SLOVAKIA

THE FLIPSIDE OF SPECIALISATION

Our growth forecasts have been revised downwards due to the tariff shock initiated by the United States, and the country's industrial specialisation. Slovakia is the most exposed Central European country to the Trump administration's tariff measures. The economy is heavily dependent on foreign trade and the automotive sector. The Slovak economy should avoid a recession thanks to public investment and consumption. The rise in inflation at the start of the year, following the increase in the VAT rate, is temporary and limited, and should not weigh heavily on consumption. In the medium term, the German stimulus plan and FDI inflows will be supportive factors for the economy.

RESILIENCE IN GROWTH

In Q1 2025, GDP growth was only 0.2% q/q and the year-on-year increase was only 1%, but it is resilient. For the rest of the year, we expect stagnation or, at best, weak growth due to the negative effects of US tariff measures and restrictive fiscal policy (EUR 2.7 bn in savings, or 2% of GDP, are forecast in the budget for 2025). However, the economy should avoid a recession.

Slovakia is the most exposed amongst Central European countries to a shock on exports, which account for 81.6% of GDP. The uncertainties generated by the back-and-forth announcements related to tariffs should also affect private investment decisions in the short term.

Our growth forecasts have been revised downwards since January (-0.3 point in 2025 and 2026 respectively), but they remain above the Eurozone average. European funds will continue to support public investment. Similarly, consumption will continue to be a major driver of growth, due to buoyant wages and falling inflation, although households are likely to adopt a cautious stance amidst an uncertain international environment.

In 2026, economic growth is expected to remain well-oriented thanks to falling inflation and improved growth prospects in Germany, Slovakia's main trading partner. However, the expected positive effects of the German investment plan will not necessarily be visible until 2027. In the meantime, growth is likely to remain below 3.1% (its average for 2010 and 2019), or even below its potential, estimated at 2.1% by the IMF.

SLOW RETURN TO INFLATION TARGET

The increase in the VAT rate from 20% to 23% since 1st January 2025 has put upward pressure on consumer prices, especially in the first quarter. Inflation accelerated to 4.2% in Q1 2025 after 3.5% in Q4 2024. The sharp slowdown in growth and the recessionary effect of tariff measures, expected later in the year, will help to bring inflation back to the rate seen at the end of 2024. Similarly, an appreciation of the euro against the dollar in the short term would help to contain imported inflation. However, the deceleration will be gradual. Wage pressures remain high, even though wage growth has eased somewhat compared with last year (+5% y/y on average between November and January 2025; +6.6% in 2024). A return to the 2% inflation target is expected by 2027.

The ECB is likely to continue with monetary easing in the short term, given the outlook for inflation in the Eurozone (2.1% in 2025 and 1.9% in 2026 after 2.4% in 2024). According to our forecasts, the deposit facility rate could reach 1.75% by the end of 2025 (it is currently at 2.25%).

LARGE AUTOMOTIVE SECTOR AND HIGH EFFECTIVE TARIFF RATE

Slovakia is rightly seen as the most exposed Central European country to US tariffs. The automotive sector, which plays a key role in the economy (16.6% of employment and 23.4% of value added in the manufacturing sector in 2022), is hit by a rate of 25%. Exports are also concentrated, unsurprisingly, in this sector. In 2024, cars and parts accounted for 33.7% of exports and 26.6% of GDP. Car exports are mainly destined for the European market, with a share of 53.9%, followed by the United States (10.6%), the United Kingdom (9.5%) and China (6.9%). Significantly, the automotive sector accounts for almost all Slovakian exports to the United States (77.4% in 2024).

Steel and aluminium products, which account for only a small proportion of Slovakia's exports, were subject to a prohibitive customs duty rate of 50%. All EU countries have been charged an additional 10% customs tax on European goods exported to the United States.

FORECASTS

	2022	2023	2024	2025e	2026e
Real GDP growth, %	0.4	2.2	2.1	1.5	1.8
Inflation, HICP, year average, %	12.1	11.0	3.1	3.9	3.1
Gen. Gov. balance / GDP, %	-1.7	-5.2	-5.3	-4.9	-4.5
Gen. Gov. debt / GDP, %	57.7	55.6	59.3	61.1	62.7
Current account balance / GDP, %	-7.3	-0.9	-2.8	-1.9	-0.8
External debt / GDP, %	105.5	95.3	98.5	95.6	93.1

TABLE 1 e: ESTIMATES & FORECASTS
SOURCE: BNP PARIBAS ECONOMIC RESEARCH

SLOVAKIA'S MAIN EXPORT PARTNERS

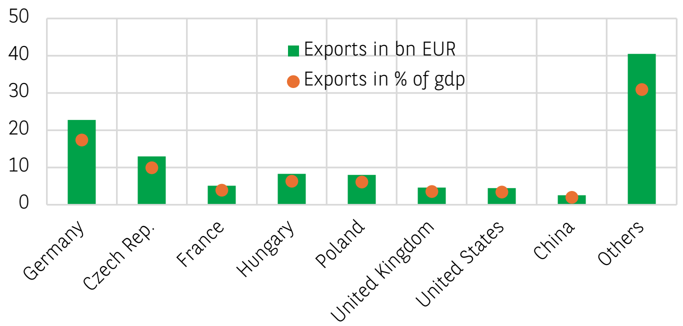

CHART 1 SOURCE: STATISTICAL OFFICE OF SLOVAKIA, BNP PARIBAS

Slovakia's effective tariff rate has risen from 2.4% before "Liberation Day" to 24.5% currently, mainly due to the concentration of its exports in the automotive sector. This is the highest rate in Central Europe. Should negotiations on reciprocal tariffs fail, pushing them up to 20%, the effective rate would rise to 26.7%. The pharmaceutical and electronics sectors could also be affected by tariff increases, but these two sectors account for a tiny share of Slovakian exports to the United States.

EFFECTS OF US TARIFFS ON TRADE FLOWS

We have estimated the direct impact of US tariffs on exports to the United States, taking into account differentiated tariff rates. All other things being equal, exports could fall by 0.9%, or an impact on GDP of -0.7 percentage point. There is also the indirect effect of a fall in German demand. The main products exported to Germany are cars and car parts (52.7% of exports) and capital goods (37.6%). We anticipate a 5-10% drop[1] in Slovakian exports to Germany, equivalent to -0.9% of GDP to -1.8% of GDP. In total, the direct and indirect impact could represent between -1.6% and -2.5% of GDP if exporters are unable to compensate for the fall in exports to the United States and Germany.

Redirecting exports to other markets will prove complex, given Slovakia's sectoral specialisation. The automotive sector is, and will be, more severely affected than most other industries. The global economic climate is particularly gloomy in this sector. Slovakian car exports have fallen by 3.8% in 2024, after rebounding strongly in 2022 and 2023. What's more, the Chinese market, which is important for manufacturers present in Slovakia, especially German ones, is highly competitive, with a strong presence of local manufacturers. The capacity to gain market share is therefore limited. Finally, the domestic market is also subdued. Vehicle registrations fell by 7.9% over the first four months of the year compared with the same period in 2024, and the survey of intentions to purchase automotive goods over the next 12 months remains downbeat.

Overall, car production fell by 8.1% last year, partly as a result of the reorganisation of production lines for new models. It could fall further this year.

WHAT ARE THE SUPPPORTIVE FACTORS?

In the medium term, the German investment plan of EUR 500 billion over 12 years, together with the rearmament plan, would indirectly benefit all the countries of Central Europe by stimulating certain sectors (construction, machinery, electrical equipment). Slovakia has also submitted a request to the European Union to activate the defence clause, which will enable it to exclude the increase in defence-related investment from the public accounts over the next four years (if the request is approved). But the scale of the impact is likely to be small, as the country has no immediate plans to increase military spending (EUR 2.8 bn; 2% of GDP expected in 2025).

CENTRAL EUROPE: EXPORTS OF CARS AND CAR PARTS

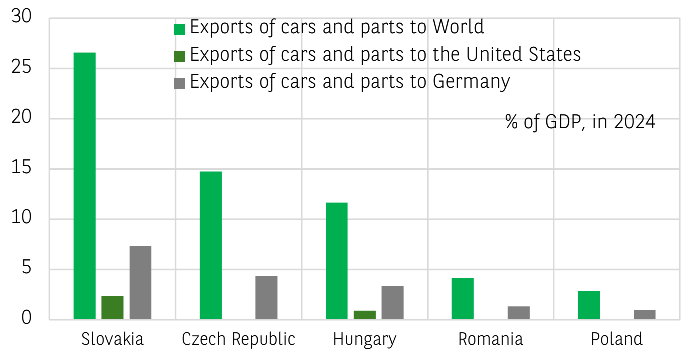

CHART 2 SOURCE: UNCTAD, BNP PARIBAS

European funds provide significant support for the economy. Between 2004 and 2024, Slovakia received net payments of around EUR 29 billion. Moreover, the country remains a net beneficiary of the European budget in several areas. It offers Slovakia an opportunity to further improve its labour productivity and to move up the value chain. The country's priority will be to improve its capacity to absorb these funds, which remains low compared to other European countries.

Net foreign direct investment has declined on average over the last three years compared with the pre-Covid period (2022-2024: 1.1% of GDP; 2017-2019: 2.1%). Nevertheless, Slovakia remains an attractive destination for foreign investment, with a skilled workforce that is competitive in terms of wages. Driven by Chinese investment in the automotive sector, Slovakia will have production capacity for electric vehicles by 2027. The country has also entered into a partnership with the Chinese company Gotion to build an electric battery factory. The automotive sector remains highly focused on internal combustion engines, and the transition to the electric segment remains marginal (0.3% of the vehicle fleet, EU: 1.8% by 2023 according to ACEA).

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1 Exports to Germany are expected to fall by around 5-10% by 2025. By way of comparison, exports fell by an average of 2.6% in 2019/2020, 10.8% in 2015 and 21% in 2009. Last year, exports to Germany rose by 0.1%.