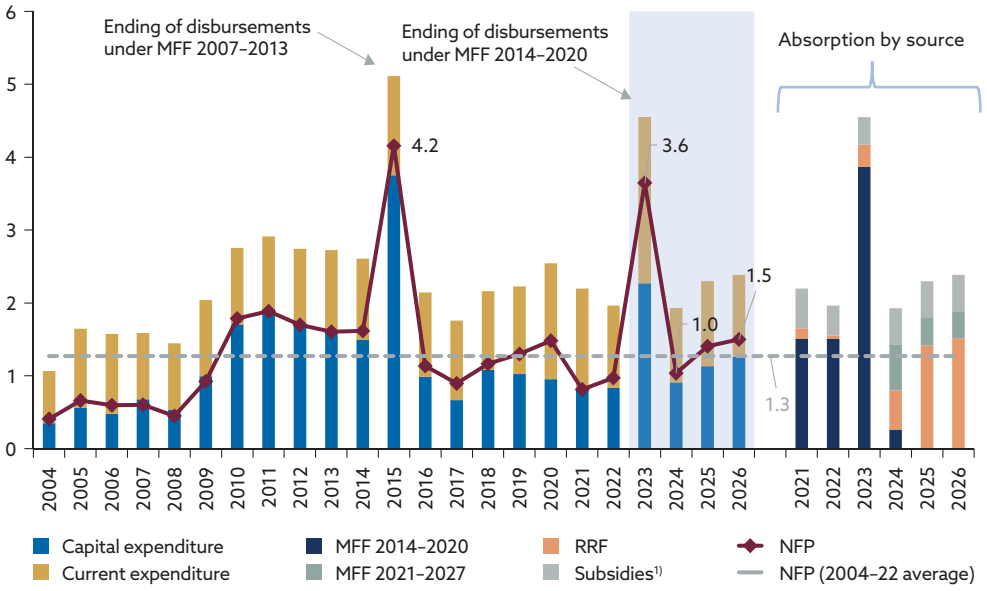


Source: NBS.

Investment demand will temporarily moderate, as disbursed EU funds are run down (Chart 35). Investment was the driver of economic growth in late 2023, with the final absorption of funds allocated under the previous EU budget. Government investment in particular is expected to slow down in coming quarters. Net receipts from the EU budget are expected to fall below the long-term average, to 1.0% of GDP, before picking up again as the deadline approaches for the use of funds from the Recovery and Resilience Facility (on the basis of Slovakia's recovery and resilience plan). With a gradual recovery in foreign demand, firms should start stepping up investment. This trend will be further supported by the planned establishment of a new car factory and by existing car factories transitioning to the production of vehicles with all types of propulsion.

Chart 35

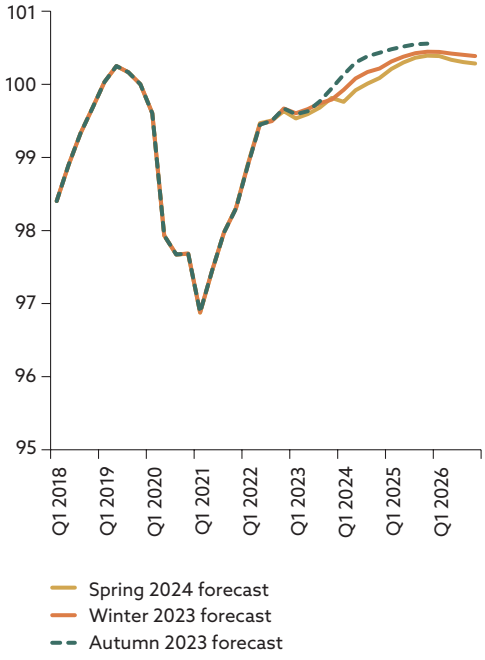
Slovakia's absorption of EU funds and net financial position (percentages of GDP)



Source: NBS.
1) 'Subsidies' comprise mainly agricultural funds under the 2014–20 and 2021–27 EU budgets.
Notes: NFP – net financial position; MFF – Multiannual Financial Framework. The forecast envisages funding under the EU's Next Generation EU instrument (through the Recovery and Resilience Facility, the Recovery Assistance for Cohesion and the Territories of Europe (REACT-EU) initiative, and the Just Transition Fund).

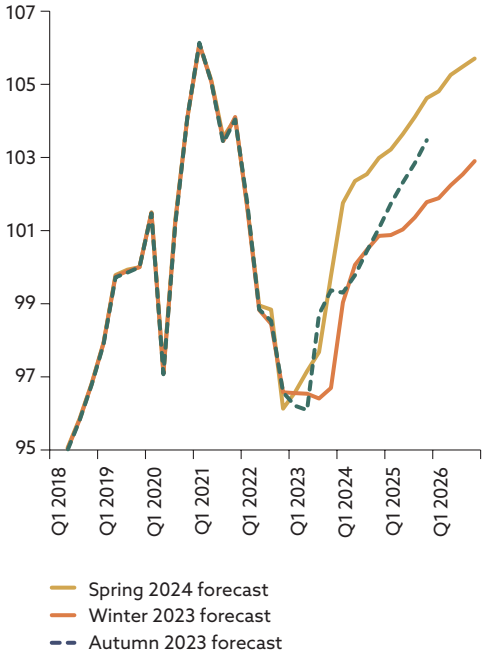
The impact of increased early retirements on employment is expected to be only marginal (Chart 36). The labour market situation remains broadly favourable, with demand for labour at very substantial levels. The easing of conditions for early retirement has resulted in applications for this option increasing within a short period of time. As a result, firms will temporarily experience a greater shortage of skilled labour, and employment is now likely to undergo a temporary decline. We therefore expect an increase in the number of hours worked by current employees. The situation should later improve, as firms hire workers both from domestic labour pools and to an increasing extent from abroad.

Chart 36
Employment (index: Q4 2019 = 100)



Source: NBS.

Chart 37
Real compensation per employee (index: Q4 2019 = 100)



Source: NBS.

Labour shortages and an increase in hours worked will put upward pressure on nominal wages. Nominal wages are projected to rise quite sharply throughout the projection horizon, with their growth partly supported by shortages of skilled labour. The sharp fall in inflation this year will provide a major boost to households' purchasing power. The recouping of real income losses from the period of high inflation is expected to continue in the years ahead (Chart 37). Given that our inflation projections for 2025 and 2026 are now lower than projected in the winter forecast, we expect wage bargaining demands and expectations to be lower than previously forecast.

Table 4 Wages (annual percentage changes)

	2022	2023	2024	2025	2026
Nominal labour productivity	7.5	10.7	5.9	4.5	6.2
Whole economy – nominal wages	7.0	9.1	7.2	5.3	5.1
Whole economy – real wages	-5.2	-1.3	4.3	1.5	1.4
Private sector – nominal wages	8.3	8.8	7.6	5.5	5.4
Private sector – real wages	-4.0	-1.5	4.7	1.8	1.7
Public administration, education and health care – nominal wages	2.9	10.1	5.7	4.6	4.4
Public administration, education and health care – real wages	-8.7	-0.4	2.8	1.0	0.8

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

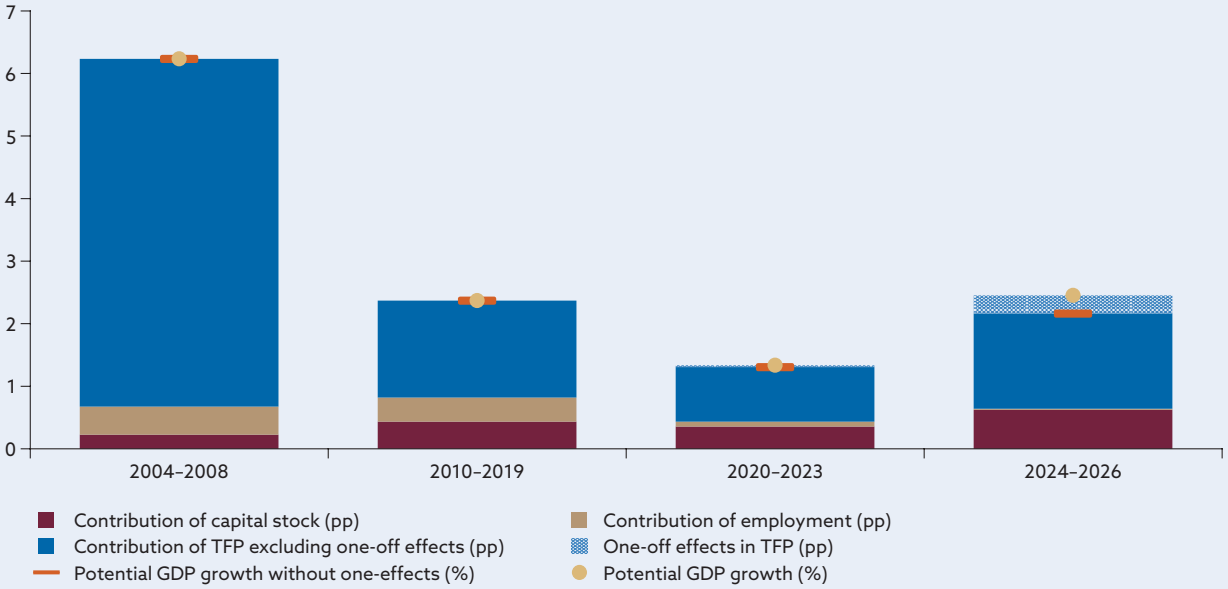
Box 3
Estimated potential growth of the Slovak economy in 2024–2026

Evolution of the economy's potential

Between 2004 and 2008, the productive potential of the Slovak economy grew at a record pace.[5] After the global financial crisis, however, the economy cooled down, as reflected in reduced potential and overall economic growth. The average growth rate of potential GDP went from 6.2% in 2004–2008, to just 2.4% in 2010–2019, and then down to 1.3% in 2020–2023. For 2024–2026, we estimate potential GDP growth to average 2.5%.

However, when assessing what is happening in an economy and forecasting its trends, attention must be paid to the economy's structure. Chart A illustrates the slowdown in the Slovak economy's potential growth, as well as the decomposition of that growth into basic production factors – capital and labour – and productivity. Ultimately, the overall productivity of production factors, i.e. total factor productivity (TFP), is the key to determining how much is produced at a given stock of capital and labour.

Chart A
Decomposition of the economy's potential growth (annual percentage changes; percentage point contributions)



Source: NBS.

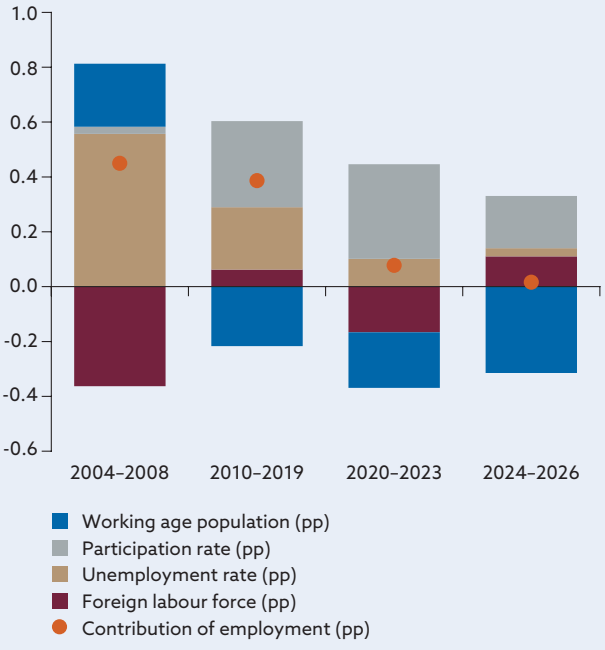
[5] Potential GDP and its growth are not directly observable. Our estimates are the result of conventionally applied 'growth accounting', which is here used to decompose an economy's growth rate into the contributions of growth in inputs – capital and labour – and in technological progress; see Solow, R.M., "Technical Change and the Aggregate Production Function", *The Review of Economics and Statistics*, Vol. 39, No 3, August 1957, pp. 312-320.

Impact of productivity

The growth of Slovakia's economic potential has long been driven by technological progress, which encompasses not only new technologies, but also the streamlining of production, the quality of human capital, and so forth. The record growth in 2004–2008 was the result of foreign investment inflows, reform efforts, and the low base from which the economy surged.

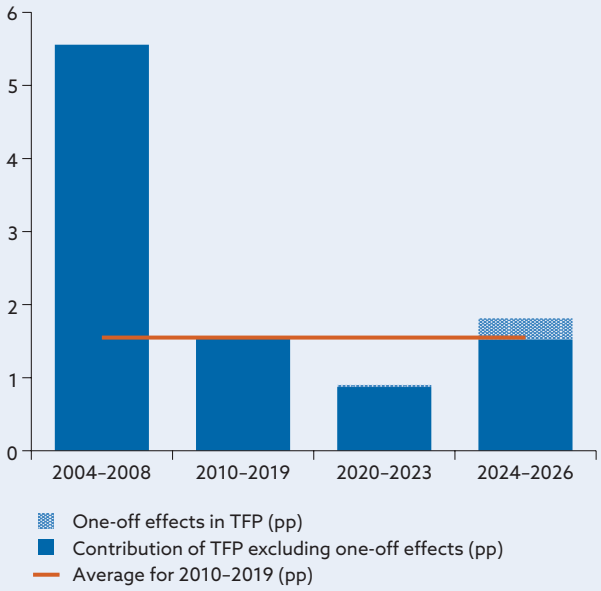
The labour market participation rate is currently compensating for adverse demographic developments. It should be noted, however, that until 2019 the economy was able to generate growth through both productivity and the labour market, whereas since 2020 the contribution of the labour force to growth has been almost negligible. The problem of an ageing population is becoming increasingly acute. The rising labour market participation rate (especially among the older age cohorts) is offsetting the impact of a smaller labour force (Chart B).

Chart B
Decomposition of the employment contribution (pp)



Source: NBS.

Chart C
Total factor productivity (TFP)



Source: NBS.

Supplying labour force

Since a further increase in the labour force participation rate and greater inclusion of the long-term unemployed are unlikely in the medium term without more substantial investment and reforms, it is important from an economic perspective to stem the outflow of labour abroad and, conversely, to attract it from abroad. Our current forecast assumes an additional

cumulative inflow of foreign workers of around 30,000, with the total number active in the labour market over the forecast horizon rising to more than 130,000.

Productivity growth

We estimate that TFP growth over the period 2024–2026 will be 1.8%, slightly above the 2010–2019 level of 1.5% (Chart C). This assumption includes a one-off contribution from investment and new production in the automotive sector. Without additional reform steps and successful promotion of productive investment, R&D and innovation, the TFP contribution cannot be expected to be higher than that of the last decade.

Overall potential GDP growth is estimated to average 2.5% over the projection horizon. Adjusted for one-off effects in the automotive sector, the growth rate would be slightly above 2%. In the absence of the above-mentioned support measures, this figure can be seen as an upper estimate of potential output growth.

3.3 Public finance projections

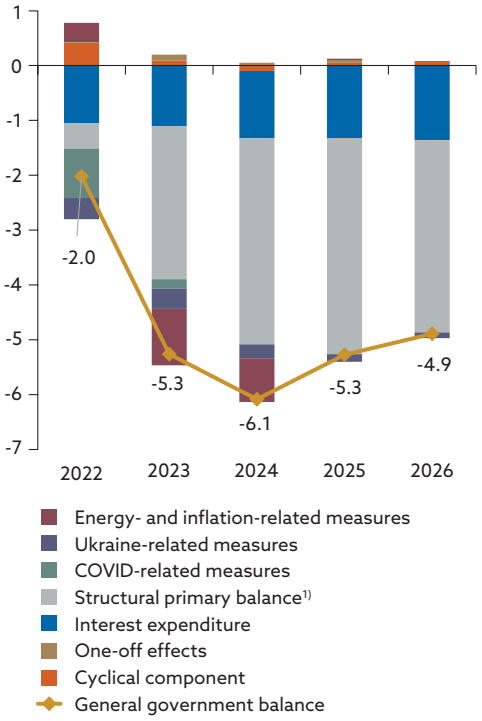
Slovakia's general government deficit for 2024 is projected to reach 6.1% of GDP, representing an increase of 0.8 pp from the already high level in 2023 (Chart 38). This deterioration is primarily structural in nature. Social expenditure growth will keep rising in 2024, owing in particular to the effects of high inflation in the previous year as well as to measures to increase old-age pensions in the current year. Further contributing negatively to the deficit is ongoing compensation for high energy prices, though its extent is lower compared with 2023. Other significant deficit-increasing items include expected deliveries of military equipment in 2024 and an increase in public debt servicing costs due to higher interest rates. In subsequent years, the expected unwinding of energy price compensation measures, coupled with ebbing inflation and the wrapping-up of some temporary social measures (related to family policy), will be reflected in a gradual improvement in the fiscal deficit, down to 4.9% of GDP in 2026.

Public debt in 2023 fell to 56.5% of GDP, according to initial estimates (Chart 40). However, the debt is expected to continue exceeding the upper limit of the debt brake.[6] The upward impact of the fiscal deficit (less interest costs) on last year's public debt growth was 4 pp. This effect was

[6] For 2023, the upper limit of sanction bands under the debt brake regime was 54% of GDP. Under a transitional provision of the constitutional Fiscal Responsibility Act, the upper

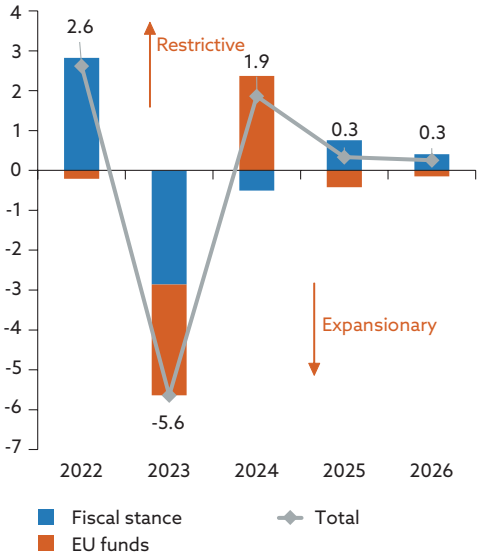
offset by nominal GPD growth, with the implicit interest rate still relatively low.[7] Partial financing from reserves also contributed to the improvement in the public debt, as a relatively high volume of liquid funds obviated the need to service the fiscal deficit entirely through the issuance of additional debt.

Chart 38
Decomposition of the general government balance (percentages of GDP)



Sources: SO SR, and NBS.
1) Excluding pandemic-, Ukraine- and energy-related measures.
Note: 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

Chart 39
Fiscal stance (percentage points of GDP)



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

Public debt is expected to rise above 60% in subsequent years, reflecting the impact of the fiscal deficit. At the end of the horizon, the debt should be almost 10 pp above the upper limit of the debt brake.[8] The expected consolidation of budget deficits is envisaged to ease government financing needs. Without additional measures, however, the pace of consolidation will not be sufficient to stop the debt from rising. The fading of the inflation

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.

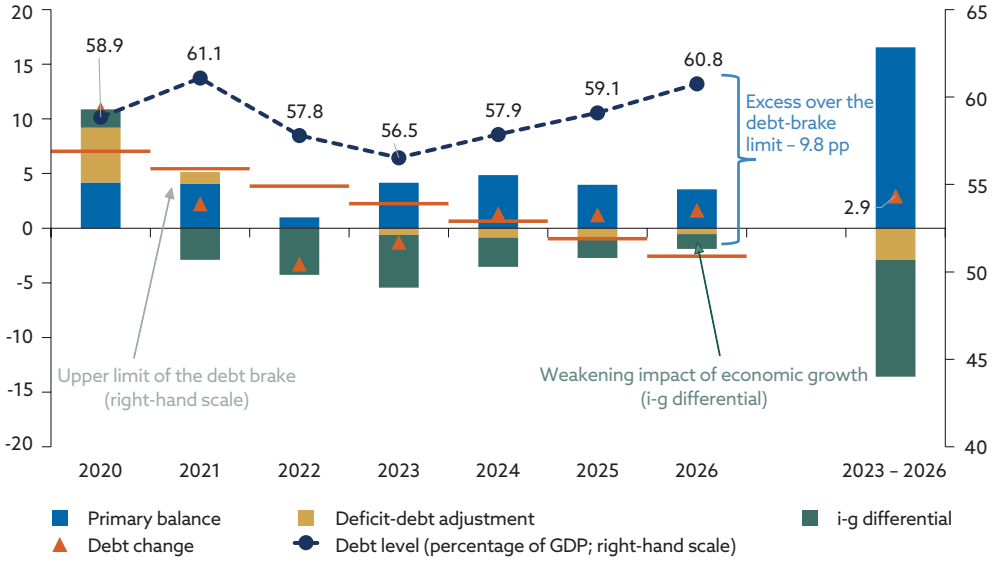
7 The implicit interest rate is calculated as the ratio of interest payments to debt in the previous year.

8 The upper debt-brake limit applicable to gross debt in 2026 is 51%.

shock is slowing down the economy's nominal growth. At the same time, the rising cost of new borrowing is making it more expensive to refinance maturing debt and to cover budget deficits. Hence, the downward impact of economic growth on public debt growth should gradually recede until it is no longer a factor.[9]

Chart 40

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



Source: 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.

Compared with the previous forecast, the deficit projection for 2024 has been revised down by 0.3 pp (Chart 41), with its improvement due mainly to lower energy price compensation and a postponement of military equipment deliveries until later years. By contrast, the deficit projections for 2025 and 2026 are worse than in the winter forecast, revised up respectively by 0.3 pp and 0.8 pp. This reflects our higher estimates for growth in social and healthcare expenditure, as well as the postponement of military equipment deliveries until those years. There is, however, also a downward impact on the deficit from the unwinding of energy price compensation, which is expected to be no longer in place in 2025.

[9] The difference between the implicit interest rate on public debt (i) and nominal GDP growth (g), known as the i-g differential, contributes to a decrease in the relative debt if g > i. Otherwise, economic growth cannot outweigh the impact of rising costs, and the debt builds up (a snowball effect). If the budget is in deficit, there is then a risk of debt spiralling up.

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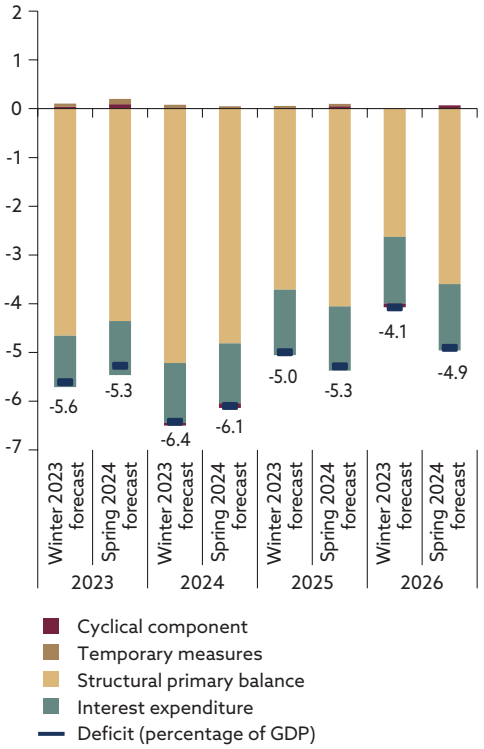
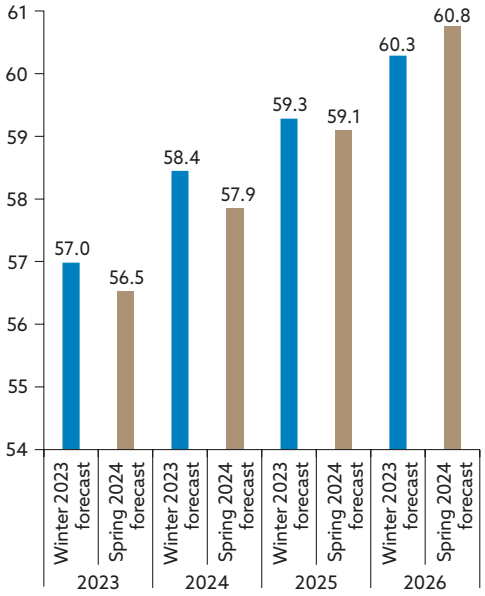
Chart 41
Comparison of projections for the deficit and its decomposition (percentages of GDP; percentage point contributions)



Source: NBS.

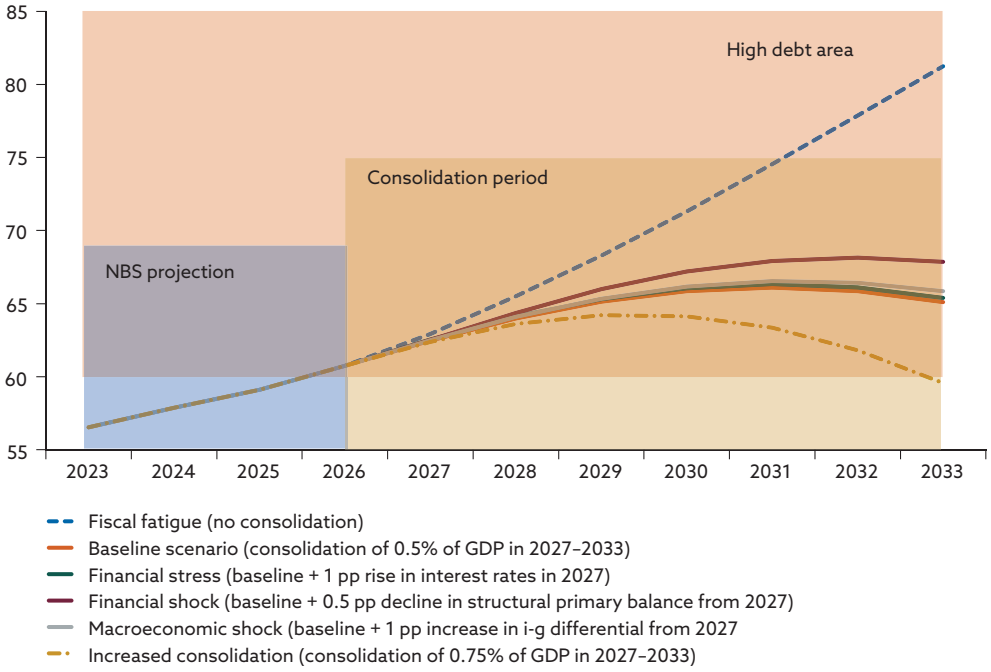
Chart 42
Comparison of public debt projections (percentages of GDP)



Sources: NBS.

Without additional consolidation measures within the projection horizon, it will take until the end of the decade for public debt to stabilise, even with the consolidation effort continuing beyond the current horizon. For the debt to stabilise, fiscal consolidation after 2026 must amount to at least 0.5% of GDP per year until 2033, in which case the debt ratio would not fall below 65% of GDP. For the debt to be brought below 60% of GDP, the fiscal deficit must improve at a rate of more than 0.75 pp of GDP per year, which would mean the budget moving into surplus in 2030. In the event of no further consolidation, i.e. 'fiscal fatigue', after 2026, public debt would spiral up to more than 80% of GDP in 2033 (Chart 43). Moreover, postponing consolidation does not allow provision for any unexpected adverse fiscal, macroeconomic or financial shocks. The possible adoption of additional consolidation measures in relation to the requirements of the new European fiscal rules represents a specific macro-fiscal risk that we discuss in more detail in Box 4.

Chart 43
General government gross debt under DSA[10] scenarios (percentages of GDP)



Source: NBS.

3.4 Risks to the forecast

Risks to the real economy outlook are tilted predominantly to the downside. The biggest risk stems from the necessary consolidation of public finances. The situation requires compliance with at least the minimum requirements of EU fiscal consolidation rules in the years ahead. If measures are taken to the necessary extent, there will be an impact on domestic demand and therefore a weakening of economic activity.

Another downside risk to the public finance outlook is the evolution of risk premia on government bonds. An increase in these premia would deplete public resources, with debt servicing costs rising at the expense of primary spending. The result would be higher debt growth and greater constraints on achieving consolidation targets.

Foreign demand also represents a downward risk to GDP growth. A faltering European economy may act as a drag on the recovery of Slovak exports. Failure to initiate the reforms needed to restore the

[10] 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.

competitiveness of European firms may adversely affect the domestic economy's performance.

A longer-term risk to the economic outlook is the transition to a low-carbon economy. Unless Slovakia catches up with current trends, it could in future lose promising economic sectors at the expense of potential GDP growth.

In addition, given Slovakia's long-standing difficulties in absorbing EU funds and in meeting disbursement targets, we see a risk that the uptake of EU funds under the Recovery and Resilience Facility and under the new programming period may be lower than projected.

The risks to inflation outlook lie mainly on the upside. The possibility of volatility in commodity markets, especially energy markets, cannot be ruled out, with any energy price increases potentially having an upward impact on headline inflation. Another upside risk is the inflationary impact of any additional consolidation that includes an increase in excise duties. As for downside risks, weaker-than-projected consumer and investment demand could have a dampening effect on inflation.

Box 4
Sensitivity analysis – additional consolidation scenario

To illustrate the potential impact of additional fiscal consolidation, we looked at the relatively extreme case of a more ambitious consolidation, where the general government deficit is reduced to below 3% of GDP by 2026 and the country's public debt ratio is consequently stabilised around its current level. The economic impact of such a scenario is appreciable, but it is also manageable given that both the domestic and external economies are expected to be in a recovery phase.

In the baseline fiscal scenario, the budget deficit is projected to decline slightly, remaining at above 3% of GDP by the end of the horizon. Meanwhile, public debt rises continuously on the back of a high budget deficit. Without additional consolidation, it would exceed the 80% level by the end of the ten-year horizon.[11]

Achieving fiscal targets in 2025 and 2026 will require additional consolidation measures. Faster consolidation will be necessary under new EU fiscal rules that are due to enter into force next year. These should take into account individual countries' specific macro-fiscal position. Countries exceeding the caps for the government debt (60% of GDP) and the government deficit (3% of GDP) are expected to adopt a medium-term fiscal structural plan

[11] Simulated using a debt sustainability analysis (DSA) tool.

based on a 'reference trajectory' submitted to the country by the European Commission.[12] The additional consolidation scenario envisages an ambitious four-year plan to consolidate the fiscal deficit by 1.7 pp from 2025[13] and to reduce the nominal deficit to below 3% in 2026.

Table A Fiscal deficit in the additional consolidation scenario

Code	Item	Unit	2023	2024	2025	2026
A	**General government balance – baseline scenario**	% of GDP	-5.3	-6.1	-5.3	-4.9
B	Structural primary balance (SPB) – baseline scenario		-4.4	-4.8	-4.1	-3.6
$C=B_{(t)}-B_{(t-1)}$	SPB consolidation – baseline scenario	pp of GDP			0.8	0.5
D	Required SPB consolidation				1.7	1.7
$E_{(t)}=D_{(t)}-C_{(t)}+E_{(t-1)}$	Additional consolidation				0.9	2.2
F=A+E	**General government balance – additional consolidation scenario**	% of GDP	-5.3	-6.1	-4.3	-2.7
H	Additional improvement in balance – unspecified consolidation measures	EUR m			1,300	3,200

Source: NBS.

In the additional consolidation scenario,[14] there are measures additional to the baseline scenario which amount to 0.9 pp of GDP in 2025, or 2.2 pp of GDP in 2025 and 2026 cumulatively. As a result, the deficit falls below the 3% threshold (to 2.7% of GDP) by the end of the horizon (Chart A). The revenue-increasing and expenditure-reducing measures that the government is required to take in this scenario amount, in nominal terms, to €1.3 billion in 2025 and €1.9 billion in 2026 (a cumulative €3.2 billion for the two years).

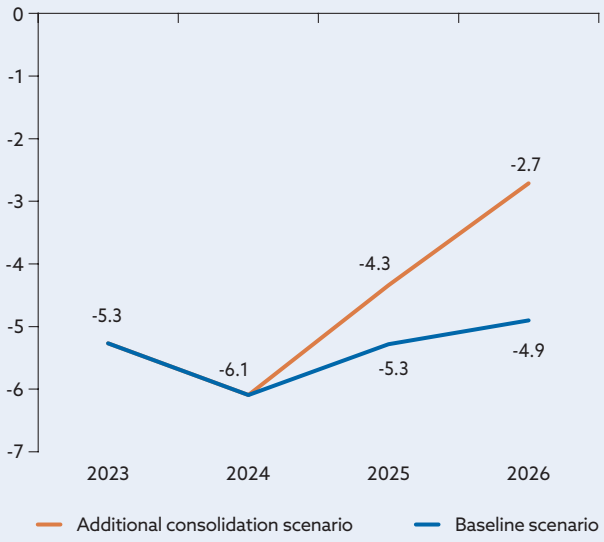
In this scenario, despite the major fiscal adjustment, the public debt ratio turns downward only in the latter part of the simulation horizon and then only slightly, reaching 58.0% of GDP in 2026 (Chart B). This is due to the response of the macroeconomic environment, which reacts to fiscal retrenchment by slowing economic growth. As a result of lower nominal GDP, the relative debt-to-GDP ratio declines more moderately.

[12] The fiscal adjustment path incorporated in the national plan is set for four years. Member States may ask for this period to be extended to seven years, if their national plan demonstrates a credible commitment to investment and structural reforms that increase the economy's resilience.

[13] This is NBS's assumption for assessing the projection risks associated with a stricter assessment of the fiscal structural plan and with the relatively rapid consolidation necessary to reduce debt sustainability risks. The actual required pace of consolidation and the potential spread of consolidation over seven years will depend on the final form of the EC's rules and assessment.

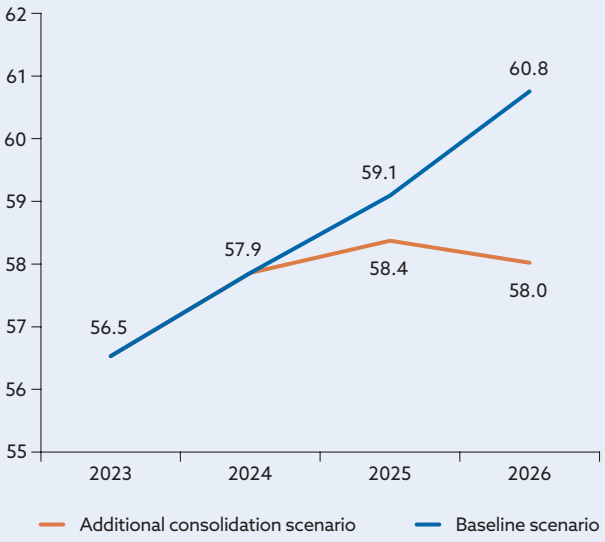
[14] In the additional consolidation scenario, the structure of measures is split 50:50 between revenue and expenditure. To simulate the macroeconomic response, the revenue-side measures were distributed within indirect taxes (VAT and excise duties). The expenditure savings were split between social transfers, wage expenditure, and purchases of goods and services.

Chart A
General government balance (percentages of GDP)



Source: NBS.

Chart B
General government gross debt (percentages of GDP)

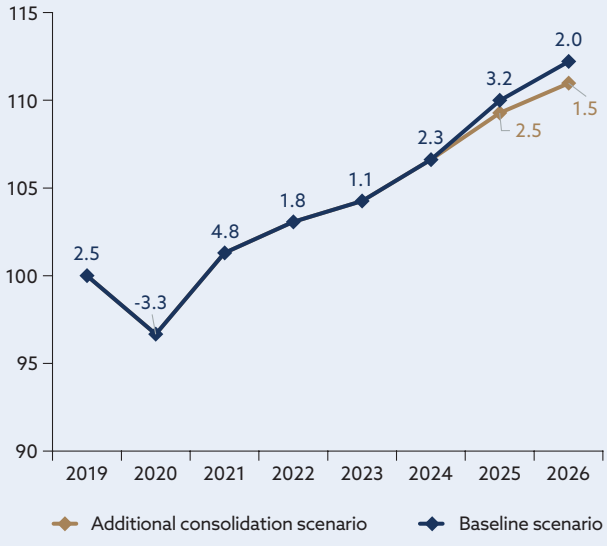


Source: NBS.

Effect of consolidation on macroeconomic developments

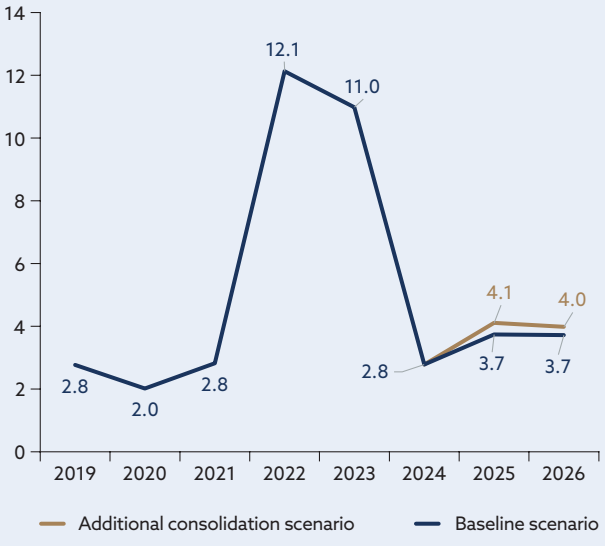
Real GDP growth in the additional consolidation scenario slows to 2.5% in 2025 and 1.5% in 2026, so the level of real GDP in 2026 is 1.1% lower compared with the baseline scenario (Chart C). Inflation is higher in both years as a result of the increase in excise duties (Chart D).

Chart C
Effect on real GDP (2019 = 100; figures next to the lines denote annual percentage change)



Source: NBS.

Chart D
Inflation profile (annual percentage changes)

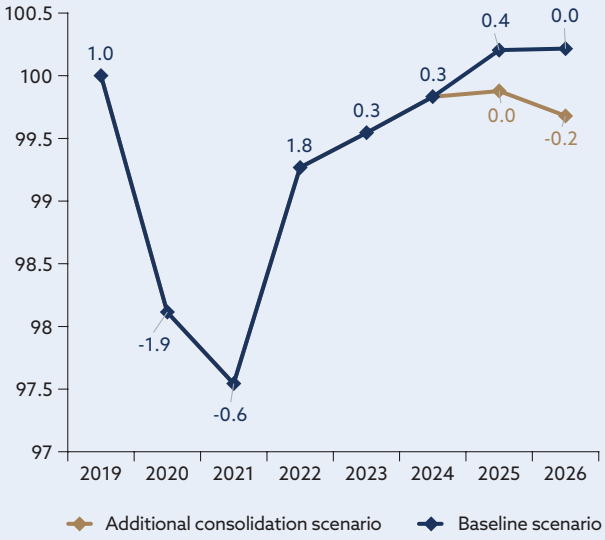


Source: NBS.

A weaker economy results in weaker labour market developments in the additional consolidation scenario (Chart E). The number of people in employment is lower in this scenario than in the baseline by 8,000 in 2025 and by 13,000 in 2026 (Chart F).

Chart E

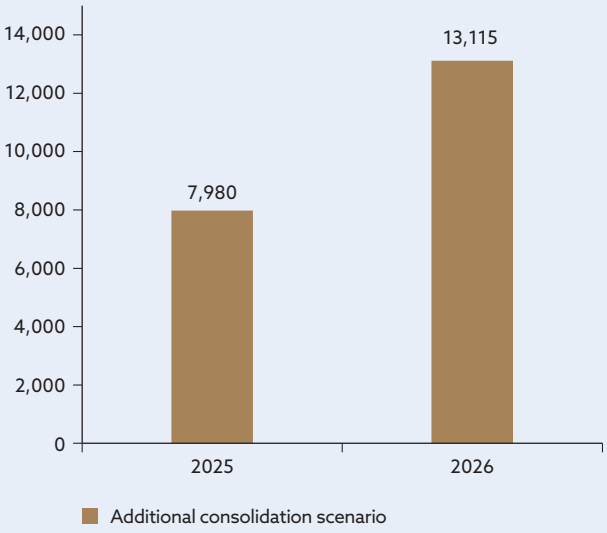
Effect on employment (2019 = 100; figures next to the lines denote annual percentage change)



Source: NBS.

Chart F

Difference between the additional consolidation and baseline scenarios in terms of the number of employed people in the given year



Source: NBS.

Table 5 Forecast for key macroeconomic indicators

Spring 2024 forecast (MTF-2024Q1)

Indicator	Unit	Actual data	Spring 2024 forecast (MTF-2024Q1)			Difference vis-à-vis the winter 2023 forecast (MTF-2023Q4)		
		2023	2024	2025	2026	2024	2025	2026
Price developments								
HICP inflation	annual percentage change	11.0	2.8	3.7	3.7	0.3	-0.9	-0.2
CPI inflation	annual percentage change	10.5	2.8	3.7	3.6	0.0	-0.8	-0.2
GDP deflator	annual percentage change	10.1	5.1	2.6	2.7	1.2	-0.2	-0.1
Economic activity								
Gross domestic product	annual percentage change, constant prices	1.1	2.3	3.2	2.0	-0.5	0.2	0.2
Private consumption	annual percentage change, constant prices	-2.3	0.6	2.0	1.6	-1.3	0.5	0.1
General government final consumption	annual percentage change, constant prices	-0.5	0.1	3.1	2.2	-0.7	0.0	0.5
Gross fixed capital formation	annual percentage change, constant prices	9.6	0.9	6.0	1.0	-3.7	2.9	1.6
Exports of goods and services	annual percentage change, constant prices	-0.9	4.2	4.2	3.4	-2.1	0.0	0.4
Imports of goods and services	annual percentage change, constant prices	-6.8	5.1	4.3	3.0	-3.1	0.9	0.7
Net exports	EUR millions at constant prices	6,734	6,242	6,438	7,006	740.6	65.4	-211.2
Output gap	percentage of potential output	0.1	-0.4	0.2	0.2	-0.2	0.1	0.5
Gross domestic product	EUR millions at current prices	122,156	131,238	138,857	145,496	1,069.9	1,155.6	1,393.1
Labour market								
Employment	thousands of persons, ESA 2010	2,434	2,441	2,450	2,450	-3.7	-1.8	-2.1
Employment	annual percentage change, ESA 2010	0.3	0.3	0.4	0.0	-0.1	0.1	0.0
Number of unemployed	thousands of persons, LFS [1]	162	152	145	145	0.3	1.8	1.2
Unemployment rate	percentage	5.8	5.5	5.3	5.3	0.0	0.1	0.1
NAIRU estimate [2]	percentage	6.2	6.1	6.1	6.1	0.0	0.0	0.0
Labour productivity [3]	annual percentage change	0.9	2.0	2.8	2.0	-0.4	0.1	0.2
Nominal productivity [4]	annual percentage change	11.1	7.1	5.4	4.8	0.6	-0.1	0.2
Nominal compensation per employee	annual percentage change, ESA 2010	9.1	7.2	5.3	5.1	0.3	-0.5	-0.1
Nominal wages [5]	annual percentage change	9.1	7.2	5.3	5.1	0.3	-0.6	-0.1
Real wages [6]	annual percentage change	-1.3	4.3	1.5	1.4	0.3	0.4	0.0
Households and non-profit institutions serving households								
Disposable income	annual percentage change, constant prices	-3.2	3.6	1.0	1.2	0.1	0.4	0.3
Saving ratio [7]	percentage of disposable income	4.4	7.2	6.3	5.9	1.1	1.1	1.2
General government sector [8]								
Total revenue	percentage of GDP	41.8	39.9	39.5	39.4	-0.3	-0.3	-0.4
Total expenditure	percentage of GDP	47.1	46.0	44.8	44.3	-0.6	0.0	0.4
General government balance [9]	percentage of GDP	-5.3	-6.1	-5.3	-4.9	0.3	-0.3	-0.8
Cyclical component	percentage of trend GDP	0.1	-0.1	0.1	0.1	0.0	0.0	0.1
Structural balance	percentage of trend GDP	-5.5	-6.0	-5.4	-5.0	0.4	-0.3	-1.0
Cyclically adjusted primary balance	percentage of trend GDP	-4.3	-4.8	-4.0	-3.6	0.4	-0.3	-1.0
Fiscal stance [10]	annual percentage point change	-2.9	-0.5	0.8	0.4	0.0	-0.7	-0.6
General government gross debt	percentage of GDP	56.5	57.9	59.1	60.8	-0.6	-0.2	0.5

Table 5 Forecast for key macroeconomic indicators (continued)

Indicator	Unit	Actual data	Spring 2024 forecast (MTF-2024Q1)			Difference vis-à-vis the winter 2023 forecast (MTF-2023Q4)		
		2023	2024	2025	2026	2024	2025	2026
Balance of payments								
Goods balance	percentage of GDP	1.3	0.8	0.5	0.9	0.6	-0.4	-0.8
Current account	percentage of GDP	-1.6	-1.9	-2.0	-1.4	0.3	-0.6	-1.0
External environment and technical assumptions								
Slovakia's foreign demand	annual percentage change	-1.3	1.5	3.4	3.4	-0.9	0.1	0.1
USD/EUR exchange rate [11), 12)]	level	1.08	1.08	1.08	1.08	0.1	0.1	0.1
Oil price in USD [11), 12)]	level	83.7	81.4	76.0	72.8	1.6	-0.8	-1.1
Oil price in USD [11)]	annual percentage change	-19.2	-2.8	-6.6	-4.1	1.8	-2.2	-0.3
Oil price in EUR [11)]	annual percentage change	-21.3	-3.2	-6.6	-4.1	1.8	-2.2	-0.3
Non-energy commodity prices in USD	annual percentage change	-12.5	0.6	2.0	0.1	2.9	-0.4	-1.6
Three-month EURIBOR	percentage per annum	3.4	3.4	2.4	2.4	-0.2	-0.4	-0.3
Ten-year Slovak government bond yield	percentage	3.6	3.5	3.5	3.5	-0.3	-0.3	-0.3

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/