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The fastest job creation since the crisis

Macroeconomic forecast for 2015 - 2018

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The Slovak economy will reach a solid 3.2 per cent growth this year, driven by the investment benefiting from fast absorption of EU funds at the end of the second programming period. On the labor market, the largest amount of new jobs since the crisis will be created. The economy will grow at a similar pace next year and the labor market will continue in its dynamic growth. A sizeable positive risk not included in the baseline forecast is posed by the construction of the Jaguar Land Rover car manufacturing plant.

Rate hike in the US is postponed to year-end

FED is postponing the tightening of monetary policy. The US central bank at its September meeting did not increase the interest rate as expected. The ECB maintains a relaxed monetary policy and continues at QE program according to the plan. The market observers are starting to speculate about the possibility of the extension to the program until mid-2017. The reactions of both monetary authorities have been influenced by a heightened risk of persistently low inflation as well as by worries about the pace of global economic growth The latter has have been reflected in the financial market turmoil, to which the FED is particularly sensitive.

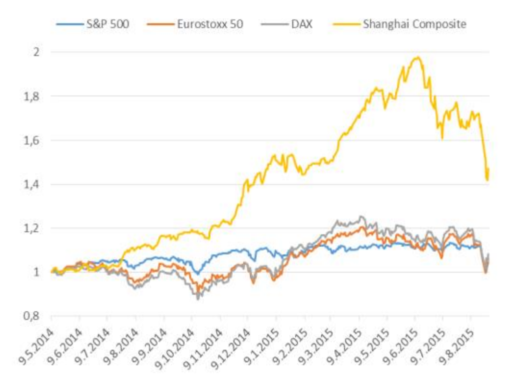
Turmoil on Chinese stock exchange

The world's stock markets experienced a Black Monday by the end of August. The revived worries about slowdown of the Chinese economy below 6 per cent resulted in the sell-off on the Chinese stock market, amid which the Shanghai Composite index erased all its this year's gains. The contagion has spread to the world's stock exchanges, however the bearish mood of European and American indices has been temporary and the rebound reflects the fundamentals of US and Eurozone economies. **The July agreement between Greece and its creditors led to a widespread decrease of bond yields in the Eurozone countries.** Even during the hectic negotiations in June, the contagion towards other peripheral Eurozone countries was limited. At the end of summer the trend of falling yields has been amplified by "risk-of" mood on the markets.

Low demand of BRICS put the commodity prices under the pressure

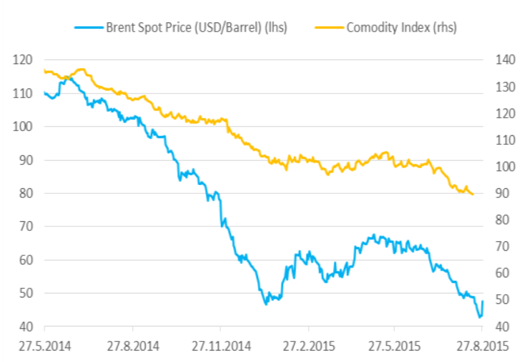
The oil price plummeted to a new post-crisis bottom (43 USD/barrel). As a result, we lower our forecast on the entire horizon by almost 20 dollars per barrel. While prices of all commodities has suffered under the lack of demand stemming from BRICs, oil price keeps being under the pressure on the back of supply reasons as well.

Chart 1: Fall of stock indices



Source: Bloomberg, IFP

Chart 2: Brent oil and other commodities



Source: Bloomberg

Strong growth in the US and deteriorating outlook for emerging countries

There are opposing trends in the global economy. The optimism stemming from the condition of the US economy is dampened by an unsatisfactory results of the emerging countries. The collapse of the Chinese stock market reflect the limitation of the Chinese growth model based mainly on export and investment. At the same time, two other large emerging countries struggle with recession – Russia and Brazil. The first palpable consequence of emerging countries' troubles is a drop in prices of commodities. In the short run, this effect does help the European economies, which are the net importers of commodities, but in the long run, low commodities' prices signal an underperforming global economy and a drag on growth of the European economy.

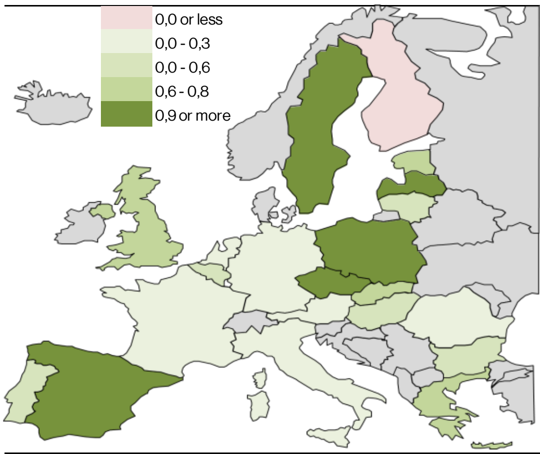
Eurozone experiences stable growth but does not accelerate

The European economy has grown, but it has stopped accelerating. The economy of the Eurozone has in the first half of the year increased by 1.5% year-on-year. The German economy has posted similar, balanced growth. Italy and Spain stand out positively among other countries. The Italian economy has grown for two quarters in a row for the first time since 2011. The positive image is undermined by France, which has stagnated in the second quarter. The economies of the Czech Republic, Poland and Hungary recorded growths almost twice as high as the EU average. The growth has exceeded expectations especially in the Czech Republic. Similarly to Slovakia, the growth of the neighboring countries is to a large extent driven by fast EU funds absorption.

Višegrád region experiences robust growth partly due to EU funds

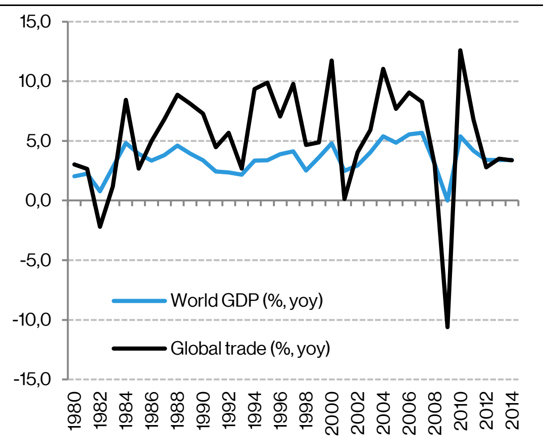
The stagnation of expectations in the Eurozone and their slight fall in Germany suggest that the economic growth will not accelerate in the next quarters. Growth in the Eurozone should reach around 1.5% this year. Germany should record similar growth. The space for an acceleration of potential growth in the Eurozone is limited by a persistent uncertainty regarding the institutional arrangement of the monetary union. The average growth of the V3 countries will exceed 3%.

Chart 3: Quarterly GDP growth in the EU countries



Source: Eurostat, IFP

Chart 4: Stagnation of foreign trade growth



Source: IFP

Weaker foreign demand outlook for this year and 2016

The forecast of the economic growth of Slovak main trading partners has been raised for this year and lowered for 2016. The improvement of the external environment growth is attributed mostly to the improved outlook of the Czech Republic while maintaining the forecasted growth in other economies. However, the weighted growth of GDP and imports will not accelerate in the remainder of the year. Similarly, the deterioration of the external environment in 2016 is related to slower growth in the Eurozone and lower outlook for large emerging countries (China, Russia). Lower forecast of the external demand at the end of the forecasted horizon is based on slower growth of global trade which is becoming decoupled from the growth of economic activity[1]. The assumptions related to external demand are based on the IMF interim forecast, corrected for the development in the second quarter and a very short forecast (nowcasting) of the Eurozone. The assumptions covering the external environment, interest rates and prices of commodities are based on information available at the beginning of September 2015.

Table 1: External environment in 2015-2018

	GDP (% growth)					Diff. from June 2015					Import (% growth)					Diff. from June 2015				
	2014	2015	2016	2017	2018	2014	2015	2016	2017	2018	2014	2015	2016	2017	2018	2014	2015	2016	2017	2018
Important trading partners of SR	2.2	2.4	2.3	2.1	2.0	0.0	0.3	0.0	-0.1	0.0	7.1	6.2	5.4	4.9	4.5	0.0	1.0	-0.2	0.0	-0.1
Eurozone*	0.9	1.5	1.8	-	-	0.0	0.0	-0.3	-	-	2.8	4.2	4.2	-	-	0.0	0.2	-0.3	-	-
Germany	1.6	1.5	1.9	-	-	0.0	0.0	-0.1	-	-	3.3	4.5	5.2	-	-	0.0	0.0	-0.4	-	-
Czech Republic	2.0	4.1	2.9	-	-	0.0	1.0	0.1	-	-	9.6	9.2	7.6	-	-	0.0	2.2	1.1	-	-
Poland	3.3	3.4	3.4	-	-	0.0	0.1	0.0	-	-	8.7	7.6	7.1	-	-	0.0	0.0	-0.1	-	-
Hungary	3.2	2.8	2.3	-	-	0.0	0.0	0.1	-	-	10.0	5.9	5.2	-	-	0.0	0.3	0.0	-	-

*Eurozone weighted by volume of Slovak exports Foreign demand indicator includes Eurozone and Visegrád countries.

Source: OECD , Bloomberg, IFP

Domestic demand remains a driver of growth in 2015

The Slovak economy will grow this year by 3.2%. The growth in the second quarter has confirmed expectations from June's forecast. However, its structure has been significantly different, as only domestic demand has contributed to growth. During the year we expect stable growth without further acceleration. **Investment and private consumption will continue to drive the growth.** Investment will grow by almost 8%, the fastest pace since 2011. Their growth will be driven from two thirds by the public sector with the peak of the EU funds absorption from the end of second programming period (more on public investment in the Box). The private investment lag behind the expectations (nominal growth in the first half of the year was below 2%), which has been reflected in the outlook for the whole year, lowering the forecast under 3%[2]. A moderate growth of private consumption reflects weaker growth of disposable income (compared to wage base) and high households' saving rate, which is reaching 15-year high. After the correction in the second quarter, the export should return to its growth trajectory through the remainder of the year.

Stable growth will continue in 2016

In 2016 the economy will grow by 3.1%. Weaker performance of our trading partners will weigh on the export growth, however its impact on the economy will be muted by cheaper oil. Public investment will not repeat its exceptional performance from 2015, while we expect private investment acceleration due to accumulation of resources. Capacity utilization hovering at post-crisis highs as well as the peak of the QE transmission are expected to contribute this foreseen rebound. An important positive risk above the baseline forecast scenario is represented by an intended construction of the car manufacturing plant by Jaguar Land Rover. **Households' consumption will accelerate due to higher real disposable income growth compared to 2015.**

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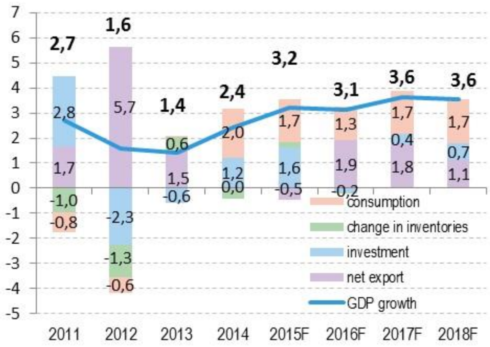
[1] In the pre-crisis period 1% global GDP growth induced approximately 2.5% of global trade growth. This ratio dropped after the crisis to approximately parity between GDP and trade growth.

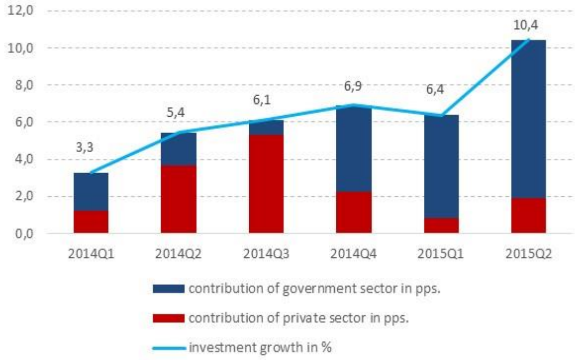
[2] Investments net of public sector and one-off factors

Chart 5: Contributions of individual components to GDP growth (p. p.)



Sorurce: SÚ SR, IFP

Chart 6: Structure of year-on-year nominal investment growth



Source: ŠÚSR, IFP

Balanced growth structure by the end of forecast period

In the following years the economy will accelerate to 3.6% with a small predominance of contribution of domestic demand over net export. Easier access to credit will support private investment, which will accelerate despite fading one-off effects in the automotive industry. Private consumption growth will follow the growth of disposable income, which will lag slightly behind the growth of real wage base. Exports will grow in line with the growth of foreign demand, while we still assume a moderate increase of our exporters' foreign market shares.

MF SR FORECAST – MAIN ECONOMIC INDICATORS (September 2015)

indicator (growth in % unless otherwise noted)	actual 2014	2015	2016	2017	2018	2015	2016	2017	2018
Gross domestic product									
GDP, real	2.4	3.2	3.1	3.6	3.6	0.0	-0.6	0.0	0.0
GDP, nominal (bn €)	75.2	77.5	80.6	85.1	89.9	-0.2	-1.1	-1.1	-1.2
Private consumption, real	2.2	2.1	2.7	2.7	2.8	0.0	-0.1	-0.2	0.0
Private consumption, nominal	2.1	2.1	3.5	4.5	4.8	-0.2	-0.7	-0.3	-0.2
Public consumption	4.4	3.4	-0.7	1.5	1.5	0.9	-2.0	0.6	0.1
Fixed investment	5.7	7.6	-0.7	2.0	3.2	3.0	-3.0	-0.5	0.6
Export of goods and services	4.6	6.1	5.6	6.3	5.6	-0.4	-0.5	0.1	0.0
Import of goods and services	5.0	7.1	3.9	4.9	5.0	0.6	-0.9	-0.2	0.3
Labor market									
Employment (registered)	1.3	1.9	1.0	0.7	0.8	0.7	0.2	0.0	0.1
Wages, nominal	4.1	2.4	3.1	4.6	4.7	0.0	-0.5	0.0	-0.1
Wages, real	4.2	2.5	2.2	2.7	2.7	0.3	-0.2	0.1	0.1
Unemployment rate	13.2	11.5	10.6	9.8	9.0	-0.6	-0.7	-0.7	-0.7
Inflation									
CPI	-0.1	-0.2	0.9	1.8	2.0	-0.4	-0.4	-0.1	-0.1

Source: ŠÚ SR, IFP

Labor market recovery continues

This year the economy will add 41 thousand jobs, which is a new post-crisis record. Number of jobs rises in every sector of the economy with the exception of construction, which grows more through productivity gains rather than employment. The unemployment rate should drop to 11.5%.

Single digit unemployment rate in 2017

In the following years we expect a solid employment growth, albeit at a slower pace. We expect a slower job creation and even decrease of jobs in public administration and higher productivity growth due to new private investment. For 2016 the employment should grow by a still vivid 1 per cent, or 24 thousand new jobs. **A single digit unemployment rate will be reached already in 2017.**

Stable real wage growth during the whole forecast period

This year real wage growth will be the second fastest since the crisis, namely 2.5%. Real wage growth will surpass real labor productivity for the second year in a row. We expect the highest wage growth in the public sector (especially due to valorization of teacher's salaries) and the lowest in the private market services. Next year's development will be similar. **The average nominal wage in the economy should reach 879 euros in 2015 and next year should exceed 900 euros for the first time.**

Prices will fall this year again

Inflation will remain below zero this year. Domestic price level is kept in negative numbers mainly by a fall of energy and food prices. Inflation of other goods and services remains on low levels and copies the general trend observed in the Eurozone. Neither the depreciation of the euro nor the QE program have yet resulted in the acceleration of price level growth.

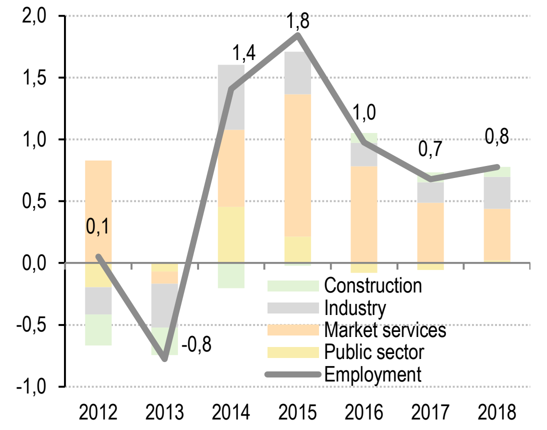
Gradual acceleration of demand inflation will be compensated by cheaper energies

Price growth will slightly accelerate in 2016, but it will still remain deep below standard values. The fall of prices of energy commodities will transmit into an anticipated decrease of price of electricity, and an additional reduction of price of gas and heating for households. Food prices will start to grow next year, although the decrease of VAT for selected food items will compensate the growth to some extent. The expected impact of the QE and gradual transmission of demand factors following the solid labor market performance should result in a gradual acceleration of prices of goods and services. Due to closing of the output gap and fading of supply shocks the inflation in years 2017-18 will approach the desired level of 2%.

Risks of macroeconomic forecast are balanced

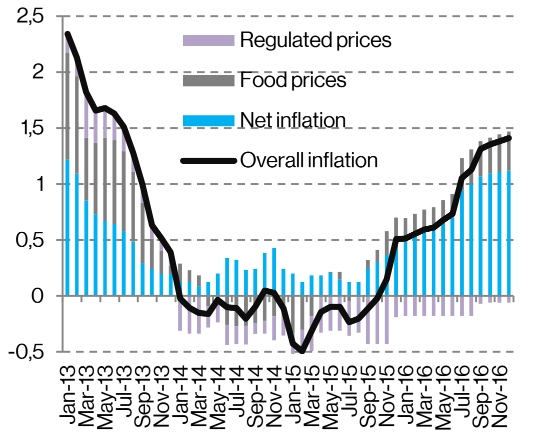
Risks of the macroeconomic forecast are balanced. Slowdown of global growth due to worsening growth outlook of several large economies (China, Russia, Brazil) is a **main negative risk** of the forecast. On the old continent, the dominant risks are those related to political fragmentation (Greece, refugee crisis), which can result in a delay of implementation of pro-growth policies on the European level (fiscal integration). **The main positive risk is the arrival of the car manufacturer Jaguar Land Rover to Slovakia,** which would increase GDP in 2016 by 0.5 p.p. Among positive risk are also a delayed, but stronger effect of QE on investment and consumption in the Eurozone.

Chart 7: Contributions of sectors to employment growth (p.p.)



Source: SÚ SR, IFP

Chart 8: Inflation and contribution of individual components (p.p.)

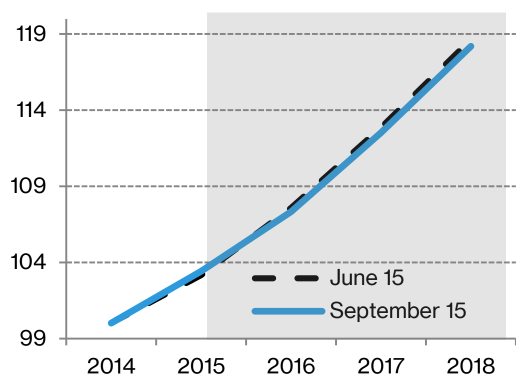


Source: ŠÚSR, IFP

Tax bases are higher this year due to employment and public investments

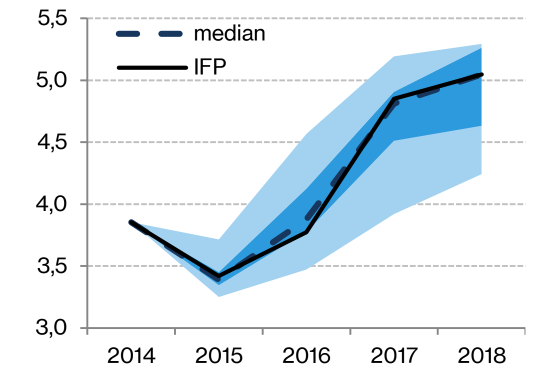
Total impact of the updated forecast on the tax bases is positive this year compared to June, mainly due to higher outlook of employment growth and public investment. Next year this impact on tax base growth dissipates, as low inflation environment will drag on nominal indicators. The total impact of the macroeconomic forecast on the estimate of taxes and contributions was discussed at a session of the Tax Forecast Committee on September 23, 2015.

Chart 9: Macroeconomic tax bases compared to June forecast



Source: IFP

Graf 10: Comparison of forecasts of macroeconomic bases[3] with the members of the Committee



Source: IFP

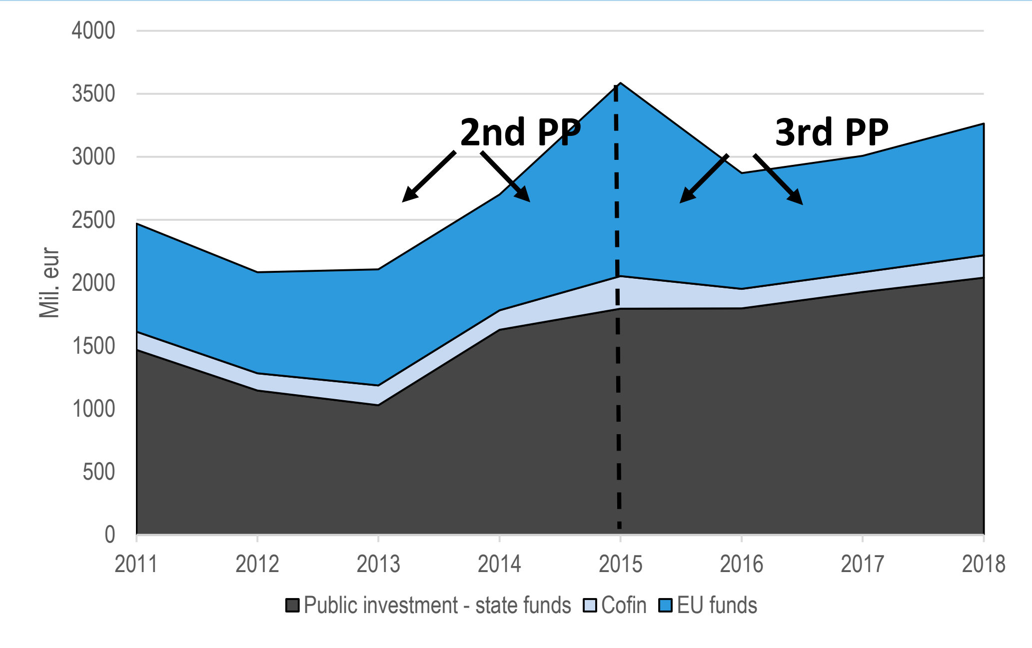
The medium term macroeconomic forecast of the MoF SR was discussed at a session of the Macroeconomic Forecasts Committee on September 16, 2015. The forecast was evaluated as **realistic** by every member of the Committee (NBS, ČSOB, Infostat, SLSP, Tatrabanka, Unicredit, VUB and Sberbank). The detailed macroeconomic forecast, as well as the minutes from the meeting and supporting materials are available on the IFP website.

[3] Macroeconomic basis for the budget revenues (weight of indicators depends on the proportional share of the particular tax on the total tax revenues); Wage base (employment x nominal wage) – 51,1%; Nominal private consumption – 25,7%; Real private consumption – 6.6%; Nominal GDP growth – 9.9%; Real GDP growth – 6.7%.

BOX Public investment on a rollercoaster

In the first half of 2015 public investment grew by 76 per cent year on year. For the whole 2015 we expect the public investment growth by one third. The main reason is a strong EU funds absorption from the ending second programming period. The contribution of EU funds and co-financing to total investment growth in 2015 should reach 26.6 p.p. After this years' peak of EU funds absorption, next year we expect public investment falling back to almost 2014 level. Year-on-year decline of public investment will be influenced by a gradual onset of new programming period of EU funds and a stabilization of investment from own sources. From 2016 onwards, the pace of investment growth should stabilize.

Chart: Public investment according to sources (mil. eur)



Source: IFP