INTERNATIONAL MONETARY FUND

IMF Country Report No. 16/13

SLOVAK REPUBLIC

January 2016

2015 ARTICLE IV CONSULTATION—PRESS RELEASE; STAFF REPORT; AND STATEMENT BY THE EXECUTIVE DIRECTOR FOR SLOVAK REPUBLIC

Under Article IV of the IMF's Articles of Agreement, the IMF holds bilateral discussions with members, usually every year. In the context of the 2015 Article IV consultation with the Slovak Republic, the following documents have been released and are included in this package:

- A **Press Release** summarizing the views of the Executive Board as expressed during its January 11, 2016 consideration of the staff report that concluded the Article IV consultation with the Slovak Republic.
- The **Staff Report** prepared by a staff team of the IMF for the Executive Board's consideration on January 11, 2016, following discussions that ended on November 3, 2015, 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 December 22, 2015.
- An **Informational Annex** prepared by the IMF staff.
- A **Staff Statement** updating information on recent developments.
- A **Statement by the Executive Director** for the Slovak Republic.

The documents listed below have been or will be separately released.

Selected Issues

The IMF's transparency policy allows for the deletion of market-sensitive information and premature disclosure of the authorities' policy intentions in published staff reports and other documents.

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International Monetary Fund
Washington, D.C.

Press Release No. 16/08
FOR IMMEDIATE RELEASE
January 14, 2016

International Monetary Fund
700 19th Street, NW
Washington, D. C. 20431 USA

IMF Executive Board Concludes 2015 Article IV Consultation with Slovak Republic

On January 11, 2016, the Executive Board of the International Monetary Fund (IMF) concluded the Article IV consultation[1] with Slovak Republic.

Slovakia remains among Europe's stronger economies, with growth continuing to pick up in 2015, driven by strong domestic demand. A push to spend expiring EU funds has underpinned rising investment while job creation and real wage growth have supported private consumption. Unemployment has fallen significantly since 2013, but is still around 11 percent overall, and is much higher for the long-term unemployed, youth, and women. Regional disparities also remain substantial. The fiscal deficit has held steady between 2.5 and 3 percent of GDP in recent years, and while public debt is manageable and easily financed, it is not far below domestic debt brake thresholds. The banking sector has sound capital and liquidity buffers and private debt is limited, but household borrowing has been rising rapidly.

The outlook is favorable with growth of 3–3.5 percent expected through the medium-term, reflecting sustained domestic demand as well as further contributions from the important export sector as substantial additional foreign auto sector investment is planned. Although Slovakia enjoys substantial buffers, external factors present the greatest risks, especially if shocks were to be transmitted via key trading partners. Negative headline inflation in 2015 is expected to turn positive in 2016.

Discussions focused on: (i) comprehensive actions to reduce unemployment and sharp regional disparities; (ii) high-quality fiscal measures to preserve room for maneuver under domestic debt brakes while funding key priorities; and (iii) macroprudential policies to guard against risks from rapid household credit growth and steps to promote 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 Slovak Republic's solid economic performance, driven by a strong pickup in domestic demand. Medium term prospects are favorable, particularly in light of additional foreign investment in the automotive sector, although external factors pose downside risks. Directors stressed the importance of addressing substantial regional disparities and still high unemployment, including for the long term jobless, youth, and women.

Directors encouraged the authorities to pursue a comprehensive approach to spur investment and employment in weaker regions, and to facilitate labor mobility. Policies should focus on enhancing transportation infrastructure, strengthening the business climate by improving the legal and procurement systems and governance, and promoting rental housing. Reducing the tax wedge, especially for low wage or part time workers, enhancing education and training, and bolstering the effectiveness of labor market policies, would encourage hiring, allay rising skill shortages, and promote labor force participation. Gradual diversification of production and export markets would also support long term growth prospects.

Directors commended the authorities' commitment to fiscal sustainability. They called for high quality and growth friendly fiscal consolidation over the medium term to ensure room for policy maneuver under domestic debt rules and address challenges related to population aging, while also tackling regional disparities and labor market challenges. In this regard, Directors encouraged the authorities to persevere with efforts to strengthen revenue collection particularly for value added and corporate income taxes, broaden the tax base including through a market value based property tax, and achieve spending efficiencies, especially in the health sector. While Directors acknowledged the important policy discipline provided by the Fiscal Responsibility Act (FRA), there was support for revisiting some aspects of the framework over time with a view to lessen potential negative economic effects without undermining discipline.

Directors welcomed the authorities' continued prudent supervision of the financial system in the context of the Single Supervisory Mechanism. Although the banking sector is sound and private sector leverage is limited, rapid household credit growth calls for close monitoring. Directors welcomed the National Bank of Slovakia's ongoing initiatives in this area, and encouraged the authorities to strengthen macroprudential measures, and to consider a positive counter cyclical capital buffer should strong credit growth continue and broaden to the corporate sector. They welcomed efforts to facilitate non-bank financing for firms and encouraged greater regional integration.

[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 Economics Indicator, 2012–16

	2012	2013	2014	2015	2016
				Projections	
National income, prices and wages					
Real GDP	1.5	1.4	2.5	3.4	3.6
Inflation (HICP)	3.7	1.5	-0.1	-0.3	0.7
Inflation (HICP, end of period)	3.4	0.4	-0.1	-0.2	1.4
Employment	0.1	-0.8	1.4	2.0	1.7
Public Finance, General Government					
Revenue	36.0	38.4	38.9	40.1	38.3
Expenditure	40.1	41.0	41.6	42.8	40.5
Overall balance	-4.2	-2.6	-2.8	-2.7	-2.2
General government debt	51.9	54.6	53.5	52.8	52.1
Monetary and financial indicators					
Bank credit to private sector (growth rate)	2.8	5.6	6.1	...	...
Lending rates 1/	4.4	4.1	4.0	...	...
Deposit rates 2/	1.4	1.0	0.9	...	...
Government 10-year bond yield	3.3	3.2	2.1	...	...
Balance of payments					
Trade balance (goods)	3.5	4.6	4.4	3.8	4.0
Current account balance	0.9	1.5	0.1	-0.5	-0.5
Gross external debt	75.8	81.9	89.7	92.8	91.9

Sources: National Authorities; and IMF staff projections.
1/ Average of interest rates on new housing loans to households and loans of less than EUR 1 million to nonfinancial corporations (all maturities).
2/ Average of interest rates on new deposits with agreed maturity (up to 1 year) from households and nonfinancial corporations.

SLOVAK REPUBLIC

STAFF REPORT FOR THE 2015 ARTICLE IV CONSULTATION

December 22, 2015

KEY ISSUES

Context. The shift toward domestic demand-led growth in Slovakia intensified in 2015, with output forecast to expand by more than 3 percent. Stepped-up use of EU funds is supporting investment, while job growth and real wage gains are fueling private consumption. Although Slovakia enjoys substantial buffers, external factors present the greatest risks to the largely positive outlook, especially if shocks were to be transmitted to the important export sector via key trading partners.

Boosting investment and employment. Labor market conditions have been improving, but high unemployment, especially long-term and among youth and women, as well as sharp regional disparities, remain key challenges. Comprehensive actions are needed to build infrastructure in lagging regions, enhance the business climate, improve incentives for working and hiring, and strengthen education and training amid skill shortages.

High-quality fiscal measures. Further fiscal adjustment is needed to ensure room for policy maneuver under domestic debt brakes, while also funding key priorities. Policies should focus on implementing high-quality measures to enhance revenue collection, broaden the tax base, and achieve spending efficiencies.

Guarding against credit growth risks. The banking sector has sound capital and liquidity buffers, and household debt remains limited. Nonetheless, rapid credit growth among households calls for further strengthening of macroprudential measures and a vigilant approach should fast credit expansion continue and broaden.

Approved By
Philip Gerson and Luis Cubeddu

Staff team: The mission took place in Bratislava October 21–November 3, 2015. The team comprised Mr. John (head), Mr. Giustiniani, Ms. Caselli, and Mr. Jobst (all EUR), and was assisted at headquarters by Ms. Chen, Ms. Calixto and Ms. Jung. Mr. Jakoby (Senior Advisor to the Executive Director) accompanied the mission.

CONTENTS

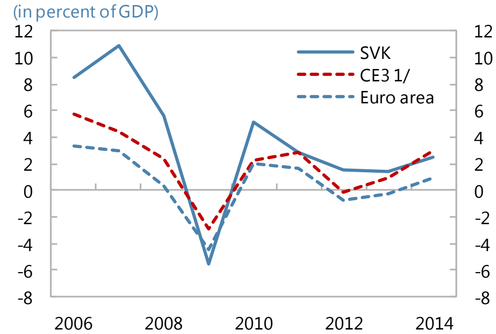
ANNEXES

RECENT DEVELOPMENTS AND OUTLOOK

A. Solid Domestic Demand-Driven Growth

1. **Growth is strengthening, driven by domestic demand** (Figure 1 and Table 1). A dynamic export sector made Slovakia one of the fastest growing economies in Europe after the crisis, and domestic demand has now picked up. A concerted push to spend expiring EU funds has boosted public investment, while accommodative ECB policies and improving lending conditions have supported a recovery in private investment. Job creation and real wage growth have fueled private consumption. Export growth remains strong, but imports have risen even faster.

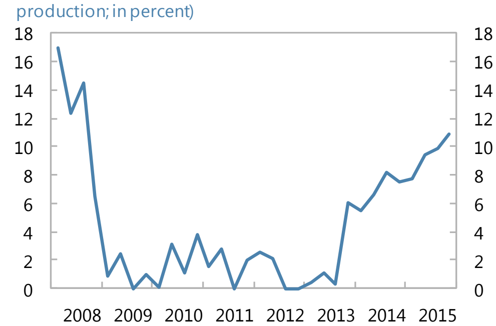
Real Output Growth
(in percent of GDP)



Source: Haver.
1/ CE3 comprises the Czech Republic, Hungary and Poland.

2. **The labor market is on the mend** (Figure 2). Job creation has accelerated and unemployment has fallen, but regional disparities remain large, and skills shortages are starting to put pressure on wages. Youth and long-term unemployment, albeit declining, remain high, and women's labor force participation continues to be low.

Labor Shortage Indicator
(Balance of firms indicating labor shortage as a factor limiting production; in percent)



Source: Haver.

3. **Inflation remains weak**. Headline inflation has been marginally negative, reflecting weak food prices and declining administered energy prices, while core inflation has hovered just below 0.5 percent. Inflation expectations, however, remain well-anchored, and prices are forecast to rise as the output gap closes. Risks from deflation remain low due to robust wage growth and limited leverage.

4. **The 2015 fiscal target is likely to be missed by a small amount** (Figure 3, Tables 2–3). Solid GDP growth and tax administration improvements have boosted revenue, and interest costs remain low amidst ECB quantitative easing (QE). Nonetheless, the budget deficit is likely to overshoot the 2015 target (2.5 percent of GDP) by a small amount (0.2 percent of GDP) owing to spending overruns for wages, intermediate consumption, and healthcare, as well as sizeable EU funds corrections. With the sale of state shares in Slovak Telekom in May (about 1 percent of GDP), government debt is expected to decline to around 53 percent of GDP, keeping it just below strict Fiscal Responsibility Act (FRA) debt brakes. Amid favorable market conditions, the authorities have further lengthened the maturity of public debt, although the share of non-resident holdings remains relatively high (Annex III).

5. **The external position is broadly in line with fundamentals** (Figures 4–6, Table 4, Box 1, and Annex IV). With solid export performance, Slovakia's market shares have continued to rise, but buoyant domestic demand has boosted imports. The narrowing of the trade surplus has moved the current account into a small deficit. External debt, which rose in recent years partly due to increases in non-resident holdings of government debt, has stabilized. Overall, the real exchange rate is assessed to be broadly in line with fundamentals.

6. **Household credit growth remains brisk despite macroprudential measures** (Figure 7 and Table 5). Recent macroprudential recommendations by the National Bank of Slovakia (NBS) have not slowed household credit growth, which is expanding by about 12 percent year-on-year, although household debt remains low compared to peers. Corporate loans have picked up as lending standards and interest rates have eased. Non-performing loans (NPLs) have increased in line with total loan growth, leaving the low NPL ratio roughly stable; impaired assets are well-provisioned on average. Bank profitability and capital buffers remain sound.

7. **The recent migration crisis has had limited impact on Slovakia.** Relatively few refugees have passed through or stayed in the country, perhaps reflecting low per-capita income and benefits compared to other EU destinations. Nonetheless, the authorities have objected strongly to the EU quota system, which would place around 1,000 migrants in the country. Slovakia has allocated resources to help secure the EU's external border and provide aid to refugees abroad.

B. Outlook and Risks

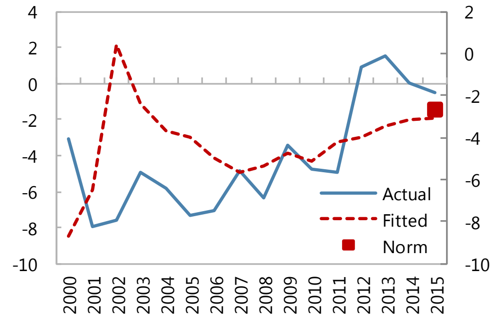
8. **Growth is expected to gather momentum, driven by new automotive investment**. Growth should accelerate from 3.4 percent this year to 3.6 percent in 2016 (closing the output gap), and will be a little more than 3 percent over the longer term, generally in line with potential growth. Despite lower public investment as EU funds drawings return to more normal levels, accommodative monetary and credit conditions, weaker oil prices, and tightening capacity utilization should support private investment. In addition, a fourth carmaker (Jaguar Land Rover) plans to invest almost 2 percent of GDP over 2016–17 in a new plant that would raise car production by one-third, boosting net exports from 2018. Finally, improving labor market conditions and real wage growth are likely to foster private consumption.

9. **A number of buffers help counter vulnerabilities, primarily to external shocks** (Risk Assessment Matrix, Annex I). A sound and liquid banking sector, low private sector leverage, and limited public debt bolster resilience to shocks. If, however, growth were to falter among key trading partners such as Germany—whether due to weakness in the euro area itself, a slowdown in China or other emerging market economies, or tensions in Russia and Ukraine—Slovakia's important export sector would be affected, lowering growth and leading to an increase in the public debt ratio. On the domestic side, rapid household credit growth could lead to financial sector risks, while high long-term unemployment could erode human capital, undermine growth, and exacerbate demographic challenges. The consequences of Volkswagen's emissions scandal remain uncertain but they represent an important downside risk given substantial operations in Slovakia (Box 2).

Box 1. External Assessment

Slovakia's real exchange rate appears broadly in line with fundamentals. The EBA-Lite current account model suggests a marginal undervaluation of the real effective exchange rate (REER) (4 percent). In contrast, the EBA-Lite REER model seems a poor fit for Slovakia—the panel estimations on which it is based do not capture the dynamics of a catching-up economy—and points to a large overvaluation (about 30 percent) despite solid trade surpluses and growing export market shares. More tailored REER analysis using a panel of peer transition economies confirms limited undervaluation (7 percent).

Current Account
(in percent of GDP)



Source: IMF staff.

Analysis suggests Slovakia's policies are generally appropriate. The small policy gap from the EBA-Lite model (0.7 percent) indicates that Slovakia's fiscal, external and financial policies are close to equilibrium, but the model estimates a current account norm of negative 2.5 percent of GDP. The actual current account is broadly in balance, but the large negative errors and omissions, possibly reflecting an overstatement of export prices, may blur the real picture. While the norm might be consistent with Slovakia still catching up with more advanced economies, a current account deficit would imply growing stress on the country's net international investment and debt positions, and hence on its external financing requirements—a risk flagged in the public sector debt sustainability analysis.

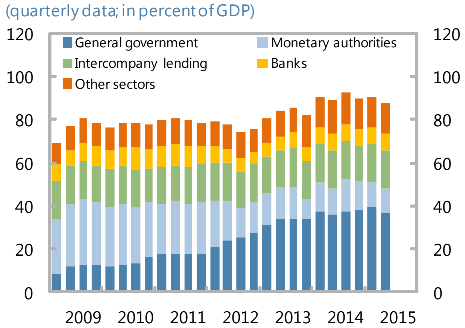
Summary Table

CA-Actual	-0.5%	CA-Fitted	-1.9%
CA-Norm	-2.6%	Residual	1.4%
CA-Gap	**2.1%**	Policy gap	0.7%
Elasticity	-0.59		
Real Exchange Rate Gap	**-3.6%**	Cyclical Contributions	-0.1%
		Cyclically adjusted CA	-0.4%
		Cyclically adjusted CA Norm	-2.5%

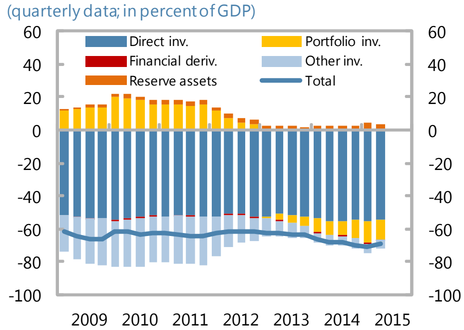
Capital and financial account. The downward trend in FDI inflows is estimated to have bottomed out in 2015, with a recovery projected in 2016–17, reflecting the planned investment of a fourth car maker. After a period of exceptionally large inflows, portfolio investment declined in 2014–15, partly due to lower net borrowing from abroad by the government. Net flows are projected to gradually converge to balance.

Foreign asset and liability position. External debt is forecast to reach 93 percent of GDP in 2015, while the net international investment position would stabilize at negative 70 percent. External vulnerabilities are mitigated by the long maturities of external debt and the large share of FDI among liabilities. Small current account surpluses are nonetheless appropriate in the medium term given the negative net international investment position.

External Debt
(quarterly data; in percent of GDP)



Net International Investment Position
(quarterly data; in percent of GDP)

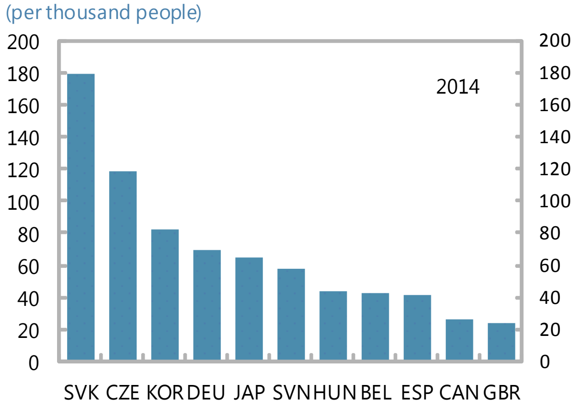


Sources: Eurostat; NBS; and IMF staff calculations.

Box 2. Slovakia's Automotive Sector and Trade Profile

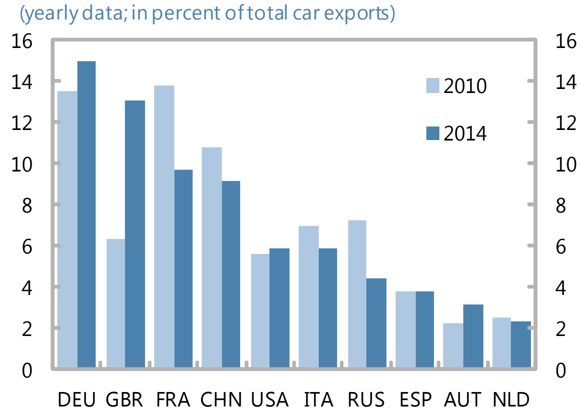
The automotive sector plays a crucial role in Slovakia's economy. The automotive sector grew out of large FDI inflows, attracted by competitive labor costs and a strategic location in the EU and at the heart of Europe. The adoption of the euro in 2009 reduced exchange rate risk, thus providing an additional incentive. The automotive industry accounts for 43 percent of Slovakia's total industrial production, and world market shares for Slovak vehicles have grown in recent years. The three car producers (Volkswagen, PSA Peugeot-Citroën, and Kia) employ 80,000 workers; taking into account suppliers boosts auto industry employment to 200,000 (about 9 percent of total employment). In 2014, car production was just under 1 million vehicles, making Slovakia the world's largest per capita car producer. Volkswagen accounts for about 40 percent of automobile production, while PSA Peugeot-Citroën and Kia have a share of 30 percent each. The core automotive industry generates 17 percent of Slovakia's gross value added, while suppliers account for an additional 22 percent, suggesting potentially significant spillovers within the economy.

Car Production
(per thousand people)



Sources: Oica; WDI; and IMF staff calculation

Car Exports: Top 10 Partners
(yearly data; in percent of total car exports)



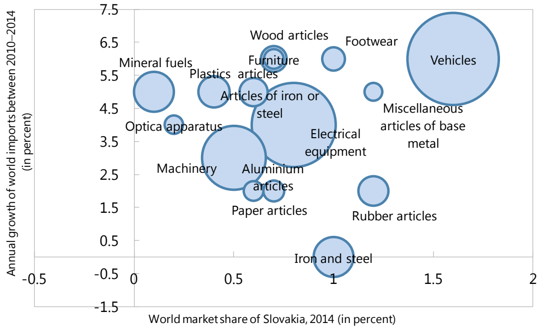
Sources: ITC and IMF staff calculation

Slovakia's trade is concentrated among relatively few countries. Five countries account for about 50 percent of total nominal exports: Germany (22 percent), Czech Republic (13 percent), Poland (8 percent), Austria and Hungary (6 percent each). Similar concentration can be observed on the import side with Germany ranking first (15 percent), followed by the Czech Republic (10 percent), and China (8 percent). If only the car industry is considered, almost all exports are shipped to Europe, with some re-routed to Asia and other markets via Germany. However, as an example, Slovakia's share of domestic value added consumed by China remains relatively low (around 2 percent).

Participation in global value chains (GVCs) has fostered convergence, but it also poses risks. Specialization in more downstream stages of GVCs and in a few specific industries makes Slovakia vulnerable to global market conditions.[1/] For instance, it is estimated that a 10 percent fall in car exports would shave 0.3-0.7 percentage points from GDP growth. Strong cost competition from neighboring countries adds to the challenges. To reduce risks, Slovakia might try to move up GVCs while also seeking gradually to diversify its production and trade partners, including by encouraging FDI from other countries and in other sectors. To this end, improving the business environment, fostering R&D through greater development of clusters, and upgrading skills and physical infrastructure are essential, while improving labor market efficiency (both in terms of flexibility and mobility) would help the economy adjust more rapidly to external shocks.

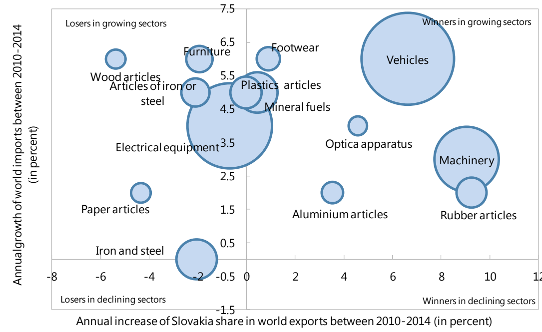
Box 2. Slovakia's Automotive Sector and Trade Profile (continued)

Size of national supply and international demand for products exported by Slovakia in 2014[1/]



Sources: ITC and IMF staff estimates.

Growth of national supply and international demand for products exported by Slovakia in 2014[1/]



Sources: ITC and IMF staff estimates.

1/ Bubble size is proportional to export value in US dollars (thousands).

[1/] Additional background can be found in: "German-Central European Supply Chain-Cluster Report," IMF Country Report No. 13/263, August 2013.

There are as yet no signs of broad changes in economic policy direction ahead of March 2016 parliamentary elections, although relatively modest "social packages" of spending and tax measures have been introduced.

Authorities' views

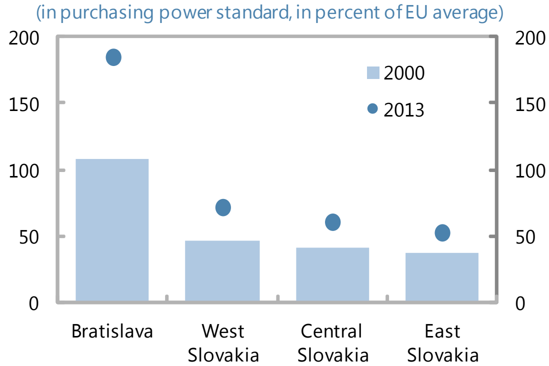
10. The authorities broadly agreed on the outlook and risks. They expect similarly solid growth through the medium term, but treat the Jaguar Land Rover investment as a further upside risk in their autumn forecasts, and foresee a somewhat faster decline in unemployment. They agree on the real exchange rate being in line with fundamentals. Direct spillovers from a slowdown in China or other emerging markets would likely be small, but indirect effects via major trading partners could be more sizeable. While acknowledging risks associated with the Volkswagen emissions scandal, high productivity at the company's relatively new Slovak plants is viewed as an important mitigating factor. The NBS stands ready to tighten macroprudential policies if needed (see below). The authorities viewed the EU quota system as unworkable given migrants' strong desire to reach wealthier destination countries, but have provided temporary housing to migrants awaiting asylum processing in Austria.

PROMOTING BROAD-BASED AND JOB-RICH GROWTH

Growth is strengthening and labor market conditions are improving. Nonetheless, high unemployment, especially long-term and among youth and women, as well as sharp regional differences remain key challenges. Spurring job-rich growth in lagging regions while addressing labor market exclusion and long-term demographic challenges calls for a comprehensive approach focused on accelerating infrastructure investment, lowering the tax wedge, orienting education toward workforce requirements, strengthening active labor market policies (ALMPs), and improving the business climate.

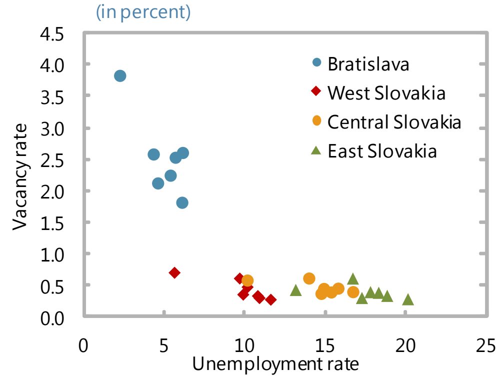
11. Strong exports have powered Slovakia's economy, but left some regions behind. Despite Slovakia's rapid economic convergence, regional disparities in terms of income and employment remain among the largest in the EU. Jobs are mostly created in the wealthiest regions, especially in or near Bratislava, where unemployment is low. Poor infrastructure discourages investment and job creation in less dynamic areas, and regional disparities are aggravated by low labor mobility, owing in part to high home-ownership and underdeveloped rental markets.

Per Capita Income
(in purchasing power standard, in percent of EU average)



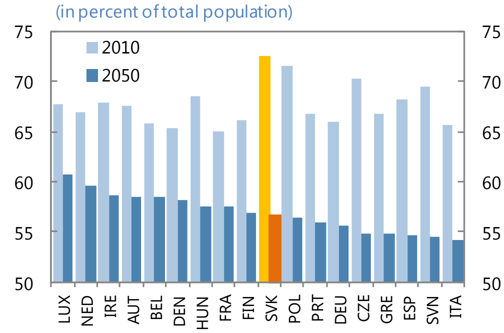
Source: Regional Statistical Office.

Beveridge Curve by Region (2008-2014)
(in percent)



12. The labor market is recovering, but subsets of the labor force face particular challenges, thereby depressing potential growth. About two-thirds of jobless are long-term unemployed, with a large share concentrated in eastern and southern regions. Youth unemployment, albeit declining, remains near 25 percent (Box 3). Slovakia compares unfavorably with European peers in terms of women's labor force participation and the gender pay gap. In addition, a disproportionate share of the Roma community is unemployed or inactive. Persistent unemployment and inactivity erodes skills and lowers participation, compounding adverse demographics and holding back potential growth.

Working Age Population
(in percent of total population)



Source: OECD.

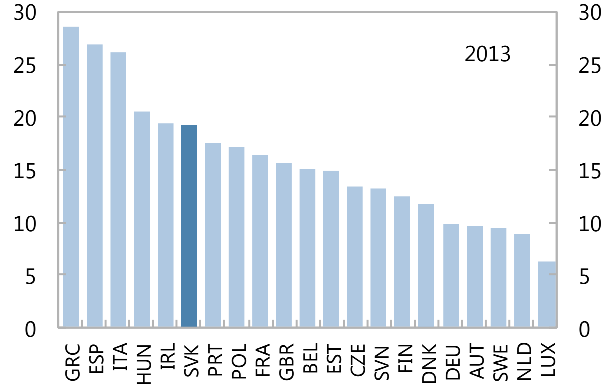
13. Spurring job-rich growth in lagging regions while addressing longer-term labor market and demographic challenges calls for a comprehensive approach:

- *Enhancing transportation infrastructure* and *strengthening the business climate* (e.g., improvements to the legal and procurement systems to address governance weaknesses) could encourage investment in weaker regions, and together with *reforms to promote rental housing* (e.g., phasing out support for home ownership, expanding means-tested rental housing allowances, and easing regulations that discourage property owners from renting), could promote labor mobility.

Box 3. Tackling High Youth Unemployment in Slovakia

Youth unemployment remains a key concern amidst improving labor market conditions. Even though overall unemployment is falling toward the EU average, more than two-thirds of the young population remains excluded from the job market, with the share of young people not in education, employment, or training high relative to EU peers. This suggests that for the young, skill mismatches and a poor school-to-work transition may exacerbate broader labor market challenges (e.g., a high tax wedge), and not getting off to a good career start can have a lasting impact on individuals (e.g., diminished skills and attachment to the workforce) and potential growth of the economy.

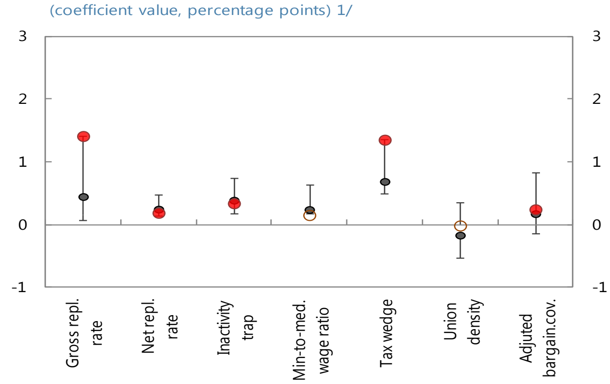
Young People Not in Education, Employment or Training
(in percent of total young population)



Source: OECD.

Economic disincentives help explain high youth unemployment in Slovakia. While growth has a powerful effect—indeed, youth unemployment in Slovakia has clearly fallen as growth has picked up in recent years—panel-based and country-specific analysis also highlight the labor tax wedge, which has increased over the past ten years, as an important factor contributing to youth unemployment in Slovakia. The gross replacement rate (GRR) also stands out and may reflect similar effects to the extent that high social contributions push up the GRR.[1/] These results reinforce the general arguments for reducing the relatively high tax wedge for low-income and low-skill workers.[2/]

Marginal Effect of Labor Market Characteristics on Youth Unemployment Level
(coefficient value, percentage points) 1/



Sources: Eurostat and IMF staff estimates.
Results based on country-specific regressions. 1/ Boxplots include the mean (black dot), the 25th and 75th percentiles (grey box, with the change of shade indicating the median), and the maximum and minimum (whiskers). The separate markers show the results for Slovakia (red dot = significant) and (red, empty dot = insignificant). Results for employment protection of temporary workers; total ALMP expenditure per unemployed; and ALMP spending on training, per unemployed were excluded for presentational clarity.

Better education and training initiatives should help address specific challenges faced by new workforce entrants. Legislation has sought to improve exchanges between schools and employers, including to tailor curriculums and vocational training to business needs, and importantly, a dual system for vocational education and practical training was launched in September 2015. EU-funded schemes have also helped create temporarily subsidized jobs for 700 young job-seekers (slightly more than 1.2 percent of total youth unemployment).

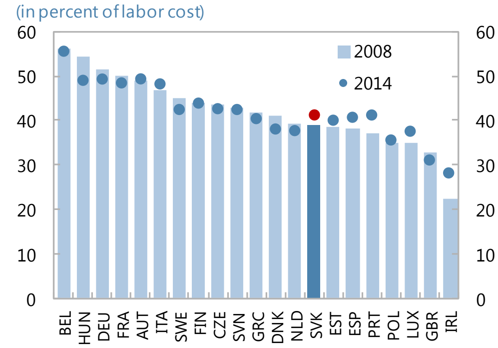
———————————

[1/] See also Banerji, Angana, Sergejs Saksonovs, Huidan Lin, and Rodolphe Blavy, 2014, "Youth Unemployment in Advanced Economies in Europe: Searching for Solutions," IMF Staff Discussion Note No. 14/11, December (https://www.imf.org/external/pubs/ft/sdn/2014/sdn1411.pdf).

[2/] European Commission, 2015, "Study on the Effects and Incidence of Labour Taxation," Taxation Papers, WP No. 56 (http://ec.europa.eu/taxation_customs/common/publications/services_papers/working_papers/index_en.htm).

- *Lowering the labor tax wedge*, especially for low-wage or part-time workers, would foster labor force participation and help reduce disincentives to hiring. In this spirit, the reduction in the health contribution allowance to offset the impact of the minimum wage increase in early 2015 was welcome.

Tax Wedge
(in percent of labor cost)



Source: OECD.

- *Strengthening education and training* would allay skill shortages, which are becoming more binding. Effective implementation of the recently launched dual vocational education system is essential to help meet labor market needs. Efforts to *improve elementary and secondary education,* especially for marginalized populations such as Roma where integration needs are substantial, should also be a high priority.

- *Comparatively low levels of active labor market policy (ALMP) spending should be raised and sustained*, and the planned evaluation of the various ALMPs should be completed to help maximize effectiveness.

- *Additional and more affordable childcare* could improve female labor force participation.

Authorities' views

14. The authorities agreed that regional disparities, skill mismatches, and especially high long-term unemployment, which can erode skills and undermine potential growth, are key challenges. The government is taking or considering action in a number of areas:

- *Infrastructure and regional disparities.* Stepped-up use of EU Funds is helping improve infrastructure and some incentives are being offered for investment in weaker regions. Initiatives to promote growth of the very limited rental housing market may be considered in the context of a third social package.

- *Education and training.* Financial incentives are being used to align better education and training with labor market needs; the recently launched dual system for vocational education will be scaled up in future years, and new curricula more relevant for potential jobs are being prepared; and temporary subsidies are being provided for jobs for unemployed young people. Efforts are also being made to support integration of marginalized communities.

- *Public Employment Service (PES) and ALMPs*. The government is committed to reform the PES and improve ALMP effectiveness. Steps have been taken to realize synergies through centralization of PES activities and reallocation of employees toward high need areas to strengthen the quality and efficiency of services. Reforms are to be implemented by 2020.

- *Labor taxes.* In November 2013, the government introduced a twelve month exemption from social security contributions for long-term unemployed returning to work. In January 2015, a reduction in health contributions for low-paid workers was adopted, which helped offset the impact of an increase in the minimum wage. The authorities felt both measures have supported the recent labor market upswing.

- *Female labor force participation.* Kindergarten capacity is being expanded and the childcare allowance has been increased modestly.

The authorities, however, cautioned that cultural and other non-economic factors meant near-term progress was likely to be limited in areas such as labor mobility, female labor force participation, and integration of marginalized groups.

15. The government outlined a broad strategy to improve the business climate. Initiatives are underway to assist development of start-ups, including a streamlined process for registration of public companies. Steps have been taken to strengthen contract enforcement through establishment of electronic registries of insolvent entities and disqualified persons. Use of an electronic marketplace for selected public procurements is now mandatory, as is disclosure of beneficial owners for companies interested in public procurement. A number of amendments have been passed to speed up the judicial process and promote court specialization.

ENSURING HIGH QUALITY FISCAL CONSOLIDATION

After a substantial narrowing of fiscal imbalances through 2013 to exit the EU's Excessive Deficit Procedure (EDP), fiscal consolidation progress has petered out. While economic conditions could argue for a supportive fiscal stance, other factors and especially the need for policy maneuver under FRA debt brakes point to the need for fiscal adjustment over the medium term. Broadening the tax base, enhancing revenue collection, and achieving spending efficiencies would help secure fiscal adjustment while funding key priorities and allowing for lower taxes on factors of production.

16. Institutional and structural factors point to the need for resuming fiscal consolidation. After four year of consolidation through 2013, which culminated in EDP exit, fiscal policy has been broadly neutral or even somewhat expansionary, with the deficit remaining between 2½ and 3 percent of GDP. Still high unemployment, large infrastructure needs, and subdued inflation could argue for a supportive fiscal stance, and borrowing conditions are favorable. However, the negative output gap is closing rapidly. In addition, for Slovakia, a prudent public debt ratio is likely to be lower than the current level (Box 4). Moreover, to allow fiscal policy to play a counter-cyclical role—crucial for a small open economy in a monetary union—a debt ratio safely below binding FRA debt brakes is necessary, and the debt brakes will begin falling in 2018, eroding already narrow fiscal space. Finally, lower debt is warranted in light of long-term fiscal challenges from one of the steepest population aging rates in Europe—challenges that have been aggravated by repeated opening of the private pension pillar.

Box 4. Should The Fiscal Responsibility Act Be Reformed? [1/]

To shore up budget credibility, Slovakia adopted the FRA in 2011. The framework includes rules to strengthen budget discipline, enhance accountability, and foster transparency.

Does the FRA provide a good fiscal rule?

In principle, debt rules can help improve countries' fiscal discipline. However, they may heighten pro-cyclicality and hamper the quality of fiscal adjustment when sanctions are substantial, as is the case for the FRA. In order to allow automatic stabilizers to operate and avoid pro-cyclical sanctions, debt levels need to be kept well below the thresholds.

Fiscal Responsibility Act

Debt level 1/ (in percent of GDP)		Action
until 2017	from 2027 onwards	
50% - 53%	40% - 43%	The Ministry of Finance sends a letter to the Parliament explaining the reasons for breaching the debt threshold and indicating measures for its reduction.
53% - 55%	43% - 45%	The government submits to the Parliament a proposal of measures for debt reduction and the wages of government members are frozen to the previous fiscal year level.
55% - 57%	45% - 47%	The Ministry of Finance reduces current year state budget expenditure by 3 percent (with specified exemptions such as interest payments, EU funds, co-financing and EU budget contributions) while restrictions apply to the release of funds from the reserves of the government and the Prime Minister. If the debt level exceeds this threshold for consecutive years, the reduction happens only in the first year. In addition, the government must submit to the parliament a general government budget for the subsequent year that does not increase the nominal expenditure level (with previously mentioned specified exemptions); it applies to local governments as well.
57% - 60%	47% - 50%	The government should submit to the Parliament a balanced (or in surplus) general government budget; it applies also to local governments.
> 60%	> 50%	The government asks the parliament for a vote of confidence.

Source: Constitutional Act of December 8, 2011 on Fiscal Responsibility.
1/ Starting in 2018, the debt ceilings will be gradually reduced by one percentage point of GDP each year to reach 40-50 percent of GDP by 2027.

Are FRA debt brakes reasonable?

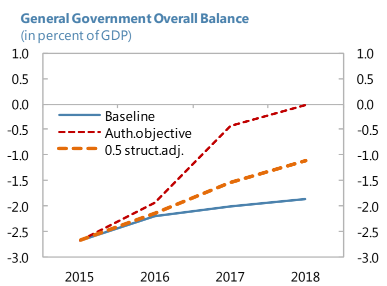
Unfortunately, there is no clear-cut answer. Empirical evidence shows that the relationship between debt and growth may be non-linear, suggesting country-specific thresholds beyond which negative effects kick in. For Slovakia, which lacks independent monetary policy as a euro area member but also shares some characteristics of an emerging economy, a prudent public debt ratio is likely to be below 50 percent of GDP. Two additional considerations support this view: (i) despite one of the lowest debt-to-GDP ratios in the EU and very narrow interest spreads, interest payments absorb about 5 percent of total revenue, which is broadly in line with the EU average and reflects a relatively low level of revenue-to-GDP; (ii) given limited absorption capacity of domestic markets, the share of government debt held by non-residents has steadily risen, thereby increasing vulnerability to sudden stops.

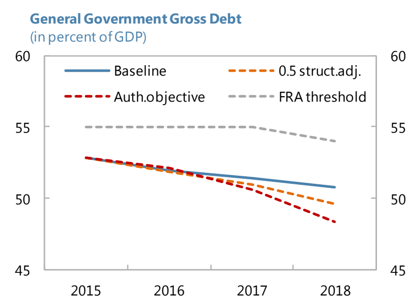
Should the debt brakes be on a gross or a net basis?

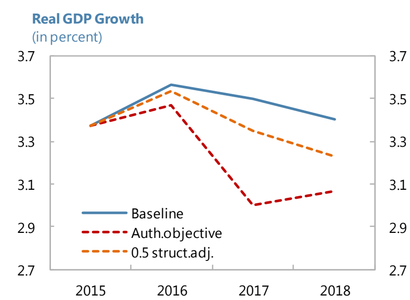
In principle, gross debt should be tracked separately from government assets since sharp swings in prices can distort underlying debt developments. Nonetheless, defining debt brakes on a gross basis may unduly constrain a country's debt management.

[1/] For more detailed analysis, see related Selected Issues Paper.

17. The 2016–18 budget plan sets ambitious fiscal targets to achieve a sharp adjustment and will be challenging to implement. The government targets deficits of 1.9 percent of GDP in 2016 and 0.4 percent of GDP in 2017 (thereby reaching the EU medium-term objective (MTO) of a structural deficit of 0.5 percent of GDP), and overall balance in 2018. The 2016 budget contains a number of deficit-increasing measures as part of social packages such as a reduction of the VAT rate on basic foodstuffs from 20 to 10 percent, gas price reimbursements for households, wage increases for some public sector employees and healthcare staff, and increases in maternity benefits and childcare allowances. Given that offsetting spending cuts, largely in government consumption, have not been specified in great detail, staff's baseline estimate is for a 2016 deficit of around 2.2 percent of GDP. Further negative risks stem from a possible third social package (to be specified in December and implemented if the current governing party remains in power), potential additional EU funds corrections, or other outlays (e.g., there is significant interest in a PPP road project which could entail initial costs). Under staff's no-policy change baseline scenario (measures to meet the 2017 and 2018 targets are still to be specified and thus are not reflected), the deficit would fall below 2 percent of GDP and the debt-to-GDP ratio would drop below 50 percent by 2020. A fiscal adjustment path broadly in line with EU requirements (0.5 percent of GDP annual improvement in the structural balance), and hence smoother than the one envisaged by the authorities, could be preferable in that it would have a lower impact on near-term growth while still putting the debt ratio on a safe downward trend, though this would imply postponing MTO achievement by two years.







Sources: Slovak Ministry of Finance and IMF staff projections.
The analysis is based on the IMF macroeconomic framework, which differs from that of the authorities.

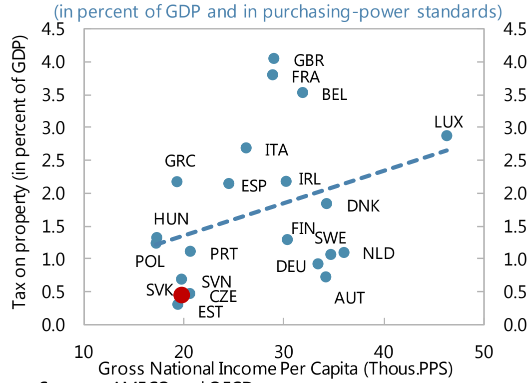
18. High-quality and growth-friendly fiscal consolidation would call for:

- *Enhancing tax compliance*. Slovakia has one of the largest VAT gaps in Europe and corporate income tax (CIT) compliance could also be strengthened. Building on good VAT collection progress in recent years, a one percentage point improvement in the effective VAT rate could yield 0.5 percent of GDP. It will be important to minimize risks from the reduced VAT rate on basic foodstuffs. As part of efforts to strengthen tax administration, plans to merge the tax, customs, and social security agencies should be sped up.

- *Broadening the tax base*. The government has adopted measures to fight CIT base erosion and profit shifting, but other areas should also be considered. Slovakia now collects little from a relatively regressive property tax based on square meters, and should accelerate the introduction of a market-value-based property tax; this could yield about 1 percent of GDP in revenue and would be more equitable and less harmful to growth than other taxes. Environmental taxation is also low compared to peers and could yield up to 2½ percent of GDP over the medium-term, according to EC estimates. Targeted measures could mitigate potential social concerns from tax regime changes.

Tax on Property and Income Level

(in percent of GDP and in purchasing-power standards)

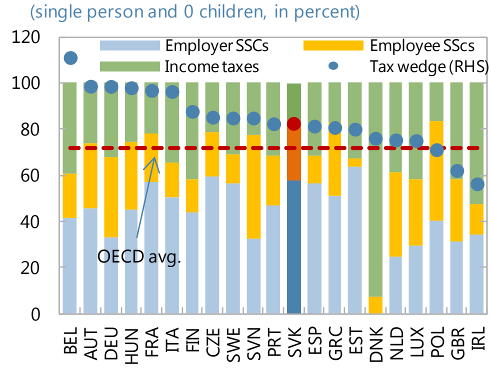


Sources: AMECO and OECD.

- *Rebalancing the tax mix*. Slovakia's current tax structure is distortive, with a comparatively high reliance on social security contributions (SSCs). The average tax wedge as well as the SSC share is higher in Slovakia than the OECD average. Although the CIT rate compares favorably with other OECD countries, it is the highest among the Visegrad countries. To preserve competitiveness and foster job creation, Slovakia should shift from labor and corporate taxes toward the less distortive revenue sources mentioned above.

Average Tax Wedge - Breakdown

(single person and 0 children, in percent)

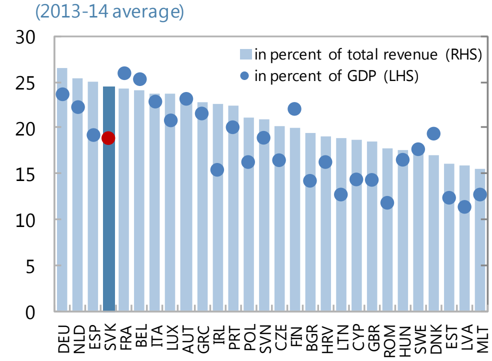


Source: OECD.

- *Improving spending efficiency*. Public expenditure remains relatively low compared to peers, and its structure is rather rigid; compensation of employees, interest payments, social benefits, and subsidies account for over 70 percent of total outlays. Consequently, cutting spending appears challenging. Nonetheless, beyond the ongoing initiative to make the government more efficient (ESO program), there is scope for expenditure rationalization, especially in the health sector, where the comparatively high level of spending does not translate into positive health outcomes. A comprehensive review of social benefits, where there is scope for better targeting, could also yield savings.

Social Benefits

(2013-14 average)



Source: Eurostat.

General Government Expenditure by Function, 2010-13

General government expenditure by function	In percent of GDP	In percent of total	Intermediate consumption	Compensation of employees	Gross capital formation	Social benefits	Other
Total	*40.6*	*100.0*	*13.2*	*20.0*	*8.2*	*46.5*	*11.9*
General public services	4.8	11.7	22.6	26.3	4.7	1.6	43.7
Defence	1.4	3.3	38.8	52.1	1.7	7.4	0.0
Public order and safety	3.2	7.9	21.9	56.3	12.5	7.8	1.0
Economic affairs	3.8	9.4	21.5	12.4	32.6	5.8	26.9
Environment protection	0.9	2.3	32.5	10.8	21.7	0.0	35.6
Housing and community amenities	0.9	2.1	24.3	0.0	43.9	12.1	21.4
Health	7.4	18.2	2.0	2.7	1.0	92.9	1.4
Recreation, culture and religion	1.3	3.2	26.8	23.2	19.0	0.0	30.2
Education	4.6	11.3	20.8	58.0	9.7	3.2	7.9
Social protection	12.5	30.6	2.2	5.2	0.6	89.4	2.6

< --- In percent of total expenditure in each category --->

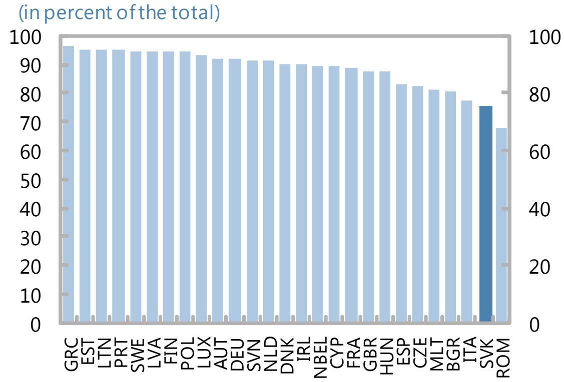
Sources: Eurostat and IMF staff calculations.

1/ Red cell indicates a value above the average of the Czech Republic, Hungary and Poland.

- *Funding priorities.* The above-mentioned measures could secure needed fiscal adjustment while still funding key spending priorities. In particular, Slovakia's low level and quality of capital infrastructure call for additional public investment, which could be supported by better implementation of EU funds, including through preparation of projects for the 2014–20 programming period.

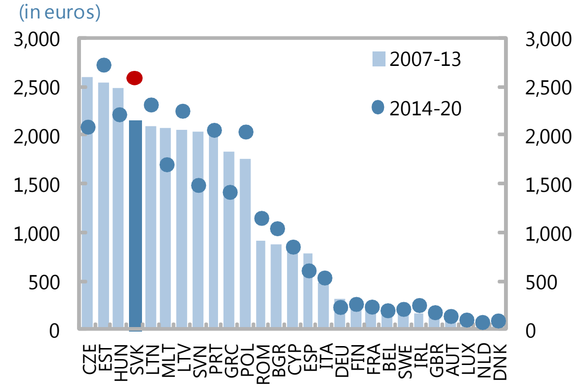
Funds Absorption Rate, Cohesion Policy 2007-2013

(in percent of the total)



EU Funds: Per-Capita Allocation

(in euros)



Sources: European Commission; Eurostat; and IMF staff calculations.

- *Reducing state ownership*. Even after full privatization of Slovak Telekom, state ownership remains sizeable with (direct or indirect) participation in a number of companies, mainly in the energy sector. Reducing state shareholdings would help lower debt in a growth-friendly way.

19. Modifications could make the FRA a more growth-friendly fiscal discipline tool. More gradual adjustment under the FRA would lessen potential pro-cyclicality, escape clauses could be better tailored to the size and nature of shocks Slovakia might face (e.g., it could take a 2009-size growth shock to trigger flexibility), and there might be less of a bias toward expenditure cuts. Although a prudent debt ratio should be maintained, keeping the FRA debt thresholds at the current levels would help preserve limited fiscal space. Netting out cash balances from government debt could facilitate debt management, for example through cash buffers or pre-financing when market conditions are favorable, but should be backed up by clear cash management guidelines.

Authorities' views

20. The authorities reaffirmed their commitment to sustainable public finances while improving living standards.

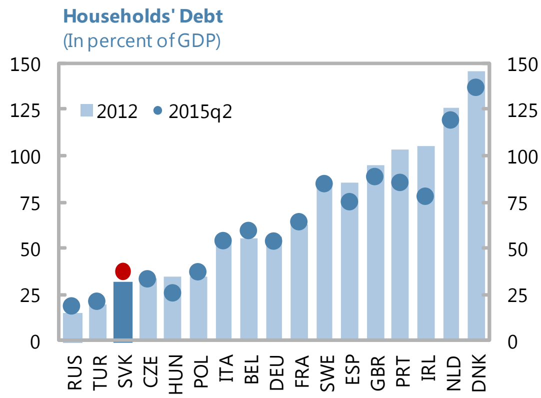
- *Budget*. The authorities are confident that improvements in tax compliance and expenditure savings, mainly in healthcare and public administration, will achieve the 2016 fiscal target. Moreover, early next year the government plans to start a major spending review program based on value-for-money analysis. The authorities underscored the results achieved so far in fighting tax evasion and fraud, especially regarding the VAT. In 2016, with a view to improving VAT collection efficiency, the so-called reverse-charge mechanism will be introduced for the construction sector, which has one of the highest VAT gaps. The government has also added 30 measures to its action plan to combat tax fraud aimed at enhancing collection.
- *Market-based real estate tax*. Implementing a market-based real estate tax will take time. The government is preparing reforms to upgrade the cadastre and to collect property transaction prices, which have not been available since the transaction tax was abolished in 2004.
- *FRA reform*. The benefits of reforms such as netting out cash balances were acknowledged, but amending the FRA is unlikely in the near term.

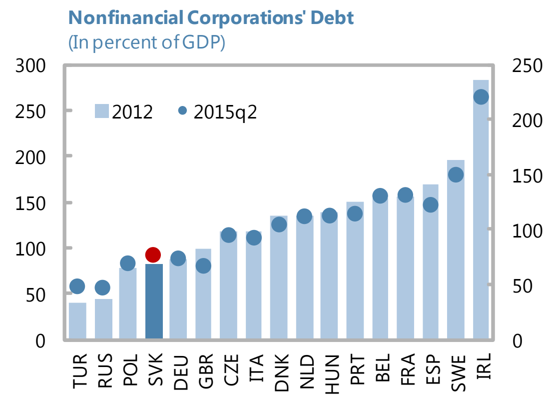
SAFEGUARDING FINANCIAL SOUNDNESS AMID HIGH CREDIT GROWTH

Despite recently introduced macroprudential measures, bank lending to households is growing at a brisk pace. Low private sector debt and high banking sector capital buffers limit vulnerabilities, but a stronger macro-prudential stance could be warranted.[1] *The low interest rate environment associated with ECB QE calls for closer monitoring of non-bank financial institutions. Steps are needed to deepen capital markets and improve access to finance.*

21. Accommodative monetary policy and robust domestic demand are fueling already strong household borrowing. Falling interest margins have led banks to boost lending, especially mortgages but also consumer loans, to maintain profitability. The increase in household debt, albeit from a low base, is among the largest in the EU, partially reflecting equity withdrawals through loan refinancing. In contrast, year-on-year credit from banks to non-financial corporates only recently turned positive.

[1] For more detailed analysis, see related Selected Issues Paper.

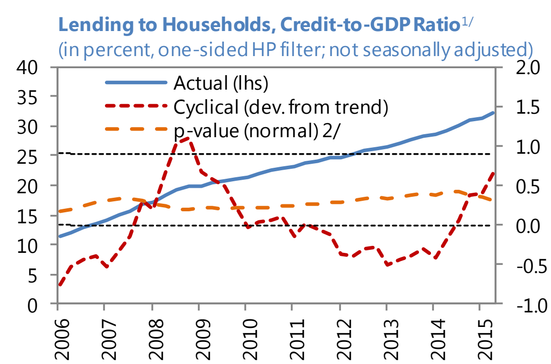




Sources: BIS and Haver.

22. Together with low private leverage, banks' sound capital and provision buffers mitigate immediate vulnerabilities. Banks are well-capitalized, with the Tier 1 capital ratio at 16 percent and leverage at a moderate 7.8 percent. In addition, a capital add-on of 2–3 percent for domestically systemically important banks will be phased in during 2016–18. Although NPLs have edged up, loan loss provisions still cover almost 70 percent of all impaired loans despite a recent slowdown in provisioning. The loan-to-deposit ratio is marginally above 90 percent, and liquid assets are high at 30 percent of total assets. Low real interest rates, rising disposable income, and broadly stable property prices are further mitigating factors.

23. To limit the buildup of credit risk, a stronger macroprudential stance may be warranted. NBS macroprudential recommendations are relatively lenient compared to those in other countries and might be strengthened to limit risks amidst rapid credit growth by:



Sources: BIS, ESRB, Haver, and IMF staff calculations.
The historical volatility of the credit gap is based on total credit over a five-year rolling window (starting Jan. 2001); 1/ GDP adjusted for output gap; 2/ statistical signficance based on a standard normal distribution of the cyclical deviation from trend.

- *Lowering the LTV limit.* With the planned transposition of its macroprudential recommendations into law, the LTV limit should be lowered from 90 to 85 percent, thus better aligning housing loan regulation with that of peers.
- *Introducing a debt-to-income ratio (DTI)*. The NBS should use authority under the planned law to issue clear guidance on a maximum ratio for overall debt-to-income of borrowers to enhance the effectiveness of the LTV limit.
- *Applying a counter-cyclical capital buffer (CCB).* If above-trend credit growth continues and broadens to the corporate sector, the adoption of a CCB of at least 0.5 percent would be warranted.
- *Adopt more tailored supply-side measures to address real-estate-related exposures*. Raising credit risk weights and imposing stricter loss-given-default assumptions on real estate-related

exposures would raise the cost of mortgage loans without affecting non-financial corporate borrowing. Implementation of the new European standards for loan classification would help, as would mandatory verification of external appraisals by lenders to avoid inflated collateral valuations.

24. Preparation will help ensure effectiveness of the bank resolution framework. Although there are no immediate risks, tests of the feasibility of resolution tools and cross-border coordination would facilitate readiness under the new European framework, especially given the large deposit base and the important role of foreign-owned banks. Allocation of the proceeds from the bank levy to a dedicated resolution fund would help finance the national contribution to the EU's Single Resolution Fund (SRF).

25. The low interest rate environment calls for close monitoring of non-bank financial institutions. Falling investment returns and rising long-term liabilities have made asset-liability matching of life insurance companies more difficult, potentially undermining the viability of guarantee-based products. The authorities should facilitate the transition towards unit-linked insurance products and explore the possibility of developing an industry-funded policyholder protection scheme, especially in the absence of a resolution mechanism for non-bank financial institutions.

26. Capital market development and integration could improve access to financing. A better functioning capital market could offer firms alternative sources of finance, provide additional investment options for savers, and make it easier for banks to issue more long-term debt such as covered bonds. A more stable approach to the second pension pillar, as well as regulations that encourage more diversified investment strategies, could help foster institutional investors and capital market development. Targeted efforts underway to promote financing for small and innovative firms are welcome and could be further supported by an EU Capital Markets Union. Links to other stock exchanges in the region should also be explored to promote market access.

Authorities' views

27. The NBS viewed the macro-prudential policy stance as appropriate but reaffirmed its readiness to act if needed. While the direct impact on credit growth of current measures has been limited, recommendations have improved lending standards in general. The NBS is currently reviewing the possibility of introducing a CCB but has deferred any action until there is more conclusive evidence of excessive credit growth, including a broadening to corporate borrowing. The NBS considers macro-financial vulnerabilities associated with the low-interest rate environment limited since most insurance companies have started offering non-guaranteed products. The government plans to reduce capital gains taxes and transaction fees, including through establishment of a new central depository, which would support domestic capital market development.

STAFF APPRAISAL

28. Growth is picking up as domestic demand strengthens further. Rising investment, reflecting especially stepped-up use of EU funds, as well as strong private consumption in the context of a recovering labor market and real wage gains, have led to solid domestic demand-driven growth. Although inflation is expected to remain slightly negative this year due to falling energy costs, prices should rise in 2016 as the output gap closes.

29. External factors present the greatest risks to Slovakia's largely positive outlook. A sound and liquid banking sector, low private sector leverage, and limited public debt enhance resilience to shocks. If, however, key trading partners such as Germany were hit by adverse developments—whether due to euro area weakness, a China or emerging market slowdown, or tensions between Russia and Ukraine—Slovakia's important export sector would be affected. On the domestic side, rapid household credit growth could sow financial sector risks, while high long-term unemployment could undermine potential growth.

30. High unemployment, inactivity, and regional disparities call for a comprehensive approach. Despite the recent pickup in job creation, the unemployment rate remains in double digits, with particular challenges for the long-term unemployed, youth, and women. Enhancing transportation infrastructure and strengthening the business climate would encourage investment in weaker regions, and together with reforms to promote rental housing, could facilitate labor mobility. Reducing the labor tax wedge, especially for low-wage or part-time workers, would encourage labor force participation and hiring. Enhancing education and training, together with strengthening the effectiveness of ALMPs, would allay rising skill shortages. Improved childcare options could facilitate greater workforce participation by women.

31. High-quality fiscal measures are needed to ensure room for policy maneuver while advancing priorities. A moderate pace of further fiscal adjustment would ensure sufficient headroom under domestic debt rules so that fiscal policy could play a counter-cyclical role in the future, and would help address longer-term fiscal challenges associated with population aging. Enhancing revenue collection, broadening the tax base including through a market value-based real estate tax, and achieving spending efficiencies, especially in the health sector and through a review of social benefits, would help secure needed adjustment while funding key priorities. These include steps to address labor market challenges and regional disparities, and to reduce the tax burden on production factors. Reducing still sizeable state shareholdings would enable further growth-friendly debt reduction.

32. Modifications to the FRA should be considered to lessen potential negative economic effects while maintaining fiscal discipline. Possible changes include a more gradual pace of adjustment when debt brakes are crossed, more realistic escape clauses, netting out cash balances, and less bias toward expenditure cuts. Keeping current debt brake levels (50–60 percent of GDP) rather than allowing them to progressively fall starting in 2018 as stipulated under the FRA would help preserve fiscal space.

33. Additional macroprudential measures would help guard against risks from rapid credit growth. Although household debt is relatively low and banks enjoy sound capital and liquidity buffers, to limit financial stability risks, the LTV limit should be lowered and clear guidance should be issued on a maximum DTI ratio. If above-trend credit growth continues and broadens to the corporate sector, a counter-cyclical capital buffer of at least 0.5 percent would be warranted. In the near term, more targeted measures on real estate-related exposures should be considered.

34. Bank resolution tools should be tested. Although there are no immediate risks on the horizon, the new European resolution framework and cross-border coordination should be tested, especially given the importance of deposit funding and foreign-owned banks. Bank levy proceeds should be placed in a dedicated resolution fund to be used for Slovakia's SRF contribution.

35. Low interest rates call for close monitoring of non-bank financial institutions. With exceptionally low interest rates potentially undermining the viability of guarantee-based products for life insurers, development of an industry-funded policyholder protection scheme should be explored.

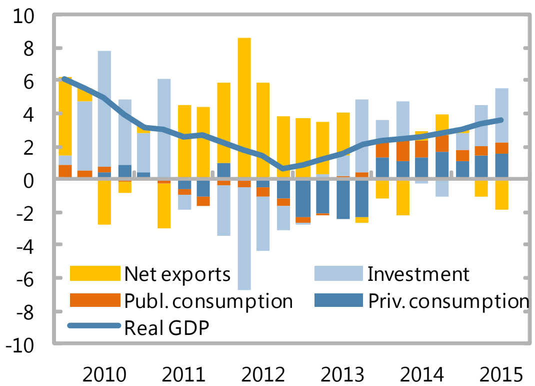
36. Further capital market development would enhance access to finance. Steps to facilitate financing for small and innovative firms and plans to reduce capital gains taxes and transaction fees are welcome, and could be complemented by an EU Capital Markets Union and links to other stock exchanges. A more stable second pension pillar would encourage growth of institutional investors.

37. 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

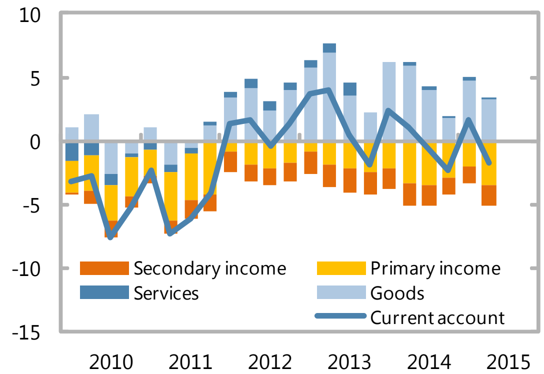
Domestic demand is driving growth…

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



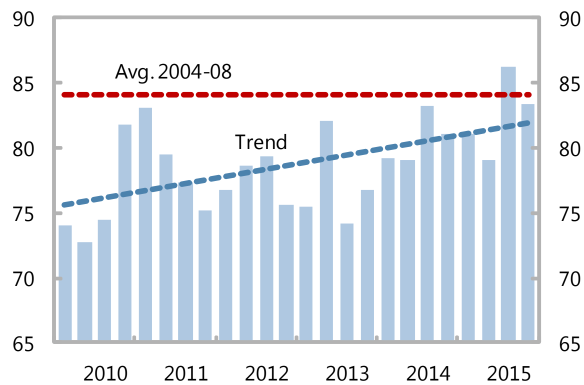
…and the external surplus has faltered…

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



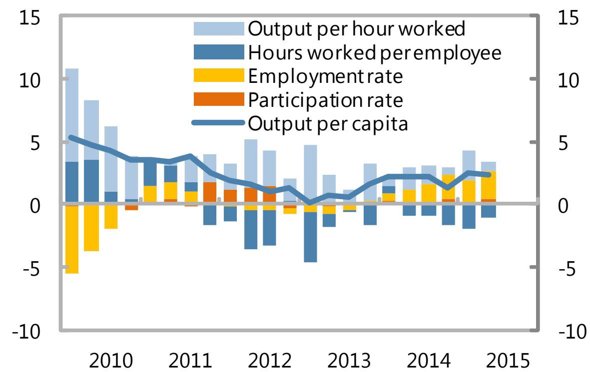
…while capacity utlization has tightened.

Capacity Utilization
(quarterly data; in percent)



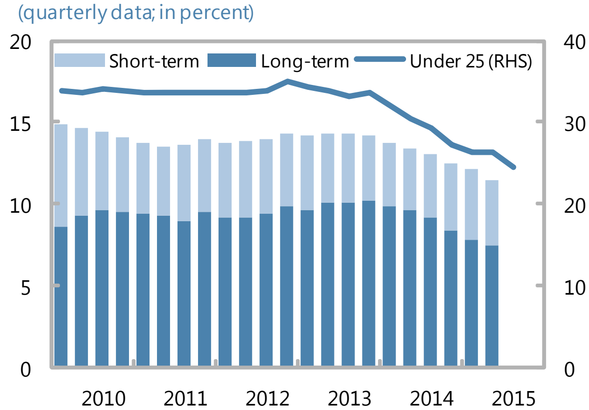
Job creation has gone hand-in-hand with productivity growth…

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



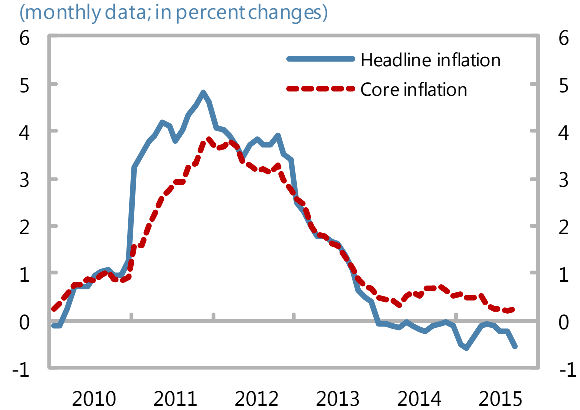
…and has dented the unemployment rate.

Unemployment
(quarterly data; in percent)



Food and oil prices have pushed inflation into negative territory, although core iflation is also low.

Inflation
(monthly data; in percent changes)



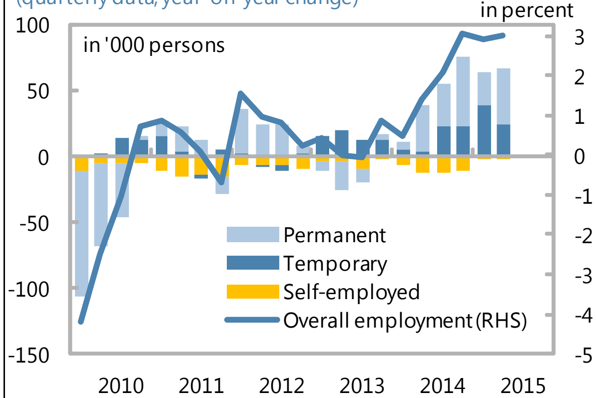
Sources: Eurostat; Haver Analytics; and IMF staff calculations.

Figure 2. Slovak Republic: Labor Market Developments

Employment growth has accelerated…

Employment

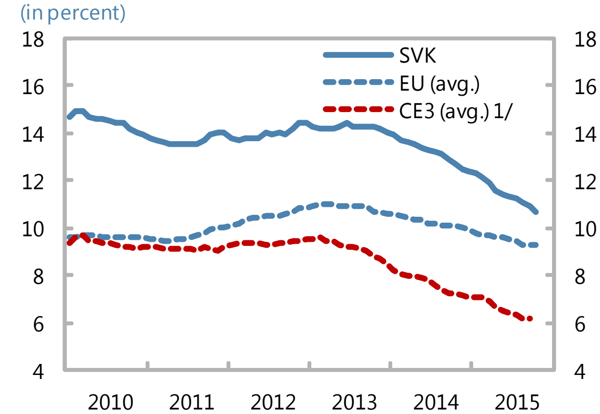
(quarterly data; year-on-year change)



…with unemployment drifting toward the EU average…

Unemployment

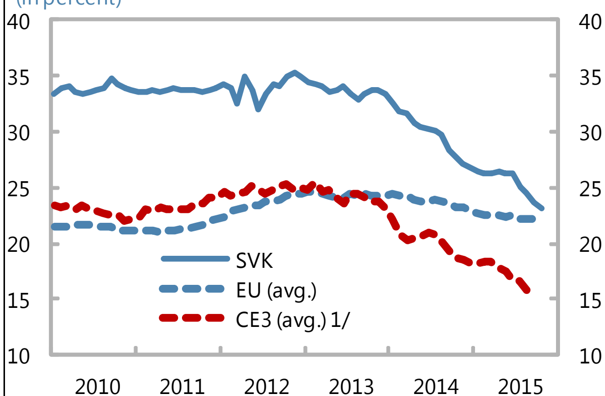
(in percent)



… particularly among young people.

Youth Unemployment

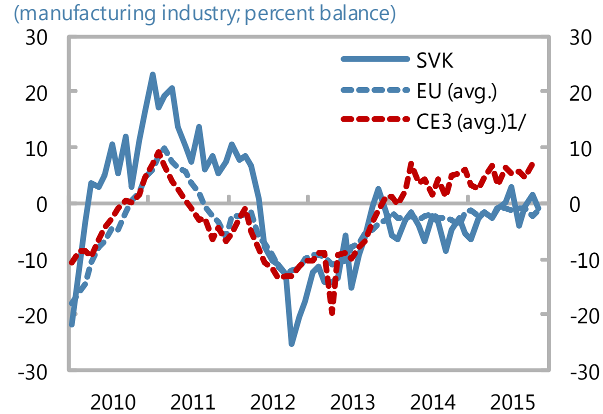
(in percent)



Employment expectations have improved…

Employment Expectations

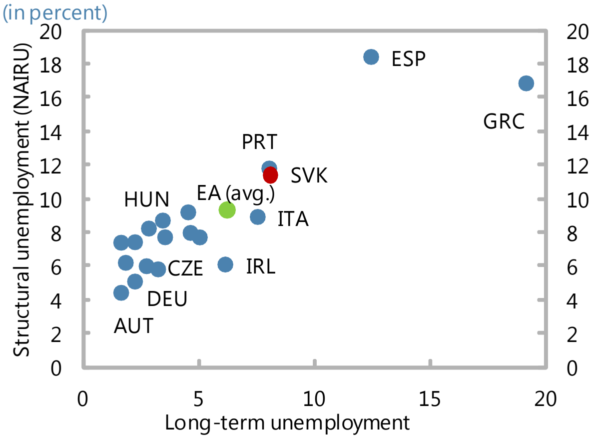
(manufacturing industry; percent balance)



…but structural joblessness is high…

Long-Term and Structural Unemployment, 2014

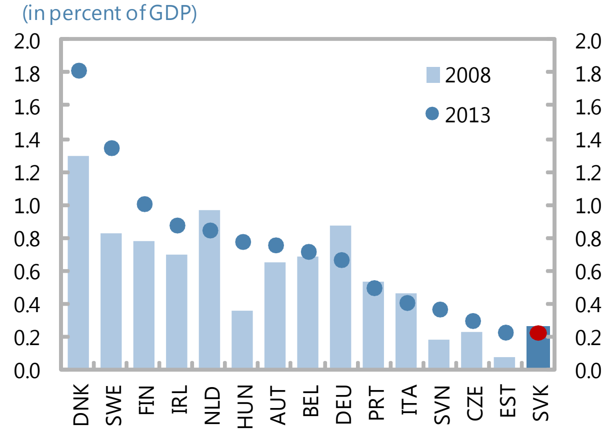
(in percent)



…and spending on labor market policies is low.

Public Expenditure on Active Labor Market Policies

(in percent of GDP)



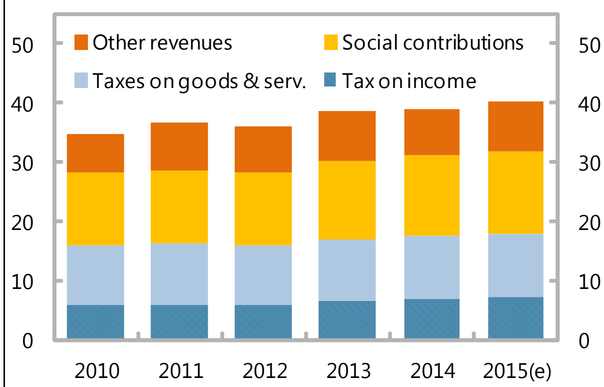
Sources: Eurostat; OECD; and IMF staff calculations.

1/ CE3 comprises the Czech Republic, Hungary, and Poland.

Figure 3. Slovak Republic: Fiscal Developments

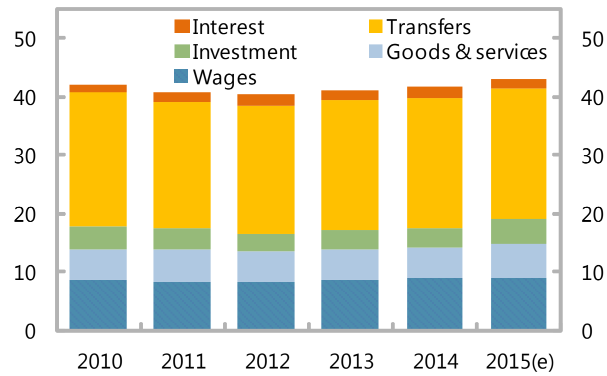
Revenue has risen slightly as a share of GDP…

General Government Revenue
(in percent of GDP)



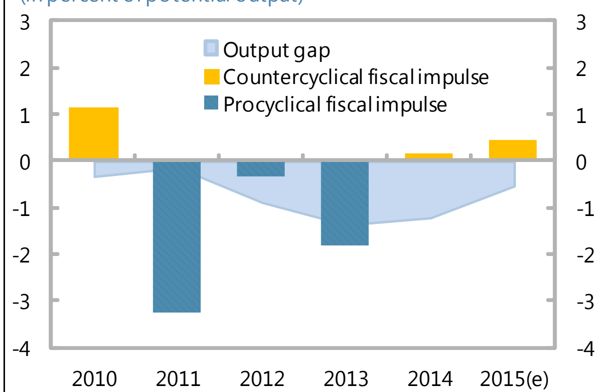
…whereas expenditure has remained broadly stable.

General Government Expenditure
(in percent of GDP)



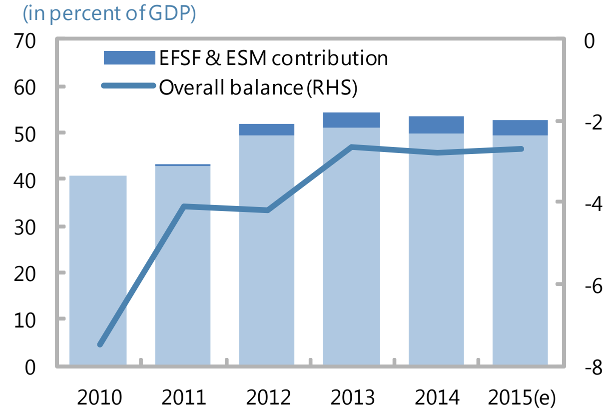
The fiscal impulse is close to neutral…

Fiscal Impulse
(in percent of potential output)



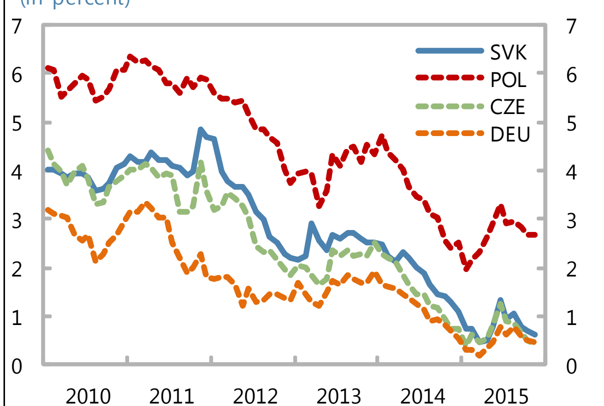
…while debt-to-GDP has broadly stabilized.

General Government Balance and Gross Debt
(in percent of GDP)



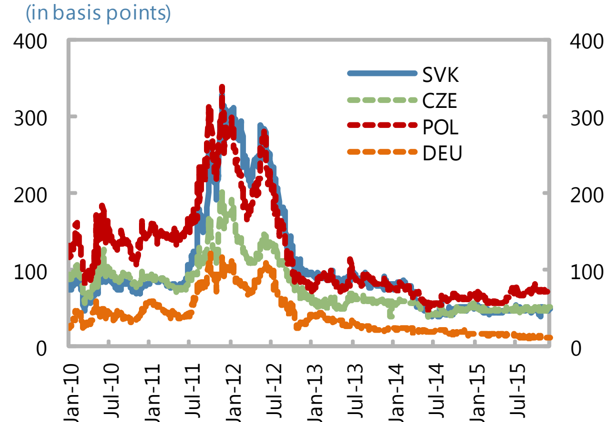
QE has further compressed bond yields…

Government 10-Year Bond Yields
(in percent)



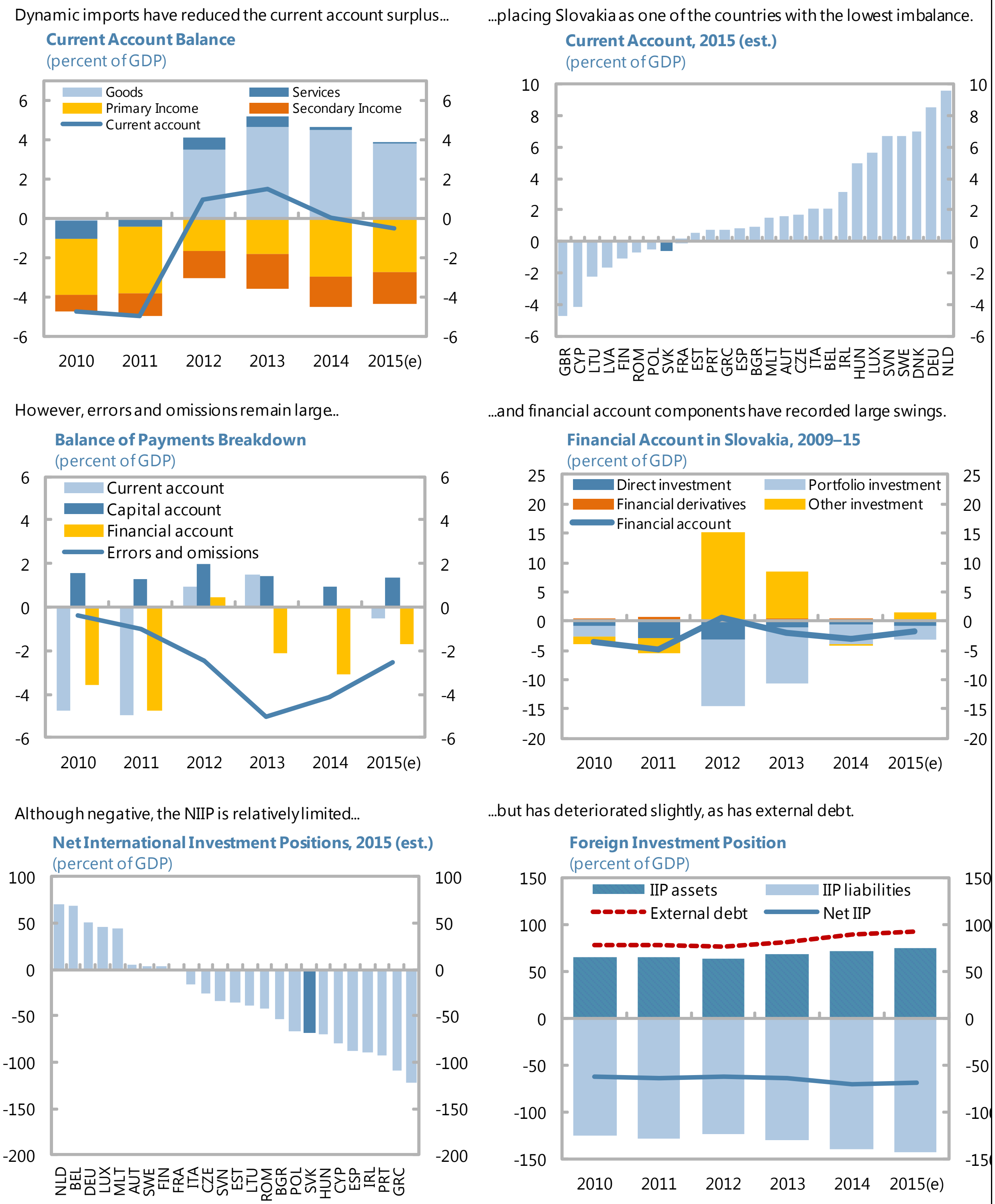
…and default risk remains low.

5-year CDS Spreads
(in basis points)



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

Figure 4. Slovak Republic: External Developments

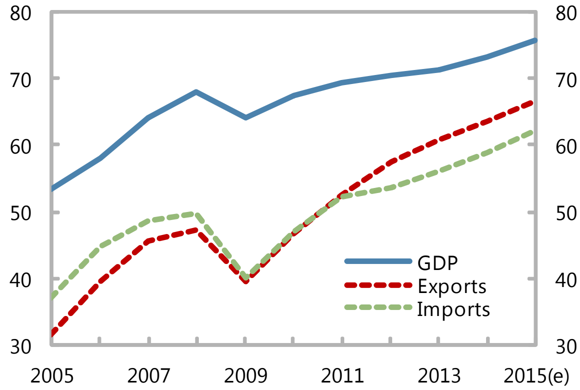


Sources: Eurostat; Haver; and IMF staff estimates.

Figure 5. Slovak Republic: Competitiveness Indicators

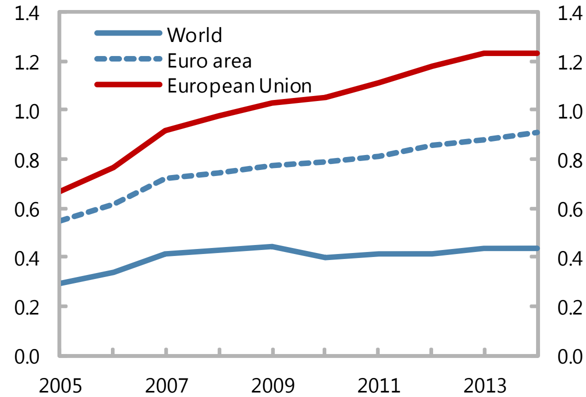
Export growth remains solid…

Real GDP, Export and Import of Goods
(billion of euros, constant prices)



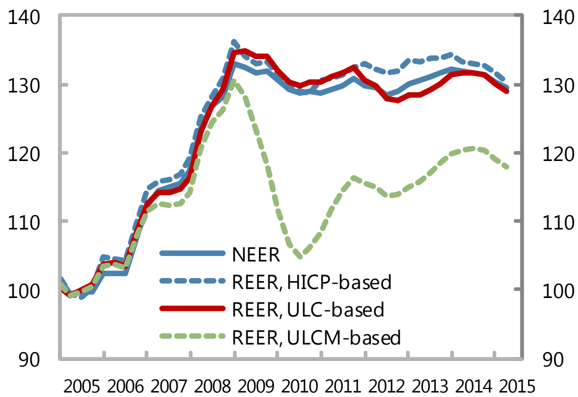
…and market shares have continued to increase.

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



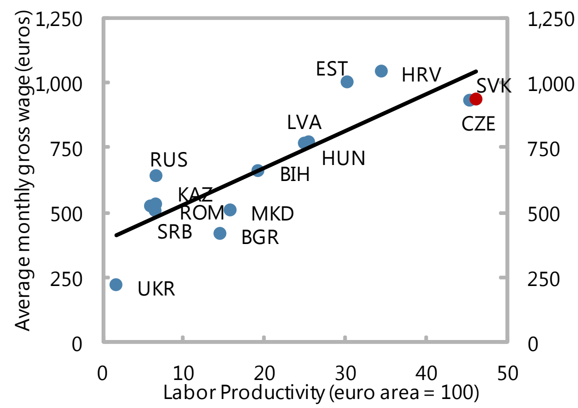
The real exchange rate has largely stabilized…

Nominal and Real Effective Exchange Rates
(2005=100)



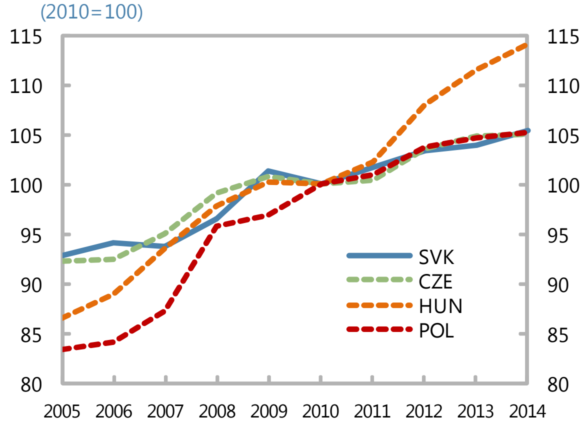
…as wages remain low relative to productivity…

Labor Productivity and Wages, 2014



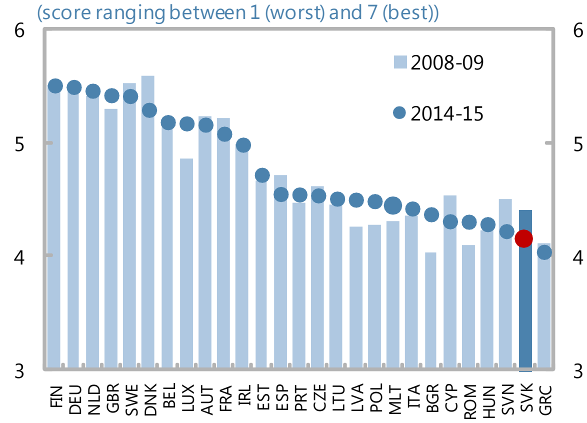
…but unit labor costs have trended upwards…

Unit Labor Cost
(2010=100)



…while the business environment has deteriorated

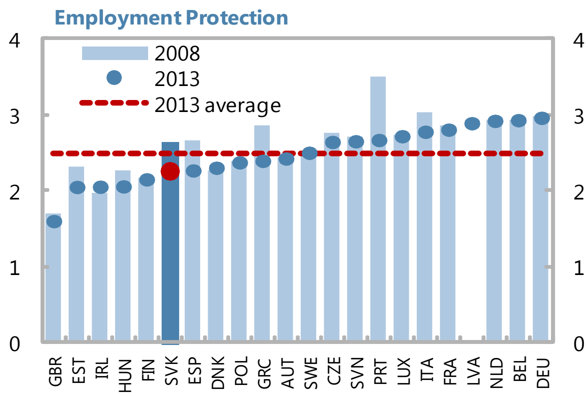
Global Competitiveness Index
(score ranging between 1 (worst) and 7 (best))



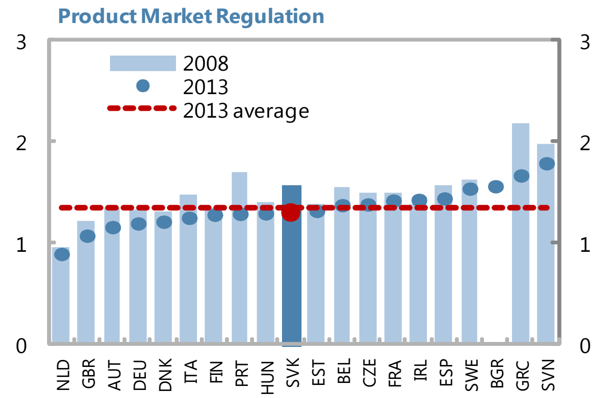
Sources: Eurostat; Haver; World Economic Forum; IMF DOTS; IMF WEO; and IMF staff calculations.

Figure 6. Slovak Republic: Structural Indicators[1/]

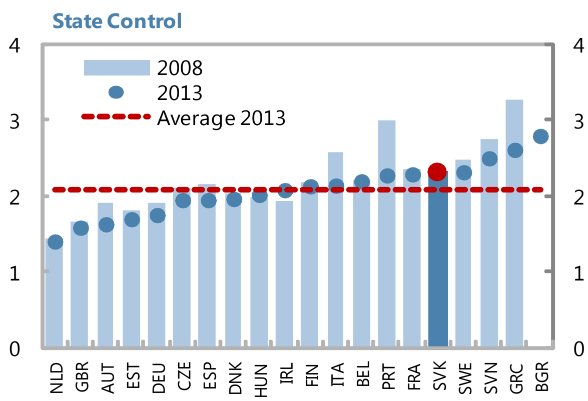
Despite some recent tightening, Slovakia's employment protection legislation compares reasonably well with peers…



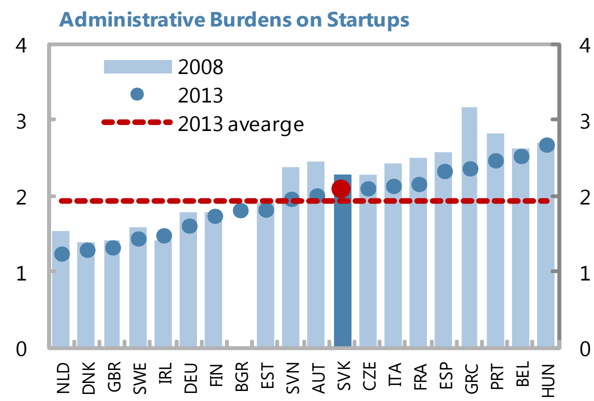
… as does product market regulation, in general.



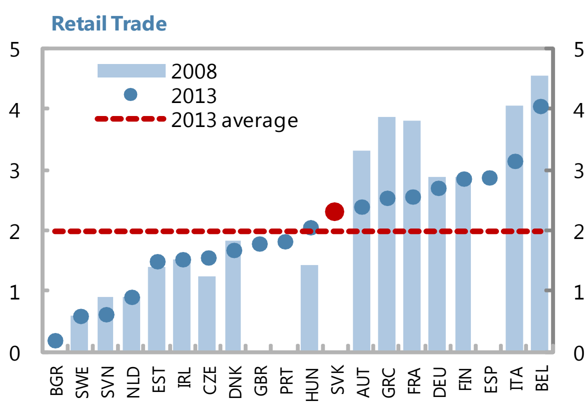
However, there are margins to reduce state control in the economy…



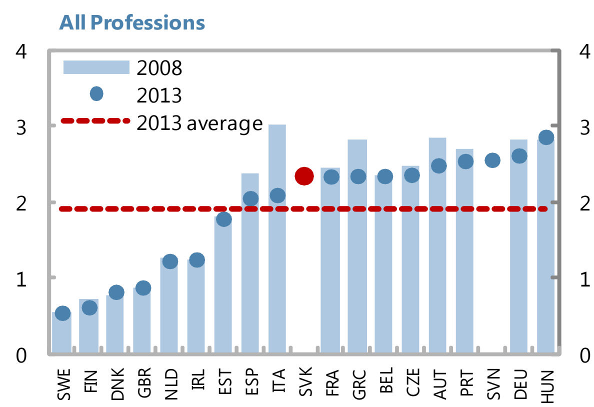
…and the administrative burden for start-ups.



Competition in the retail sector could be improved…



…and professional services might be liberalized further.

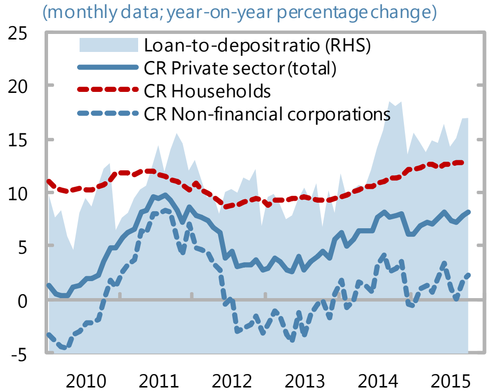


Source: OECD.
1/ Performance is measured on a scale of 0 to 6 with lower values considered better in terms of the business environment.

Figure 7. Slovak Republic: Monetary and Banking Developments

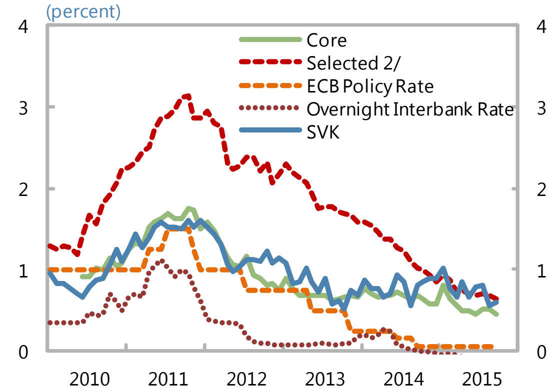
Credit has grown amid stable funding conditions…

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



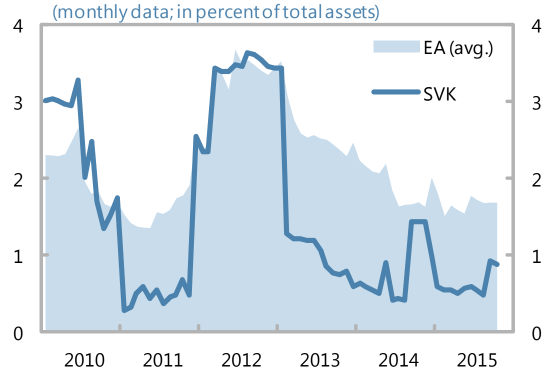
….with deposit rates very low…

Deposit rates 1/
(percent)



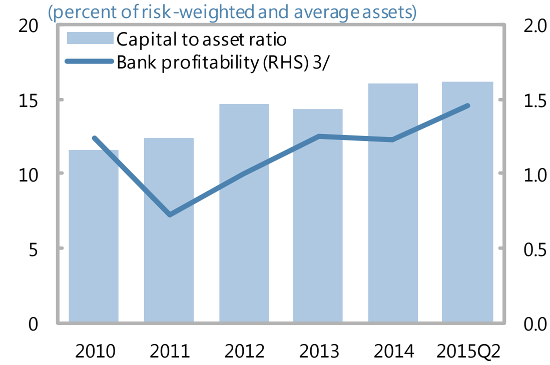
…and very limited ECB borrowing.

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



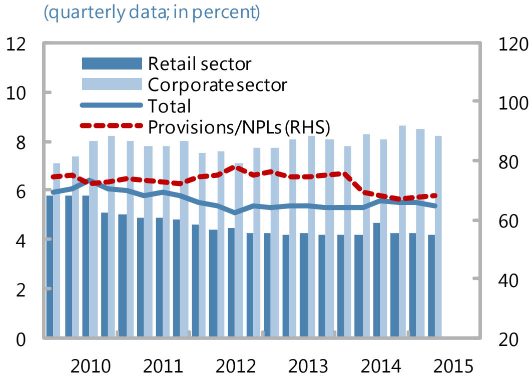
Capital buffers and profitability are sound…

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



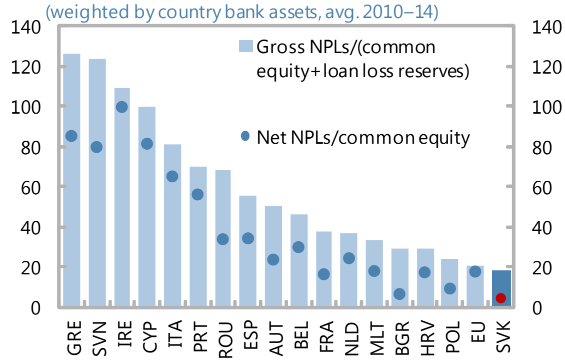
…while the share of non-performing loans remains broadly stable…

Nonperforming Loans and Provisions
(quarterly data; in percent)



… with high provisioning rates.

Europe: "Texas Ratio" (NPL to Common Equity and Loan Loss Reserves)
(weighted by country bank assets, avg. 2010–14)



Sources: EBA; Haver; National Bank of Slovakia; Global Financial Stability Report; SNL; and IMF staff calculations.
1/ Values are weighted by total assets of banks within each country.
2/ Average of deposit interest rates in Italy, Portugal and Spain.
3/ Net income after taxes on average assets.

Table 1. Slovak Republic: Summary of Economic Indicators, 2012–20

	2012	2013	2014	2015	2016	2017	2018	2019	2020
				Projections					
	(Annual percentage change, constant prices, unless noted otherwise)								
Output/Demand									
Real GDP	1.5	1.4	2.5	3.4	3.6	3.5	3.4	3.3	3.2
Domestic demand	-4.2	0.3	3.1	4.1	3.3	3.8	3.2	2.9	2.6
Public consumption	-2.6	2.2	5.9	3.8	3.4	2.6	2.5	2.5	2.4
Private consumption	-0.4	-0.8	2.3	2.3	2.9	2.8	2.6	2.6	2.5
Gross fixed capital formation	-9.2	-1.1	3.5	9.7	4.3	7.4	5.1	4.1	2.9
Exports of goods and services	9.3	6.2	3.6	6.5	5.6	5.6	6.0	6.0	6.1
Imports of goods and services	2.5	5.1	4.3	7.5	5.4	6.0	5.8	5.7	5.7
Potential Growth	2.3	1.9	2.4	2.7	3.1	3.2	3.4	3.4	3.3
Output Gap	-0.9	-1.4	-1.2	-0.5	0.0	0.2	0.2	0.2	0.1
Contribution to growth									
Domestic demand	-4.2	0.3	2.9	4.0	3.2	3.7	3.1	2.8	2.5
Public consumption	-0.5	0.4	1.1	0.7	0.7	0.5	0.5	0.5	0.5
Private consumption	-0.2	-0.5	1.3	1.3	1.6	1.6	1.4	1.4	1.4
Gross fixed capital formation	-2.2	-0.2	0.7	2.0	0.9	1.6	1.2	1.0	0.7
Inventories	-1.3	0.6	-0.2	0.0	0.0	0.0	0.0	0.0	0.0
Net exports	5.7	1.2	-0.4	-0.6	0.3	-0.2	0.3	0.5	0.7
Prices									
Inflation (HICP)	3.7	1.5	-0.1	-0.3	0.7	1.6	1.8	1.9	2.0
Inflation (HICP, end of period)	3.4	0.4	-0.1	-0.2	1.4	1.7	1.8	1.9	2.0
GDP deflator	1.3	0.5	-0.2	-0.2	0.6	1.4	1.6	1.8	1.9
Employment and wages									
Employment	0.1	-0.8	1.4	2.0	1.7	1.3	1.0	0.8	0.8
Unemployment rate (percent)	14.0	14.3	13.2	11.6	10.4	9.7	9.3	9.3	9.3
Nominal wages	2.5	2.3	4.1	3.3	3.5	3.8	3.9	4.0	4.0
	(In percent of GDP)								
Public Finance, General Government									
Revenue	36.0	38.4	38.9	40.1	38.3	38.2	38.0	37.9	37.8
Expenditure	40.1	41.0	41.6	42.8	40.5	40.2	39.8	39.7	39.6
Overall balance	-4.2	-2.6	-2.8	-2.7	-2.2	-2.0	-1.8	-1.8	-1.8
Primary balance	-2.4	-0.8	-0.9	-1.0	-0.6	-0.5	-0.5	-0.5	-0.5
Structural balance (percent of potential GDP)	-3.9	-2.1	-2.6	-2.5	-2.1	-2.1	-1.9	-1.9	-1.8
General government debt	51.9	54.6	53.5	52.8	52.1	51.6	51.0	50.3	49.7
excl. Intergov. lending fin. crisis	49.5	51.3	50.0	49.4	48.8	48.5	48.0	47.5	47.0
	(In percent)								
Monetary and financial indicators									
Bank credit to private sector (growth rate)	2.8	5.6	6.1	…	…	…	…	…	…
Lending rates 1/	4.4	4.1	4.0	…	…	…	…	…	…
Deposit rates 2/	1.4	1.0	0.9	…	…	…	…	…	…
Government 10-year bond yield	3.3	3.2	2.1	…	…	…	…	…	…
	(In percent of GDP)								
Balance of payments									
Trade balance (goods)	3.5	4.6	4.4	3.8	4.0	3.8	4.0	4.3	4.8
Current account balance	0.9	1.5	0.1	-0.5	-0.5	-0.5	-0.4	0.0	0.7
Gross external debt	75.8	81.9	89.7	92.8	91.9	90.1	87.9	85.5	83.2
Saving and investment balance									
Gross national savings	21.9	22.5	21.0	21.4	21.5	22.1	22.5	22.9	23.5
Private sector	23.4	22.6	20.9	20.4	21.1	21.5	21.7	22.1	22.6
Public sector	-1.5	-0.1	0.1	1.0	0.3	0.6	0.8	0.8	0.9
Gross capital formation	21.0	21.0	20.9	21.9	22.0	22.6	22.9	22.9	22.8

Sources: National Authorities and IMF staff calculations.

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

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

Table 2A. Slovak Republic: Statement of Operations of the General Government, 2012–20

(In millions of euros)

				Projections					
	2012	2013	2014	2015	2016	2017	2018	2019	2020
Revenue	**26,037**	**28,329**	**29,364**	**31,302**	**31,092**	**32,521**	**34,015**	**35,677**	**37,426**
Taxes	11,391	12,347	13,165	13,869	14,275	14,854	15,464	16,205	16,988
Personal income tax	2,123	2,175	2,295	2,442	2,569	2,702	2,835	2,973	3,126
Corporate income tax	1,715	2,118	2,398	2,589	2,684	2,814	2,959	3,114	3,275
VAT	4,328	4,696	5,021	5,246	5,384	5,625	5,876	6,143	6,424
Excises	2,120	2,156	2,196	2,272	2,307	2,362	2,418	2,528	2,643
Other taxes	1,106	1,202	1,255	1,320	1,330	1,352	1,376	1,447	1,521
Social contributions	9,047	9,940	10,289	10,708	11,158	11,730	12,311	12,914	13,541
Grants	807	818	1,195	2,184	1,234	1,495	1,771	1,861	1,957
Other revenue	4,793	5,225	4,715	4,541	4,424	4,443	4,469	4,697	4,939
Expenditure	**29,077**	**30,284**	**31,462**	**33,387**	**32,893**	**34,253**	**35,669**	**37,411**	**39,220**
Expense	26,845	27,946	28,897	30,036	30,323	31,556	32,834	34,432	36,087
Compensation of employees	5,876	6,243	6,580	6,854	7,120	7,392	7,679	7,986	8,302
Use of goods and services	3,787	3,853	3,984	4,558	4,243	4,413	4,637	4,874	5,125
Interest	1,280	1,384	1,441	1,279	1,303	1,285	1,168	1,251	1,295
Subsidies	690	772	717	738	755	793	833	876	921
Grants	1,154	1,283	1,351	1,134	1,132	1,187	1,271	1,336	1,404
Social benefits	13,579	13,934	14,354	14,737	15,248	15,939	16,702	17,556	18,459
Other expense	479	478	469	735	521	547	545	553	581
Net acquisition of nonfinancial assets	2,232	2,338	2,565	3,352	2,570	2,697	2,835	2,980	3,133
Gross Operating Balance	-808	383	467	1,267	769	965	1,181	1,245	1,339
Net lending(+)/borrowing(-) (overall balance)	**-3,040**	**-1,955**	**-2,098**	**-2,085**	**-1,802**	**-1,732**	**-1,654**	**-1,734**	**-1,794**
Net financial transactions	-3,040	-1,955	-2,098	-2,085	-1,802	-1,732	-1,654	-1,734	-1,794
Net acquisition of financial assets	4,245	1,475	-1,519	-1,298	-719	0	0	0	0
Currency and deposits	2,831	437	-2,231	-1,298	-719	0	0	0	0
Debt securities	-5	1	-10	0	0	0	0	0	0
Loans	1,420	581	74	0	0	0	0	0	0
Equity and investment fund shares	185	-28	-171	0	0	0	0	0	0
Other financial assets	-185	484	820	0	0	0	0	0	0
Net incurrence of liabilities	7,285	3,430	579	787	1,083	1,732	1,654	1,734	1,794
Currency and deposits	-9	17	-5	0	0	0	0	0	0
Debt securities	5,981	1,788	886	787	1,083	1,732	1,654	1,734	1,794
Loans	1,461	1,078	-573	0	0	0	0	0	0
Other liabilities	-151	547	270	0	0	0	0	0	0
Memorandum items:									
One-off measures	40	0	238	78	-48	0	0	0	0
Primary balance	-1,759	-571	-657	-806	-498	-447	-486	-483	-500
Net lending/borrowing (excluding one-offs)	-3,080	-1,955	-2,335	-2,163	-1,754	-1,732	-1,654	-1,734	-1,794
Structural balance	-2,846	-1,560	-1,973	-1,997	-1,742	-1,810	-1,735	-1,790	-1,817
Gross public debt	37,614	40,284	40,404	41,191	42,273	44,006	45,660	47,394	49,189
of which EFSF and ESM contributions	1,758	2,422	2,656	2,656	2,656	2,656	2,656	2,656	2,656
Cash on GG accounts	4,321	4,761	2,612	2,714	1,995	1,995	1,995	1,995	1,995

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

Table 2B. Slovak Republic: Statement of Operations of the General Government, 2012–20

(In percent of GDP)

				Projections					
	2012	2013	2014	2015	2016	2017	2018	2019	2020
Revenue	**36.0**	**38.4**	**38.9**	**40.1**	**38.3**	**38.2**	**38.0**	**37.9**	**37.8**
Taxes	15.7	16.7	17.4	17.8	17.6	17.4	17.3	17.2	17.2
Personal income tax	2.9	2.9	3.0	3.1	3.2	3.2	3.2	3.2	3.2
Corporate income tax	2.4	2.9	3.2	3.3	3.3	3.3	3.3	3.3	3.3
VAT	6.0	6.4	6.6	6.7	6.6	6.6	6.6	6.5	6.5
Excises	2.9	2.9	2.9	2.9	2.8	2.8	2.7	2.7	2.7
Other taxes	1.5	1.6	1.7	1.7	1.6	1.6	1.5	1.5	1.5
Social contributions	12.5	13.5	13.6	13.7	13.7	13.8	13.7	13.7	13.7
Grants	1.1	1.1	1.6	2.8	1.5	1.8	2.0	2.0	2.0
Other revenue	6.6	7.1	6.2	5.8	5.4	5.2	5.0	5.0	5.0
Expenditure	**40.1**	**41.0**	**41.6**	**42.8**	**40.5**	**40.2**	**39.8**	**39.7**	**39.6**
Expense	37.1	37.8	38.2	38.5	37.3	37.0	36.7	36.6	36.5
Compensation of employees	8.1	8.5	8.7	8.8	8.8	8.7	8.6	8.5	8.4
Use of goods and services	5.2	5.2	5.3	5.8	5.2	5.2	5.2	5.2	5.2
Interest	1.8	1.9	1.9	1.6	1.6	1.5	1.3	1.3	1.3
Subsidies	1.0	1.0	0.9	0.9	0.9	0.9	0.9	0.9	0.9
Grants	1.6	1.7	1.8	1.5	1.4	1.4	1.4	1.4	1.4
Social benefits	18.8	18.9	19.0	18.9	18.8	18.7	18.6	18.6	18.6
Other expense	0.7	0.6	0.6	0.9	0.6	0.6	0.6	0.6	0.6
Net acquisition of nonfinancial assets	3.1	3.2	3.4	4.3	3.2	3.2	3.2	3.2	3.2
Gross Operating Balance	-1.1	0.5	0.6	1.6	0.9	1.1	1.3	1.3	1.4
Net lending(+)/borrowing(-) (overall balance)	**-4.2**	**-2.6**	**-2.8**	**-2.7**	**-2.2**	**-2.0**	**-1.8**	**-1.8**	**-1.8**
Net financial transactions	-4.2	-2.6	-2.8	-2.7	-2.2	-2.0	-1.8	-1.8	-1.8
Net acquisition of financial assets	5.9	2.0	-2.0	-1.7	-0.9	0.0	0.0	0.0	0.0
Currency and deposits	3.9	0.6	-3.0	-1.7	-0.9	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	2.0	0.8	0.1	0.0	0.0	0.0	0.0	0.0	0.0
Equity and investment fund shares	0.3	0.0	-0.2	0.0	0.0	0.0	0.0	0.0	0.0
Other financial assets	-0.3	0.7	1.1	0.0	0.0	0.0	0.0	0.0	0.0
Net incurrence of liabilities	10.1	4.6	0.8	1.0	1.3	2.0	1.8	1.8	1.8
Currency and deposits	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Debt securities	8.3	2.4	1.2	1.0	1.3	2.0	1.8	1.8	1.8
Loans	2.0	1.5	-0.8	0.0	0.0	0.0	0.0	0.0	0.0
Other liabilities	-0.2	0.7	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:									
Primary balance	-2.4	-0.8	-0.9	-1.0	-0.6	-0.5	-0.5	-0.5	-0.5
Net lending/borrowing (excluding one-offs)	-4.3	-2.6	-3.1	-2.8	-2.2	-2.0	-1.8	-1.8	-1.8
Structural balance (percent of potential GDP)	-3.9	-2.1	-2.6	-2.5	-2.1	-2.1	-1.9	-1.9	-1.8
Gross public debt	51.9	54.6	53.5	52.8	52.1	51.6	51.0	50.3	49.7
of which intergovernmental lending	2.4	3.3	3.5	3.4	3.3	3.1	3.0	2.8	2.7
Cash on GG accounts	6.0	6.4	3.5	3.5	2.5	2.3	2.2	2.1	2.0
GDP at current market prices	72,420	73,835	75,561	77,972	81,214	85,221	89,563	94,140	98,985

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

Table 3. Slovak Republic: General Government Balance Sheet, 2009–14

	2009	2010	2011	2012	2013	2014
			(In billions of euros)			
Net financial worth	**-11,339**	**-17,928**	**-21,455**	**-22,640**	**-24,682**	**-26,395**
Financial assets	**15,396**	**13,582**	**13,245**	**19,126**	**20,009**	**18,712**
Currency and deposits	5,189	2,850	2,641	3,886	3,744	2,478
Debt securities	344	204	209	206	21	50
Loans	1,140	1,254	1,450	2,833	3,271	3,331
Equity and other investment fund shares	6,403	6,358	5,342	8,628	8,773	8,645
Other accounts receivable	2,321	2,917	3,603	3,572	4,201	4,208
Financial liabilities	**26,735**	**31,510**	**34,699**	**41,766**	**44,692**	**45,107**
Currency and deposits	84	71	101	93	110	105
Debt securities	20,857	25,479	27,672	33,486	34,987	35,985
Loans	2,481	2,497	3,346	4,729	5,728	4,998
Other liabilities	3,314	3,462	3,581	3,458	3,867	4,018
			(In percent of GDP)			
Net financial worth	**-17.8**	**-26.6**	**-30.5**	**-31.3**	**-33.4**	**-34.9**
Financial assets	**24.1**	**20.2**	**18.8**	**26.4**	**27.1**	**24.8**
Currency and deposits	8.1	4.2	3.7	5.4	5.1	3.3
Securities other than shares	0.5	0.3	0.3	0.3	0.0	0.1
Loans	1.8	1.9	2.1	3.9	4.4	4.4
Shares and other equity	10.0	9.4	7.6	11.9	11.9	11.4
Other accounts receivable	3.6	4.3	5.1	4.9	5.7	5.6
Financial liabilities	**41.9**	**46.8**	**49.3**	**57.7**	**60.5**	**59.7**
Currency and deposits	0.1	0.1	0.1	0.1	0.1	0.1
Debt securities	32.7	37.8	39.3	46.2	47.4	47.6
Loans	3.9	3.7	4.8	6.5	7.8	6.6
Other liabilities	5.2	5.1	5.1	4.8	5.2	5.3
Memorandum items:						
Pulic debt	22,980	27,504	30,480	37,614	40,284	40,404
Net lending/borrowing	-5,023	-5,032	-2,885	-3,040	-1,955	-2,098
GDP	63,819	67,387	70,444	72,420	73,835	75,561

Source: Eurostat.

Table 4. Slovak Republic: Medium-term Balance of Payments, 2012–20

	2012	2013	2014	Projections 2015	2016	2017	2018	2019	2020
	(Millions of euros)								
Current account	**684**	**1,119**	**38**	**-405**	**-380**	**-458**	**-333**	**-28**	**657**
Trade balance (goods)	2,506	3,382	3,348	2,932	3,235	3,201	3,555	4,035	4,732
Exports, f.o.b.	60,159	62,279	62,658	65,553	69,502	74,569	80,231	85,824	91,944
Imports, f.o.b.	57,653	58,897	59,309	62,621	66,268	71,368	76,676	81,788	87,213
Services balance	421	411	133	78	96	74	92	123	176
Receipts	6,049	6,892	6,517	6,818	7,229	7,756	8,345	8,926	9,563
Payments	5,628	6,481	6,384	6,740	7,133	7,682	8,253	8,803	9,387
Primary income balance	-1,210	-1,353	-2,250	-2,193	-2,457	-2,412	-2,586	-2,711	-2,690
Credit	3,321	3,175	3,235	3,292	3,591	3,908	4,226	4,482	4,775
Debit	4,531	4,528	5,485	5,485	6,048	6,320	6,812	7,193	7,465
Secondary income balance	-1,034	-1,321	-1,194	-1,222	-1,255	-1,322	-1,395	-1,475	-1,561
Credit	403	398	486	526	536	553	571	589	608
Debit	1,436	1,719	1,680	1,748	1,791	1,875	1,966	2,065	2,169
Capital account	**1,415**	**1,064**	**730**	**1,046**	**1,051**	**1,087**	**1,024**	**979**	**1,028**
Financial Account	**319**	**-1,548**	**-2,353**	**-1,323**	**671**	**629**	**691**	**952**	**1,685**
Direct investment, net	-2,314	-763	-454	-605	-1,140	-1,065	-598	-446	-453
Portfolio investment, net	-8,247	-7,182	-2,606	-1,914	-1,044	-940	-581	-463	-393
Other investment, net	10,869	6,004	-66	966	2,763	2,534	1,848	1,836	2,507
Financial derivatives, net	29	320	320	231	91	101	23	24	25
Reserve assets	-17	73	454	0	0	0	0	0	0
Errors and omissions	**-1,780**	**-3,731**	**-3,120**	**-1,964**	**0**	**0**	**0**	**0**	**0**
Net International Investment Position	**-44,929**	**-46,978**	**-52,825**	**-54,147**	**-53,476**	**-52,848**	**-52,157**	**-51,205**	**-49,520**
External Debt	**54,882**	**60,445**	**67,776**	**72,388**	**74,619**	**76,805**	**78,696**	**80,535**	**82,375**
	(Percent of GDP)								
Current account	**0.9**	**1.5**	**0.1**	**-0.5**	**-0.5**	**-0.5**	**-0.4**	**0.0**	**0.7**
Trade balance (goods)	3.5	4.6	4.4	3.8	4.0	3.8	4.0	4.3	4.8
Exports, f.o.b.	83.1	84.3	82.9	84.1	85.6	87.5	89.6	91.2	92.9
Imports, f.o.b.	79.6	79.8	78.5	80.3	81.6	83.7	85.6	86.9	88.1
Services balance	0.6	0.6	0.2	0.1	0.1	0.1	0.1	0.1	0.2
Receipts	8.4	9.3	8.6	8.7	8.9	9.1	9.3	9.5	9.7
Payments	7.8	8.8	8.4	8.6	8.8	9.0	9.2	9.4	9.5
Primary income balance	-1.7	-1.8	-3.0	-2.8	-3.0	-2.8	-2.9	-2.9	-2.7
Credit	4.6	4.3	4.3	4.2	4.4	4.6	4.7	4.8	4.8
Debit	6.3	6.1	7.3	7.0	7.4	7.4	7.6	7.6	7.5
Secondary income balance	-1.4	-1.8	-1.6	-1.6	-1.5	-1.6	-1.6	-1.6	-1.6
Credit	0.6	0.5	0.6	0.7	0.7	0.6	0.6	0.6	0.6
Debit	2.0	2.3	2.2	2.2	2.2	2.2	2.2	2.2	2.2
Capital account	**2.0**	**1.4**	**1.0**	**1.3**	**1.3**	**1.3**	**1.1**	**1.0**	**1.0**
Financial Account	**0.4**	**-2.1**	**-3.1**	**-1.7**	**0.8**	**0.7**	**0.8**	**1.0**	**1.7**
Direct investment, net	-3.2	-1.0	-0.6	-0.8	-1.4	-1.3	-0.7	-0.5	-0.5
Portfolio investment, net	-11.4	-9.7	-3.4	-2.5	-1.3	-1.1	-0.6	-0.5	-0.4
Other investment, net	15.0	8.1	-0.1	1.2	3.4	3.0	2.1	2.0	2.5
Financial derivatives, net	0.0	0.4	0.4	0.3	0.1	0.1	0.0	0.0	0.0
Reserve assets	0.0	0.1	0.6	0.0	0.0	0.0	0.0	0.0	0.0
Errors and omissions	**-2.5**	**-5.1**	**-4.1**	**-2.5**	**0.0**	**0.0**	**0.0**	**0.0**	**0.0**
Net International Investment Position	**-62.0**	**-63.6**	**-69.9**	**-69.4**	**-65.8**	**-62.0**	**-58.2**	**-54.4**	**-50.0**
External Debt	**75.8**	**81.9**	**89.7**	**92.8**	**91.9**	**90.1**	**87.9**	**85.5**	**83.2**

Sources: National Bank of Slovakia and IMF staff estimates and projections.

Table 5. Slovak Republic: Financial Soundness Indicators for the Banking Sector, 2010–15

(Percent, unless otherwise indicated)

	2010	2011	2012	2013	2014	2015Q2
Capital adequacy						
Regulatory capital to risk-weighted assets	12.7	13.4	15.7	16.5	17.3	17.5
Regulatory Tier 1 capital to risk-weighted assets	11.6	12.4	14.7	14.4	16.0	16.2
Capital to assets	9.7	10.8	11.7	12.1	11.9	11.3
Asset quality						
Nonperforming loans to gross loans	5.8	5.6	5.2	5.1	5.3	5.3
Nonperforming loans net of provisions to capital	16.7	15.5	13.3	13.1	15.8	15.8
Earnings and Profitability						
Return on assets (after tax)	1.2	0.7	1.0	1.3	1.2	1.5
Return on equity (after tax)	12.6	6.9	9.1	10.7	10.4	12.5
Interest margin to gross income	75.9	73.9	84.1	78.1	80.4	71.8
Noninterest expenses to gross income	57.5	52.5	64.3	59.1	60.0	54.8
Liquidity						
Customer deposits to total (noninterbank) loans	116.6	109.4	114.2	113.0	110.3	109.4
Liquid assets to total assets	40.9	37.4	38.3	36.2	34.1	33.2
Liquid assets to short-term liabilities	56.5	52.9	55.9	49.1	46.0	44.1
Sectoral distribution of loans to total loans						
Residents	93.6	93.6	92.4	91.6	91.0	92.5
Deposit-takers	0.0	0.0	0.0	0.0	0.0	0.0
Central bank	0.0	0.0	0.0	0.0	0.0	0.0
Other financial corporations	2.9	2.8	2.3	2.3	1.9	2.0
General government	3.2	2.9	2.6	2.3	2.3	2.1
Nonfinancial corporations	42.2	41.6	38.9	36.2	33.4	34.0
Other domestic sectors	45.3	46.2	48.6	50.7	53.5	54.4
Nonresidents	6.4	6.4	7.6	8.4	9.0	7.5
Other indicators						
Nonfinancial corporation debt (in percent of GDP)	81.7	83.9	81.4	85.6	86.3	93.0
Households debt (in percent of GDP)	27.8	29.2	32.0	34.4	36.8	38.3
Households debt (in percent of disposable income)	44.2	47.4	52.8	56.3	59.8	62.2
Gross asset position in financial derivatives to capital	7.6	8.0	5.5	3.7	5.4	4.5
Gross liability position in financial derivatives to capital	9.4	9.1	6.7	4.8	6.6	5.9
Trading income to total income	2.9	-4.1	1.4	3.5	3.9	3.7
Personnel expenses to noninterest expenses	38.6	40.1	39.9	39.7	39.4	37.4
Spread between reference lending and deposit rates (basis points)	395.0	376.5	359.0	379.3	369.4	361.1
Foreign currency-denominated loans to total loans	1.5	1.6	1.5	1.1	1.9	1.9
Foreign currency-denominated liabilities to total liabilities	3.2	4.1	3.6	3.9	4.2	4.2
Net open position in equities to capital	9.6	9.1	8.3	14.4	12.6	12.2
Net open position in foreign exchange to capital	-1.2	-1.7	0.1	2.2	3.7	2.7

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

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

External Risks	Relative Likelihood	Impact if Realized	Policy Response
Tighter or more volatile global financial conditions *(short term)* • **Sharp asset price adjustment and decompression of credit spreads**. Investors reassess underlying risk and respond to unanticipated changes in growth prospects, Fed policy rate path, and increases in U.S. term premia, with poor market liquidity amplifying the effect on volatility. • **Euro area bond market contagion**. Sovereign and financial sector stress re-emerges across the Euro area due to protracted policy uncertainty and delays in debt servicing by Greece, faltering reforms, and political and social upheaval.	High Medium	**Low** • Interest costs could rise, but from very low levels. • External borrowing might become more difficult. Non-residents hold about two-thirds of government debt, but the stock is relatively low and in euro or hedged, and financing needs are declining. • The Slovak banking sector is deposit-funded and enjoys robust capitalization. • Lower exports and growth if trading partners are substantially affected.	• Draw on cash balances if needed. • Slow diversification of holders of government debt and turn to domestic banking sector as a backstop. • Persevere on fiscal adjustment. • Improve labor market and business climate to boost growth, including through stronger domestic demand.
Structurally weak growth in key advanced and emerging economies (the "new mediocre") • **Euro area:** Weak demand and persistently low inflation from a failure to fully address crisis legacies and undertake structural reforms, leading to low medium-term growth and accumulation of financial imbalances. *(medium term)* • **Emerging markets, including China.** Maturing of the cycle, misallocation of investment and excess corporate leverage (including in FX) fueled by a prolonged period of easy global financial conditions, and insufficient progress with reforms leads to a significant medium-term growth slowdown. *(medium term)* • **Sharp China slowdown in 2015-16.** Growth falls significantly below target, possibly due to a severe housing downturn or a shock in the shadow banking sector. *(short term)*	High Medium Low	**High (euro area)** **Medium (EMs incl. China)** • Strong trade links to Europe, especially Germany, would hit exports and growth, exacerbating unemployment (e.g., a 1 percent fall in euro area GDP could lower Slovak industrial production by 7 percent within a year).[2/] • Weaker EM/China growth would be primarily felt indirectly, to the extent key trading partners are affected. • 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. • Implement high-quality fiscal measures to avoid debt ceilings. • Draw on strong provision and capital buffers.

External Risks	Relative Likelihood	Impact if Realized	Policy Response
Political fragmentation erodes the globalization process and fosters inefficiency *(short term)* • Russia/Ukraine: the mounting conflict depresses business confidence and heightens risk aversion, amid disturbances in global financial, trade and commodity markets.	**Medium**	**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.	• Over long-term, diversify sources of energy supply. • Improve labor market and business climate to boost growth, including through stronger domestic demand.
Domestic Risks	**Relative Likelihood**	**Impact if Realized**	**Policy Response**
Prolonged high unemployment *(medium term)*	**Medium**	**Medium** • Sustained high unemployment could inhibit recovery in domestic demand and lower growth. • Hysteresis effects could exacerbate unfavorable demographics and lower potential growth. • Public debt is especially sensitive to growth shocks.	• Improve labor market and strengthen business climate through investment in weaker regions, active labor market policies, and better education and training. • Persevere on fiscal adjustment.
Deterioration in loan quality due to rapid household credit growth *(medium term)*	**Medium**	**Medium** • An increase in non-performing loans would require higher provisioning, eroding bank profits and capital with negative implications for lending and growth; however, capital and liquidity levels are currently strong, and private debt is low. • The real estate market would be negatively affected.	• Strengthen macroprudential measures such as loan-to-value requirements and accompany with debt-to-income ratios. Further build capital buffers.

[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 of 30 percent or more). 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/] Staff analysis based on VECM model.

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

IMF 2014 Article IV Recommendations	Authorities' Response
Achieving High-quality Fiscal Consolidation	
• 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. • Lower debt through sale of state shares in companies. • Improve spending efficiency (especially in the healthcare sector).	• Reducing tax evasion and VAT efficiency are top priorities and have benefited from FAD analysis. An ambitious action plan to combat tax fraud is being implemented. • Work on a property value-based real estate tax is underway, but implementation is unlikely before 2016. • Raising the retirement age is not desirable due to low life expectancy and small expected savings. • State shares in Slovak Telekom were sold and the proceeds were used to reduce outstanding debt.
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, and has taken steps to streamline and improve ALMPs. • Health insurance contributions have been reduced and benefits can be claimed concurrent with work to encourage hiring and work for the low-income labor force. • Education and training initiatives, including to create a dual vocational education and training system, are underway. • Efforts to improve government efficiency and to facilitate financing for SMEs are underway. • Labor Code changes to allow extension of collective bargaining agreements 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. • Adopt a regulation on loan-to-value and debt-to-income ratios to prevent an excessive build-up of credit risk.	• 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, etc.) have been transposed into national legislation. Risks are low and closely-tracked by the NBS. • The NBS introduced a set of recommendations regarding loan-to-value ratios, real estate collateral values, and customer repayment ability.

Annex III. Public Sector Debt Sustainability Analysis (DSA)

Slovak Republic: Public DSA – Baseline Scenario

(in percent of GDP unless otherwise indicated)

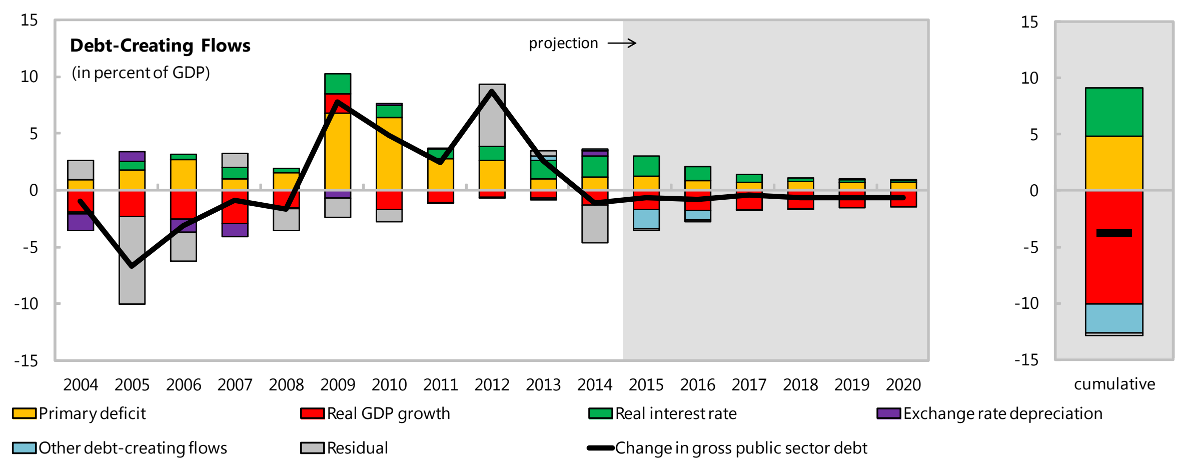
Debt, Economic and Market Indicators [1/]

	Actual			Projections					
	2004-2012 [2/]	2013	2014	2015	2016	2017	2018	2019	2020
Nominal gross public debt	37.3	54.6	53.5	52.8	52.1	51.6	51.0	50.3	49.7
Public gross financing needs	11.1	10.6	10.1	7.4	7.8	8.6	4.9	4.5	6.1
Public debt (in percent of potential GDP)	37.2	53.8	52.8	52.6	52.0	51.8	51.1	50.4	49.7
Real GDP growth (in percent)	4.5	1.4	2.5	3.4	3.6	3.5	3.4	3.3	3.2
Inflation (GDP deflator, in percent)	1.9	0.5	-0.2	-0.2	0.6	1.4	1.6	1.8	1.9
Nominal GDP growth (in percent)	6.6	2.0	2.3	3.2	4.2	4.9	5.1	5.1	5.1
Effective interest rate (in percent) [4/]	4.6	3.7	3.6	3.2	3.0	2.8	2.4	2.3	2.2

As of November 23, 2015		
Sovereign Spreads		
EMBIG (bp) 3/	11	
5Y CDS (bp)	49	
Ratings	Foreign	Local
Moody's	A2	A2
S&Ps	A	A
Fitch	A+	A+

Contribution to Changes in Public Debt

	Actual			Projections							
	2004-2012	2013	2014	2015	2016	2017	2018	2019	2020	cumulative	debt-stabilizing primary balance [9/]
Change in gross public sector debt	1.1	2.6	-1.1	-0.6	-0.8	-0.4	-0.7	-0.6	-0.7	-3.8	
Identified debt-creating flows	1.9	2.1	2.3	-0.5	-0.7	-0.3	-0.6	-0.7	-0.7	-3.5	
Primary deficit	2.9	1.0	1.1	1.2	0.8	0.7	0.7	0.7	0.7	4.8	-1.4
Primary (noninterest) revenue and grants	35.0	38.2	38.6	40.0	38.1	38.0	37.8	37.7	37.6	229.2	
Primary (noninterest) expenditure	37.9	39.1	39.7	41.2	38.9	38.7	38.5	38.4	38.3	234.0	
Automatic debt dynamics [5/]	-1.0	0.7	1.0	0.0	-0.6	-1.0	-1.3	-1.4	-1.4	-5.7	
Interest rate/growth differential [6/]	-0.6	0.9	0.5	0.0	-0.6	-1.0	-1.3	-1.4	-1.4	-5.7	
Of which: real interest rate	0.8	1.6	1.9	1.7	1.2	0.7	0.3	0.2	0.1	4.4	
Of which: real GDP growth	-1.5	-0.7	-1.3	-1.7	-1.8	-1.7	-1.7	-1.6	-1.5	-10.1	
Exchange rate depreciation [7/]	-0.4	-0.1	0.4	…	…	…	…	…	…	…	
Other identified debt-creating flows	0.0	0.4	0.2	-1.7	-0.9	0.0	0.0	0.0	0.0	-2.6	
Net privatization proceeds (negative)	0.0	0.0	0.0	-1.2	0.0	0.0	0.0	0.0	0.0	-1.2	
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 contribution	0.0	0.4	0.2	-0.5	-0.9	0.0	0.0	0.0	0.0	-1.3	
Residual, including asset changes [8/]	-0.7	0.5	-3.3	-0.2	-0.1	-0.1	0.0	0.0	0.1	-0.3	

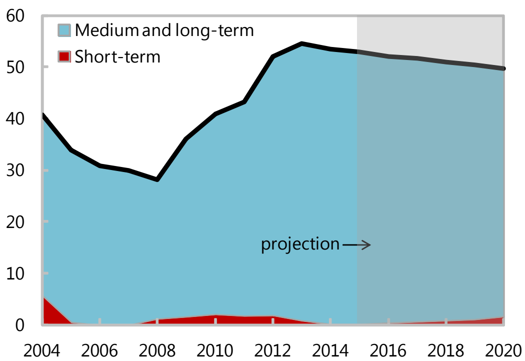


Source: IMF staff.
1/ Public sector is defined as general government.
2/ Based on available data.
3/ Long-term bond spread over German bonds.
4/ Defined as interest payments divided by debt stock (excluding guarantees) at the end of previous year.
5/ Derived as [(r - π(1+g) - g + ae(1+r)]/(1+g+π+gπ)) times previous period debt ratio, with r = interest rate; π = growth rate of GDP deflator; g = real GDP growth rate; a = share of foreign-currency denominated debt; and e = nominal exchange rate depreciation (measured by increase in local currency value of U.S. dollar).
6/ The real interest rate contribution is derived from the numerator in footnote 5 as r - π (1+g) and the real growth contribution as -g.
7/ The exchange rate contribution is derived from the numerator in footnote 5 as ae(1+r).
8/ Includes asset changes and interest revenues (if any). For projections, includes exchange rate changes during the projection period.
9/ Assumes that key variables (real GDP growth, real interest rate, and other identified debt-creating flows) remain at the level of the last projection year.

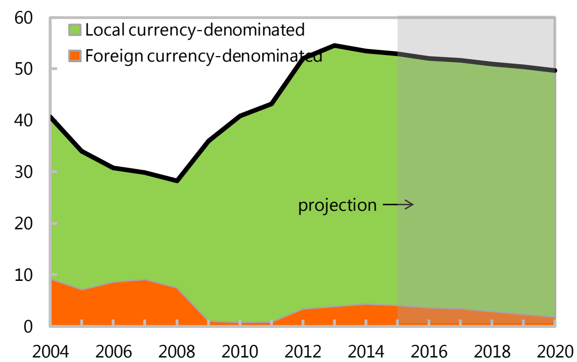
Slovak Republic: Public DSA – Composition of Public Debt and Alternative Scenarios

Composition of Public Debt

By Maturity
(in percent of GDP)



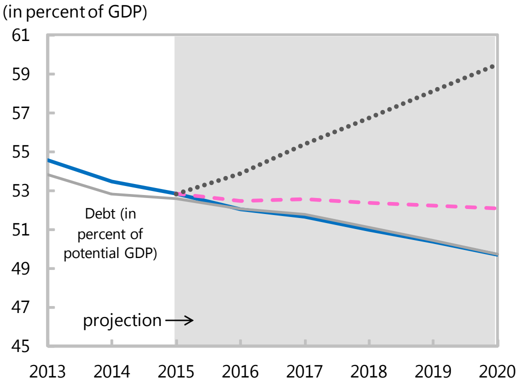
By Currency
(in percent of GDP)



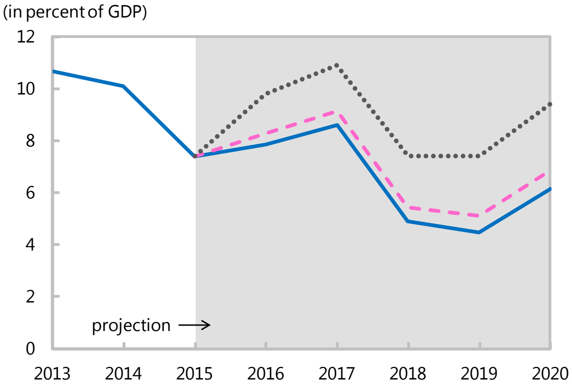
Alternative Scenarios

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	2015	2016	2017	2018	2019	2020
Real GDP growth	3.4	3.6	3.5	3.4	3.3	3.2
Inflation	-0.2	0.6	1.4	1.6	1.8	1.9
Primary Balance	-1.2	-0.8	-0.7	-0.7	-0.7	-0.7
Effective interest rate	3.2	3.0	2.8	2.4	2.3	2.2
Constant Primary Balance Scenario						
Real GDP growth	3.4	3.6	3.5	3.4	3.3	3.2
Inflation	-0.2	0.6	1.4	1.6	1.8	1.9
Primary Balance	-1.2	-1.2	-1.2	-1.2	-1.2	-1.2
Effective interest rate	3.2	3.0	2.8	2.3	2.3	2.2

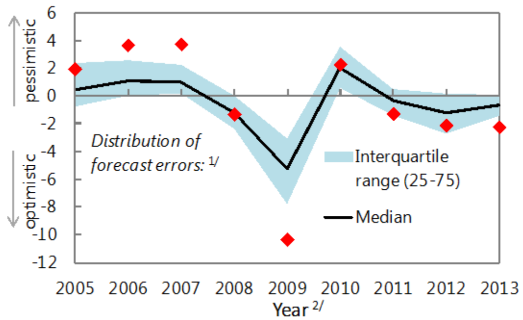
Historical Scenario	2015	2016	2017	2018	2019	2020
Real GDP growth	3.4	3.9	3.9	3.9	3.9	3.9
Inflation	-0.2	0.6	1.4	1.6	1.8	1.9
Primary Balance	-1.2	-2.8	-2.8	-2.8	-2.8	-2.8
Effective interest rate	3.2	3.0	3.0	2.8	2.9	2.9

Source: IMF staff.

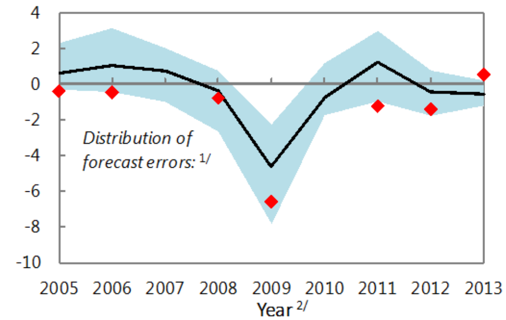
Slovak Republic: Public DSA – Realism of Baseline Assumptions

Forecast Track Record, versus surveillance countries

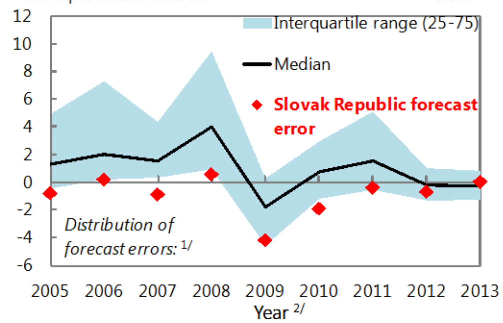
Real GDP Growth
(in percent, actual-projection)
Slovak Republic median forecast error, 2005-2013: **-1.27**
Has a percentile rank of: **16%**



Primary Balance
(in percent of GDP, actual-projection)
Slovak Republic median forecast error, 2005-2013: **-0.78**
Has a percentile rank of: **34%**

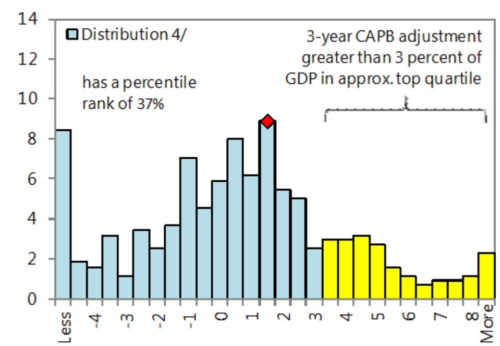


Inflation (Deflator)
(in percent, actual-projection)
Slovak Republic median forecast error, 2005-2013: **-0.69**
Has a percentile rank of: **10%**

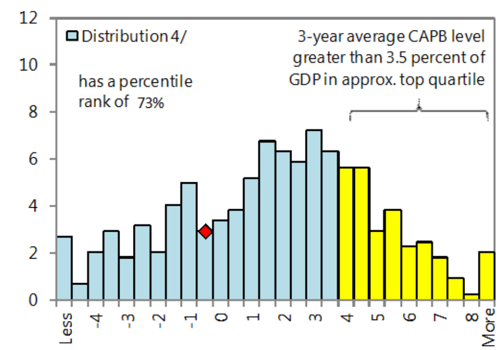


Assessing the Realism of Projected Fiscal Adjustment

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

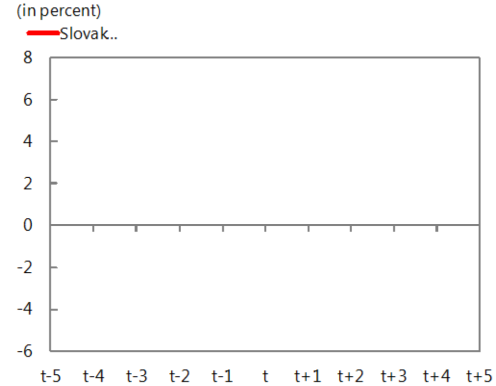


3-Year Average Level of Cyclically-Adjusted Primary Balance (CAPB)
(Percent of GDP)



Boom-Bust Analysis 3/

Real GDP growth
(in percent)



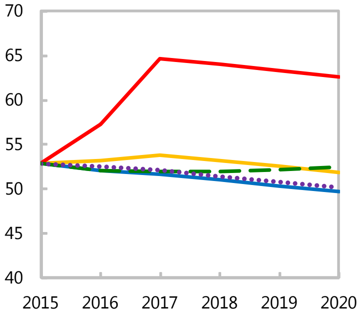
Source : IMF Staff.
1/ Plotted distribution includes surveillance countries, percentile rank refers to all countries.
2/ Projections made in the spring WEO vintage of the preceding year.
3/ Not applicable for Slovak Republic.
4/ Data cover annual obervations from 1990 to 2011 for advanced and emerging economies with debt greater than 60 percent of GDP. Percent of sample on vertical axis.

Slovak Republic: Public DSA – Stress Tests

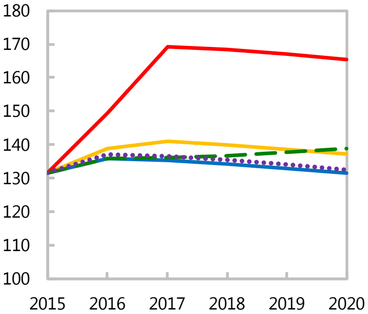
Macro-Fiscal Stress Tests

Baseline
Real GDP Growth Shock
Primary Balance Shock
Real Exchange Rate Shock
Real Interest Rate Shock

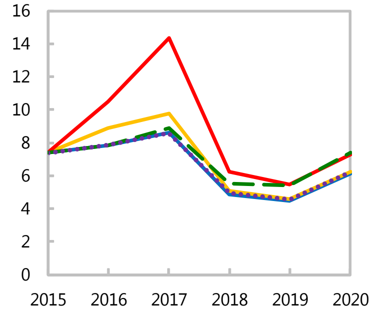
Gross Nominal Public Debt
(in percent of GDP)



Gross Nominal Public Debt
(in percent of Revenue)



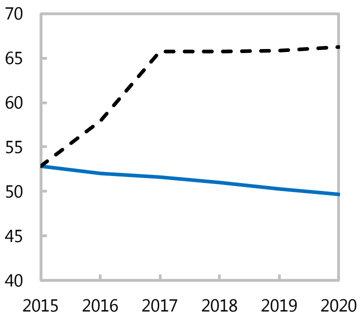
Public Gross Financing Needs
(in percent of GDP)



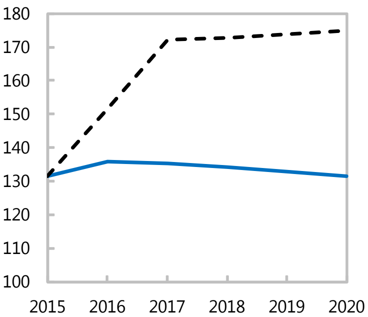
Additional Stress Tests

Baseline
Combined Macro-Fiscal Shock

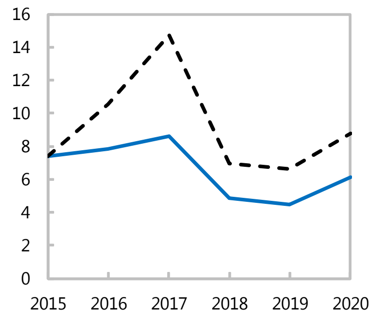
Gross Nominal Public Debt
(in percent of GDP)



Gross Nominal Public Debt
(in percent of Revenue)



Public Gross Financing Needs
(in percent of GDP)



Underlying Assumptions
(in percent)

Primary Balance Shock	2015	2016	2017	2018	2019	2020
Real GDP growth	3.4	3.6	3.5	3.4	3.3	3.2
Inflation	-0.2	0.6	1.4	1.6	1.8	1.9
Primary balance	-1.2	-1.9	-1.8	-0.7	-0.7	-0.7
Effective interest rate	3.2	3.0	2.9	2.5	2.4	2.3
Real Interest Rate Shock						
Real GDP growth	3.4	3.6	3.5	3.4	3.3	3.2
Inflation	-0.2	0.6	1.4	1.6	1.8	1.9
Primary balance	-1.2	-0.8	-0.7	-0.7	-0.7	-0.7
Effective interest rate	3.2	3.0	3.4	3.7	4.0	4.2
Combined Shock						
Real GDP growth	3.4	-0.9	-1.0	3.4	3.3	3.2
Inflation	-0.2	-0.6	0.3	1.6	1.8	1.9
Primary balance	-1.2	-3.0	-5.3	-0.7	-0.7	-0.7
Effective interest rate	3.2	3.1	3.5	3.8	4.1	4.3

Real GDP Growth Shock	2015	2016	2017	2018	2019	2020
Real GDP growth	3.4	-0.9	-1.0	3.4	3.3	3.2
Inflation	-0.2	-0.6	0.3	1.6	1.8	1.9
Primary balance	-1.2	-3.0	-5.3	-0.7	-0.7	-0.7
Effective interest rate	3.2	3.0	2.9	2.9	2.8	2.6
Real Exchange Rate Shock						
Real GDP growth	3.4	3.6	3.5	3.4	3.3	3.2
Inflation	-0.2	1.1	1.4	1.6	1.8	1.9
Primary balance	-1.2	-0.8	-0.7	-0.7	-0.7	-0.7
Effective interest rate	3.2	3.1	2.8	2.4	2.3	2.2

Source: IMF staff.

Slovak Republic: Public DSA – Risk Assessment

Heat Map

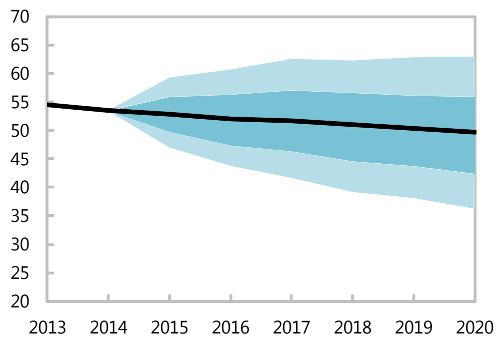
Debt level [1/]	Real GDP Growth Shock	Primary Balance Shock	Real Interest Rate Shock	Exchange Rate Shock	Contingent Liability shock
Gross financing needs [2/]	Real GDP Growth Shock	Primary Balance Shock	Real Interest Rate Shock	Exchange Rate Shock	Contingent Liability Shock
Debt profile [3/]	Market Perception	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

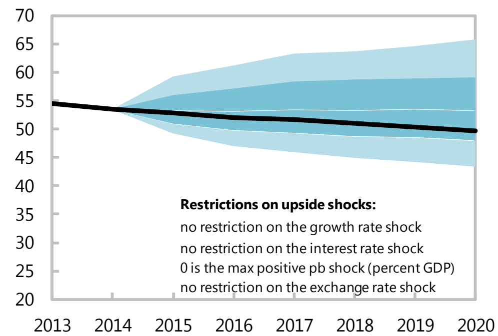
(in percent of GDP)

Baseline   Percentiles: 10th-25th   25th-75th   75th-90th

Symmetric Distribution

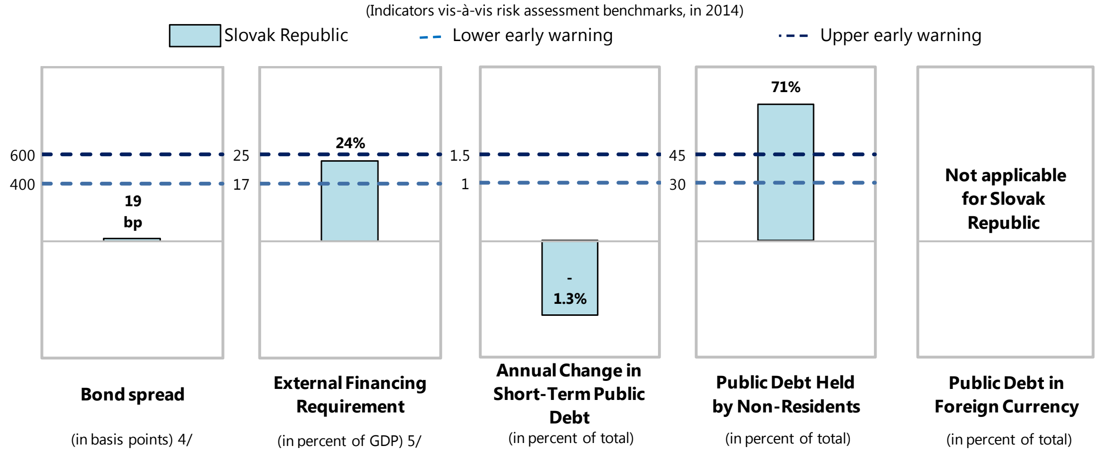


Restricted (Asymmetric) Distribution



Debt Profile Vulnerabilities

(Indicators vis-à-vis risk assessment benchmarks, in 2014)



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:

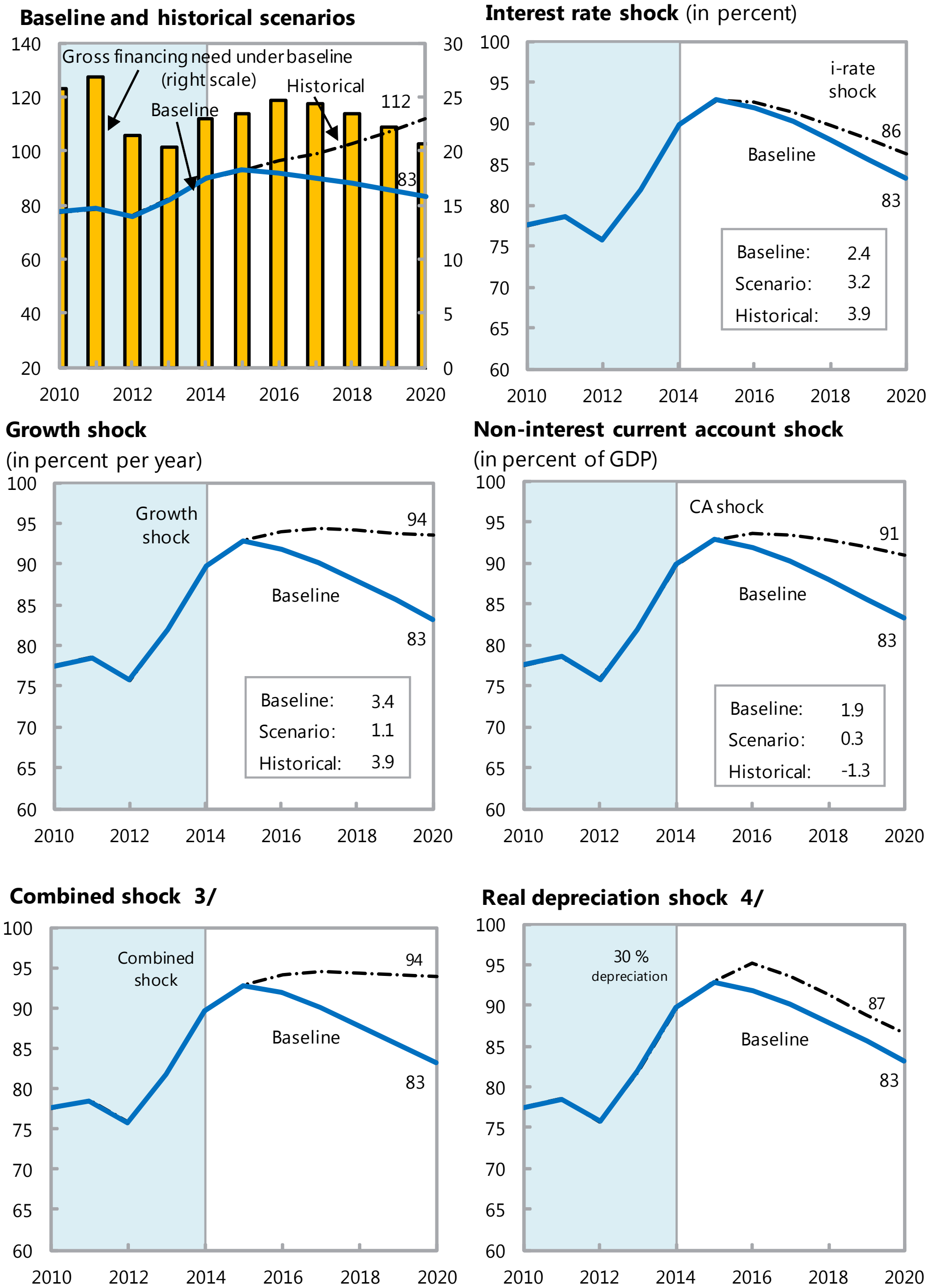
400 and 600 basis points for bond spreads; 17 and 25 percent of GDP for external financing requirement; 1 and 1.5 percent for change in the share of short-term debt; 30 and 45 percent for the public debt held by non-residents.

4/ Long-term bond spread over German bonds, an average over the last 3 months, 25-Aug-15 through 23-Nov-15.

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. External Debt Sustainability Analysis

Slovak Republic: External DSA – Bound Tests, 2010–20 1/ 2/



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.

Slovak Republic: External DSA– Framework, 2010–20

	Actual							Projections						
	2010	2011	2012	2013	2014			2015	2016	2017	2018	2019	2020	**Debt-stabilizing non-interest current account 6/**
Baseline: External debt	77.5	78.5	75.8	81.9	89.7			**92.8**	**91.9**	**90.1**	**87.9**	**85.5**	**83.2**	**-1.4**
Change in external debt	-1.0	1.0	-2.7	6.1	7.8			3.1	-1.0	-1.8	-2.3	-2.3	-2.3	
Identified external debt-creating flows (4+8+9)	3.4	4.7	11.2	7.4	2.9			0.5	0.0	-0.2	-1.2	-1.7	-2.4	
Current account deficit, excluding interest payments	3.0	3.3	-3.1	-3.4	-2.6			-1.9	-1.9	-1.7	-1.6	-1.9	-2.5	
Deficit in balance of goods and services	1.1	0.5	-3.9	-5.0	-5.0			-4.0	-4.1	-3.8	-4.1	-4.4	-4.9	
Exports	76.5	89.8	89.1	90.8	98.6			95.8	94.2	96.7	98.7	100.3	102.2	
Imports	77.6	90.2	85.2	85.8	93.6			91.8	90.1	92.9	94.6	95.9	97.3	
Net non-debt creating capital inflows (negative)	2.8	2.8	14.2	10.4	4.4			3.3	2.7	2.4	1.3	1.0	0.9	
Automatic debt dynamics 1/	-2.3	-1.4	0.0	0.4	1.0			-1.0	-0.8	-0.8	-1.0	-0.8	-0.7	
Contribution from nominal interest rate	1.8	1.9	2.2	1.9	2.5			2.4	2.4	2.3	1.9	1.9	1.9	
Contribution from real GDP growth	-4.2	-2.1	-1.2	-1.0	-2.2			-3.4	-3.2	-3.1	-2.9	-2.7	-2.6	
Contribution from price and exchange rate changes 2/	0.1	-1.3	-1.0	-0.5	0.8			1.4	-0.6	-1.3	-1.5	-1.5	-1.6	
Residual, incl. change in gross foreign assets (2-3) 3/	-4.5	-3.7	-13.9	-1.3	5.0			1.3	-0.4	-0.3	0.4	1.0	1.7	
External debt-to-exports ratio (in percent)	101.4	87.5	85.0	90.2	91.0			96.9	97.6	93.2	89.0	85.3	81.4	
Gross external financing need (in billions of US dollars) 4/	22.9	25.0	20.4	20.6	21.4			19.6	21.7	22.5	22.8	22.9	22.5	
in percent of GDP	25.7	26.9	21.3	20.3	23.0	10-Year	10-Year	23.4	24.7	24.3	23.4	22.3	20.7	
Scenario with key variables at their historical averages 5/								**92.8**	**96.3**	**99.1**	**102.6**	**106.9**	**111.8**	**1.9**
Key Macroeconomic Assumptions Underlying Baseline						Historical Average	Standard Deviation							
Real GDP growth (in percent)	5.1	2.8	1.5	1.4	2.5	3.9	4.5	3.4	3.6	3.5	3.4	3.3	3.2	
GDP deflator in US dollars (change in percent)	-9.0	1.3	1.4	4.4	-10.2	3.5	11.0	-13.0	1.3	1.5	1.9	2.4	2.6	
Nominal external interest rate (in percent)	2.2	2.6	2.8	2.7	2.8	3.9	1.5	2.4	2.7	2.6	2.3	2.3	2.3	
Growth of exports (US dollar terms, in percent)	13.6	22.3	2.2	7.9	0.0	13.4	17.4	-12.7	3.2	7.9	7.5	7.5	7.9	
Growth of imports (US dollar terms, in percent)	13.4	21.2	-2.8	6.7	0.5	12.4	17.4	-11.9	3.0	8.3	7.4	7.2	7.4	
Current account balance, excluding interest payments	-3.0	-3.3	3.1	3.4	2.6	-1.3	3.3	1.9	1.9	1.7	1.6	1.9	2.5	
Net non-debt creating capital inflows	-2.8	-2.8	-14.2	-10.4	-4.4	-5.0	5.0	-3.3	-2.7	-2.4	-1.3	-1.0	-0.9	

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, 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.

INTERNATIONAL MONETARY FUND

SLOVAK REPUBLIC

December 22, 2015

STAFF REPORT FOR THE 2015 ARTICLE IV CONSULTATION—INFORMATIONAL ANNEX

Prepared By

European Department

CONTENTS

FUND RELATIONS

(As of November 30, 2015)

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

General Resources Account:

	SDR Million	Percent of Quota
Quota	427.50	100.00
Fund holdings of currency	307.49	71.93
Reserve position	120.02	28.07
Lending to the Fund		
Borrowing Agreement	4.90	

SDR Department:

	SDR Million	Percent of Allocation
Net cumulative allocation	340.48	100.00
Holdings	322.71	94.78

Outstanding Purchases and Loans: None

Financial Arrangements:

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

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

		Forthcoming			
	2015	**2016**	**2017**	**2018**	**2019**
Principal					
Charges/Interest	0.00	0.01	0.01	0.01	0.01
Total	0.00	0.01	0.01	0.01	0.01

Exchange Rate Arrangement:

The currency of the Slovak Republic is the euro, which was adopted on January 1, 2009. The Slovak Republic has accepted the obligations of Article VIII, Sections 2, 3, and 4 and maintains an exchange system that is free of restrictions on the making of payments and transfers for current international transactions. 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 October 21–Novmber 3, 2015. The mission met with Minister of Finance Kažimír; National Bank of Slovakia (NBS) Governor Makúch; Minister of Economy Hudák; Minister of Interior Kaliňák; officials from the Ministry of Finance, the NBS, the debt management agency (ARDAL), and the Ministries of Economy, Transportation, and Interior; as well as representatives of financial institutions, labor unions, employers' associations, and enterprises.

The team comprised Messrs. John (head), Giustiniani, and Jobst, and Ms. Caselli (all EUR), and was assisted at headquarters by Mmes. Calixto and T. Chen. Mr. Jakoby (Senior Advisor to the Executive Director) accompanied the mission. The mission's concluding statement was published on the IMF website on November 3, 2015.

The previous consultation with the Slovak Republic was concluded on August 27, 2014 (IMF Country Report No. 14/254).

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).

Slovak Republic: Technical Assistance, 2000–15 [1/]		
Department	**Timing**	**Purpose**
MFD	February 2000	Mission on pros and cons, and modalities of moving to an inflation targeting framework, operational issues (money markets and policy instruments), and dealing with potential problems posed by capital inflows for monetary operations
	December 2001	Long-term resident expert on banking supervision
	May 2002	Two missions on inflation modeling
FAD	April 2000	Tax administration
	February 2001	Tax administration (follow-up)
	April 2001	Public Finance Management (follow-up)
	August 2001	Tax administration: Installation of resident expert to advise on establishment of Large Taxpayer Unit (LTU)
	August 2001–August 2002	Regular visits by FAD consultant on establishment of LTU
	December 2001	Tax administration follow-up, tax investigation/fraud issues
	June 2002	Mission to prepare Report on the Observance of Standards and Codes (ROSC), Fiscal Transparency Module
	February 2003	Tax policy
	March 2003	Tax administration
	May 2003	Expenditure policy
	December 2013	VAT Gap Analysis
	November 2015	Expenditure review workshop
	December 2015	VAT gap follow-up and excise gap analysis
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. With the adoption of the European System of Accounts (ESA) 2010 in September 2014, past statistical discrepancies between the supply and demand sides of GDP have been resolved. Weaknesses in the data on prices and volumes of imports and exports have also been addressed. Nevertheless, errors and omissions in the balance of payments statistics remain large and reported financial account flows are subject to large volatility. 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 preannounced 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.

Fiscal Sector

3. **The compilation of general government statistics is in line with the new ESA 2010 methodology.** The Ministry of Finance began compiling its fiscal accounts according to ESA 2010 standards in 2014 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.

External Sector

4. **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 started 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 and have provided data back to 2004.

Monetary Sector

5. **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 December 15, 2015)

	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/]	October 2015	November 2015	D	W	W		
Reserve/Base Money	October 2015	November 2015	M	M	M	…	…
Broad Money	October 2015	November 2015	M	M	M	…	…
Central Bank Balance Sheet	October 2015	November 2015	M	M	M	…	…
Consolidated Balance Sheet of the Banking System	October 2015	November 2015	M	M	M		
Interest Rates [2/]	Current	Current	D	D	D		
Consumer Price Index	October 2015	November 2015	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	April 2014	July 2014	M	M	M	O, O, LO, O	LO, O, LO, O, LO
Exports and Imports of Goods and Services	April 2014	July 2014	M	M	M		
GDP/GNP	2015Q2	November 2015	Q	Q	Q	O, O, LO, LO	LO, O, LO, O, LO
Gross External Debt	2014Q1	June 2014	Q	Q	Q		
International Investment Position [7/]	2015Q2	September 2015	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 on the Slovak Republic
January 11, 2016

This statement provides additional information on developments that took place as the staff report was being finalized. The information does not alter the thrust of the staff appraisal.

- *Third social package:* At the December conference of the governing Smer-SD party, the Prime Minister outlined a third social package to be implemented during 2016-2020 should Smer-SD retain power after the general election in March 2016. The cost of the proposals (about €1 billion or a little above 1 percent of GDP) is larger than expected and exceeds the combined cost of the two previous packages. The package would aim to:

  - create 100,000 new jobs by 2020 through an array of measures including support for lagging regions, families, agriculture, construction, and expansion of nursery schools;
  - improve second- and third-class roads;
  - reduce health insurance contributions for low-wage workers;
  - build rental apartments for young people with specific low-cost flats for new teachers, renovate student dormitories, and reduce student housing costs;
  - increase support for low-income pensioners, caregivers, and students; and
  - raise the number of police officers and special military forces.

  The government would prepare implementing legislation in 2016. The Prime Minister indicated that higher revenues from stronger economic growth and better tax collection would finance the package while still allowing a balanced budget to be achieved in 2018.

- *Jaguar Land Rover:* On December 11, 2015, the Slovak government and the carmaker Jaguar Land Rover finalized an investment agreement for construction of a new factory in Nitra. The approximately €1.4 billion investment is in line with assumptions in the staff report. Construction will start in 2016 with the plant expected to become operational in 2018 and directly employ about 2,800 people.

- *Power producer Slovenské Elektrárne (SE):* On December 18, 2015, the Italian energy company Enel agreed to sell its 66 percent stake in SE (currently valued at about €750 million) to the Czech energy company EPH in a two-stage deal, with the second part taking place only after completion of the delayed expansion of the Mochovce nuclear plant. The government retains options in the second stage of the deal to acquire an additional 17 percent stake, which would make it the majority shareholder with 51 percent of total capital, or to buy up to 100 percent of SE's shares under a right of first refusal.

Statement by Ibrahim Canakci, Executive Director for Slovak Republic and Marek Jakoby, Senior Advisor to the Executive Director January 11, 2016

The Slovak authorities appreciate the candid and useful discussions with the IMF team during the 2015 Article IV Consultation meetings. The staff report and the informative Selected Issues paper cover well the developments of and the outlook for the Slovak economy, and provide a fair picture of the policy challenges facing the authorities.

Overview

The Slovak economy has been performing well in a weak external environment, comparing favorably with the Eurozone as well as the European Union. Following 2.5 percent growth in 2014, economic activity has been accelerating in the course of 2015, reaching 3.7 percent in the third quarter (y/y) with robust domestic demand, and most notably public investment providing key contributions. Public investment accelerated particularly with respect to the end of the availability of EU funds within the 2007-13 programming period.

A major positive development has been the continued improvement in major labor market indicators throughout 2015 as employment increased by 2.6 percent in the first three quarters and the unemployment rate declined to 11.3 percent in the third quarter against 12.9 percent a year ago. The stagnating overall price level (with a modest decline into negative territory in the second half of 2015) due primarily to declining energy prices helped push real wage growth to over 3 percent in the third quarter, supporting private consumption.

The 2016 state budget is based on the assumption of 3.1 percent growth of GDP to be driven by the acceleration of private consumption while export growth is expected to weaken reflecting the slow growth in the main trading partners. Inflation is expected to pick up only modestly to 0.9 percent. Both real wage and employment gains should positively contribute to consumption growth with a somewhat lower saving rate providing additional impulse. While an acceleration of investment in the private sector is expected in 2016 it will merely compensate for the lower public investment due to the base effect of 2015. The Ministry of Finance projects further increases of GDP growth to 3.6 percent in 2017 and 2018. The negative output gap, estimated at 0.8 percent in 2015, should decline to 0.4 percent in 2016 and be closed in 2017. The risks to the outlook primarily stem from the external environment.

Unlike in the staff report, the government's GDP growth projections are conservative in the sense that they do not include the envisaged positive impact of the now confirmed investment of the fourth car manufacturer (Jaguar-Land Rover) which thus presents an upside risk to actual growth and should also lift potential growth currently estimated by the Ministry of Finance at 2.6 percent.

Fiscal Policy

The solid economic performance and the effectiveness of the measures aimed at tax revenue efficiency helped bringing tax revenues to above the budgeted levels in both 2014 and 2015.

However, higher revenues have not fully counter-balanced the increase in investment spending, healthcare outlays and the negative effect of the correction of EU funds in 2015. This is expected to result in an end-2015 general government deficit of 2.7 percent of GDP, slightly higher than the budgeted 2.5 percent of GDP.

The Slovak government remains committed to fiscal consolidation to ensure the sustainability of public finances. The path envisaged under the approved 2016-18 general government budget targeting the gradual reduction of the headline deficit to 1.9 percent of GDP in 2016, to 0.4 percent in 2017 and to zero in 2018, is ambitious but feasible. It is also in line with Slovakia's EU commitments and the domestic fiscal responsibility act. The structural deficit should decline from 2.1 percent in 2015 to no more than 0.5 percent of GDP in 2017, thus meeting Slovakia's medium-term objective (MTO). General government debt is expected to gradually decline from 52.8 percent of GDP at the end of 2014 to 48.9 percent of GDP in 2018. The envisaged adjustment relies primarily on the spending side, with intermediate consumption accounting for the bulk of the adjustment. The ongoing "ESO" reform, seeking more efficient public administration and the improvement in public procurement should be the key sources of the savings.

The authorities are aware that credible fiscal adjustment is essential for maintaining a high credit rating and favorable market financing terms and for preventing the materialization of the risk linked to the high share of non-resident holdings of Slovak government debt. At the same time, the authorities have been pursuing policies towards economic and social goals in line with the program manifesto and the National Reform Program. The measures included in several "social packages", including the reduction of the VAT from 20 to 10 percent on selected staple foods in effect since January 1, aim at spreading the benefits of solid economic performance particularly to the lower-income groups and lagging regions. In addition, measures such as higher day care allowances or investments in public day care capacities are also expected to support female labor market participation.

The government is committed to the continued improvement of tax collection efficiency and tax compliance as a key source of additional revenue. The authorities appreciate the very useful technical assistance provided by the FAD in 2012 on the assessment on the VAT Gap and the design of the action plan of 50 measures to mitigate tax evasion, particularly in VAT, by strengthening prevention and control, and stricter penalties. Recognizing the developing nature of tax fraud the government approved in 2015 the amended action plan with further 30 measures. With a substantial segment of fraud linked to cross-border activities the authorities recognize the need for the effective frameworks for international cooperation and exchange of information. Besides revenue collection, tax policy measures also aim at improving the business environment, e.g. introduction of a reverse charge for VAT payments in construction (liability of the buyer rather than the seller for the VAT) or the cash accounting scheme (VAT payment liability upon receipt of payment rather than at the time of invoice issuance) for small enterprises; and shortening of VAT refund periods. The government is also committed to improving the quality of spending by introducing the comprehensive and regular expenditure reviews to promote a value-for-money concept across all budgetary chapters. The pilot expenditure reviews have been launched, also with the support from the FAD for the Ministry of Education and the Ministry of Finance.

Financial Sector

The Slovak banking sector remains healthy and resilient to potential stresses, with solid levels of key indicators regarding capital, liquidity, asset quality and profitability.

At the same time, the authorities are aware of the developments that could create vulnerabilities, particularly with respect to the continued strong growth of household credit (over 13 percent in the first three quarters of 2015). After a three-year stagnation, corporate credit started to pick up modestly in mid-2015.

The National Bank of Slovakia (NBS), as the banks' regulator and supervisor in the framework of the Single Supervisory Mechanism (SSM), regards the existing prudential rules, including the recommendations guiding the maximum loan-to-value (LTV) levels on new housing loans, limits on new loans with very long maturity, and stress-testing the housing loan portfolios to an increase in interest rates and the deterioration of macroeconomic situation, as sufficient at the current juncture. In addition, the recently adopted act on housing loans which will come into effect in March 2016 tightens lending standards, mandating the banks to assess the borrowers' repayment capacity including at the time of significant loan top-up, disregarding the value of collateral. However, the NBS intends sending a stronger signal to the market by incorporating the recommendations into binding legislation and possibly tightening the prudential limits in 2016 should the strong growth continue. In addition, such legislation would also enable the introduction of debt-to-income (DTI) limits if needed. The NBS also recognizes the rising need for an increase of the counter-cyclical capital buffer from its current zero level, particularly if corporate credit growth shows signs of excessive growth as well.

Despite the adverse impact on the protracted period of low interest rates on insurance companies the sector remains relatively stable. The NBS currently does not see the need for macroprudential measures for insurance companies at this juncture, but stresses the importance of their prudent behavior, particularly with respect to payment of dividends in cases of weakening solvency.

Structural Issues

Despite the improvement in headline labor market indicators the Slovak authorities consider the significant structural challenges as well described in the staff report, particularly the high long-term and youth unemployment rates as well as the low labor participation of women. A set of measures has been adopted to improve incentives on both the demand and supply side of the labor market including a health contribution allowance for low-income workers, subsidies for the creation of jobs for the youth or re-training programs. The recent internal staff reallocation in labor offices has led to the improved ratio of clients to the contact point employees. The government is planning to comprehensively assess the efficiency of the all active labor market policies to further improve the system. The dual education scheme, aiming at better matching vocational education with the needs of businesses, has been off to a good start and the participation of businesses and students is expected to gradually increase.

Recognizing that private sector investment and economic activity are central to employment creation, the Slovak authorities put strong emphasis on the further enhancement in transport infrastructure, particularly the completion of the motorway and expressway network, improvement in the business environment, including by lowering the administration burden on entrepreneurs, as well as support to start-ups and research activities.