SLOVAK REPUBLIC

The economy rebounded strongly in 2010, and is expected to continue to do so in 2011, driven by strong external demand and business investment. Household consumption, however, will be damped by fiscal consolidation and persistent high unemployment. Growth should be more balanced in 2012, not least due to more favourable labour market developments.

The fiscal deficit is projected to fall to around 4% of GDP in 2012 owing to planned consolidation measures. Efforts will be appropriately concentrated on the expenditure side. Recently announced reforms of the pension system, in particular the introduction of stabilisation mechanisms in the first pillar, are welcome as they will reduce future increases in ageing-related spending.

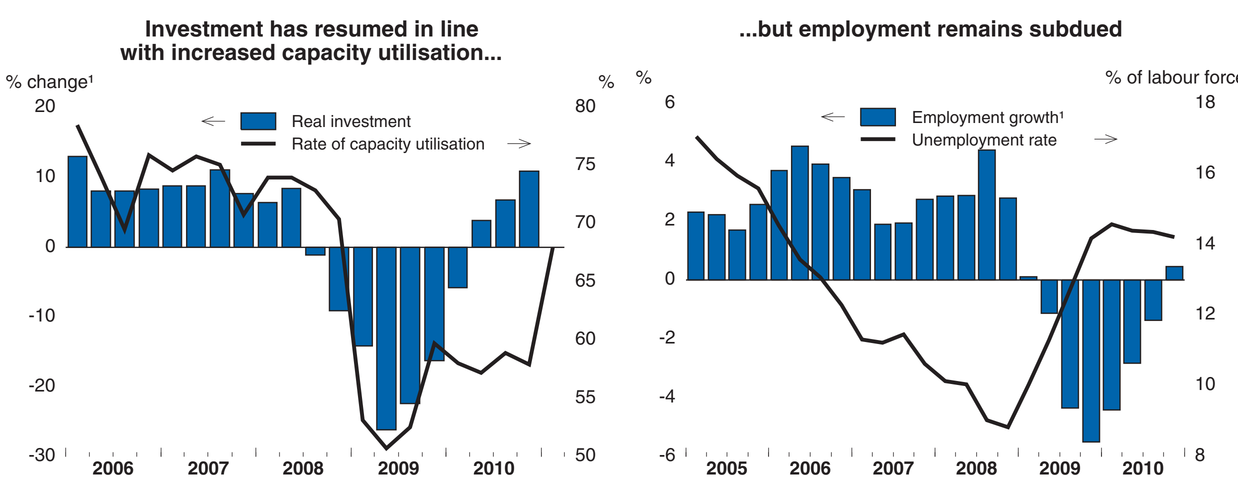
Economic activity has recovered strongly…

Economic growth in 2010 was the fastest among euro area countries and real GDP has returned to its pre-crisis level. This mostly reflects buoyant world trade, in particular strong growth in Germany. Business investment also rebounded, reflecting an improvement in business climate and an increase in capacity utilisation, which is converging to its long-term average. By contrast, household consumption growth remained subdued on the back of continued weakness in employment growth and public expenditures began to decline in the last quarter of 2010, reflecting the start of consolidation measures.

… but is expected to slow down in the short run

Recent indicators suggest that the recovery will continue, but at a slower pace over the coming months. Business confidence in the main trading partners has recently weakened, suggesting that external demand will slow somewhat. In addition, consumer confidence has continued to worsen and retail sales have increased only slightly. Employment remained weak and inflation rose significantly mainly due to increases in

Slovak Republic



1. Year-on-year percentage change.

Source: OECD Economic Outlook 89 database; OECD, Main Economic Indicators database.

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Slovak Republic: **Demand, output and prices**

	2007	2008	2009	2010	2011	2012
	Current prices € billion	Percentage changes, volume (2000 prices)				
GDP at market prices	61.6	5.8	-4.8	4.0	3.6	4.4
Private consumption	34.5	6.2	0.3	-0.3	0.4	3.0
Government consumption	10.6	6.1	5.6	0.1	-3.6	0.3
Gross fixed capital formation	16.1	1.0	-19.9	3.6	6.7	7.1
Final domestic demand	61.2	4.8	-3.8	0.6	0.9	3.4
Stockbuilding[1]	1.0	1.1	-3.6	1.8	0.3	0.0
Total domestic demand	62.2	5.8	-7.3	2.4	1.2	3.3
Exports of goods and services	53.4	3.1	-15.9	16.4	10.4	7.8
Imports of goods and services	54.1	3.1	-18.6	14.9	7.4	6.5
Net exports[1]	- 0.7	0.0	2.6	1.0	2.4	1.1
Memorandum items						
GDP deflator	_	2.9	-1.2	0.5	1.9	2.6
Harmonised index of consumer prices	_	3.9	0.9	0.7	3.9	2.9
Private consumption deflator	_	4.5	0.1	0.9	3.9	2.9
Unemployment rate	_	9.5	12.1	14.4	13.8	12.8
General government financial balance[2]	_	-2.1	-8.0	-7.9	-5.1	-4.0
Current account balance[2]	_	-6.6	-3.2	-3.5	-2.4	-1.3

Note: National accounts are based on official chain-linked data. This introduces a discrepancy in the identity between real demand components and GDP. For further details see *OECD Economic Outlook* Sources and Methods *(http://www.oecd.org/eco/sources-and-methods).*

1. Contributions to changes in real GDP (percentage of real GDP in previous year), actual amount in the first column.
2. As a percentage of GDP.

Source: OECD Economic Outlook 89 database.

StatLink http://dx.doi.org/10.1787/888932431065

food and energy prices and a hike in VAT and excise duties. This has weighed on households' purchasing power.

Fiscal consolidation and unemployment will weigh on consumption

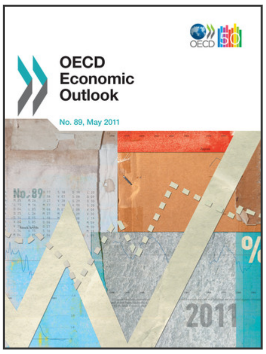
The main feature of the projection is the weakness in private consumption in 2011, which reflects fiscal consolidation measures and a slow recovery of employment. The government plans ambitious cuts in the budget deficit in 2011 and 2012 to reach its target of 2.9% of GDP in 2013. In 2011, the consolidation package should amount to around 2.5% of GDP, 60% coming from public expenditure cuts, which will weaken domestic demand. In particular, the planned 10% cut in public wage costs, to be achieved both through layoffs and cuts in remuneration, already has had a negative impact on the labour market. Unemployment rose somewhat further at the beginning of the year, suggesting that layoffs in the public sector exceeded employment gains in the private sector. Together with the increase in hours worked per employee, this will damp the overall employment response during the recovery. As a result, unemployment is expected to decline only slowly in 2011 overall and is likely to induce a certain level of wage moderation and a stagnation in real household disposal income.

Investment will add to the export-driven recovery

Annual GDP growth is projected to slow from 4% in 2010 to 3.6% in 2011. Growth will continue to be mainly driven by exports, as foreign demand is expected to remain strong. In addition, low increases in worker compensation will maintain cost competitiveness of exporting firms. While the partial cancellation of public-private-partnership projects for motorway construction may lower public investment expenditure, announced private investments, in particular in the automotive sector, should boost gross capital formation. Favourable monetary conditions will also sustain investment growth. In 2012, growth is expected to bounce back and reach 4.4% as less fiscal tightening is budgeted and a more progressive employment recovery will trigger a rebound in domestic consumption. While headline inflation will be pushed up in the short run by increases in commodity prices, underlying inflationary pressures are expected to be limited as the output gap remains negative.

Substantial risks remain

As the economy is highly sensitive to the external environment, the main risks relate to growth of its trading partners. A further rise in commodity prices could lead to a weaker-than-projected GDP growth outcome over the projection horizon. Regarding internal risks, employment could accelerate more than expected, which would stimulate consumption.



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