27th June 2024

A consumption-driven economy

Macroeconomic forecast for years 2024 – 2028

IFP Team

The Slovak economy has been recovering after the price shock. Real GDP is forecast to grow by 2.5 per cent in 2024, supported mainly by domestic demand. Rising real wages will boost household consumption, while investment activity will slow after EU funds' projects have been completed. Labour market tightness will persist with the unemployment rate reaching a historical minimum. However, increased early retirements will shrink the labour force. GDP is set to grow by 2.6 per cent in 2025 as household consumption will be replaced by the implementation of projects from the EU Recovery and Resilience Plan. A revival in world trade will lead to higher foreign demand next year, boosting subdued Slovak exports and industry performance. The risks to the forecast are rather skewed to the downside: (i) the ability to complete the Recovery Plan projects on time is in question as well as (ii) a possible slowdown in world trade due to the onset of protectionism in the global economy.

In 2024, the economy is driven by domestic demand

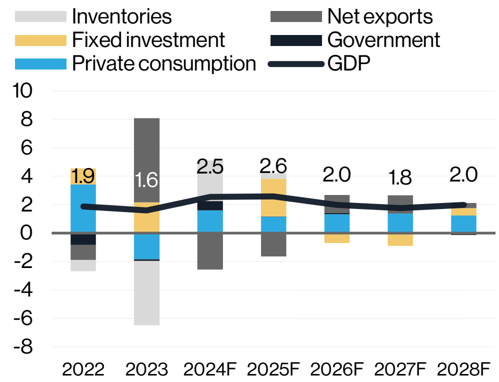
In 2024, domestic demand will recover due to the deceleration of inflation and the economy is set to grow by 2.5 per cent. After a period of stagnation and slumps, household consumption finally recovered and grew by 3 per cent year-on-year. Room for recovery was created by milder inflation and brisk income growth. We expect household consumption to evolve in line with the wage growth throughout the year which will alleviate the pressure on households‘ depleted savings.

Government consumption has been supported in 2024 by last year's wage indexations and will be pushed up additionally by healthcare spending. Investment from EU funds reached a record high last year due to the ending of the programming period and will therefore be significantly lower in 2024. However, they will be replaced by investment in the automotive industry (notably Volvo), military spending and the launch of a stronger Recovery and Resilience Plan (RRP) uptake.

Net exports will not contribute significantly to economic growth this year. Yet, the foreign demand has been improving only slowly and the outlook for our trading partners suggests growth of foreign trade of only 1.3 per cent this year. The economic development of our trading partners is being held back by competition with China and a euro appreciation, while the already easing monetary conditions in the euro area is a tailwind for the recovery.

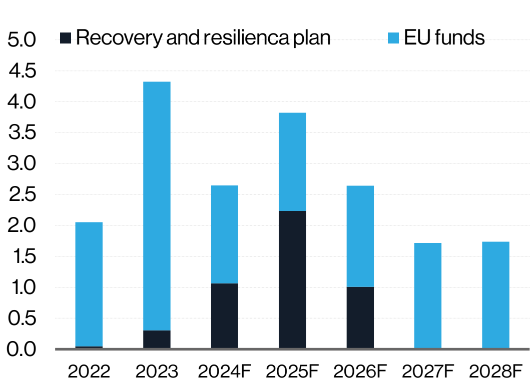
Investments will thrive in 2025

Figure 1: Contributions to GDP growth (constant prices, p.p.)



Source: SO SR, IFP

Figure 2: Planned volume of EU funds (per cent of GDP)



Source: IFP

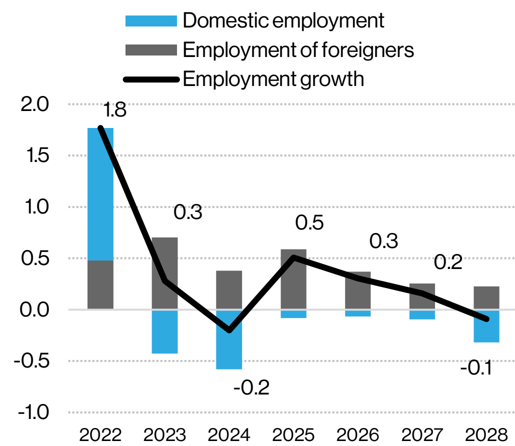
The economy will grow in 2025 thanks to the gradual implementation of projects financed by the RRP with GDP increasing by 2.6 per cent. Economic developments will be partly dampened by the consolidation of public finances which path was presented in the Stability Programme. In our forecast, we adopt a technical assumption for regulated household gas price growth, but we expect the government to introduce measures to moderate gas price growth by the end of the year. Therefore, in our forecast, we assume that the rise in gas prices to match the market levels in 2025 will slightly slow down the growth in household consumption. Exports of goods will pick up due to the recovery of the economies of our trading partners, boosting the overall performance. Foreign workers will continue to support the economy as well.

Back to normal in 2026 – but labour force continues to decliine

In 2026-2028, the growth of the Slovak economy will arise from two main sources - a combination of strong foreign and domestic demand. Economic growth will converge to the potential output growth pace on the horizon reaching values close to 2 per cent. Inflation will stabilise at its equilibrium level of around 2.5 per cent and the growth of real household incomes will continue despite the consolidation of public finances. Wage growth will be supported by persisting labour market tightness, from which domestic workers will increasingly retire. An additional boost to the economy will come from the expansion of the automotive export capacity, which will substantially boost exports in particular.

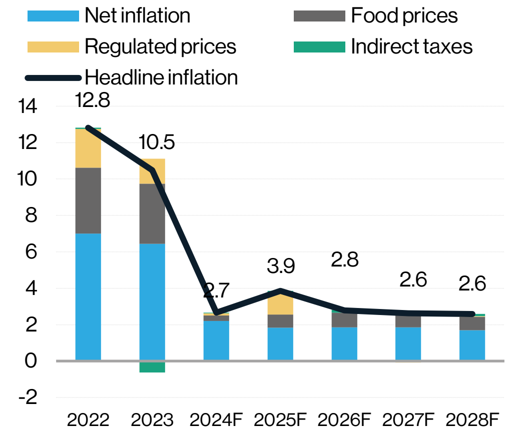
The downside risks to the forecast outweigh the upside risks. The potential for conflict in Ukraine to destabilise prices or production is still present globally. Domestically, weaker absorption of RRP funds remains a risk. The outcome of the US elections or trade disputes with China may affect the degree of protectionism in trade relations with the EU. On the other hand, the stronger integration of foreigners into the domestic labour market represents a positive risk.

Figure 3: Contributions of domestic and foreign workers to ESA employment (p. p.)



Source: SO SR, IFP

Figure 4: Contributions to inflation rate (p.p.)



Source: SO SR, IFP

The temporary decline of employment

Employment will decrease this year due to elevated early retirees. We expect the most significant declines in physically demanding industries such as manufacturing, but also in trade, transport, warehousing and administrative services. Despite this shortfall in the labour force, the labour market is managing to attract inactive and discouraged workers. The participation rate of Slovaks in the labour market has never been higher. At the same time, the number of foreigners working in the labour market is growing, with more than 105 000 already working in the country. The unemployment rate will fall to 5.5 per cent in this period, the lowest in 30 years.

Employment will return to growth in 2025. Not only domestic workers but also foreign workers, whose recruitment should become easier from the middle of this year, will help to fill the shortage of employees intensified by early retirements. Job creation will also be boosted by a pickup in the use of RRP resources in the economy, in addition to a rebound in foreign and domestic demand. The unemployment rate will decrease towards 5 per cent at the end of the forecast horizon.

Real wage growth will exceed 4 per cent

Real wages will increase this year by 4.2 per cent, the most in 5 years. Nominal wage growth will moderate year-on-year, along with lower productivity growth, inflation and backwards indexation. September's tariff indexation coupled with the automatic wage increases for health workers, translated into double-digit public sector wage growth in the early part of the year. Thus, the public sector will again outpace the private sector in the pace of wage growth this year. In the coming years, wage dynamics will be supported mainly by a shortage of workers. However, wages will increase at a slower pace in line with more moderate price and labour productivity growth. Real wage growth will remain above 2 per cent over the entire horizon from 2025 onwards.

Inflation dips below 3 per cent

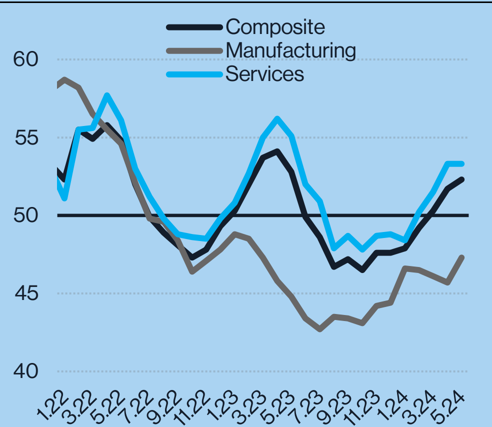
Consumer inflation will slow below 3 per cent in 2024 and the price shock will subside. Inflation has been declining since last April and will continue to do so in 2024. Year-on-year price growth bottomed out in April, and we expect a modest increase in the months ahead. Low price growth was also ensured by the continuation of subsidies for household energy prices, which have not risen this year. Food prices have stabilised after sharp increases in the previous two years, while prices of tradable goods and services have slowed as well.

Price growth will accelerate slightly in 2025. The new decree of the Regulatory Office for Network Industries will lead to electricity prices for households remaining unchanged in the medium term. For the price of heat, we expect a gradual increase spread over several years. In the case of gas, we technically expect a return to the market price, which represents an increase of around a quarter of the current subsidised level. But it is very likely that the government measures introduced in the coming months will allow this rise to be pushed as low as possible. Developments in the futures markets suggest a decline in energy commodity prices in the coming years. In the medium term, therefore, we can expect the price of gas to fall, which will put a brake on inflation. Once the inflation shocks subside and the base effect wears off, we expect food and tradable goods prices to return to the average growth rates seen in 2017-20. Services prices will rise faster, but overall price level growth will be dampened by consolidation of public finances over the medium term.

BOX 1: External environment assumptions

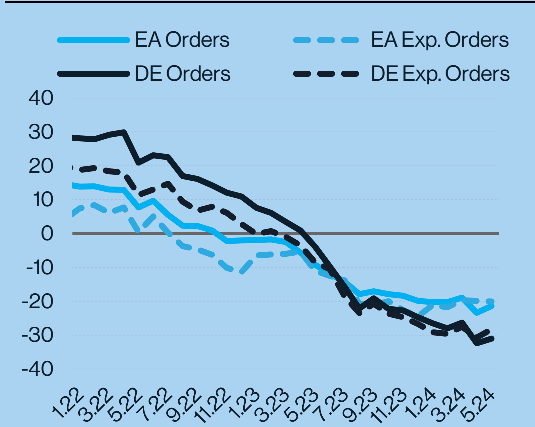
Developments abroad brought several positive surprises in the first quarter of 2024. Economic performance in both the euro area and Germany slightly exceeded expectations, but industry remained subdued. However, the steady decline in inflation across Europe gives hope for continued monetary easing, which the ECB started in early June by cutting key interest rates by 0.25 bp. This should support economic growth in the euro area in months to come. However, recent developments in shipping prices, influenced by geopolitical conflicts in the Middle East pose a risk for the development. A possible return of inflationary pressures would negatively affect the pace of the ongoing recovery.

Figure A: Recovery in the euro area continues (Purchasing Managers' Index, values above 50 = expansion)



Source: Bloomberg, IFP

Figure B: Manufacturing is still under pressure (manufacturing orders in the euro area and Germany, ESI, points)

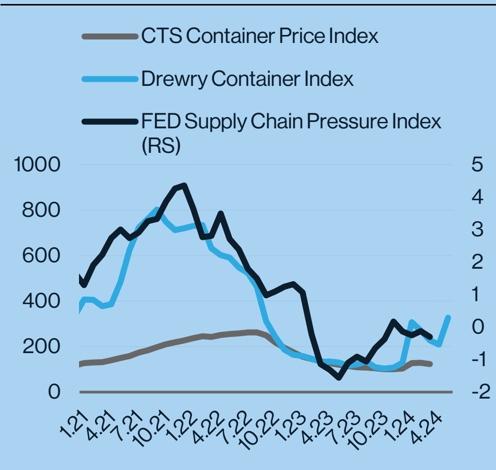


Source: EK, IFP

The euro area economy is showing signs of acceleration after last year's very moderate growth rate. The recovery is undergoing mainly in the services sector, benefiting countries in the European South such as Italy and Spain. In contrast, GDP numbers in countries with a larger industrial sector, such as the Czech Republic and Austria, surprised negatively in the first quarter. However, high-frequency indicators suggest that

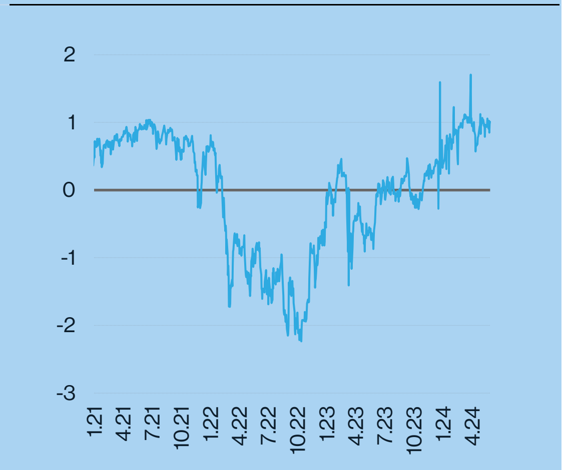
the situation in the industrial sector is beginning to stabilise and the degree of optimism among managers in the sector is rising. This is also due to rising demand from China and the US, which continue to perform well. Expectations of further monetary easing at home and around the world, which should boost subdued investment activity, are also supporting the optimism.

Figure C: Freight prices are on the rise once again (Container shipping prices, indexed and FED GSCPI)



Source: Bloomberg, IFP

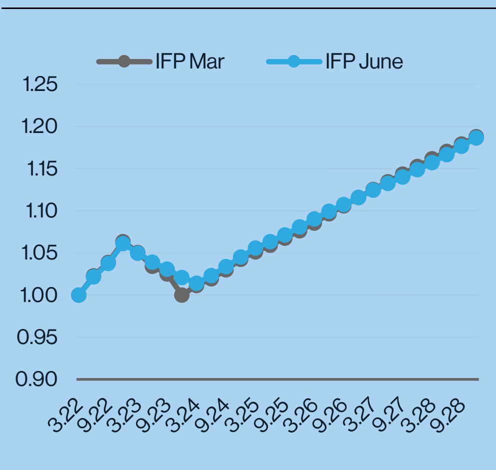
Figure D: Easing financial conditions will support the recovery (Euro area financial conditions index, positive values = easing financial conditions)



Source: Bloomberg, IFP

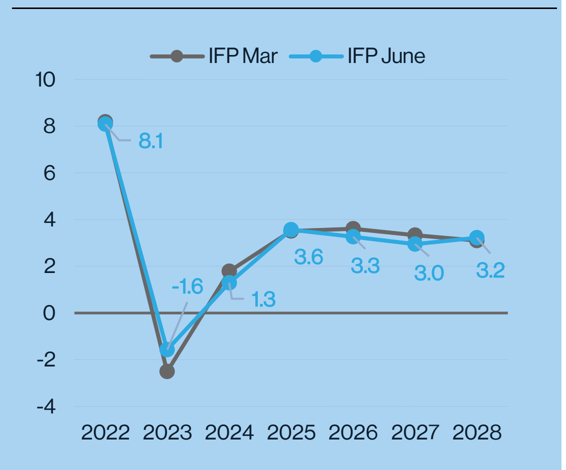
Foreign demand will accelerate in the coming years. The recovery in the world economy will affect our trading partners as well and support the growth of domestic exports. They should reach their peak in 2025, when the inflation shock will have been fully accommodated and financing conditions will have steadily eased. Growth will accelerate especially in our close neighbours in the V3 region. Risks to this development are the ongoing geopolitical tensions, which are causing both rising shipping freight rates and volatile energy commodity prices, which may renew inflationary pressures and thus put the brakes on the ongoing recovery.

Figure E: External demand meets the expectations
(weigh. ind. of ex. dem., level, indexed)



Source: IFP

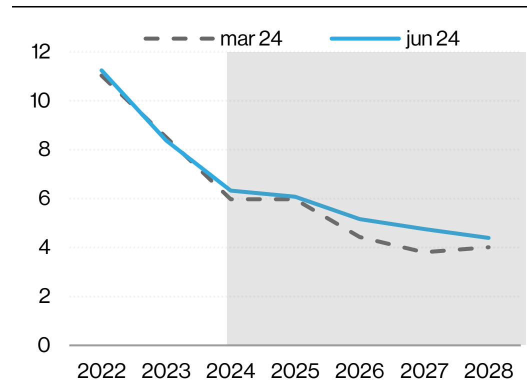
Figure F: Recovery will culminate in 2025
(yoy, weigh. ind. of ex. dem., per cent)



Source: IFP

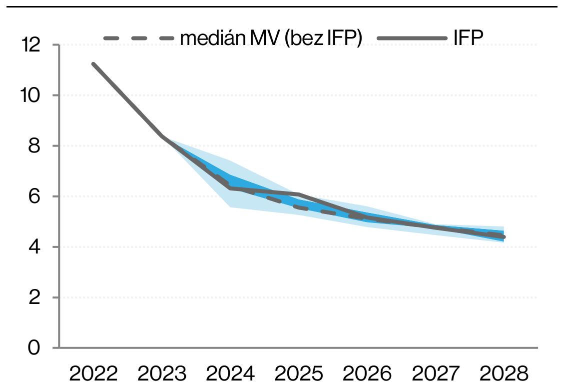
The update of the Ministry of Finance's macroeconomic forecast was the subject of a meeting of the Committee for Macroeconomic Forecast on 14 June 2024. **The forecast was assessed as realistic by the majority of the Committee members** (NBS, SAV, RRZ, Tatrabanka, Infostat, Unicredit, VÚB a ČSOB), **SLSP considers the forecast to be optimistic.** The forecast update as well as the minutes of the Macroeconomic Forecast Committee and the background materials are available on the IFP website.

Figure 5: Evolution of macroeconomic bases compared to the previous forecast (growth, per cent)



Source: IFP

Figure 6: Comparison of tax bases forecasts[1] by members of the MFC (growth, per cent)



Source: IFP

[1] Macroeconomic bases for budget revenues (weight of indicators depends on a proportional share of particular taxes on total tax revenues): Wage base (employment + nominal wage) – 55.9 per cent; Nominal private consumption – 24.4 per cent; Real private consumption – 4.2 per cent; Nominal GDP growth – 10.6 per cent; Real GDP growth – 4.9 per cent..

MF SR FORECAST – MAIN ECONOMIC INDICATORS (June 2024)

indicator (growth in per cent unless otherwise noted)		forecast					difference (March 2024)					
	2023	2024	2025	2026	2027	2028	2023	2024	2025	2026	2027	2028
Gross Domestic Product												
GDP, real	1.6	2.5	2.6	2.0	1.8	2.0	0.4	0.6	-0.5	-0.3	0.1	-0.1
GDP, nominal (bn. €)	11.9	7.2	6.7	4.8	4.5	4.8	0.5	0.2	-0.1	0.1	0.6	0.5
Private consumption, real	-3.2	2.9	2.1	2.4	2.5	2.2	-0.7	0.6	-0.2	0.5	0.8	0.4
Private consumption, nominal	6.8	6.1	6.2	5.3	5.2	4.9	-0.8	0.0	-0.1	1.2	1.3	0.8
Government spending	-0.6	3.8	0.2	0.5	-0.6	-0.8	-0.1	1.9	-1.0	-0.3	0.0	-0.8
Fixed investment	10.6	-0.1	12.2	-3.0	-3.5	2.4	1.0	1.5	1.5	-1.6	0.3	0.6
Export of goods and services	-1.4	2.1	3.1	4.4	4.5	3.1	0.0	-0.6	0.0	-0.1	0.0	-0.1
Import of goods and services	-7.6	5.3	5.1	3.2	3.4	2.9	-0.1	-1.1	0.4	0.1	0.4	0.3
Labour market												
Registered employment	0.2	-0.1	0.5	0.3	0.2	-0.1	0.0	-0.2	-0.2	-0.2	0.1	0.1
Wages, nominal	9.7	7.0	6.1	5.4	4.9	4.6	0.0	0.7	0.6	1.0	0.9	0.1
Wages, real	-0.7	4.2	2.1	2.5	2.2	2.0	0.1	1.0	0.7	0.5	0.4	-0.2
Unemployment rate	5.8	5.5	5.2	5.1	5.0	5.0	0.0	-0.1	-0.1	0.0	0.0	0.0
Inflation												
CPI	10.5	2.7	3.9	2.8	2.6	2.6	0.0	-0.4	-0.1	0.5	0.4	0.3

Source: SO SR, IFP

Preliminary plan of RRP allocation (mil. EUR, excl. VAT, ESA2010)

	2022	2023	2024	2025	2026
RRP Total	**49**	**374**	**1 391**	**3 115**	**1 475**
Public investment	2	81	779	2 120	1 096
Compensations	27	38	138	152	64
Intermediate consumption	13	25	94	93	30
Soc. transfers in kind	0	2	13	5	0
Social transfers	4	9	30	30	0
GFCG firms	3	39	252	618	183
GFCG households	0	180	86	97	102

Source: IFP