

Slovakia Business Forecast Report Q1 2015

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Abstracts

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Core Views

Prime Minister Robert Fico will continue to benefit from his party's outright majority in parliament, which has eased the policy formation and implementation process. While this is positive for political stability in the short term, it does not provide much space for consensus politics, with Fico's tax and welfare reforms likely to keep investors cautious.

Fico's failed bid for the presidency in March 2014 is a sign of growing voter wariness of single-party rule and mainstream political parties, with general elections in 2016 unlikely to give the ruling party another outright parliamentary majority.

Although Slovakia has been released from the European Commission's Excessive Deficit Procedure, the government will have to maintain a relatively tight fiscal stance in light of rising public debt loads and looming constitutional debt brakes. However, we believe Slovakia is on a sustainable fiscal trajectory with few risks to its solid sovereign credit profile.

The short-term economic outlook has brightened as export growth led growth of the previous years is beginning to translate to a visible pick-up in domestic demand. We expect domestic demand growth to remain robust, driving growth in the coming years. The current account will remain in surplus over the medium term, even as economic growth becomes increasingly weighted towards domestic demand.

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CHAPTER 1: POLITICAL OUTLOOK

SWOT Analysis

BMI Political Risk Index

Domestic Politics

Russia Ties To Strain EU Relations

Slovakia will attempt to maintain good relations with Russia while at the same time being part of the EU's efforts to aid Ukraine, a delicate balancing act that threatens to fray relations with both sides. This will be negative for Slovakia's diplomatic standing within EU institutions and among NATO members.

Table: Political Overview

Long-Term Political Outlook

Convergence With West Remains Core View

We expect Slovakia to continue to converge with Western European policies and standards of living over the next 10 years as the small economy has benefited greatly from inclusion in the bloc. However, we stress that the country will face a number of challenges to political stability including corruption, relations with the eurozone, ethnic tensions and population decline.

CHAPTER 2: ECONOMIC OUTLOOK

SWOT Analysis

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Economic Activity

Domestic Demand Will Prop Up Growth

Economic activity in Slovakia will face headwinds in the coming quarters from weaker external demand, but domestic demand will remain strong enough to avert a significant slowdown.

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Smaller Current Account Surpluses Ahead

Weak external demand and relatively strong domestic demand will narrow Slovakia's current account surplus from 2.1% of GDP in 2013 to 0.9% by 2015. Slovakia has outperformed Central European peers in terms of its ability to attract foreign direct investment, which bodes well for medium-term growth and export potential.

Table: Balance Of Payments

Fiscal Policy

On A Stable Trajectory

We forecast the pace of fiscal consolidation in Slovakia to be slower than government projections and EU recommendations in the coming years. However, we see few risks to the country's sovereign credit profile given that public debt and deficit levels are at sustainable levels and will remain comfortably within EU-mandated limits.

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The ECB has embarked on additional monetary easing at the September meeting, earlier than we had expected. The ECB's almost knee-jerk reaction to the longstanding deterioration in headline inflation and macro data suggests that the central bank has started to backpedal fast, having previously played down the risks of deflation.

EUR: Structural Bearish View Playing Out

Our long-running bearish EUR view is finally playing out. Even if the euro bounces in the coming months (given how bearish sentiment has now turned and how inflated expectations of aggressive monetary easing have become), the direction versus the dollar and a broad set of currencies remains lower over a multiyear period.

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Macroeconomic stability and institutional convergence with Western norms will be bolstered in the long term by Slovakia's eurozone membership. However, we believe the drawbacks of having the euro will outweigh the benefits, limiting potential growth in the next decade. Nevertheless, we expect real GDP growth to average 2.5% over our 10-year forecast period, well above eurozone averages.

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