

SLOVAKIA

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ENERGY DEPENDENCY

All growth drivers weakened in the second quarter of 2022. With a high exposure to Russia for its oil and gas supplies, Slovakia could be amongst the most affected Central European countries by the consequences of the war in Ukraine. The steep rise in energy costs, as well as supply disruptions, will have an adverse impact on industrial activity, which has not yet returned to its pre-Covid level. Moreover, inflation has increased rapidly but is still more moderate compared to other countries in the region. Finally, public and external accounts will deteriorate in the short term, but this situation remains manageable.

The Covid pandemic led to a GDP contraction of 4.4% in 2020. The rebound in activity of 3% in 2021 has not yet enabled the economy to return to its pre-crisis level. The catching-up will not happen before 2023 given diminished growth outlook for the next two years.

GROWTH IS SLOWING DOWN

Economic activity weakened in Q2 2022, with a GDP print of 1.8% year-on-year compared with 3.1% in the first quarter. Growth was dragged down by net exports and by government consumption, which resulted in negative contributions of -0.3 and -1.3 points respectively. Exports suffered from supply disruptions in industry, particularly in the electronics sector. The contribution made by investment was practically nil. Consumption slowed down, but was still the main driver of growth. Households have drawn on their savings to maintain their purchasing power to some extent. The partial freeze on electricity tariffs for households since the beginning of the year has also helped.

The soft patch in investment reflects the deterioration in the business climate. The uncertainties related to the war in Ukraine, alongside with the squeeze on margins due to soaring production costs, and labour shortage have undoubtedly resulted in the postponement of investment projects.

In terms of economic indicators, retail sales are struggling to exceed their pre-Covid level. They have slowed in recent months, to +1.2% year-on-year in July after +1.5% in June and +7.8% in May. Another point to note is that registrations of new vehicles continue to record very sharp declines (-20.3% year-on-year in July, -29.5% in June and -15.9% in May). The slowdown in domestic demand is likely to continue in the short term.

STRONG DEPENDENCE ON RUSSIAN OIL AND GAS

Of the Central European countries, Slovakia, the Czech Republic and Hungary are amongst the most vulnerable to the consequences of the conflict in Ukraine, given their dependence on Russia for energy. Thus, the Slovak economy is likely to be hit harder than Poland or Romania in the short term. This fragility is due to the country's high exposure to Russia for its supplies of gas and oil (85% of gas imports and 100% of oil imports). The reduction in gas deliveries via Nordstream 1 pipeline, followed by its shutdown since September, reinforces this vulnerability. The Slovakian government has sought to diversify its sources of gas supply since the war began in Ukraine. Agreements have been signed with Norway and the United States to supply liquefied natural gas. A new pipeline between Poland and Slovakia also became operational at the end of August. This will allow Slovakia to source supplies from Norway or the Baltic Sea. The country's gas reserves were 87% of maximum capacity at the end of September. Furthermore, Slovakia along with Hungary and the Czech Republic have obtained an exemption from the EU to continue importing Russian oil until the end of 2023.

FORECASTS

	2019	2020	2021	2022e	2023e
Real GDP growth, %	2.6	-4.4	3.0	1.0	0.3
Inflation, CPI, year average, %	2.6	1.9	3.2	11.6	7.3
Gen. Gov. balance / GDP, %	-1.3	-5.5	-6.2	-5.5	-3.6
Gen. Gov. debt / GDP, %	48.1	59.7	63.1	61.5	60.7
Current account balance / GDP, %	-3.4	0.4	-2.0	-5.5	-6.0
External debt / GDP, %	112.2	120.5	137.0	130.5	129.8
Forex reserves, EUR bn	6.4	7.7	8.5	9.9	10.2
Forex reserves, in months of imports	1.0	1.3	1.2	1.2	1.1

e: ESTIMATE & FORECASTS

SOURCE: BNP PARIBAS ECONOMIC RESEARCH

TABLE 1

SLOVAKIA: INDUSTRIAL PRODUCTION AND RETAIL SALES

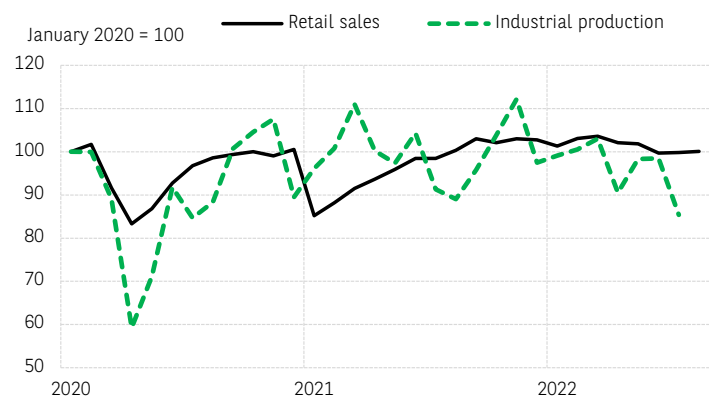


CHART 1

SOURCE: STATISTICAL OFFICE OF SLOVAKIA, EUROSTAT, BNP PARIBAS

While these efforts provide some respite, the industry is still being hit hard. Industrial production fell by 6.4% year-on-year in July compared to -4.8% on average over the past three months. It is still a long way from pre-Covid levels. The latest figures confirm that all sectors have been affected, including power, electronics, transport equipment and machinery. Energy-intensive industries are on the front line, as their energy bills are soaring. Under these circumstances, production at some aluminium plants has been temporarily suspended.

The country is also very dependent on the automotive sector, which represents 48% of its industrial production. This sector was particu-



larly badly affected by supply disruptions in 2021. The war in Ukraine is likely to exacerbate these issues this year. Increases in production costs and energy bills will also hurt this sector. In order to support its industrial sector, the authorities announced at the start of September that they were considering extending the freeze on electricity and gas tariffs to companies.

INFLATION HAS NOT YET PEAKED

The rise in the Harmonised Index of Consumer Prices (HICP) has continued to gather pace, reaching 13.6% year-on-year in September after 13.4% in August and 12.8% in July. It is above the Eurozone average (+9.1% in August) but significantly lower than neighbouring countries. In Hungary and the Czech Republic, the Harmonised Index of Consumer Prices rose by 18.6% and 17.1% respectively in August. This regional difference is partly due to higher wage growth in these countries. It was 13.5% year-on-year on average in the second quarter in Poland and 15.2% in Hungary compared to 7.4% in Slovakia.

According to the latest available figures, inflation is being driven mainly by food and transport items. Food prices rose by 21% year-on-year in August and contributed 4.8 points to the HICP inflation figure. The surge in energy prices will continue to fuel food production costs. In addition, temporary halts of production at fertiliser plants in Poland could also have an impact on the price of agricultural goods. Transport contributed 1.3 points.

Core inflation, which is also rising sharply (+9% year-on-year in September), is the result of supply constraints, higher wages and production costs.

To contain inflation, the authorities decided in February to implement a partial freeze on household electricity tariffs until 2024. Inflation could peak at the end of the year or early in 2023.

With regards to monetary policy, the ECB has raised its key policy rate by 125 basis points since June. Meanwhile, the pace of monetary tightening has been greater in neighbouring countries, mainly in Hungary, with a cumulative rate hike of +1240 basis points since May 2021.

DETERIORATING CURRENT ACCOUNT BALANCE AND PUBLIC ACCOUNTS

The current account balance deteriorated significantly during the first seven months of the year, to -4.1 billion euros compared to -0.3 billion euros over the same period last year and -1.9 billion euros over 2021 as a whole (-2% of GDP in 2021). In 2022 and 2023, this deficit is expected to increase to 5.5% and 6.0% of GDP respectively. The trade balance, which has been in structural surplus for years, could show a deficit in 2022, mainly due to higher energy bill. Over the first 7 months of the year, the trade balance was -2.8 billion euros. Financing the deficit should not be a major problem. It should be partly financed by foreign direct investment flows (2.1 billion euros since January 2022) and European funds under the resilience plan.

SLOVAKIA: INFLATION RATE

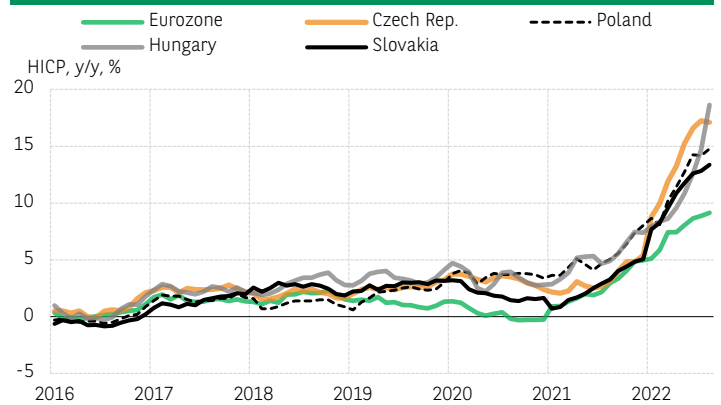


CHART 2

SOURCE: EUROSTAT, BNP PARIBAS

As for public accounts, the budget deficit is likely to remain high at 5.5% of GDP in 2022, according to our estimates. Supportive measures aimed at containing inflation risks are estimated at 1% of GDP this year. They have taken the shape of subsidies (100 euros per child) and tax rebates for families with children. With regard to pensions, the thirteenth month's payment will be brought forward to support pensioners. A nationwide freeze on electricity and gas prices is also being considered. Fiscal easing is likely to continue next year, as in most central European countries. The process of fiscal consolidation is expected to resume after 2023 and public debt should gradually return to the level observed before the Covid-19 crisis. Public debt-to-GDP slightly exceeded the 60% threshold in 2021, at 63.1%, and is likely to stay above 60% in 2022.

Cynthia KALASOPATAN ANTOINE

cynthia.kalasopatanantoine@bnpparibas.com