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ACRA assigns long-term credit ratings of A+ to Slovakia under the international scale, outlook Stable

The Slovak Republic (hereinafter, Slovakia, or the country) has been assigned the following ratings under the international scale:

- **Long-term** foreign currency credit rating at **A+** and local currency credit rating at **A+**;
- **Short-term** foreign currency credit rating at **S1** and local currency credit rating at **S1**.

The outlook on the long-term foreign currency credit rating is **Stable** and local currency credit rating is **Stable**.

The **Stable outlook** assumes that the rating will most likely stay unchanged within the 12 to 18-month horizon.

Credit rating rationale

Slovakia's A+ sovereign credit rating is based on a relatively wealthy economy, which has been growing rapidly in the last few years, strong public finances, a moderate debt level, sustainable external position, and good institutional factors. However, the country's GDP growth outlook is a source of concern due to the high concentration on the automotive industry, which means exposure to industry-specific risks and risks associated with global trade tensions. Moreover, economic potential is constrained by the quality and quantity of the labor force, as well as the small size and considerable openness of the Slovakian economy.

Slovakia has benefited from a favorable economic environment. Economic growth has been more than 3% over the last four years (3.5% compared to the EU average of 2.2%). On the back of rapid industrialization, a strategically good location in the center of Europe, large FDI inflows, an abundance of low-cost and skilled labor, and access to EU structural funds, the income level in Slovakia has converged to the average EU level. Now it is the third highest (33,900 international dollars) among Eastern EU countries. Above average growth has contributed to the record low unemployment rate and higher than EU average inflation. However, ACRA expects the country's economic growth to decelerate to 2.3–2.8% in 2019–2020.

This is mainly due to the risks associated with global trade tensions, which affect Slovakia's key trade partners. In particular, there are risks of an imposition of tariffs on exports to the UK due to its possible withdrawal from the EU and potential limitations on car exports to the US. Moreover, Slovakia's dependence on the German economy, which is expected to slow down in 2019 and 2020, will negatively affect the country. In the longer term, Slovakian carmakers are exposed to major changes due to the increased use of electric vehicles, growth of the sharing economy, and the emergence of self-driving cars. The failure of Slovakia's car manufacturers to respond to these challenges could have a considerable negative impact on the country's economic growth and employment.

Another long-term factor is the quality and size of the labor force, which may shrink due to negative demographic trends. Factors that negatively impact the quality of the labor force are brain drain, weak education scores compared to Central and Eastern European (CEE) peers, and insufficient R&D spending. All this could compromise the country's competiveness.

Slovakia's public finances have benefited from a favorable economic environment, Eurozone membership, and a strong debt rule. High GDP growth in recent years has led to a decline in the general government consolidated debt to GDP ratio from 54.7% in 2013 to 49.4% in 2018, which makes it one of the lowest among CEE peers. ACRA expects the ratio to continue to decline to 47.5% of GDP in 2019 and further drop to

45.5% in 2020. However, in our view this decline will mostly be attributable to GDP growth, as the government's plan to balance the budget this year is unlikely to materialize. As for 2020, ACRA expects a small budget deficit (1.5% of GDP) due to a hike in social spending and a cut in corporate tax, which have been promised by the ruling party before parliamentary elections in 2020.

Although the share of public debt held by non-residents is high — 63.9% at the end of 2018 — in our view it is not a concern. This is because Slovakia is a member of a monetary union whose currency has reserve status. Moreover, the outright monetary transaction program (OMT) launched by the ECB in 2016 guarantees the country unlimited access to the market for refinancing purposes.

Contingent liability risks are contained. The level of public guarantees is not only the lowest among CEE peers, but also in the EU as a whole. Contingent liability risks related to the banking sector are mitigated by its good capital adequacy and asset quality metrics. Moreover, the National Bank of Slovakia's (NBS) effective macroprudential measures and an increase in household income, which has been matched by an increase in real estate prices, contain the growth of the household debt-to-GDP ratio. Non-financial sector contingent liability risk is low. The share of non-financial corporations' debt is lower than that of CEE peers and the EU average.

Slovakia's external position is strong. This is due to the high reserve coverage of the FX component of the country's external debt, which stood at 200% in 2018. Also, the rise in external debt, which reached 113% in 2018 compared to 85% in 2015, was mainly associated with the increase of foreign deposits in the NBS. Slovakia's current account was moderately negative in 2018, as well as its net investment position. This, however, reflects the country's FDI-intensive growth model rather than the result of a trade deficit.

Institutional factors are above average on the scale ACRA uses to assess countries, but lower compared to countries with the same level of creditworthiness. The biggest constraint for Slovakia is its relatively low Control of Corruption score in the World Governance Indicators, which are compiled by the World Bank. Corruption was identified as the most problematic factor (by 19.1% of respondents) for doing business in the 2017–2018 World Economic Forum survey. Also, in 2018, Slovakia ranked 50th (the first rank means the lowest level of corruption) in the Transparency International Corruption Perception Index for 180 countries.

Sovereign model application results

Slovakia has been assigned an A+ Indicative credit rating in accordance with the core part of ACRA's sovereign model. A number of modifiers in the modifiers part of the model allow the Indicative credit rating to be increased. These include the following, which are determined by the Methodology for Credit Rating Assignment to Sovereign Entities under the International Scale:

- Market access and sources of funding;
- External debt sustainability.

Negative modifiers are the following:

- Potential economic growth;
- Sustainability of economic growth.

The Assigned A+ credit rating coincides with the Indicative credit rating as the total impact of positive modifiers is offset by the total impact of negative modifiers. There are no extraordinary factors that could adjust the Final credit rating.

Potential rating upgrade factors

- Decline in public debt;
- Increase in domestic holding of public and private debt;

- Material improvement in governance.

Potential rating downgrade factors

- Increase in public debt;
- Potentially serious external or industry-specific shocks and developments that may lead to decline in economic growth;
- Risk of redenomination.

Issue ratings

No outstanding issues have been rated.

Regulatory disclosure

The sovereign credit ratings have been assigned to Slovakia under the international scale based on the Methodology for Credit Rating Assignment to Sovereign Entities under the International Scale and the Key Concepts Used by the Analytical Credit Rating Agency Within the Scope of Its Rating Activities.

The sovereign credit ratings have been assigned to Slovakia for the first time. The sovereign credit ratings and their outlook are expected to be revised within 182 days following the publication date of this press release as per the Calendar of planned sovereign credit rating revisions and publications.

The sovereign credit ratings are based on information from publicly available sources, as well as ACRA's own databases. The sovereign credit ratings are unsolicited. The Government of Slovakia did not participate in the credit rating assignment.

ACRA provided no additional services to the Government of Slovakia. No conflicts of interest were discovered in the course of the sovereign credit rating assignment.

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