INTERNATIONAL MONETARY FUND

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SLOVAK REPUBLIC

2014 ARTICLE IV CONSULTATION—STAFF REPORT; AND PRESS RELEASE

September 2014

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 2014 Article IV consultation with the Slovak Republic, the following documents have been released and are included in this package:

- The **Staff Report** prepared by a staff team of the IMF for the Executive Board's consideration on August 27, 2014, following discussions that ended on June 17, 2014 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 July 30, 2014.
- An **Informational Annex** prepared by the IMF.
- A **Staff Statement** of August 27 updating information on recent developments.
- A **Press Release** summarizing the views of the Executive Board as expressed during its August 27, 2014 consideration of the staff report that concluded the Article IV consultation with Slovak Republic.

The document listed below has been or will be separately released.

Selected Issues Paper

The publication policy for staff reports and other documents allows for the deletion of market-sensitive information.

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INTERNATIONAL MONETARY FUND

SLOVAK REPUBLIC

STAFF REPORT FOR THE 2014 ARTICLE IV CONSULTATION

July 30, 2014

KEY ISSUES

Context. After slowing in 2013, the Slovak economy is gathering momentum as the euro area and domestic demand recover, the latter complementing the strong export sector that has made Slovakia one of Europe's more dynamic economies. Reducing still very high unemployment remains a key challenge, as does sustaining fiscal adjustment. Manageable public and private debt as well as a sound banking system limit vulnerabilities, but Slovakia's fortunes remain closely tied to external developments, especially in the euro area, and there are risks from regional tensions since Russia provides much of Slovakia's energy and is a reasonably important export market, including for Slovakia's trading partners.

Growth and jobs. Despite positive growth, unemployment is very high and reflects large regional disparities, which are also seen in income levels and infrastructure. Wide-ranging actions are needed to encourage investment and job creation, reduce disincentives to working and hiring, enhance skills, and facilitate workforce participation.

Fiscal policy. Fiscal consolidation has continued, allowing exit from the EU's Excessive Deficit Procedure (EDP), but domestic debt brakes have started to bite and challenges remain in sustaining adjustment, in part because of reliance on temporary measures. Given these factors, as well as potential difficulties in focusing on spending cuts for future deficit reduction, strengthening revenue collection should be a priority. Consideration also might be given to refining the fiscal framework over time.

Financial sector policy. Slovakia's sound, liquid, and well-capitalized banking sector is well-positioned should corporate credit demand pick up. Household lending has grown rapidly, and while real estate prices are flat and household debt moderate, recommendations on loan-to-value (LTV) or debt-to income ratios would help guard against a build-up of risks. Reducing taxes and fees would address some of the factors that have inhibited capital market activity.

Approved By
Philip Gerson and Mark Flanagan

Staff team: The mission took place in Bratislava June 4 – 17, 2014. The team comprised Mr. John (head), Mr. Giustiniani, Ms. Q. Chen, Mr. Semmelmann (all EUR), and Ms. Zavacka (SEC), and was assisted at headquarters by Mr. Winnekens, Ms. T. Chen, and Ms. de Moraes Rego. Mr. Jakoby (Senior Advisor to the Executive Director) accompanied the mission and Mr. Prader (Executive Director) took part in the concluding meeting.

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ANNEXES

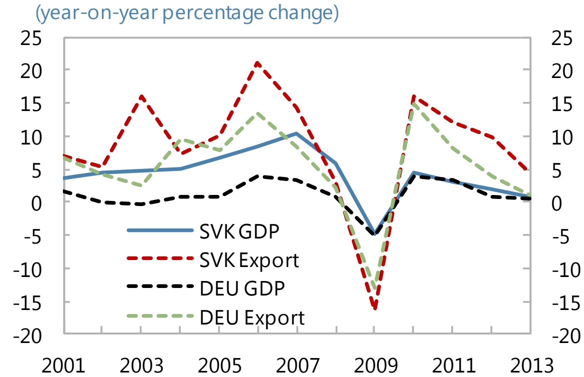
RECENT DEVELOPMENTS AND OUTLOOK

Growth is gathering pace in 2014 with signs that domestic demand is recovering to complement the vibrant export sector that has been a key element in Slovakia's positive economic performance since joining the EU ten years ago (Box 1). Fiscal consolidation progress, moderate debt levels, favorable market conditions, trade and current account surpluses, and a sound banking system help provide a solid economic foundation. Nonetheless, unemployment remains elevated and significant regional disparities persist. External risks include potential weakness in Europe and effects from regional tensions given energy imports from and exports to Russia.

A. Economic Recovery Gathering Pace

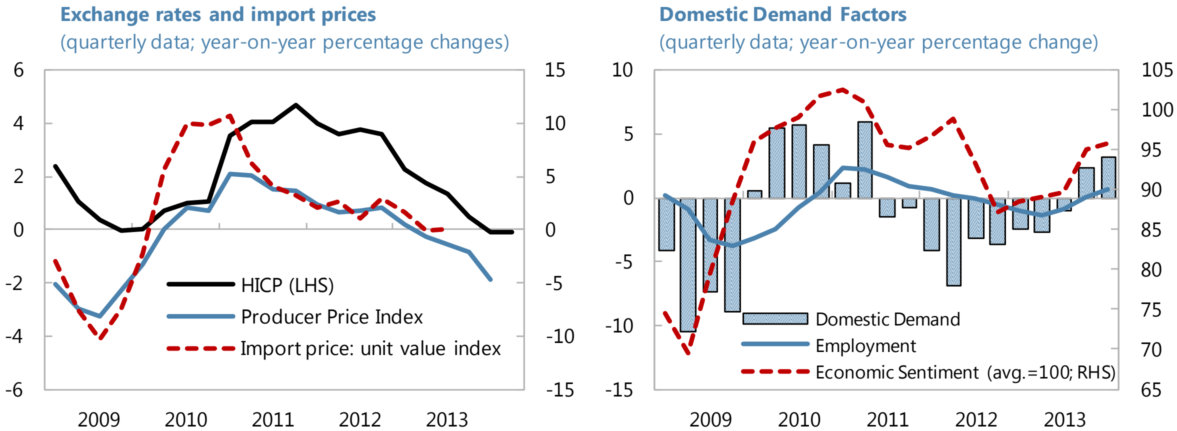
1. **After slowing, growth is set to pick up again** (Figure 1 and Table 1). Slovakia has enjoyed one of the fastest recoveries from the 2009 crisis among EU countries, benefiting from investment and competitiveness that spurred export growth. As economic activity in Germany and the euro area slowed in 2012–13, however, the Slovak economy lost momentum, with growth bottoming out in mid-2013 and domestic demand depressed. Investment picked up strongly at end-2013, and private consumption rose sharply in Q1 2014, reflecting higher real wages.

Export and GDP Growth Rates in Slovakia and Germany
(year-on-year percentage change)



Sources: Haver and IMF staff calculations.

2. **Headline inflation has declined sharply, reflecting lackluster domestic demand, weak commodity prices, and euro appreciation**. Domestic demand has acted as a drag on growth and core inflation, reflecting weak investment and stagnant private consumption. The impact of declining energy prices and abating pressure from food prices has been compounded by euro appreciation and Czech koruna depreciation, which have lowered import prices. Producer price inflation has been negative since mid-2013 while headline inflation moved into negative territory in the first months of 2014.



Sources: Eurostat, Haver, and IMF staff calculations

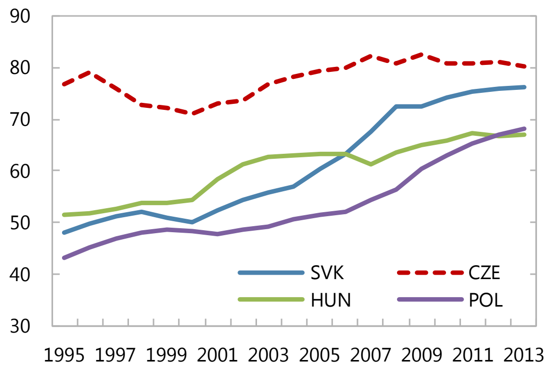
3. Unemployment remained well above the EU average (Figure 2). Employment contracted in 2013, but with the working-age population also declining, the unemployment rate stabilized at around 14 percent. Youth unemployment is near 33 percent and long-term unemployment represents more than two-thirds of the total, reflecting structural challenges. Regional disparities are great, with joblessness much higher in central and eastern Slovakia. There was, however, an encouraging uptick in employment in early 2014. Moderate wage increases and robust productivity translated into subdued unit labor cost growth.

4. Fiscal consolidation continued but debt brakes started to bite (Figure 3, Tables 2–3, and Annex III). The general government deficit declined to 2.8 percent of GDP in 2013 (against a target of 2.9 percent of GDP), enabling exit from the EU's Excessive Deficit Procedure (EDP). Deficit reduction, while substantial, was achieved partly through low-quality and temporary measures such as under-spending EU funds, significant cuts in capital outlays especially by local governments, and allowing a shift of pension assets from the fully funded second pillar to the public first pillar scheme, which offset wage bill and other expenditure overruns. Explicit one-off measures in 2013 totaled 0.3 percent of GDP while savings from lower co-financing on EU Funds—by delaying potentially useful projects—totaled 0.4 percent of GDP. Welcome improvements in VAT collection—Slovakia's VAT efficiency has been among the lowest in the EU—started materializing late in 2013 and yielded about 0.4 percent of GDP. The recent inclusion of the railway company in the general government per a determination by Eurostat also contributed to the better-than-budgeted outturn. General government debt rose above a debt brake threshold of 55 percent of GDP in 2013, partly reflecting Eurostat classification of the newly-created Emergency Oil Stocks Agency (EOSA) as a public unit. Under the national Fiscal Responsibility Act (FRA), breaching this debt threshold triggers some expenditure cuts during 2014 and the submission of a 2015 budget that freezes much spending at 2014 budgeted levels.

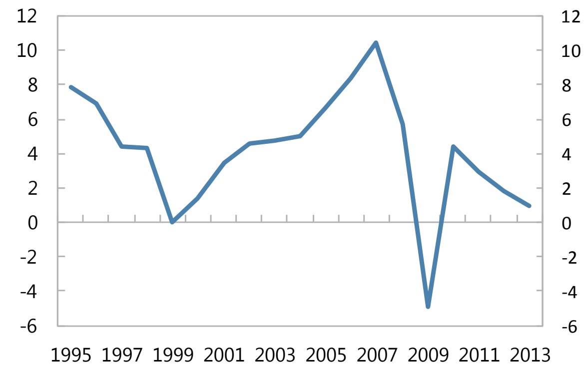
Box 1. Slovak Republic: Ten Years in the EU[1]

EU membership catalyzed a remarkable turnaround for the Slovak Republic. The Velvet Revolution in 1989 led to a peaceful dissolution of Czechoslovakia, but the new Slovak Republic lagged its Czech neighbor in terms of income level, starting near that of Hungary and Poland and well below the EU average. Relatively strong growth early in the transition slowed progressively and eventually stalled, as had the EU accession process. The election of a reform-minded government in 1998 with an ambitious agenda helped restart EU talks, and Slovakia was able to join the first wave of eastern EU enlargement on May 1, 2004. Slovakia took an additional step toward further European integration by adopting the euro in January 2009.

Per-Capita GDP in Purchasing Power Standards
(In percent of EU average)



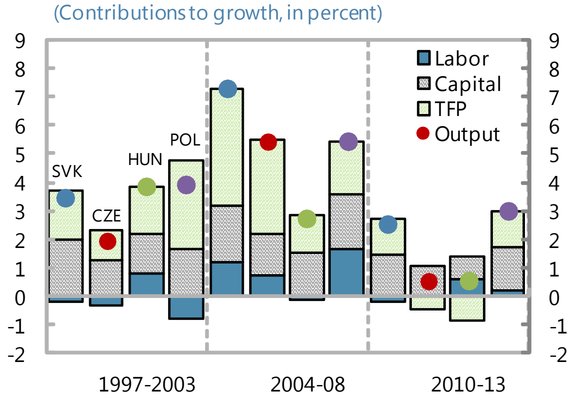
Slovak Republic: GDP Growth
(In percent)



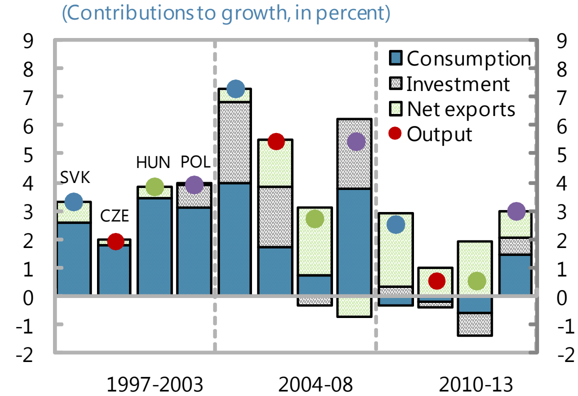
Sources: Eurostat and IMF staff calculations.

EU accession has fostered a rapid catch-up in income. Slovakia's per-capita income climbed to roughly 75 percent of the EU average in 2012 from less than half in the mid-1990s, outpacing Poland and Hungary and closing much of the gap with the Czech Republic. Output growth accelerated significantly in the post-accession years, averaging 7.2 percent in 2004–08. After a contraction in 2009, reflecting the large international trade collapse, economic activity rebounded to a more moderate average growth rate of 2.5 percent in 2010–13. While Slovakia and its neighbors all benefited from sharp increases in FDI, Slovakia also enjoyed high total factor productivity growth. With substantial investment in export industries (especially autos and electronics) following accession, net exports became a key driver of Slovak growth, particularly after 2009, resulting in a current account surplus in 2012–13, following years of deficits due in part to capital goods imports.

Growth Breakdown: Supply Side
(Contributions to growth, in percent)



Growth Breakdown: Demand Side
(Contributions to growth, in percent)

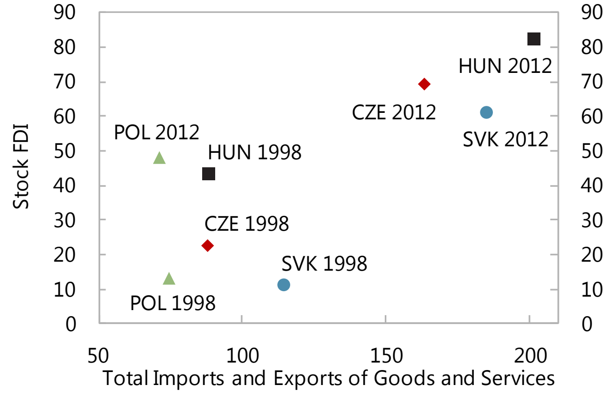


Sources: Eurostat, OECD and IMF staff calculations.

Box 1. Slovak Republic: Ten Years in the EU (concluded)

Integration into the world economy has deepened substantially. Since the mid-1990s, the degree of openness of the economy, as measured by the sum of exports and imports of goods as a percent of GDP, has risen sharply to about 170 percent in 2013, and Slovakia's export market share in the European Union has tripled. This expansion was supported by significant inflows of foreign direct investment and went hand-in-hand with growing participation of the Slovak economy in global value chains (GVCs), especially in the auto industry.

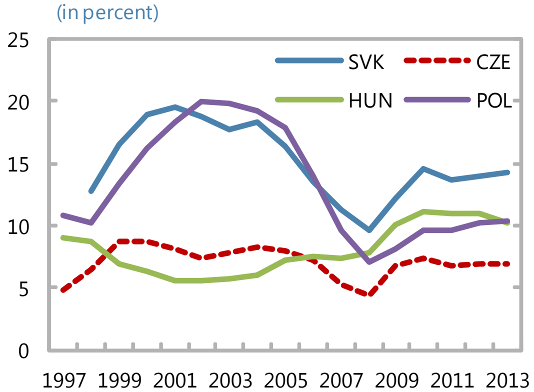
Openess to Trade and Foreign Direct Investment
(In percent of GDP)



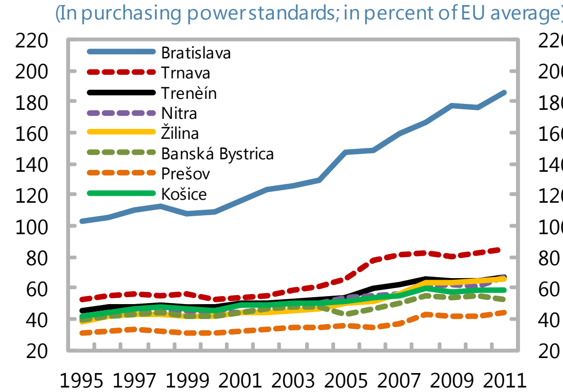
Sources: OECD, WEO and IMF staff calculations

The significant benefits of EU membership have not addressed unemployment or been shared uniformly. Very high unemployment during the transition period fell significantly until the 2009 downturn when joblessness rose again, and now remains well above peers. Striking differences among regions persist in terms of per-capita income and unemployment. These differences are partly the legacy of historical and geographical conditions, but also reflect investment and growth patterns from the recent past. While outward migration expanded to new destinations after EU accession (e.g., the United Kingdom), much of this reversed in the wake of the crisis with the exception of Austria.

Unemployment in CEE-4
(in percent)



Regional Per-Capita Income
(In purchasing power standards; in percent of EU average)



Sources: Eurostat, Haver, Slovak Regional Statistics Database, and IMF staff calculations.

[1] The first chapter of the Selected Issues (*Ten Years on from EU Accession) provides a* fuller discussion.

5. **Market conditions remain favorable**. The government had secured more than 65 percent of its 2014 financing needs by early June, maintains large cash balances (6 percent of GDP at end-2013), and has tapped new markets while extending the average maturity of debt. Strong demand from non-resident investors more than offset some divestment by domestic banks, which hold a high share of government bonds to total assets among euro area banks. Bond and CDS spreads remain low and rating agencies have upgraded outlooks to stable.

6. **Robust exports continued to support Slovakia's external position** (Figures 4–5 and Table 5). Strong competitiveness prompted additional gains in export market shares, consolidating

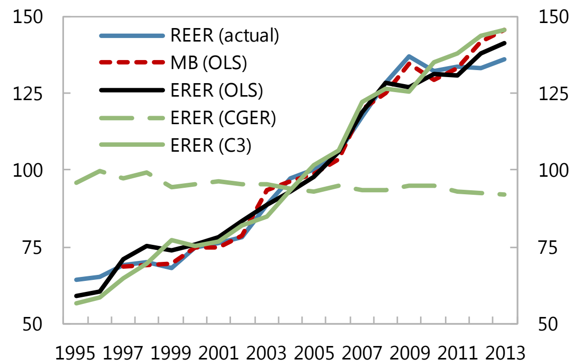
trade and current account surpluses. However, the country's negative net investment position deteriorated marginally and gross external debt rose (Annex IV), mainly reflecting an increase in the share of non-resident holdings of government debt (now more than 50 percent) as part of the authorities' strategy to reduce risks by diversifying the investor base. The external position is broadly consistent with medium-term fundamentals and desirable policy settings (Box 2).

Box 2. Slovak Republic: Competitiveness

Current account. The current account remained in surplus in 2013, at around 2 percent of GDP. A decomposition of current account drivers shows that cyclical factors explain much but not all of the recent improvement.[1] There is some uncertainty, however, over balance of payments statistics in light of large errors and omissions and anecdotal accounts of "branding," potentially involving overstatement of export prices.

Real effective exchange rate (REER). A CGER-like methodology using a large panel of heterogeneous countries provides a mixed assessment of Slovakia's REER. While the current account approaches (macroeconomic balance (MB) and external sustainability) point to an undervaluation of about 2.5 to 9 percent in 2013, the equilibrium real exchange rate (ERER) approach suggests an overvaluation of almost 40 percent. A closer look at CGER-like estimates shows the long-run equilibrium exchange rates to be nearly constant over time, which seems unlikely for fast-changing economies such as Slovakia. More tailored analysis using panels of transition economies suggests that Slovakia's REER is broadly in line with fundamentals. Over time, policies targeted at boosting domestic demand and employment would be expected to narrow the small degree of real exchange rate undervaluation found under some approaches.

Slovak Republic: REER Assessments
(Index , 2005 = 100)



Sources: WEO and IMF staff calculations.

Capital and financial account. FDI inflows to Slovakia declined in 2013, but are expected to pick up again in 2014. Large portfolio inflows in 2012 and 2013 reflect the strategy of the Slovak government to mitigate risks by diversifying the investor base while also extending maturities and lowering funding costs. Overall, capital flows are expected to remain generally stable although, as noted above, large errors and omissions complicate the assessment somewhat.

Foreign asset and liability position. External debt rose to a still manageable 83 percent of GDP and the net international investment position (NIIP) deteriorated in 2013, but at negative 66 percent is in line with peers in Central Europe. Despite the weakening NIIP, external vulnerabilities are mitigated by the large share of FDI among liabilities and by recent increases in portfolio liabilities being due mostly to government debt with long maturities. Staff consider the moderate current account surpluses projected over the medium term, even while allowing room for the policies noted above to support domestic demand and reduce high unemployment, as consistent with lowering external debt,.

[1] The second chapter of the Selected Issues (*Evolution of Drivers of the Business Cycle in Slovakia)* considers the structural and cyclical components of external surpluses.

7. **The banking sector remains sound while lending increased marginally** (Figure 7 and Table 6). Household borrowing, mainly for housing, continued to grow at around 11 percent, while corporate lending turned just positive, but only due to large transactions of two state-owned

enterprises. Average LTV ratios remain around 70 percent and average property prices have been flat or slightly falling, but loans with higher LTVs have become more common, reflecting stronger competition among lenders. Robust net interest margins supported profitability, despite the impact of the bank levy. Although impaired loans to the corporate sector edged up, nonperforming loans (NPLs) are low and well provisioned. Banks continue to enjoy stable domestic funding and further strengthened their capital buffers.

B. Outlook and Risks

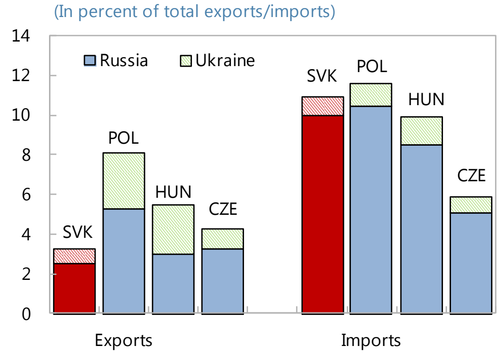
8. Activity is picking up amid a more favorable outlook. Growth is projected to accelerate to 2.4 percent in 2014 and to 3 percent over the next few years, despite fiscal headwinds. The forecast reflects an improving external environment as well as more balanced growth as confidence, investment, and employment improve, enabling domestic demand to replace net exports as the main driver of growth. Medium-term potential growth is estimated at around 2½ percent, largely reflecting continued improvements in total factor productivity. As domestic demand strengthens and energy prices rebound, headline inflation is projected to edge up in the second half of 2014 but remain subdued over the forecast period. The trade and current account balances will remain in surplus, reflecting some further gain in export market shares. Unemployment is expected to fall gradually, owing to higher employment and a decline in the working-age population, but to stay near 12 percent in the medium term.

9. Slovakia faces positive and negative risks (Annex I, Risk Assessment Matrix).

- On the upside, market sentiment and conditions in key trading partners are improving, and ECB easing could provide further support. Additional positive impulses could come from residential and other infrastructure investment, as well as greater absorption of EU funds.

- Negative spillovers could come from prolonged low-growth/low-inflation in Europe given the importance of trade and FDI to Slovakia.[1] Slower growth would place public debt on an upward trajectory and operation of debt brakes could make fiscal policy more pro-cyclical. In terms of prices, additional downward pressure could come from further appreciation of the euro as a result of either improving euro area prospects (although this could also help boost confidence and domestic demand) or safe haven capital inflows should global financial market volatility resume.

Exports and Imports from Russia and Ukraine
(In percent of total exports/imports)



Source: Direction of Trade Statistics.

[1] Analysis of the impact of shocks is considered in the second chapter of the Selected Issues (*Evolution of Drivers of the Business Cycle in Slovakia).*

- Potential escalation of tensions between Russia and Ukraine might affect Slovakia given high dependence on Russian energy, although Slovakia has sufficient reserves to withstand a short-lived interruption of gas supply. Exports to Russia are 2 percent of GDP, whereas trade and financial links with Ukraine are negligible. Risks would rise if Germany and the euro area were significantly affected.

- With relatively low levels of public and private debt, declining government financing needs, and healthy cash balances, bouts of financial market volatility would likely have limited impact.

- On the domestic side, prolonged high unemployment could inhibit a recovery in domestic demand and lead to lower growth, both in the near-term and in the longer-term as the erosion of human capital could damage potential output.

10. Policies should be geared toward sustaining growth and supporting domestic demand. With external surpluses and falling debt levels projected over the medium term, but domestic demand only recently starting to rebound amid very high unemployment, policy efforts should seek to encourage investment and job creation. This could be supported by structural policies to unlock growth, moderately paced fiscal adjustment focused on enhanced revenue collection to fund key priorities, as well as steps to facilitate access to credit, especially for small firms.

Authorities' views

11. The authorities and staff generally agreed on the outlook and risks. The latest government forecasts are similar to staff projections, although somewhat more optimistic for 2015 growth, even as fiscal adjustment continues. They agreed on the importance of strengthening domestic demand and foresaw somewhat greater reductions in unemployment. The authorities concurred on the above-mentioned risks, although a long-lasting interruption of gas supply by Russia was viewed as unlikely. While banks in Slovakia are considered robust, the authorities flagged the possibility of broader market volatility if stress tests reveal capital deficiencies elsewhere in Europe.

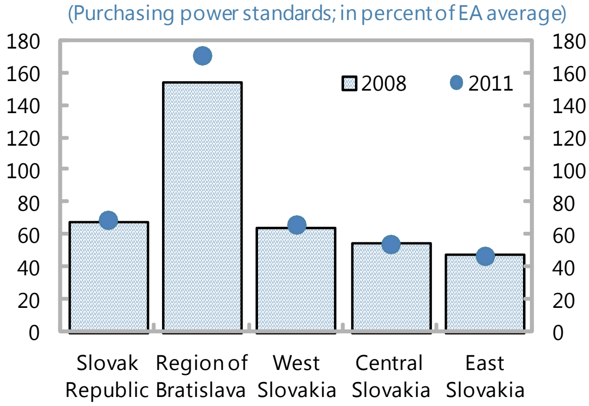
STRENGTHENING GROWTH AND EMPLOYMENT

Trade and financial integration have placed Slovakia among Europe's fastest growing economies, helping rapidly close much of the gap with European income levels. Unemployment is very high, however, and large regional disparities persist. Steps to encourage investment in lagging regions as well as to improve labor market functioning and enhance skills would help boost employment and strengthen domestic demand, while preserving the competitiveness that has underpinned Slovakia's export success.

12. Slovakia's export-led growth model has been successful but challenges remain. Investment and exports by high-productivity multinational firms, especially around Bratislava and focused on automobile and electronics assembly, have been critical to the country's relatively strong growth and provide high-quality jobs, but also make Slovakia more subject to global market conditions. At the other end of the spectrum, there are many SMEs, but they are often very small and have limited innovation capacity. Growth has been driven by capital accumulation funded mainly though FDI, and increases in total factor productivity. The labor income share, as measured by real unit labor costs, has been on a downward trend amid cost competition from neighboring countries.

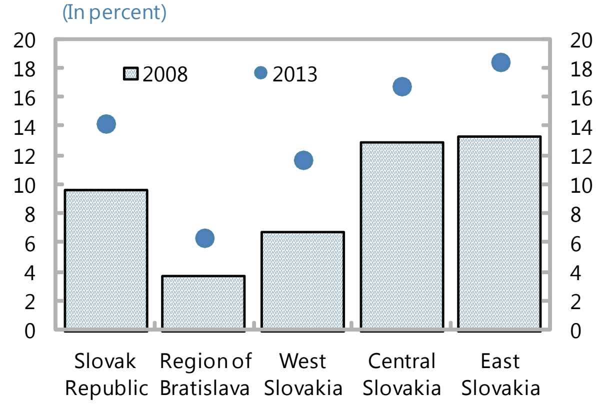
13. Regional differences are large. Behind rapid catching-up with EU income levels are sizeable differences among regions, with those outside Bratislava having lower per-capita income, lower productivity, significant innovation performance gaps, higher unemployment, and limited job opportunities (Box 3). Low mobility, reflecting high home-ownership and an underdeveloped rental market, as well as skill mismatches hamper labor market adjustment, and this is compounded by poor infrastructure and business climate challenges that inhibit investment and job creation in weaker regions.

Slovak Republic: Regional Per-capita Income
(Purchasing power standards; in percent of EA average)



Sources: Haver and Regional Statistics Database.

Slovak Republic: Regional Unemployment Rate
(In percent)



Source: Regional Statistics Database.

14. Slovakia suffers from very high unemployment, especially long-term and among youth. Despite the economic rebound in the aftermath of the 2009 crisis, unemployment remains elevated as productivity has improved, but at the expense of employment. The crisis has exacerbated persistent long-term unemployment and aggravated youth unemployment, which has nearly doubled. Joblessness is more acute in the eastern and central parts of the country where there are limited vacancies. The high unemployment rates in these regions may even understate the challenge given marginal participation in the labor market by the Roma population (only 20 percent of Roma men and less than 10 percent of Roma women, according to a World Bank estimate).[2]

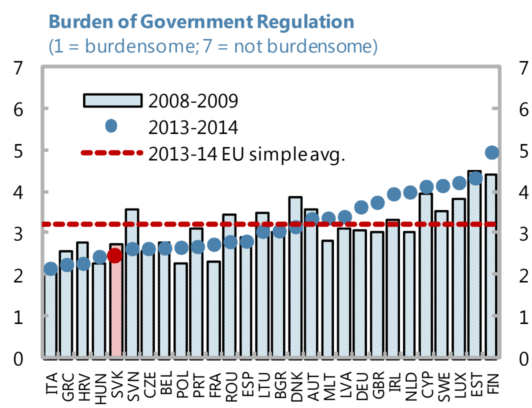
15. Wide-ranging policy actions are needed to unlock the potential of the Slovak economy. Given limited vacancies in weaker regions, it is especially important to encourage

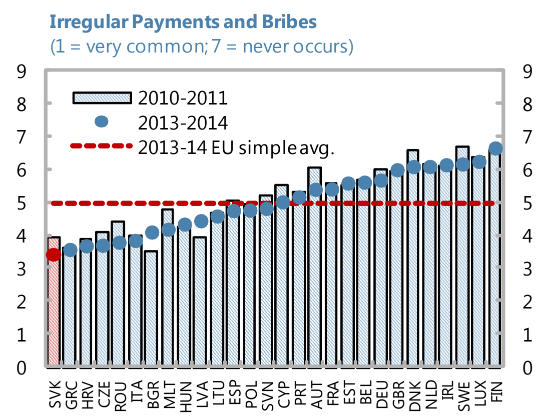
[2] *Policy Advice on the Integration of Roma in the Slovak Republic*, (World Bank, 2012) (http://documents.worldbank.org/curated/en/2012/09/16791578/diagnostics-policy-advice-integration-roma-slovak-republic-vol-1-2-main-report).

investment and job creation. These efforts should be complemented by actions to reduce financial disincentives to working and hiring, enhance skills, and facilitate the transition from school to work as well as from unemployment back to the workforce. Over the medium term, action in these areas could also help Slovakia move up global value chains and diversify its production structure, thereby improving resiliency to external shocks. Policy and budget priorities should seek to:

- *Improve infrastructure*. With few unfilled jobs in high unemployment areas, strengthening infrastructure, especially highways such as the main east-west route where faster progress is needed, is critical to opening up investment opportunities and fostering job creation in lagging regions. Increased absorption of EU funds in this area and more efficient procurement practices could help. Facilitating access to rental housing would also enhance labor mobility and regional integration.

- *Strengthen the business climate* (Figure 6). Slovakia's regulatory burden compares unfavorably with other EU countries and regional peers. In addition, corruption challenges are perceived as widespread and have involved EU Funds.[3] Strengthening contract enforcement (e.g., to address payment delays that particularly affect small firms), improving administrative procedures and public procurement, as well as enhancing the legal system and strengthening anti-corruption efforts would create more favorable conditions for doing business. Firms would also benefit from lower energy costs, which are among the highest in the EU. Reducing regulation in professional services and retail trade would foster competition with benefits for consumers.





Source: World Economic Forum.

- *Maintain labor market flexibility*. Slovakia's employment protection legislation, even after the unwinding of some 2011 reforms, appears broadly in line with that of peers. However, the decision taken in early 2014 to allow extension of collective bargaining agreements to most employers in a sector introduces rigidity that could discourage hiring and hinder adaption to wide regional differences. Consideration should be given to re-introducing the previous arrangement that allowed firms to opt out of collective bargaining agreements (e.g., Germany

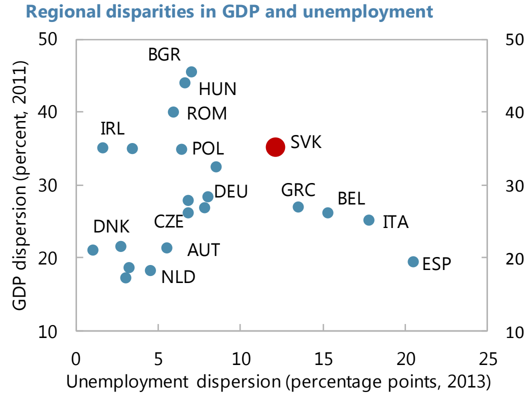
[3] See Annex on Slovakia to the *EU Anti-Corruption Report (2014)* (http://ec.europa.eu/dgs/home-affairs/what-we-do/policies/organized-crime-and-human-trafficking/corruption/anti-corruption-report/index_en.htm).

and Italy allow opt-outs) or increasing the threshold number of employees at which collective agreements would be extended to firms. Also, setting different minimum wages across regions would better reflect widely varying labor market conditions. Plans for a uniform minimum wage rise could increase challenges to securing employment for some workers.

Box 3. Slovak Republic: Regional Disparities

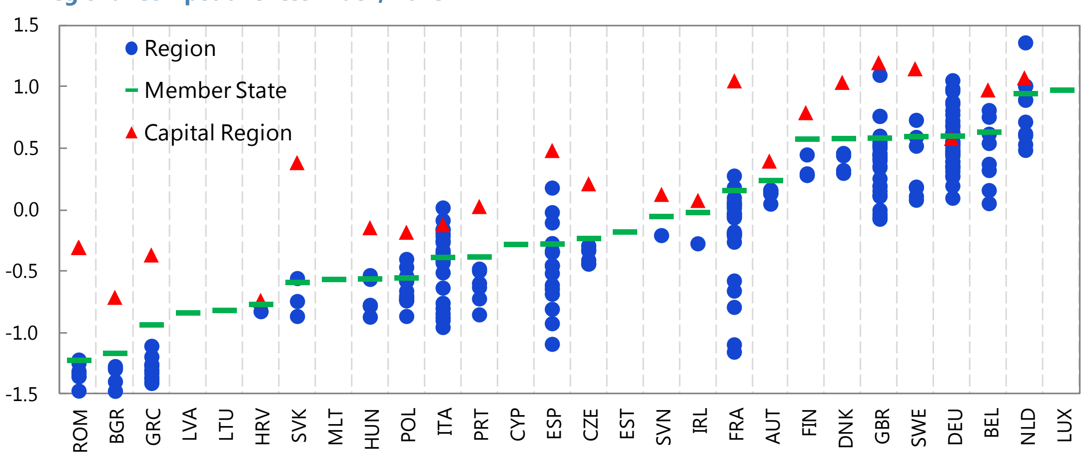
Regional disparities are among the highest in the EU. The gap between the region with the lowest unemployment (Bratislava) and the highest (east Slovakia) is the fifth largest in the EU, with only Spain, Italy, Belgium, and Greece recording wider differences. In terms of regional dispersion of per-capita GDP, only Bulgaria, Hungary and Romania show greater disparities. More comprehensive indicators, such as the EU regional competitiveness index, which covers a wide range of issues (e.g., innovation, quality of institutions, infrastructure, health and human capital), show a similar picture. Only France, Romania and Greece show as large a gap between the capital and the second most competitive region.

Regional disparities in GDP and unemployment



Source: Eurostat.

Regional Competitiveness Index, 2013

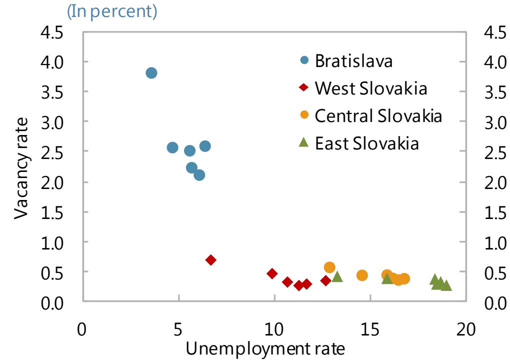


Source: EU Regional Competitiveness Index, 2013.

Lack of job opportunities is a main cause of regional differences. Beveridge curves show very low vacancy rates in most parts of the country, while in Bratislava the curve is steep, indicating that unemployment could be even lower if vacancies were filled.

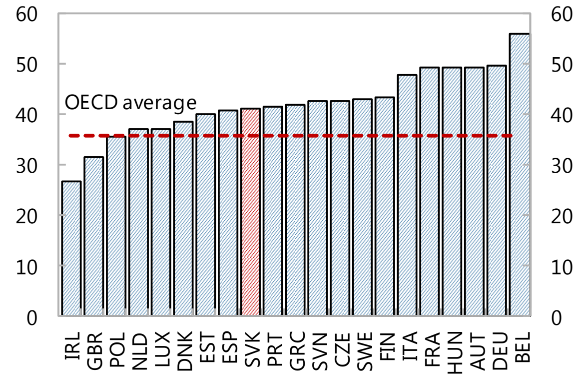
Beveridge Curve by Region

(In percent)



Source:s Regional Statistical Office and IMF staff calculations.

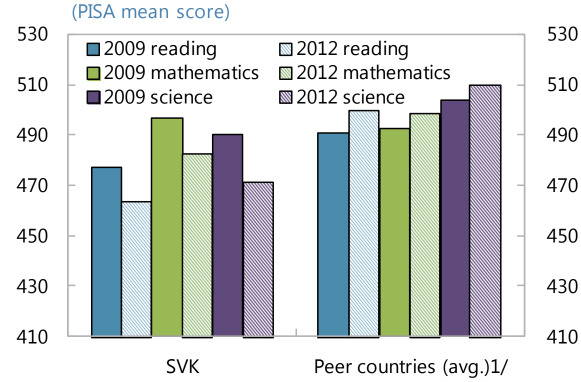
Total Tax Wedge, 2013
(In percent of labor costs)



Source: OECD

- *Lower labor taxes and improve incentives.* Reducing the high tax wedge that makes it unattractive for firms to hire and for people with low skill levels to work should be a high priority in the budget (¶22). Incentives under the benefit structure might be improved (e.g., consideration might be given to tapering general social benefits over time while continuing to provide some benefits when beginning work).

Student Performance
(PISA mean score)



Sources: OECD; and IMF staff calculations.
1/ Peer countries are Czech Republic, Hungary and Poland.

- *Improve the quality of education and training*. Deteriorating PISA scores have highlighted educational challenges. Consistent with OECD recommendations, strengthening the quality of teachers would be appropriate, while vocational training efforts should seek to improve curricula to better match workforce needs and create an effective dual system of vocational training based on close cooperation with businesses to ensure substantial practical experience in workplaces.[4]

- *Strengthen active labor market policies (ALMPs).* ALMP spending, which compares unfavorably with that in other EU countries, should be raised and its effectiveness improved through more tailored activation incentives and services as well as increasing the share of spending allocated to training. The envisaged reform of the Public Employment Service (PES) should be accelerated and its resources increased. Recent initiatives to focus on youth unemployment might be complemented by greater attention to the long-term unemployed and marginalized groups.

Authorities' views

16. Supporting growth and reducing unemployment are top government priorities. A number of steps have been taken or are planned:

- *Infrastructure.* Efforts are ongoing, especially highway construction, although technical challenges (e.g., building tunnels) are among the complicating factors. Reforms intended to improve procurement practices have been approved.

[4] *Slovak Republic: Fostering an Inclusive Job-Rich Recovery* (OECD, 2013) (http://www.oecd.org/slovakia/BrochureSlovakRepublicapril2013.pdf)

- *Business climate.* The government has passed a resolution on improving the business environment and has focused initially on facilitating payment of taxes and cross-border trade (e.g., through simplified customs procedures). A major reform is underway to streamline public administration and improve service efficiency (the ESO initiative). In addition, the time for incorporation and granting a trade license has been shortened, and the government intends to lower relevant fees.

- *Education.* Teacher salaries were raised in 2013 and remain a high priority to attract well-qualified instructors, testing is being strengthened to track school quality, and a new higher education act is being drafted with a view toward strengthening universities and creating a closer connection with the private sector. A new vocational educational and training act also is being prepared to introduce formally a dual system involving workplace experience. Pre-school education capacities are being enhanced.

- *ALMPs and incentives to work.* Less effective ALMP programs have been eliminated and emphasis on educational programs and counseling has been increased. One-year relief for firms from social and health contributions for hiring the long-term unemployed was introduced. Creation of new jobs for people under 29 years of age is being subsidized using European Social Funds. The government is considering gradually reducing social benefits after hiring, to increase disposable income for new hires. Also, the authorities intend to decrease significantly health contributions for low-income workers. PES reforms are underway to create a three-pillar system (information counseling services, professional services, and data centralization) by 2020. Measures to increase Roma inclusion are being implemented.

On the other hand, the authorities did not expect recent changes to the Labor Code and the extension of collective agreements to have adverse effects on employment. Regional differentiation of the minimum wage is not viewed as a feasible option, especially in a relatively small country. The government intends to increase the minimum wage, but expects the impact on wage costs for low-income workers to be offset by the decrease in health contributions.

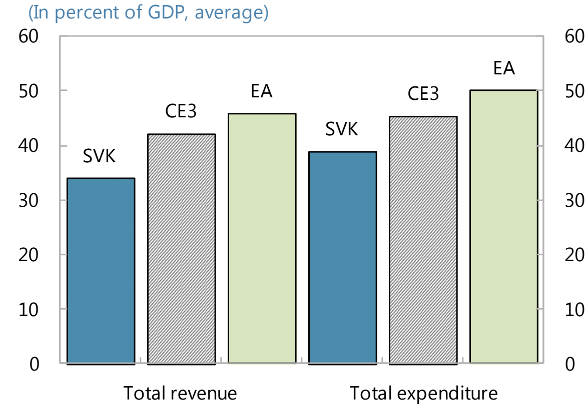
SUSTAINING FISCAL CONSOLIDATION

Despite slower growth in 2013, substantial fiscal adjustment was achieved and brought the budget deficit below the threshold for exiting the EU's EDP. To achieve further gradual deficit reduction and move toward the EU medium-term objective, a focus on the revenue side would be appropriate, but a debt brake under Slovakia's own FRA instead mandates a more expenditure-based approach. Implementing spending measures of the required magnitude is likely to be difficult, and it will therefore be important to continue to strengthen revenue collection to sustain medium-term adjustment and make room for priority budget items.

17. Sizeable fiscal adjustment has allowed Slovakia to exit the EDP. Since 2009, the budget deficit has been reduced by about 5 percentage points to 2.8 percent of GDP in 2013—just below the threshold for exiting the EU's EDP. Over the period 2010–13 the annual average fiscal effort reached 1.5 percent of GDP, well above the average fiscal effort of at least 1 percent of GDP called for by the EU, and was largely pro-cyclical.

18. From a macroeconomic perspective, gradual adjustment with emphasis on correcting revenue underperformance would be advisable. Slovakia has an output gap, subdued inflation, and important spending needs (e.g., to address high unemployment and infrastructure gaps). Public debt has been easily financed and would stabilize at around 60 percent of GDP with little additional action. Against this background, a gradual adjustment path toward the EU medium-term objective (MTO) of a structural deficit of 0.5 percent of GDP would be reasonable—with the target preferably being met in 2018, rather than 2017 as envisaged—and would put debt-to-GDP on a downward path. With both revenue and expenditure well below averages for the EU and CE3 neighbors, adjustment should focus largely on revenue measures.

General Government Total Revenue & Expenditure, 2010-13
(In percent of GDP, average)



Source: Eurostat.

19. EU and domestic fiscal frameworks, however, require faster fiscal adjustment, largely (in the latter case) through expenditure cuts. Given the cyclical position of the economy, EU commitments would require a positive structural adjustment of at least 0.1 percent of GDP this year. However, achieving the EU MTO in 2017 would call for much larger consolidation efforts in the following years. Slovakia's domestic FRA is more restrictive and emphasizes spending reductions now. Breaching the 55 percent of GDP debt threshold in 2013 mandates a 3 percentage point cut in general government expenditure in 2014 (excluding debt service payments, EU funds and co-financing, EU budget contributions, transfers to the Social Insurance Agency and natural disaster spending) amounting to 0.4 percent of GDP and submission of a budget that freezes spending (with the same exemptions) in subsequent years as long as debt remains above 55 percent of GDP. Compared to a no-policy change scenario, staff estimate that implementation of the FRA would result in 2015 growth being lower by 0.3 percentage points (i.e., 2.7 versus 3.0 percent).[5] Crossing the next debt threshold at 57 percent of GDP would require submission of a balanced budget and potentially sharp adjustment with more negative growth effects.

20. For 2014, additional measures should yield a deficit similar to last year with the impact of the FRA limited due to contingency buffers.

[5] The estimate assumes fiscal multipliers of 0.3 in year one, and 0.1 in year two.

- Given an expected widening of the deficit in the absence of policy changes, partly due to past reliance on temporary approaches, the 2014 budget contained measures of about 1 percent of GDP, intended to deliver a deficit of 2.6 percent of GDP. A little more than half of the savings would come from public wages and other spending, with much of the rest from continuation of a special levy on regulated industries and a minimum lump-sum corporate income tax (partially offset by reducing the corporate tax rate from 23 percent to 22 percent). Roughly half of the measures in the 2014 budget are one-off or temporary items.[6]

- An adverse determination by Eurostat on carryover of dividends from 2013 into 2014 created a revenue shortfall (0.5 percent of GDP). Stronger-than-budgeted taxes, especially VAT, and the mandatory expenditure cuts triggered by the domestic debt brake could address much of the shortfall. The budget and growth impact of the FRA is limited in 2014 since much of the required spending reduction can be met by unwinding budgeted but unallocated outlays.

- Staff see risks in containing spending, especially on the public wage bill given past overruns. There are also risks from one-off special levy revenue associated with still-to-be-determined changes in the ownership structure of a gas company. Staff estimate a 2014 deficit of 2.9 percent of GDP. Debt is expected to remain just above 55 percent of GDP, assuming some drawdown of healthy accumulated cash reserves, and that the government is successful in restructuring the oil agency (EOSA) to reverse the contribution to debt in 2013.

21. Medium-term government consolidation efforts would focus on reducing spending. Consistent with the FRA's emphasis on expenditure cuts, the government's medium-term budget plan targets much lower outlays (a drop of about 4 percentage points of GDP from 2014 to 2017) to achieve a 2017 headline deficit of 0.5 percent of GDP and meet the MTO. While the government's Stability Program identifies some revenue measures—sustaining improvements in VAT collection and small amounts from withholding taxes for doctors, expanded use of electronic cash registers, and more effective social contributions collections—the majority of adjustment would come from spending cuts, largely unidentified, although the ongoing streamlining of public administration through the ESO initiative would yield some savings. Under the authorities' medium-term plan, debt would remain above the 55 percent of GDP debt threshold through 2015 before falling, although the share held by non-residents (more than 50 percent) would remain somewhat high.[7]

22. Expenditure-based adjustment will be difficult and could put pressure on priority outlays. Staff's forecast assumes that the constitutional level FRA is implemented through spending cuts applied proportionally across expenditure, recent improvements in revenue and especially VAT collection are sustained, and cash reserves are kept constant in nominal terms after 2014. The debt-

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[6] The government's Stability Program (http://ec.europa.eu/europe2020/pdf/csr2014/sp2014_slovakia_en.pdf.) provides additional detail on the 2014 budget and medium-term fiscal plans.

[7] The third chapter of the Selected Issues (*An Overview of the Slovak Economy through the Lenses of the National Financial Accounts)* provides additional information on changes in assets and liabilities of the government and other sectors.

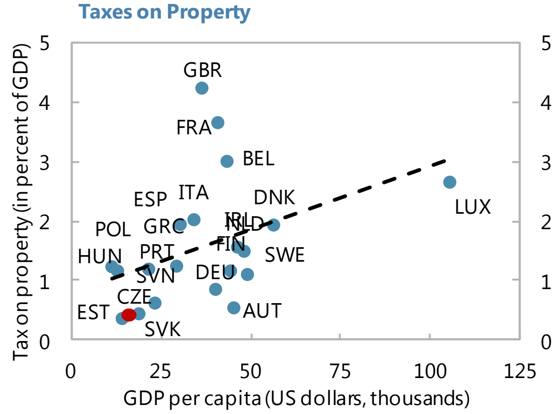
to-GDP ratio would remain above 55 percent through 2015, thus requiring submission of budgets with spending freezes in 2015 and 2016, although the privatization of Slovak Telekom (more below) represents a positive risk. Debt would not cross the 57 percent of GDP threshold requiring submission of a balanced budget. Deficits would be broadly in line with the authorities' targets and the MTO would be achieved before 2017, but the implicit structural adjustment in 2015–16 would amount to almost 1 percent of GDP per year. Challenges in controlling the public wage bill and substantial cuts to investment spending in recent years, as well as the need to fund priority items to address unemployment and regional disparities (e.g., investing in infrastructure and reducing the tax wedge), suggest reliance on spending cuts could be difficult to sustain and undesirable in terms of key objectives. As an example of the potentially limited appetite for spending cuts, in late June the Prime Minister announced plans for €250 million (0.3 percent of GDP) in new spending and tax breaks.

23. Against this background, strengthening revenue collection should be a priority.

- *Improving tax collection*. Sustaining and making further improvements to address low VAT efficiency is essential, as is strengthening tax collection and reducing evasion and fraud more broadly. Implementation of a comprehensive 50-point action plan is intended to address concerns and efforts have focused in particular on VAT control statements. Estimates suggest improving VAT efficiency by 1 percentage point could lift revenue by about 0.5 percent of GDP. Staff stressed the benefits of maintaining the current VAT rate of 20 percent (it was to fall to 19 percent in 2015 given a 2013 deficit below 3 percent of GDP); doing so would yield about 0.3 percent of GDP. Merging tax, customs, and social contribution collections, which is taking some time, could reduce administrative costs and help combat evasion and fraud.

- *Market value-based real estate tax*. Real estate taxation, based on square meters, yields about 0.4 percent of GDP, more than 1 percentage point lower than the EU average. A property value-based real estate tax could yield substantial revenue and would be more equitable and less distortive than other taxes in terms of effects on growth. Support for low-income households could mitigate potential social concerns.

Taxes on Property

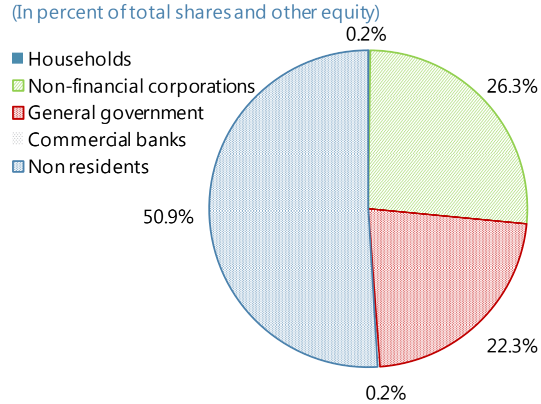


Source: OECD.

24. Other options could help alleviate pressure on expenditure.

- *Privatization* would lower debt in a growth-friendly way and help avoid the FRA's spending constraints. The government's decision to sell its 49 percent stake in Slovak Telekom could yield about 1 percent of GDP, potentially lowering debt below 55 percent of GDP and avoiding an additional year's spending freeze. More generally, privatization of still sizeable state ownership could have potential benefits in terms of debt, the budget, and capital market development. The recent increase of the state role in a key energy company runs in the opposite direction, however, and could imply fiscal costs if, as indicated in the Prime Minister's June announcement, energy price increases are not passed on or are lowered.

Ownership of the Nonfinancial Corporate Sector
(In percent of total shares and other equity)



- *EU Funds*. Slovakia lags many other EU countries in its EU Funds execution rate (about 46 percent of the 2007–13 allocation remains available until 2015, equivalent to about 7 percent of GDP). Improving procurement procedures and other steps could facilitate priority outlays since use of EU Funds and co-financing is exempted from FRA spending cuts and freezes.

- *Spending efficiency*. Beyond the broader ESO initiative, compared to peers, healthcare outlays remain inefficient relative to outcomes and could offer room for savings or better care without adding to costs.

25. Over time, refinement of the fiscal framework might be considered. Having the FRA on top of evolving EU fiscal rules has created a complicated framework with some undesirable effects, as described above. The credibility costs of modifying the framework the first time it becomes binding would argue against adjusting the FRA now, but in the future the government might consider whether there is scope to make the FRA less biased toward expenditure cuts and less pro-cyclical, for instance by considering a smoother adjustment path, or even whether the FRA is still needed given European commitments. If retained, the framework also might be more reflective of debt vulnerabilities; for example, accumulation of cash balances (pre-funding) increases gross debt but reduces short-term rollover risks. In addition, contingency provisions might be considered to address changes in EU statistical definitions such as what is included in the general government.

26. Further pension reforms would strengthen long-term finances. Reforms in 2012 significantly improved long-term sustainability of the pension system by linking the retirement age with demographic trends, changing pension indexation, and capping the accrual of pension benefits for higher earners. Nonetheless, a long-term financing gap persists. Linking pension calculations to a sustainability factor and shortening the transition period to a higher retirement age could help address the long-term gap.

Authorities' views

27. The authorities reaffirmed their commitment to responsible fiscal policy while promoting economic growth and improving living standards.

- *Fiscal policies*. The substantial adjustment achieved to enable EDP exit demonstrates the government's ability to meet fiscal targets. The authorities concurred on the need to enhance revenue collection and in July the parliament approved an amendment to keep the VAT rate unchanged. They underscored results achieved so far in fighting tax evasion and fraud. Control statements and an IT system to allow real-time cross-checking of VAT declarations have been introduced, and roughly half of the measures in their action plan to reduce tax evasion and fraud have been implemented. Regarding property taxes, the authorities are considering options, including differentiated rates under the current system, but indicated that a new system cannot be in place earlier than 2016. They consider prospects good for a relatively rapid sale of shares in Slovak Telekom and a yield of about 1 percent of GDP realistic, but downplayed further privatization opportunities. The authorities saw limited vulnerability from non-resident holdings of government debt, which are mainly long-term investors, but do not plan further increases in the share.

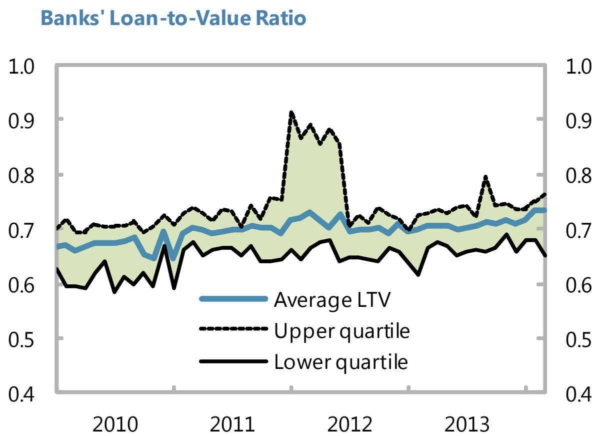
- *FRA.* Changes to the FRA are not envisioned in the near term, although potential challenges under the framework were acknowledged. Taking advantage of favorable market conditions for pre-funding is not possible, spending priorities could be difficult to pursue (e.g., salary increases for teachers could be constrained by binding FRA limits on local governments), and changes in EU statistical definitions could affect fiscal policy.
- *Pensions.* A sustainability factor in the calculation of pension benefits may be considered, but the authorities do not see raising the retirement age more quickly as desirable given relatively low life expectancy.

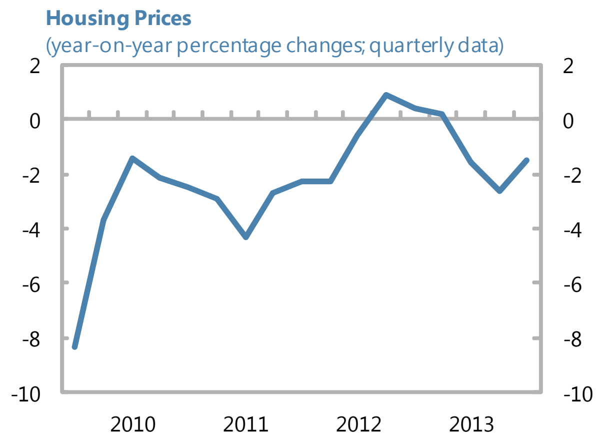
MAINTAINING FINANCIAL STABILITY

The banking system remains sound with strong liquidity and capital levels, stable deposit-based funding, and improving profitability. Much of the banking sector will come under ECB direct supervision with the Single Supervisory Mechanism (SSM). Regular stress-testing by the National Bank of Slovakia (NBS) indicates resilience to shocks. While corporate demand for loans has been weak, lending to households has continued to grow quickly with higher LTVs becoming more common. Domestic capital markets remain underdeveloped, reflecting high fees and other factors.

28. The largely foreign-owned banking sector enters the ECB comprehensive assessment in a strong position. A traditional retail-oriented business model with healthy capital and liquidity buffers as well as stable domestic deposit-based funding has underpinned banks' soundness. The main banks are foreign subsidiaries, but their reliance on external funding is limited. NBS stress tests indicate that the banking sector is broadly resilient to financial and real shocks. With the SSM, about 70 percent of the banking sector will come under ECB direct supervision although the NBS will continue to play a crucial role. The recent transposition into national legislation of a number of EU directives as part of implementation of the Basel III framework has further strengthened the supervisory powers of the NBS. While the special levy on bank liabilities to fund potential resolution costs does not seem to have affected lending activity significantly, it is relatively high and should be reduced and replaced once the system for contributions to the Single Resolution Fund (SRF) is implemented. Moreover, the proceeds from the levy should be placed in a more well-defined resolution fund.

29. Household lending continued to expand rapidly. Strong household credit growth reflects substantial home refinancing and some equity withdrawals. While borrowing can help support a recovery in domestic demand, competition among banks has made high LTVs more common (e.g., through higher LTV mortgages or topping up regular mortgages with housing loans). Although real estate prices remain subdued and household debt is not high, this practice could lead to over-borrowing by consumers. Adoption of a regulation on LTV or debt-to-income ratios could help prevent an excessive build-up of risks for borrowers and banks.



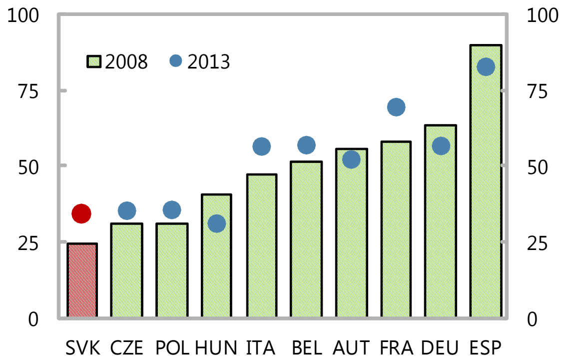


Source: National Bank of Slovakia.

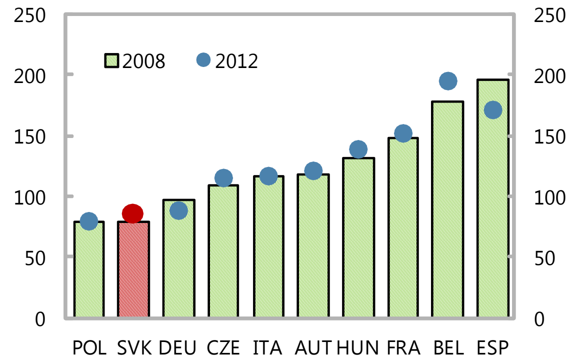
30. Credit to the corporate sector remained sluggish. With interest rates on new corporate loans among the lowest in the eurozone (and large foreign firms able to draw on parent company financing), anemic corporate credit primarily reflects weak domestic demand, and may pick up as consumption and investment recover. The healthy banking sector is well-positioned to lend in this scenario. Many SMEs, however, do find access to finance a challenge. Insufficient collateral or guarantees is the most important factor, in addition to information requirements and administrative burdens.[8] Greater use of financial instruments supported by EU Funds including the JEREMIE initiative to improve access to finance for small firms would help, as would business climate improvements such as strengthening the legal system, for example to reduce the length of court insolvency proceedings.

[8] ECB (2013) *Survey on the Access to Finance of Small and Medium Enterprises in the Euro Area, November* (http://www.ecb.europa.eu/pub/pdf/other/accesstofinancesmallmediumsizedenterprises201311en.pdf) and K. Belanová, *Access to Finance of Small and Medium-Sized Enterprises in Slovakia*, Ročnik 42, 3/2013.

Households' Debt
(In percent of GDP)



Nonfinancial Corporations' Debt
(In percent of GDP)



Source: Haver.

31. Domestic capital market activity languishes. Few companies are listed on the stock exchange and trading is limited in both equities and bonds (e.g., there is little to no secondary market trading in government bonds). Factors include limited issuance, still-embryonic institutional investors, high transaction costs, taxation and fees, administrative burdens, and poor market infrastructure. Households' rather conservative investment decisions, possibly a legacy of the unfortunate experience with voucher privatization, and investment restrictions for second pillar pension funds weigh on the demand side. A more efficient capital market could create an alternative to banks to channel savings to firms, although the relatively small market overall and the large share of SMEs may hinder prospects somewhat. Cooperation with more established stock exchanges in the region could also provide opportunities. It will be important to ensure effective supervision of non-banks as part of capital market development efforts.

Authorities' views

32. The authorities emphasized their prudent approach to the financial sector. To preserve strong bank capitalization, the NBS will require full implementation of the capital conservation buffer (1.5 percent of risk-weighted assets from August 2014 and 2.5 percent from October 2014). Furthermore, the NBS intends to introduce a recommendation related to housing loans. Recent ECB decisions are not expected to have a significant impact on lending since banks already have adequate liquidity. The government is taking advantage of the JEREMIE initiative and has adopted a broad strategy for capital market development. The strategy seeks to reduce taxation of investment income, create a new and more efficient central depository, promote start-ups and long-term investment by pension funds, modernize the collective investment legal framework, and enhance financial education.

STAFF APPRAISAL

33. **After slowing, growth is gathering pace and becoming more balanced**. Slovakia has been one of Europe's more dynamic economies in recent years due to strong exports, but a weakening external environment contributed to a slowdown in 2013. A pick-up in domestic demand and more favorable conditions among trading partners are expected to lift growth. Stronger domestic consumption and investment should support moderate inflation in 2014 after falling prices early in the year.

34. **Slovakia's economy faces upside and downside risks**. Stronger domestic demand could enhance confidence and investment, while the outlook in key trading partners could improve further, including in light of supportive ECB policies. On the other hand, there are still risks to the recovery in Europe and from the possibility of protracted slow global growth. If geopolitical tensions involving Russia and Ukraine intensify, Slovakia could be affected by energy supply shocks as well as through trade channels. Domestically, prolonged high unemployment could hinder recovery of domestic demand and lower long-term growth potential.

35. **Wide-ranging policy actions are needed to tackle very high unemployment and regional disparities**. Despite sustained growth, unemployment remains elevated, especially for youth and the long-term jobless and regional disparities are great in terms of income, employment, and infrastructure. Policy and budget priorities should focus on coordinated actions to encourage investment and job creation, reduce financial disincentives to working and hiring, enhance skills, and help people enter or return to the labor market.

36. **Significant fiscal adjustment progress has been achieved**. Slovakia's strong fiscal commitment is evident from the sizeable adjustment undertaken since 2009 to exit the EDP. Its debt remains manageable and market conditions have allowed an extension of maturities at lower interest rates.

37. **Durable fiscal measures are still needed given the budget framework and past reliance on temporary measures.** With economic output still below potential, subdued inflation, high unemployment, and infrastructure and other needs, gradual adjustment would be advisable. However, with a debt brake under the FRA crossed, spending cuts triggered and freezes expected, and the next debt brake calling for a rapid move to a balanced budget with potentially harmful effects on growth, early fiscal adjustment is needed. EU commitments will also require consolidation. Based on experience under the FRA and in light of the evolving EU fiscal framework, the government might consider over time whether there is scope for a more streamlined set of fiscal rules that are less pro-cyclical, less biased toward expenditure cuts, and reflect debt vulnerabilities better, for example by taking into account cash reserves.

38. **Expenditure-based adjustment will be difficult**. Medium-term plans to substantially reduce outlays—consistent with the FRA's emphasis on spending cuts—appear challenging given an already low share of revenue and spending compared to peers, and difficulties in controlling the

public wage bill. Lower spending also could make it hard to reverse recent cuts in investment spending and fund priority items to address unemployment and regional disparities.

39. Strengthening revenue collection should be a priority. Additional revenue would help sustain medium-term adjustment given likely pressure for higher spending in the future and the need for infrastructure and human capital investment. Continued progress to strengthen VAT collection is critical, and recent action to maintain the current VAT rate is especially welcome. A property value-based real estate tax could yield substantial revenue. In addition to better revenue collection, privatization of state assets would help reduce debt in a growth-friendly way.

40. Continued prudence will maintain the strength of the banking system. Sound capital levels and liquidity buffers, rising profits, and deposit-based funding contribute to the strength of the banking system, make it resilient to shocks, and should facilitate corporate lending as demand picks up, complementing strong household lending growth. The ECB's comprehensive banking assessment in preparation for the SSM as well as implementation of the Basel III framework to strengthen the already robust supervisory and regulatory framework should further enhance confidence. While risks from higher LTV ratios are moderate at this stage, a recommendation on maximum LTV levels for mortgages and housing loans or debt-to-income levels would be appropriate. The bank levy should be decreased and replaced once the system for contributions to the SRF is implemented, and revenues from the levy should be placed in a more well-defined resolution fund.

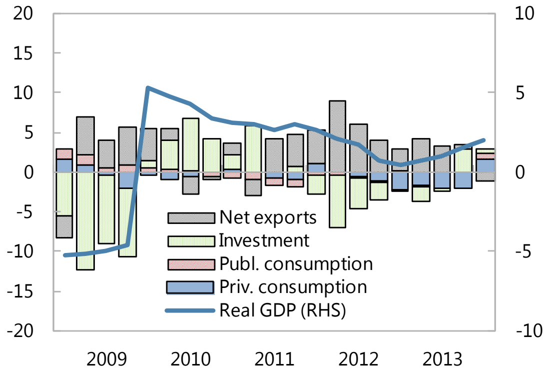
41. Actions could help support non-bank finance and credit to small firms. Reducing high taxes on investment income and lowering transaction fees by establishing a more efficient central depository would address some of the factors that have contributed to very limited capital market activity. Prospects for small businesses could be enhanced by efforts to facilitate access to finance in addition to steps to strengthen the business environment.

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

Figure 1. Slovak Republic: Main Economic Developments

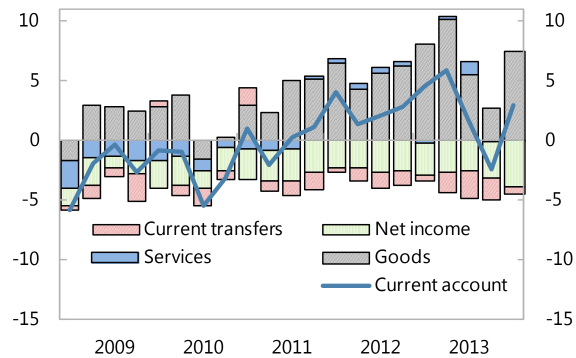
Net exports have sustained growth...

Output Growth and Demand Components
(quarterly data; year-on-year percentage changes)



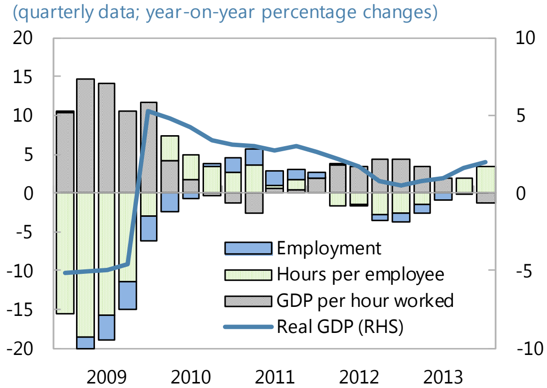
...and contributed to trade and current account surpluses.

Current Account Balance
(quarterly data; in percent of GDP)



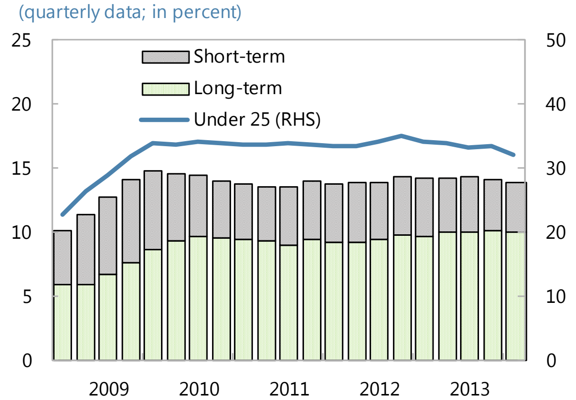
While productivity improved, employment stagnated...

Output Growth and Productivity
(quarterly data; year-on-year percentage changes)



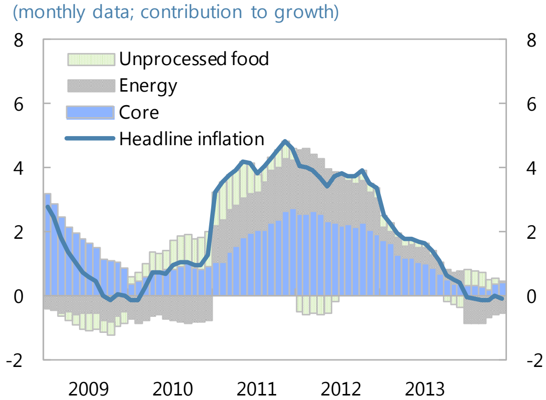
...and unemployment, especially among youth, remained high.

Unemployment
(quarterly data; in percent)



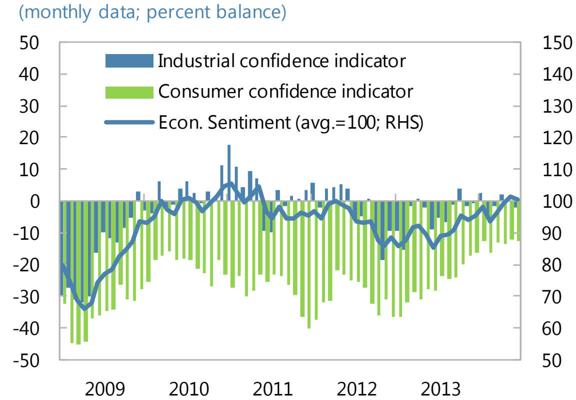
Weak food and energy prices contributed to declining inflation.

Inflation
(monthly data; contribution to growth)



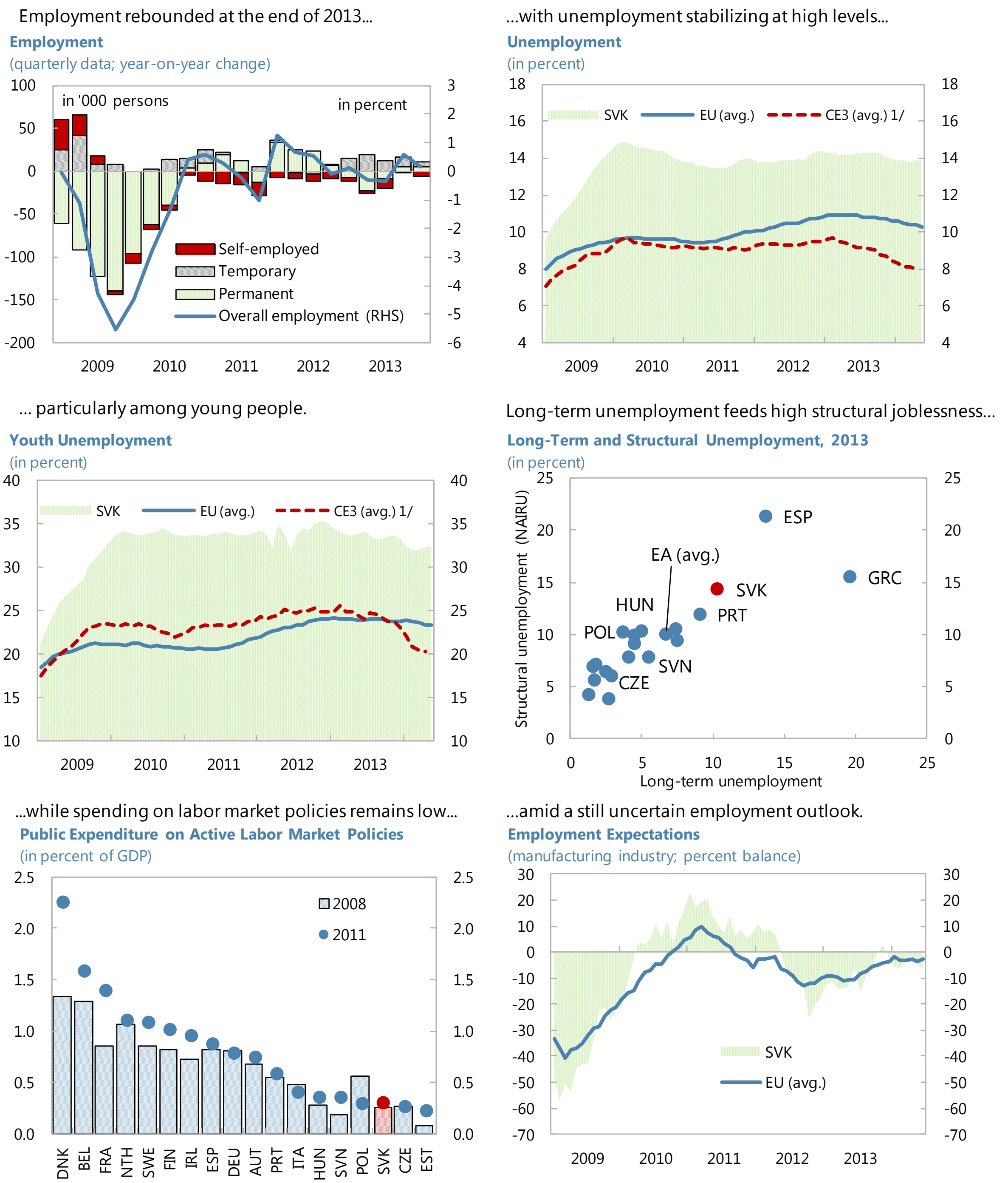
Domestic confidence has improved.

Economic sentiment
(monthly data; percent balance)



Sources: Eurostat and IMF staff calculations.

Figure 2. Slovak Republic: Labor Market Developments



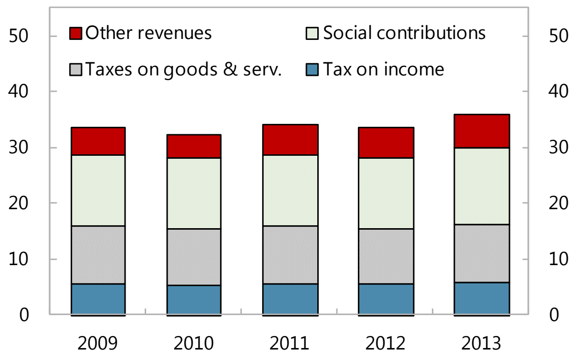
Sources: Eurostat; OECD; and IMF staff calculations.
1/ CE3 comprises Czech Republic, Hungary, and Poland.

Figure 3. Slovak Republic: Fiscal Developments

Revenue slightly improved as a share of GDP...

General Government Revenue

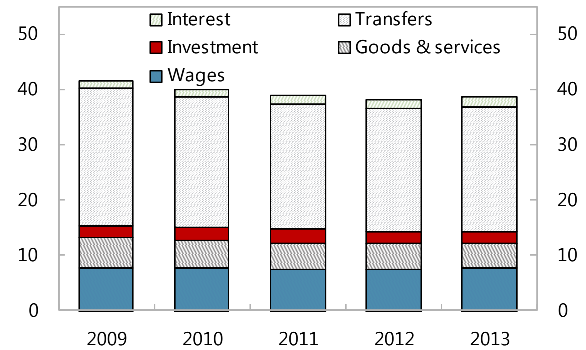
(in percent of GDP)



...whereas expenditure has fallen over time.

General Government Expenditure

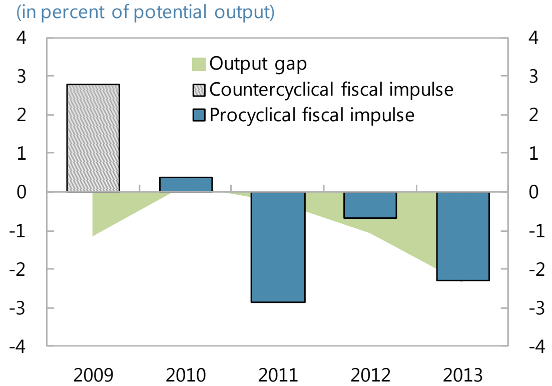
(in percent of GDP)



The fiscal impulse remained procyclical...

Fiscal Impulse

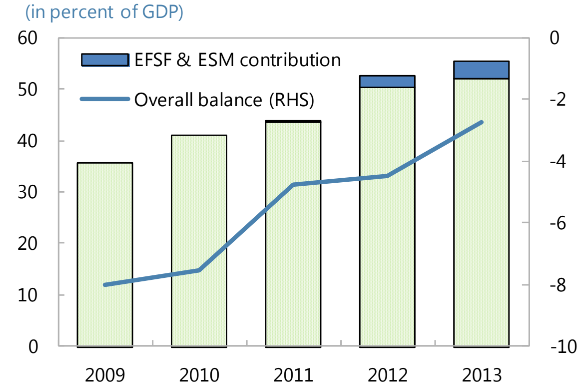
(in percent of potential output)



...while debt edged up partially due to firewall contributions.

General Government Deficit and Gross Debt

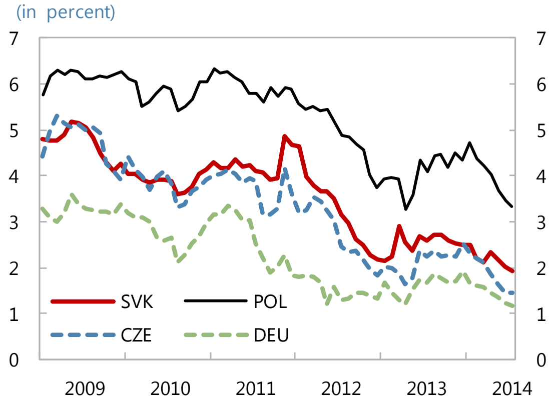
(in percent of GDP)



Market perceptions of risk have improved...

Government 10-Year Bond Yields

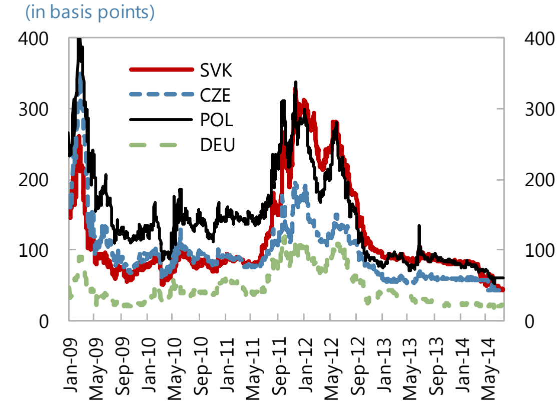
(in percent)



...and spreads have stabilized at low levels.

5-year CDS Spreads

(in basis points)



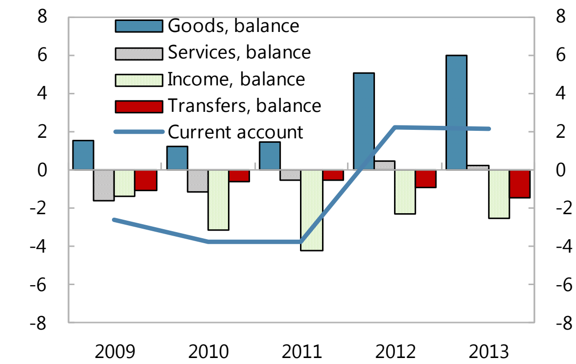
Sources: Eurostat; National Authorities; Bloomberg; and IMF staff calculations.

Figure 4. Slovak Republic: External Developments

Goods exports shifted the current account into surplus...

Current Account in Slovakia

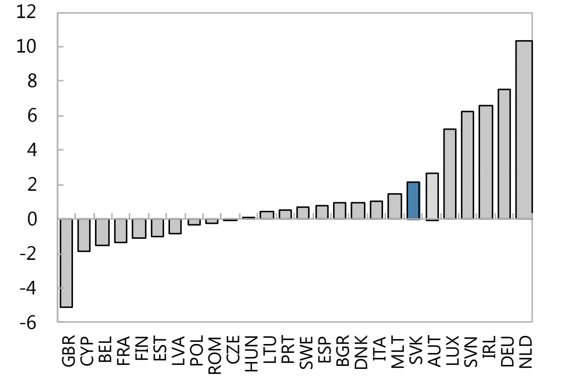
(percent of GDP)



...placing Slovakia among Europe's stronger exporters.

Current Account in 2013

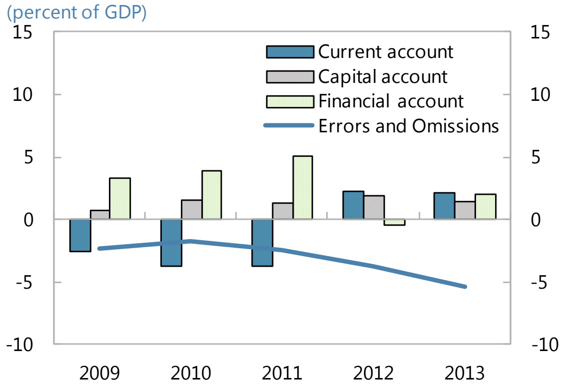
(percent of GDP)



However, errors and omissions became larger...

Balance of Payments in Slovakia, 2009–13

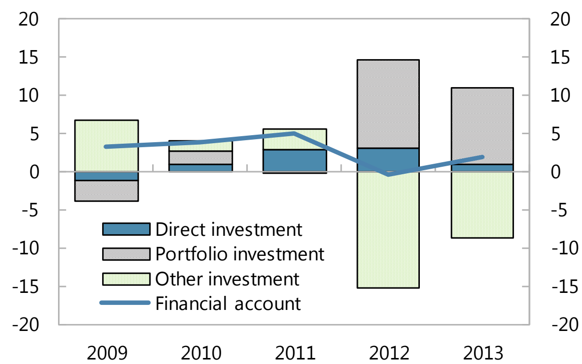
(percent of GDP)



...and the financial account recorded large swings.

Financial Account in Slovakia, 2009–13

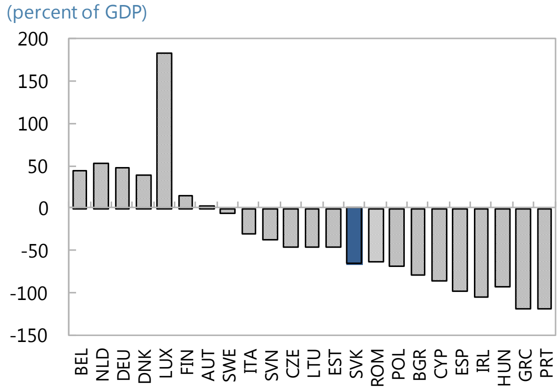
(percent of GDP)



Although negative, the NIIP is relatively limited...

Net International Investment Positions, 2013

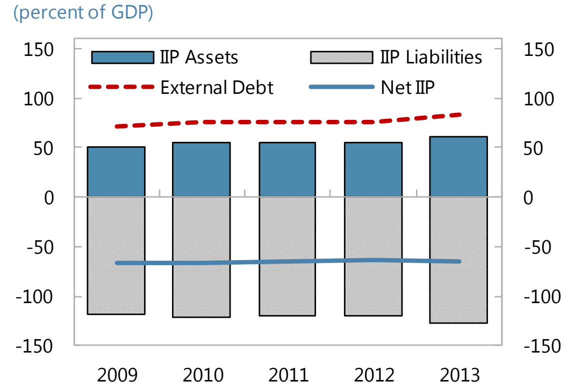
(percent of GDP)



...but has deteriorated slightly, as has external debt.

Foreign Investment Position in Slovakia, 2009–13

(percent of GDP)

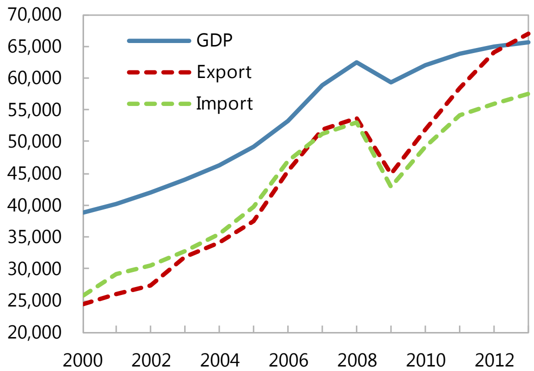


Sources: Eurostat and Haver.

Figure 5. Slovak Republic: Competitiveness Indicators

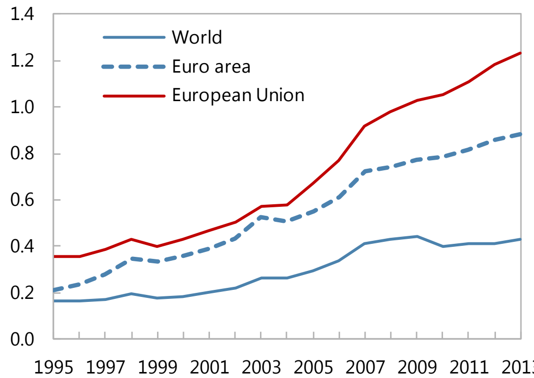
Trade recovered with exports growing at a faster pace...

Real GDP, Export and Import
(million EUR)



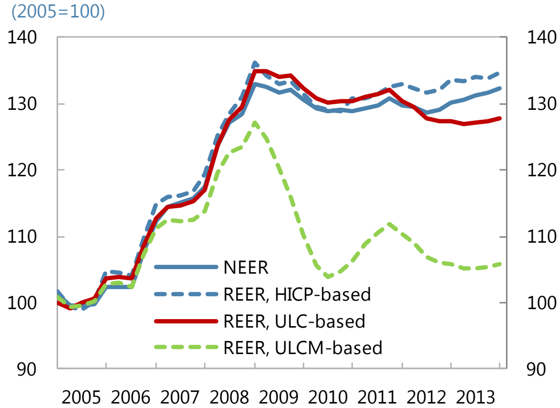
...and market shares have continued to increase.

Slovak Export Shares
(percent of destination's total imports)



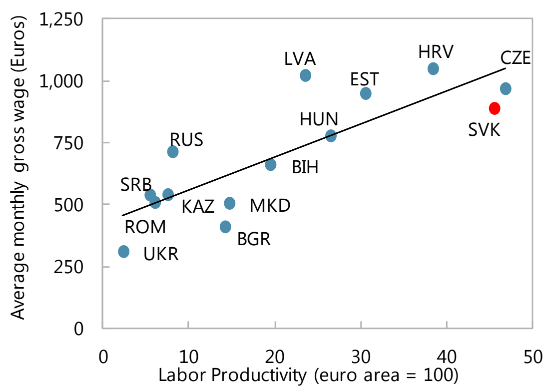
The real exchange rate has largely stabilized after some depreciation...

Nominal and Real Effective Exchange Rates
(2005=100)



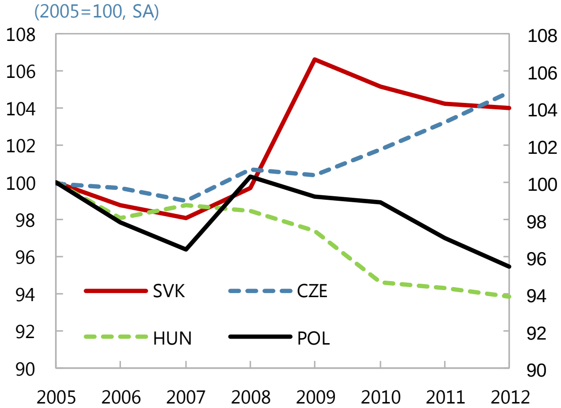
...as wages remain low relative to productivity...

Labor Productivity and Wages, 2013



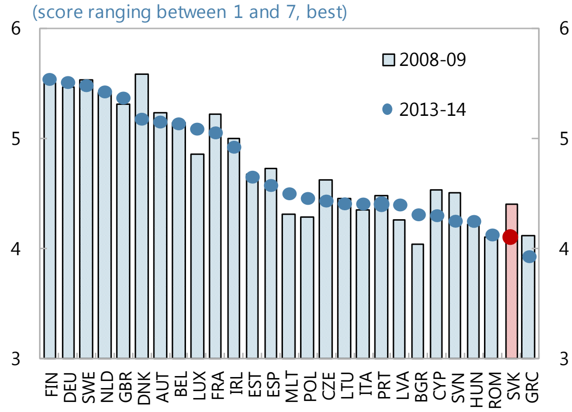
...and unit labor cost decreased...

Real Unit Labor Cost
(2005=100, SA)



...while the business environment deteriorated somewhat.

Global Competitiveness Index
(score ranging between 1 and 7, best)

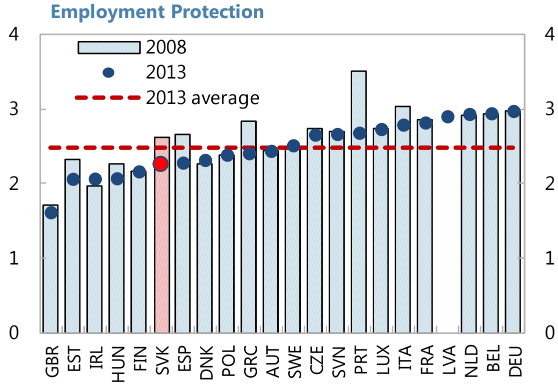


Sources: Eurostat; Haver; World Economic Forum; IMF DOTS; IMF WEO; and IMF staff calculations.

Figure 6. Slovak Republic: Business Environment

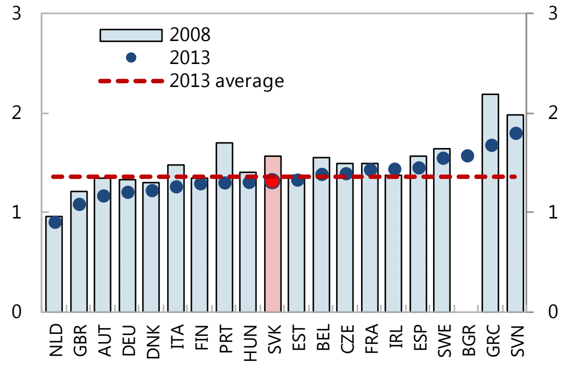
Despite recent reform reversals, Slovakia's employment protection legislation compares reasonably well with peers...

Employment Protection



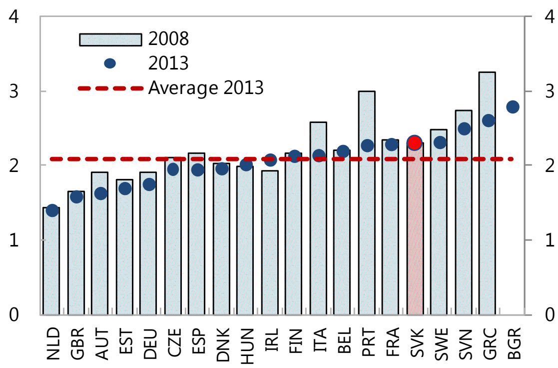
... as does product market regulation, in general.

Product Market Regulation



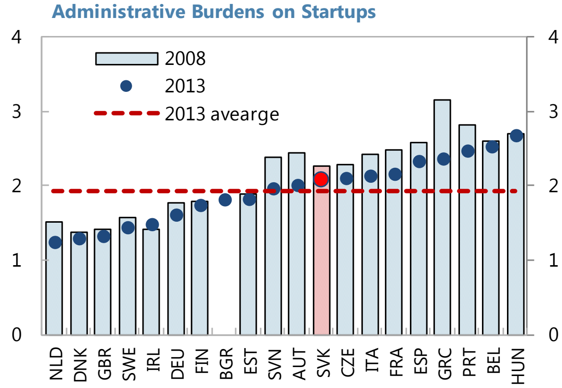
However, there are margins to reduce state control in the economy...

State Control



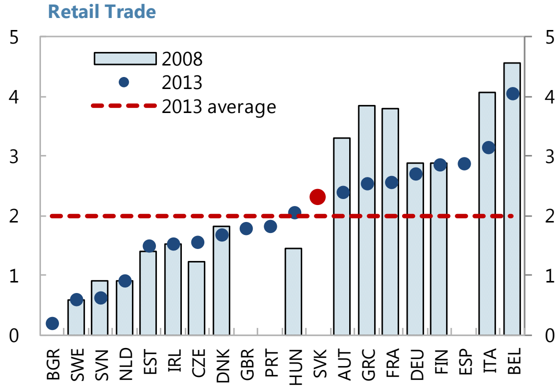
...and the administrative burden for start-ups.

Administrative Burdens on Startups



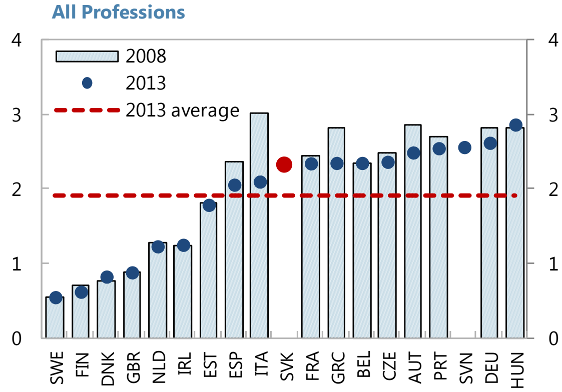
Competition in the retail sector could be improved...

Retail Trade



...and professional services might be liberalized further.

All Professions

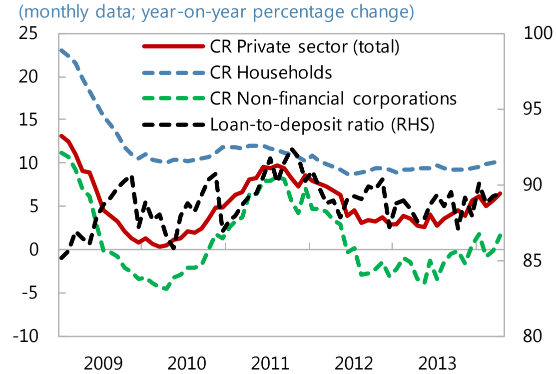


Source: OECD.
Note: Performance is measured on a scale of 0 to 6 with lower values considered better in terms of the business environment.

Figure 7. Slovak Republic: Monetary and Banking Developments

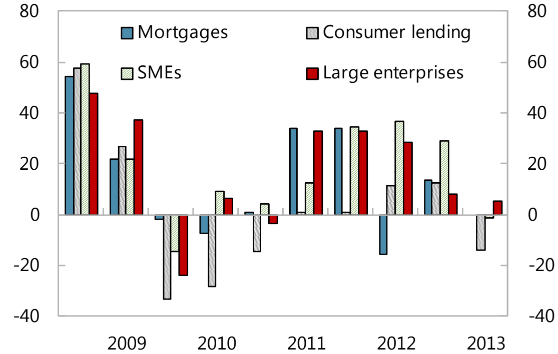
Credit growth inched up, funded by domestic deposits...

Private Sector Credit and Deposits
(monthly data; year-on-year percentage change)



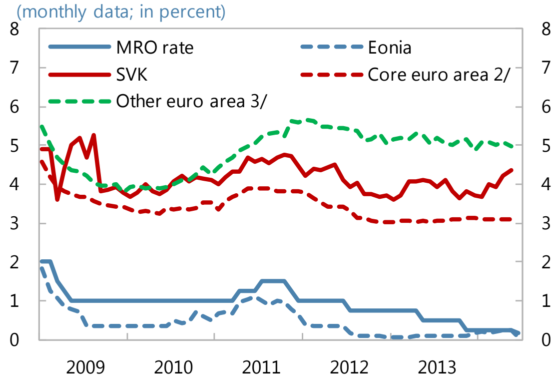
....as lending standards stabilized ...

Lending Survey
(Net percentage of banks contributing to tightening credit standards)



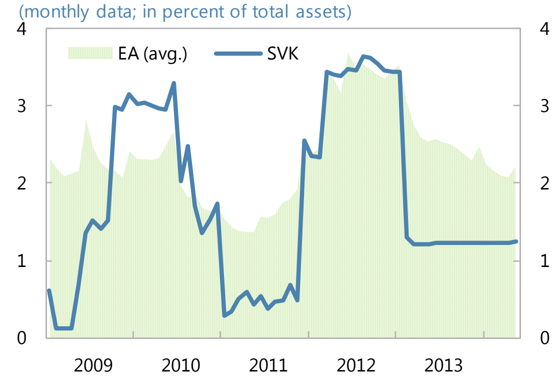
...and lending rates largely tracked rates in core countries.

Money Market and Lending Rates 1/
(monthly data; in percent)



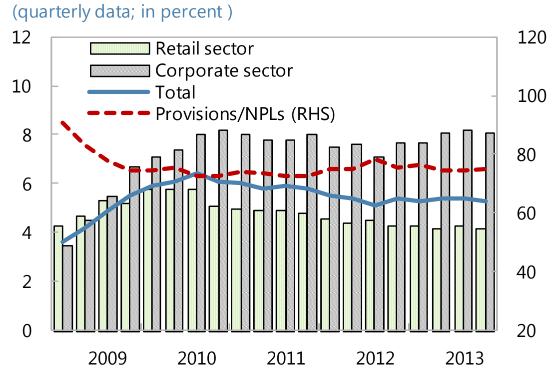
ECB borrowing is limited with LTROs largely repaid.

ECB Borrowing
(monthly data; in percent of total assets)



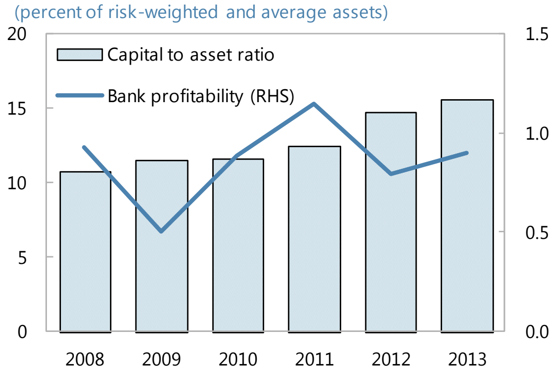
Nonperforming loans remained low and well provisioned...

Nonperforming Loans and Provisions
(quarterly data; in percent)



...while profitability recovered and capital buffers strengthened.

Tier 1 Capital Adequacy Ratio and Bank Profitability
(percent of risk-weighted and average assets)



Sources: Haver; National Bank of Slovakia; Global Financial Stability Report; and IMF staff calculations.
1/ Interest rate on new loans of less than EUR 1 million to nonfinancial corporations (all maturities).
2/Core euro area comprises Finland, France, Germany and the Netherlands.
3/Other euro area comprises Ireland, Italy, Spain and Portugal.

Table 1. Slovak Republic: Summary of Economic Indicators, 2011–19

	2011	2012	2013	2014	2015	2016	2017	2018	2019
				Projections					
	(Annual percentage change, constant prices, unless noted otherwise)								
Output/Demand									
Real GDP	3.0	1.8	0.9	2.4	2.7	2.9	3.1	3.1	3.0
Domestic demand	1.2	-4.5	-0.9	2.0	2.0	2.5	2.7	2.7	2.6
Public consumption	-4.3	-1.1	1.4	1.0	-1.7	0.2	1.1	1.5	1.5
Private consumption	-0.5	-0.2	-0.1	2.0	2.3	2.5	2.5	2.4	2.4
Gross fixed capital formation	14.2	-10.5	-4.3	2.8	4.5	4.6	4.6	4.5	4.0
Exports of goods and services	12.2	9.9	4.5	6.4	6.5	6.0	5.7	5.7	5.6
Imports of goods and services	9.7	3.3	2.9	6.3	6.1	5.8	5.5	5.5	5.5
Output Gap	-0.3	-1.1	-2.4	-2.4	-2.2	-1.8	-1.2	-0.5	0.0
Potential Growth	3.4	2.6	2.3	2.4	2.5	2.5	2.5	2.4	2.4
Contribution to growth									
Domestic demand	1.0	-4.1	-0.7	1.9	1.9	2.3	2.5	2.5	2.4
Public consumption	-0.8	-0.2	0.3	0.2	-0.3	0.0	0.2	0.2	0.2
Private consumption	-0.3	-0.1	0.0	1.2	1.3	1.4	1.4	1.4	1.4
Gross fixed capital formation	3.0	-2.4	-0.9	0.5	0.9	0.9	0.9	0.9	0.8
Inventories	-0.8	-1.4	-0.1	0.0	0.0	0.0	0.0	0.0	0.0
Net exports	2.0	5.9	1.7	0.5	0.8	0.6	0.6	0.6	0.6
Prices									
Inflation (HICP)	4.1	3.7	1.5	0.4	1.5	1.5	1.7	2.0	2.0
Inflation (HICP, end of period)	4.6	3.4	0.4	1.5	1.5	1.5	1.7	2.0	2.0
GDP deflator	1.6	1.3	0.5	0.4	1.4	1.7	1.7	1.8	1.8
Employment and wages									
Employment	1.8	0.1	-0.8	0.4	0.4	0.6	0.7	0.7	0.6
Nominal wages	3.7	4.1	3.6	3.9	3.5	3.3	3.4	3.4	3.4
Unemployment rate (percent)	13.7	14.0	14.2	14.0	13.7	13.2	12.7	12.1	11.6
				(In percent of GDP)					
Public Finance, General Government 1/									
Revenue	34.1	33.7	35.9	35.4	34.1	33.2	33.0	32.9	32.7
Expenditure	38.9	38.2	38.7	38.3	36.3	34.3	33.6	33.4	33.3
Overall balance	-4.8	-4.5	-2.8	-2.9	-2.2	-1.2	-0.7	-0.5	-0.5
Primary balance	-3.2	-2.7	-0.8	-1.1	-0.5	0.6	1.1	1.1	1.2
Structural balance (percent of potential GDP	-5.1	-4.2	-2.2	-2.3	-1.4	-0.5	-0.2	-0.4	-0.5
General government debt	43.6	52.7	55.4	55.4	55.3	53.8	51.8	49.9	48.2
excl. Intergov. lending fin. crisis	43.4	50.2	52.1	51.8	51.8	50.5	48.7	46.9	45.3
				(In percent)					
Monetary and financial indicators									
Bank credit to private sector (growth rate)	8.6	2.8	5.6						
Lending rates 2/	4.7	4.4	4.1						
Deposit rates 3/	1.6	1.4	1.0						
Government 10-year bond yield	4.4	3.3	3.2						
				(In percent of GDP)					
Balance of payments									
Trade balance (goods)	1.5	5.0	5.9	6.1	6.4	6.5	6.7	6.8	6.9
Current account balance	-3.8	2.2	2.1	2.2	2.4	2.5	2.5	2.6	2.6
Gross external debt	75.3	76.0	83.3	84.9	83.8	83.3	82.0	80.3	78.8
Saving and investment balance									
Gross national savings	19.7	21.4	20.6	20.9	21.6	22.3	22.9	23.3	23.6
Private sector	21.5	23.7	21.4	21.6	21.7	21.4	21.5	21.8	22.1
Public sector	-1.8	-2.2	-0.8	-0.7	-0.1	0.9	1.4	1.5	1.5
Gross capital formation	23.8	19.4	18.3	18.6	19.2	19.8	20.4	20.7	21.0

Sources: National Authorities; and IMF staff calculations.

1/ Assumes 3 percent cut of some expenditures in 2014 and partial spending freeze in 2015-16, consistent with Fiscal Responsibility Act provisions.

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

3/ 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, 2011–19
(In millions of euros)

				Projections 1/					
	2011	2012	2013	2014	2015	2016	2017	2018	2019
Revenue	**23,554**	**23,974**	**25,926**	**26,269**	**26,356**	**26,817**	**27,955**	**29,221**	**30,511**
Taxes	11,052	11,009	11,739	12,051	12,418	12,764	13,290	13,902	14,531
Personal income tax	1,729	1,862	1,871	1,949	2,025	2,106	2,195	2,287	2,380
Corporate income tax	1,699	1,715	1,973	2,008	2,118	2,118	2,228	2,337	2,449
VAT	4,651	4,244	4,697	4,896	5,085	5,291	5,514	5,760	6,015
Excises	2,129	2,120	1,985	1,986	1,995	2,003	2,101	2,204	2,309
Other taxes	843	1,069	1,214	1,211	1,196	1,246	1,253	1,315	1,377
Social contributions	8,651	9,040	9,932	10,077	10,473	10,958	11,374	11,867	12,363
Grants	793	807	818	1,388	1,365	1,040	1,281	1,344	1,409
Other revenue	3,058	3,118	3,437	2,753	2,100	2,056	2,009	2,108	2,208
Expenditure	**26,838**	**27,165**	**27,919**	**28,387**	**28,052**	**27,757**	**28,519**	**29,709**	**31,024**
Expense	25,088	25,622	26,457	26,858	26,492	26,152	26,836	27,944	29,173
Compensation of employees	5,131	5,224	5,488	5,510	5,323	5,226	5,224	5,328	5,434
Use of goods and services	3,308	3,309	3,319	3,382	3,369	3,431	3,557	3,731	3,910
Interest	1,092	1,298	1,411	1,315	1,326	1,393	1,490	1,504	1,618
Subsidies	595	718	812	763	736	757	794	833	872
Grants	1,322	1,054	1,217	671	628	646	678	711	745
Social benefits	12,773	13,307	13,661	13,764	13,584	13,406	13,938	14,623	15,322
Other expense	867	713	549	1,454	1,526	1,294	1,157	1,214	1,272
Net acquisition of nonfinancial assets	1,750	1,543	1,462	1,529	1,560	1,605	1,683	1,766	1,850
Gross Operating Balance	-1,535	-1,648	-531	-589	-135	665	1,119	1,278	1,338
Net lending(+)/borrowing(-) (overall balance	**-3,285**	**-3,191**	**-1,993**	**-2,118**	**-1,696**	**-940**	**-564**	**-488**	**-512**
Net financial transactions	-3,285	-3,191	-1,993	-2,118	-1,696	-940	-564	-488	-512
Net acquisition of financial assets	-530	4,082	1,011	-499	0	0	0	0	0
Currency and deposits	-903	2,610	347	-752	0	0	0	0	0
Debt securities	-1	-3	0	0	0	0	0	0	0
Loans	184	1,421	401	122	0	0	0	0	0
Equity and investment fund shares	-129	171	0	0	0	0	0	0	0
Other financial assets	319	-117	264	132	0	0	0	0	0
Net incurrence of liabilities	2,755	7,273	3,004	1,619	1,696	940	564	488	512
Currency and deposits	30	-8	0	0	0	0	0	0	0
Debt securities	2,196	5,989	2,887	1,498	1,696	940	564	488	512
Loans	752	1,672	401	122	0	0	0	0	0
Other liabilities	-223	-380	-284	0	0	0	0	0	0
Statistical discrepancy (nonfin. vs. fin. accounts)	*0*	*0*	*0*	*0*	*0*	*0*	*0*	*0*	*0*
Memorandum items:									
One-off measures	294	84	240	287	0	0	0	0	0
Primary balance	-2,193	-1,893	-582	-803	-370	452	925	1,016	1,106
Net lending/borrowing (excluding one-offs)	-3,579	-3,275	-2,232	-2,405	-1,696	-940	-564	-488	-512
Structural balance	-3,519	-3,015	-1,592	-1,772	-1,110	-439	-214	-330	-501
Gross public debt	30,106	37,439	39,975	41,113	42,696	43,516	43,925	44,413	44,925
of which EFSF and ESM contributions	173	1,758	2,422	2,676	2,676	2,676	2,676	2,676	2,676
Cash on GG accounts	...	3,981	4,328	3,576	3,576	3,576	3,576	3,576	3,576

Sources: National Authorities and IMF staff estimates and projections.

1/ Assumes 3 percent cut of some expenditures in 2014 and partial spending freeze in 2015-16, consistent with Fiscal Responsibility Act provisions.

Table 3. Slovak Republic: Statement of Operations of the General Government, 2011–19

(In percent of GDP)

				Projections [1/]					
	2011	2012	2013	2014	2015	2016	2017	2018	2019
Revenue	**34.1**	**33.7**	**35.9**	**35.4**	**34.1**	**33.2**	**33.0**	**32.9**	**32.7**
Taxes	16.0	15.5	16.3	16.2	16.1	15.8	15.7	15.6	15.6
Personal income tax	2.5	2.6	2.6	2.6	2.6	2.6	2.6	2.6	2.6
Corporate income tax	2.5	2.4	2.7	2.7	2.7	2.6	2.6	2.6	2.6
VAT	6.7	6.0	6.5	6.6	6.6	6.5	6.5	6.5	6.5
Excises	3.1	3.0	2.8	2.7	2.6	2.5	2.5	2.5	2.5
Other taxes	1.2	1.5	1.7	1.6	1.5	1.5	1.5	1.5	1.5
Social contributions	12.5	12.7	13.8	13.6	13.6	13.6	13.4	13.3	13.3
Grants	1.1	1.1	1.1	1.9	1.8	1.3	1.5	1.5	1.5
Other revenue	4.4	4.4	4.8	3.7	2.7	2.5	2.4	2.4	2.4
Expenditure	**38.9**	**38.2**	**38.7**	**38.3**	**36.3**	**34.3**	**33.6**	**33.4**	**33.3**
Expense	36.4	36.0	36.7	36.2	34.3	32.4	31.7	31.4	31.3
Compensation of employees	7.4	7.3	7.6	7.4	6.9	6.5	6.2	6.0	5.8
Use of goods and services	4.8	4.7	4.6	4.6	4.4	4.2	4.2	4.2	4.2
Interest	1.6	1.8	2.0	1.8	1.7	1.7	1.8	1.7	1.7
Subsidies	0.9	1.0	1.1	1.0	1.0	0.9	0.9	0.9	0.9
Grants	1.9	1.5	1.7	0.9	0.8	0.8	0.8	0.8	0.8
Social benefits	18.5	18.7	18.9	18.6	17.6	16.6	16.4	16.4	16.4
Other expense	1.3	1.0	0.8	2.0	2.0	1.6	1.4	1.4	1.4
Net acquisition of nonfinancial assets	2.5	2.2	2.0	2.1	2.0	2.0	2.0	2.0	2.0
Gross Operating Balance	-2.2	-2.3	-0.7	-0.8	-0.2	0.8	1.3	1.4	1.4
Net lending(+)/borrowing(-) (overall balance	**-4.8**	**-4.5**	**-2.8**	**-2.9**	**-2.2**	**-1.2**	**-0.7**	**-0.5**	**-0.5**
Net financial transactions	-4.8	-4.5	-2.8	-2.9	-2.2	-1.2	-0.7	-0.5	-0.5
Net acquisition of financial assets	-0.8	5.7	1.4	-0.7	0.0	0.0	0.0	0.0	0.0
Currency and deposits	-1.3	3.7	0.5	-1.0	0.0	0.0	0.0	0.0	0.0
Debt securities	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Loans	0.3	2.0	0.6	0.2	0.0	0.0	0.0	0.0	0.0
Equity and investment fund shares	-0.2	0.2	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Other financial assets	0.5	-0.2	0.4	0.2	0.0	0.0	0.0	0.0	0.0
Net incurrence of liabilities	4.0	10.2	4.2	2.2	2.2	1.2	0.7	0.5	0.5
Currency and deposits	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Debt securities	3.2	8.4	4.0	2.0	2.2	1.2	0.7	0.5	0.5
Loans	1.1	2.4	0.6	0.2	0.0	0.0	0.0	0.0	0.0
Other liabilities	-0.3	-0.5	-0.4	0.0	0.0	0.0	0.0	0.0	0.0
Statistical discrepancy (nonfin. vs. fin. accounts)	*0.0*	*0.0*	*0.0*	*0.0*	*0.0*	*0.0*	*0.0*	*0.0*	*0.0*
Memorandum items:									
Amount of spending cuts	...	...	...	0.4	1.1	0.6	...	...	...
One-off measures	0.4	0.1	0.3	0.4	0.0	0.0	0.0	0.0	0.0
SGP target (revised)	...	...	-3.0	-2.6	-2.5	-1.6	-0.5	...	...
Primary balance	-3.2	-2.7	-0.8	-1.1	-0.5	0.6	1.1	1.1	1.2
Net lending/borrowing (excluding one-offs)	-5.2	-4.6	-3.1	-3.2	-2.2	-1.2	-0.7	-0.5	-0.5
Structural balance (percent of potential GDP)	-5.1	-4.2	-2.2	-2.3	-1.4	-0.5	-0.2	-0.4	-0.5
Gross public debt	43.6	52.7	55.4	55.4	55.3	53.8	51.8	49.9	48.2
of which intergovernmental lending	0.3	2.5	3.4	3.6	3.5	3.3	3.2	3.0	2.9
Cash on GG accounts	...	5.6	6.0	4.8	4.6	4.4	4.2	4.0	3.8
GDP at current market prices	68,974	71,096	72,134	74,197	77,261	80,836	84,768	88,932	93,182

Sources: National Authorities and IMF staff estimates and projections.

1/ Assumes 3 percent cut of some expenditures in 2014 and partial spending freeze in 2015-16, consistent with Fiscal Responsibility Act provisions.

Table 4. Slovak Republic: General Government Balance Sheet, 2009–13

	2009	2010	2011	2012	2013
			(In billions of euros)		
Net financial worth	**-9,917**	**-14,644**	**-18,015**	**-17,728**	**-18,352**
Financial assets	**15,431**	**17,686**	**15,073**	**22,496**	**26,156**
Currency and deposits	2,413	4,231	1,154	3,833	4,775
Securities other than shares	977	191	498	839	6
Loans	1,229	1,215	1,354	2,828	1,546
Shares and other equity	9,030	9,721	9,361	12,331	13,294
Other accounts receivable	1,781	2,327	2,706	2,665	6,536
Financial liabilities	**25,348**	**32,330**	**33,088**	**40,224**	**44,508**
Currency and deposits	83	2,182	41	93	-2,859
Debt securities	20,857	25,479	27,672	33,357	34,987
Loans	1,862	2,001	2,774	4,375	4,693
Other liabilities	2,546	2,668	2,601	2,399	7,687
			(In percent of GDP)		
Net financial worth	**-15.8**	**-22.2**	**-26.1**	**-24.9**	**-25.4**
Financial assets	**24.6**	**26.8**	**21.9**	**31.6**	**36.3**
Currency and deposits	3.8	6.4	1.7	5.4	6.6
Securities other than shares	1.6	0.3	0.7	1.2	0.0
Loans	2.0	1.8	2.0	4.0	2.1
Shares and other equity	14.4	14.8	13.6	17.3	18.4
Other accounts receivable	2.8	3.5	3.9	3.7	9.1
Financial liabilities	**40.4**	**49.1**	**48.0**	**56.6**	**61.7**
Currency and deposits	0.1	3.3	0.1	0.1	-4.0
Debt securities	33.2	38.7	40.1	46.9	48.5
Loans	3.0	3.0	4.0	6.2	6.5
Other liabilities	4.1	4.0	3.8	3.4	10.7
Memorandum items:					
Pulic debt	22,331	26,998	30,106	37,439	39,975
Net lending/borrowing	-5,040	-4,969	-3,285	-3,191	-1,993
GDP	62,794	65,897	68,974	71,096	72,134

Source: National Authorities.

Table 5. Slovak Republic: Medium-Term Balance of Payments, 2011–19

				Projections					
	2011	2012	2013	2014	2015	2016	2017	2018	2019
				(Millions of euros)					
Current account	-2,597	1,585	1,550	1,661	1,873	1,983	2,142	2,311	2,435
Trade balance (goods)	1,015	3,578	4,284	4,529	4,951	5,290	5,671	6,063	6,418
Exports, f.o.b.	56,783	62,308	64,362	66,730	69,453	72,777	76,041	79,206	82,317
Imports, f.o.b.	-55,768	-58,730	-60,078	-62,202	-64,502	-67,487	-70,370	-73,143	-75,899
Services balance	-372	307	149	244	276	299	326	354	379
Receipts	4,749	5,570	5,603	6,113	6,362	6,666	6,965	7,255	7,540
Payments	-5,121	-5,263	-5,454	-5,869	-6,086	-6,367	-6,639	-6,901	-7,161
Income balance	-2,886	-1,652	-1,810	-1,997	-2,168	-2,342	-2,520	-2,698	-2,877
Receipts	2,607	2,648	2,612	2,717	2,828	2,920	3,027	3,127	3,224
Payments	-5,493	-4,300	-4,422	-4,714	-4,995	-5,262	-5,546	-5,825	-6,102
Current transfers	-354	-648	-1,073	-1,114	-1,187	-1,264	-1,335	-1,409	-1,485
Capital account	864	1,376	1,027	773	867	871	908	848	808
Financial Account	3,460	-343	1,423	-2,434	-2,740	-2,854	-3,050	-3,158	-3,244
Direct foreign investment	1,998	2,257	764	1,952	2,080	2,169	2,259	2,352	2,448
Portfolio investment	-134	8,247	7,182	6,754	6,686	6,642	6,614	6,596	6,584
Other investment	1,939	-10,818	-6,203	-11,140	-11,506	-11,665	-11,923	-12,106	-12,275
Financial derivatives	-343	-29	-320	0	0	0	0	0	0
Reserve assets 1/	-65	17	-73	0	0	0	0	0	0
Errors and omissions	-1,662	-2,635	-3,927	0	0	0	0	0	0
Net International Investment Position	-44,534	-45,580	-47,322	-44,888	-42,148	-39,294	-36,244	-33,086	-29,842
External Debt	51,970	54,062	60,062	62,996	64,741	67,370	69,527	71,437	73,410
				(Percent of GDP)					
Current account balance	-3.8	2.2	2.1	2.2	2.4	2.5	2.5	2.6	2.6
Trade balance (goods)	1.5	5.0	5.9	6.1	6.4	6.5	6.7	6.8	6.9
Exports, f.o.b.	82.3	87.6	89.2	89.9	89.9	90.0	89.7	89.1	88.3
Imports, f.o.b.	-80.9	-82.6	-83.3	-83.8	-83.5	-83.5	-83.0	-82.2	-81.5
Services balance	-0.5	0.4	0.2	0.3	0.4	0.4	0.4	0.4	0.4
Receipts	6.9	7.8	7.8	8.2	8.2	8.2	8.2	8.2	8.1
Payments	-7.4	-7.4	-7.6	-7.9	-7.9	-7.9	-7.8	-7.8	-7.7
Income balance	-4.2	-2.3	-2.5	-2.7	-2.8	-2.9	-3.0	-3.0	-3.1
Receipts	3.8	3.7	3.6	3.7	3.7	3.6	3.6	3.5	3.5
Payments	-8.0	-6.0	-6.1	-6.4	-6.5	-6.5	-6.5	-6.5	-6.5
Current transfers	-0.5	-0.9	-1.5	-1.5	-1.5	-1.6	-1.6	-1.6	-1.6
Capital account	1.3	1.9	1.4	1.0	1.1	1.1	1.1	1.0	0.9
Financial Account	5.0	-0.5	2.0	-3.3	-3.5	-3.5	-3.6	-3.6	-3.5
Direct foreign investment	2.9	3.2	1.1	2.6	2.7	2.7	2.7	2.6	2.6
Portfolio investment	-0.2	11.6	10.0	9.1	8.7	8.2	7.8	7.4	7.1
Other investment	2.8	-15.2	-8.6	-15.0	-14.9	-14.4	-14.1	-13.6	-13.2
Financial derivatives	-0.5	0.0	-0.4	0.0	0.0	0.0	0.0	0.0	0.0
Reserve assets 1/	-0.1	0.0	-0.1	0.0	0.0	0.0	0.0	0.0	0.0
Errors and omissions	-2.4	-3.7	-5.4	0.0	0.0	0.0	0.0	0.0	0.0
Net International Investment Position	-64.6	-64.1	-65.6	-60.5	-54.6	-48.6	-42.8	-37.2	-32.0
External Debt	75.3	76.0	83.3	84.9	83.8	83.3	82.0	80.3	78.8

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 6. Slovak Republic: Financial Soundness Indicators for the Banking Sector, 2009–13

(Percent, unless otherwise indicated)

	2009	2010	2011	2012	2013
Capital adequacy					
Regulatory capital to risk-weighted assets	12.6	12.7	13.4	15.7	16.5
Regulatory Tier 1 capital to risk-weighted assets	11.4	11.6	12.4	14.7	14.4
Capital to assets	9.6	9.7	10.8	11.7	12.1
Asset quality					
Nonperforming loans to gross loans	5.3	5.8	5.6	5.2	5.1
Nonperforming loans net of provisions to capital	14.3	16.7	15.5	13.3	13.1
Earnings and Profitability					
Return on assets (after tax)	0.6	1.2	0.7	1.0	1.3
Return on equity (after tax)	6.7	12.6	6.9	9.1	10.7
Interest margin to gross income	76.8	75.9	73.9	84.1	78.1
Noninterest expenses to gross income	62.3	57.5	52.5	64.3	59.1
Liquidity					
Customer deposits to total (noninterbank) loans	116.1	116.6	109.4	114.2	113.0
Liquid assets to total assets	43.4	40.9	37.4	38.3	36.2
Liquid assets to short-term liabilities	57.3	56.5	52.9	55.9	49.1
Sectoral distribution of loans to total loans					
Residents	93.4	93.6	93.6	92.4	91.6
Deposit-takers	0.1	0.0	0.0	0.0	0.0
Central bank	0.0	0.0	0.0	0.0	0.0
Other financial corporations	4.2	2.9	2.8	2.3	2.3
General government	2.6	3.2	2.9	2.6	2.3
Nonfinancial corporations	44.1	42.2	41.6	38.9	36.2
Other domestic sectors	42.5	45.3	46.2	48.6	50.7
Nonresidents	6.6	6.4	6.4	7.6	8.4
Other indicators					
Nonfinancial corporation debt (in percent of GDP)	83.5	81.7	83.9	81.4	85.6
Households debt (in percent of GDP)	27.3	27.8	29.2	32.0	34.4
Households debt (in percent of disposable income)	43.1	44.2	47.4	52.8	56.3
Gross asset position in financial derivatives to capital	9.0	7.6	8.0	5.5	3.7
Gross liability position in financial derivatives to capital	10.4	9.4	9.1	6.7	4.8
Trading income to total income	1.5	2.9	-4.1	1.4	3.5
Personnel expenses to noninterest expenses	38.5	38.6	40.1	39.9	39.7
Spread between reference lending and deposit rates (basis points)	430.0	395.0	376.5	359.0	379.3
Foreign-currency-denominated loans to total loans	2.0	1.5	1.6	1.5	1.1
Foreign-currency-denominated liabilities to total liabilities	2.8	3.2	4.1	3.6	3.9
Net open position in equities to capital	10.5	9.6	9.1	8.3	14.4
Net open position in foreign exchange to capital	-0.1	-1.2	-1.7	0.1	2.2

Sources: National Bank of Slovakia; Haver; and IMF FSI Database.

Annex I. Slovak Republic: Risk Assessment Matrix[1/]

External Risks	Relative Likelihood	Impact if Realized	Policy Response
Side-effects from global financial conditions (short-term)	**High** • Surges in global financial market volatility, triggered by geopolitical tensions or revised market expectations on UMP exit/emerging market fundamentals.	**Low** • The Slovak banking sector is self-funded by deposits and enjoys robust capitalization. • Interest costs could rise somewhat. • The government has already pre-funded much of 2014 financing needs. • Non-residents hold about half of government debt, but the stock is relatively low and financing needs are declining. • Lower exports and growth if trading partners are substantially affected.	• Draw on cash balances. • Slow diversification of holders of government debt and turn to domestic banking sector as a backstop.
Protracted period of slower growth in advanced and emerging economies (medium-term)	**High** • Advanced Economies: Lower-than-anticipated potential growth and persistently low inflation due to a failure to fully address legacies of the financial crisis, leading to secular stagnation. • Emerging Economies: Maturing of the cycle, misallocation of investment, and incomplete structural reforms leading to prolonged slower growth.	**High** • Strong trade links to Europe, especially Germany, would hit exports and growth, exacerbating high unemployment.[2/] • Given integration into global supply chains, slower emerging market growth could hit Slovakia.[2/] • Public debt dynamics are especially sensitive to growth shocks and debt brakes harmful to growth could be breached. • Banks' asset quality could deteriorate due to weaker growth and higher unemployment.	• Over long-term, diversify exports and FDI. • Improve labor market and business climate to attract FDI and boost growth, including through stronger domestic demand. • Recalibrate a more gradual fiscal adjustment path to the extent possible (given debt brake rules), while prioritizing spending on active labor market and other policies to address high unemployment. • Banks can draw on strong provision and capital buffers.
A sharp increase in geopolitical tensions surrounding Russia/Ukraine (short/medium-term)	**Medium** • Could create significant disruptions in global financial, trade and commodity markets.	**Medium** • Trade and financial links with Ukraine are limited, but Slovakia is largely dependent on Russia for energy and as a market for exports worth about 2 percent of GDP. • Potential headwinds would strengthen if Germany and the euro area were significantly affected.	• Draw on cash balances. • Draw on gas reserves. • Over long-term, diversify sources of energy supply. • Improve labor market and business climate to boost growth, including through stronger domestic demand.

Slovak Republic: Risk Assessment Matrix (concluded)			
External Risks	**Relative Likelihood**	**Impact if Realized**	**Policy Response**
Bond market stress from a reassessment of sovereign risk (short-term)	**Low** • Euro area: Sovereign stress re-emerges due to incomplete reforms, unanticipated outcomes from the asset quality review and stress tests in the absence of a fiscal backstop.	**Low** • Slovak sovereign spreads remained relatively contained even at the height of the crisis and financing needs are falling. • Interest costs could rise. • The government has already pre-funded much of 2014 financing needs. • Non-residents hold about half of government debt, but the stock is relatively low and financing needs are declining. • Possible adverse AQR/stress test findings are likely manageable given low non-performing loans, subdued credit growth, and robust bank capitalization.	• Draw on cash balances. • Slow diversification of holders of government debt and turn to domestic banking sector as a backstop. • Banks can draw on strong provision and capital buffers.
Domestic Risks	**Relative Likelihood**	**Impact if Realized**	**Policy Response**
Prolonged high unemployment (medium-term)	**Medium**	**High** • Sustained high unemployment would inhibit recovery in domestic demand and lower growth. • Hysteresis effects could lower potential growth and contribute to a lost generation of workers. • Public debt is especially sensitive to growth shocks.	• Improve labor market / business climate. • Recalibrate a more gradual fiscal adjustment path to the extent possible (given debt brake rules), while prioritizing spending on active labor market and other policies to address high unemployment.

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 of risks listed 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.

2/ Additional information on the effects of shocks can be found in the second chapter of the Selected Issues (*Evolution of Drivers of the Business Cycle in Slovakia*).

Annex II. Slovak Republic: Authorities' Response to Past IMF Policy Recommendations

IMF 2013 Article IV Recommendations	Authorities' Response
Achieving High-quality Fiscal Consolidation	
• Maintain VAT rate, improve VAT collection efficiency, and reduce tax evasion. • Introduce a property value-based real estate tax. • Move more quickly to a higher retirement age and raise the overall retirement age to strengthen the pension system.	• Parliament approved maintaining VAT rate. • Reducing tax evasion and VAT efficiency are top priorities and has benefited from FAD analysis. An ambitious action plan to combat tax fraud is being implemented. • Property tax changes are being considered, but implementation is unlikely before 2016. • Raising the retirement age is not desirable due to low life expectancy and small expected savings.
Boosting Growth and Reducing Unemployment	
• Address high unemployment by lowering labor taxes, strengthening active labor market policies (ALMPs), improving education, and training, and enhancing mobility • Use EU Funds effectively. • Improve investment climate by strengthening infrastructure and governance, lowering administrative burdens for businesses and ensuring a predictable legal climate, including with respect to labor regulations.	• The government is committed to reducing unemployment, has taken steps to streamline and improve ALMPs and focus on disadvantaged job seekers, including through a labor cost subsidy. • Education and training initiatives, including to create a dual system, are underway. • Efforts to improve government efficiency and to facilitate financing for SMEs are underway. • Labor Code changes are unlikely to affect unemployment.
Preserving Financial Stability	
• Lower the bank levy in line with other European countries and allocate proceeds to a well-defined special resolution fund. • Enhance the supervisory framework through a more well-specified intervention and resolution framework, in line with European directives and banking union developments.	• The proceeds of the bank levy are available for resolution if needed and the levy rate will gradually decline with the accumulation of resources. • All the recent EU directives (CRD IV/CRR, etc.) have been transposed into national legislation. Risks are low and well-understood by the NBS.

Annex III. Slovak Republic: Public Sector Debt Sustainability Analysis (DSA) – Baseline Scenario

(in percent GDP unless otherwise indicated)

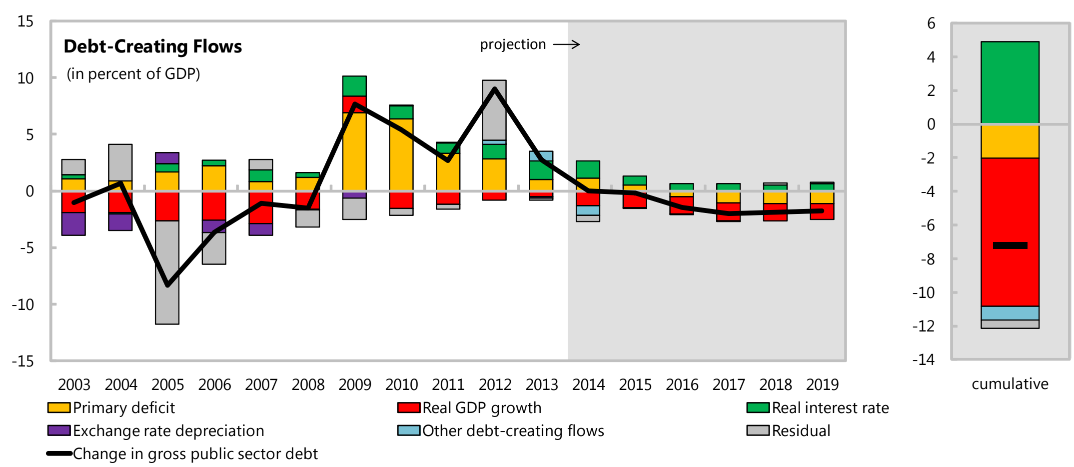
Debt, Economic and Market Indicators [1]

	Actual			Projections					
	2003-2011 [2]	2012	2013	2014	2015	2016	2017	2018	2019
Nominal gross public debt	36.3	52.7	55.4	55.4	55.3	53.8	51.8	49.9	48.2
Public gross financing needs	11.6	12.2	10.9	6.7	6.0	7.0	6.8	5.7	5.5
Public debt (in percent of potential GDP)	36.5	52.1	54.1	54.1	54.1	52.8	51.2	49.7	48.2
Real GDP growth (in percent)	4.8	1.8	0.9	2.4	2.7	2.9	3.1	3.1	3.0
Inflation (GDP deflator, in percent)	2.4	1.3	0.5	0.4	1.4	1.7	1.7	1.8	1.8
Nominal GDP growth (in percent)	7.4	3.1	1.5	2.9	4.1	4.6	4.9	4.9	4.8
Effective interest rate (in percent) [4]	4.9	4.3	3.8	3.3	3.0	3.0	3.0	2.9	3.2

As of July 07, 2014		
Sovereign Spreads		
EMBIG (bp) 3/		76
5Y CDS (bp)		44
Ratings	Foreign	Local
Moody's	A2	A2
S&Ps	A	A
Fitch	A+	A+

Contribution to Changes in Public Debt

	Actual			Projections							
	2003-2011	2012	2013	2014	2015	2016	2017	2018	2019	cumulative	debt-stabilizing primary balance [9]
Change in gross public sector debt	0.1	9.0	2.8	0.0	-0.1	-1.4	-2.0	-1.9	-1.7	-7.2	
Identified debt-creating flows	1.3	3.8	2.9	0.6	-0.1	-1.4	-2.0	-2.0	-1.9	-6.7	
Primary deficit	2.7	2.9	1.0	1.1	0.5	-0.5	-1.0	-1.1	-1.1	-2.0	-0.7
Primary (noninterest) revenue and grants	33.6	33.5	35.7	35.3	34.1	33.1	32.9	32.8	32.7	200.9	
Primary (noninterest) expenditure	36.3	36.4	36.7	36.5	34.6	32.6	31.9	31.7	31.6	198.9	
Automatic debt dynamics [5]	-1.5	0.5	1.1	0.2	-0.6	-0.9	-0.9	-1.0	-0.7	-3.9	
Interest rate/growth differential [6]	-0.9	0.5	1.2	0.2	-0.6	-0.9	-0.9	-1.0	-0.7	-3.9	
Of which: real interest rate	0.8	1.3	1.7	1.5	0.8	0.7	0.7	0.6	0.7	4.9	
Of which: real GDP growth	-1.6	-0.8	-0.5	-1.3	-1.4	-1.5	-1.6	-1.5	-1.4	-8.8	
Exchange rate depreciation [7]	-0.6	0.0	-0.1	…	…	…	…	…	…	…	
Other identified debt-creating flows	0.0	0.4	0.8	-0.8	0.0	0.0	0.0	0.0	0.0	-0.8	
Net privatization proceeds (negative)	0.0	0.0	0.0	-1.0	0.0	0.0	0.0	0.0	0.0	-1.0	
Contingent liabilities	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	
Accumulation of deposits and ESM contri	0.0	0.4	0.8	0.2	0.0	0.0	0.0	0.0	0.0	0.2	
Residual, including asset changes [8]	-1.2	5.3	-0.2	-0.6	-0.1	-0.1	-0.1	0.2	0.1	-0.5	



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 $[(r - \pi(1+g) - g + ae(1+r)]/(1+g+\pi+g\pi))$ 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 $r - \pi(1+g)$ and the real growth contribution as $-g$.

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

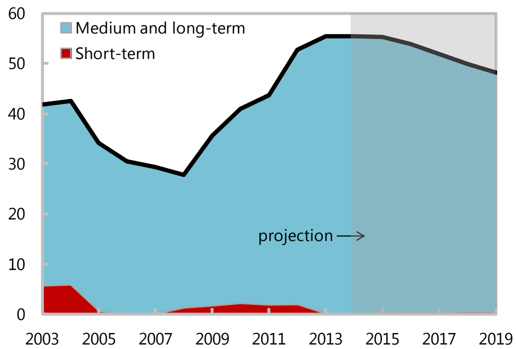
8/ Includes asset changes and interest revenues (if any). For projections, includes exchange rate changes during the projection period.

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.

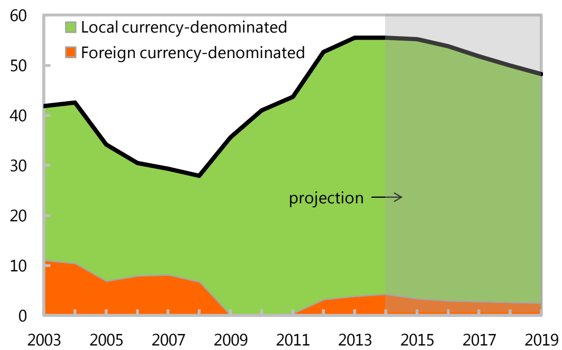
Slovak Republic: Public DSA – Composition of Public Debt and Alternative Scenarios

Composition of Public Debt

By Maturity
(in percent of GDP)



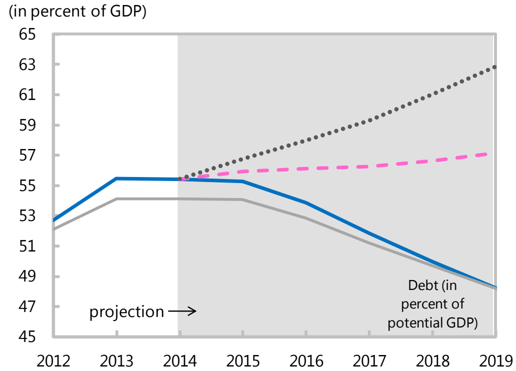
By Currency
(in percent of GDP)



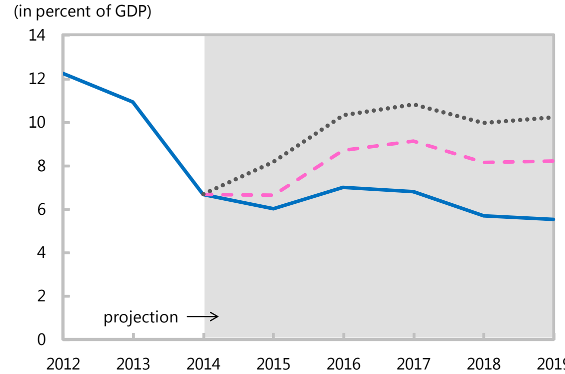
Alternative Scenarios

Baseline   Historical   Constant Primary Balance

Gross Nominal Public Debt
(in percent of GDP)



Public Gross Financing Needs
(in percent of GDP)



Underlying Assumptions
(in percent)

Baseline Scenario	2014	2015	2016	2017	2018	2019
Real GDP growth	2.4	2.7	2.9	3.1	3.1	3.0
Inflation	0.4	1.4	1.7	1.7	1.8	1.8
Primary Balance	-1.1	-0.5	0.5	1.0	1.1	1.1
Effective interest rate	3.3	3.0	3.0	3.0	2.9	3.2
Constant Primary Balance Scenario						
Real GDP growth	2.4	2.7	2.9	3.1	3.1	3.0
Inflation	0.4	1.4	1.7	1.7	1.8	1.8
Primary Balance	-1.1	-1.1	-1.1	-1.1	-1.1	-1.1
Effective interest rate	3.3	3.0	3.0	3.0	3.0	3.2

Historical Scenario	2014	2015	2016	2017	2018	2019
Real GDP growth	2.4	4.2	4.2	4.2	4.2	4.2
Inflation	0.4	1.4	1.7	1.7	1.8	1.8
Primary Balance	-1.1	-2.7	-2.7	-2.7	-2.7	-2.7
Effective interest rate	3.3	3.0	3.1	3.4	3.5	3.9

Source: IMF staff.

Slovak Republic: Public DSA – Realism

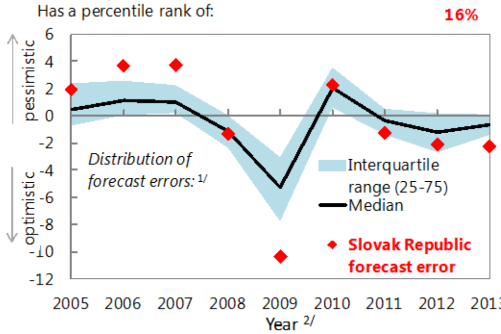
Forecast Track Record, versus surveillance countries

Real GDP Growth

(in percent, actual-projection)

Slovak Republic median forecast error, 2005-2013: **-1.27**

Has a percentile rank of: **16%**

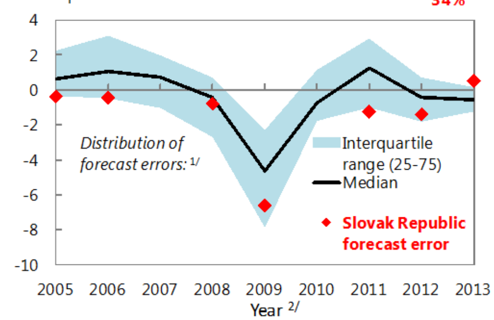


Primary Balance

(in percent of GDP, actual-projection)

Slovak Republic median forecast error, 2005-2013: **-0.78**

Has a percentile rank of: **34%**

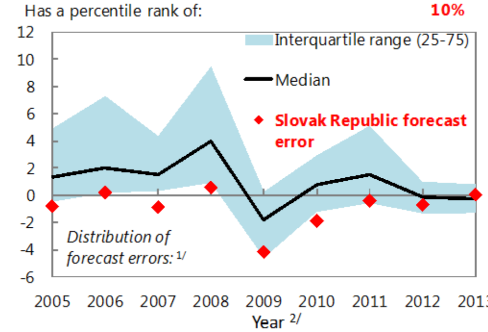


Inflation (Deflator)

(in percent, actual-projection)

Slovak Republic median forecast error, 2005-2013: **-0.69**

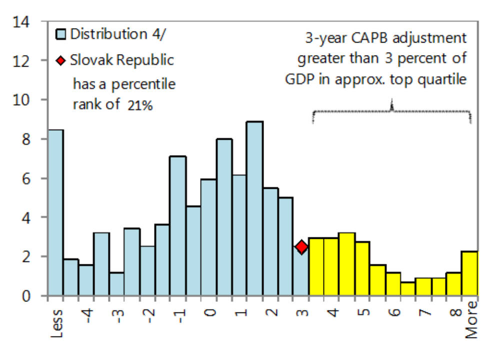
Has a percentile rank of: **10%**



Assessing the Realism of Projected Fiscal Adjustment

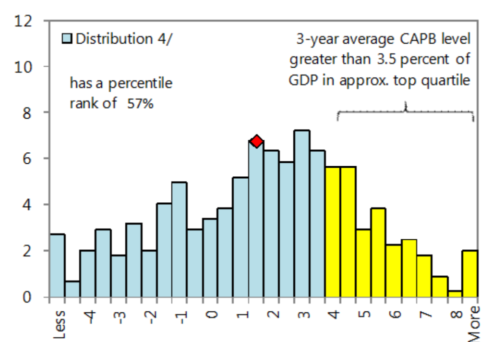
3-Year Adjustment in Cyclically-Adjusted Primary Balance (CAPB)

(Percent of GDP)



3-Year Average Level of Cyclically-Adjusted Primary Balance (CAPB)

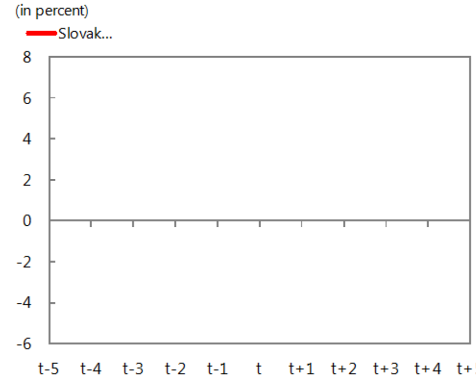
(Percent of GDP)



Boom-Bust Analysis 3/

Real GDP growth

(in percent)



Source : IMF Staff.

1/ Plotted distribution includes surveillance countries, percentile rank refers to all countries.

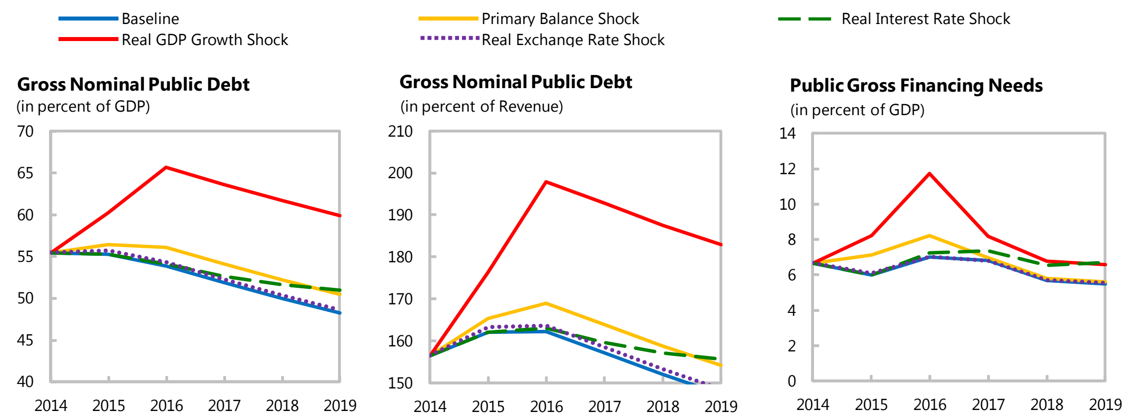
2/ Projections made in the spring WEO vintage of the preceding year.

3/ Not applicable for Slovak Republic.

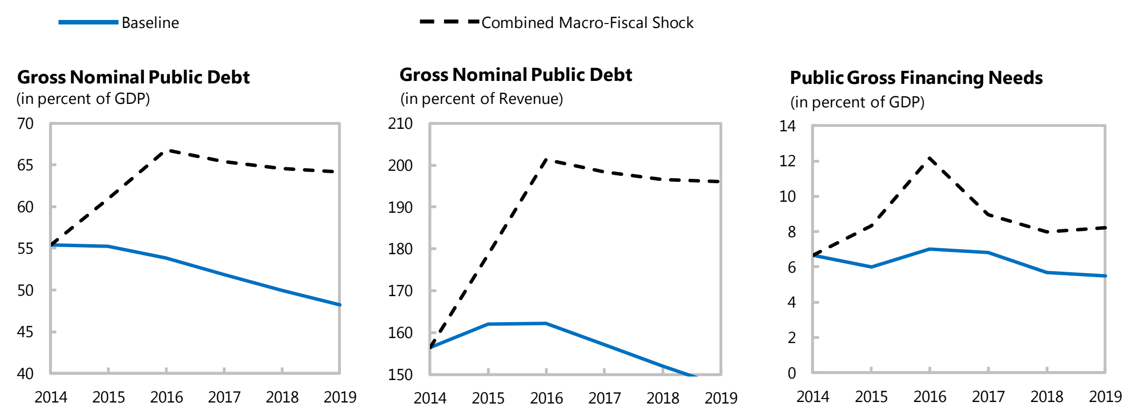
4/ Data cover annual obervations from 1990 to 2011 for advanced and emerging economies with debt greater than 60 percent of GDP. Percent of sample on vertical axis.

Slovak Republic: Public DSA – Stress Tests

Macro-Fiscal Stress Tests



Additional Stress Tests



Underlying Assumptions

(in percent)

Primary Balance Shock	2014	2015	2016	2017	2018	2019
Real GDP growth	2.4	2.7	2.9	3.1	3.1	3.0
Inflation	0.4	1.4	1.7	1.7	1.8	1.8
Primary balance	-1.1	-1.6	-0.6	1.0	1.1	1.1
Effective interest rate	3.3	3.0	3.0	3.1	3.0	3.3
Real Interest Rate Shock						
Real GDP growth	2.4	2.7	2.9	3.1	3.1	3.0
Inflation	0.4	1.4	1.7	1.7	1.8	1.8
Primary balance	-1.1	-0.5	0.5	1.0	1.1	1.1
Effective interest rate	3.3	3.0	3.5	4.1	4.6	5.4
Combined Shock						
Real GDP growth	2.4	-1.6	-1.4	3.1	3.1	3.0
Inflation	0.4	0.3	0.6	1.7	1.8	1.8
Primary balance	-1.1	-2.4	-3.2	1.0	1.1	1.1
Effective interest rate	3.3	3.0	3.6	4.4	4.9	5.6

Real GDP Growth Shock	2014	2015	2016	2017	2018	2019
Real GDP growth	2.4	-1.6	-1.4	3.1	3.1	3.0
Inflation	0.4	0.3	0.6	1.7	1.8	1.8
Primary balance	-1.1	-2.4	-3.2	1.0	1.1	1.1
Effective interest rate	3.3	3.0	3.0	3.2	3.2	3.4
Real Exchange Rate Shock						
Real GDP growth	2.4	2.7	2.9	3.1	3.1	3.0
Inflation	0.4	1.9	1.7	1.7	1.8	1.8
Primary balance	-1.1	-0.5	0.5	1.0	1.1	1.1
Effective interest rate	3.3	3.0	3.0	3.0	2.9	3.2

Source: IMF staff.

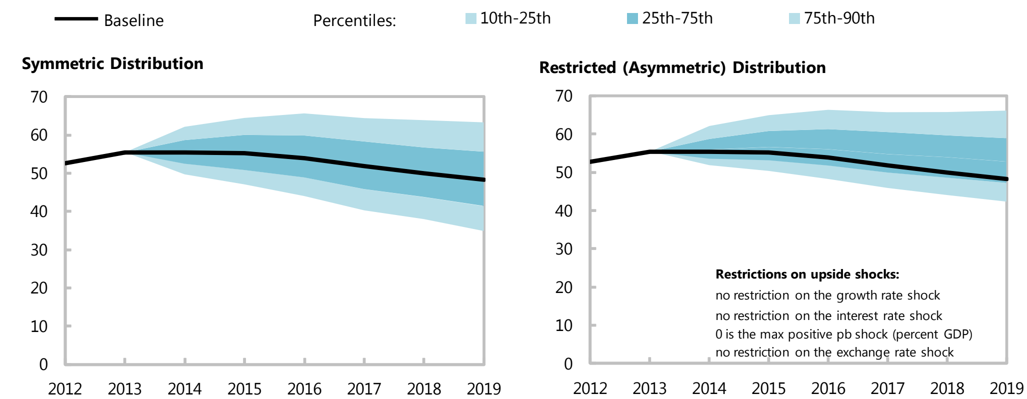
Slovak Republic: Public DSA Risk Assessment

Heat Map

Debt level 1/	Real GDP Growth Shock	Primary Balance Shock	Real Interest Rate Shock	Exchange Rate Shock	Contingent Liability shock
Gross financing needs 2/	Real GDP Growth Shock	Primary Balance Shock	Real Interest Rate Shock	Exchange Rate Shock	Contingent Liability Shock
Debt profile 3/	Market Perception	External Financing Requirements	Change in the Share of Short-Term Debt	Public Debt Held by Non-Residents	Foreign Currency Debt

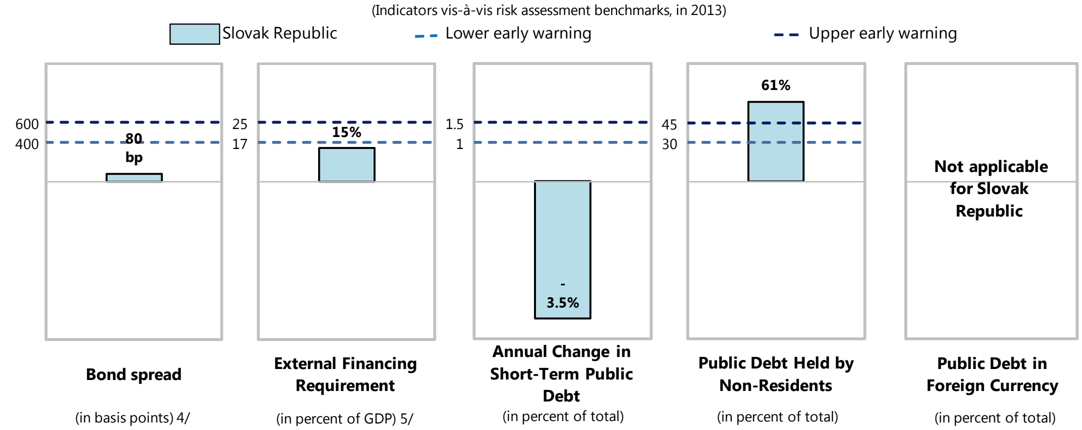
Evolution of Predictive Densities of Gross Nominal Public Debt

(in percent of GDP)



Debt Profile Vulnerabilities

(Indicators vis-à-vis risk assessment benchmarks, in 2013)



Source: IMF staff.

1/ The cell is highlighted in green if debt burden benchmark of 85% is not exceeded under the specific shock or baseline, yellow if exceeded under specific shock but not baseline, red if benchmark is exceeded under baseline, white if stress test is not relevant.

2/ The cell is highlighted in green if gross financing needs benchmark of 20% is not exceeded under the specific shock or baseline, yellow if exceeded under specific shock but not baseline, red if benchmark is exceeded under baseline, white if stress test is not relevant.

3/ The cell is highlighted in green if country value is less than the lower risk-assessment benchmark, red if country value exceeds the upper risk-assessment benchmark, yellow if country value is between the lower and upper risk-assessment benchmarks. If data are unavailable or indicator is not relevant, cell is white.

Lower and upper risk-assessment benchmarks are:

400 and 600 basis points for bond spreads; 17 and 25 percent of GDP for external financing requirement; 1 and 1.5 percent for change in the share of short-term debt; 30 and 45 percent for the public debt held by non-residents.

4/ Long-term bond spread over German bonds, an average over the last 3 months, 08-Apr-14 through 07-Jul-14.

5/ External financing requirement is defined as the sum of current account deficit, amortization of medium and long-term total external debt, and short-term total external debt at the end of previous period.

Annex IV. Slovak Republic: External Debt Sustainability Analysis (DSA) – Framework, 2009–19

(In percent of GDP, unless otherwise indicated)

	Actual							Projections						
	2009	2010	2011	2012	2013			2014	2015	2016	2017	2018	2019	Debt-stabilizing non-interest current account 6/
Baseline: External debt	71.2	75.6	75.3	76.0	83.3			**84.9**	**83.8**	**83.3**	**82.0**	**80.3**	**78.8**	**2.4**
Change in external debt	13.6	4.3	-0.2	0.7	7.2			1.6	-1.1	-0.5	-1.3	-1.7	-1.5	
Identified external debt-creating flows (4+8+9)	17.3	7.4	-4.3	-0.1	0.4			3.1	1.2	2.0	1.2	0.7	0.7	
Current account deficit, excluding interest payments	1.1	2.4	2.2	-4.1	-4.1			-4.0	-4.1	-4.2	-4.3	-4.3	-4.4	
Deficit in balance of goods and services	-0.2	-0.1	-0.7	-5.2	-5.6			-6.1	-6.4	-6.6	-6.8	-6.9	-15.0	
Exports	70.2	79.9	89.2	95.5	97.0			98.2	98.1	98.3	97.9	97.2	96.4	
Imports	69.9	79.8	88.5	90.3	91.4			92.0	91.7	91.7	91.2	90.3	81.5	
Net non-debt creating capital inflows (negative)	9.9	3.6	-1.4	-1.6	6.0			7.2	5.8	6.8	6.1	5.7	5.6	
Automatic debt dynamics 1/	6.2	1.4	-5.1	5.6	-1.5			-0.1	-0.4	-0.6	-0.7	-0.7	-0.5	
Contribution from nominal interest rate	1.4	1.3	1.6	1.8	2.0			1.8	1.7	1.7	1.8	1.7	1.7	
Contribution from real GDP growth	3.1	-3.2	-2.1	-1.4	-0.7			-1.9	-2.2	-2.3	-2.4	-2.4	-2.2	
Contribution from price and exchange rate changes 2/	1.7	3.2	-4.7	5.2	-2.8			...	...	...	...	...	...	
Residual, incl. change in gross foreign assets (2-3) 3/	-3.7	-3.0	4.1	0.8	6.9			-1.4	-2.3	-2.5	-2.5	-2.4	-2.3	
External debt-to-exports ratio (in percent)	101.5	94.5	84.5	79.6	85.8			86.5	85.4	84.8	83.8	82.6	81.7	
Gross external financing need (in billions of US dollars) 4/	27.4	38.6	39.1	34.9	27.9			25.5	26.6	27.8	29.1	30.3	31.5	
in percent of GDP	31.3	44.2	40.7	38.2	29.1	10-Year	10-Year	25.1	24.8	24.6	24.2	23.6	23.0	
Scenario with key variables at their historical averages 5/								**84.9**	**80.9**	**76.9**	**73.4**	**70.6**	**67.9**	**-4.7**
Key Macroeconomic Assumptions Underlying Baseline						Historical Average	Standard Deviation							
Real GDP growth (in percent)	-4.9	4.4	3.0	1.8	0.9	4.2	4.3	2.4	2.7	2.9	3.1	3.1	3.0	
GDP deflator in US dollars (change in percent)	-2.9	-4.3	6.6	-6.4	3.8	7.2	10.3	3.5	2.8	2.6	3.1	3.5	3.5	
Nominal external interest rate (in percent)	2.3	1.9	2.3	2.3	2.7	3.5	1.7	2.3	2.1	2.2	2.2	2.2	2.3	
Growth of exports (US dollar terms, in percent)	-22.0	13.9	22.5	1.9	6.5	19.4	20.8	7.3	5.5	5.7	5.9	5.9	5.7	
Growth of imports (US dollar terms, in percent)	-22.4	14.1	21.6	-2.8	6.1	18.5	20.7	6.7	5.2	5.5	5.6	5.7	-3.9	
Current account balance, excluding interest payments	-1.1	-2.4	-2.2	4.1	4.1	-1.9	3.4	4.0	4.1	4.2	4.3	4.3	4.4	
Net non-debt creating capital inflows	-9.9	-3.6	1.4	1.6	-6.0	-0.3	4.7	-7.2	-5.8	-6.8	-6.1	-5.7	-5.6	

1/ Derived as [r - g - r(1+g) + ea(1+r)]/(1+g+r+gr) times previous period debt stock, with r = nominal effective interest rate on external debt; r = change in domestic GDP deflator in US dollar terms, g = real GDP growth rate, e = nominal appreciation (increase in dollar value of domestic currency), and a = share of domestic-currency denominated debt in total external debt.

2/ The contribution from price and exchange rate changes is defined as [-r(1+g) + ea(1+r)]/(1+g+r+gr) times previous period debt stock. r increases with an appreciating domestic currency (e > 0) and rising inflation (based on GDP deflator).

3/ For projection, line includes the impact of price and exchange rate changes.

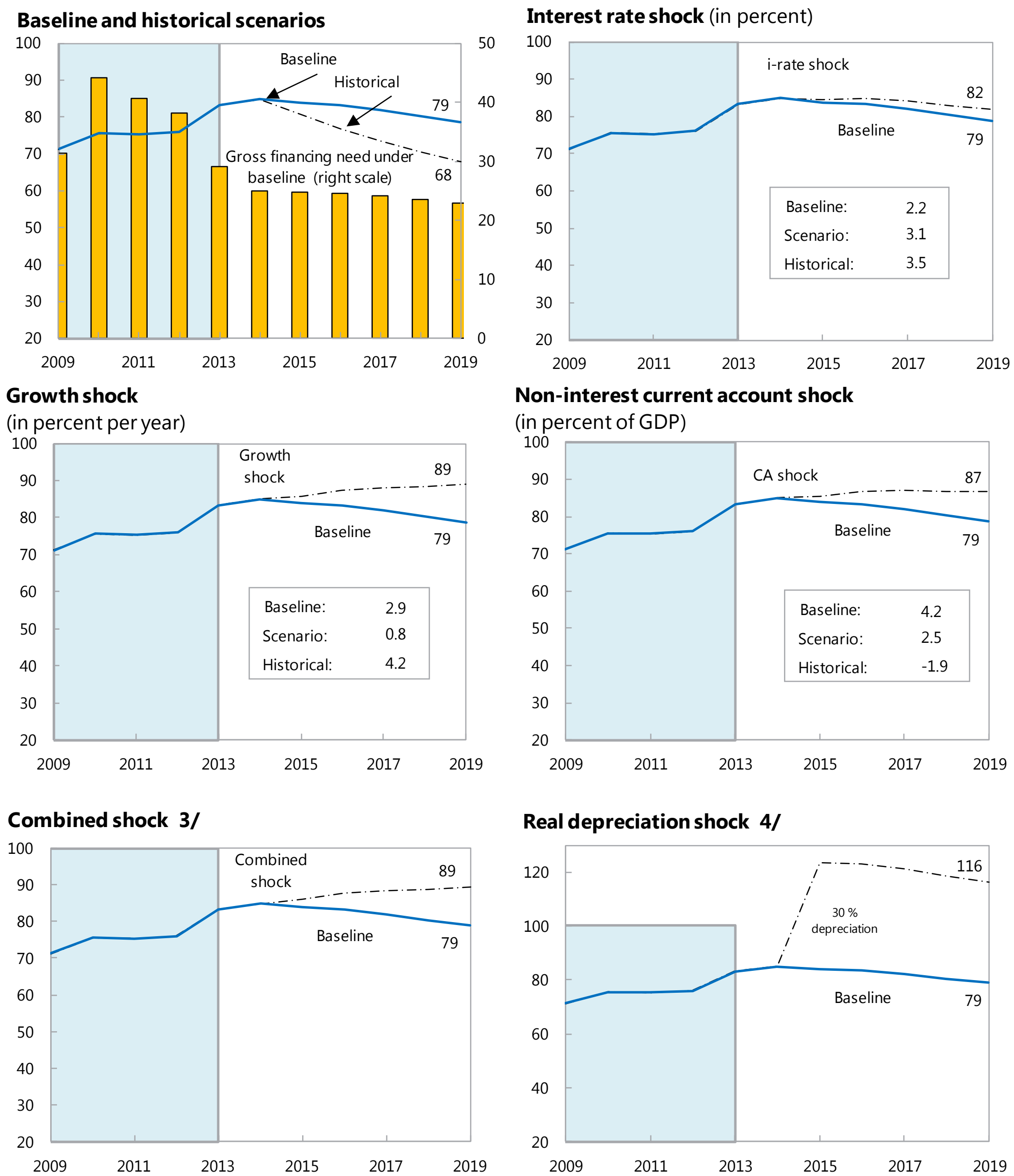
4/ Defined as current account deficit, plus amortization on medium- and long-term debt, plus short-term debt at end of previous period.

5/ The key variables include real GDP growth; nominal interest rate; dollar deflator growth; and both non-interest current account and non-debt inflows in percent of GDP.

6/ Long-run, constant balance that stabilizes the debt ratio assuming that key variables (real GDP growth, nominal interest rate, dollar deflator growth, and non-debt inflows in percent of GDP) remain at their levels of the last projection year.

Slovak Republic: External DSA – Bound Tests 1/2/

(External debt in percentage of GDP)



Sources: International Monetary Fund, Country desk data, and staff estimates.
1/ Shaded areas represent actual data. Individual shocks are permanent one-half standard deviation shocks. Figures in the boxes represent average projections for the respective variables in the baseline and scenario being presented. Ten-year historical average for the variable is also shown.
2/ For historical scenarios, the historical averages are calculated over the ten-year period, and the information is used to project debt dynamics five years ahead.
3/ Permanent 1/4 standard deviation shocks applied to real interest rate, growth rate, and current account balance.
4/ One-time real depreciation of 30 percent occurs in 2010.

INTERNATIONAL MONETARY FUND

SLOVAK REPUBLIC

July 30, 2014

STAFF REPORT FOR THE 2014 ARTICLE IV CONSULTATION—INFORMATIONAL ANNEX

Prepared By | European Department

CONTENTS

FUND RELATIONS

(As of June 30, 2014)

Membership Status: Joined 1/1/1993; Article VIII

General Resources Account:

	SDR Million	Percent of Quota
Quota	427.5	100
Fund holdings of currency	267.8	62.64
Reserve position	159.71	37.36
Lending to the Fund	48.43	

SDR Department:

	SDR Million	Percent of Allocation
Net cumulative allocation	340.48	100
Holdings	322.99	94.86

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	115.8	32.15

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

	Forthcoming				
	2014	2015	2016	2017	2018
Principal					
Charges/Interest	0.01	0.02	0.02	0.02	0.02
Total	0.01	0.02	0.02	0.02	0.02

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 and maintains an exchange system that is free of restrictions on the making of payments and transfers for current international transactions. The Slovak Republic maintains exchange restrictions for security reasons, based on UN Security Council Resolutions and Council of the European Union Regulations that have been notified to the Fund under the procedures set forth in Executive Board Decision No. 144–(52/51).

Article IV Consultation:

The consultation discussions were held in Bratislava during June 4–17, 2014. The mission met with Minister of Finance Kažimír; National Bank of Slovakia (NBS) Governor Makúch; officials from the Ministry of Finance, the NBS, the debt management agency (ARDAL), the National Property Fund, and the Ministries of Labor, Education, Transportation, and Interior; as well as representatives of financial institutions, labor unions, employers' associations, and enterprises.

The team comprised Messrs. John (head), Giustiniani, and Semmelmann, Mmes. Q. Chen (all EUR) and Zavacka (SEC), and was assisted at headquarters by Mr. Winnekens and Mmes. Moraes Rego and T. Chen and Mr. Moran Arce. Mr. Jakoby (Senior Advisor to the Executive Director) accompanied the mission and Mr. Prader (Executive Director) attended the concluding meeting. The mission's concluding statement was published on the IMF website on June 17, 2014.

The previous consultation with the Slovak Republic was concluded on August 2, 2013 (IMF Country Report No. 13/262).

FSAP Participation and ROSCs:

An FSAP was concluded with the completion of the 2002 Article IV consultation on August 7, 2002 on the basis of missions that took place in February 2002 and April 2002. The FSSA report was published (IMF Country Report No. 02/198). An FSAP update mission was held in December 2006. The FSSA update report was circulated to the Executive Board together with the staff report for the 2007 Article IV Consultation and published on the IMF website on July 17, 2007.

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).

Table 1. Slovak Republic: Technical Assistance, 2000–13 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
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.** From the point of view of macroeconomic analysis and policy making, significant data improvements have been made, particularly in the national accounts. A data ROSC mission during February–March 2004 found that the integrity, methodological soundness, and reliability of the data were satisfactory, despite some shortcomings in the data revision policy. The main issues remaining are: (i) a significant statistical discrepancy between the supply and demand sides for GDP; and (ii) weaknesses in the data on prices and volumes of imports and exports. The Slovak Republic has subscribed to the Special Data Dissemination Standard (SDDS) since 1996 and observes or exceeds all related standards.

2. **With regard to timeliness and public access, the authorities in general follow a free and open data publication policy.** Data are promptly released to news services, and are also published regularly in various monthly and quarterly statistical publications, and on the Internet according to a pre-announced schedule. Data on core surveillance variables are provided regularly to the Fund, and with minimal lags: a week or less for foreign exchange reserves; a day for monthly state budget implementation data; 10 days to a month for consumer prices, reserve money, broad money, and interest rates; two months for foreign trade data; and about three months for other fiscal, balance of payments, and national accounts data.

Real Sector and Prices

3. **Despite significant progress made so far, the compilation of the national accounts statistics still suffers some weaknesses.** The quarterly and annual national accounts data exhibit some statistical discrepancies between the supply side and the demand side. An important outstanding issue is the compilation of reliable price deflators for imports and exports that would enable better decomposition into volume and price changes. The statistical authorities are aware of these issues and improvements are ongoing, as part of the transition to the new European System of National and Regional Accounts (ESA2010).

Fiscal Sector

4. **The compilation of general government statistics is in transition to the new ESA2010 methodology.** The Ministry of Finance has compiled its fiscal accounts according to ESA95 standards and reports general government net lending/borrowing and gross debt on a quarterly basis. Monthly reconciliation of government operations above and below-the-line is restricted to state budget transactions on a cash basis. A modern treasury system has been operating since January 2004. The system has improved fiscal control and public debt management by allowing the recording of expenditures at the planning and commitment stages. The ESA 2010 methodology will be implemented from September 2014.

External Sector

5. External sector statistics are generally of good quality, and are reported on a timely basis to the Fund. However, errors and omissions in the balance of payments statistics are large and reported financial account flows are subject to large volatility. The statistical authorities are aware of these issues and are working to address them. The statistical authorities will start to submit data to the Fund following the standard of the sixth edition of the Balance of Payments and International Investment Position Manual (BPM6) in September 2014.

Monetary Sector

6. Monetary statistics are of good quality, and are reported on a timely basis to the Fund.

Table 1. Slovak Republic: Table of Common Indicators Required for Surveillance
(As of July 11, 2014)

	Date of Latest Observation	Date Received	Frequency of Data 6/	Frequency of Reporting 6/	Frequency of Publication 6/	Memo Items: Data Quality – Methodological soundness 8/	Memo Items: Data Quality – Accuracy and reliability 9/
Exchange Rates	Current	Current	D	D	D		
International Reserve Assets and Reserve Liabilities of the Monetary Authorities 1/	July 2014	July 2014	D	W	W		
Reserve/Base Money	May 2014	July 2014	M	M	M	...	...
Broad Money	May 2014	July 2014	M	M	M	...	...
Central Bank Balance Sheet	May 2014	July 2014	M	M	M	...	...
Consolidated Balance Sheet of the Banking System	May 2014	July 2014	M	M	M		
Interest Rates 2/	Current	Current	D	D	D		
Consumer Price Index	May 2014	July 2014	M	M	M		
Revenue, Expenditure, Balance and Composition of Financing 3/ – General Government 4/	2013	July 2014	A	A	A	LO, LO, LO, O	O, O, O, O, O, NA
Revenue, Expenditure, Balance and Composition of Financing 3/ – Central Government	June 2014	July 2014	M	M	M		
Stocks of Central Government and Central Government-Guaranteed Debt 5/	2014Q1	May 2014	Q	Q	Q		
External Current Account Balance	Apr. 2014	July 2014	M	M	M	O, O, LO, O	LO, O, LO, O, LO
Exports and Imports of Goods and Services	Apr. 2014	July 2014	M	M	M		
GDP/GNP	2014Q1	May 2014	Q	Q	Q	O, O, LO, LO	LO, O, LO, O, LO
Gross External Debt	2014Q1	Jun. 2014	Q	Q	Q		
International Investment Position 7/	2014Q1	Jun. 2014	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.
8/ Reflects the assessment provided in the data ROSC (published on May 17, 2005, and based on the findings of the mission that took place during February 18–March 3, 2004) for the dataset corresponding to the variable in each row. The assessment indicates whether international standards concerning concepts and definitions, scope, classification/sectorization, and basis for recording are fully observed (O), largely observed (LO), largely not observed (LNO), or not observed (NO).
9/ Same as footnote 7, except referring to international standards concerning source data, statistical techniques, assessment and validation of source data, assessment and validation of intermediate data and statistical outputs, and revision studies.

Statement by the IMF Staff Representative
August 27, 2014

This statement summarizes the main developments in the Slovak Republic since the staff report was issued on July 31, 2014. The information does not alter the thrust of the staff appraisal.

- *Growth:* Preliminary data for the second quarter of 2014 showed seasonally adjusted output growing by 0.6 percent quarter-on-quarter and 2.6 percent year-on-year, consistent with forecast growth of 2.4 percent for the year.

- *Inflation:* In July, headline HICP inflation was -0.2 percent year-on-year, primarily reflecting declining fuel prices, while core HICP inflation was 0.5 percent. Recent data suggest somewhat greater downside risks to the forecast of 0.4 percent headline inflation for 2014, although annual deflation is not expected.

- *Fiscal policy:* Data for the first quarter of 2014 are broadly in line with expectations for the year and confirm the improvement in VAT collection seen in 2013. While government debt reached 58 percent of GDP in the first quarter, this mainly reflects pre-funding, and debt is still forecast to be just above 55 percent of GDP at end-2014. The first draft of the budget for 2015 and the medium term is largely in line with staff projections.

- *Minimum wage:* The Finance Ministry has proposed that the minimum wage be increased from €352 to €380 per month, effective in January 2015. It also has proposed that employer health contributions for low-wage workers be reduced to help offset the impact of the minimum wage increase on labor costs.

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IMF Executive Board Concludes 2014 Article IV Consultation with the Slovak Republic

On August 27, 2014, the Executive Board of the International Monetary Fund (IMF) concluded the Article IV consultation[1] with the Slovak Republic.

The Slovak economy slowed in 2013, but is gathering momentum as the euro area and domestic demand recover, complementing the strong export sector that has underpinned the economy in recent years. While output has climbed each year since the 2009 downturn, unemployment remains very high—around 14 percent—with about two-thirds of this long-term, and higher joblessness among youth (around 33 percent). Substantial fiscal adjustment brought the deficit to 2.8 percent of GDP in 2013, enabling exit from the EU's Excessive Deficit Procedure. Public debt is manageable and has been easily financed on favorable terms. Private debt is also moderate, and the banking sector remains sound with strong capital and liquidity levels.

The outlook is favorable with growth of 2.4 percent forecast this year and 2.7 percent for 2015, although there are downside risks related to the strength of the recovery in Europe and geopolitical tensions. Inflation turned negative in early 2014, reflecting weak domestic demand as well as falling food and energy prices, but is expected to return to moderately positive territory later in the year. The trade and current account balances are forecast to remain in surplus.

Policy discussions focused on: (i) actions to support growth, reduce high unemployment, and address regional disparities; (ii) the need for high-quality and durable fiscal measures, especially on the revenue side, to sustain fiscal adjustment progress, limit the impact of debt brakes, and make room for budget priorities; (iii) and steps to strengthen further the prudent approach to financial sector regulation and encourage capital market development.

[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.

Executive Board Assessment[2]

Executive Directors welcomed the improved growth outlook, which reflects a pick-up in domestic demand, following the strong export performance in recent years. Directors noted, however, that a slow recovery in Europe and geopolitical tensions constitute important risks to the outlook. Moreover, Directors agreed that high unemployment and large regional disparities remain key challenges.

Directors encouraged the implementation of wide-ranging policies to promote investment and job creation, particularly in lagging regions. They agreed that these policies should focus on strengthening infrastructure, including through better use of EU funds; and creating a more favorable business environment by improving contract enforcement, public procurement, and the legal system, and addressing corruption. Actions are also needed to enhance the functioning of labor markets by reducing the tax wedge, reforming the benefit structure to make work more attractive, strengthening education and training, and bolstering public employment services.

Directors recognized the significant fiscal adjustment carried out by the authorities since 2009, which allowed the Slovak Republic to exit the EU's Excessive Deficit Procedure. Nonetheless, they emphasized the need for additional durable fiscal measures to sustain the progress achieved and put debt firmly on a declining path while protecting growth. In view of the need for stepped-up investment in infrastructure and human capital, and against the backdrop of below-EU-average revenue and expenditure levels as shares of GDP, Directors agreed that strengthening revenue collection, including by reducing evasion and fraud, is crucial. In this regard, they welcomed recent progress in strengthening VAT efficiency and the decision to maintain the VAT rate, and encouraged the authorities to consider a property tax based on market values, which would be more equitable and less distortive than other taxes. Furthermore, they concurred that privatization of state assets would help reduce debt in a growth-friendly way.

Directors noted that the combination of domestic and EU fiscal rules have created a complicated fiscal framework. While emphasizing the need to preserve credibility, Directors encouraged the authorities to consider streamlining the framework over time, after experience has been gathered, to make it less pro-cyclical and less focused on expenditure cuts.

Directors commended the authorities' continued prudent supervision of the financial system. While noting the staff assessment that risks related to the housing market remain moderate, Directors considered that increasing loan-to-value ratios for mortgages and the sustained growth of other housing loans warrant attention. They welcomed efforts to encourage domestic capital market development, which could help support non-bank finance and credit to small and medium enterprises.

[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 summings up can be found here: http://www.imf.org/external/np/sec/misc/qualifiers.htm.

Slovak Republic: Selected Economic Indicators 2011–15

				Projections	
	2011	2012	2013	2014	2015
	(Annual percentage change, constant prices, unless noted otherwise)				
National Income, prices and unemployment					
Real GDP	3.0	1.8	0.9	2.4	2.7
Inflation (HICP)	4.1	3.7	1.5	0.4	1.5
Inflation (HICP, end of period)	4.6	3.4	0.4	1.5	1.5
Unemployment rate (percent)	13.7	14.0	14.2	14.0	13.7
	(In percent of GDP)				
Public Finance, General Government 1/					
Revenue	34.1	33.7	35.9	35.4	34.1
Expenditure	38.9	38.2	38.7	38.3	36.3
Overall balance	-4.8	-4.5	-2.8	-2.9	-2.2
General government debt	43.6	52.7	55.4	55.4	55.3
	(In percent)				
Monetary and financial indicators					
Bank credit to private sector (growth rate)	8.6	2.8	5.6		
Lending rates 2/	4.7	4.4	4.1		
Deposit rates 3/	1.6	1.4	1.0		
Government 10-year bond yield	4.4	3.3	3.2		
	(In percent of GDP)				
Balance of payments					
Trade balance (goods)	1.5	5.0	5.9	6.1	6.4
Current account balance	-3.8	2.2	2.1	2.2	2.4
Gross external debt	75.3	76.0	83.3	84.9	83.8

Sources: National Authorities; and IMF staff calculations.

1/ Assumes 3 percent cut of some expenditures in 2014 and partial spending freeze in 2015-16, consistent with Fiscal Responsibility Act provisions.

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

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