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| Quarterly report |

Slovak Economic Outlook

Show on the labour market goes on


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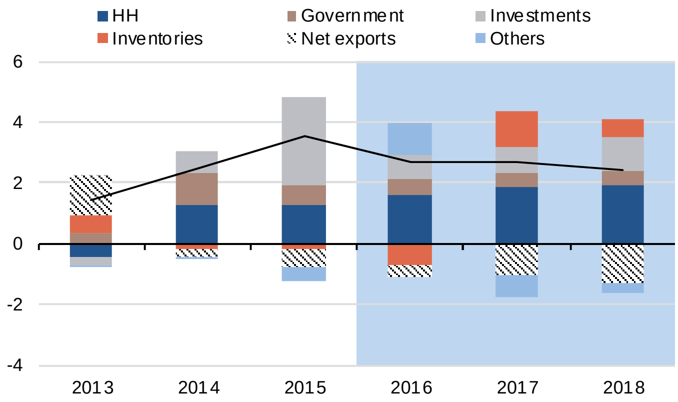
Economic growth boosted by the inflow of EU funds last year is over, and the Slovak economy started to slow down. In Q116, it grew 0.7% (SA), which is 3.6% in year-on-year terms. It is the first yoy growth slowdown since the end of 2012. However, there were persistently higher dynamics than recorded by the euro area and still the highest among regional peers. Nevertheless, a further deceleration of economic activity is expected in the remainder of the year. Economic growth is set to print yoy dynamics of 2.7% this year.

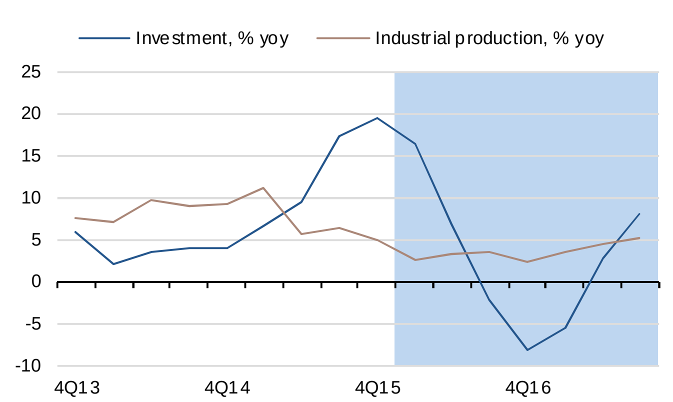
- Private consumption is the key growth driver in the times following the 2008-14 programming period. Consumers benefit from sound labour market conditions, increasing employment, a decreasing unemployment rate and resulting wage growth.
- In spite of the fact that investment activity has lost its growth momentum, it should still add positively to GDP growth. Government investment will be partially replaced by private investment due to sound domestic demand.
- Import growth is stimulated by the performance of domestic demand as well, which outperforms the dynamics of exports and hence keeps the net export contribution to GDP growth in the negative.

Private consumption is the key growth driver



Source: Eurostat, Economy & Strategy Research, Komerční banka

Investment dynamics is driven by the base effect from last year



Source: SSO, Eurostat, Economy & Strategy Research, Komerční banka

- Consumer prices are set to decrease yet again this year, dragged by food, fuel and administrative prices. Only adjusted inflation supported by rising domestic demand contributes positively to inflation. However, the price dynamics of food and fuel prices are expected to speed up at the turn of 2016/17 and thus inflation should rise to the level of 1.7%.

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Mid-term macroeconomic forecasts for the Slovak Republic

External environment: Lower GDP growth; Brexit represents a risk

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Compared to our last prognosis, the growth prospects for the United States and the euro area have changed just marginally. The common feature is that GDP growth in the U.S. and the euro area, as well as in the CEE region, is driven by domestic demand. The risks remained virtually unchanged, chiefly the potential exit of the United Kingdom from the EU, a slowdown of the Chinese economy, commodity price changes and the ongoing refugee crisis.

United States: Growth is driven by demand

The U.S. economy is likely to grow 1.8% this year.

Growing prospects of the U.S. economy were revised by SG economists just marginally. The main driver remains domestic demand. The labour market has already reached full employment (NAIRU), which creates pressure on wage growth. The unemployment rate is still likely to mildly decline (currently it stands at 5%), unit labour costs are already growing well above 2%, while the participation rate substantially increased. Household consumption is supported by low energy prices, while savings accumulated during the past year contributes to the willingness of households to spend, as well. Residential investments are also likely to boost GDP. On the other hand, business investments still remain under the pressure of lower energy prices and a stronger U.S. dollar (although the dollar has weakened against the euro since January, it is still 18% stronger than in summer 2014). Lower investments in the energy sector are likely to reduce this year's GDP by 0.4%, while net exports are likely to diminish the growth by another 0.5%. All together, the U.S. economy is expected to add 1.9% this year. Next year, the economy is likely to slightly pick up speed to 2.3%.

This year, the Fed is likely to hike rates just once.

U.S. core inflation has kept its solid dynamics despite global disinflationary pressures. Core prices are rising especially thanks to the labour market tightening and development of the housing market. Mortgage loans are the lowest in the past three years, which together with the undersupply of housing creates pressure on core prices. At the end of this year, core prices are likely to hover around the current 2.1%, according to SG economists. Headline inflation, which moves around 1%, is expected to reach 2% at the beginning of 2017 on the back of higher energy prices. Regarding monetary policy settings, SG economists expect the Fed to hike rates just once this year (in December). By then, the Fed is likely to persuade the market that its expectations are too dovish (the market expects just one rate hike with the probability of 75%). The Fed itself anticipates two rate hikes this year. As a result, the Fed's rhetoric is likely to be more hawkish during the summer months to prepare the space for potential rate hikes.

Eurozone: Inflation is likely to gradually go up

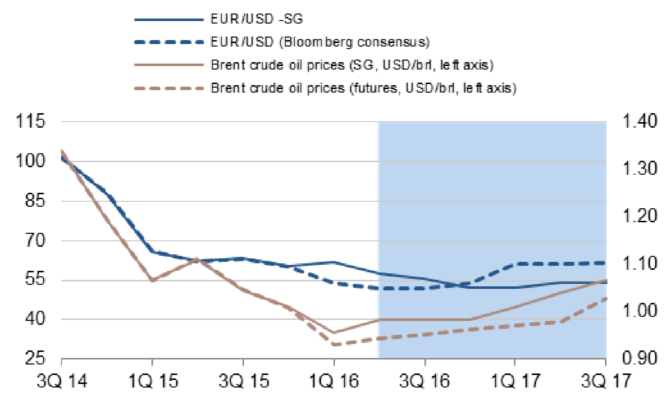
Inflation should reach 0.4% on average this year.

Inflation in the euro area is at a persistently low level. According to SG economists, inflation is likely to hover around zero through the summer, but in H216 it is likely to accelerate given the base effects. Nevertheless, inflation is unlikely to exceed 0.4% on average this year. At the beginning of 2017, inflation is likely to rise temporarily to close to 2%, which might spark the discussion about interest rates' setting. For 2016-20, inflation is however likely to average around 1.4%, still substantially below the ECB's inflationary target of 2%. As a result, SG economists do not believe the ECB will hike rates over the forecasted period (2020). GDP growth is expected to rise 1.6% this year. Growth is driven especially by domestic demand, while investments still lag behind and net exports represent a drag. The forecast for 2017 counts with GDP growth of 1.5%.

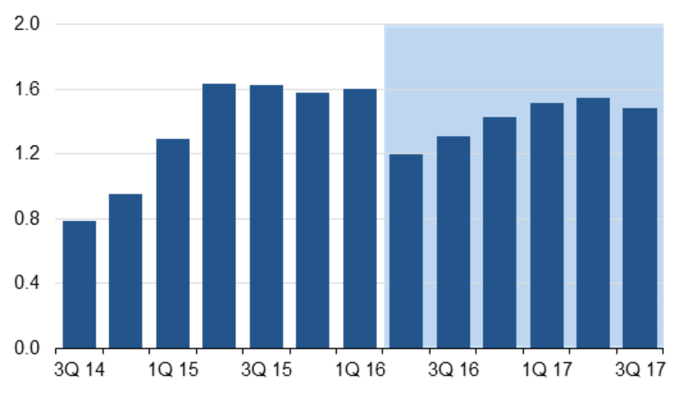
President Draghi sees no room for further rate cuts.

The European Central Bank delivered another package of measures in March to push inflation closer to the inflation target. The ECB lowered all interest rates, with the deposit rate cut by another 10bb to -0.4%. At the same time, ECB President Draghi stated that he doesn't see the scope for further rate cuts. The amount of purchased assets will be raised by €20bn to €80bn starting in April. In addition, investment-grade corporate bonds have now been added to the programme. From June, a new TLTRO programme will start. The interest rate for this programme will move within a range of -0.4% to 0%, according to the amount of lending provided by individual banks. As inflation is likely to rise given the base effects, we cannot expect a great deal of action from the ECB this year. The main question is what the ECB will do in 2017 and beyond if inflation persists below the central bank's target. Currently, the ECB's appetite for buying bank bonds or equities is low. According to SG economists, the most likely scenario is an extension of the asset purchase programme through the end of 2017, extending the TLTRO and possibly including mortgage loans.

Oil prices and EUR/USD



Euro area GDP



Source: Economic & Strategy Research, Komerční banka,SG Cross Asset Research/Economics

The German economy is expected to rise just 1.7% this year and the next. Private consumption is likely to remain the key source of GDP growth, while investment is likely to remain sluggish, and exports will probably wipe out part of the growth. Household consumption is well supported by the positive situation on the labour market. The number of vacancies is at a record high, and slow inflation growth boosts the real disposable income of households. Inflation persists at low levels. This year, it is likely to reach 0.5% on average, according to SG economists, and 1.8% next year. In their view, the risks are balanced. Inflation is expected to be pushed higher by oil prices in H216. On the other hand, there is a risk for wage growth, which could be lower as a consequence of lower external demand and higher labour supply (refugees).

CEE region: Growth driven by domestic demand

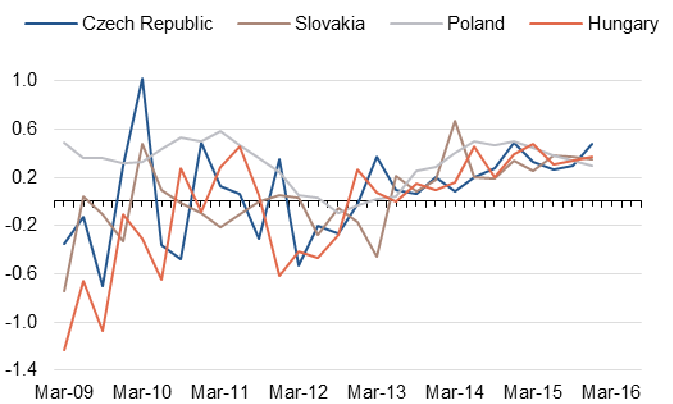
The prospect of individual central banks meeting inflationary targets is still not within sight.

Inflation in the CEE region (the Czech Republic, Poland, Hungary and Slovakia) persists at low levels. Only in the Czech Republic and Hungary is inflation in the positive territory (+0.6% and +0.2% yoy, respectively, in April). In Poland, consumer prices have already been negative since July 2014 (-0.9% yoy in March). Although consumer prices in the region are likely to gradually rise, the prospect of individual central banks meeting inflationary targets is still not within sight. In the Czech Republic, inflation should reach the central bank's target next year. For Slovakia and Poland, it would be a success to break out of deflation by the end of this year (SG economists expect the exit from deflation in Q316 at the earliest). Hungary is not faring any better. According to the Hungarian central bank, the country should achieve its target in H118 at the earliest. Finally, Poland will probably not be able to hit its inflationary target any sooner than 2018.

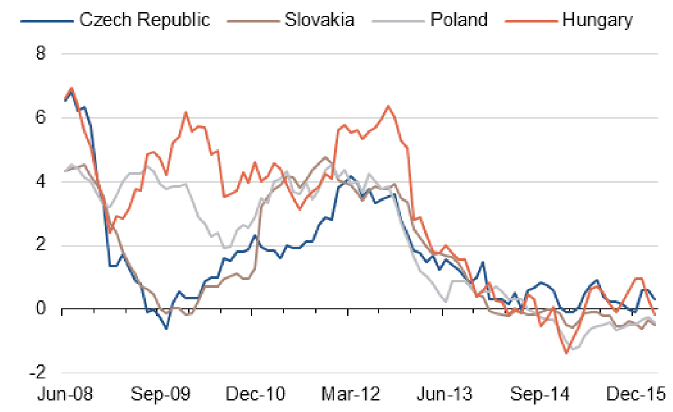
The Hungarian CB cut rates; the Polish CB is likely to stay on hold.

Inflation in the region determines the monetary policy settings of the central banks. The Czech central bank is maintaining its FX commitment at EUR/CZK 27 and, according to our assumptions, is likely to scrap this in Q317. The Hungarian central bank renewed its cycle of rate cuts. From March, it had cut rates three times to the current level of 0.9%. After the last rate cut in May, the central bank stated that the current inflationary outlook and the state of the real economy allow rates to be left unchanged at the current level of 0.9%. The Polish central bank is likely to leave rates unchanged at the current level of 1.5% over the coming months, in SG's view. Any change could undermine the inflationary target, which currently stands at 2.5% +/- 1%. According to SG, the polish central bank could address this question during discussions about the monetary policy strategy for 2017, which will take place soon. The best solution, according to SG, would be an asymmetric inflation target, i.e. inflation no higher than 2.5%.

CEE: Household consumption, contribution to the GDP growth (pp, qoq)



Harmonised inflation (%, yoy)



Source: Economic & Strategy Research, Komerční banka, Eurostat

Fiscal policy stimulates GDP growth in the CEE region.

The main source of GDP growth in the region remains domestic demand. The appetite of households to spend is well supported, not just by positive dynamics on the labour market but also by government measures that improve household budgets. The Hungarian government reduced personal income tax by one percentage point, increased the family tax allowance for families with two children, and the minimum wage was raised 5.7%. The real wages of employees at budgetary institutions rose 10.8% in real terms in January, while unemployment is at its lowest since 2014 (5.8% in April). Poland is in a similar situation; government measures are also stimulating consumption. From 1 April, the 500+ child benefit programme came into operation. The programme provides a subsidy for a second child and every subsequent child thereafter, regardless of household income. According to SG economists, this could raise private consumption 1.0-1.3pp over the coming quarters and GDP growth 0.2-0.3pp. Although fiscal policy supports growth in the region, the deceleration in investment resulting from the new programming period for EU funding will be a drag. In Poland, GDP is expected to grow 3.4% this year, 2.7% in Slovakia, 2.8% in Hungary and 2.1% in the Czech Republic.

Macroeconomic outlook: Inflation continues on a muted note

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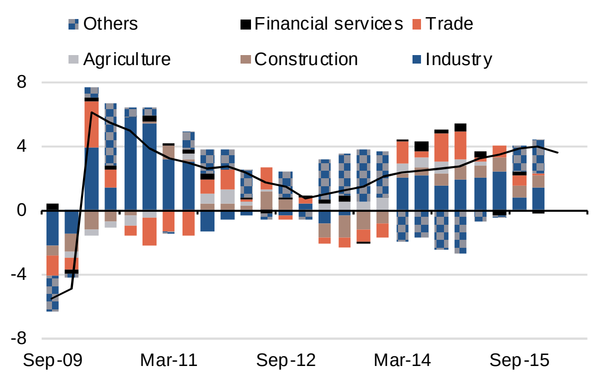
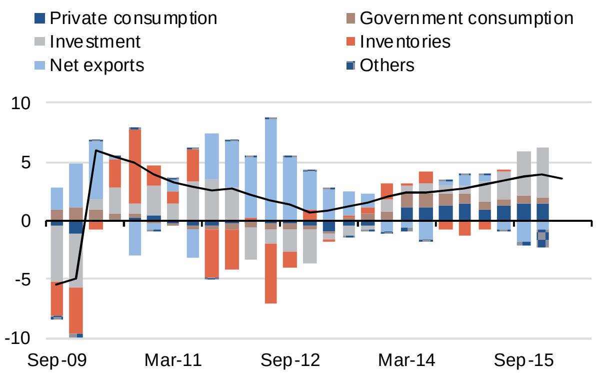
The Slovak economy is running this year without speed enhancer in the form of EU funds. The framework for channelling funds under the new third programming period 2014-2020 is being constructed and hence does not transmit a reasonable amount yet. Therefore, the steam for the economy is provided by private consumption, which largely benefits from outstanding labour market conditions. Employment is rising, and the unemployment rate is gradually decreasing, which results in sound wage growth. The economy is expected to grow 2.7%. Inflationary pressures are muted, and inflation will achieve -0.2% on average this year. However, the price dynamics are expected to speed up at the turn of the year.

Sources of GDP growth (in %, yoy)



Source: Eurostat, Economic & Strategy Research, Komerční banka

Components of GDP demand (in %, yoy)

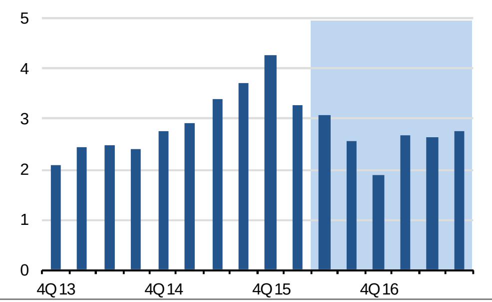


Source: Eurostat, Economic & Strategy Research, Komerční banka

The economy slows down as the inflow of EU funds fades.

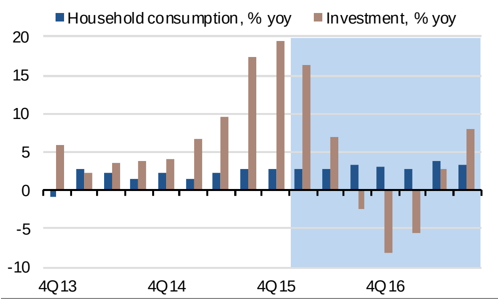
The Slovak economy grew 0.7% qoq (SA) in Q116, which is an increase of 3.6% in yoy terms. This surpasses our expectations. It is highly probable that investment activity boosted by EU funds tapping at the end of last year has been recast into the first quarter to a greater extent than expected. However, investment activity is set to calm down after last year. Private consumption began this year on a low note. Nevertheless, private consumption benefits and will continue to benefit from an improving labour market. Government consumption should also make a positive contribution. Net exports contribute negatively. The import intensity of investment, as well as private consumption, induces imports, which are expected to outperform exports again this year.

GDP growth outlook (in % yoy)



Source: Eurostat, Economic & Strategy Research, Komerční banka

Private consumption to outperform investment (in % yoy)



Source: Eurostat, Economic & Strategy Research, Komerční banka

Employment is supported by older cohorts.

Private consumption is expected to be the leading GDP contributor this year. This is not just because of the decline of fixed investment but rather due to the sound situation of the labour market. The unemployment rate is decreasing, both the one registered by Labour Ministry and the one based on a statistical survey by the Slovak Statistical Office. On top of that, employment is further increasing from already high levels. The source of the growth is the age group of 50-64. The rising share of these older workers is rather structural based on the postponed pension availability age, prolonged life expectancy, and their motivation and ability to continue working. This effect is more pronounced among women, whose share of the labour force has increased by 20 pp to 30% over the past 20 years. Whereas the share of the 50-64 age group has increased 10 pp to 25% in the case of the male labour force. The participation rate is increasing and again after 12 years reached 60% of the Slovak population. In addition, the vacancy rate as well as the number of vacancies have been steadily increasing. Hence, the Slovak economy is creating enough working opportunities.

Slovak consumers don't benefit from good conditions on the labour market just in terms of job opportunities; they also reap the fruits of wage setting conditions.

Real wage dynamics outperform the growth of nominal wages.

The situation on the labour market pushes wages up, as well. They further accelerated in the fourth quarter of 2015 both in real and nominal terms. The year-on-year dynamics of nominal wages reached 4.1%, which is lower than real growth due to persisting deflation. Real growth of wages reached 4.6% yoy. Increasing wage growth supports the rising wage bill as well as the increasing number of hours worked in the domestic economy.

The favourable situation of the labour market is mirrored in improving consumer confidence indicators, not just at the total level but within the particular components, as well. The only component of expected unemployment is slightly correcting its steep improvement at the beginning of the year.

Retail sales lag behind. at the beginning of the year.

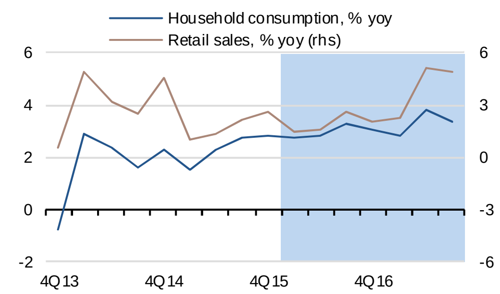
However, the improving situation on the labour market is not visible in retail sales excluding motor vehicles sales. Their qoq dynamics lag behind the pace recorded in previous quarters, slowing down from an average of 0.5% qoq to 0.2% qoq based on the slowdown in many retail sales segments. Developments in automotive sales continue on a high note. They added 12% qoq in the first quarter of 2016. On top of that, motor vehicle parts are rising 4% qoq.

The year-on-year growth of retail sales is expected to stay at the level of the previous year, around 2%. The dynamics of wages, set to underperform the tempo of wages last year, result from increased absorption on the labour market due to the speeding decline of unemployment to 9.6%. The situation is expected to switch when unemployment is

set to decrease another 0.6pp and hence wage growth will accelerate to 3.2% and retails sales are expected to add another 5% in 2017.

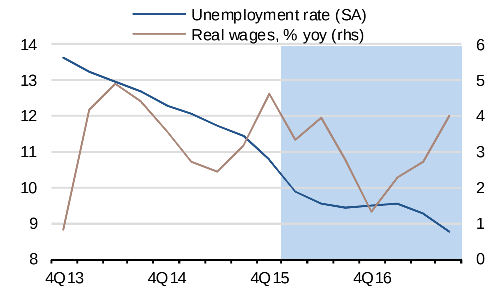
The labour market development will be mirrored by private consumption to add 3% this year and 3.5% in 2017.

Household consumption and retail sales (in %, yoy)



Source: SSO, Economic & Strategy Research, Komerční banka

Unemployment and wages (in %, yoy)



Source: SSO, MLSA, Economic & Strategy Research, Komerční banka

The government has outsourced some its investment in PPP projects.

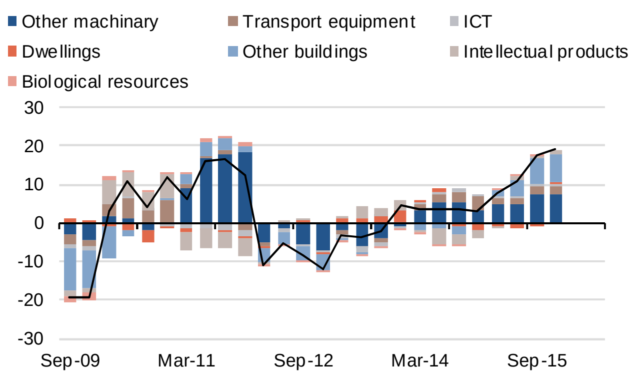
The government was the main investment driver last year thanks to elevated EU funds tapping, which will not be repeated this year. Thus, the structure of fixed investment will shift back to the historically dominant sector of non-financial corporations. A lack of EU funds will not be the only reason for government investment. The government plans several PPP[1] projects. Among the most discussed ones these days is the Bratislava highway bypass prepared by a consortium composed of Cintra (transport infrastructure development), Macquire (financing) and Porr (construction). An increase of using PPP projects in infrastructure building will by definition lead to lower government investment in favour of non-financial corporations' investment, which will make the actual investment. However, his effect will be in the long run.

Investment surpasses that of last year.

The short-term view proposes a different story. Last year's boosted investment activity is expected to have passed over to the beginning of this year. Not all projects were finished on time in Q415 or will be finished in 2016 since the administration process related to EU funds tapping has to be ended by the end of this year. These are the reasons that investment activity has not slowed down abruptly but will rather fade gradually over the year. Therefore, the fixed investment yoy dynamics will slow down from 13.9% in 2015 to 3.2% this year.

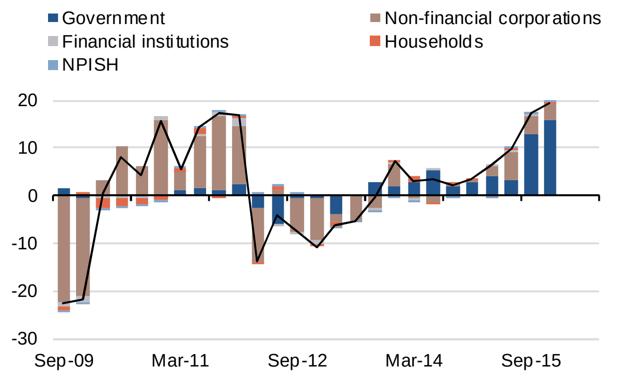
[1] PPP (public private partnership) allows government to make an investment since it is finance by private sector and the government repays it subsequently by yearly instalment.

Fixed investment growth by type of capital (in %, pp, yoy)



Source: SSO, Economic & Strategy Research, Komerční banka

Sectoral decomposition of fixed investment growth (in %, pp, yoy)



Source: SSO, Economic & Strategy Research, Komerční banka

Engineering construction will drag the sector down.

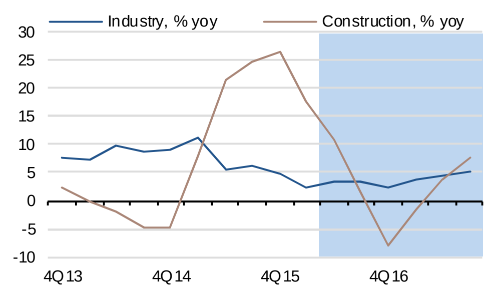
The dynamics of fixed investment can be presented in a nutshell in the case of construction. This sector has the same pattern of yoy dynamics, just with higher amplitude. Construction benefited last year from the EU funds inflow overwhelmingly due to engineering construction. The yoy dynamics stayed at an elevated level during the first two months of 2016 and markedly slowed down only in March. **In spite of the sound beginning of this year, the fading effect of EU funds support will continue, and the yoy rate will decelerate to 5.5% from 20.2% last year. We assume that the transmission channel will most probably be engineering construction.**

A slowdown of industrial activity is expected as well, although in comparison with the construction industry it will be milder. Muted investment activity is set to stimulate industry production by only 2.8% this year.

Manufacturing and electronic equipment production keeps industry growing.

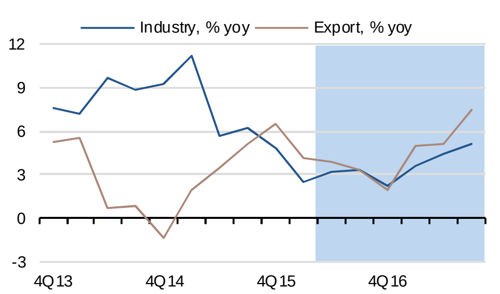
Several sources for this development might be distinguished. One of the most important is the lack EU funds transmitted into industry via subcontracts for construction works. Second is the disappointment at the beginning of the year, which might not be compensated during rest of the year. Industrial activity has slowed down during the first quarter of 2016 in most sectors. However, there are still exceptions that prevail, such as the sectors of electronic equipment production and manufacturing. Manufacturing is doing well in spite of the deceleration of the transport equipment sector. This deceleration is due to other transport means for the domestic market since vehicle production is performing well, as recorded by exports as well as retail sales.

Industry and construction (in %, yoy)



Source: SSO, Economic & Strategy Research, Komerční banka

Export dynamics and industry (in %, yoy)



Source: SSO, Economic & Strategy Research, Komerční banka

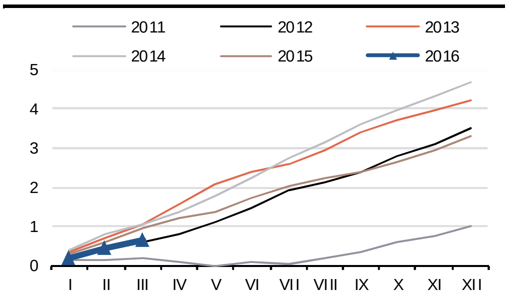
Net exports contribute negatively.

The negative contribution of net exports to GDP growth is set to continue this year, as well. Export dynamics are outperformed by those of imports. Import dynamics benefit from both investment as well as private consumption. However, the trade balance is staying positive, although the surplus is at a lower level than recorded last year. This is due to a deceleration of exports of many items. On the contrary, the stable performance of exports of vehicles adds almost 1% mom since January 2015 and maintains a double-digit yoy growth rate.

Two external trade items stand out clearly due to their deceleration of export and import dynamics, namely food and mineral products, which is not surprising given their global price development.

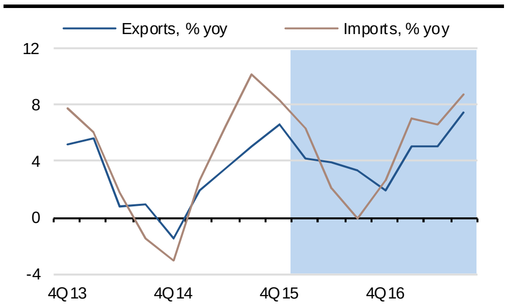
The geographical orientation of exports is supported by the sound dynamics of exports to the EU, the euro area and Germany, specifically. Exports to Russia continue to decline at a double-digit rate, and the beginning of the year is not good for exports to the United States. Imports maintain solid growth dynamics for the main trading partners e.g. the EU, the euro area and the Czech Republic, but they decelerate for other countries.

Trade balance developments (EURbn)



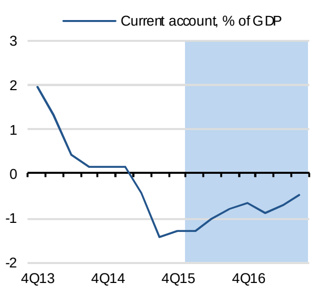
Source: SSO, Economic & Strategy Research, Komerční banka

Export and import dynamics outlook (in %, yoy)



Source: SSO, Economic & Strategy Research, Komerční banka

Current account is set to get back towards zero



Source: NBS, Economic & Strategy Research, Komerční banka

Growth rates on a year-on-year basis for both exports and imports are expected to slow down this year and further accelerate in 2017 as the euro area growth path will speed up and revived investment activity will induce higher imports to the Slovak economy. The contribution of net exports to the GDP growth is expected to contribute negatively, like last year.

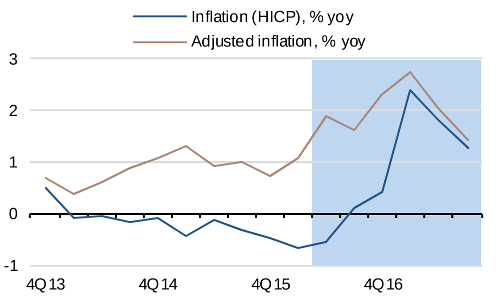
The current account deficit temporarily stagnated at the level of -1.3% of GDP at the end of last year. The balance of goods was lower at the end of 2015 compared with 2014 by around EUR 1bn, and this drop was not compensated by the balance of services or even supported by primary or secondary incomes. The negative current account balance is set to continue this year, as well. However, it is expected to rebound to -0.7% of GDP due to the improved trade balance.

Inflation continues on a muted note this year.

Deflation prevails in the Slovak economy. The price level has decreased throughout the first quarter due to most consumer inflation items except for adjusted inflation. This item represents freely established and not volatile prices in the Slovak economy. An increase in the price level in this segment is a sign of increasing private consumption. Other items recorded negative contributions. The biggest drag came from food prices, and the first quarter of this year was the fourth quarter in a row with a negative contribution to overall inflation. The negative contribution of food prices is expected to prevail until the end of this year. The negative contribution of fuels and administrative prices represented a quarter of a percentage point. This is not a very surprising result given that Brent crude oil prices on the global market are still 23% lower. Fuel prices at Slovak gas stations decreased 11.3% yoy in the first quarter. The evolution of administrative prices mimics the path of fuels, since energy prices influence the vast majority of administrative prices.

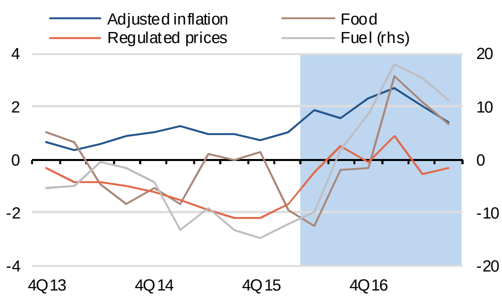
Development of inflation is expected to stay muted this year. The average yoy rate is expected to attain -0.2% this year. The dynamics are set to speed up next year to 1.7% yoy, when adjusted inflation will grow further. Food prices will add positively in 2017 as well as fuel prices, as the high statistical base effect will fade at the end of this year.

Inflation forecast (in %, yoy)



Source: SSO, Economic & Strategy Research, Komerční banka

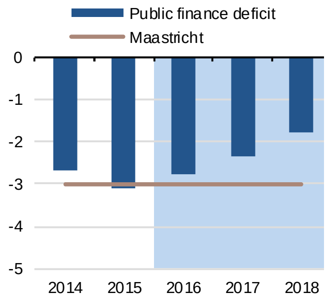
Inflation components (in %, yoy)



Source: SSO, Economic & Strategy Research, Komerční banka

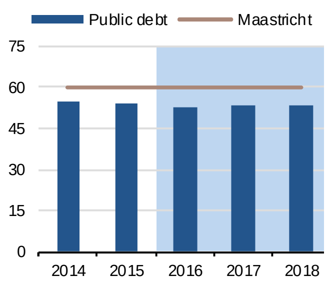
Public sector

Public finance deficit (% of GDP)



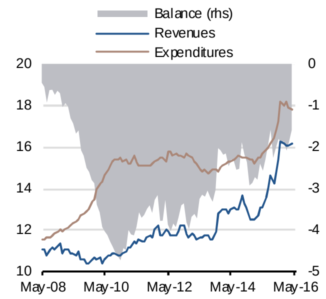
Source: Eurostat, Economic & Strategy Research, Komerční banka

Public sector debt (% of GDP)



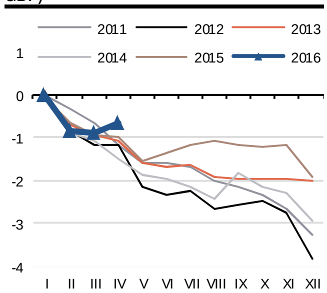
Source: Eurostat, Economic & Strategy Research, Komerční banka

State budget (12m cumulative, bn EUR, % of GDP (rhs))



Source: MFSR, Economic & Strategy Research, Komerční banka

State budget (cumulative deficit, % of GDP)



Source: MFSR, Economic & Strategy Research, Komerční banka

No stimulus from EU funds but ambitious plans

Last year's public sector balance ended in a deficit of 3% of GDP, but the ambition for this year is to achieve a fiscal deficit at a level of 2.1% of GDP. Moreover, the longer-term plan of the newly established government after the election in March targets a gradual improvement of the deficit, which is set to tilt to a fiscal surplus in 2019. The stability programme further explains that the improvement is both due to a cyclical deficit as well as consolidation efforts by the government. The debt-to-GDP ratio is expected to decrease accordingly.

The economy this year will not receive a boost from an inflow of EU funds, as the 2007-13 programming period was closed at end-2015. Some final payments are still flowing into the budget, as can be inferred from the data in April. Perhaps the final rate of tapping achieved will be close to 94.21%, the number recorded at the end of April. However, the ultimate result will be published in March 2017, when the administrative process surrounding the second programming period, 2008-13, will be finished. The country's tapping of the ongoing third programming period, 2014-20, is starting slowly as the state bureaucracy needs to shift its attention to current programmes.

The fiscal deficit for 2015 was revised down 0.5pp. But the four-party government, established after the March election, has confirmed an ambitious plan to reduce the deficit this year to 2.1% of GDP. This looks difficult to us, given that EU co-financing will be missing and the government has to rely on the standard development of the revenue side of the budget, although this should benefit from solid economic growth this year. Moreover, the coalition government will likely limit some of the social programmes announced by the winning party, Smer-SD, before and during its election campaign. Nevertheless, we forecast a fiscal deficit of 2.8% for 2016, mainly due to lower GDP growth than the government assumes.

The government has ambitious long-term plans, as well. It aims to have a fiscal surplus by 2019, which we think is based on overly optimistic GDP assumptions. However, as compared to our assumptions, it does not take into account the global business cycle hitting the Slovak economy as part of the international supply chain in 2019. On top of that, the Council for Budget Responsibility identifies a risk in the forecast for a fiscal deficit in the size of 0.8pp for this year alone due to uncovered expenditures, shifting the estimated horizon of expenditures beyond the budget horizon. Lastly, the budget assumes a small reserve for an unexpected economic slowdown. Therefore, while we still forecast improvements in the fiscal deficit, we are more conservative than the government.

Gross borrowing needs this year are set to compensate for the redemption of bonds expiring this year including the issue denominated in Japanese yen. Therefore, we estimated it for roughly EUR 6.5bn this year and EUR 7.2bn next year.

Public sector debt is expected to print 53.2% of GDP at the end of this year after last year's 52.9%. The stabilisation effort is set to lead to debt reduction in terms of GDP percentage from next year onward.

2016 borrowing needs and financing, EURm

	ARDAL	KB (May)
Borrowing needs		
Budget deficit	1940.9	1932.6
Buybacks	500.0	500.0
Redemption of T-bills	0.0	0.0
Redemption of bonds		3819.3
JPY bonds		199.7
Redemption of loans		0.0
Total		**6451.6**
Financing		
Gross T-bill issuance (ex revolving)		
Gross bond issuance (in auctions)		3800.0
Gross bond issuance (syndicated)		2000.0
Loans		225.0
Tap of liquidity reserve		426.6
Total financing		**6451.6**
Change in debt		*1506.0*

Source: Economic & Strategy Research, Komerční banka, ARDAL

2017 borrowing needs and financing, EURm

	ARDAL	KB (May)
Borrowing needs		
Budget deficit		1973.1
Buybacks		500.0
Redemption of T-bills		0.0
Redemption of bonds		3727.8
Redemption of Eurobonds		1000.0
Redemption of loans		0.0
Total		**7200.9**
Financing		
Gross T-bill issuance (ex revolving)		0.0
Gross bond issuance (in auctions)		3000.0
Gross bond issuance (syndicated)		4000.0
Loans		0.0
Tap of liquidity reserve		200.9
Total financing		**7200.9**
Change in debt		*1772.2*

Source: Economic & Strategy Research, Komerční banka, ARDAL

Risks

Mostly external risks are present surrounding the forecast.

Risks are biased to the downside due elevated policy uncertainty. The main risks related to our forecast are the following:

- **Policy uncertainty on the European Continent is linked to** the OMT judgement from the German Constitutional Court (21 June), then **mainly to the Brexit referendum** (23 June) followed by the repeated Spanish election (26 June) and the Italian constitutional referendum about transforming the Senate of the Republic into the Senate of Regions. Heading into 2017 will be a year of elections in France, Germany and possibly Italy.
- **A hard landing for the Chinese economy has still a high probability.** The Chinese authorities are tackling their policy challenges since last summer. First, it was the equity bubble, then the new FX policy setup. The current issue is the rising property bubble, as well as a mountain of non-performing loans.
- As the refugee crisis might enter the next stage during the summer, any **subsequent possible restrictions or even breakdown of the Schengen area** would seriously hit the economic performance of Slovakia, which is an example of a small, open economy heavily dependent on international supply chains and the free movement of goods and people across the EU.
- **A greater fiscal boost due to the electoral cycle in many European countries,** which might offset the impact of structural reforms in many euro area countries.
- **Investment in the eurozone causes an upside risk** since investment still lags behind compared with the current phase of the business cycle. Cash-rich companies, low rates, high capacity utilisation and favourable profit margins might be behind the lift-off of capital expenditures.

We are able to identify risks that stem purely from the domestic economy:

- **Fiscal development poses a risk for the economy since** the budget is related to high uncertainty stemming from low budget reserves and incorrect fiscal planning. Lastly, a discussion about loosening fiscal debt burden limits might cause uncertainty related to negative outcomes.
- **Favourable financing conditions and strengthening of domestic demand** might push investment higher in spite of the decline due to EU funds financing.

Key economic indicators

	4Q15	1Q16	2Q16	3Q16	4Q16	1Q17	2Q17	3Q17	2015	2016	2017
GDP (real, yoy, %)	4.3	3.3	3.1	2.6	1.9	2.7	2.6	2.8	3.6	2.7	2.7
Household consumption (real, yoy, %)	2.8	2.7	2.8	3.3	3.0	2.8	3.8	3.3	2.4	3.0	3.5
Fixed investments (real, yoy, %)	19.4	16.4	6.8	-2.3	-8.2	-5.5	2.7	7.9	13.2	3.2	3.8
Foreign trade (EUR bn)	0.9	0.7	0.7	0.7	0.6	0.6	0.5	0.5	3.3	2.7	1.8
Industrial production (real, yoy, %)	4.8	2.5	3.3	3.4	2.2	3.6	4.4	5.2	7.0	2.8	4.6
Construction (real, yoy, %)	26.3	17.5	10.7	1.5	-7.9	-1.5	3.7	7.5	20.2	5.5	4.9
Retail sales (real, yoy, %)	2.6	1.5	1.5	2.6	2.0	2.2	5.1	5.0	1.8	1.9	5.0
Wages (real, yoy, %)	4.6	3.3	4.0	2.8	1.3	2.3	2.7	4.0	3.2	2.8	3.2
Unemployment (COLSAF, %)	10.8	10.1	10.5	10.5	10.5	10.6	10.2	9.7	11.5	10.4	10.0
Inflation (HICP, yoy, %)	-0.5	-0.7	-0.6	0.1	0.4	2.4	1.8	1.3	-0.3	-0.2	1.7
Adjusted inflation (yoy, %)	0.7	1.1	1.9	1.6	2.3	2.7	2.0	1.4	1.0	1.7	1.9
Food prices (yoy, %)	0.3	-1.9	-2.5	-0.4	-0.3	3.1	2.2	1.3	-0.3	-1.3	2.1
Fuel prices (yoy, %)	-14.8	-11.9	-9.9	2.0	8.6	17.9	15.5	11.3	-12.6	-2.8	14.3
Regulated prices (yoy, %)	-2.2	-1.6	-0.5	0.5	-0.1	0.9	-0.6	-0.3	-1.9	-0.4	-0.1

Source: Eurostat, SSO, NBS, MF, COLSAF, Economic & Strategy Research, Komerční banka
Note: KB forecasts are in blue

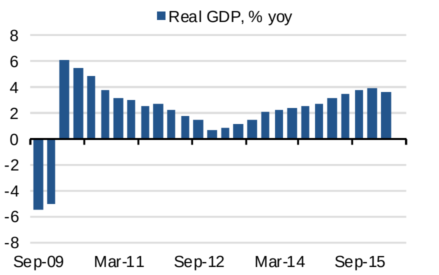
Slovak long-term macroeconomic forecasts

		2011	2012	2013	2014	2015	2016	2017	2018	2019
Gross Domestic Product	current prices, EUR bn	70.4	72.4	73.8	75.6	78.1	80.5	84.4	88.3	92.2
Gross Domestic Product	real growth, %	2.8	1.6	1.4	2.5	3.6	2.7	2.7	2.4	1.6
Industrial output	real growth, %	5.4	7.2	3.9	8.7	7.0	2.8	4.6	4.1	2.0
Construction	real growth, %	-0.5	-11.9	-4.4	-2.8	20.2	5.5	4.9	7.2	3.0
Retail sales	real growth, %	-2.6	-1.1	0.3	3.8	1.8	1.9	5.0	4.2	3.5
Unemployment rate	end of period, %	12.5	13.6	14.4	12.3	10.5	10.5	9.5	9.3	9.6
Average national wage	EUR, nominal, average	786	806	824	858	883	907	953	994	1037
Average national wage	average growth, real, %	-1.8	-1.2	0.9	4.2	3.2	2.8	3.2	2.0	2.2
Consumer prices	HICP, average, %	4.1	3.7	1.5	-0.1	-0.3	-0.2	1.7	2.2	2.1
Consumer prices	HICP, end of period, %	1.3	4.6	3.4	-0.3	-0.6	1.4	1.5	2.7	1.7
Foreign trade	current prices, EUR bn	1.0	3.6	4.2	4.7	3.3	4.0	3.0	2.0	1.8
Exports of goods	current prices, EUR bn	56.8	62.1	64.2	64.7	67.9	69.4	73.9	78.8	81.7
Imports of goods	current prices, EUR bn	55.8	58.6	59.9	60.0	64.6	65.5	70.9	76.8	79.8
Exports of goods	nominal growth, %	18.5	9.2	3.5	1.4	4.3	3.4	6.2	6.4	3.6
Imports of goods	nominal growth, %	18.6	4.9	2.5	0.8	6.9	2.7	7.9	8.0	3.9
Current account	current prices, EUR bn	-3.5	0.7	1.4	0.1	-1.0	-0.5	-0.5	-0.9	-1.1
Current account	% of GDP	-5.0	0.9	2.0	0.1	-1.3	-0.7	-0.6	-1.1	-1.2
Balance of goods	% of GDP	-0.1	3.5	4.1	3.8	2.4	3.5	3.3	2.9	2.9
Balance of services	% of GDP	-0.4	0.6	0.6	0.1	0.1	0.1	0.1	-0.1	-0.5
Income balance	% of GDP	-3.4	-1.7	-0.9	-2.2	-2.3	-2.7	-2.5	-2.4	-2.3
State budget	EUR bn	-3.3	-3.8	-2.0	-2.9	-1.9	-1.0	0.0	0.2	-0.1
State budget	% of GDP	-4.7	-5.3	-2.7	-3.9	-2.5	-1.3	0.0	0.3	-0.1
Public sector deficit	% of GDP	-4.1	-4.3	-2.7	-2.7	-3.1	-2.8	-2.3	-1.8	-1.5
Public debt	EUR bn	30.5	37.9	40.6	40.7	41.3	42.8	44.8	46.4	47.7
Public debt	% of GDP	43.3	52.4	55.0	53.9	52.9	53.2	53.1	52.6	51.8
External debt	% of GDP	78.5	75.8	81.9	89.7	86.1	83.9	81.5	79.8	82.4

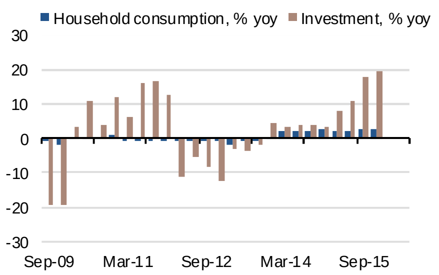
Source: SSO, NBS, MF, COLSAF, Economic & Strategy Research, Komerční banka
Note: KB forecasts are in blue

Macroeconomic indicators

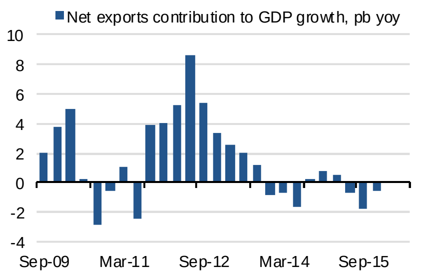
GDP (yoy)



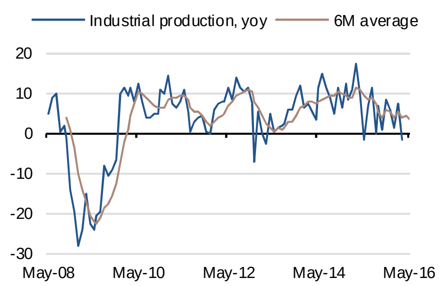
HH consumption, investment (yoy)



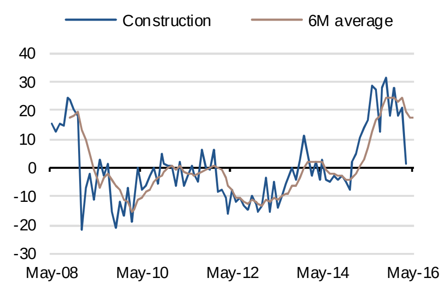
Net exports



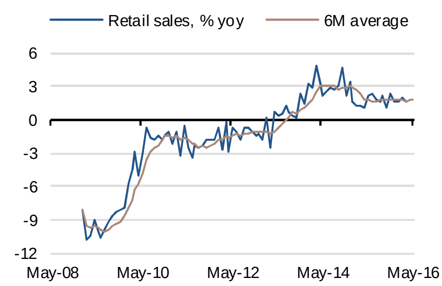
Industry (yoy)



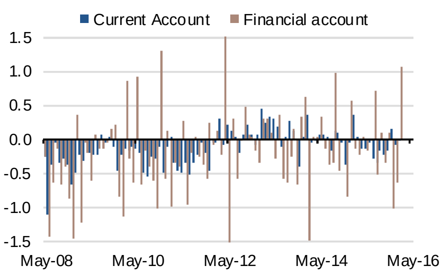
Construction (yoy)



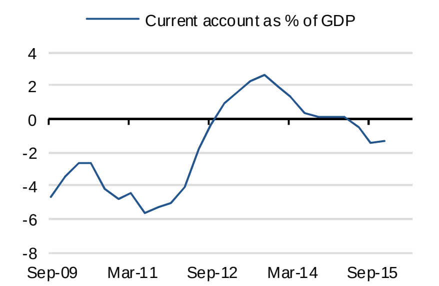
Retail sales (yoy)



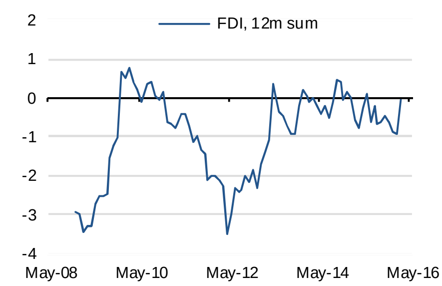
Balance of payments (EUR bn)



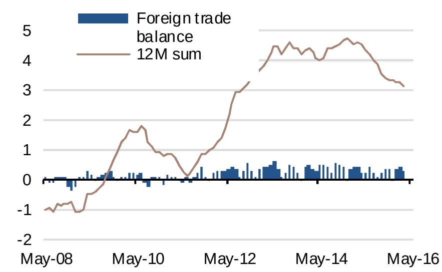
Current account (% of GDP)



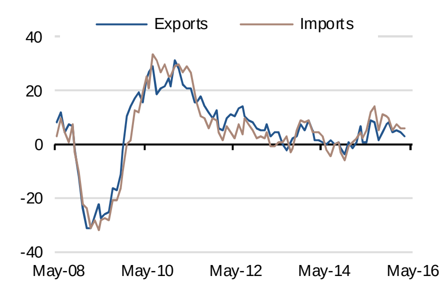
Foreign direct investments (EUR bn)



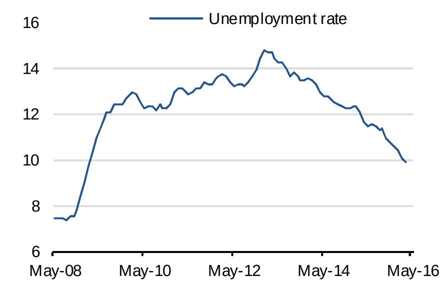
Foreign trade balance (EUR bn)



Export and import dynamics (yoy)

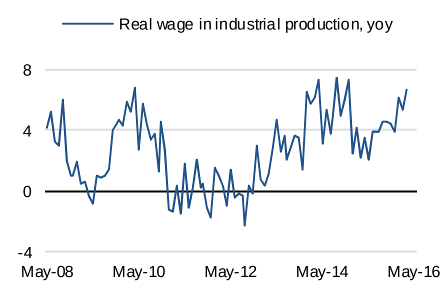


Unemployment rate (%)

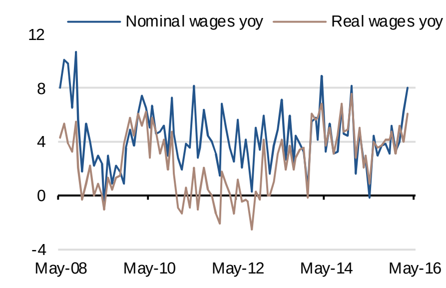


Source: Eurostat, SSO, NBS, Economic & Strategy Research, Komerční banka

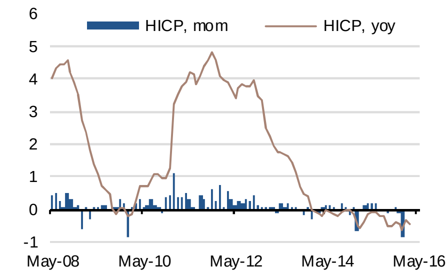
Real wages in industrial production (yoy)



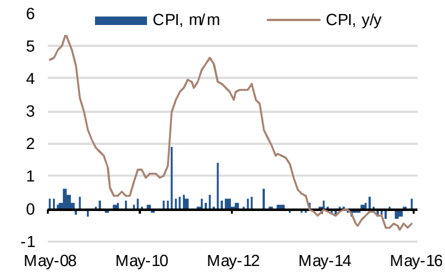
Wages in the economy (yoy)



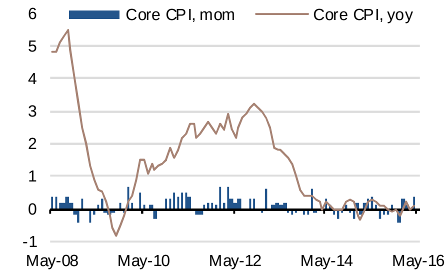
Consumer prices (HICP, %)



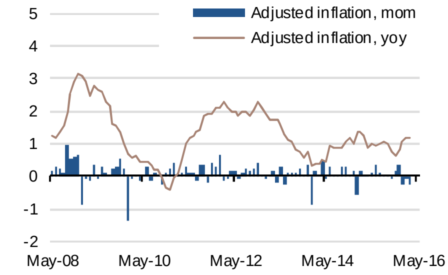
Consumer prices (%)



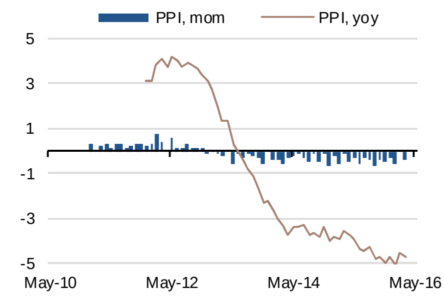
Core inflation (%)



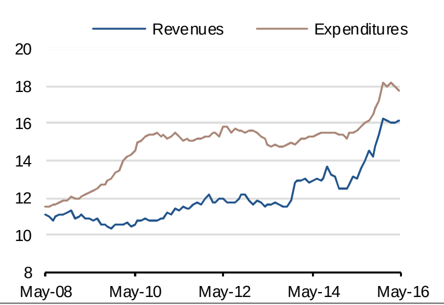
Adjusted inflation (%)



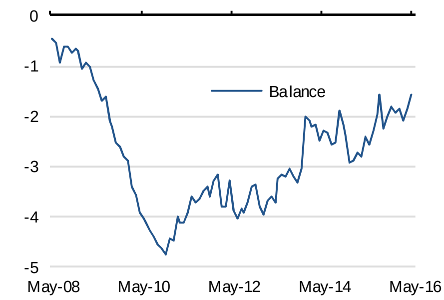
Producer prices (%)



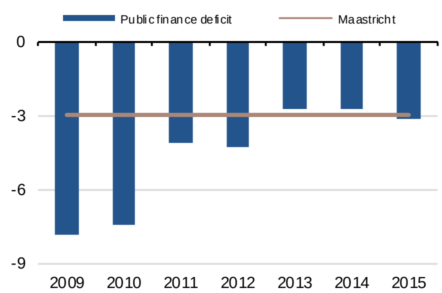
State budget (revenues, expenditures, in EURbn, cumulative for past 12M)



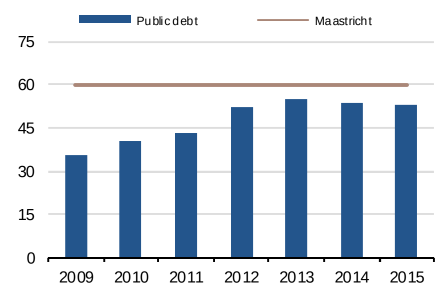
State budget (balance, in EURbn, cumulative for past 12M)



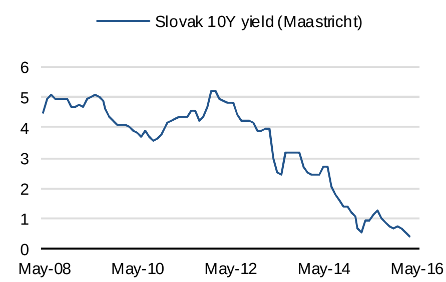
Public finance deficit (% of GDP)



Public debt (% of GDP)



Slovakia government 10Y bond yield (Maastricht)



Source: SSO, NBS, Eurostat, Economic & Strategy Research, Komerční banka

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