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RRP investment heatwave

Macroeconomic forecast for years 2024 – 2028

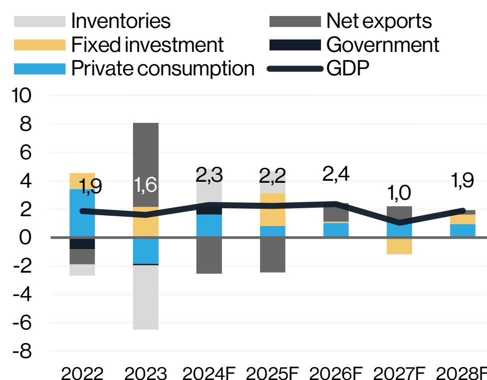
IFP Team

The Slovak economy will grow by 2.3 per cent in 2024 supported mainly by domestic demand. Real incomes of the population will rise significantly after the price shock wears off, which will be reflected in household consumption. Investment activity will shift to the private sector, but overall fixed capital formation will stagnate due to a slower take-up of new EU funds. GDP will grow by 2.2 per cent in 2025, mainly due to the absorption of Recovery and Resilience Plan (RRP) resources. The pace of job creation will decelerate while unemployment will reach historically low levels. Accelerating inflation will dampen household consumption, but exports will be supported by the euro area's economic recovery. Economic growth will peak at 2.4 per cent in 2026, thanks to continued absorption from the RRP. The risk to the forecast is skewed to the downside by possible (i) delay and incomplete finalization of RRP projects and (ii) a slowdown in world trade due to the onset of protectionism in the global economy.

Domestic demand driven growth in 2024

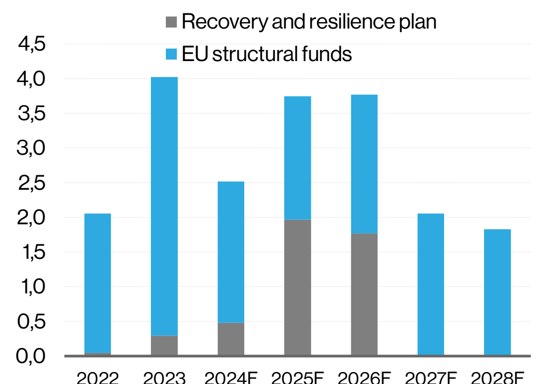
Slovakia's GDP will grow by 2.3 per cent in 2024, the economy will be supported mainly by domestic demand. Supported by the dissipating price shock, the real incomes of the population have strengthened this year. Household consumption has been rising sharply after last year's decline. After the exhaustion of EU funds, investment activity has shifted from the public sector to the private sector. Overall capital formation has been stagnating with the slow run-up of the new EU structural funds programming period. Foreign demand is to remain subdued as an industry in the Eurozone has been underperforming and Chinese demand remains weak. The labour market will be stable with job creation stagnating. Demand for labour will remain high and constrained a by declining supply of labour forces, mainly due to higher numbers of early retirements.

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



Source: SO SR, IFP

Figure 2: Funds from EU (per cent of GDP)



Source: IFP

In 2025, GDP will increase by 2.2 per cent, driven by resources from the RRP. Investment generation will accelerate to double-digit growth not only due to RRP but also supported by military equipment imports. Falling interest rates will boost investment activity as well, supporting the employment growth and reducing the unemployment rate to an all-time low. Unfavourable demographic developments will dampen labour supply and the

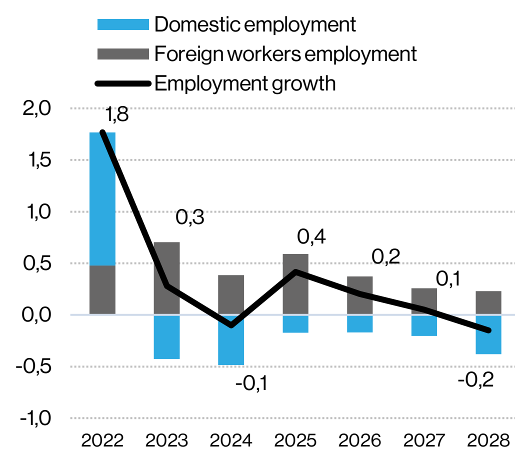
economy's potential will rely on capital resources. Household consumption will moderate under the pressure of higher inflation. Consumer prices will be pushed up by rising energy prices and higher value-added tax as part of the planned consolidation. Exports will start to recover along with demand in the euro area, but the overall trade balance will be dampened by increased imports of capital goods.

In 2026, the drawdown of RRP resources will continue and economic growth will peak at 2.4 per cent. The Eurozone economy will pick up, reigniting the positive contribution of foreign trade to the Slovak economy after two years of decline. In 2027, the drawdown of RRP funds will come to an end, causing GDP growth to slow to around 1 per cent. On the other hand, the introduction of Volvo production will give a boost to the economy. In 2028, economic growth will accelerate above 2 per cent as investment activity stabilises. Over the entire forecast horizon, we expect the economy to operate slightly under its potential due to the planned consolidation of public finances.

Investments will flourish in 2025

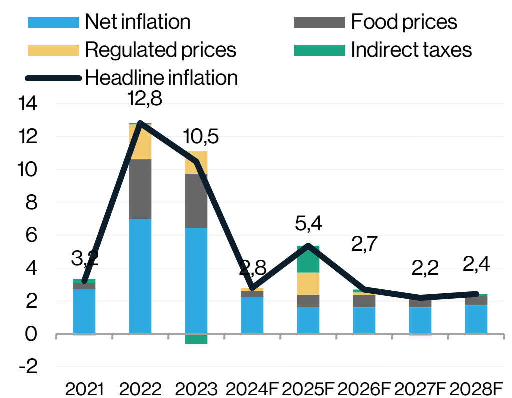
Current domestic and external economic developments are characterised by a high degree of uncertainty, with negative risks outweighing positive ones. Domestically, the lower uptake of the RRP may dampen employment and investment expectations. Geopolitical tensions may jeopardise the prospects for a recovery in external demand, in particular by restricting international trade routes or increasing global commodity prices. The risk of erecting trade barriers with China may intensify after the US elections and threaten the recovery of global trade and domestic exports.

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



Source: SO SR, IFP

Graf 4: Contributions to inflation (per cent)



Source: SO SR, IFP

Employment to decline moderately

Employment will decrease by 0.1 per cent in 2024, equivalent to around 3,000 jobs. The negative development reflects declines in the first half of the year, to which elevated early retirements contributed significantly. We expect increased amount od early retirement departures at the turn of this year and next year as well. Employment in industry and low-skilled services has been on a long-term decline. However, the public sector and construction are expected to see the fastest employment growth, building on the previous year's success despite the slower year-on-year absorption of EU funds. Nevertheless a temporary shortfall in the older workforce, participation rates are rising. The number of foreign workers is also increasing, reaching 110 000 in the summer. The unemployment rate will decline to 5.4 per cent, the lowest in 30 years.

In 2025, employment will increase by 0.4 per cent. The number of early retirements will fall slightly and the demand for labour will be boosted by the drawdown from the RRP as

well as by the recovery in economic activity abroad. On the other hand, public sector employment will drop by 1 per cent due to austerity measures. In the coming years, the effects of several factors will offset each other. The peak in the use of RRP resources and the new investment activity (Volvo Car Slovakia, s.r.o. and Gotion, officially GIB EnergyX Slovakia s.r.o.) will be growth-enhancing, while fiscal measures aimed at consolidating public finances will detract from performance. The declining supply of domestic labour due to demographics will be outweighed by the number of workers coming from abroad. The unemployment rate will decline towards 5 per cent at the end of the forecast horizon.

The fastest growth of real wages in 4 years

Real wages will rise by 4 per cent in 2024, the highest rate in four years. Nominal wage increases will slow slightly year-on-year, along with weaker productivity growth, inflation and also back-indexation. Public sector employees will benefit the most, with wages rising by more than 8 per cent. The public sector will thus again outpace the private sector in the pace of pay rises this year. In the coming years, the continuing record labour shortages and the government's austerity measures will have a contractionary effect on wages. In 2025, sharp inflation will reduce real wage growth to 0.5 per cent. However, in the following years, real wage growth will again rise to above 2 per cent.

Inflation will fall below 3 per cent

Inflation will accelerate slightly towards the end of the year. Energy prices are stable year-on-year and are expected to rise only moderately, held down by subsidies, while goods prices will follow the same path. However, services prices will maintain a strong upward momentum and food prices will accelerate again. At the end of the year, inflation will climb above 3 per cent and annual inflation will equal 2.8 per cent.

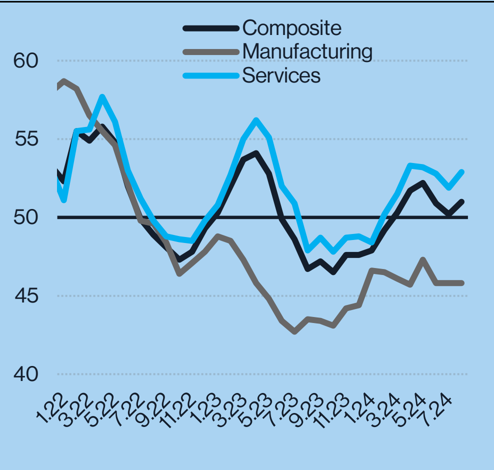
Price increases will reach 5.4 per cent in 2025. Inflation will be affected by the increase in the VAT rate and the rise in energy prices. Higher VAT will contribute by 1.5 p.p. to the increase in the price level and regulated energy prices will contribute another 1 p.p. While electricity prices for households will remain unchanged in the medium term according to the URSO decree, we expect a return to the market price in the case of gas. Together with the higher VAT, this represents an increase of around 30 per cent compared to the current subsidised level. For the price of heat, we expect a gradual increase spread over several years. Developments in 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 dampen inflation. Once the inflation shocks fade and the base effect wears off, we expect food and tradable goods prices to return to the average rates of increase seen between 2017 and 2020. Services prices will increase faster, but overall price level growth will be dampened by public finance consolidation over the medium term.

BOX 1: External environment assumptions

The economic situation abroad has been developing unfavourably in the third quarter. The deepening of problems continues, particularly in the industrialised countries. Germany, whose economy slowed slightly in the second quarter, was a negative surprise. This was also reflected in lower growth for the currency bloc as a whole, which slowed compared to the previous quarter and fell short of expectations. Austria, whose economy has been stagnating for the past two years, is also struggling. In contrast, countries with larger services and tourism sectors are doing very well. Economic growth in Spain has been continuously surprising on the upside for over a year now, and Italy has also recorded a solid performance. For Slovakia, the continuing moderate recovery in the V3 region is

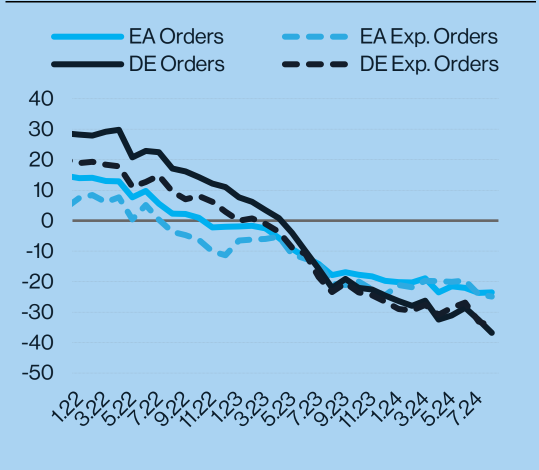
positive news and should gather momentum in the coming quarters and boost foreign demand. A slight deterioration is also evident in the rest of the global economies. China's growth remains historically sluggish, and the US economy, despite its robust performance, is showing signs of slowing, putting financial markets under pressure.

Figure A: Eurozone recovery progressing slowly (Purchasing Managers' Index, readings above 50 = expansion)



Source: Bloomberg, IFP

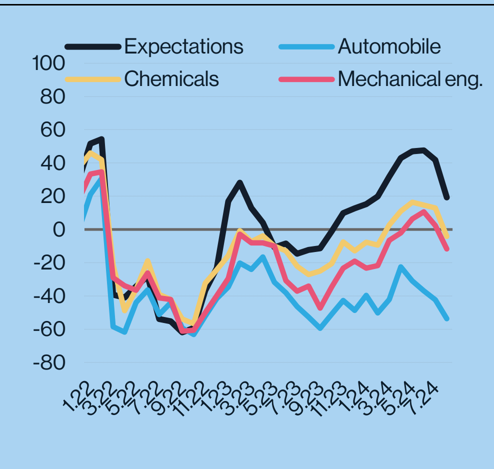
Figure B: The situation in industry sector remains unfavourable (industrial orders in the euro area and Germany, ESI, points)



Source: EC, IFP

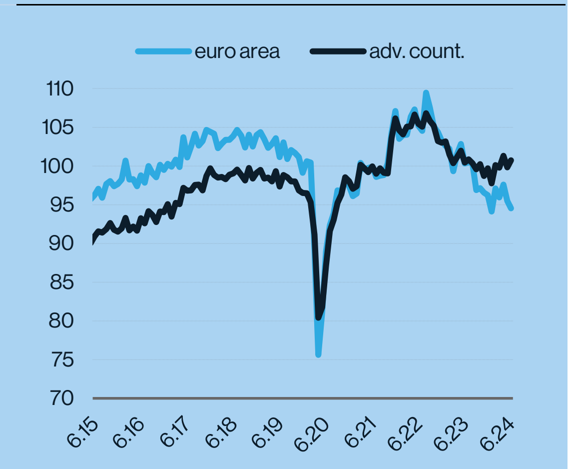
The industry is failing to emerge from the recession. Leading indicators point to a gradual increase in pessimism about the next periods. Expectations are particularly negative in the German automotive industry and the pessimistic statements by the leaders of the German Volkswagen are not signalling any improvement of the situation. According to the Purchasing Managers' Index, the industry in the euro area has been in contraction territory for more than two years, with the US industry joining in in August. The reason for this is the severe decline in orders that the euro area has been facing since last year, which does not give hope of a significant improvement in the short term. The weaker performance of industry in the euro area in particular is also reflected in the decelerating global trade in the developed countries.

Figure C: Expectations for the next 6 months have deteriorated (ZEW Germany Economic Expectations Index, points)



Source: Macrobond, IFP

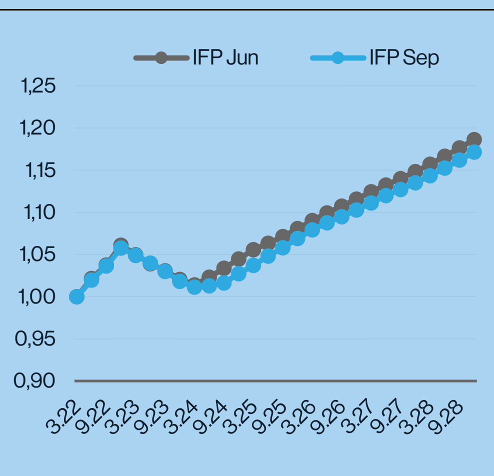
Figure D: Global trade stagnates, hampered by the eurozone (World Trade Monitor Index, imports, points)



Source: Macrobond, IFP

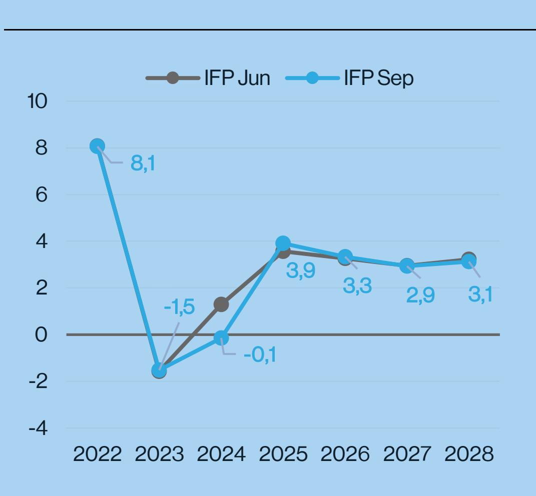
Foreign demand will only recover in 2025 and 2026. Although the recovery in the euro area is gradually progressing, it is so far mainly in the services sector. However, imports from our trading partners have been stagnating or declining in recent quarters. This, together with negative sentiment in the industry, does not give much hope for an acceleration in external demand this year. The situation should change in the coming years. Foreign demand should be stimulated by an easing monetary policy as well as a growing investment appetite, also supported by the RRP projects. The acceleration of the recovery in our close neighbours in the V3 will also be important and should support domestic industry. The possible continuation of the slow pace of recovery in Germany and deepening problems in the automotive industry are risks for the future.

Figure E: Foreign demand is picking up more slowly than expected (weigh. ind. of ex. dem., level, indexed)



Source: IFP

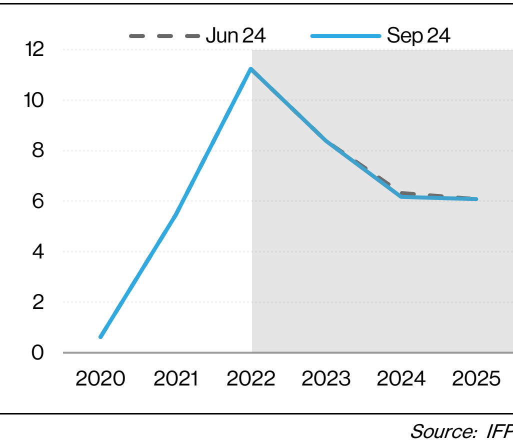
Figure F: Recovery will accelerate into the next year (yoy, weigh. ind. of ex. dem., per cent)



Source: IFP

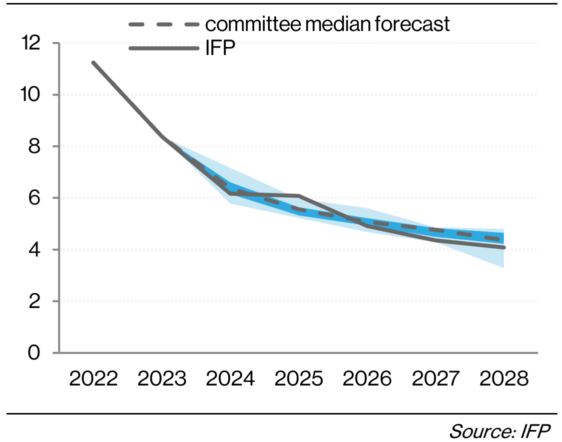
The update of the Ministry of Finance's macroeconomic forecast was the subject of a meeting of the Committee for Macroeconomic Forecast on 16 September 2024. **The forecast was assessed as realistic by all of the Committee members** (NBS, SAV, RRZ, Infostat, Unicredit, VÚB, ČSOB). Two members of the committee decided not to assess the forecast. 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

BOX 2: Lower drawing of the Recovery and Resilience Plan (risk scenario)

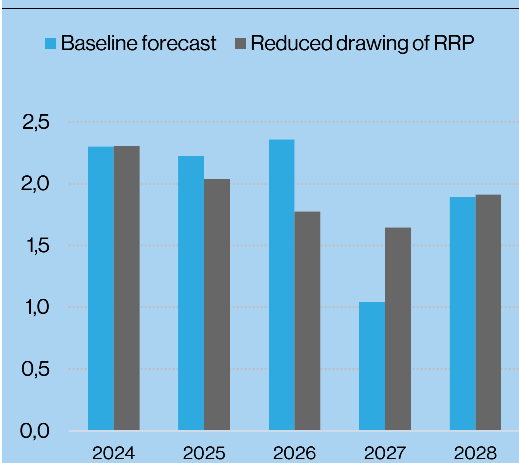
The development of the Slovak economy in the coming years will be largely driven by the resources from the RRP. The current projections assume that the entire funding will be drawn by 2027. In the alternative scenario with a lower absorption rate of 80 per cent, Slovak GDP would grow on average 0.4 pp slower in the next two years (2025 and 2026) and would be 0.15 per cent lower at the end of the forecast horizon.

Of the total funds available under the RRP in the amount of EUR 6.4 billion, Slovakia has so far used EUR 697 million as of mid-September this year. The September forecast expects a slightly faster uptake in the second half of 2024 followed by a significant acceleration in the next two years. We assume that in 2025 and 2026, the absorption of RRP will equal EUR 2.7 billion and EUR 2.6 billion respectively, exhausting the allocated fund completely.

In the alternative scenario, we assume that only 80 per cent of the RRP will be drawn. In this case, GDP would grow by 2.0 per cent in 2025, which is 0.2 p.p. lower than in the forecast. In 2026, growth would be lower by 0.6 pp. The fall in investment would lead to a lower capital stock, which would be reflected in lower potential output as well as lower economic activity over the forecast horizon. GDP at constant prices would be 0.15 per cent lower in 2028. The labour market responds to the shortfall in resources with a lag, and the largest differences would show up in 2027 when employment would be down by 11 thousand people in comparison with the baseline forecast.

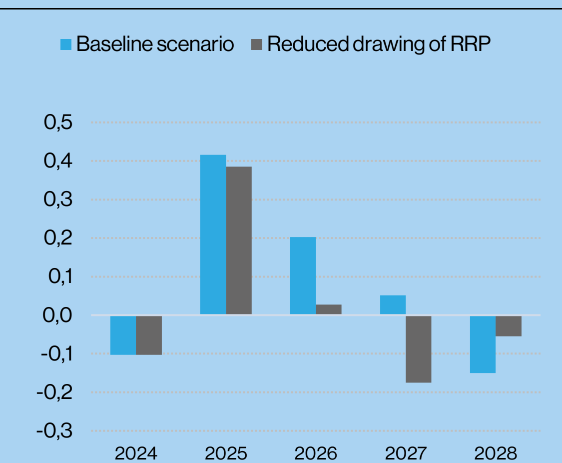
[1] Macroeconomic bases for budget revenues (weight of indicators depends on a proportional share of particular taxes on total tax revenues): Wage base (employment + nominal wage) – 55.9 per cent; Nominal private consumption – 24.4 per cent; Real private consumption – 4.2 per cent; Nominal GDP growth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

Figure G: GDP growth under the baseline and risk scenario (per cent)



Source: IFP

Figure H: Employment growth under the baseline and risk scenario (per cent)



Source: IFP

MF SR Macroeconomic forecast – Main indicators (September 2024)

(growth in per cent unless otherwise noted)		Forecast					Forecast revision – June 2024				
	2023	2024	2025	2026	2027	2028	2024	2025	2026	2027	2028
Gross Domestic Product											
GDP, real	1.6	2.3	2.2	2.4	1.0	1.9	-0.2	-0.4	0.4	-0.8	-0.1
GDP, nominal (bn. €)	122.8	131.2	139.9	147.3	152.1	158.6	-0.5	-0.5	0.1	-1.7	-2.6
GDP, nominal	11.9	6.8	6.6	5.3	3.3	4.2	-0.4	-0.1	0.5	-1.2	-0.6
Private consumption, real	-3.2	2.9	1.4	1.9	2.3	1.7	0.0	-0.7	-0.5	-0.2	-0.5
Private consumption, nominal	6.8	6.0	6.9	4.7	4.6	4.2	-0.1	0.7	-0.6	-0.6	-0.7
Government spending	-0.6	3.6	0.1	-0.4	-0.2	-0.3	-0.2	-0.1	-0.9	0.4	0.5
Fixed investment	10.6	-0.3	10.6	0.4	-4.9	3.1	-0.2	-1.6	3.4	-1.4	0.7
Export of goods and services	-1.4	1.8	3.7	4.3	4.6	3.9	-0.3	0.6	-0.1	0.1	0.8
Import of goods and services	-7.6	4.8	6.7	3.0	3.7	3.8	-0.5	1.6	-0.2	0.3	0.9
Labour market											
Registered employment	0.2	-0.1	0.4	0.2	0.0	-0.2	0.0	-0.1	-0.1	-0.2	-0.1
Wages, nominal	9.7	6.9	5.9	5.2	4.9	4.5	-0.1	-0.2	-0.2	0.0	-0.1
Wages, real	-0.7	4.0	0.5	2.5	2.6	2.1	-0.2	-1.6	0.0	0.4	0.1
Unemployment rate	5.8	5.4	5.3	5.1	5.0	5.0	-0.1	0.1	0.0	0.0	0.0
Inflation											
CPI	10.5	2.8	5.4	2.7	2.2	2.4	0.1	1.5	-0.1	-0.4	-0.2

Source: SO SR, IFP

Recovery and Resillience Plan funds absorption (million EUR, w/o VAT, ESA2010)

	2022	2023	2024	2025	2026
RRF total	**49**	**357**	**621**	**2 706**	**2 552**
Public investments	23	37	57	118	115
Public compensations	15	25	40	79	76
Public intermediate consumption	2	81	295	1 888	1 812
Social transfers in kind	2	2	2	4	11
Social transfers	4	9	2	33	24
Private compensations	0	1	6	28	22
Private intermediate consumption	0	1	3	13	13
Private investments	3	24	54	513	471
Household investments	0	180	172	71	42

Source: IFP