INTERNATIONAL MONETARY FUND

IMF Country Report No. 18/241

SLOVAK REPUBLIC

July 2018

2018 ARTICLE IV CONSULTATION—PRESS RELEASE; STAFF REPORT AND STATEMENT BY THE EXECUTIVE DIRECTOR FOR THE SLOVAK REPUBLIC

Under Article IV of the IMF's Articles of Agreement, the IMF holds bilateral discussions with members, usually every year. In the context of the 2018 Article IV consultation with the Slovak Republic, the following documents have been released and are included in this package:

- A **Press Release** summarizing the views of the Executive Board as expressed during its July 23, 2018 consideration of the staff report that concluded the Article IV consultation with the Slovak Republic.
- The **Staff Report** prepared by a staff team of the IMF for the Executive Board's consideration on July 23, 2018 following discussions that ended on May 22, 2018 with the officials of the Slovak Republic on economic developments and policies. Based on information available at the time of these discussions, the staff report was completed on June 13, 2018.
- An **Informational Annex** prepared by the IMF staff.
- A **Statement by the Executive Director** for the Slovak Republic.

Selected Issues

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IMF Executive Board Concludes 2018 Article IV Consultation with the Slovak Republic

On July 23, 2018, the Executive Board of the International Monetary Fund (IMF) concluded the 2018 Article IV Consultation with the Slovak Republic.[1]

Slovakia's economic performance continues to be favorable, with real per capita GDP growing at the average annual rate of 3 percent over the past five years. Growth has been supported by predominantly domestic demand. Private consumption continued to benefit from strong credit growth, robust job creation, and rising wages, while investment reversed its temporary decline from 2016 that was due to a slow start in the implementation of new EU funds programming period. Unemployment reached a record low of 7.7 percent at end-2017. The output gap is slightly positive with inflation picking up recently, likely reflecting both strong domestic demand and a tight labor market. On the back of strong economic growth, fiscal consolidation has continued putting public debt on a firmly downward trajectory. The banking sector is well-capitalized and profitable. Despite a declining interest margin, banks have maintained their profitability by increasing lending volumes.

Real GDP growth is projected to accelerate to 4 percent this year and 4.2 percent in 2019, reflecting additional investment in the automotive industry and expanded export capacity, before converging towards its potential of 3½ percent in the medium term. The current account balance is expected to continue improving along with the trade balance. On the external front, rising trade protectionism constitutes the main downside risk for Slovakia's export-dependent economy as well as possible financial turmoil in the euro area. On the domestic front, downside risks arise from labor shortages, particularly for skilled workers, and vulnerabilities related to the fast credit growth. On the upside, growth can become stronger if there is a pick-up in investment, including from higher absorption of the EU funds.

Notwithstanding the favorable outlook, Slovakia faces some important structural challenges. As in other countries, post-crisis productivity growth has slowed significantly. Some initial progress

[1] Under Article IV of the IMF's Articles of Agreement, the IMF holds bilateral discussions with members, usually every year. A staff team visits the country, collects economic and financial information, and discusses with officials the country's economic developments and policies. On return to headquarters, the staff prepares a report, which forms the basis for discussion by the Executive Board.

has been made on structural reforms, including plans to expand the provision of formal childcare and pre-primary education, and efforts to enhance public administration transparency. However, challenges remain, including acute labor shortages, significant gaps in quality of education and institutions relative to EU peers, and an ageing workforce.

Executive Board Assessment[2]

Executive Directors welcomed the Slovak economy's favorable performance, with robust real per capita GDP growth, record-low unemployment, and sustained improvement in fiscal balances. Strong real convergence has been facilitated by increasing and successful integration into the European Union and the euro area. Growth is expected to accelerate in 2018 and converge to its potential over the medium term. However, Directors noted risks from rising international trade tensions, persistent labor shortages, and a potential sudden downturn in the property market. Directors urged the authorities to decisively address these challenges.

Directors noted that labor shortages and low labor force participation of women and disadvantaged groups pose constraints to potential growth. They highlighted the need to focus structural policies on increasing labor supply and improving education and institutional quality to strengthen productivity and potential growth.

To address rising labor shortages and skills mismatches, Directors supported recent measures to streamline the issuance of work permits for foreign workers, and recommended further simplification of administrative procedures. Focusing active labor market policies on training, job counseling, and enhancing labor mobility will be important. Directors also welcomed the planned expansion of formal childcare services and broadly encouraged greater gender flexibility in the use of childcare-related leave.

To close the education gap, Directors encouraged further measures to enhance the attractiveness of the teaching profession and strengthen collaboration between vocational schools and employers. Investment in R&D will also be important to foster innovation and move up the export value chain. On governance, Directors underscored the importance of the effective implementation of the recently approved Civil Service Act and Anti-Offshore Law, as well as a more competitive public procurement system.

Directors supported the authorities' fiscal policy efforts which, together with robust growth, are helping to improve fiscal balances and create policy space. The planned fiscal path to achieve a balanced position in the medium term would create sufficient buffers to weather macroeconomic shocks within the framework of the Fiscal Responsibility Law. Continued efforts to improve public sector efficiency would unlock resources to finance policy priorities, such as measures to

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[2] At the conclusion of the discussion, the Managing Director, as Chairman of the Board, summarizes the views of Executive Directors, and this summary is transmitted to the country's authorities. An explanation of any qualifiers used in summing up can be found here: http://www.imf.org/external/np/sec/misc/qualifiers.htm.

increase domestic labor supply and address gaps in infrastructure and education quality. Against this backdrop, Directors welcomed planned measures to combat tax evasion and further improve tax administration, and urged the authorities to fully capture the savings identified in the ongoing public expenditure reviews.

Directors concurred that the banking system is well capitalized, liquid, and profitable. However, they cautioned that increased household indebtedness renders households and the banking sector vulnerable to adverse macroeconomic shocks and a property market downturn. In this respect, Directors commended the authorities for proactively using macroprudential policies over the past four years to curb lending to risky and highly-indebted borrowers. They viewed these measures as striking an appropriate balance between financial deepening and safeguarding financial stability, and welcomed the authorities' readiness to further tighten macroprudential measures if needed. Many Directors also saw scope to raise property taxes or reduce tax subsidy to help manage housing demand.

It is expected that the next Article IV consultation with the Slovak Republic will be held on the standard 12-month cycle.

Slovak Republic: Selected Economic Indicators, 2015–2020

	2015	2016	2017	2018	2019	2020
			Est.	Projections		
National income, prices and wages (Annual percentage change)						
Real GDP	3.9	3.3	3.4	4.0	4.2	3.8
Inflation (HICP)	-0.3	-0.5	1.3	2.4	2.1	2.0
Inflation (HICP, end of period)	-0.5	0.2	2.0	2.5	2.0	2.0
Employment	2.0	2.4	2.2	1.6	1.1	1.0
Unemployment rate (Percent)	11.5	9.7	8.1	7.4	6.8	6.4
Public finance, general government (Percent of GDP)						
Revenue	42.5	39.3	39.4	38.4	38.1	38.6
Expenditure	45.2	41.5	40.4	39.1	38.6	38.6
Overall balance	-2.7	-2.2	-1.0	-0.8	-0.5	0.0
General government debt	52.3	51.8	50.9	49.3	46.7	44.9
Monetary and financial indicators (Percent)						
Credit to private sector (Growth rate)	9.6	9.7	11.0	10.3	9.7	9.0
Lending rates[1]	2.7	2.0	…	…	…	…
Deposit rates[2]	1.0	0.9	…	…	…	…
Government 10-year bond yield	0.9	0.5	…	…	…	…
Balance of payments (Percent of GDP)						
Trade balance (goods)	1.3	2.0	0.8	0.3	0.9	1.5
Current account balance	-1.7	-1.5	-2.1	-1.8	-0.9	-0.3
Gross external debt	85.2	90.9	110.8	110.0	108.9	108.0

Sources: National Authorities; and IMF staff projections.

[1]Average of interest rates on new housing loans to households and loans of less than €1 million to nonfinancial corporations (all maturities).

[2]Average of interest rates on new deposits with agreed maturity (up to 1 year) from households and nonfinancial corporations.

INTERNATIONAL MONETARY FUND

SLOVAK REPUBLIC

STAFF REPORT FOR THE 2018 ARTICLE IV CONSULTATION

June 13, 2018

KEY ISSUES

Context: The Slovak economy is enjoying consecutive years of favorable performance marked by robust real per capita GDP growth, record-low unemployment and sustained improvement in fiscal balances. However, shortages of skilled labor, and gaps in education and institutional quality pose risks to an already declining productivity growth. A decade-long double-digit mortgage lending growth has more than doubled household indebtedness relative to GDP, posing financial stability risks.

Key Policy Recommendations

Structural Policy. To reverse the slowdown in productivity growth, reform priorities are to address labor and skills shortages and improve institutional quality. This will require policies to strengthen the current framework for employing foreign workers, increase participation and employment of women and disadvantaged groups, better align regular and vocational education with labor market needs, increase transparency and competitiveness of the public procurement system, and enhance anti-corruption efforts.

Fiscal Policy. Robust job-rich growth and policy efforts have significantly reduced the headline fiscal deficit in recent years. With a positive output gap, the authorities' objective to continue consolidation is appropriate and will create sizable fiscal space to counter unforeseen macroeconomic shocks. Priority spending for infrastructure, education and labor market reforms should be financed through higher revenue and spending efficiency and efficient use of EU funds.

Financial Policy. Household indebtedness and private sector credit growth are both assessed to be somewhat higher than levels implied by economic fundamentals. Pro-active macroprudential measures have rightly focused on preserving lending standards, guarding against excessive household indebtedness, and increasing banks' buffers against potential macroeconomic and property market downturns. These measures seem to be slowing credit growth to households. However, with persistent and high cyclical risks, further tightening of macroprudential measures should not be ruled out. Considerations can be given to reducing implicit subsidies to homeownership that currently arise from the tax exemption of capital gains.

Approved By
Enrica Detragiache (EUR) and Zeine Zeidane (SPR)

Discussions were held in Bratislava, May 9–22, 2018. The mission met with Finance Minister Kažimír, NBS Governor Makuch, other senior officials from Finance, Education, Labor, and Interior ministries and NBS, the Council for Fiscal Responsibility, and representatives from the private sector, European Union and trade unions.

The staff team comprised Ms. Rahman (head), Ms. Yackovlev, Mr. Stepanyan and Ms. Jirasavetakul. Mr. Hagara (OED) attended the meetings. Messrs. Park and Smith assisted in the preparation of the staff report.

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CONTEXT

1. The Slovak economy is enjoying consecutive years of favorable performance. Supported by strong credit and jobs growth, real per capita GDP expanded by about 3 percent annually during the last five years taking both the unemployment rate and the fiscal deficit to their lowest levels ever. Real GDP growth is expected to pick up further in the medium term reflecting additional investments and capacity expansion in the automotive sector. The output gap is slightly positive, while external sector developments are in line with long-term averages (Figure 1).

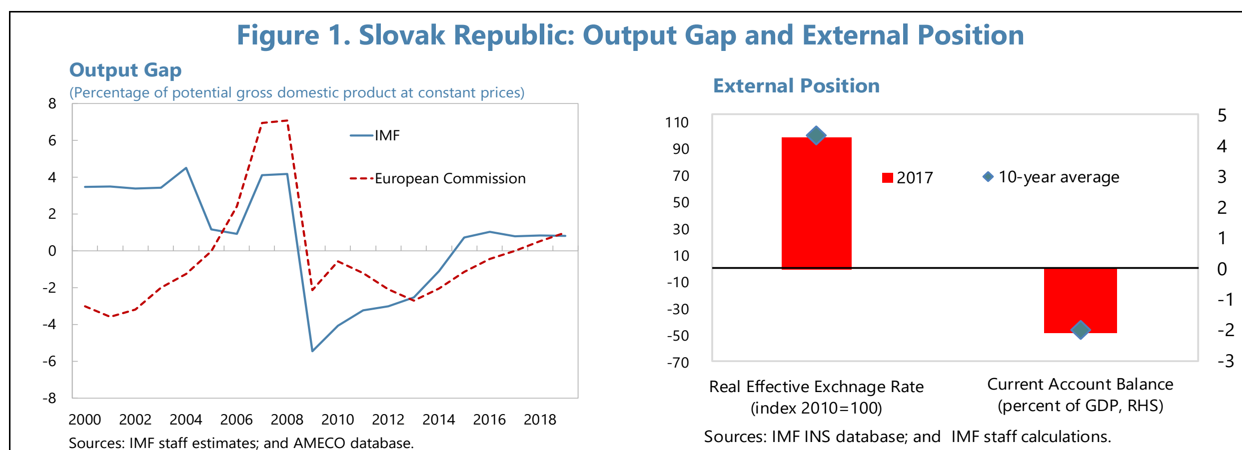


Figure 1. Slovak Republic: Output Gap and External Position

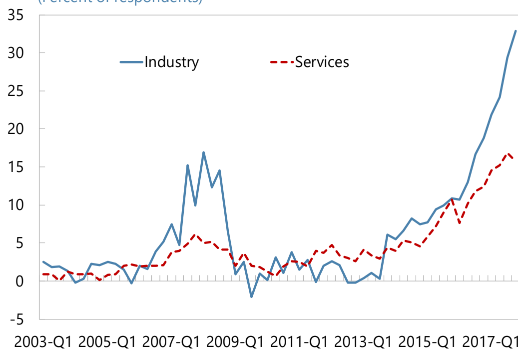
2. With the cyclical recovery completed, the economy is facing challenges in the form of acute labor shortages and rising household indebtedness. The share of survey respondents reporting labor shortages in the industrial sector, where the problem is most critical, increased by five folds over the last five years (Figure 2). After a decade of double-digit credit growth, household indebtedness, albeit from a low level, has more than doubled relative to GDP and household income, posing risks to banks and overall economy.

3. There are also long-standing challenges that are likely to affect productivity and potential growth. Post-crisis employment and total factor productivity growth rates have been less than half of their pre-crisis levels, in line with developments in Central European peers. Shortcomings in education and institutional quality and the projected decline in the workforce, if left unaddressed, may further dent productivity growth (Figure 2). Key indicators point to notable gaps in education outcomes relative to European Union (EU) peers, partly due to diverging performance of students impacted by school location and socioeconomic background. Slovakia is also set to experience one of the fastest decline in working age population in the EU in coming decades which, besides putting pressures on labor supply, may affect productivity due to ageing of the workforce. In addition, survey-based indicators show that the quality of institutions, particularly that of judiciary and public administration, is perceived to be in need of improvement.

4. Against this background, this year's consultation addresses how structural, fiscal and financial policies can mitigate Slovakia's challenges to ensure a sustained convergence to EU income levels.

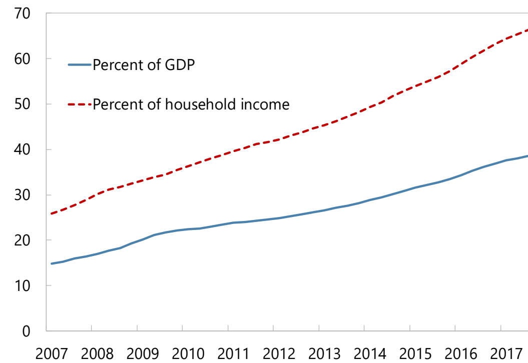
Figure 2. Slovak Republic: Challenges to Productivity and Growth

Labor Shortages
(Percent of respondents)



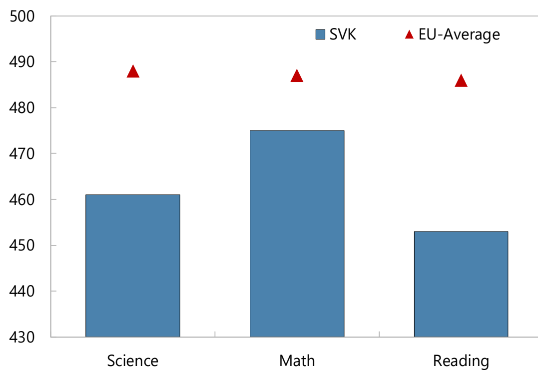
Sources: Eurostat; and IMF staff calculations.

Household Loans Stock



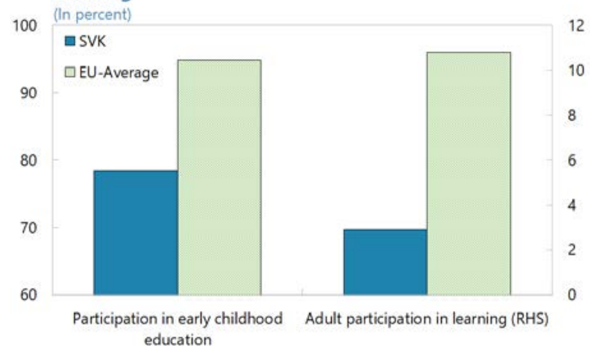
Sources: Haver; and the Statistical Office of the Slovak Republic.

PISA Scores



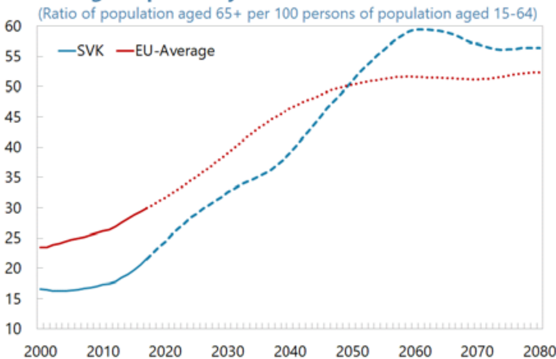
Source: OECD.

Participation in Early Childhood Education and Adult Training
(In percent)



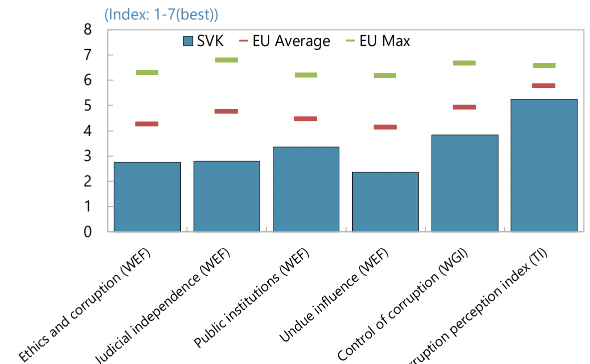
Source: Eurostat.

Old-age Dependency Ratio
(Ratio of population aged 65+ per 100 persons of population aged 15-64)



Source: Eurostat.

Governance Indictors, Slovakia and the EU
(Index: 1-7(best))

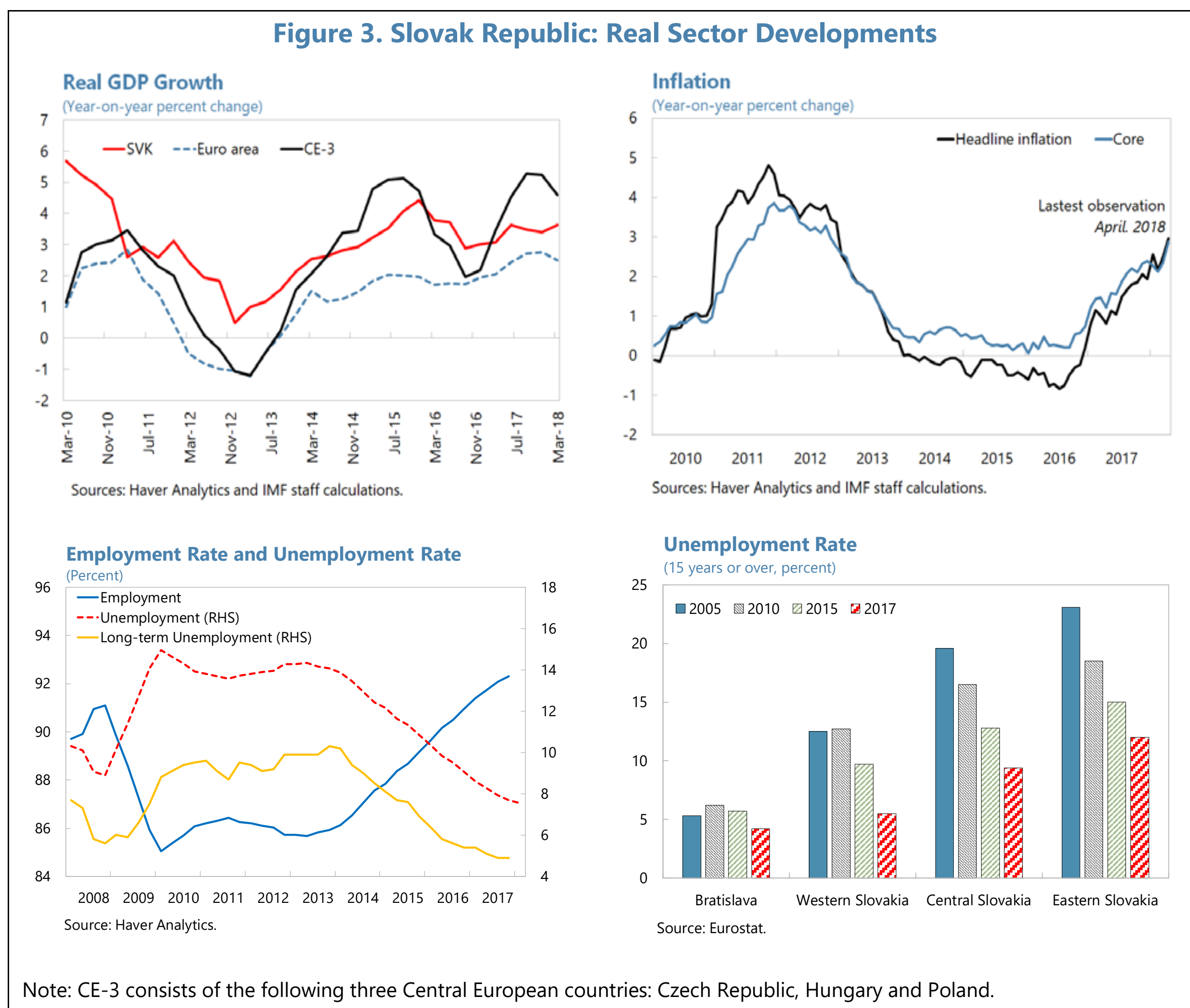


Sources: World Economic Forum (WEF); Transparency International (TI); and World Governance Indicators (WGI).

RECENT DEVELOPMENTS

5. **Real GDP growth in 2017 was mostly driven by domestic demand.** Strong credit growth on the back of accommodative financial conditions, robust job creation, and rising wages continued to bolster private consumption (Table 1, Figure 3). Investment also contributed to growth, reversing the fall in 2016 caused by a slow start in the implementation of the 2014–20 programming period for EU funds. The economy expanded by 3.6 percent y-o-y during 2018: Q1. Headline and core inflation accelerated in 2017 with core inflation reaching 1.8 percent, well above the euro area average, driven by higher processed food prices in the second half of the year. Inflation accelerated further in 2018 reaching 2.9 percent y-o-y in April driven by food, transport, and services prices.

Figure 3. Slovak Republic: Real Sector Developments



Note: CE-3 consists of the following three Central European countries: Czech Republic, Hungary and Poland.

6. Broad-based employment growth continued to reduce both overall and long-term unemployment rates albeit with significant heterogeneities across regions. Strong labor demand has led to a decline in the unemployment rate from about 14 percent during 2010–14 to below 8 percent at end-2017. Regional differences have declined but remain high with the unemployment rate ranging from 4.2 percent in Bratislava to 12 percent in Eastern Slovakia (Figure 3). Low labor mobility, in part due to insufficient transport infrastructure and underdeveloped rental housing markets, contributes to relatively higher unemployment rates in the Central and Eastern regions. At the same time, the coexistence of robust wage growth and a high share of long-term unemployed despite rising vacancies, is a clear sign of skills mismatch and shortage.

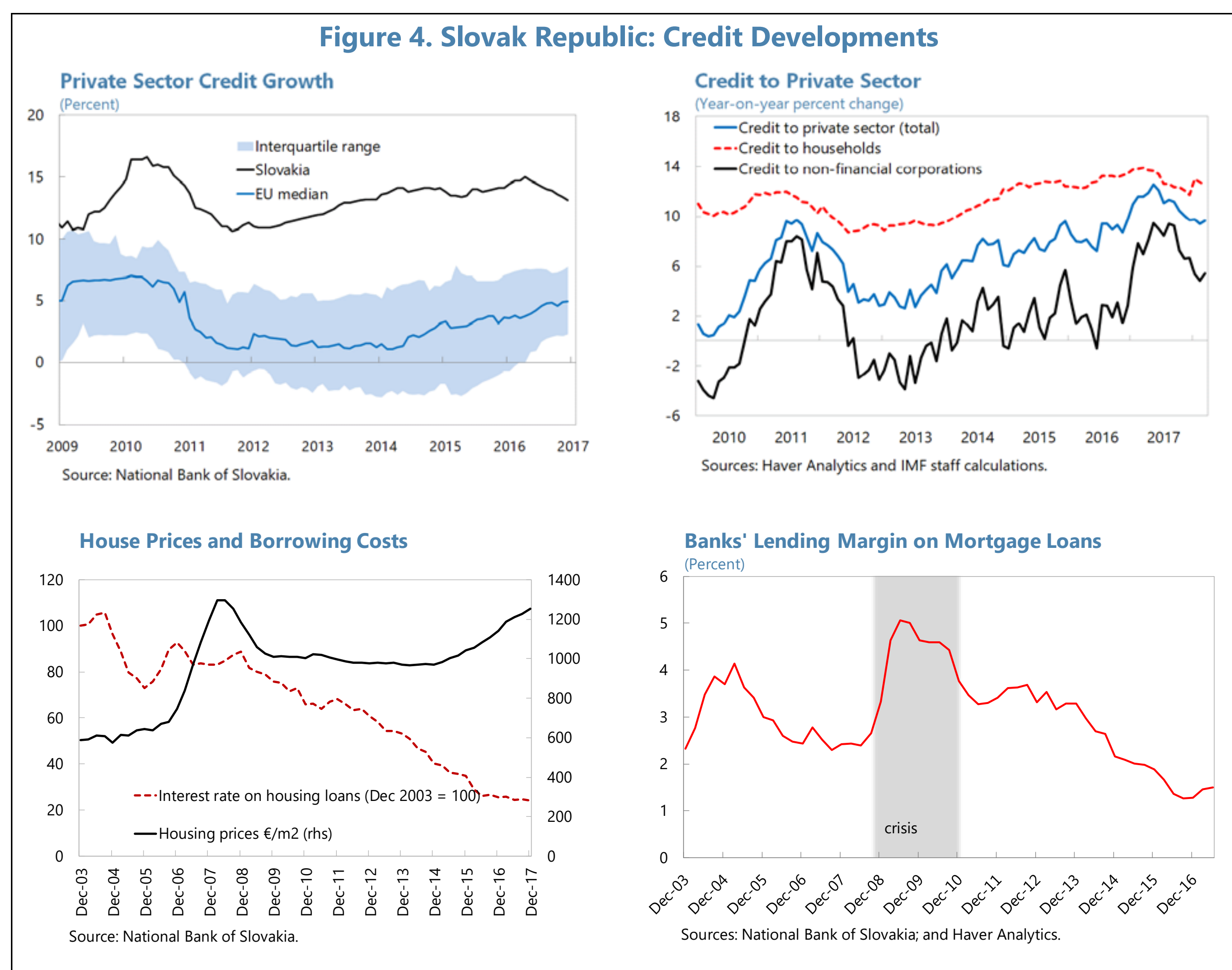


Figure 4. Slovak Republic: Credit Developments

7. Private sector credit growth continued at a brisk pace. Despite a slowdown in mortgage credit growth, partly reflecting macroprudential measures taken to date, overall private sector credit rose by 11 percent in 2017 (Figure 4). Strong credit demand from households and more recently from non-financial corporates (NFCs) is supported by robust economic growth and the preference to lock in lower borrowing costs for longer maturities while ECB monetary policy remains accommodative. On the supply side, declining interest margins have put downward pressure on bank profitability, encouraging an overall easing of credit conditions and volume growth.

The composite indicator of financial cycle used by the National Bank of Slovakia (NBS) suggests that the phase and magnitude of the current financial cycle is similar to that of the 2005–07 with the current cycle driven more by lending to households than to corporates and by growing risk appetite within the banking sector.

8. Benefitting from strong growth and policy efforts, overall fiscal deficit declined significantly reaching 1 percent of GDP in 2017. Strong fiscal consolidation of 1.7 percent of GDP during 2015–16 was driven by developments on both revenue and expenditure sides (Text Table1). On the revenue side, consolidation was aided by higher social security contributions from strong employment growth. VAT and PIT receipts also showed buoyancy as a share of GDP, but were countered by lower CIT receipts. On the spending side, favorable macroeconomic and financial developments reduced the interest bill and expenses on social benefits, while non-wage current spending was also reduced significantly. Gross public debt remained on a firmly downward trajectory reaching 50.9 percent as of end-2017 (Table 2).

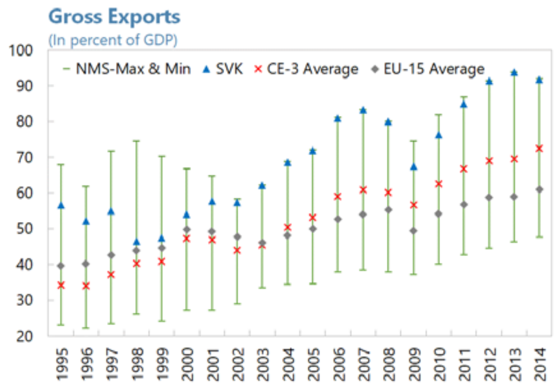
Text Table 1. Fiscal Consolidation during 2015–17 and Sources (Percentage points of GDP)

Overall balance	1.7
Of which	
Social contributions	0.8
Social benefits	0.5
Interest payments	0.3
Other non-wage current spending	0.7
Capital spending net of grants	-0.3
Wages and compensation	-0.3

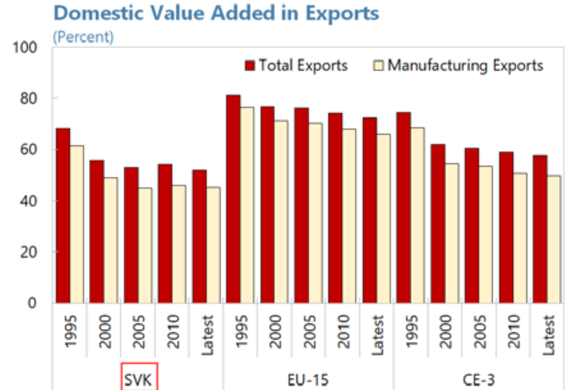
Source: IMF staff calculations.

9. Slovakia's external position is assessed to be in line with its economic fundamentals. The cyclically-adjusted current account deficit was 2.0 percent of GDP in 2017, marginally below the norm assessed at 2.1 percent; the real effective exchange rate is also assessed to be in line with economic fundamentals (Tables 3 and 4). Slovakia's gross exports relative to GDP are among the highest in EU reflecting its strong links to European supply chains although the share of domestic value-added in total exports have declined over time (Figure 5). The increase in gross exports as a share of GDP over the past two decades has been supported mostly by the expansion of machinery and transport manufacturing sectors. The primary income account recorded notable negative balances in recent years reflecting dividend outflows, similar to neighboring countries with high levels of FDI stock (Table 3, Figure 5). Despite recent acceleration in wage growth, productivity-adjusted average compensation of employees remains in line with Central European peers. Rising labor shortages in the industrial sector in recent years have not translated into significant wage pressures so far.

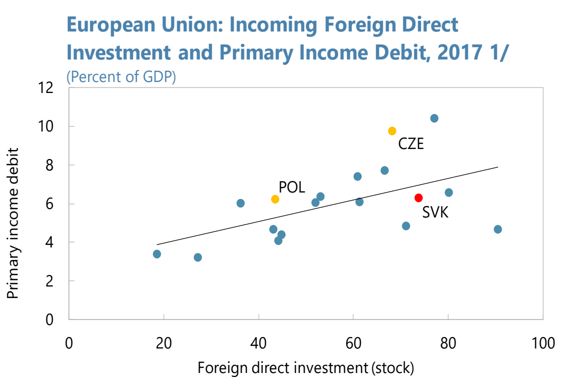
Figure 5. Slovak Republic: External Sector Competitiveness



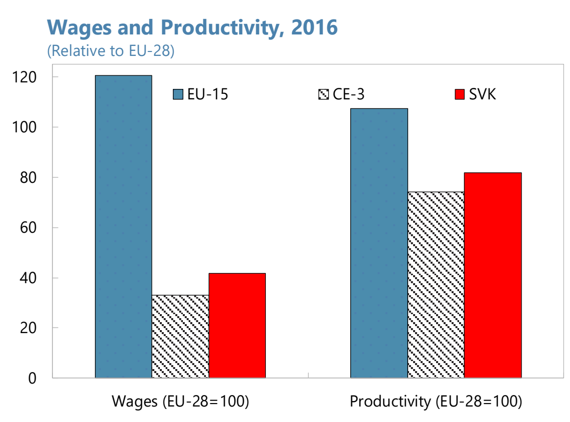
Sources: OECD.



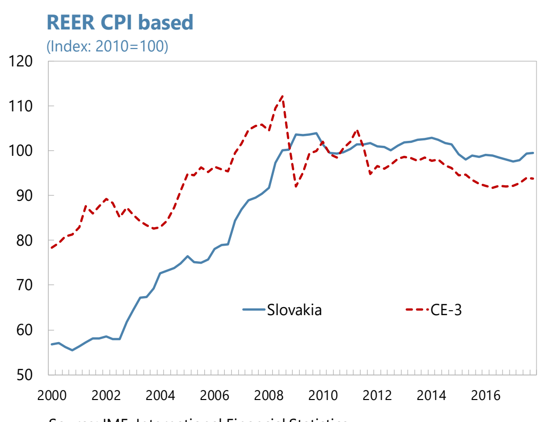
Sources: OECD.



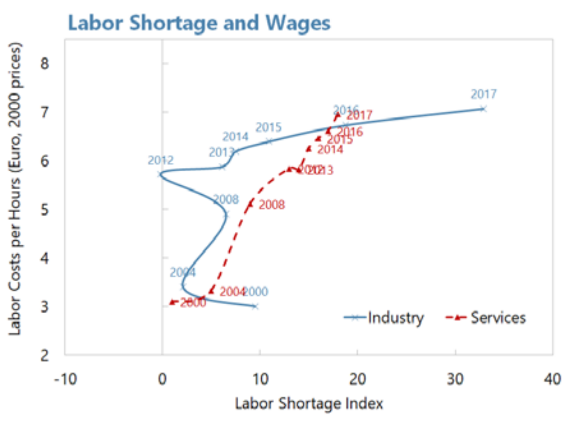
Source: IMF, World Economic Outlook.
1/ Excluding BEL, CYP, EST, FRA, HUN, IRL, LUX, MLT, NLD and ESP.



Sources: Eurostat; and IMF staff calculations.



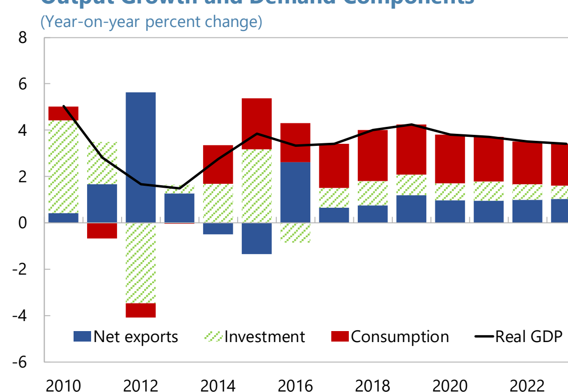
Source: IMF, International Financial Statistics.



Source: Eurostat and European Commission's Business and Consumer Survey.

OUTLOOK AND RISKS

10. Real GDP growth is projected to pick up in 2018–19 before converging to its potential in the medium term. Fueled by ongoing investments in the automotive industry and continued robust growth in wages and private credit, real GDP growth is projected to accelerate to 4 percent in 2018. With higher automotive exports coming into stream beginning in 2019, growth is projected to become more balanced in the medium term. With tight labor market, core inflation rate is expected to stay above 2 percent in 2018 and beyond.



Sources: Eurostat; and IMF staff calculations.

11. Risks to the outlook are slightly tilted on the downside (Table 5). On the downside, there are external risks from rising protectionism in international trade and possible financial turmoil in the euro area (EA) that could weigh on Slovakia's export-dependent economy. On the domestic front, persistent labor shortages, particularly for skilled workers, could put the brakes on economic expansion and accelerate wage inflation with a negative impact on competitiveness and investor interest. In addition, a sudden downturn in the economy and the property market can negatively impact households—which have become increasingly vulnerable after a decade of double-digit mortgage credit growth. On the upside, higher public investment from a pick-up in the absorption of EU funds could boost growth further.

Authorities' Views

12. The authorities broadly agreed with staff's views on outlook and risks. They expect slightly higher growth in the near-term driven by stronger exports. They also project somewhat higher overall inflation in the medium-term relative to staff's forecast. The authorities view risks to the outlook to be more balanced. On the downside, rising trade protectionism and geopolitical tensions are viewed as main external risks. Domestically, they concur with staff's view that an extended period of high credit growth has made households more vulnerable to downturns and increased labor shortages endanger growth prospects. Upside risks are mostly domestic from faster wage growth that could result in higher growth in private consumption and better fiscal balances, as well as higher capital investment from a faster absorption of EU funds.

POLICY DISCUSSION

A. Structural Reforms: Lifting Productivity

Background

13. The sharp increase in labor shortages, including for skilled labor, are among the most severe in the EU (Figure 6). While overall qualification mismatch is moderate, Slovakia has one of the highest level of field-of-study mismatch in the EU. Difficulties in finding qualified workers are likely to limit technology adoption and, if remain unaddressed, could have negative implications for productivity.

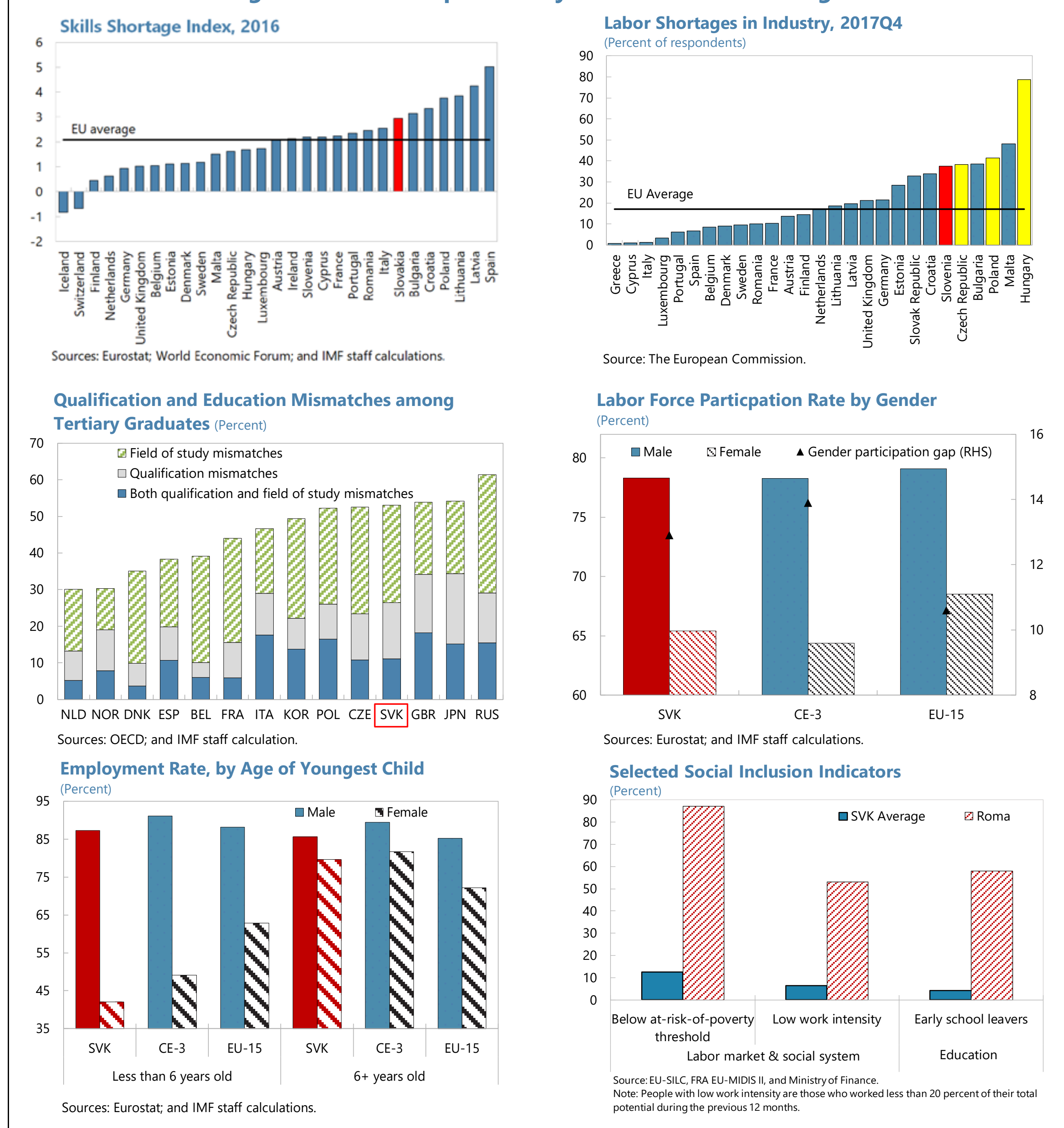
14. Significant gaps in education quality contribute to skills shortage and mismatch. Low PISA scores relative to EU average across academic subjects and low participation in early and lifelong education point to significant need for improvement. Inability to attract high quality teachers, partly due to low pay, and an inefficient schooling network are contributing to the poor education performance. Vocational training is widespread, but is not well-connected with work opportunities, resulting in many vocational school graduates pursuing work that is not in their field contributing to skills mismatch. In addition, use of work-based learning in vocational education is limited, hindering school-to-work transition.

15. Low labor force participation of women and various disadvantaged groups limit labor supply. The gender gap in participation has been persistently higher than EU peers, driven mostly by a lack of affordable early childcare facilities and long parental leave hardly taken up by fathers (Box 1). Around 75 percent of women aged between 25 and 49 years report family care responsibilities as the main reason for not participating in the labor market. Labor supply is also constrained by low work intensity among the Roma population, which constitutes a non-negligible share of population, but faces strong integration challenges in the labor market, including due to gaps in skills and education.

16. A menu of short and long-term policies is needed to address labor and skills shortage. In the short run, the focus may need to be on measures to facilitate recruitment of foreign skilled workers, as the policies to increase domestic labor supply may need time to take effect. Most of the reforms are complementary to each other and can mostly be financed by increasing efficiency of current social spending, as well as more efficient and extensive use of EU funds (see para 22).

- **Strengthen the current framework for issuing work permits to foreigners.** The amendment to the Employment Services Act has simplified conditions for hiring non-EU nationals for occupations experiencing labor shortages with company-level and regional restrictions. In recent quarters, Slovakia has seen an increase in non-EU workers reflecting policy efforts. However, clarifying the treatment of skilled versus mid- or low-skilled foreign workers and streamlining further time-consuming administrative requirements would help Slovakia compete better with neighboring peers for skilled foreign workers.

Figure 6. Slovak Republic: Key Labor Market Challenges



- **Focus active labor market policies (ALMP) on building skills.** Spending on ALMP is still one of the lowest in the EU and largely focused on job creation, despite rising job vacancies, rather than on employability. Given the skills mismatch between vacancy requirements and the skill set of the long-term unemployed and job-seekers from other disadvantaged groups, efforts should focus more on training, job counseling, and measures to enhance labor mobility, especially for these target groups.

- **Increase labor force participation and employment of women and disadvantaged groups.** The authorities' plan to expand formal childcare services, especially for children aged below three, is appropriate (Box 1). A reform of parental leave benefits to encourage gender parity between paid and unpaid work, including by allowing parents to alternate between periods of leave and work and further supporting flexible employment for mothers, could improve participation of women with children. Policies to establish equal education opportunities for disadvantaged groups, including by expanding the provision of pre-primary education, better integration into standard schools, as well as supporting teacher training in special needs education are welcome and should be steadily pursued.

- **Improve education quality.** Higher remuneration to increase attractiveness of the teaching profession should go hand-in-hand with improvements in teachers' training and the optimization of the regional school network. Policies to increase on-the-job participation of vocational students should focus on strengthening involvement of employers as well as providing effective career guidance and information on curriculum options and employment prospects. In addition, with ageing population and high risks of job automation, a forward-looking strategy for higher education taking into account rapidly changing skills demand is also needed.

17. Perceived gaps in institutional quality are additional drags to productivity growth. Slovakia fares unfavorably in various governance indicators relative to EU peers (Figure 2). Low prosecution rates of cases against public officials and lengthy court procedures contribute to the perception of weak judiciary. The EU 2018 country report highlights several other institutional weaknesses that could result in inefficiencies: frequent change in laws, limited coordination between government ministries, anti-competitive practices in public procurement, and political influence in hiring and functioning of regulatory bodies. Significant compliance gaps in core taxes contribute to low public confidence in the effectiveness and integrity of tax administration.

18. More efficient public institutions would be critical for lifting productivity growth. Staff's analysis shows that lowering by half the gap between Slovakia and the EU-15 best performer in perception of corruption could yield significant productivity gains in the long run, although these estimates are subject to large uncertainties (Box 2, Chapter II of the Selected Issues Paper). Effective implementation of the recently approved Civil Service Act and the Anti-Offshore Law will be important to limit political influence in public administration and enhance transparency. These measures, together with reforms to increase competition in and transparency of the public procurement system, strengthen judicial independence, and improve tax compliance, could boost future productivity.

Authorities' Views

19. The authorities broadly agreed on the need for multi-faceted structural policies to lift productivity growth. They highlighted that the government's recent policy efforts are in line with policy priorities identified by staff.

- ***Labor shortages:*** The authorities are currently finalizing the list of occupations facing labor shortages which will be published in June. They noted that a part of the labor shortage can be met by a slowdown in net emigration and increased inter-regional mobility facilitated by the relocation and commuting allowance. To expand formal childcare services, they noted the construction of 90 additional childcare facilities with a capacity of 1,800 children. They view the disadvantaged groups, which include Roma population and long-term unemployed, as a larger source of potential labor supply than women with small children and highlighted the role of education and ALMP.

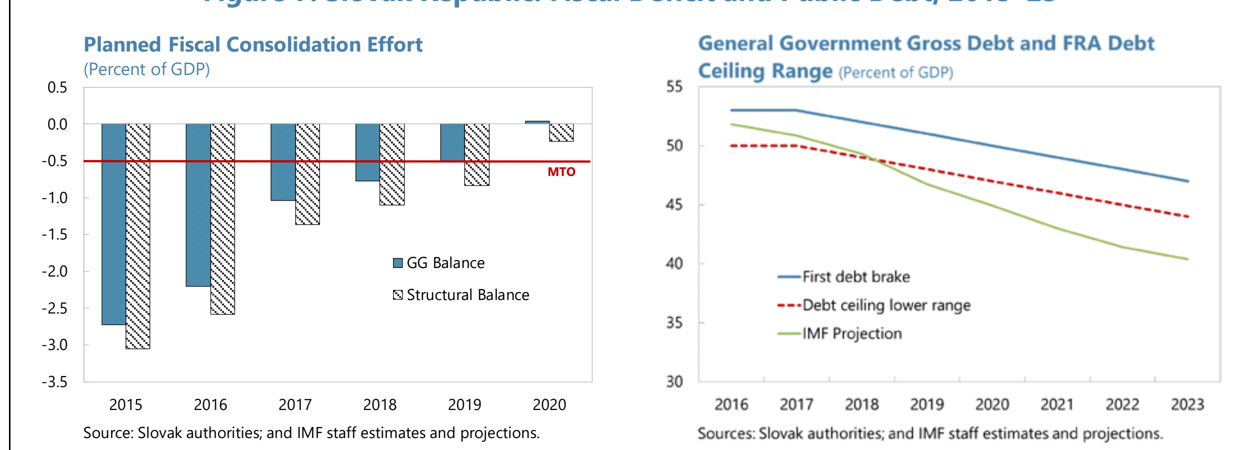
- ***Education:*** The authorities' plans to increase participation in on-the-job training through easing of administrative burdens and increasing cooperation between schools and firms. On education, they are planning to introduce compulsory pre-primary education for children at the age of five, starting in September with the plan to extend it to children at the age of three in the future. Such policies, with time, are expected to integrate Roma population better into the labor force.

- ***Institutions:*** The authorities are working on a comprehensive strategy for corruption prevention. To limit the room and incentives for rent-seeking behavior in public administration, they introduced measures aimed at reducing procedural time of public procurement, increasing transparency through e-procurement, and investing in capacity building. They highlighted that a recent amendment to the Civil Service Act establishes clear rules for recruitment and dismissal of civil servants limiting room for political interference. It also provides an opportunity for greater public scrutiny of nominees for high-level public posts.

B. Fiscal Policy: Increasing Efficiency to Invest in Priority Areas

20. With a positive output gap, the authorities' objective to continue fiscal consolidation is appropriate. Staff's baseline projections show that Slovakia is on track to reach its MTO, a structural balance of -0.5 percent of potential GDP, by 2020 and a balanced budget by 2020. Gross public debt will drop below the lower range of the debt ceiling path set by the current Fiscal Responsibility Act (FRA) (Figure 7). The baseline projections assume no additional revenue efficiency gains, and incorporate authorities' planned infrastructure and education investments as well as projected savings from recent pension and health sector reforms. A declining and low fiscal deficit, single-digit gross financing needs, and stable access to financing are expected to create sizable fiscal space under the FRA in the medium term, which will be available to help mitigate potential macroeconomic shocks and accommodate growth-enhancing public investment. In the near term, there are downside risks to the baseline fiscal scenario because of strong wage pressures in the private sector which could spill over into the public sector. In line with staff's past policy advice, the authorities are not contemplating introducing any escape clause to the FRA to accommodate specific spending.

Figure 7. Slovak Republic: Fiscal Deficit and Public Debt, 2015–23



21. In recent years, the authorities' fiscal policy efforts have focused on improving revenue and expenditure efficiency in line with staff advice. Sustained implementation of the three-phase action plan to fight tax evasion significantly improved VAT compliance (Box 3). The authorities are in the process of formulating a new tax administration reform plan for 2018–20 which aims to simplify taxpayers' interactions with the tax system, expand e-services, and increase the use of analytics to target non-compliance with tax obligations. These measures are expected to reduce gaps in VAT and CIT further. Staff strongly supports the multi-year thematic spending review program (Value for Money Program) which is entering its third wave in 2018. The program has completed a review of most major ministries and is expected to cover public wage bill this year. However, progress has been limited in prioritizing action plans and realizing operational savings except in the health sector.

22. Staff supports the authorities' efforts to further increase efficiency of the public sector which can generate significant fiscal resources (Text Table2).

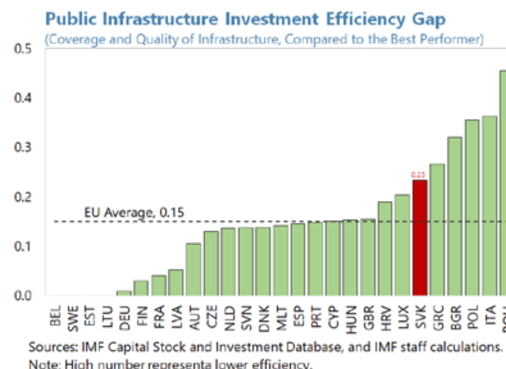
23. *Revenue efficiency*. In line with recommendations of the recently completed TADAT assessment, measures to be included in the 2018–20 reform plan need clear prioritization in line with the limited administrative capacity. The focus should be on strengthening and broadening audits to include all core tax areas and upskilling of audit staff, identification and assessment of risks of non-compliance by taxpayers, more effective dispute resolution mechanisms, and communication with taxpayers.

Text Table 2. Estimated Yields from Proposed Measures
(Cumulative, 2018–2023)

	Billions of euros	Percent of 2023 GDP
Proposed measures	3.6	3.0
Higher EU funds absorption in education and transport[1]	2.9	2.5
Implementing savings measures identified in spending reviews	0.6	0.5
Education	0.1	0.1
Healthcare	0.4	0.3
Environment	0.1	0.1
Increasing public investment efficiency[2]	1.7	1.4
Reducing the VAT gap[3]	1.3	1.1

Source: IMF staff calculations.
[1] Assumes 95 percent ESIF funds allocated to educational and vocational training and network infrastructures and transport and energy will be absorbed; and shows amounts net of what is already budgeted and of needed co-financing.
[2] Assumes Slovakia closes a quarter of its investment efficiency gap with respect to Germany.
[3] Assumes Slovakia closes a quarter of its VAT efficiency gap with EU-28 average.

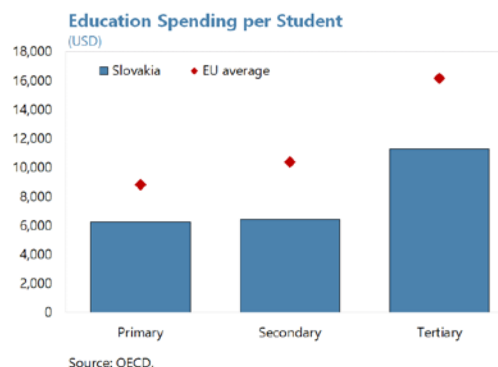
- ***Public expenditure efficiency.*** To fully capture the efficiency gains identified in the expenditure reviews, continued efforts to adequately resource the Implementation Unit and clearly integrate identified savings into the medium-term budgetary process are key. The efficiency of public infrastructure investment is particularly low in Slovakia due to project selection and procurement weaknesses, with an overall efficiency gap of around 23 percent compared to the EU-15 average gap of 13 percent. In keeping with previous staff advice, the authorities are working toward strengthening the public procurement system. Encouragingly, cost assessments have become a standard pre-requisite to procurement in the transport sector. This should be complemented by a prioritization of projects in the sector.



Sources: IMF Capital Stock and Investment Database, and IMF staff calculations.
Note: High number representa lower efficiency.

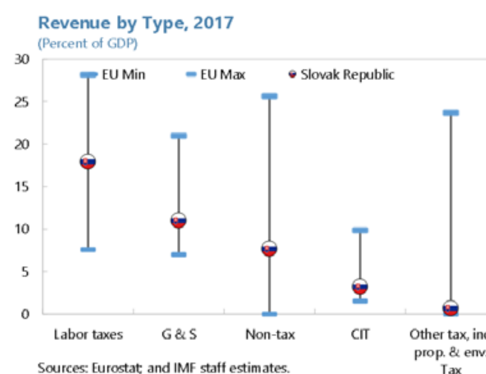
- ***EU funds absorption efficiency.*** Full absorption of EU funds programmed for education and infrastructure would make available nearly €3 billion in additional funding for priority spending from the 2014–20 programming period. But to fully utilize these funds requires improvements in staff expertise and capacity to assess projects, a simplification of national rules, better transparency and more competition in the public procurement process, and more strategic focus of project selection.

24. Resources freed up by higher efficiency could be used for priority spending in education, infrastructure and labor market. Slovakia shows significant gaps in motorway infrastructure measured relative to both population and area. As spending on motorway currently captures most spending on transport, other priority needs, such as improving lower-class roads, which carries most road traffic, railway modernization and maintenance of existing roads face resource constraints. The authorities estimate large transport infrastructure investment needs to increase both inter-regional connectivity and connectivity within lagging regions. In addition, there are spending needs in education and ALMP to address deficiencies identified in paragraph 19.



Source: OECD.

25. There is also a scope to raise property and environmental taxes. Bringing Slovakia's current property and environmental tax revenue in line with the EU average would create up to 1.3 percent of GDP per year in additional revenues. As discussed in previous IMF staff reports, a meaningful increase in property taxes, by linking the taxable amount to the market value of the property, would also support the authorities' efforts to slow down residential mortgage growth.



26. Rising pension and health care costs due to population aging remain the main risk for long-term fiscal sustainability despite recent reforms. Slovakia embarked on an ambitious pension reform in 2012 with an implementation period spanning several years. As prescribed by the reform, in 2017, the pensionable age calculation was changed to link it to average life expectancy. However, an ad hoc measure to increase pensions valorization by 2 percent in 2017 and to introduce higher valorization in 2018–21 for low-income pensioners will likely offset some of the reforms' hard-earned savings. Inefficiencies in health care spending are being addressed through a series of reforms, including costs savings from better management of hospital personnel, the introduction of an e-health system, and pilot project for diagnosis-linked reimbursement systems.

Authorities' Views

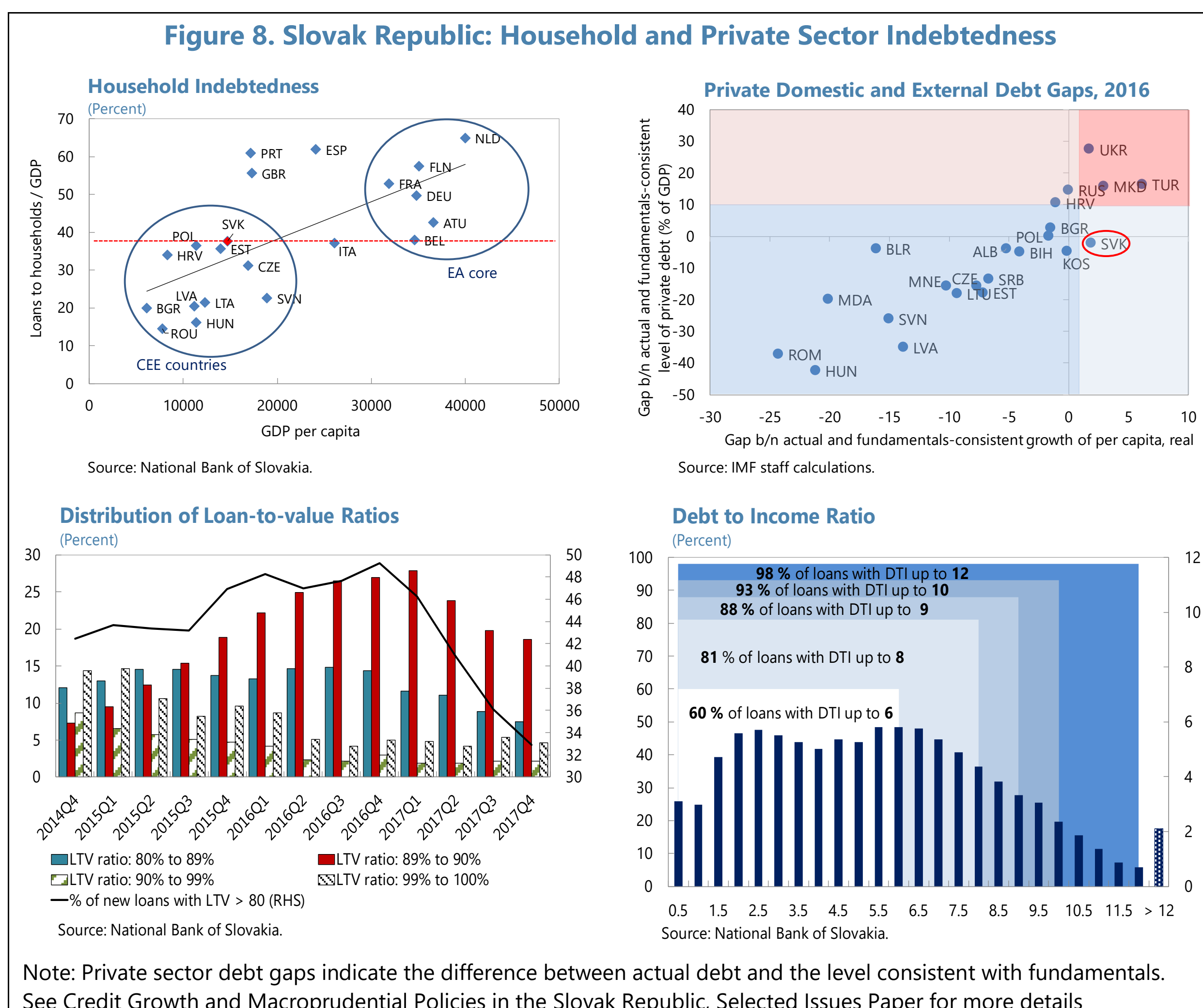
27. The authorities stressed their commitment to achieve a balanced budget in 2020. For 2018, they project a deficit of 0.8 percent of GDP, but agree with staff that there are some downside risks from higher wage increases in the public sector. They expressed confidence that, if needed, moderate wage increases could largely be absorbed through the reallocation of existing reserve funds. As public debt is projected to fall below the lowest threshold specified in the Fiscal Responsibility Act, the authorities are currently studying possible options for an expenditure ceiling to be introduced in the medium term which could serve as the operational tool for fiscal policy. They expressed interest in a discussion with staff at a later stage when the considerations for such a ceiling or rule are more concrete.

28. The authorities are committed to raising revenue and spending efficiency. On the revenue side, they plan to further improve taxpayer compliance, building on the significant progress made so far. While agreeing to the need to reduce VAT gap further, they expressed some reservations regarding comparing the gap to that of the EU average due to methodological issues. The authorities underscored the high priority placed on the implementation of measures identified by the Value for Money program, and pointed to the ongoing efforts to strengthen the mandate and capacity of the Implementation Unit as indications of their commitment to improving expenditure efficiency across the public sector. They stressed that ongoing spending reviews should undergo regular implementation assessment serving also as the starting point for future follow-up reviews as is the case now in the health sector. They are planning to undertake a Public Investment Management Assessment next year.

C. Financial Sector: Ensuring Stability

29. A sustained period of strong credit growth has increased household indebtedness and related vulnerabilities (Figure 8). The overall household loan stock, at 40 percent of GDP in end-2017, is slightly above the level implied by economic fundamentals as is credit growth to the private sector (See *Credit Growth and Macroprudential Policies in the Slovak Republic*, Selected Issues Paper for more details). In addition, one third of new loans to households has a loan-to-value ratio of 80 percent indicating a relative elevated share of risky borrowers. However, overall private sector indebtedness remains in line with economic fundamentals. Average house prices have increased, but are significantly below their pre-crisis levels, although apartment prices in certain areas have experienced faster increase.

Figure 8. Slovak Republic: Household and Private Sector Indebtedness



Note: Private sector debt gaps indicate the difference between actual debt and the level consistent with fundamentals. See Credit Growth and Macroprudential Policies in the Slovak Republic, Selected Issues Paper for more details

30. The banking sector is sound, but vulnerable to adverse macroeconomic shocks. Profitability remains high supported by low operating costs. Banks' capital adequacy strengthened in 2017 due to higher retained earnings and loans are fully funded by domestic deposits (Table 6). Non-performing loans is low and adequately provisioned. Banks have sought to maintain their

profitability by expanding their loan books to compensate for low interest rates, which has increased their sensitivity to adverse shocks and, specifically, to a further decline in the net interest margin or an increase in operational cost. Banks also face some risks from increasing maturity mismatches and exposure to the commercial real estate sector.

31. The authorities have gradually tightened both capital and borrower-based macro-prudential measures to counter rising vulnerabilities (Text Table3). The borrower-based measures consisting of limits on Loan-to-value (LTV) ratios and Debt Service-to-Income (DSTI) ratios were initially recommendations, but became binding restrictions and now cover both mortgage and consumer lending as well as bank and non-bank lending. In addition, the countercyclical capital buffer (CCB) on domestic exposures was raised to 0.5 percent in August 2017 and will be raised to 1.25 percent as of August 1, 2018. These core measures are complemented by maturity limits, interest rate sensitivity tests, and a mandatory amortization schedule for annuities. The measures taken to date seem to be slowing down household credit growth, and the share of loan with high LTV ratio is declining. Staff welcomes recent measures to impose limits on the Debt-to-Income ratio (DTI) and further tighten LTV limits.

Text Table 3. Slovak Republic: Overview of Authorities' Macroprudential Policy Measures

	Introduction of Measures 2014–15 (Non-binding)	**1st Revision 2016–17** (Binding)	**2nd Revision** (Approved in end-May)
LTV limit	Share of 90+limited to 10% (phase-in applied)	Additional limit for 80+limited to 40% (phase-in applied)	80% of Share of 80+ limited to 20% (phase-in applies)
DSTI limit	100%	80% (phase-in applies)	
Interest Rate Sensitivity Test	Applies to new loans only	Applies to all customer's loans with variable interest rates	
Maturity Limit	Pre-secured loans: 30Y (excep. 10%) Unsecured loans: 8Y (phase-in applied)	No change	
Amortization Rule	Mandatory amortization with annuity	No change	
DTI			8, (phase-in applies)

Source: National Bank of Slovakia

32. To complement macroprudential policy efforts, consideration could be given to reducing tax subsidies for owner-occupied housing (Figure 9). Staff's analysis shows that the tax on owner-occupied housing in Slovakia is just 58 percent of the tax-neutral benchmark indicating sizable subsidies consisting of untaxed capital gains and exemption of imputed rent. In Slovakia, main residences are exempt from capital gains tax after 2 years of tenure, which contributes to tax subsidy. The average subsidy on untaxed capital gains could be reduced from the current level of 18 percent to bring it in line with the EU average of 13 percent. In addition, there are also direct subsidies for home ownership for individuals under the age of 35.

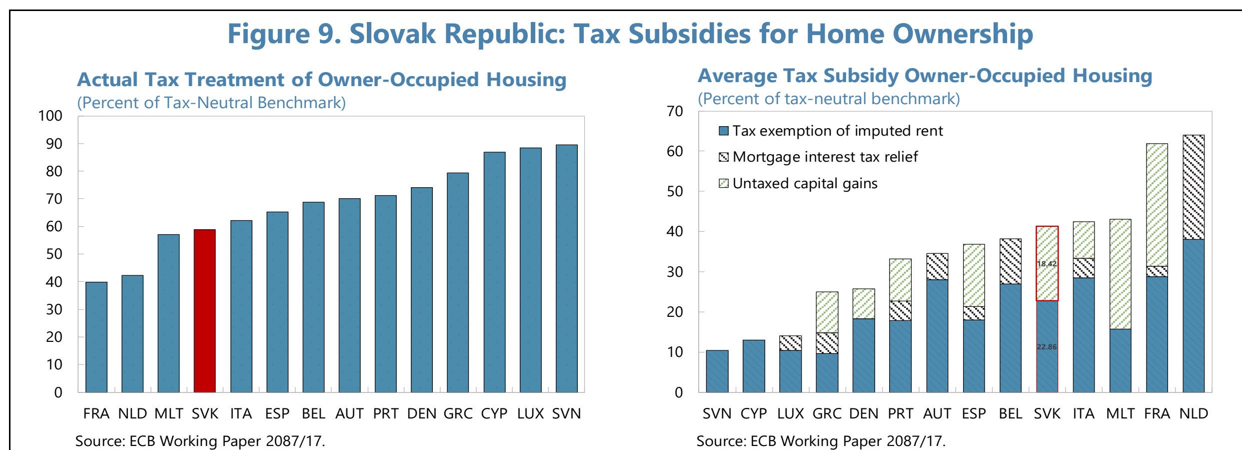


Figure 9. Slovak Republic: Tax Subsidies for Home Ownership

Authorities' Views

33. The authorities view the macroprudential policies taken so far to be adequate and stand ready to further tighten policies if warranted. According to the NBS, the DSTI calibration applied in Slovakia is at least as strict as in other countries for households earning median income and even stricter for those with lower incomes, but it is less binding for households with higher incomes. The DTI limit would curb the risk of excessive borrowing by highly-indebted high-income households and be complementary to existing limits on DSTI by covering the entire income spectrum. They estimate that the second round of macroprudential measures approved in end-May are likely to help slow credit growth by 0.5 to 1.4 percentage points, which could bring the growth of indebtedness more in line with economic fundamentals. However, they stressed that the financial sector conditions remain fluid and are not ruling out further measures including another increase in the countercyclical capital buffer. Regarding subsidies to owner-occupied housing, the national authorities do not view these as significantly contributing to excess demand.

34. The authorities support European efforts to further strengthen banking regulations. However, the national authorities stressed the importance of taking steps to ensure that the relative position of subsidiaries and host supervisors is not undermined by these efforts. Assessments by both SSM and NBS supervisors show that a relatively high profitability and adequate capital buffers provide Slovak banks with room to change their funding structure and absorb the costs of issuing MREL-eligible liabilities if required. Another significant EU level reform, the migration to IFRS 9, was implemented on January 1, but with a five-year transition period. While the change to IFRS 9 is expected to have a mild effect on the banking sector's own funds as provisioning standards are tightened, it is not expected to have an impact on bank profitability in 2018.

35. The NBS and ECB share a common understanding of financial sector risks and the need for targeted macroprudential measures. There is consensus that the fast rise in household indebtedness represents a risk that has been building for quite some time, underscoring the importance of sustained and continued vigilance in the implementation of targeted non-interest rate policies.

STAFF APPRAISAL

36. The Slovak economy is enjoying consecutive years of favorable performance. Per capita real income grew by around 3 percent annually during the last five years supported by strong labor market dynamics and credit growth. Real GDP growth is expected to reach 4 percent in 2018 and pick up further in the medium term supported by the coming on stream of new production capacity in the automotive sector.

37. The positive medium-term outlook is not without risks. On the downside, there are risks from rising trade protectionism, possible financial turmoil in the EA, and skills shortages in the domestic labor market that could weigh on Slovakia's export-dependent economy as well as and a sudden downturn in the property market that can affect indebted households and banks. On the upside, higher absorption of EU funds could boost growth further.

38. Staff welcomed policy efforts to address rising labor shortages. Recent measures to facilitate procedures for issuing work permits to foreigners are steps in the right direction and should be strengthened by finalizing the list of occupations and further simplifying administrative procedures. Plans to expand formal childcare services, especially for young children, are expected to help increase female labor force participation and should be complemented by encouraging greater gender flexibility in the use of childcare-related leave.

39. Strong policy implementation is needed to address significant gaps in education and institutional quality. On education, measures to increase attractiveness of the teaching profession and strengthen collaboration between vocational schools and employers are appropriate. These should be complemented by teachers' training, optimization of regional school network and a forward-looking higher education strategy that takes into account rapidly changing demand for skills. On governance, effective implementation of the recently approved Civil Service Act and the Anti-Offshore Law is important. These reforms, together with measures to increase competition in the public procurement system and improve tax compliance, and anti-corruption efforts, are expected to improve governance.

40. Robust growth and policy efforts are helping to improve fiscal balances and create policy space. Recent fiscal consolidation has been supported by higher social contributions, lower interest payments, and lower social benefits and non-wage current spending. In the absence of further discretionary measures or large wage hikes, the overall fiscal balance is projected to improve further, reaching -0.8 percent of GDP this year and a balanced position in the medium-term. This would create sufficient fiscal buffers to withstand possible macroeconomic shocks, even under the constraints of the Fiscal Responsibility Law.

41. Continued policy efforts to improve efficiency could unlock significant resources. The authorities' planned measures to combat tax evasion are welcome. On reform of the tax administration, priorities should be strengthening and broadening of audit activities in all core tax areas, reducing risks of tax compliance and improving governance. Strong political commitment is

needed to fully capture savings identified in the spending reviews, with continued efforts to strengthen the capacity of the Implementation Unit, and integrate the findings of these reviews in the medium-term budget plans. Additionally, there is scope to save sizable resources in capital investment through strengthened project prioritization and improved public procurement system, which would also ensure timely and full absorption of EU funds.

42. These resources should be used for priority spending in infrastructure, education, and labor market reforms. Staff's estimates show that, under conservative assumptions, fiscal resources of 3 percent of GDP can be raised through higher efficiency in the public sector with room for additional resources through higher property and environmental taxation. These resources should be used on measures to increase domestic labor supply and address gaps in infrastructure and education quality.

43. The banking sector is sound, but vulnerable to adverse macroeconomic shocks. Banking sector is highly profitable with low levels of non-performing loans that are adequately provisioned. Capital adequacy strengthened further in 2017. However, banks have sought to maintain their profitability by expanding their loan volume to compensate for low interest rates, which has increased household indebtedness significantly. As a result, both household and banking sectors are vulnerable to adverse macroeconomic shocks and possible property market downturns.

44. Pro-active tightening of macroprudential policies by the authorities is slowing down credit growth and building needed buffers. Sustained tightening of macroprudential measures over the last four years targeting risky and highly-indebted borrowers, including the introduction of binding limits on loan-to-value and debt-service-to-income ratios, appear to be slowing down household credit growth. Recently-adopted limits on debt-to-income ratios would complement existing borrower-based measures to dampen further lending growth to highly-indebted borrowers. These measures appropriately balance the need to preserve access to credit for Slovak households with the need to safeguard financial stability. To complement macroprudential policy efforts, consideration could be given to reducing tax subsidies for owner-occupied housing which arise from capital gains exemptions.

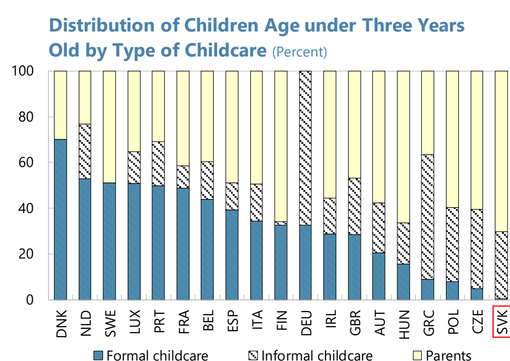
45. It is recommended that the next Article IV consultation with the Slovak Republic take place on the standard 12-month consultation cycle.

Box 1. Low Female Labor Force Participation and Employment in Slovak Republic: The Role of Childcare and Parental Leave Policies

In Slovakia, children and family responsibilities seem to inhibit female labor force participation and employment. A significant number of women report that children and family care are the main reason for not participating in the labor market, and their employment rates are relatively low when they have young children. A cross country analysis of advanced economies suggests that childcare and parental leave policies are primary factors affecting women's labor force participation (IMF, 2018). Comparing Slovakia's policies in these areas with its peers and other advanced European countries could therefore help identify priorities.

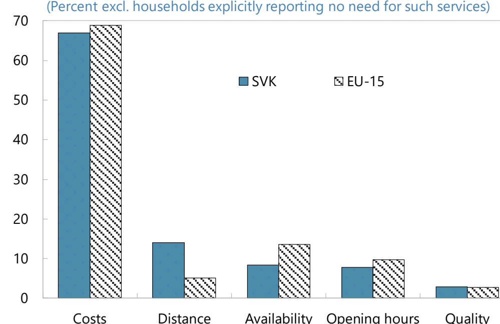
Relatively low public spending on early childhood education and care, and insufficient formal childcare services put childcare responsibilities on parents. Per child public spending on early childhood education and care is around 2,000 USD PPP, just above one-third of the EU-15 average, with less than half of it going to children aged less than three years old. Not surprisingly, only 0.5 percent of children under three receive formal childcare services compared to 70 percent in Denmark. Parents attribute the reasons for not using formal childcare services primarily to costs.

Distribution of Children Age under Three Years Old by Type of Childcare (Percent)



Sources: Eurostat; OECD; and IMF staff calculation.

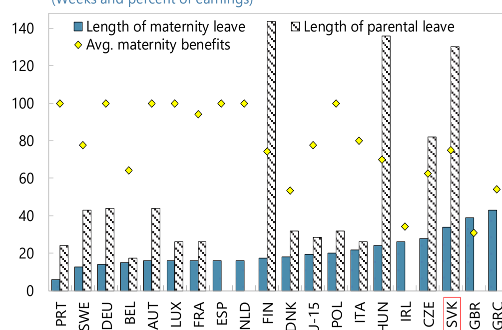
Reasons for Not Using Formal Childcare Services
(Percent excl. households explicitly reporting no need for such services)



Source: Eurostat.

Maternity and parental leaves are generous in terms of duration. An eligible Slovak mother is entitled to 34 weeks of paid maternity leave with monthly benefits of 75 percent of her gross wage, compared to the EU-average of nearly 20 weeks (with average monthly benefits of around 78 percent of gross wages).[1] In addition, after the paid maternity leave, mothers can stay on parental leave until the child is three years old, which is one of the longest parental leave periods among advanced EU countries receiving €213.20 per month. Similar to mothers, fathers are eligible for parental leave and the parental allowance. Since 2011, fathers have been allowed to take up to 28 weeks of paternity leave and receiving benefits similar to those of the maternity leave—providing that the contributory criteria are met and that the mother does not receive maternity or parental benefits at the same time.

Paid Maternity and Parental Benefits
(Weeks and percent of earnings)



Source: OECD.

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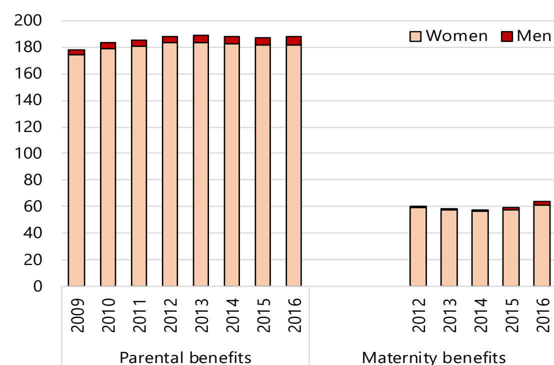
[1]To be eligible for the maternity benefits, a beneficiary has to have contributed to the health insurance for at least 270 days in the two years preceding the childbirth. Monthly maternity benefits are capped at two times of the average national gross wages.

Box 1. Low Female Labor Force Participation and Employment in Slovak Republic: The Role of Childcare and Parental Leave Policies (concluded)

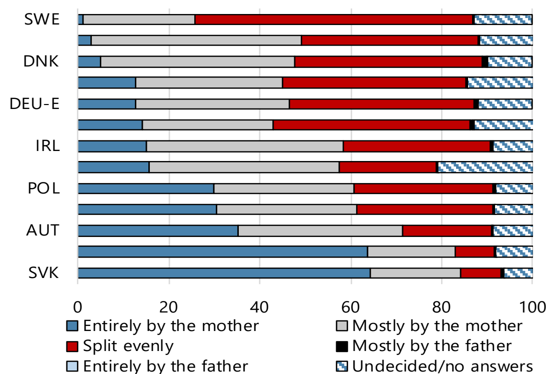
Childcare-related leaves are mainly used by women. Despite the right to use parental and paternity leave, participation of men in childcare has been low. While the limited male uptake of parental leave is likely due to relatively higher-foregone earned income, their low participation in parental leave could also be due to social attitudes towards the roles of mothers in caring for young children. Nearly 85 percent of the Slovaks think that paid leave to take care of children should be taken entirely or mostly by mothers, compared to about 50 percent for the EU-15 citizens. Inflexibility and generous duration of the parental leave, together with limited opportunities for part-time employment, also discourage mothers to return to work early.

Beneficiaries of Slovakia's Parental and Maternity Leave
(Thousand persons)



Sources: Eurofound (2017)

Attitudes towards Gender Distribution of Childcare
(Percent)



Sources: OECD

To increase female labor force participation and employment, the authorities have identified the following areas as priorities.

- *Formal childcare services.* The 2018 Budget Plan highlights the role of childcare provisions, especially for children aged under three in supporting female labor force participation. The legislative framework for childcare facilities was adopted in early 2017, and resources have been allocated for construction of 90 childcare facilities for children below three with a capacity to absorb 1,800 children during 2017–20.

- *Flexibility of parental benefits*. The 2017 public expenditure review on labor market and social policies notes that the parental leave period is relatively long, but is inflexible for both parents to share responsibility and alternate between periods of leave and work. In addition, the length of parental leave and cash benefits for parents are not found to have significant impacts on a family's decision to have children.

- *Targeting of family benefits*. The 2017 public expenditure review concludes that total public spending on family policies as a share of GDP are around the OECD average. Nonetheless, most family benefits (such as child and family allowances) are provided to beneficiaries regardless of their income, resulting in a lower benefit amount per beneficiary. The review therefore recommends better targeting of family benefits to improve the effectiveness of resources allocated for family policies.

Reference

International Monetary Fund (2018), "*Labor Force Participation in Advanced Economies: Drivers and Prospects*", in "*World Economic Outlook, April 2018 – Cyclical Upswing, Structural Change*", Washington DC, IMF, April 2018.

Box 2. Potential Productivity Gains from Strengthening Institutions and Reducing Skill Mismatch

Staff's analysis tries to shed light on the long-term productivity gains from reduction of skills mismatch and improvement in institutional quality (Chapter II of the Selected Issues Paper). To understand the link between productivity and its determinants, the following panel regression is estimated for 26 European countries over 1995–2016:

$$TFP_{i,t} = \alpha S_{i,t} + \mu J_{i.t} + \beta X_{i,t} + \gamma_t + \theta_i + \varepsilon_{i,t}$$

where,

- *TFP* is estimated based on the production function approach.
- *Skill mismatch index* $S_{i,t}$ is constructed following Estevao and Tsounta (2011) which uses data on employment and labor force by education level.
- *Quality of public institutions* $J_{i,t}$ is measured by the Worldwide Governance Indicator on control of corruption, which captures perceptions of the extent to which public authority is exercised for private gains.
- *Other control variables* $X_{i,t}$ *to capture the role of market friendliness, intensity of research and development, and human capital* are mainly from the Fraser Institute, the World Development Indicators, and the World Economic Forum, some of which are survey based indicators. As an alternative measure, we used judicial independence index from Fraser Institute Index of Economic Freedom, which measures the perception of judiciary independence from political influences of members of government, citizens, or firms.

The empirical results show that skill mismatch and quality of public institutions are significantly correlated with productivity in the long run. A low skill mismatch and a better control for corruption are positively associated with high level of productivity. These results, including controls for other policy variables, are robust to specification changes, use of an alternative measure for institutional quality, and to using labor productivity as a dependent variable. The results are also consistent with the literature.

Closing half of the gaps in corruption perception and skill mismatch between Slovakia and the best EU performer could yield significant productivity gains. Lowering half of the difference between Slovakia and the best EU performer in perceived corruption could increase productivity by 10 percent in the long run. The results for Slovakia are robust to using different methodology and other measures of public institutional quality—such as independence of the judiciary and impartiality of courts (IMF 2016). The robust results underscore the importance of broad-based structural reforms to strengthen governance and public institutions. Meanwhile, potential gains in productivity from closing half of the gap in skill mismatch could be around 6 percent in the long-run. Potential gains from other policy measures range from 2–5 percent.

Although the empirical results are consistent with the literature, the large productivity gain estimates should be interpreted with caution. First, due to a likely correlation among policy variables, the partial gains could be overestimated, thus resulting in a smaller overall productivity gains from addressing various policies simultaneously than the sum of the partial gain estimates reported above. Second, the efforts and time required to close half of the gap will differ across policies. More specifically, Slovakia is lagging significantly behind the best EU performer in terms of perceived corruption and other indicators of governance and institution quality, and hence the simulated policy improvement will likely require substantial reforms over a long period of time. Third, there are considerable uncertainties surrounding the estimates for productivity gains. For example, the 95 percent confidence band for productivity gains from improvements in corruption perception is 0.4–21.

References:

Estevão, M. and E. Tsounta (2013), "*Has the Great Recession Raised U.S. Structural Unemployment?*", IMF working paper: WP/11/105.

International Monetary Fund (2016), "*Central, Eastern, and South-eastern Europe – How to Get back on the Fast Track*", Regional Economic Issues (REI), May 2016.

Box 3. Domestic Revenue Mobilization: Achievements, Policy Efforts and Priorities

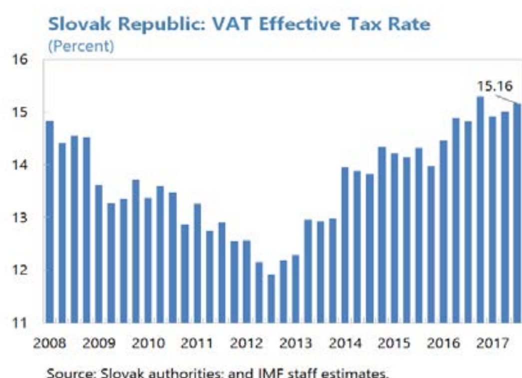
The Slovak authorities have undertaken sustained efforts to improve tax compliance and reduce VAT, CIT, and excise tax gaps which peaked following the global financial crisis.

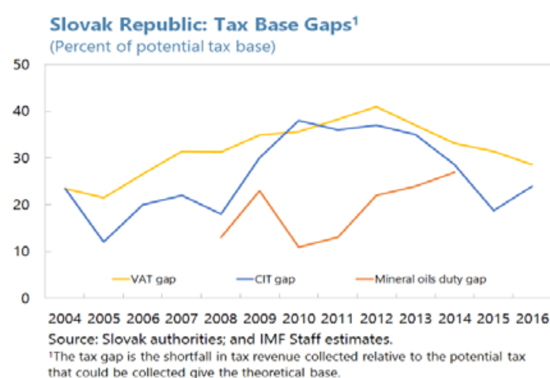
The action plan for combating tax evasion was implemented in 2012, and supplemented with additional measures in 2015. The action plan initially included 50 broad-ranging measures, including a pilot project to encourage inter-agency collaboration on solving cases of serious tax fraud, and the introduction of cashless payments and electronic control statements (KV). In 2015–16, the authorities took additional measures to supplement the action plan that focused on higher efficiency of taxpayer identification, collection, and tax recovery, and include excise taxes.

VAT. Initial efforts focused on reducing tax evasion to increase VAT revenue collection. The plan was successful in reducing the VAT base gap from over 40 percent in 2012 to 26.3 percent in 2017; VAT collections rose by 1.35 percent of GDP over that same period.

CIT. In 2013, the CIT rate was raised from 19 to 23 percent and special levies on banks and regulated industries were introduced to raise revenues. Following the implementation of measures to broaden the tax base in 2014–15—including tightening the loss carry forward rule and the introduction a thin capitalization rule—the CIT rate was lowered to 22 percent in 2014 and again to 21 percent in 2017. Preliminary estimates show that the CIT base gap declined from 37 percent since 2012 to 24 percent in 2016, and CIT collections are up by more than 1 percent of GDP. Further work on estimating the CIT base gap using a bottom up approach based on audit data is planned.

Excises. An increase in the mineral oils duty gap from 11 percent in 2010 to 27 percent in 2014, together with anecdotal reports of extensive cross-border shopping, prompted the financial administration to expand the measures on compliance risks to non-mineral oils excise tax. Excise tax collections remained broadly stable, however.





In 2017, the authorities launched a new action plan to be implemented through 2018 that includes the following key measures:

- improvements in tax audits, in part through the introduction of the electronic cash desk eKASA connecting cash registers to the central register at the financial administration;
- establishment of a Unified Analytical Center to deal with financial delinquency and prepare draft legislation to reduce tax fraud; and
- strengthening voluntary tax compliance and improving taxpayer services by introducing electronic taxpayer customer service channels, enhancing Call Center services, and sending out pre-filled tax returns for vehicle circulation taxes for business.

Table 1. Slovak Republic: Summary of Economic Indicators, 2015–23

(Percent, unless otherwise indicated)

	2015	2016	2017	2018	2019	2020	2021	2022	2023
			Est.			Projections			
	(Annual percentage change, constant prices, unless noted otherwise)								
Output/Demand									
Real GDP	3.9	3.3	3.4	4.0	4.2	3.8	3.7	3.5	3.4
Domestic demand	5.6	0.9	2.7	3.5	3.3	3.1	3.0	2.8	2.7
Public consumption	5.4	1.6	0.2	1.7	1.7	1.8	1.9	2.0	2.0
Private consumption	2.2	2.7	3.6	3.7	3.6	3.5	3.1	3.0	3.0
Gross fixed capital formation	19.8	-8.3	3.2	4.9	5.7	4.6	2.7	1.7	1.9
Exports of goods and services	6.4	6.2	4.3	7.0	7.2	6.3	6.3	6.1	5.9
Imports of goods and services	8.4	3.6	3.9	6.8	6.5	5.9	5.9	5.7	5.5
Potential Growth	2.0	3.0	3.6	4.0	4.2	4.0	3.9	3.6	3.6
Output gap	0.7	1.0	0.8	0.8	0.9	0.7	0.5	0.4	0.2
Contribution to growth									
Domestic demand	5.4	0.8	2.8	3.2	3.0	2.8	2.7	2.5	2.4
Public consumption	1.0	0.3	0.0	0.3	0.3	0.3	0.3	0.3	0.3
Private consumption	1.2	1.4	1.9	1.9	1.9	1.8	1.6	1.5	1.5
Gross fixed capital formation	4.2	-2.0	0.7	1.1	1.2	1.0	0.6	0.4	0.4
Inventories	-1.0	1.2	0.2	0.0	-0.3	-0.3	0.2	0.3	0.1
Net exports	-1.4	2.6	0.6	0.8	1.2	1.0	1.0	1.0	1.0
Prices									
Inflation (HICP)	-0.3	-0.5	1.3	2.4	2.1	2.0	2.0	2.0	2.0
Inflation (HICP, end of period)	-0.5	0.2	2.0	2.5	2.0	2.0	2.0	2.0	2.0
Core inflation	0.3	0.3	1.8	2.2	2.4	2.4	2.3	2.3	2.2
GDP deflator	-0.2	-0.4	1.3	1.9	2.2	2.1	2.1	1.9	1.8
Employment and wages									
Employment	2.0	2.4	2.2	1.6	1.1	1.0	0.9	0.9	0.9
Unemployment rate (Percent)	11.5	9.7	8.1	7.4	6.8	6.4	6.1	6.0	5.9
Nominal wages	2.9	3.2	4.6	5.6	5.7	5.5	5.0	4.9	4.8
					(Percent of GDP)				
Public Finance, General Government									
Revenue	42.5	39.3	39.4	38.4	38.1	38.6	38.0	37.5	37.5
Expenditure	45.2	41.5	40.4	39.1	38.6	38.6	37.9	37.5	37.5
Overall balance	-2.7	-2.2	-1.0	-0.8	-0.5	0.0	0.0	0.0	0.0
Primary balance	-1.0	-0.6	0.4	0.5	0.7	1.1	1.1	1.0	1.0
Structural balance (Percent of potential GDP)	-3.0	-2.6	-1.4	-1.1	-0.8	-0.2	-0.2	-0.1	-0.1
General government debt	52.3	51.8	50.9	49.3	46.7	44.9	43.0	41.4	40.4
					(Percent)				
Monetary and financial indicators									
Credit to private sector (Growth rate)	9.6	9.7	11.0	10.3	9.7	9.0	8.4	7.7	7.0
Lending rates[1]	2.7	2.0	...	...	...	...	...	...	...
Deposit rates[2]	1.0	0.9	...	...	...	...	...	...	...
Government 10-year bond yield	0.9	0.5	...	...	...	...	...	...	...
					(Percent of GDP)				
Balance of payments									
Trade balance (goods)	1.3	2.0	0.8	0.3	0.9	1.5	1.9	2.3	2.5
Current account balance	-1.7	-1.5	-2.1	-1.8	-0.9	-0.3	-0.1	0.1	0.2
Gross external debt	85.2	90.9	110.8	110.0	108.9	108.0	107.1	106.6	106.1
Saving and investment balance									
Gross national savings	22.5	21.1	20.6	21.8	22.7	23.3	24.1	24.6	25.0
Private sector	19.4	20.1	19.5	20.4	21.3	21.9	22.8	23.4	23.9
Public sector	3.0	1.0	1.2	1.4	1.4	1.4	1.3	1.2	1.1
Gross capital formation	24.2	22.6	22.7	23.5	23.4	23.5	24.2	24.5	24.8
Memo item									
Nominal GDP (Millions of euros)	78,896	81,154	84,985	90,107	95,961	101,671	107,655	113,544	119,529

Sources: National Authorities; and IMF staff calculations.

[1]Average of interest rates on new housing loans to households and loans of less than EUR 1 million to nonfinancial corporations (all maturities).

[2]Average of interest rates on new deposits with agreed maturity (up to 1 year) from households and nonfinancial corporations.

Table 2. Slovak Republic: Statement of Operations of the General Government, 2015–23

	2015	2016	2017	2018	2019	2020	2021	2022	2023
			Est.			Projections			
					(Millions of euros)				
Revenue	**33,533**	**31,893**	**33,466**	**34,563**	**36,578**	**39,233**	**40,887**	**42,602**	**44,781**
Taxes	14,302	14,578	15,344	16,162	17,216	17,981	18,812	19,841	20,887
Personal income tax	2,464	2,682	2,877	3,085	3,325	3,575	3,819	4,028	4,241
Corporate income tax	2,917	2,829	2,726	2,753	2,911	3,050	3,261	3,440	3,621
VAT	5,420	5,420	5,958	6,201	6,571	6,916	7,285	7,684	8,089
Excises	2,310	2,394	2,506	2,607	2,727	2,808	2,883	3,041	3,201
Other taxes	1,191	1,252	1,277	1,516	1,682	1,631	1,563	1,648	1,735
Social contributions	11,042	11,617	12,534	13,267	14,079	14,847	15,556	16,350	17,145
Grants	4,073	1,543	1,334	959	963	1,962	1,948	1,590	1,673
Other revenue	4,116	4,156	4,254	4,175	4,320	4,443	4,571	4,821	5,075
Expenditure	**35,684**	**33,684**	**34,351**	**35,258**	**37,060**	**39,197**	**40,852**	**42,572**	**44,840**
Expense	30,628	30,878	31,700	33,031	34,464	36,203	37,513	39,506	41,612
Compensation of employees	7,050	7,400	7,803	8,266	8,995	9,631	10,115	10,669	11,231
Use of goods and services	4,655	4,459	4,791	4,835	5,104	5,351	5,597	5,868	6,178
Interest	1,379	1,336	1,186	1,143	1,147	1,110	1,143	1,135	1,195
Subsidies	464	376	363	395	387	396	291	352	395
Grants	1,489	1,374	1,459	1,705	1,935	2,375	2,620	2,764	2,909
Social benefits	14,960	15,520	15,715	16,351	16,598	17,020	17,437	18,391	19,360
Other expense	631	412	385	336	298	320	310	327	344
Net acquisition of nonfinancial assets	5,056	2,806	2,650	2,227	2,596	2,994	3,339	3,066	3,227
Gross Operating Balance	2,905	1,016	1,766	1,533	2,114	3,030	3,374	3,096	3,168
Net lending(+)/borrowing(-)	**-2,151**	**-1,791**	**-884**	**-695**	**-482**	**36**	**35**	**30**	**-59**
					(Percent of GDP)				
Revenue	**42.5**	**39.3**	**39.4**	**38.4**	**38.1**	**38.6**	**38.0**	**37.5**	**37.5**
Taxes	18.1	18.0	18.1	17.9	17.9	17.7	17.5	17.5	17.5
Personal income tax	3.1	3.3	3.4	3.4	3.5	3.5	3.5	3.5	3.5
Corporate income tax	3.7	3.5	3.2	3.1	3.0	3.0	3.0	3.0	3.0
VAT	6.9	6.7	7.0	6.9	6.8	6.8	6.8	6.8	6.8
Excises	2.9	3.0	2.9	2.9	2.8	2.8	2.7	2.7	2.7
Other taxes	1.5	1.5	1.5	1.7	1.8	1.6	1.5	1.5	1.5
Social contributions	14.0	14.3	14.7	14.7	14.7	14.6	14.5	14.4	14.3
Grants	5.2	1.9	1.6	1.1	1.0	1.9	1.8	1.4	1.4
Other revenue	5.2	5.1	5.0	4.6	4.5	4.4	4.2	4.2	4.2
Expenditure	**45.2**	**41.5**	**40.4**	**39.1**	**38.6**	**38.6**	**37.9**	**37.5**	**37.5**
Expense	38.8	38.0	37.3	36.7	35.9	35.6	34.8	34.8	34.8
Compensation of employees	8.9	9.1	9.2	9.2	9.4	9.5	9.4	9.4	9.4
Use of goods and services	5.9	5.5	5.6	5.4	5.3	5.3	5.2	5.2	5.2
Interest	1.7	1.6	1.4	1.3	1.2	1.1	1.1	1.0	1.0
Subsidies	0.6	0.5	0.4	0.4	0.4	0.4	0.3	0.3	0.3
Grants	1.9	1.7	1.7	1.9	2.0	2.3	2.4	2.4	2.4
Social benefits	19.0	19.1	18.5	18.1	17.3	16.7	16.2	16.2	16.2
Other expense	0.8	0.5	0.5	0.4	0.3	0.3	0.3	0.3	0.3
Net acquisition of nonfinancial assets	6.4	3.5	3.1	2.5	2.7	2.9	3.1	2.7	2.7
Gross Operating Balance	3.7	1.3	2.1	1.7	2.2	3.0	3.1	2.7	2.7
Net lending(+)/borrowing(-)	**-2.7**	**-2.2**	**-1.0**	**-0.8**	**-0.5**	**0.0**	**0.0**	**0.0**	**0.0**
Memorandum items:									
Primary balance	-1.0	-0.6	0.4	0.5	0.7	1.1	1.1	1.0	1.0
Structural primary balance	-1.3	-0.9	0.0	0.2	0.4	0.9	0.9	0.9	0.9
Cyclically-adj. structural balance (Percent of potential GDP)	-3.0	-2.6	-1.4	-1.1	-0.8	-0.2	-0.2	-0.1	-0.1
Gross public debt	52.3	51.8	50.9	49.3	46.7	44.9	43.0	41.4	40.4
GDP at current market prices (Millions of euros)	78,896	81,154	84,985	90,107	95,961	101,671	107,655	113,544	119,529

Sources: National Authorities; and IMF staff estimates and projections.

Table 3. Slovak Republic: Balance of Payments, 2015–23

	2015	2016	2017	2018	2019	2020	2021	2022	2023
			Est.		Projections				
					(Millions of euros)				
Current account	**-1,367**	**-1,183**	**-1,776**	**-1,488**	**-650**	**-233**	**-92**	**83**	**240**
Trade balance (goods)	1,049	1,637	643	422	1,165	1,773	2,354	2,879	3,403
Exports, f.o.b.	64,650	67,164	71,547	71,933	77,010	81,713	87,407	92,484	97,702
Imports, f.o.b.	63,601	65,527	70,904	71,511	75,846	79,939	85,053	89,606	94,299
Services balance	181	456	841	821	956	1,073	1,197	1,308	1,421
Receipts	7,324	7,680	8,499	8,545	9,148	9,707	10,383	10,986	11,606
Payments	7,144	7,225	7,658	7,724	8,192	8,634	9,186	9,678	10,185
Primary income balance	-1,366	-1,906	-1,977	-1,708	-1,685	-1,885	-2,214	-2,535	-2,804
Credit	3,968	2,880	3,355	3,661	3,795	3,791	3,768	3,769	3,816
Debit	5,334	4,786	5,332	5,369	5,480	5,677	5,982	6,304	6,621
Secondary income balance	-1,231	-1,369	-1,282	-1,023	-1,086	-1,193	-1,429	-1,569	-1,780
Credit	551	326	618	511	534	561	560	558	580
Debit	1,782	1,695	1,901	1,533	1,621	1,755	1,990	2,127	2,360
Capital account	**2,790**	**1,631**	**790**	**1,436**	**1,487**	**1,655**	**1,419**	**1,376**	**1,440**
Financial Account	**-474**	**-482**	**-3,691**	**-52**	**837**	**1,422**	**1,327**	**1,459**	**1,680**
Direct investment, net	-90	491	-1,710	-2,066	-1,705	-1,682	-1,634	-1,587	-1,539
Assets	1,266	3,725	3,603	899	768	813	861	908	956
Liabilities	1,357	3,234	5,313	2,965	2,473	2,496	2,496	2,496	2,496
Portfolio investment, net	1,856	3,962	-716	3,001	3,794	3,809	3,826	3,747	3,456
Assets	-529	4,381	2,039	3,294	3,915	4,318	4,280	4,300	4,310
Liabilities	-2,385	419	2,755	293	122	509	454	554	854
Other investment, net	-2,713	-5,124	-1,967	-1,010	-1,276	-730	-890	-727	-262
Assets	-2,976	-1,541	12,192	3,514	3,742	3,965	4,199	4,428	4,662
Liabilities	-264	3,583	14,159	4,524	5,019	4,695	5,089	5,155	4,924
Financial derivatives, net	231	231	231	23	24	25	25	26	26
Reserve assets 1/	242	-43	471	0	0	0	0	0	0
Errors and omissions	**-1,896**	**-930**	**-2,705**	**0**	**0**	**0**	**0**	**0**	**0**
Net International Investment Position	**-50,984**	**-50,646**	**-54,265**	**-54,317**	**-53,481**	**-52,059**	**-50,732**	**-49,273**	**-47,593**
External Debt	**67,185**	**73,750**	**94,149**	**98,965**	**104,106**	**109,310**	**114,852**	**120,560**	**126,338**
					(Percent of GDP)				
Current account	**-1.7**	**-1.5**	**-2.1**	**-1.7**	**-0.7**	**-0.2**	**-0.1**	**0.1**	**0.2**
Trade balance (goods)	1.3	2.0	0.8	0.5	1.2	1.7	2.2	2.5	2.8
Exports, f.o.b.	81.9	82.8	84.2	79.8	80.3	80.4	81.2	81.5	81.7
Imports, f.o.b.	80.6	80.7	83.4	79.4	79.0	78.6	79.0	78.9	78.9
Services balance	0.2	0.6	1.0	0.9	1.0	1.1	1.1	1.2	1.2
Receipts	9.3	9.5	10.0	9.5	9.5	9.5	9.6	9.7	9.7
Payments	9.1	8.9	9.0	8.6	8.5	8.5	8.5	8.5	8.5
Primary income balance	-1.7	-2.3	-2.3	-1.9	-1.8	-1.9	-2.1	-2.2	-2.3
Credit	5.0	3.5	3.9	4.1	4.0	3.7	3.5	3.3	3.2
Debit	6.8	5.9	6.3	6.0	5.7	5.6	5.6	5.6	5.5
Secondary income balance	-1.6	-1.7	-1.5	-1.1	-1.1	-1.2	-1.3	-1.4	-1.5
Credit	0.7	0.4	0.7	0.6	0.6	0.6	0.5	0.5	0.5
Debit	2.3	2.1	2.2	1.7	1.7	1.7	1.8	1.9	2.0
Capital account	**3.5**	**2.0**	**0.9**	**1.6**	**1.5**	**1.6**	**1.3**	**1.2**	**1.2**
Financial Account	**-0.6**	**-0.6**	**-4.3**	**-0.1**	**0.9**	**1.4**	**1.2**	**1.3**	**1.4**
Direct investment, net	-0.1	0.6	-2.0	-2.3	-1.8	-1.7	-1.5	-1.4	-1.3
Portfolio investment, net	2.4	4.9	-0.8	3.3	4.0	3.7	3.6	3.3	2.9
Other investment, net	-3.4	-6.3	-2.3	-1.1	-1.3	-0.7	-0.8	-0.6	-0.2
Financial derivatives, net	0.3	0.3	0.3	0.0	0.0	0.0	0.0	0.0	0.0
Reserve assets	0.3	-0.1	0.6	0.0	0.0	0.0	0.0	0.0	0.0
Errors and omissions	**-2.4**	**-1.1**	**-3.2**	**0.0**	**0.0**	**0.0**	**0.0**	**0.0**	**0.0**
Net International Investment Position	**-64.6**	**-62.4**	**-63.9**	**-60.3**	**-55.7**	**-51.2**	**-47.1**	**-43.4**	**-39.8**
External Debt	**85.2**	**90.9**	**110.8**	**109.8**	**108.5**	**107.5**	**106.7**	**106.2**	**105.7**

Sources: National Bank of Slovakia; and IMF staff estimates

1/ Does not include the transfer of reserve assets from the NBS to the ECB which took place in 2009

Table 4. Slovak Republic: External Sector Assessment

Foreign Asset and Liability Position and Trajectory	**Background.** The net international investment position (NIIP) of the Slovak Republic fell to about -66 percent of GDP by the end of 2009. Since then it has recovered somewhat, increasing to around -64 percent in 2017. The improvement was entirely driven by strong nominal GDP growth since current account was largely in deficit during this period. Growth in both gross asset and liability positions accelerated recently driven by FDI and other investments. Gross positions are now about 92 percent of GDP for assets and 156 percent of GDP for liabilities in 2017. **Assessment.** The negative NIIP does not imply notably risks to external sustainability since projected improvement in the current account balance is expected to bring the NIIP down to 40 percent of GDP by 2023. In addition, mostly long-term and local-currency-denominated and FDI-heavy external liabilities provide a cushion against possible vulnerabilities.	**Overall Assessment:** The external position of the Slovak Republic was broadly in line with the level implied by medium-term fundamentals and desirable policies in 2017. One-off production delays in automotive and chemical industries contributed to negative current account balance in 2017. In 2018 current account is expected to improve only slightly due to high import intensity of ongoing investments in the automotive industry.
Current Account	**Background.** Current account (CA) deficit has improved in recent years from around 5 percent of GDP during 2010–11 to 1.8 percent during 2016–17. The improvement was driven by stronger export growth relative to import. The projected pick up in export growth, supported by investments in automotive industry to expand production capacities, is expected to move the CA balance into surplus in the medium-term. **Assessment.** The EBA light CA model suggests a norm of -2.1 percent of GDP for 2017, which is lower than the observed cyclically-adjusted CA balance (-2.0 percent of GDP). This suggests only small CA gap (0.1 percent of GDP) implying marginal REER undervaluation of 0.2 percent. A policy gap of 1.5 percent suggests that Slovakia's financial, fiscal and external policies are appropriate. Therefore, staff assesses Slovakia's external position as broadly consistent with medium-term fundamentals and desirable policy settings. However, large errors and omissions create uncertainties regarding assessment of the external position.	
Real Exchange Rate	**Background.** The CPI-based real effective exchange rate (REER) was broadly unchanged in 2017 compared with 2016. The ULC-based REER has appreciated slightly (0.5 percent) in 2017 relative to 2016 reflecting higher wage growth relative to trading partners. **Assessment.** The REER EBA-lite approach points to a large overvaluation of 11 percent. Given that the estimated overvaluation in this approach is mostly driven by large residuals, staff relies on the CA approach for assessment of the overall external position. The REER index methodology also has limitations when applied to countries with large structural changes, such as the adoption of the euro in 2009 in the case of Slovakia. Overall, staff assesses the real exchange rate to be broadly around its equilibrium value.	
Capital and Financial Accounts: **Flows and Policy Measures**	**Background.** Mirroring the 2017 CA deficit, the Slovak Republic experienced net capital inflows, largely driven by FDI. **Assessment.** Slovakia enjoys high investor interest. The dominance of FDI in capital inflows mitigate risks from sudden changes in market sentiment.	
FX Intervention and Reserves Level	**Background.** The euro has the status of a global reserve currency. **Assessment.** Reserves held by euro area economies are typically low relative to standard metrics, but the currency is free floating.	
Technical Background Notes		

Table 5. Slovak Republic: Risk Assessment Matrix[1]

Source of Risks	Relative Likelihood	Time Horizon	Impact	Policy Response
Global	**Retreat from cross-border integration.**	Medium	**Medium/High** • Slovakia's exports and growth could be negatively affected by rising protectionism.	**Medium/High** • Diversify exports products and destination, and increase value added in exports. • Improve labor market and business environment to attract new and more diversified FDI.
	Policy and geopolitical uncertainty: • **Policy uncertainty**, including uncertainty associated with post-Brexit arrangements • **Intensification of the risks of fragmentation/** security dislocation, incl. in parts of Europe leading to socio-economic disruptions	Medium/ High	**Low/Medium** • Direct links to the UK are limited, but potential negative spillovers could materialize through lower euro area (EA) growth. • Socio-economic disruptions among European trading partners could slow exports or impact FDI.	**Low/Medium** • Create fiscal space through efficiency-based consolidation, broadening of the tax base. • Diversify exports products and destination, and increase value added in exports. • Improve labor market and business environment to attract new and more diversified FDI.
	Financial conditions: • **Tighter global financial conditions, stemming from an abrupt change in global risk appetite.** • **Further pressure on traditional bank business models.**	High/ Medium	**Low/Medium** • A depreciation of the euro could positively impact exports. • Financial turmoil in the EA could affect some parent banks, but spillovers to domestic subsidiaries would be contained. The impact on the real economy would depend on how EA growth is affected.	**Low/Medium** • Continue to monitor financial developments. • Use active debt management to pre-finance fiscal needs.
	Weaker-than-expected global growth: • **Structurally weak growth in key advanced economies.** • **Significant U.S. slowdown and its spillovers.** • **Significant China slowdown and its spillovers.**	High Medium Low/ Medium	**Medium/High** • Exports and growth would be strongly hit by a slowdown in Europe, especially Germany while the impact of weaker EM/China growth would be mostly indirect. • Debt ceilings could be breached in the event of a large adverse growth shock. • Weaker growth and higher unemployment would worsen banks' asset quality.	**Medium/High** • Allow automatic stabilizers to work. • Create fiscal space through efficiency-based consolidation, and broadening of the tax base. • Improve labor market and business environment to boost productivity and potential output. • Draw on banks' capital buffers.
Local	**Property market downturn in the event of a worsening economic situation.**	Medium/ High	**Medium** • Weakening of banks' balance sheets	**Medium** • Continue using pro-active macro-prudential toolkit and close supervision of lending practices.
	Further increase in labor shortages, including for skilled labor.	Medium/ High	**Medium/High** • This could limit Slovak firms' ability to expand and could discourage foreign investors • Higher wage growth could undermine the economy's cost competitiveness	**Medium/High** • Ease conditions for attracting foreign workers, including skilled workers. • Adopt childcare and family leave policies to increase participation of women • Enhance effectiveness of active labor marker policies

[1]The Risk Assessment Matrix (RAM) shows events that could materially alter the baseline path (the scenario most likely to materialize in the view of IMF staff). The relative likelihood is the staff's subjective assessment of the risks surrounding the baseline ("low" is meant to indicate a probability below 10 percent, "medium" a probability between 10 and 30 percent, and "high" a probability between 30 and 50 percent). The RAM reflects staff views on the source of risks and overall level of concern as of the time of discussions with the authorities. Non-mutually exclusive risks may interact and materialize jointly. "Short term" and "medium term" are meant to indicate that the risk could materialize within 1 year and 3 years, respectively. exclusive risks may interact and materialize jointly. "Short term" and "medium term" are meant to indicate that the risk could materialize within 1 year and 3 years, respectively.

Table 6. Slovak Republic: Financial Soundness Indicators, 2011–17

(Percent, unless otherwise indicated)

	2011	2012	2013	2014	2015	2016	2017
Capital adequacy							
Regulatory capital to risk-weighted assets	13.4	15.7	16.5	17.3	17.8	18.0	18.8
Regulatory Tier 1 capital to risk-weighted assets	12.4	14.7	14.4	16.0	16.5	16.2	16.8
Capital to assets	10.8	11.7	12.1	11.9	11.1	11.0	10.8
Asset quality							
Nonperforming loans to gross loans	5.6	5.2	5.1	5.3	4.9	4.4	3.7
Nonperforming loans net of provisions to capital	15.5	13.3	13.1	15.8	13.9	11.8	9.1
Earnings and Profitability							
Return on assets (after tax)	0.7	1.0	1.3	1.2	1.3	1.4	1.1
Return on equity (after tax)	6.9	9.1	10.7	10.4	11.2	13.0	10.1
Interest margin to gross income	73.9	84.1	78.1	80.4	90.9	61.8	77.4
Noninterest expenses to gross income	52.5	64.3	59.1	60.0	70.8	54.2	68.3
Liquidity							
Customer deposits to total (noninterbank) loans	109.4	114.2	113.0	110.3	111.0	105.7	101.6
Liquid assets to total assets	37.4	38.3	36.2	34.1	34.2	31.7	29.7
Liquid assets to short-term liabilities	52.9	55.9	49.1	46.0	45.9	42.1	39.5
Sectoral distribution of loans to total loans							
Residents	93.6	92.4	91.6	91.0	93.6	94.0	94.1
Deposit-takers	0.0	0.0	0.0	0.0	0.1	0.2	0.1
Central bank	0.0	0.0	0.0	0.0	0.0	0.0	4.0
Other financial corporations	2.8	2.3	2.3	1.9	1.9	1.9	2.1
General government	2.9	2.6	2.3	2.3	2.2	1.7	1.5
Nonfinancial corporations	41.6	38.9	36.2	33.4	33.7	32.4	31.4
Other domestic sectors	46.2	48.6	50.7	53.5	55.7	57.8	59.0
Nonresidents	6.4	7.6	8.4	9.0	6.4	6.0	5.9
Other indicators							
Nonfinancial corporation debt (in percent of GDP)	83.9	81.4	85.6	89.3	90.1	89.7	92.2 1/
Households debt (in percent of GDP)	29.2	32.0	34.4	36.8	37.8	40.7	42.3 1/
Households debt (in percent of disposable income)	47.4	52.8	56.3	60.9	64.8	69.5	71.0 2/
Gross asset position in financial derivatives to capital	8.0	5.5	3.7	5.4	4.3	3.4	2.7
Gross liability position in financial derivatives to capital	9.1	6.7	4.8	6.6	5.5	4.4	3.4
Trading income to total income	-4.1	1.4	3.5	3.9	5.5	2.8	5.2
Personnel expenses to noninterest expenses	40.1	39.9	39.7	39.4	44.3	44.0	43.1
Spread between reference lending and deposit rates (basis points)	376.5	359.0	379.3	369.4	343.4	294.7	287.0
Foreign currency-denominated loans to total loans	1.6	1.5	1.1	1.9	1.8	1.7	1.6
Foreign currency-denominated liabilities to total liabilities	4.1	3.6	3.9	4.2	3.8	3.3	3.5
Net open position in equities to capital	9.1	8.3	14.4	12.6	12.6	11.9	11.3
Net open position in foreign exchange to capital	-1.7	0.1	2.2	3.7	2.5	0.9	1.0

Sources: National Bank of Slovakia; Haver; IMF FSI Database; and IMF staff estimates.
1/ 2017Q3 data.
2/ 2017Q2 data.

Annex I. Public Debt Sustainability Analysis (DSA)

Figure 1. Public Sector Debt Sustainability Analysis (DSA)—Baseline Scenario

(Percent of GDP, unless otherwise indicated)

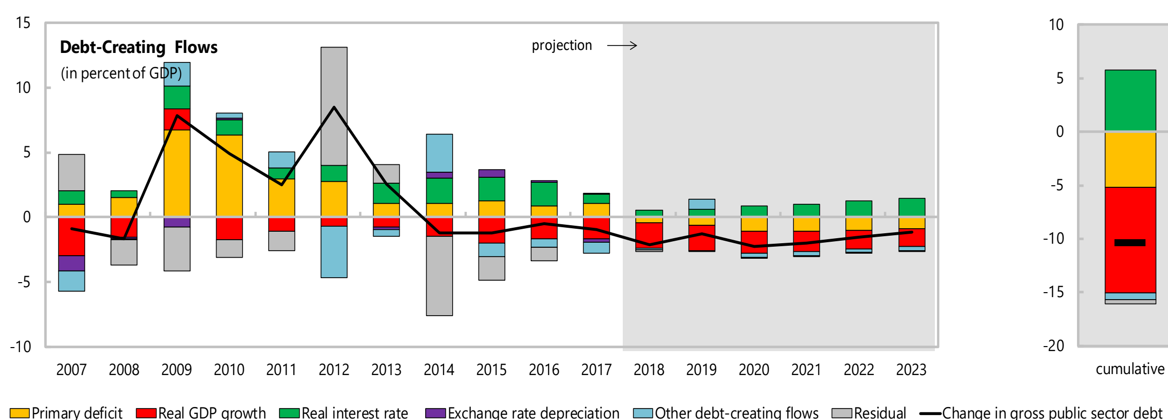
Debt, Economic and Market Indicators [1/]

	Actual			Projections					
	2007-2015 [2/]	2016	2017	2018	2019	2020	2021	2022	2023
Nominal gross public debt	43.6	51.8	50.9	48.8	47.5	45.2	43.2	41.7	40.5
Public gross financing needs	10.1	7.9	7.7	4.4	3.3	4.7	3.0	3.5	3.9
Net public debt	43.6	51.8	50.8	48.7	47.4	45.2	43.2	41.7	40.5
Real GDP growth (in percent)	3.2	3.3	3.4	4.0	4.2	3.8	3.7	3.5	3.4
Inflation (GDP deflator, in percent)	0.7	-0.4	1.3	1.9	2.2	2.1	2.1	1.9	1.8
Nominal GDP growth (in percent)	3.9	2.9	4.7	6.0	6.5	6.0	5.9	5.5	5.3
Effective interest rate (in percent) [4/]	4.1	3.2	2.8	3.2	3.6	4.1	4.6	5.0	5.5

As of May 23, 2018		
Sovereign Spreads		
EMBIG (bp) 3/		26
5Y CDS (bp)		39
Ratings	Foreign	Local
Moody's	A2	A2
S&Ps	A+	A+
Fitch	A+	A+

Contribution to Changes in Public Debt

	Actual			Projections							
	2007-2015	2016	2017	2018	2019	2020	2021	2022	2023	cumulative	debt-stabilizing primary balance [9/]
Change in gross public sector debt	2.4	-0.5	-1.0	-2.1	-1.3	-2.3	-2.0	-1.5	-1.2	-10.3	
Identified debt-creating flows	2.7	0.5	-1.0	-1.9	-1.2	-2.2	-1.9	-1.5	-1.1	-9.9	
Primary deficit	2.8	0.8	1.0	-0.5	-0.7	-1.1	-1.1	-1.0	-0.9	-5.2	-0.2
Primary (noninterest) revenue and grants	36.7	39.0	38.0	38.3	38.1	38.6	37.9	37.5	37.4	227.8	
Primary (noninterest) expenditure	39.5	39.9	39.0	37.9	37.4	37.5	36.9	36.5	36.5	222.6	
Automatic debt dynamics [5/]	0.0	0.3	-1.2	-1.4	-1.3	-0.8	-0.6	-0.2	0.1	-4.1	
Interest rate/growth differential [6/]	0.1	0.2	-0.9	-1.4	-1.3	-0.8	-0.6	-0.2	0.1	-4.1	
Of which: real interest rate	1.3	1.9	0.7	0.6	0.6	0.9	1.0	1.3	1.4	5.8	
Of which: real GDP growth	-1.2	-1.7	-1.7	-1.9	-1.9	-1.7	-1.6	-1.4	-1.3	-9.9	
Exchange rate depreciation [7/]	-0.1	0.1	-0.3	…	…	…	…	…	…	…	
Other identified debt-creating flows	-0.1	-0.6	-0.8	-0.1	0.7	-0.3	-0.3	-0.3	-0.3	-0.6	
Privatization/Drawdown of Deposits (+ reduces financing need) (negative)	-0.1	-0.6	-0.8	-0.1	0.7	-0.3	-0.3	-0.3	-0.3	-0.6	
Contingent liabilities	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	
Other debt-creating flows (specify) (+ increases financing need)	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	
Residual, including asset changes [8/]	-0.3	-1.1	0.0	-0.2	-0.1	-0.1	0.0	0.0	0.0	-0.4	



Source: IMF staff.

1/ Public sector is defined as general government.

2/ Based on available data.

3/ Long-term bond spread over German bonds.

4/ Defined as interest payments divided by debt stock (excluding guarantees) at the end of previous year.

5/ Derived as [(r - π(1+g) - g + ae(1+r)]/(1+g+π+gπ)) times previous period debt ratio, with r = interest rate; π = growth rate of GDP deflator; g = real GDP growth rate; a = share of foreign-currency denominated debt; and e = nominal exchange rate depreciation (measured by increase in local currency value of U.S. dollar).

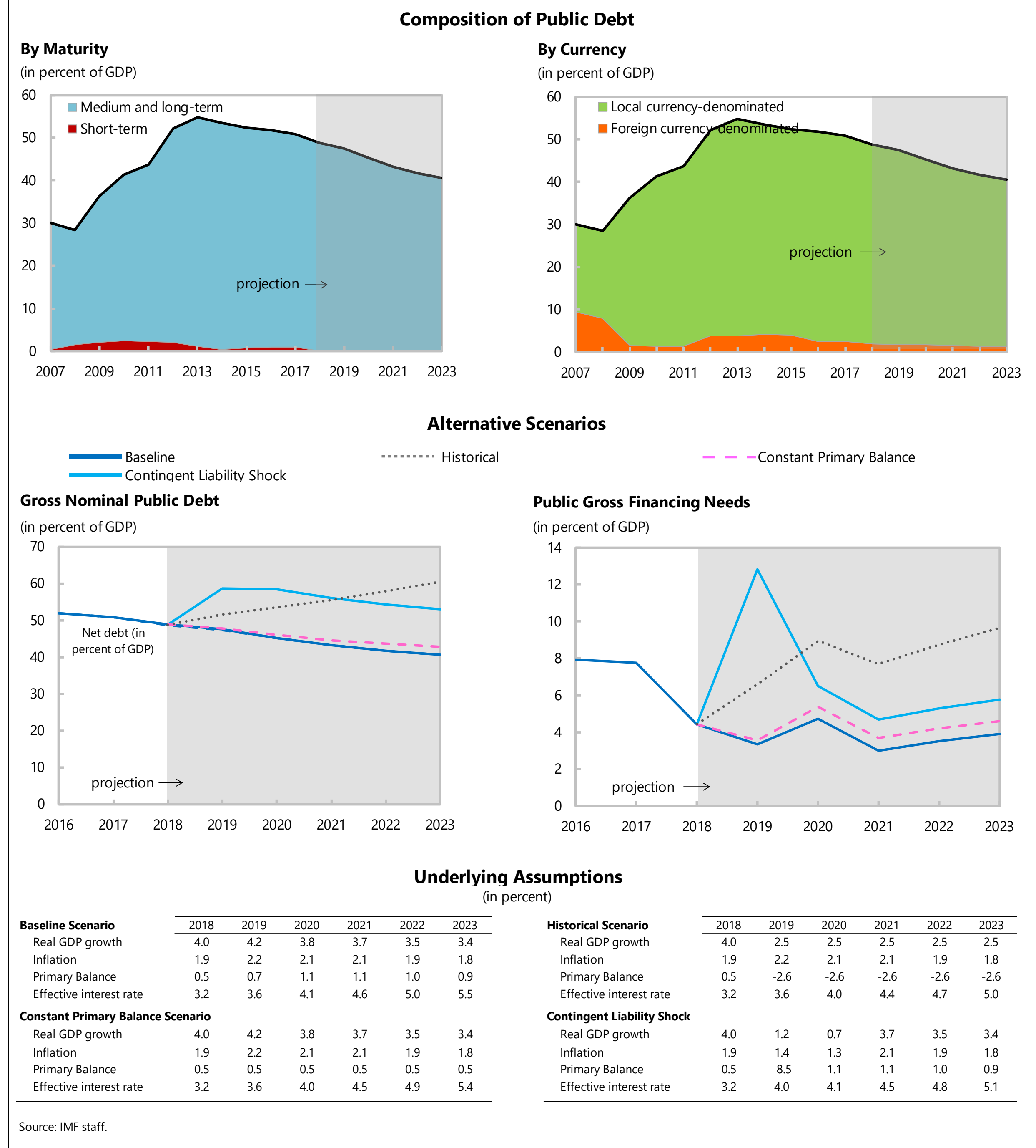
6/ The real interest rate contribution is derived from the numerator in footnote 5 as r - π (1+g) and the real growth contribution as -g.

7/ The exchange rate contribution is derived from the numerator in footnote 5 as ae(1+r).

8/ Includes asset changes and interest revenues (if any). For projections, includes exchange rate changes during the projection period.

9/ Assumes that key variables (real GDP growth, real interest rate, and other identified debt-creating flows) remain at the level of the last projection year.

Figure 2. Public DSA—Composition of Public Debt and Alternative Scenarios



Underlying Assumptions
(in percent)

Baseline Scenario	2018	2019	2020	2021	2022	2023
Real GDP growth	4.0	4.2	3.8	3.7	3.5	3.4
Inflation	1.9	2.2	2.1	2.1	1.9	1.8
Primary Balance	0.5	0.7	1.1	1.1	1.0	0.9
Effective interest rate	3.2	3.6	4.1	4.6	5.0	5.5
Constant Primary Balance Scenario						
Real GDP growth	4.0	4.2	3.8	3.7	3.5	3.4
Inflation	1.9	2.2	2.1	2.1	1.9	1.8
Primary Balance	0.5	0.5	0.5	0.5	0.5	0.5
Effective interest rate	3.2	3.6	4.0	4.5	4.9	5.4

Historical Scenario	2018	2019	2020	2021	2022	2023
Real GDP growth	4.0	2.5	2.5	2.5	2.5	2.5
Inflation	1.9	2.2	2.1	2.1	1.9	1.8
Primary Balance	0.5	-2.6	-2.6	-2.6	-2.6	-2.6
Effective interest rate	3.2	3.6	4.0	4.4	4.7	5.0
Contingent Liability Shock						
Real GDP growth	4.0	1.2	0.7	3.7	3.5	3.4
Inflation	1.9	1.4	1.3	2.1	1.9	1.8
Primary Balance	0.5	-8.5	1.1	1.1	1.0	0.9
Effective interest rate	3.2	4.0	4.1	4.5	4.8	5.1

Source: IMF staff.

INTERNATIONAL MONETARY FUND

SLOVAK REPUBLIC

STAFF REPORT FOR THE 2018 ARTICLE IV CONSULTATION—INFORMATIONAL ANNEX

June 13, 2018

Prepared By European Department

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FUND RELATIONS

(As of June 4, 2018)

Membership Status: Joined January 01,1993; Article VIII

General Resources Account:	SDR Million	Percent of Quota
Quota	1,001.00	100.00
Fund holdings of currency	863.03	86.22
Reserve position	137.97	13.78
Lending to the Fund		

SDR Department:	SDR Million	Percent of Allocation
Net cumulative allocation	340.48	100.00
Holdings	299.31	87.91

Outstanding Purchases and Loans: None

Financial Arrangements:

Type	Date of Arrangement	Expiration Date	Amount Approved (SDR Million)	Amount Drawn (SDR Million)
Stand-by	7/22/1994	3/21/1996	115.80	32.15

Projected Payments to Fund:
(SDR Million; based on existing use of resources and present holdings of SDRs):

	Forthcoming				
	2018	2019	2020	2021	2022
Principal					
Charges/Interest	0.27	0.37	0.37	0.37	0.37
Total	0.27	0.37	0.37	0.37	0.37

Exchange Rate Arrangement:

The currency of the Slovak Republic is the euro, which was adopted on January 1, 2009.
The Slovak Republic has accepted the obligations of Article VIII, Sections 2, 3, and 4 and maintains an exchange system that is free of restrictions on the making of payments and transfers for current international transactions, other than those imposed for security reasons, based on UN Security Council Resolutions and Council of the European Union Regulations, and which have been notified to the Fund under the procedures set forth in Executive Board Decision No. 144-(42/51).

Article IV Consultation:

The Slovak Republic is on a standard 12-month consultation cycle. The previous consultation with the Slovak Republic was concluded on March 17, 2017 (IMF Country Report No. 17/71).

FSAP Participation and ROSCs:

An FSAP was concluded with the completion of the 2002 Article IV consultation on August 7, 2002 (IMF Country Report No. 02/198). An FSAP update mission was held in December 2006 (IMF Country Report 07/243).

The report on the Fiscal ROSC was issued in August 2002 (IMF Country Report No. 02/189), and updates were issued in August 2003 (IMF Country Report No. 03/236) and in March 2005 (IMF Country Report No. 05/73). The report on the Data ROSC was issued in May 2005 (IMF Country Report No. 05/161).

Technical Assistance: See the attached table.

Resident Representative Post: None (closed at end-April 2004).

Slovak Republic: Technical Assistance, 2000–2018[1]		
Department	**Timing**	**Purpose**
MFD	February 2000	Mission on pros and cons, and modalities of moving to an inflation targeting framework, operational issues (money markets and policy instruments), and dealing with potential problems posed by capital inflows for monetary operations
	December 2001	Long-term resident expert on banking supervision
	May 2002	Two missions on inflation modeling
FAD	April 2000	Tax administration
	February 2001	Tax administration (follow-up)
	April 2001	Public Finance Management (follow-up)
	August 2001	Tax administration: Installation of resident expert to advise on establishment of Large Taxpayer Unit (LTU)
	August 2001–August 2002	Regular visits by FAD consultant on establishment of LTU
	December 2001	Tax administration follow-up, tax investigation/fraud issues
	June 2002	Mission to prepare Report on the Observance of Standards and Codes (ROSC), Fiscal Transparency Module
	February 2003	Tax policy
	March 2003	Tax administration
	May 2003	Expenditure policy
	December 2013	VAT gap analysis
	November 2015	Expenditure review workshop
	December 2015	VAT gap follow-up and excise gap analysis
	April 2016	Expenditure review
	November 2016	Tax efficiency
		Expenditure review
	March 2017	Corporate income tax gap
	May 2017	Expenditure review
	November 2017	Cost-benefit analysis of transport investment projects
		Expenditure review (follow-up)
	April 2018	TADAT
		International taxation
STA	February 2000	National accounts and price statistics
	March 2001	Multi sector mission
	July 2003	Government finance statistics
	February–March 2004	Data ROSC mission

[1]See Appendix I of IMF Country Report No. 05/71 for technical assistance during 1991–99.

STATISTICAL ISSUES

1. **Coverage, periodicity, and timeliness of data provided to the Fund are adequate for surveillance purposes.** The Slovak Republic has subscribed to the Special Data Dissemination Standard (SDDS) since 1996 and observes or exceeds all related standards. The Slovak Republic is subject to the statistical requirements and timeliness and reporting standards of Eurostat and the European Central Bank (ECB).

2. **Real sector.** All data on national accounts follow the ESA 2010.

3. **Fiscal sector.** The compilation of general government statistics is in line with the ESA 2010. Monthly reconciliation of government operations above and below the line is restricted to state budget transactions on a cash basis Quarterly reconciliation of general government operations above and below the line, as well as a financial balance sheet data are available on an accrual basis within 85 days after the end of the quarter.

4. **External sector.** External sector statistics are generally of good quality, and are reported on a timely basis to the Fund following the standard of the sixth edition of the Balance of Payments and International Investment Position Manual (BPM6). Official BPM6 basis data are available back to 2004. However, net errors and omissions in the balance of payments statistics are large (1.6 times larger than the current account deficit in 2017) and reported financial account flows are subject to large volatility. The statistical authorities are aware of these issues and are working to address them.

5. **Monetary Statistics**: The ECB reporting framework is used for monetary statistics and data are reported to the IMF through a "gateway" arrangement with the ECB. The arrangement provides an efficient transmission of monetary statistics to the IMF and for publication in the International Financial Statistics. Monetary statistics for Slovak Republic published in the IFS cover data on central bank and other depository corporations (ODCs) using Euro Area wide and national residency criteria.

6. **Financial sector surveillance:** Slovak Republic reports all core and encouraged financial soundness indicators (FSIs) for deposit takers, except for large exposures.

Table 1. Slovak Republic: Table of Common Indicators Required for Surveillance

(As of June 4, 2018)

	Date of Latest Observation	Date Received	Frequency of Data [6/]	Frequency of Reporting [6/]	Frequency of Publication [6/]
Exchange Rates	Current	Current	D	D	D
International Reserve Assets and Reserve Liabilities of the Monetary Authorities [1/]	March 2018	April 2018	D	W	W
Reserve/Base Money	March 2018	April 2018	M	M	M
Broad Money	March 2018	April 2018	M	M	M
Central Bank Balance Sheet	March 2018	April 2018	M	M	M
Consolidated Balance Sheet of the Banking System	March 2018	April 2018	M	M	M
Interest Rates [2/]	Current	Current	D	D	D
Consumer Price Index	March 2018	April 2018	M	M	M
Revenue, Expenditure, Balance and Composition of Financing [3/] — General Government [4/]	2016	July 2017	A	A	A
Revenue, Expenditure, Balance and Composition of Financing [3/] —Central Government	March 2018	April 2018	M	M	M
Stocks of Central Government and Central Government-Guaranteed Debt [5/]	2018Q1	April 2018	Q	Q	Q
External Current Account Balance	March 2018	April 2018	M	M	M
Exports and Imports of Goods and Services	March 2018	April 2018	M	M	M
GDP/GNP	2017Q4	February 2018	Q	Q	Q
Gross External Debt	2017Q4	February 2018	Q	Q	Q
International Investment Position [7/]	2017Q4	February 2018	Q	Q	Q

[1/]Includes reserve assets pledged or otherwise encumbered as well as net derivative positions.

[2/]Both market-based and officially-determined, including discount rates, money market rates, rates on treasury bills, notes and bonds.

[3/]Foreign, domestic bank, and domestic nonbank financing.

[4/]The general government consists of the central government (budgetary funds, extra budgetary funds, and social security funds) and state and local governments.

[5/]Including currency and maturity composition.

[6/]Daily (D), Weekly (W), Monthly (M), Quarterly (Q), Annually (A), Irregular (I), Not Available (NA).

[7/]Includes external gross financial asset and liability positions vis-à-vis nonresidents.

Statement by Ms. Michaela Erbenova, Executive Director for Slovak Republic and Mr. Eduard Hagara Senior Advisor
July 23, 2018

The Slovak authorities thank staff for the candid and constructive discussions during the 2018 Article IV mission. The Staff Report and the informative Selected Issues Papers provide a fair picture of the economic developments and policy challenges facing the authorities.

The Slovak economy continues to perform strongly. Real GDP growth reached 3.4 percent in 2017 on the back of domestic demand, driven by strong labor market outcomes and rebounding investment. Owing to the authorities' prudent policies, the long-lasting strong economic growth has not resulted in the emergence of any major imbalances. Inflation, although increasing due to higher services and food prices, remained low at 1.3 percent in 2017. Robust job creation resulted in a record low unemployment rate of about 8 percent. The fiscal deficit has been contained, translating into a further decline in the already low public debt, and the external sector balance is assessed to be in line with fundamentals. While credit growth has been high, the banking sector remained well-capitalized, liquid and sound with a low and further declining non-performing loan (NPL) ratio.

The main risks to the outlook stem from the external environment. Since the Article IV discussions in May, the protectionist tensions in international trade have intensified, raising downside risks for Slovakia's small open economy with its large concentration in car manufacturing. This has been reflected in slight downward revisions in the authorities' most recent growth projections, acknowledging also that the balance of risks is skewed to the downside. Nevertheless, for the time being the medium-term outlook remains favorable, with Slovakia's economic growth projected to be among the highest among EU countries. Owing to new investments in the automotive industry by Jaguar-Land Rover and Volkswagen, growth is expected to accelerate further in 2018-2019. For 2018, the authorities' most recent GDP projections are in line with staff's estimates, while the authorities are somewhat more optimistic for 2019, with the Ministry of Finance (MoF) projecting 4.5 percent growth and the National Bank of Slovakia (NBS) 4.8 percent. Thereafter, growth is projected to soften towards its high potential, estimated at around 3.5-4 percent. This continued strong performance is expected to take the unemployment rate to new record lows of around 5.5 percent in 2021, while inflation is envisaged to edge to around 2.5 percent. The authorities concur with staff that high credit growth and labor shortages are the main domestic risks for the medium-term outlook.

Slovakia's recent performance is part of a longer-term trend of a very successful economic convergence. In 1993, the first year of Slovakia's modern existence after the breakup of Czechoslovakia, GDP per capita in purchasing power standards stood as low as 35 percent of Germany's level. In the decade towards Slovakia's European Union accession in 2004, the figure increased to almost 50 percent. Since then, Slovakia's EU membership and adoption of the euro helped boost its GDP per capita to 65 percent of Germany's level in 2017, and staff projects a

further increase to 75 percent by 2023. Having said that, the authorities acknowledge the challenges ahead and largely agree with staff on the priority structural areas to be addressed.

Fiscal policy

The authorities have advanced fiscal consolidation. The fiscal deficit was reduced from 2.2 percent of GDP in 2016 to 1.0 percent in 2017, exceeding the budget target that had been set at 1.3 percent of GDP. Against the backdrop of a positive output gap, the government aims to achieve a balanced budget in 2020. Public debt is projected to decline further from 51 percent in 2017, to 45 percent in 2020. The MoF acknowledges that the tightening labor market can translate into higher wage demands in the public sector, but considers risks to be contained and manageable within the approved medium-term budget envelope. Furthermore, the most recent forecast raised the projected revenues by 0.3-0.4 percent of GDP in 2018-2021, creating an additional buffer to cover fiscal risks.

In the long term, Slovakia will face one of the most adverse population aging developments in the EU, with the old-age dependency ratio increasing from the recent 20 percent to 60 percent in 2060. With this in mind, the substantial pension reform implemented in 2012 mitigates aging pressures on pension expenditures by linking retirement age to life expectancy, unifying the retirement age of men and women and indexing pension benefits only to inflation, among others. The explicit link between the retirement age and statistical life expectancy implies that the legal retirement age will continuously increase from 2017 onwards. Raising pension benefits for pensioners at the lower end of income distribution, discussed in the Staff Report, is important from the pension adequacy perspective, while having only a limited and temporary impact on the pension system balance.

The European Union fiscal rules and the national debt brake rule as defined in the constitutional Fiscal Responsibility Act provide strong fiscal anchors. The government has launched two important policy initiatives with the help of much appreciated Fund technical assistance in recent years:

(i) The comprehensive anti-tax- avoidance program, launched in 2012, has substantially reduced compliance gaps, mobilizing approximately 2 percent of GDP of additional VAT and CIT revenues (annually). To address remaining gaps, measures currently being implemented focus on further enhancing tax administration efficiency through the higher use of new technologies, improving coordination within the tax administration and increasing voluntary compliance. In addition, the Slovak Financial Administration (the tax administration authority) is updating its operational strategy, for which the April 2018 TADAT assessment provides valuable and timely input. A new strategy for voluntary tax compliance is being prepared with the help of international experts under the financial support from the European Commission.

(ii) In 2016, the government introduced the “Value for Money” program with a mandate to conduct regular and systematic spending reviews as part of the budgetary process, with the aim to assess a majority of general government expenditures, including tax expenditures, over the election cycle. Over the first two years of its existence, the program has assessed expenditures in the transportation, health, IT, environment, labor, and education areas; covering two-fifths of the overall general government expenditures (15 percent of GDP), identifying potential savings worth 0.6 percent of GDP, with the implementation period spanning through 2020. The implementation is being monitored by the Implementation Unit at the Prime Minister’s Office, reinforcing its mandate and highlighting the government’s commitment. Status implementation reports are being published as annexes to the general government budget. Three new spending reviews are currently ongoing, focusing on the public wage bill, agriculture, and marginalized groups expenditure. In 2017, the mandate of the “Value for Money” program was extended to cost-benefit appraisals of all investment projects with costs exceeding EUR 40 million (and 10 million for IT projects) with the obligation to publish the assessments.

Short-term priority areas

In the short term, the tightening labor market and strong credit growth are the main challenges which need to be addressed to maintain the high rate of economic growth. The tightening of the labor market has started to feed into higher wages and inflation, but has not affected Slovakia’s competitiveness so far, as indicated for example by the stable REER. Nevertheless, the authorities agree that most of the remaining unemployment is of a structural nature, and labor shortages, if left unaddressed, would limit growth prospects. Domestically, the activation of long-term unemployed and marginalized groups through ALMPs and improved education are seen as the main avenues to help unlock the largest labor force reserves. Staff focused their analysis on female labor force participation. The authorities agree with the substance of staff’s recommendations and are working on measures to further increase female participation, but wish to note that the potential labor force gains would be lower than for the aforementioned groups. Further, the 2012 pension reform will continue to increase the labor market participation among older people, especially for women, owing to the unification of the retirement age for men and women. Simultaneously, the legislation changes enabled easier access of foreign workers to Slovakia and their number increased by 40 percent in 2017, although from a low base. A set of additional measures has been approved this year.

The authorities appreciate the opportunity for the NBS staff to engage in the preparation of the Selected Issues Paper on credit growth and macroprudential policies. Notwithstanding the sound banking sector with low and declining NPLs, the authorities concur with staff that the long-lasting strong credit growth and accelerated house prices require vigilance and active policy measures. Since 2014, the NBS has been introducing and gradually tightening the macroprudential LTV and DSTI limits and the countercyclical buffer (CCB). While there has been some softening of credit and house price growth, the NBS continues with its proactive approach in 2018, introducing a new DTI limit, further restricting the LTV limit and most

recently increasing the CCB to 1.5 percent effective as of August 2019. Furthermore, the legislative change extending the application of the macroprudential measures to pre-approved loans is expected by the end of this year and will close the existing gap in the macroprudential toolkit.

From a macroeconomic perspective, the authorities broadly agree on the merit of staff's recommendation to increase property taxation. They are taking a cautious stance, however, since housing demand appears to be driven to a large extent by demographic factors. Strong 25–39 age cohorts have entered the labor market boosting the housing demand. Furthermore, living space per person in Slovakia is one of the smallest in the EU and demand for improved living conditions is a natural consequence of income convergence. Tax measures might therefore not be the best solution at this juncture to address strong housing demand.

Structural reforms

The authorities agree with the need for structural reforms to sustain high growth and broadly concur with the identified priority areas. The recent healthcare policy measures have been mostly guided by the 2016 healthcare spending review, including better management of hospital personnel, the introduction of an e-health system, and the pilot project for diagnosis-linked reimbursement systems. To improve the education outcomes, the Ministry of Education has prepared a substantial update of the long-term educational strategy with an action plan of measures to be introduced over the next 10 years. The first phase of this action plan starts in September 2018 and focuses on improving the quality of teachers' training and a gradual increase of teachers' salaries, aimed at attracting higher quality teachers. Furthermore, to enhance skill-job matching, the authorities have identified and removed legal impediments to the greater use of work-based training in vocational education.