INTERNATIONAL MONETARY FUND

IMF Country Report No. 21/133

SLOVAK REPUBLIC

June 2021

2021 ARTICLE IV CONSULTATION—PRESS RELEASE; STAFF REPORT

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 2021 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 June 18, 2021 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 June 18, 2021, following discussions that ended on May 17, 2021, with the officials of the Slovak Republic on economic developments and policies. Based on information available at the time of these discussions, the staff report was completed on June 3, 2021.
- An **Informational Annex** prepared by the IMF staff.

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

Selected Issues

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PRESS RELEASE

PR21/190

IMF Executive Board Concludes 2021 Article IV Consultation with Slovak Republic

FOR IMMEDIATE RELEASE

Washington, DC – June 22, 2021: On June 18, 2021 the Executive Board of the International Monetary Fund (IMF) concluded the Article IV consultation[1] with the Slovak Republic.

The Slovak economy faced the COVID-19 pandemic from a position of strength, with unemployment at record lows, a banking system with strong capital and liquidity buffers, and some fiscal space. While the pandemic exacted a heavy toll, the effective and timely policy response and resilient external demand limited the economic fallout. The output contraction of 4.8 percent in 2020 was milder than the euro area average and smaller than feared at the onset of the pandemic. The array of measures deployed by the authorities focused on providing income and liquidity support to households and corporates, saving tens of thousands of jobs and businesses. Nonetheless, registered unemployment increased by about 3 percentage points, hitting some workers and regions particularly hard. The fiscal deficit jumped to 6.1 percent of GDP, and the debt-to-GDP ratio, which had been on a declining path, rose above 60 percent.

The outlook for 2021 is for a rebound in economic activity though uncertainty remains very high. With the second wave of infections receding and continued strong policy support, real GDP growth is forecast at 4¾ percent this year, accelerating further in 2022. Over the medium term, growth will be boosted by sizable EU-funded investments. Nevertheless, some scarring is foreseen with medium-term output remaining below the pre-crisis trend. Risks to the forecast are large and dominated by the virus dynamics and the success of the vaccination campaign.

Executive Board Assessment[2]

Executive Directors agreed with the thrust of the staff appraisal. They commended the Slovak authorities for their swift and effective policy response, which helped limit the social and economic impact from the crisis. Looking ahead, Directors noted that, despite high uncertainty, risks are broadly balanced and medium-term prospects are robust on the back of sizable investments.

Directors concurred that the fiscal support budgeted for this year will help secure the recovery and provide insurance against downside risks. They considered that policy support should gradually shift to facilitating needed reallocation of labor and capital and minimizing scarring as the recovery takes hold. Directors welcomed the planned reforms in taxation, public finance administration and the fiscal framework, which will help to strengthen tax collection, improve the efficiency of public spending and

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[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.

[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.

increase buffers. Directors emphasized the need to begin the planning process for a credible medium-term consolidation plan. They stressed the importance of well-designed fiscal rules and pension reform and welcomed the envisaged introduction of expenditure ceilings and the relinking of retirement age to life expectancy as outlined in Slovakia's Recovery and Resilience Plan.

Directors commended the resilience of the banking sector, which entered the crisis with strong capital and liquidity buffers. They encouraged maintaining the flow of credit, while safeguarding financial stability. Directors considered that corporate vulnerabilities and housing market risks require continued vigilance. They assessed the current macroprudential stance as broadly adequate and suggested strengthening restructuring mechanisms and the insolvency framework. Efforts to continue to upgrade the AML/CFT framework were also encouraged.

Directors praised the authorities for the ambitious investments and reforms embedded in the Slovak Recovery and Resilience Plan and encouraged them to use promptly and efficiently EU funds including from the Next Generation EU. They welcomed the focus of the authorities' reform agenda on accelerating the digital and green transformation, strengthening human and physical capital and boosting productivity, through greater investments in education and healthcare, research and innovation, more efficient public services and improved governance. Directors noted the relative strength of the Slovak labor market and recommended more targeted measures for those disproportionately affected by the crisis to assist the transition of workers and prepare them for the demands of the future.

Timely and effective execution of investments and implementation of reforms would be essential to sustain robust and inclusive growth.

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

Slovak Republic: Summary of Economic Indicators, 2019−22

	2019	2020	2021	2022
			Projections	
	(Annual percentage change, constant prices, unless noted otherwise)			
Output/Demand				
Real GDP	2.5	-4.8	4.7	4.9
Domestic demand	3.7	-5.6	3.0	6.8
Public consumption	4.6	0.3	2.2	2.1
Private consumption	2.7	-1.2	0.3	5.9
Gross fixed capital formation	6.6	-12.0	3.7	11.9
Exports of goods and services	0.8	-7.6	11.5	4.2
Imports of goods and services	2.1	-8.5	10.1	6.1
Potential Growth	3.0	0.8	3.1	3.3
Output gap	1.0	-4.6	-3.1	-1.5
Contribution to growth				
Domestic demand	3.7	-5.4	3.1	6.5
Public consumption	0.8	0.0	0.4	0.4
Private consumption	1.5	-0.7	0.2	3.3
Gross fixed capital formation	1.4	-2.6	0.8	2.4
Inventories	0.0	-2.1	1.8	0.5
Net exports	-1.2	0.6	1.6	-1.6
Prices				
Inflation (HICP)	2.8	2.0	1.3	1.9
Inflation (HICP, end of period)	3.2	1.6	1.6	1.8
Core inflation	2.5	2.4	1.9	1.6
GDP deflator	2.5	2.4	1.2	2.2
Employment and wages				
Employment	1.0	-1.9	-0.3	0.8
Unemployment rate (Percent)	5.8	6.7	7.3	6.6
Nominal wages	7.8	3.7	4.8	4.6
		(Percent of GDP)		
Public Finance, General Government				
Revenue	41.3	41.6	41.8	41.6
Expenditure	42.7	47.8	50.6	46.5
Overall balance	-1.3	-6.1	-8.8	-4.9
Primary balance	-0.3	-5.1	-7.9	-4.0
Structural balance (Percent of potential GDP)	-1.8	-2.1	-4.2	-4.2
General government debt	48.2	60.3	63.0	65.0
Monetary and financial indicators		(Percent)		
Credit to private sector (Growth rate)	6.6	4.8	6.5	7.8
Lending rates	1.4	1.1	…	…
Balance of payments		(Percent of GDP)		
Trade balance (goods)	-1.0	0.6	1.5	0.2
Current account balance	-2.7	-0.4	-0.6	-1.6
Gross external debt	112.4	121.2	118.1	115.0
Saving and investment balance		(Percent of GDP)		
Gross national savings	20.7	18.0	17.7	19.3
Private sector	19.2	16.4	16.3	18.0
Public sector	1.4	1.5	1.4	1.3
Gross capital formation	23.4	18.3	18.3	21.0
Memo item				
Nominal GDP (Millions of euros)	93,900	91,555	97,037	104,080

Sources: National Authorities and IMF staff projections.

INTERNATIONAL MONETARY FUND

SLOVAK REPUBLIC

STAFF REPORT FOR THE 2021 ARTICLE IV CONSULTATION

June 3, 2021

KEY ISSUES

Context: The Slovak Republic faced the pandemic from a position of strength with fiscal space and comfortable banking sector buffers. Effective policy support, through measures aimed at preserving jobs, providing liquidity support, and ensuring credit supply, have limited the economic fallout. Output is expected to reach pre-crisis level before the end of 2021, but uncertainty is high.

Key policy recommendations: The near-term priority is to keep the pandemic at bay and accelerate the distribution of vaccines, while mitigating economic costs through continued policy support. However, policies should increasingly shift towards targeted measures that enable needed resource reallocation and prevent scarring.

- Continued fiscal support to affected households and firms is appropriate to secure the recovery. Current schemes could be complemented with measures that facilitate job creation and reallocation and address elevated corporate solvency risks. A gradual fiscal consolidation should not begin until the recovery is well underway, but the planning process should start now and identify concrete consolidation measures that underpin a credible medium-term fiscal path. Implementing envisaged reforms to Slovakia's fiscal rules framework would help rebuild buffers, which should also be a guiding objective of the pension reform.
- Financial sector policies should continue enabling banks to supply credit, while guarding against the buildup of risks. To ensure continued credit flow, the loan guarantee program should be strengthened. Further release of the broad-based countercyclical capital buffers or a relaxation of regulatory requirements for retail lending could support credit growth if needed. Capital-based measures on mortgage exposures including a sectoral systemic risk buffer could be considered if housing market imbalances persist. Prudential flexibility should be carefully withdrawn, with supervisors ensuring sound provisioning.
- Structural reforms can set the stage for robust, sustainable, and inclusive growth. Leveraging sizable NGEU resources to strengthen investment in human and physical capital, boost productivity and accelerate the green and digital transformation would be critical for Slovakia's continued convergence.

Approved By
Jörg Decressin (EUR) and Martin Čihák (SPR)

Discussions took place by video conference during May 3–17, 2021. The mission met with Finance Minister Matovič, National Bank of Slovakia Governor Kažimír, other senior officials from the Finance, Economy, Education, Environment, Health, Justice and Labor ministries, the National Bank of Slovakia, the Council for Fiscal Responsibility, ARDAL, and representatives from the private sector, the European Commission and the ECB. The staff team comprised Ms. Topalova (head), Mr. Spector, Ms. Valderrama and Mr. Wu (all EUR). Messrs. Acosta and Garrido (both LEG) participated in some discussions. Mr. Harvan (OED) also attended the meetings. Ms. Espinoza and Ms. Sandhu assisted in the staff report preparation.

CONTENTS

CONTEXT 4

PANDEMIC IMPACT AND POLICY RESPONSE 5

OUTLOOK AND RISKS 9

POLICY DISCUSSIONS 12
A. Fiscal Policy 12
B. Financial Sector Policies 15
C. Structural Policies 20

STAFF APPRAISAL 22

BOXES
1. Slovakia and the Recovery and Resilience Facility 11
2. The Corporate Sector during the COVID-19 Pandemic 16
3. The Banking Sector: Stress and Sensitivity Tests 17

FIGURES
1. Real Sector Developments 25
2. Labor Market Developments 26
3. External Sector Developments 27
4. Fiscal Sector Developments and Challenges 28
5. The Slovak Banking Sector in a Cross-Country Perspective 29
6. Credit Developments 30
7. The Unequal Impact of the Pandemic 31
8. The Need for Human Capital Investment 32
9. The Green and Digital Transition 33
10. Boosting Productivity 34

TABLES

1. Summary of Economic Indicators, 2018–26 35
2. Statement of Operations of the General Government, 2018–26 36
3. Balance of Payments, 2018–26 37
4. Financial Soundness Indicators for the Banking Sector, 2013–20 38

ANNEXES

I. Authorities' Response to Past IMF Policy Recommendations 38
II. Policy Measures in Response to COVID-19 41
III. External Sector Assessment 42
IV. Risk Assessment Matrix 44
V. Debt Sustainability Analysis 46
VI. Slovakia's Pension System: Recent Reforms and Challenges 57

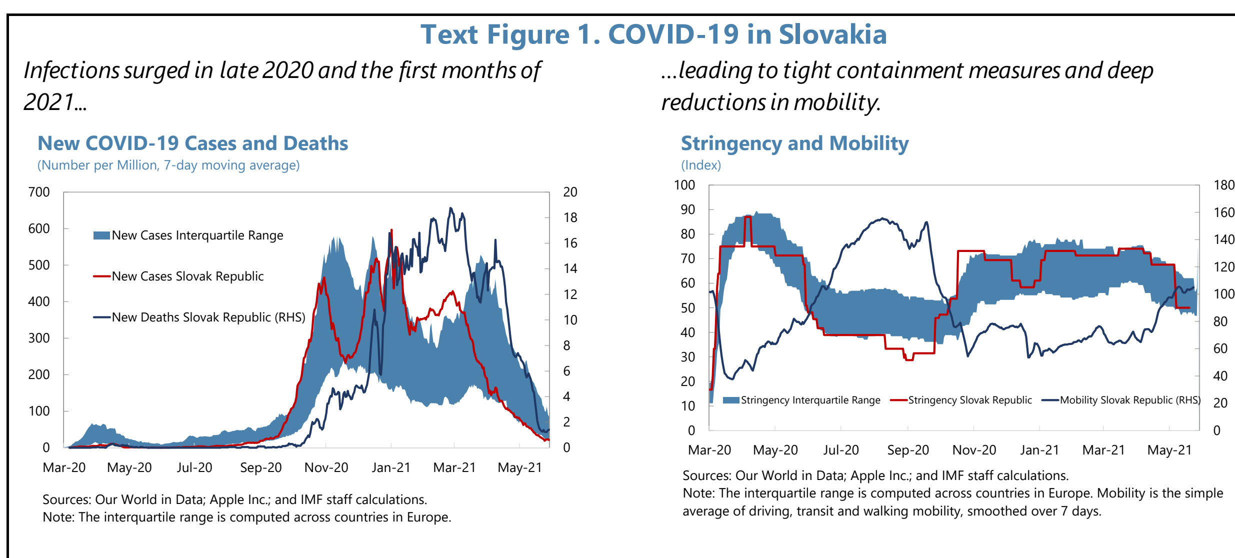
CONTEXT

1. **The Slovak economy faced the COVID-19 pandemic from a relatively strong position.** It had experienced sustained growth for years, with per capita income reaching 72 percent of the EU average. Growth decelerated in 2019, but the labor market continued to improve, with unemployment at record lows and participation at record highs. Slovakia had also accumulated fiscal space, and its banking system had strong capital and liquidity buffers.

2. **An effective policy response helped Slovakia weather the crisis well initially, but subsequent infection waves tested these achievements.** Prompt and strict containment measures and deep reductions in mobility resulted in a mild initial outbreak, an early reopening and strong rebound in activity, supported by fiscal, monetary, and financial sector measures, and robust demand for Slovakia's exports. A vicious second wave took hold in the fall, hospitalization and death rates rose precipitously, and stringent public health measures were reinstated. The economy struggled to maintain momentum in early 2021 with retail sales declining sharply and unemployment inching up due to supply constraints and depressed demand. However, the manufacturing sector remained open and high frequency indicators point to a rebound in consumer confidence as the second wave recedes. The vaccination rollout is proceeding, but, amid initial procurement delays at the EU level and vaccine hesitancy, only about one-third of adults had received at least one dose by late May.

3. **A fragile coalition complicates policymaking.** Running on an anti-corruption platform, the center-right opposition party, OĽaNO, won the February 2020 elections and formed a coalition government with three other parties. While the government has a constitutional majority, tensions within the coalition mounted over the proper management of the crisis, culminating with the resignation of the government and the formation of a new one in April 2021, with a slightly modified cabinet and a largely unchanged policy agenda.

Text Figure 1. COVID-19 in Slovakia



Infections surged in late 2020 and the first months of 2021...

Sources: Our World in Data; Apple Inc.; and IMF staff calculations.
Note: The interquartile range is computed across countries in Europe.

...leading to tight containment measures and deep reductions in mobility.

Sources: Our World in Data; Apple Inc.; and IMF staff calculations.
Note: The interquartile range is computed across countries in Europe. Mobility is the simple average of driving, transit and walking mobility, smoothed over 7 days.

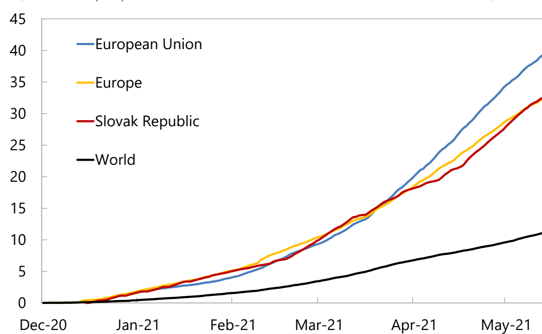
Text Figure 1. COVID-19 in Slovakia (Concluded)

Vaccination is proceeding in line with the average pace in Europe.

Total reported deaths from COVID-19 are above the European average when scaled by population.

COVID-19 Administered Vaccines

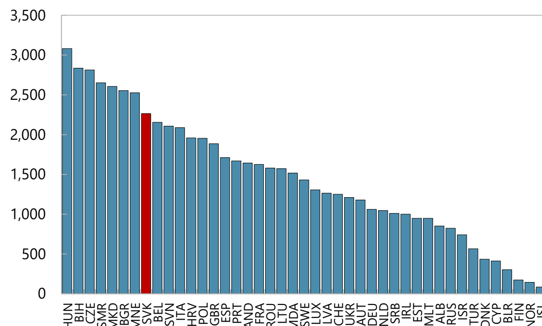
(Percent of people who received at least one dose of COVID-19 vaccine)



Sources: Our World in Data; and IMF staff calculations.

COVID-19 Total Reported Deaths

(Number per Million, June 2, 2021)



Sources: Our World in Data; and IMF staff calculations.

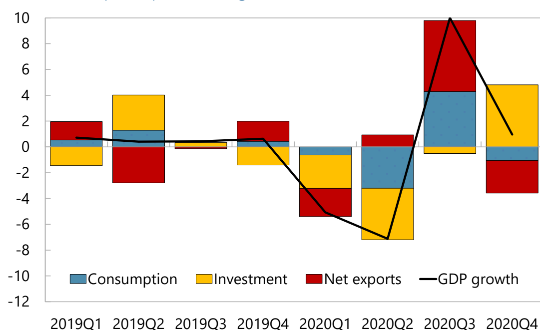
PANDEMIC IMPACT AND POLICY RESPONSE

4. The Slovak economy experienced a deep recession. GDP declined by 4.8 percent in 2020, with a much larger investment collapse. On the supply side, a sharp contraction of contact-intensive sectors and manufacturing due to lockdowns and supply chain disruptions led to a historic drop in activity in Q2. But activity rebounded and became more resilient to the pandemic through 2020. Factories remained operational and robust export demand and inventory replenishment helped industrial production reach pre-pandemic levels by end-2020. Overall, the 2020 contraction was milder than the Euro Area average and smaller than initially feared (Figure 1).

Text Figure 2. Real Sector Developments

Contributions to Real GDP Growth

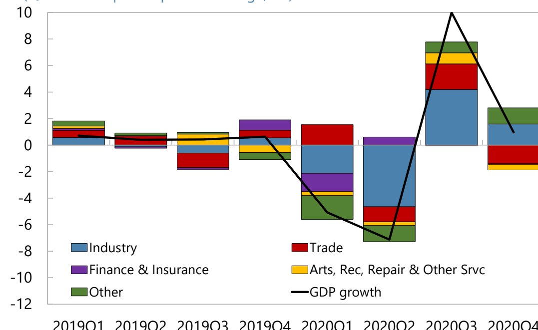
(Quarter-on-quarter percent change, SA)



Source: Haver Analytics.

Contributions to Real GDP Growth

(Quarter-on-quarter percent change, SA)



Source: Haver Analytics.

5. **An array of policy measures were deployed in response to the pandemic.** Most policy support was promptly introduced and appropriately extended and expanded (Annex II).

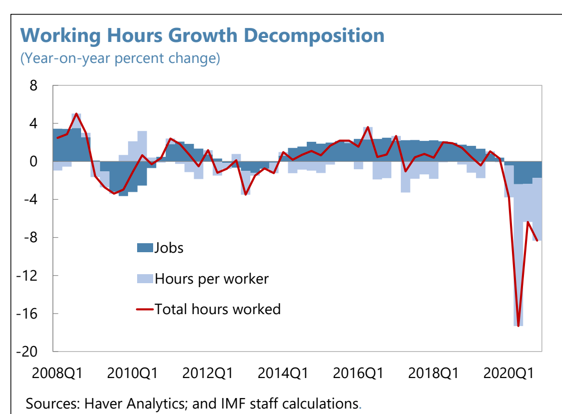
- Key fiscal policy measures include ramped-up health spending, and support to households and businesses, through wage subsidies, expanded sickness and unemployment benefits, and tax relief. Direct aid in 2020 amounted to 2.1 percent of GDP. The fiscal deficit rose to 6.1 percent of GDP and public debt reached 60.3 percent (Figure 4 and Annex V).

- To alleviate liquidity pressures, the government deferred income taxes and social contributions for affected businesses, introduced debt moratoria, and rolled out loan guarantee programs. More than 11 percent of loans to households and corporates had taken advantage of the legislated debt moratorium by June 2020. The take-up of some of the guaranteed loans schemes, however, has been more limited. The authorities estimate utilized liquidity support of 2.2 percent of GDP in 2020.

- To support credit provision, the National Bank of Slovakia (NBS), together with the ECB and the European Banking Authorities, allowed banks to operate temporarily below the Pillar 2 capital guidance, the capital conservation buffer, and the liquidity coverage ratio. Further relief was provided through flexibility in accounting and supervisory standards and changes in EU capital regulation. The NBS reduced the counter-cyclical capital buffer (CCyB) to 1 percent, and recommended banks do not pay out dividends, while the cancellation of the bank levy provided a further boost to bank capital. Staff estimate that these measures (dividend restriction, CCyB cut, and bank levy cancellation) could have added roughly 0.9 percent of GDP to banks' capital.

6. **Policies were effective in limiting the damage to households and corporates so far with the banking sector playing an important complementary role.**

- Despite the large contraction in output, job and income losses were muted, supported by the newly introduced job retention schemes, with most labor market adjustment occurring through lower hours worked (Figure 2). The 2020 decline in private consumption was among the smallest in Europe. Nonetheless, registered unemployment increased by about 3 percentage points with uneven effects across workers and regions.

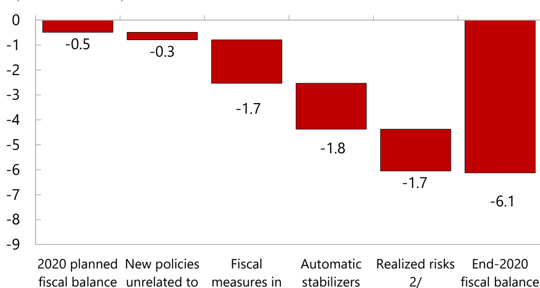


Sources: Haver Analytics; and IMF staff calculations.

Text Figure 3. Fiscal Measures and Outturn in 2020

The widening of the fiscal deficit reflects implemented COVID-19 measures, automatic stabilizers, as well as sizable realized budgetary risks unrelated to the pandemic.

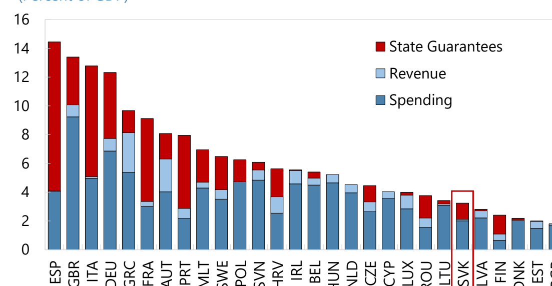
Contribution to the 2020 General Government Deficit
(Percent of GDP)



Source: 2021 Stability Program.
1/ After deducting EU funding for COVID-19 measures (0.4 percent of GDP).
2/ Includng other factors (positive 0.3 percent of GDP).

The package of discretionary measures was somewhat smaller than the average in the EU and other advanced European economies.

Implemented Measures in Response to COVID-19 in 2020: On-budget (General Government) and State Guarantees
(Percent of GDP)



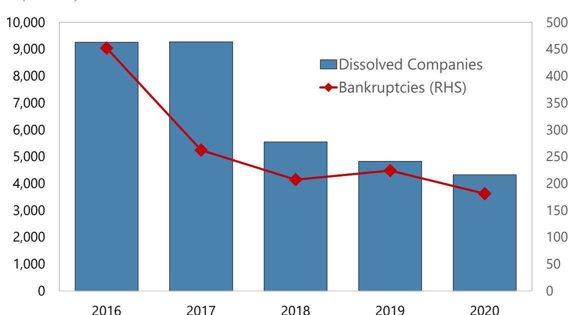
Source: EUR REO database of fiscal measures. The sample includes EU and other advanced European economies.

- Corporate bankruptcies have also remained subdued to date. Implemented policies absorbed a significant fraction of corporates' liquidity needs, which, together with easy financial conditions and temporary insolvency protection, limited firm distress (Box 2). Surveys of corporates suggest policy measures were widely used and relatively well-targeted. Solvency support (e.g. grants), however, was more limited in 2020, with the crisis potentially widening corporate equity gaps by 2–5 percent of GDP.

Text Figure 4. The Use of Corporate Support Measures

Corporate bankruptcies declined in 2020.

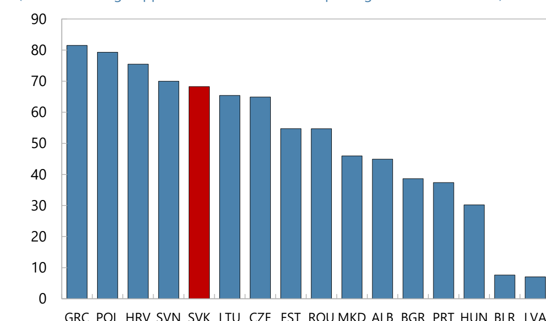
Dissolved Companies and Corporate Bankruptcies
(Number)



Sources: Finstat; and Ministry of Justice of the Slovak Republic.

A large share of firms that experienced a drop in demand reported using government support ...

Corporate Support Access
(Firms Receiving Support as Percent of Firms Reporting Decline in Demand)



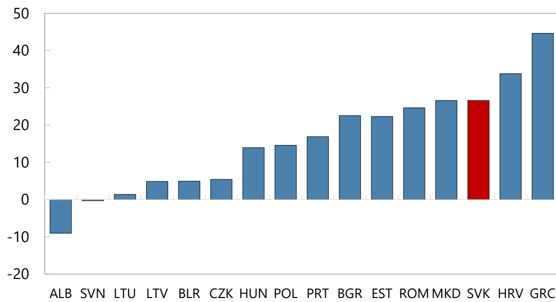
Sources: World Bank Enterprise Surveys, COVID-19 Module, Wave 1.

Text Figure 4. The Use of Corporate Support Measures (Concluded)

… with the incidence of support higher among firms with a drop in demand versus those without.

Corporate Support Targeting

(Difference in Percent of Firms Receiving Support Among Firms with Lower Demand and Percent of Firms Receiving Support Among Firms without Lower Demand)

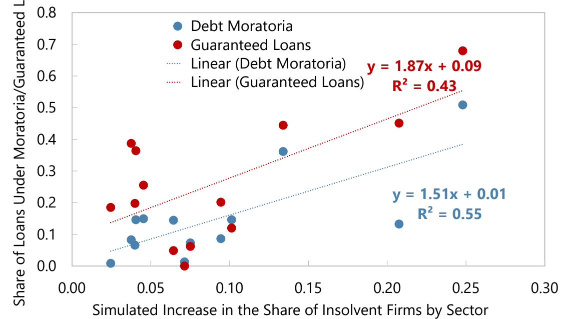


Sources: World Bank Enterprise Surveys, COVID-19 Module, Wave 1.

Firms in sectors hit hardest by the pandemic were more likely to use debt moratoria and/or guaranteed loans.

Debt Moratoria and Guaranteed Loans Across Sectors

(Share of Total in Sector)



Sources: National Bank of Slovakia; Orbis; and IMF staff calculations. See Box 2.

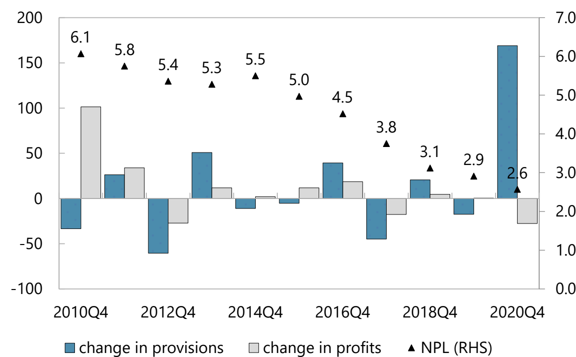
- The financial sector also weathered the COVID-19 shock well. Bank solvency and liquidity increased, and NPL ratios declined through 2020 (Figure 5). Banks, however, proactively tripled provisions expecting support withdrawal. The financial and business cycle disconnected in 2020: the positive credit-to-GDP gap widened while the output gap turned negative. Credit growth remained resilient, fueled by mortgage loans, while business lending slowed, and consumer loans contracted (Figure 6). Real estate prices continued to rise. With the significant GDP decline in 2020, a non-negligible gap emerged between actual and model-predicted house values though the extent of house price misalignment is difficult to gauge given the unique nature of the shock.[1]

Text Figure 5. Banking Sector Asset Quality and Housing Prices

NPL ratios continued to decline through 2020, though banks significantly stepped up provisioning...

Build up of Provisions

(Year-on-year percent change; percent)

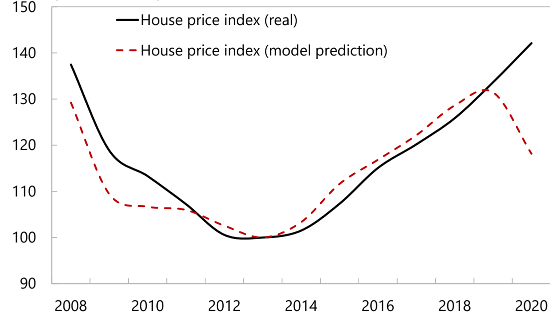


Sources: Haver Analytics; and IMF staff calculations.

House prices continued growing, reaching an estimated overvaluation of about 20 percent.

House Price Index and Model Prediction

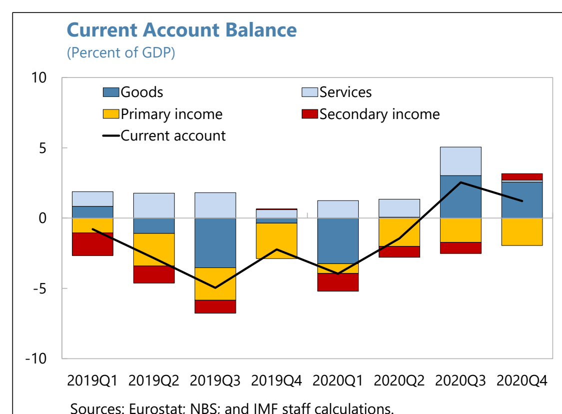
(2013=100, real)



Sources: Eurostat; National Bank of Slovakia; and IMF staff estimates.

[1] A key driver of the housing price gap is the decline in GDP, which may be a poor proxy for households' perceived permanent income during the pandemic.

7. The external position remained broadly in line with fundamentals and desirable policies (Figure 3 and Annex III). The current account deficit narrowed significantly with an improvement in the trade balance as foreign private spending shifted from services to goods. The cyclically adjusted current account balance coincides with its EBA-lite model norm, implying no REER misalignment.



OUTLOOK AND RISKS

8. A recovery is projected for 2021. Assuming 60 percent of the population is vaccinated by end 2021:Q3, and disruptions in semiconductor supply do not lead to prolonged closures of car factories, staff expects activity to rebound in 2021:H2 and reach pre-crisis level by 2021:Q3.[2] The weak start to the year, however, limits projected annual GDP growth for 2021 to 4.7 percent. Some scarring is foreseen with 2025 output about 1.5 percent below pre-pandemic forecasts. Inflation is expected to dip in 2021, reflecting lower regulated energy prices and a sizable output gap.

9. Over the medium term, growth is expected to remain robust on the back of sizable investments. Slovakia is set to receive 6.9 percent of 2020 GDP in grants over 2021–26 from the Recovery and Resilience Facility (RRF) of the Next Generation EU (NGEU) Recovery Plan, most of which will be allocated to new public investment (Box 1). Capacity expansion of the auto sector would also boost activity through higher investment, and subsequently exports. Population ageing, however, will begin weighing on growth.

10. Uncertainty is unusually high, with risks broadly balanced (Annex IV). Resurgent infections, new variants, vaccination delays and hesitancy could lead to a protracted period of start-stop activity. Continued tensions within the government coalition could increase uncertainty. The phasing out of support measures could trigger a rise in corporate bankruptcies (Box 2) and unemployment, which could weigh on private consumption and investment both directly and by limiting credit supply due to the erosion of bank capital (Box 3). A housing price correction poses a risk to the banking sector after years of robust mortgage credit growth (Box 3 and Selected Issues Papers). As a highly specialized export-dependent economy, Slovakia is vulnerable to disruptions in supply chains, production re-shoring and technological changes, such as automation or e-mobility (Selected Issues Papers). Conversely, successful virus containment could boost confidence, stimulus packages in the US and the EU could strengthen export demand, and stronger investments and reforms dividends could lift growth above baseline.

[2] As of mid-May 2021, semiconductor supply disruptions have led some car manufacturing plants to close intermittently for short periods of time.

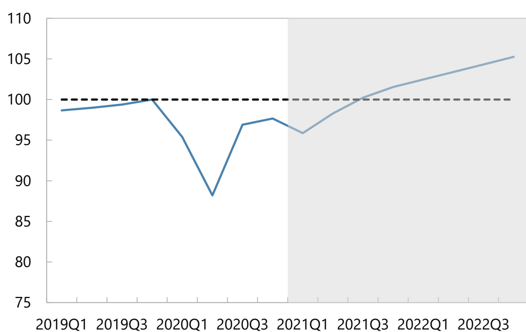
Authorities' Views

11. The authorities broadly agreed with staff's assessment of the near-term outlook and risks. After a weak start to 2021 due to the reintroduction of lockdowns, they expect the economy to rebound as containment measures are eased and vaccination proceeds, with the industrial and export sectors remaining important drivers of growth. The high degree of uncertainty, however, is reflected in the wide range of forecasts across institutions. The NBS downside risk scenario assumes that the virus will not be successfully suppressed, leading to the adoption of stricter and more permanent containment measures. Conversely, a faster-than-expected containment of the virus and large support packages in the EU and the US present key upside risks.

Text Figure 6. The Outlook

Output is expected to return to pre-pandemic levels in the second half of 2021 ...

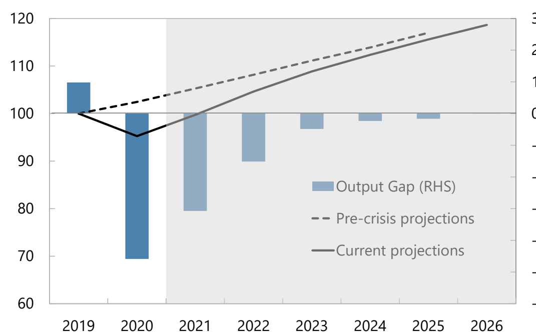
Quarterly Real GDP Projections
(2019Q4=100)



Sources: Haver Analytics; and IMF staff calculations.

...and display sustained growth through 2026, though some scarring is foreseen.

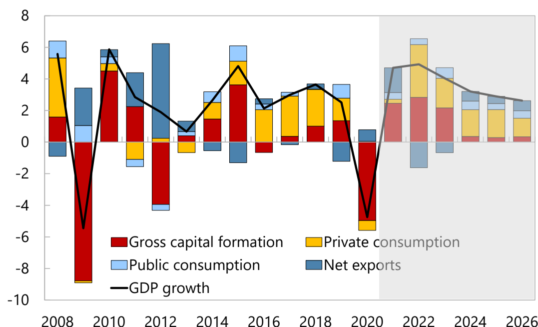
Real GDP and Output Gap Projections
(2019=100; Percent of Potential GDP)



Sources: WEO; and IMF staff calculations.

Economic activity in 2021 will be supported by foreign demand, while domestic demand will be the key driver of growth in subsequent years.

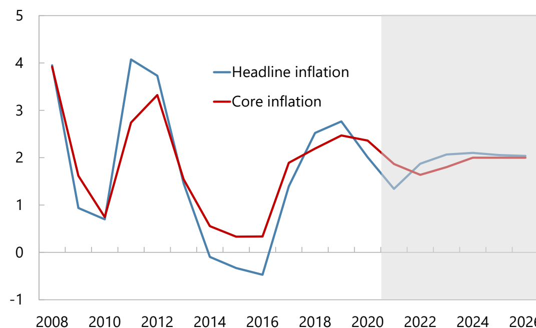
Contributions to GDP growth
(Percentage Point)



Sources: Haver Analytics; and IMF staff calculations.

Prices are expected to decelerate in 2021 mostly due to a decrease in regulated energy prices.

Inflation
(Percent change of period average prices)

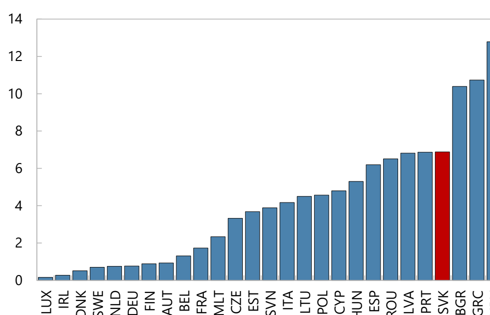


Sources: Haver Analytics; and IMF staff calculations.

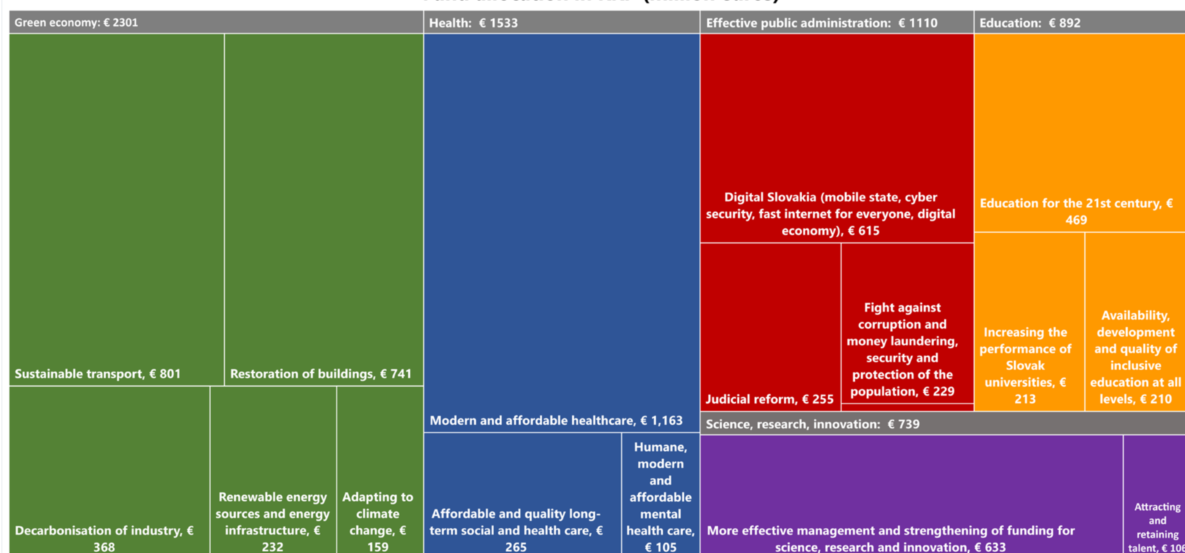
Box 1. Slovakia and the Recovery and Resilience Facility

Slovakia will be a key beneficiary of the Recovery and Resilience Facility (RRF), the centerpiece of the Next Generation EU recovery plan. Its RRF grant envelope of €6.3 billion (6.9 percent of 2020 GDP) will be distributed over 2021-26 to finance new investments and reforms, without any co-financing requirements.

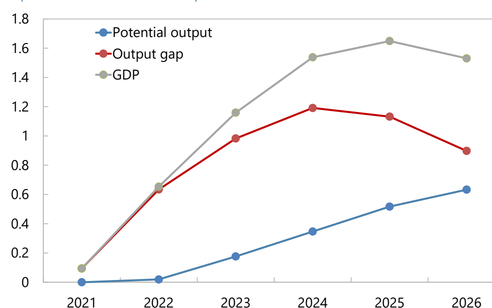
Slovakia's Recovery and Resilience Plan (RRP) identifies five main areas for investment and reforms that tackle many of the country's structural challenges: green economy, health, education, public administration, and research and innovation. Various projects within these areas will contribute to digitalization.



Sources: European Commission; and Eurostat.



Staff estimate that RRF grants could significantly raise Slovakia's GDP. Under standard assumptions on multipliers and persistence, the positive effect on the level of GDP is expected to peak in 2025, with GDP 1.6 percent higher than in the absence of grants.[1] The RRF funds would help close the output gap faster as well as boost potential output as the capital stock expands. Beyond the forecast horizon, structural reforms could raise potential output through higher productivity and improvements in both physical and human capital.



Source: IMF staff calculations.

[1] Staff assume a multiplier of 0.5, with a persistence factor of 0.5. 80 percent of funds are assumed to finance public investment, and thus raise potential output by expanding the stock of capital.

POLICY DISCUSSIONS

The near-term priority is to keep the pandemic at bay and accelerate the distribution of vaccines, while mitigating economic costs through continued policy support. Going forward, fiscal policy should increasingly shift towards targeted measures that enable needed resource reallocation and prevent scarring, while not losing sight of the need to rebuild space when the economic recovery is entrenched. The high uncertainty about the recovery's path requires continued flexibility, in terms of the size and mix of policy measures, and clear communication. Financial sector policies should continue enabling credit provision, while guarding against the buildup of risks. Structural reforms should aim to make the Slovak economy more productive, inclusive, and resilient, and support the green and digital transformation, including through the efficient use of EU funds.

A. Fiscal Policy

12. Fiscal policy is projected to remain appropriately expansionary in 2021. The 2021 Stability Program envisages a sizable increase in the fiscal deficit, with higher allocation for health spending, extended and expanded job retention schemes, support to selected sectors and buffers for pandemic-related contingencies. The continued expansionary fiscal stance and sizable buffers are appropriate, given the negative output gap, high uncertainty surrounding the path of the pandemic and potential for long-term scarring. If activity surprises on the upside, it would be advisable to save the unspent reserves for pandemic-related contingencies. Staff projects the fiscal deficit to reach 8.8 percent of GDP, lower than the budgeted 9.9 percent of GDP, reflecting a stronger economic rebound than forecast in the Stability Program and some savings of pandemic-related reserves. The authorities should ensure governance safeguards and accountability of crisis-related spending, including transparency in procurement.

13. However, policies should increasingly shift to targeted support that facilitates the necessary resource reallocation and minimizes long-term scarring. As the recovery firms up and demand for lifelines declines, policies should focus on preventing the crisis from eroding the economy's potential. While job retention schemes limited the initial impact of the pandemic on labor markets, policies could shift towards supporting workers' reallocation to growth sectors, thus curbing the rise in long-term unemployment and associated scarring, through higher spending on active labor market policies (ALMP), like well-targeted hiring subsidies, training, reskilling, and job search assistance. While encouraging the smooth exit of *unviable* firms, the authorities could strengthen the balance sheets of *viable* firms (especially SMEs) in affected sectors to prevent excessive bankruptcies, depressed investment, and zombification. Estimated equity gaps call for well-targeted solvency support including through equity-like instruments.[3]

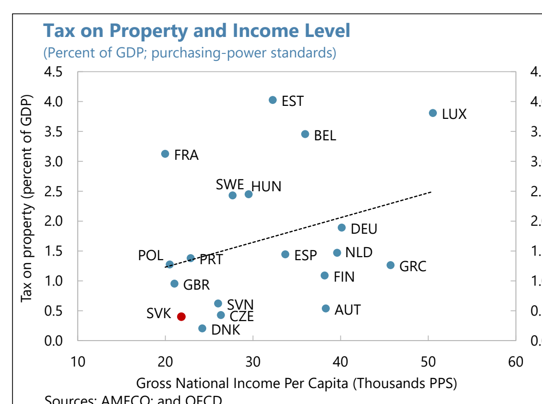
[3] Viability assessments should be based on business forecasts demonstrating firms can generate value when the economy recovers conditional on receiving support. For micro firms and very small SMEs, for which viability assessments may be impractical, support could be based on the pandemic's estimated impact.

14. Timely and effective absorption of sizable EU transfers will be crucial to strengthen the recovery, boost potential and accelerate the green and digital transformation.[4] Staff welcomes authorities' progress in improving public investment efficiency, by creating a central public investment authority and a pipeline by ministries. Further actions may be needed, following the 2019 PIMA recommendations, such as better coordination between regional and sectoral strategies, a specialized unit to strengthen the financial oversight of major SOEs, and stronger procurement auditing.

15. When a robust expansion is firmly in place, fiscal buffers will need to be rebuilt to restore room for maneuver and accommodate rising ageing-related spending. Under the no-consolidation baseline scenario, staff projects the fiscal deficit to decline to 2.8 percent of GDP by 2026, above pre-pandemic levels due to the permanent measures and realized risks that contributed to the 2020 deficit. Debt would reach 62½ percent of GDP by 2026, above the upper ceiling of national fiscal rules.[5] While debt is not high from a cross-country perspective and interest rates are expected to remain low, Slovakia faces large fiscal pressures from population ageing (Annex V and VI). Staff emphasized that the timing of consolidation (beginning in 2023 according to the Stability Report) should depend on the economic situation, but the authorities should start the planning process now and identify measures that underpin a credible medium-term fiscal path. Possible adverse growth impacts of consolidation could be mitigated by a faster drawdown of the 2021–27 MFF grants and effective and timely absorption of NGEU funds.

16. Planned reforms in taxation, public finance administration, the fiscal framework and the pension system will help rebuild fiscal buffers while addressing structural weaknesses.

- **Taxation.** The RRP envisages an increase in property and environmental taxes (as recommended in past staff reports) and a reduction in labor taxation. Raising real-estate taxation to EU levels (e.g., via linking real-estate taxes to market values) could have sizable fiscal yields and contain house price growth. Property tax is also a growth-friendly, efficient, and equitable revenue source, while environmental taxation could help address climate and other externalities.



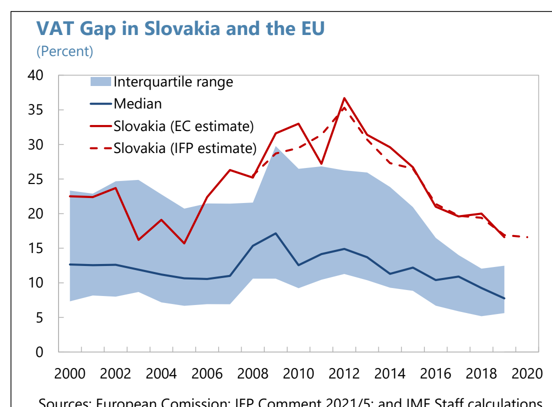
Sources: AMECO; and OECD.

- **Revenue and spending efficiency.** Staff welcomes plans to improve revenue and expenditure efficiency. VAT gaps remain sizable despite significant progress. The adoption of eInvoice will

[4] In addition to NGEU grants, Slovakia has to absorb €7.9 billion under the 2014–20 Multiannual Financial Framework (MFF) and €12.8 billion under the 2021–27 MFF cycle.

[5] Under current fiscal rules, if debt exceeds 54 percent of GDP in 2023, a vote of confidence would be needed. The appointment of a new government in April 2021 triggered a 24-month escape clause.

strengthen VAT and corporate income tax collection. Integrating the principle of value for money (VfM) into budgetary processes should help free up resources.



- **Fiscal framework reform.** Envisaged amendments to the Constitutional Act on Budgetary Responsibility, namely multiannual expenditure ceilings, debt brake rule revisions, and an enhanced role for the Council for Budget Responsibility, will be critical to strengthen public finances and mitigate policy procyclicality. Spending limits would ensure savings during periods of economic strength, which was difficult in the past. The shift to targeting net debt could allow more flexible debt management. Modified sanctions and escape clauses would strengthen the ability of fiscal policy to play a macro-stabilizing role.

Estimated Fiscal Yields from Possible Measures (Percent of GDP)	
Raising property tax to the EA average controlling for income	0.9
Closing half of VAT gap with the EU median level	0.4
Realizing half of additional VfM saving potential	0.4
Total	**1.7**

Sources: National authorities; and IMF staff calculations.

- **Pension reform.** Implemented and proposed changes to the pension system, however, could have a mixed fiscal impact (Annex VI). Slovakia's pension system already faces challenges due to its rapidly ageing population and the 2012 reform reversal. To ensure sustainability, it would be essential to relink retirement age to life expectancy and minimize the cost of the parental bonus.

- Authorities' commitment in the RRP to restore the link between retirement age and life expectancy and introduce expenditure ceilings is encouraging. Prompt implementation will send a strong signal of the government's commitment to fiscal prudence and reforms.

Authorities' Views

17. The authorities noted that fiscal measures were crucial in supporting the economy and limiting the fallout from the crisis. The fiscal policy response in 2020 was efficient and effective in limiting the rise in unemployment and supporting household consumption and is set to continue in the first half of 2021. The 2021 Stability Program, prepared in a conservative fashion, ensures sufficient funds to support the economy and ample reserves for additional pandemic-related measures, which will be saved if COVID-19 contingencies do not materialize.

18. The authorities broadly agreed with staff's policy recommendations. They concurred with the need to gradually shift from emergency support to targeted measures to safeguard growth potential. Bringing debt down continues to be a key objective in line with the constitutional debt brake, as demonstrated by the tightening of the medium-term budgetary objective in the 2021 Stability Program to a structural surplus of 0.5 percent of GDP. The authorities noted that, under their baseline forecast, consolidation of 1 percent of GDP annually will begin in 2023, as in 2022 the

unwinding of support measures will weigh on growth and be only partially offset by expected NGEU disbursements. They noted that the introduction of eInvoice could further reduce the VAT gap, and significant progress is being made in integrating the Value for Money principles in budgetary processes and strengthening public investment efficiency throughout the lifetime of a project. To strengthen the long-term public finance sustainability, authorities committed to introduce reforms of the pension system improving the long-term sustainability S2 indicator by at least 1.8 percent of GDP and plan to amend the Constitutional Act on Budgetary Responsibility to introduce binding multiannual expenditure ceilings.

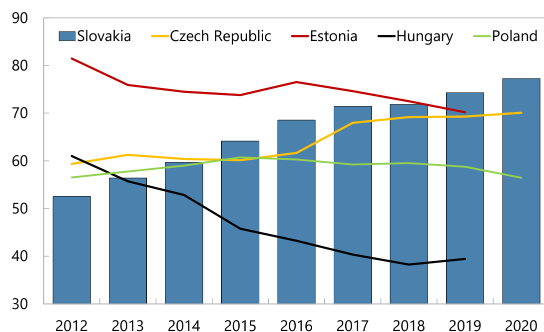
B. Financial Sector Policies

19. The banking sector has sustained the flow of credit but the full impact of the pandemic is still uncertain. Insolvency risks in the corporate sector have increased (Box 2), even if banks' exposure to the most affected sectors is relatively contained. The proactive use of macroprudential policies since 2016 has limited the buildup of systemic risks. However, persistently rapid mortgage growth, growing household indebtedness, rising real estate prices, and the bunching of loans just below macroprudential thresholds require continued vigilance.

Text Figure 7. Banking Sector Vulnerabilities

Household indebtedness has grown rapidly, with brisk growth of mortgage loans.

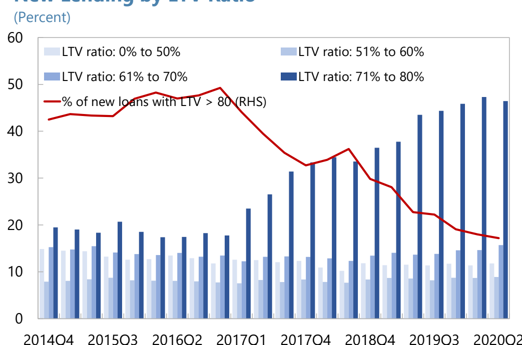
Household Debt to Disposable Income
(Percent)



Sources: Haver Analytics; and IMF staff calculations.

Macroprudential policies led to a steep decline in the share of loans with LTV>80% but there is a bunching of loans just below regulatory limits.

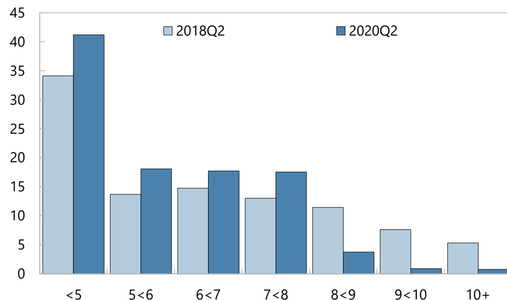
New Lending by LTV Ratio
(Percent)



Sources: National Bank of Slovakia; and IMF staff calculations.

Similarly, the issuance of mortgage loans with DTI>8 declined but there is concentration below the threshold.

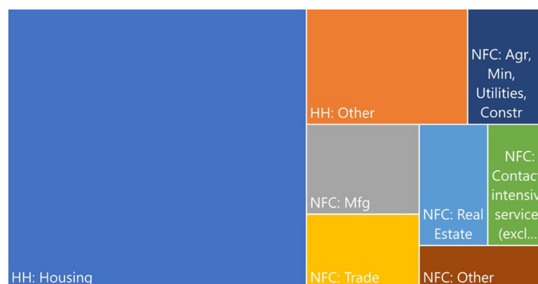
New Lending by DTI Ratio
(Percent)



Sources: National Bank of Slovakia; and IMF staff calculations.

Banks are heavily exposed to the real estate market. Exposure to contact-intensive services is relatively contained.

Credit to Households and Non-Financial Corporates
(Percent of Total, December 2020)



Sources: National Bank of Slovakia; EBA Interactive Dashboard, Q42020; and IMF staff calculations.

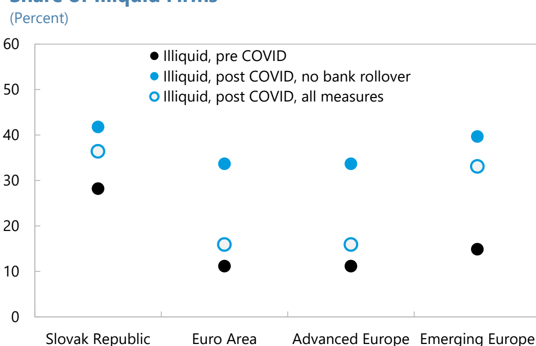
Box 2. The Corporate Sector during the COVID-19 Pandemic

So far, Slovak firms have been shielded from bankruptcy by policy measures, but vulnerabilities are high. To quantify the impact of the COVID-19 crisis on corporate distress and assess the effectiveness of implemented policy measures, staff analyzed the 2017 balance sheets and income statements of roughly 200,000 firms in Slovakia (see Ebeke et al. 2021). Staff simulated firms' liquidity and solvency given the 2020 decline in sectoral output in two scenarios: a no-policy scenario, in which firms are assumed to have no access to policy support and bank credit, and the "actual" scenario, in which eligible firms avail themselves of all policy measures. A firm is considered in distress if it has a liquidity or equity gap, common grounds for insolvency under Slovak law.

Simulations suggest that the policy response significantly mitigated liquidity risks. Policies reduced the pandemic-induced rise in illiquid firms and liquidity gap by almost half, with debt moratoria contributing the most, given their large size, extended duration, and broad coverage. A full uptake of guaranteed loans would have allowed an additional 5 percent of firms to fill their liquidity needs.

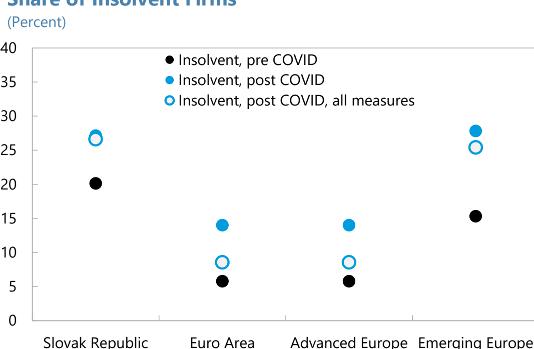
Policies appear less effective in addressing equity gaps. Simulations suggests that even with policy support, the share of insolvent firms could increase by 6.5 percentage points, accounting for 8.7 percent of corporate turnover and 5.7 percent debt-at-risk. In addition to construction and manufacturing, firms in transportation, and accommodation and food services are particularly vulnerable. Focusing only on firms that were solvent before the pandemic, the analysis suggests that the pandemic could turn 9.1 percent of them insolvent. The support needed to close the equity gaps of these firms is estimated at 1.9 percent of GDP, with an additional 2.9 percent of GDP needed to reach the minimum equity threshold above which firms are not considered "in difficulty."

Share of Illiquid Firms
(Percent)



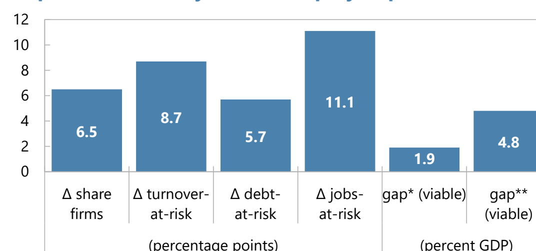
Sources: Orbis; and IMF staff estimates.

Share of Insolvent Firms
(Percent)



Sources: Orbis; and IMF staff estimates.

Corporate Insolvency Risk and Equity Gaps



Sources: Orbis; and IMF staff calculations.
Note: * Amount needed to close the equity gap of viable firms. ** Amount needed to bring equity level of viable firms to the minimum threshold above which they would not considered "in difficulty" accodring to Article 2(18) of the Commission Regulation (EU) No 651/2014 (European Commission, 2014).

Box 3. The Banking Sector: Stress and Sensitivity Tests

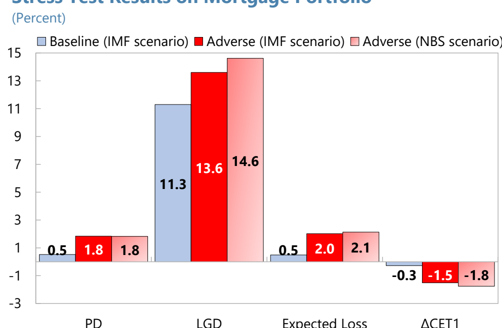
To assess banking system resilience, staff conducted a range of stress tests and projected banks' asset quality and solvency against minimum requirements. Results suggest that minimum capital requirements are met in aggregate, on the back of an estimated 550-basis points capital management buffer, but capital erosion could weigh on banks' ability and willingness to lend under some stressed conditions.

Under the "COVID-19 policy unwinding" scenario, banks could shed 130 bps of CET1 capital. The end of the temporary protection, debt moratoria, and the phase-out of prudential flexibility could increase NPLs to 5.1 percent, assuming that corporate defaults are in line with staff's simulations (Box 2) and household defaults are consistent with repayment problems observed at the end of moratoria. The needed increase in provisioning and loss of net interest income would lower the CET1 ratio from 17.0 to 15.7 percent.

Under the "mortgage stress" scenario, bank capital could fall by an additional 150 bps to 14.2 percent, above the Maximum Distributable Amount (MDA). In an adverse scenario of 5.7 percentage point higher unemployment (Box 2), 3.8 percent lower household income, and a 25-percent housing price correction, the probability of default of the mortgage book would reach 1.8 percent, resulting in an additional increase in expected losses over 3 years of 2.0 percent relative to the "COVID-19 policy unwinding" scenario. The aggregate CET1 ratio would decline to 14.2 percent, above the MDA level, whose breach would trigger automatic restrictions. The risk is concentrated in new vintages whose probability of default could reach 4.7 percent. A tightening of the LTV limit from the current 80 percent with exemptions to 70 percent would reduce expected losses by 35 percent with an annual reduction of capital depletion under stress of 20 basis points (see also Selected Issues Papers).

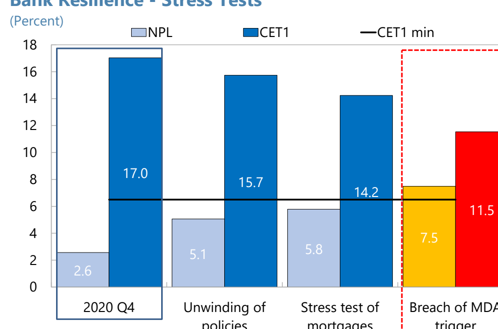
Banks are resilient to a range of additional shocks taken individually but could breach the MDA trigger under a 30 percent migration of risky loans to the default category. A corporate credit downgrade would dent capital by 180 basis points, the default of guaranteed loans would reduce it by 15 basis points, while a 50 percent default of loans under moratoria would erode it by 240 basis points. A 30 percent migration of stage 2 loans to default status would breach the MDA trigger. More broadly, a reverse stress test suggests that the banking sector could afford an increase in NPLs to 7.5 percent given its 550-basis points capital management buffer.

Stress Test Results on Mortgage Portfolio
(Percent)



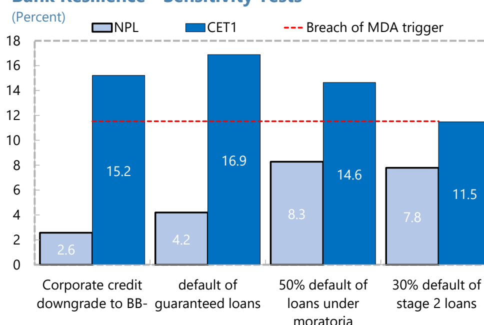
Source: IMF staff estimates

Bank Resilience - Stress Tests
(Percent)



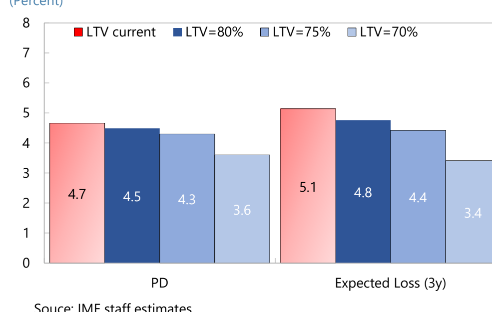
Source: IMF staff estimates

Bank Resilience - Sensitivity Tests
(Percent)



Source: IMF staff estimates

Counterfactual Macroprudential Policy Scenario: Credit risk of new vintages under IMF stress scenario
(Percent)



Souce: IMF staff estimates

20. Financial sector policies need to remain carefully calibrated to sustain the flow of credit while safeguarding financial stability and preventing the build-up of vulnerabilities. Stress tests and sensitivity tests suggest that the banking system has sufficient capital buffers to withstand a wide range of shocks (Box 3). However, in some stress scenarios, capital erosion could weigh on banks' willingness and ability to lend.

- To support the recovery, liquidity support through guaranteed loans should be maintained. The low uptake of some of the guaranteed loan schemes points at potential barriers from high administrative costs and strict conditionality. Until the recovery is firmly entrenched, it will be important to extend and redesign programs to incentivize appropriate use by banks and viable businesses.

- Should downside risks materialize, the authorities should release the CCyB or relax regulatory requirements for retail lending. As one of the few jurisdictions with a still positive CCyB, the authorities can create additional balance sheet capacity to support credit provision.

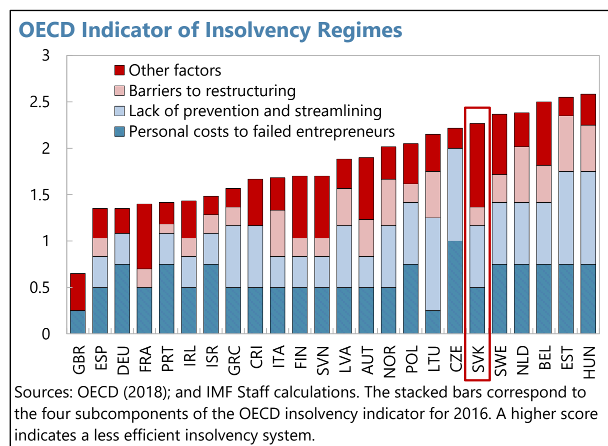
- Supervisors need to carefully balance priorities until the recovery takes hold. Prudential flexibility for loan loss provisions should be carefully withdrawn once the pandemic is under control. Supervisors need to ensure sound IFRS staging of loans and provisioning for timely risk identification, while avoiding excessive pro-cyclicality. Conservative dividend payout distributions should be maintained and made conditional on adequate buffers. The authorities should continue upgrading the AML/CFT framework including by developing a risk-based supervisory model, improving the availability of beneficial ownership information, and taking measures to mitigate risks posed by politically exposed persons.

- The macroprudential stance is broadly adequate from a financial stability point of view but there is scope to augment the macroprudential policy mix if housing market imbalances persist. Systemic risk stemming from the housing market, while manageable, has not dissipated. Notwithstanding the tightening of regulatory limits, mortgage credit and real estate prices continue to grow, and housing loans account for an increasing share in banks' private sector loan portfolio. At the same time, consumer loans are contracting, and corporate lending is slowing. The NBS could consider complementing borrower-based tools with targeted capital-based measures on mortgage exposures, including minimum risk weights (possibly differentiated across risk buckets). The NBS could also explore applying the sectoral systemic risk buffer (SyRB) to target systemic risks from mortgage loans under the new Capital Requirements Directive (CRD V) flexibility.[6]

21. Strengthening restructuring mechanisms and insolvency frameworks will help support the reallocation of resources, by releasing the capital trapped in unviable businesses and minimizing inefficient liquidations. According to indicator-based measures of efficiency of insolvency regime, Slovakia has room for improvement in pre-insolvency procedures, early warning

[6] Staff estimates that a 2.7 percent sectoral SyRB buffer on residential real estate exposures would absorb one-year losses on housing loans under the IMF stress scenario. See also Selected Issues Papers.

mechanisms and the degree of court involvement, among others. The implementation of measures proposed in Slovakia's RRP, namely digitalization of insolvency processes, early warning systems, professionalization of insolvency administrators and specialization of courts, could significantly improve the efficiency of the insolvency framework. Implementation of the 2019 EU Directive on preventive restructuring frameworks presents an opportunity to facilitate early and cost-effective restructuring through hybrid mechanisms that reduce court involvement.



Sources: OECD (2018); and IMF Staff calculations. The stacked bars correspond to the four subcomponents of the OECD insolvency indicator for 2016. A higher score indicates a less efficient insolvency system.

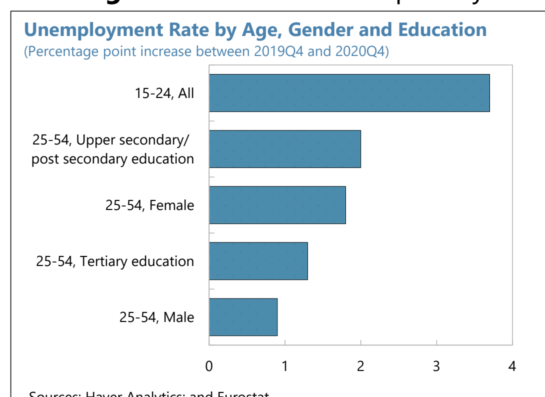
Authorities' Views

22. The authorities emphasized the resilience of the financial sector during the pandemic and concurred that uncertainty about the depth and breadth of its impact remains high. The banking sector has sufficient capital buffers to cover possible losses under a broad range of macro-financial shocks and the level of coverage of loans by provisions is adequate. Although the pandemic has weighed on banks' profitability, capital ratios have increased, and non-performing loans remain low and decreasing due to supporting measures. The abolition of the bank levy in 2020 will further improve bank profitability. The authorities are continuing to enhance AML/CFT supervisory functions to address MONEYVAL's recommendations. Cyclical credit risks have not yet fully materialized, though the authorities are encouraged by the relatively low share of firms and households facing repayment difficulties for loans emerging from legislative debt moratoria. At the same time, persistently rapid mortgage growth, fueled by fierce competition and declining interest rates, growing household indebtedness, and rising real estate prices call for continued attention.

23. The authorities stand ready to relax macroprudential policy further in a countercyclical manner and see merit in expanding the toolkit to contain systemic risk. The authorities are prepared to release the CCyB buffer and ease regulatory requirements for retail lending if provisioning needs increase and credit growth falters. Given persistently robust mortgage credit growth and rising housing prices, they are open to expanding their macroprudential toolkit and exploring minimum risk weights as well as a targeted use of the systemic risk buffer to address risks from real estate market exposures. However, they highlighted the operational challenges of activating capital-based measures in the EU and noted that any re-calibration of policies should be supported by a thorough cost-benefit analysis.

C. Structural Policies

24. Structural reforms can support the recovery, minimize the long-term effects of the crisis, and set the stage for robust, sustainable and inclusive growth. An immediate priority is adjusting labor market policies to facilitate resource reallocation and foster the reintegration of those affected by the crisis. This would also help counter the demographic pressure on labor supply. Boosting investment in human and physical capital, strengthening productivity, and accelerating the green and digital transformation will help lift potential and reignite convergence. The RRP seems well aligned with Slovakia's needs and tackles many structural gaps flagged in previous staff reports.

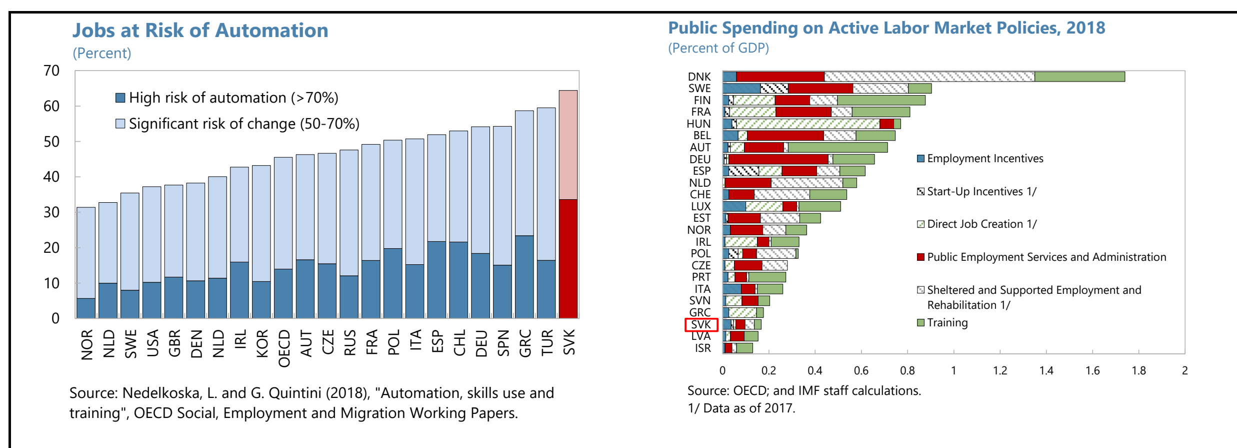


Supporting the Labor Market

25. The labor market has shown resilience, but the pandemic's impact was uneven across workers and regions, deepening pre-existing inequalities (Figure 7). Already less likely to participate in labor markets, women were disproportionately affected by the crisis due to their outsize employment in contact-intensive sectors and family responsibilities. A permanent contraction in some services could put further pressure on female participation when greater labor supply is needed to counter demographic trends. Younger and less educated workers have lost jobs at even higher rates during the pandemic, which could trigger scarring by disrupting early careers. Regional disparities may also widen given larger unemployment increases in areas with higher pre-pandemic unemployment rates. Roma communities are particularly vulnerable due to their lower education, weaker labor market attachment, and concentration in hard-hit regions.

- Targeted measures are needed for those affected disproportionately by the crisis. Staff welcomes programs to facilitate the hiring of new graduates through wage subsidies and reduced administrative obstacles. The RRP also aims to address some of the barriers to female employment by increasing the availability of childcare and pre-primary education.

- As the pandemic could accelerate structural transformation, automation, and digitalization trends, more effective ALMPs could assist workers transition between jobs, through training, reskilling, job search services, and hiring subsidies. In Slovakia, the need is exacerbated by the relatively high incidence of long-term unemployment and jobs at risk of change.



Source: Nedelkoska, L. and G. Quintini (2018), "Automation, skills use and training", OECD Social, Employment and Migration Working Papers.

Source: OECD; and IMF staff calculations.
1/ Data as of 2017.

Strengthening Human and Physical Capital

- **Human Capital.** Slovakia has long-standing gaps in education, with lower participation in early, lifelong, and tertiary education, lower test scores, and a sizable share of graduates pursuing work outside their field (Figure 8). To boost human capital, the education strategy should address these gaps, while taking into account the rapidly changing demand for skills. The RRP's focus on strengthening the health sector and long-term care for the elderly is also warranted given gaps in life expectancy, avoidable mortality rate, and the relatively high COVID-19 related mortality rate.

- **Physical Capital.** Sizable NGEU resources present an opportunity to accelerate the green and digital transformation. The RRP envisages significant investments in renewable energy, sustainable transport, and energy efficiency of buildings; full execution of these projects would contribute towards achieving Slovakia's carbon reduction targets. The planned reforms and investment towards improved digital access and skill development are also welcome (Figure 9).

Boosting Productivity

- **Governance and public administration.** Closing Slovakia's gaps in the area of governance and public sector efficiency could lift potential output and amplify gains from other structural reforms.[7] Several reforms are envisaged in this area, including judicial reform, strengthening public procurement, improving infrastructure investment processes, and public services digitalization.

- **Innovation.** Although Slovakia has successfully integrated in global value chains, it remains engaged mostly in low value-added assembly activities. Investments in innovation and upskilling are crucial to move towards a higher value-added production, which would help Slovakia escape the middle-income trap (Figure 10). The RRP appropriately aims to improve the quantity and quality of research and development (R&D) through public and private sector cooperation, a

[7] Addressing the recommendations made by the Council of Europe's Groups of States against corruption (GRECO) could strengthen the anticorruption framework.

more efficient grant evaluation system, and incentives to attract and retain talent, including through immigration reform.

Authorities' Views

26. The authorities highlighted several reforms to strengthen the social safety net and promote the employment of disadvantaged groups. Building on the experience with the job retention schemes during the pandemic, the government is introducing a permanent Kurzarbeit scheme in 2022. Employment support to disadvantaged groups includes funds to social enterprises, and assistance in training and retraining and improvement of employment services. The authorities also adopted in April 2021 a new Strategy for Equality, Inclusion and Participation of the Roma until 2030, which prioritizes employment, education, health, and housing.

27. The authorities agreed broadly with staff on policy priorities, and they pointed to reforms and investments in the RRP to close structural gaps and promote sustainable and inclusive growth. A comprehensive education reform, including mandatory education from age 5, the right to attend kindergarten at age 3, curricular reform, and reforms to funding and governance of universities, should raise human capital. Research and innovation will be strengthened through consolidating research capacities, and focusing funding on competitive support schemes, support for private sector innovation, and international cooperation. Sizable investment in transport, green and digital infrastructure will boost the economy's potential output, lift productivity and help Slovakia meet its climate mitigation goals. The transition to a green economy will be accelerated through increasing nuclear and renewable energy sources, improving energy infrastructure, and investing in sustainable passenger and freight transport. On digital infrastructure, the authorities envisage building an ultra-fast internet network, and significantly improving digitalization in many areas of the public administration. Finally, the authorities highlighted the progress made in judicial reforms to fight against corruption and strengthen the integrity and independence of the judiciary. They noted that the ongoing reform of the judicial map will further improve the efficiency of the judicial system including through increased court specialization.

STAFF APPRAISAL

28. Slovakia faced the COVID-19 pandemic from a position of strength and effective policy support has limited the economic fallout. The output contraction of 4.8 percent in 2020 was milder than the Euro Area average, reflecting among other things a timely and effective policy response and resilient export demand. The external position remained broadly in line with fundamentals and desirable policy settings. An array of measures deployed by the authorities helped save tens of thousands of jobs and businesses. Real GDP is projected to rebound with growth forecast at 4.7 percent in 2021 and accelerating further in 2022. Uncertainty, however, remains very high.

29. Policy support should continue until the recovery is well entrenched but should gradually shift to facilitating resource reallocation and minimizing scarring. The expansionary fiscal stance envisaged in the 2021 Stability Program including sizable reserves for COVID-19 related measures appears justified considering the severity of the pandemic in the beginning of 2021 and

downside risks. If activity surprises on the upside, the authorities should save the unspent reserves for pandemic-related contingencies. As the recovery gains traction, the policy mix should shift to targeted measures that prevent the crisis from eroding the economy's potential. A rise in long-term unemployment could be limited by active labor market policies, such as well-targeted hiring subsidies, training, and reskilling, that would help workers reallocate to more dynamic sectors. Targeted solvency support to viable firms, especially SMEs, could prevent excessive bankruptcies.

30. Rebuilding fiscal buffers should begin once the recovery is on a firm footing to create room for maneuver and accommodate rising ageing-related spending. While the timing of consolidation should depend on the economic situation, it is important to begin the planning process and provide a credible medium-term fiscal path. Strengthening tax efficiency and raising real estate and environmental taxation could yield sizable fiscal revenues. On the expenditure side, fully implementing savings measures identified in spending reviews should free up resources without compromising public services quality. The timely and effective absorption of EU funds can alleviate the economic impact of consolidation.

31. Envisaged amendments to the Constitutional Act on Budgetary Responsibility and some elements of the pension reform are critical to reestablish fiscal space and strengthen public finances. The introduction of expenditure ceilings will ensure savings during times of economic strength. Relinking retirement age to life expectancy and minimizing the cost of the parental bonus will help shore up the sustainability of the pension system. The implementation of these reforms, as envisaged in the Recovery and Resilience Plan, would send a strong signal of the government's commitment to fiscal prudence and reforms.

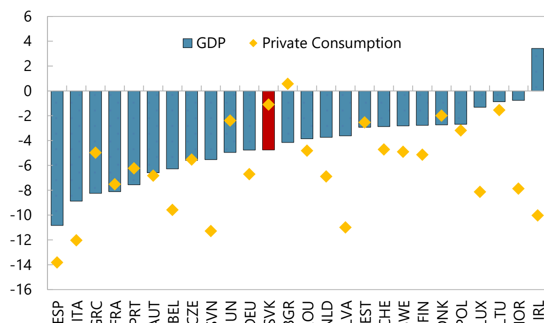
32. Financial sector policies should continue enabling credit provision, while guarding against the buildup of risks. The banking sector has weathered the COVID-shock well so far but the full impact of the pandemic remains uncertain. To ensure adequate credit supply to the corporate sector, liquidity support through guaranteed loans should be maintained and its design adjusted to remove obstacles to take-up. Should downside risks materialize, the authorities should stand ready to release the CCyB or relax regulatory requirements for retail lending. Prudential flexibility should be carefully withdrawn once the pandemic is under control, with supervisors ensuring sound provisioning. The macroprudential stance is broadly adequate, and the banking system has sufficient capital to withstand a wide range of shocks. The authorities could consider a targeted use of the systemic risk buffer to address real estate market risks under the new CRD-V flexibility.

33. Structural reforms that strengthen human and physical capital, and boost productivity will be essential to sustain robust and inclusive growth after the pandemic. More effective labor market and education policies, and targeted measures for those affected disproportionately by the crisis, could facilitate workers' transition between jobs. The ambitious investment and reforms included in the RRP address many of Slovakia's challenges, and the authorities are appropriately leveraging the sizable NGEU funds to accelerate the digital and green transformation. The timely and effective execution of these investments and the unwavering implementation of reforms could lift the economy's potential and reignite income convergence.

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

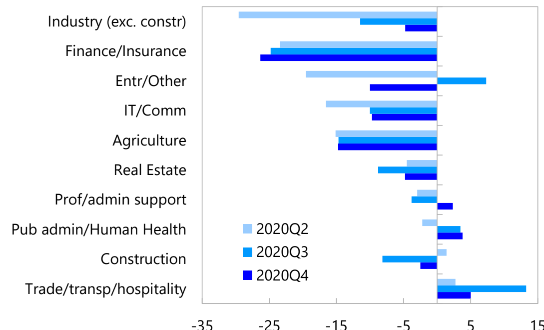
Figure 1. Real Sector Developments

Slovakia experienced a deep recession in 2020, although private consumption remained very resilient.



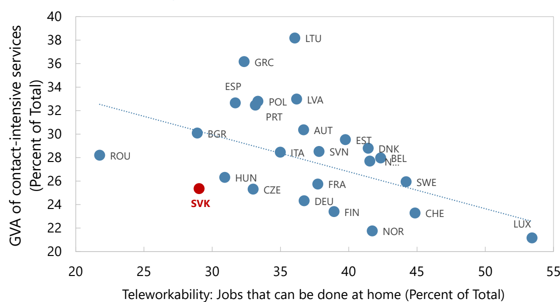
Sources: Eurostat; and Haver Analytics.

The impact of the crisis was highly unequal across sectors.



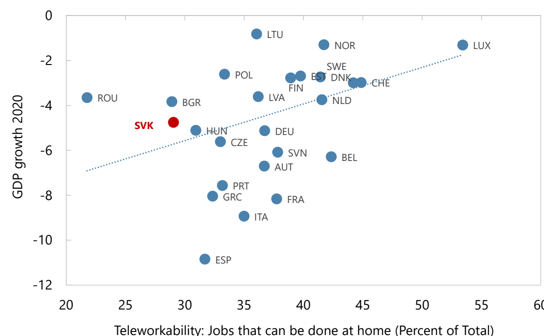
Sources: Haver Analytics; and IMF staff calculations.

While Slovakia's share of jobs that can be done remotely is low, it also has a relatively small contact-intensive services sector ...



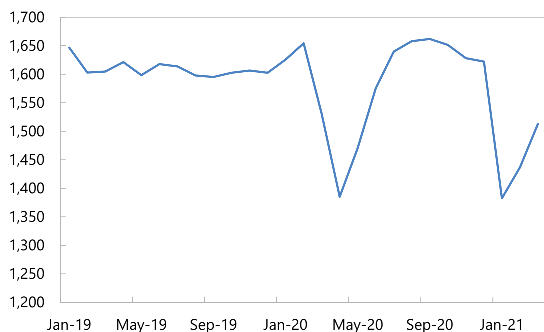
Sources: Haver Analytics; Dingel and Neiman (2020); and IMF staff calculations.
Note: Contact-intensive services include wholesale and retail trade; repair of motor vehicles and motorcycles; transportation and storage; accommodation and food service activities education; arts, entertainment and recreation; other service activities.

... contributing to a somewhat smaller GDP decline than projected based on teleworkability.



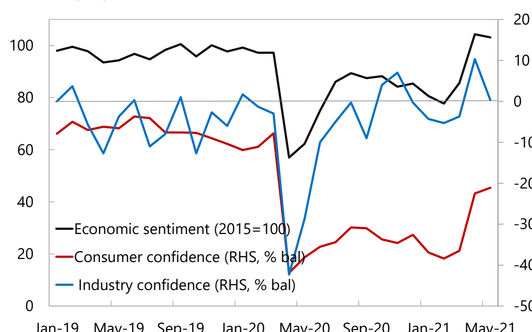
Sources: Haver Analytics; Dingel and Neiman (2020); and IMF staff calculations

With the strong second wave, retail sales declined in early 2021 at a rate comparable to the spring of 2020.



Source: National Bank of Slovakia.

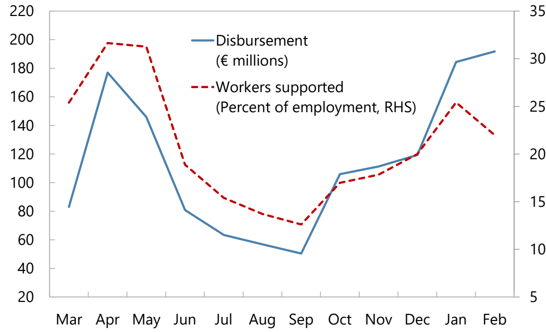
However, economic sentiment has improved significantly as the second wave recedes.



Source: Haver Analytics.

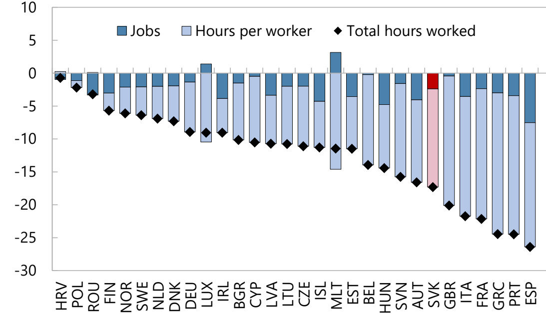
Figure 2. Labor Market Developments

The government provided wage subsidies supporting almost a third of total jobs…



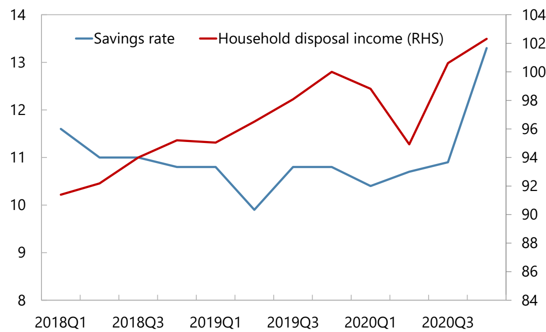
Source: Ministry of Labour, Social Affairs and Family.

… which helped preserve employment despite a large drop in hours worked…



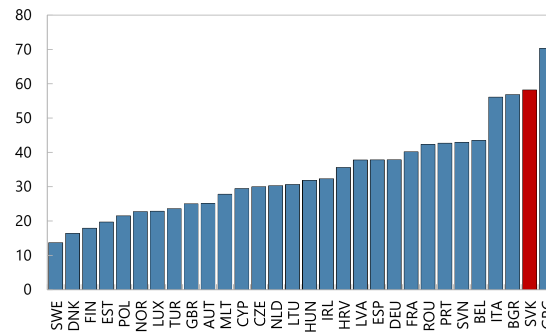
Sources: Eurostat; and IMF staff calculations.
Note: Data for MLT and LUX is as of 2020Q1.

… and also helped shield household balance sheets.



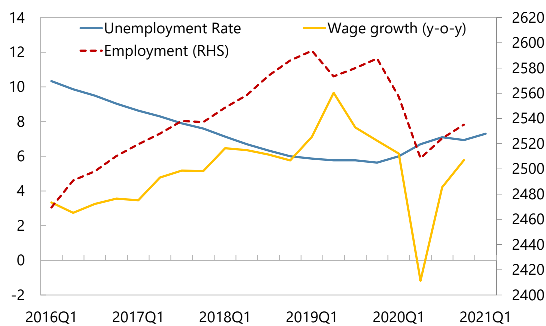
Source: Haver Analytics.

However, with high long-term unemployment, more targeted support might be needed to reduce labor market scarring.



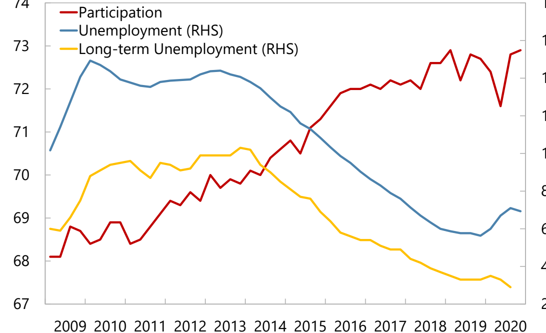
Source: Haver Analytics.

Wage growth sharply decelerated in 2020:Q2 as employment declined, but recovered in 2020:H2,…



Source: Haver Analytics

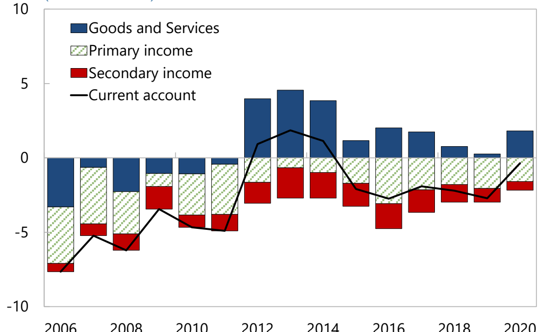
… while labor force participation had a mild drop from historic highs and also rebounded with the reopening.



Source: Haver Analytics.

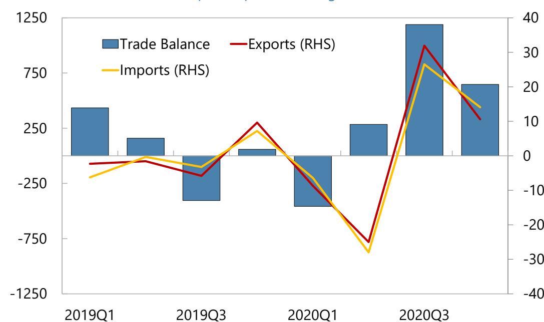
Figure 3. External Sector Developments

Slovakia entered the crisis with a moderate current account deficit, which contracted further in 2020…



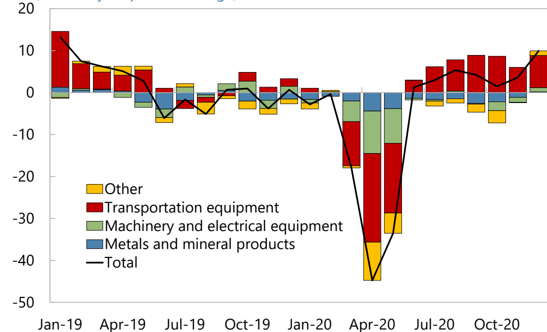
Sources: Eurostat; NBS; and IMF staff calculations.

… mainly due to a strong trade balance in 2020:H2.



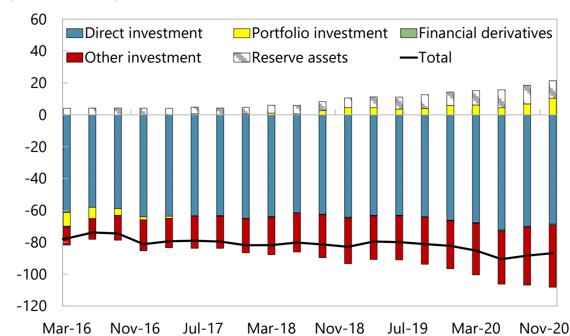
Source: Haver Analytics.

Foreign demand for consumption goods boosted exports, particularly during 2020:H2.



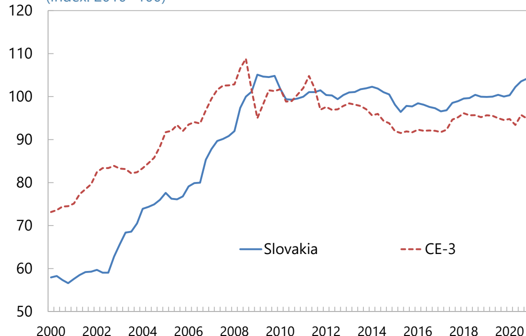
Sources: Haver Analytics; and IMF staff calculations.

Slovakia has a large negative NIIP, but external liabilities are FDI-heavy, reducing exposure to capital flow reversals.



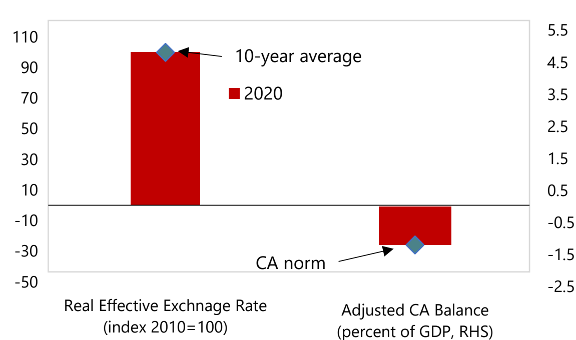
Sources: Haver Analytics and staff calculations

The REER has remained in line with peer countries…



Sources: IMF, International Financial Statistics.

…and staff assesses the external position in 2020 to be in line with fundamentals.

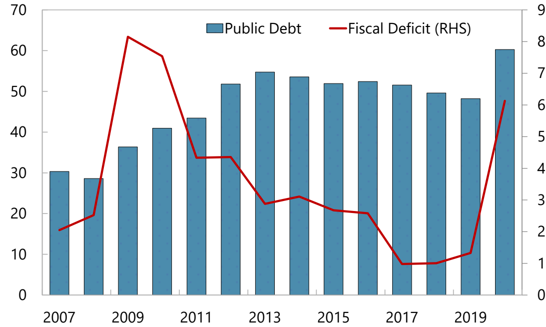


Sources: IMF INS database; and IMF staff calculations.

Figure 4. Fiscal Sector Developments and Challenges

While declining deficit helped reduce public indebtedness before the pandemic, debt increased sharply in 2020.

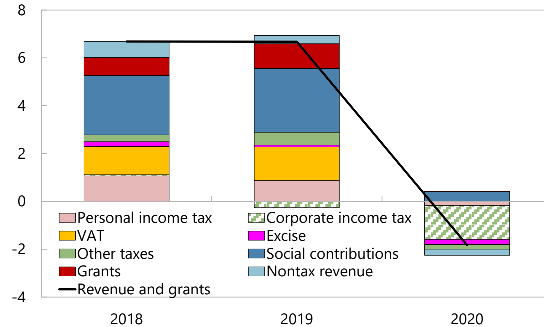
Fiscal Deficit and Public Debt
(Percent of GDP)



Source: Slovak authorities.

Revenues declined with the contraction of economic activity…

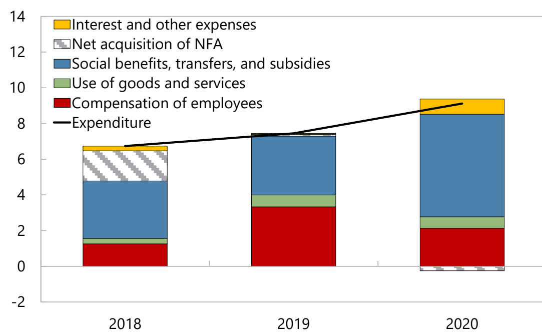
Contribution to Government Revenue Growth
(Year-on-year percent change)



Source: Slovak authorities.

… and expenditures rose, reflecting measures implemented in response to the pandemic and realized budget risks.

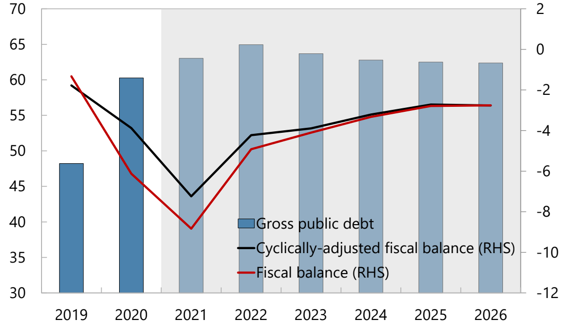
Contribution to Government Expenditure Growth
(Year-on-year percent change)



Source: Slovak authorities.

Public debt is projected to stay above 60 percent of GDP over the medium term in the no-consolidation baseline.

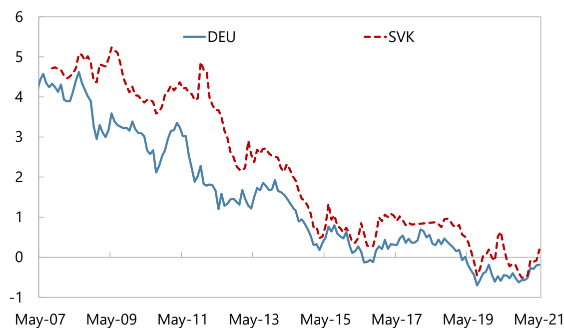
Fiscal Balance and Public Debt
(Percent of GDP) 1/



Sources: Slovak authorities; and IMF staff projections.
1/ Percent of potential GDP for cyclically-adjusted fiscal balance.

Although low financing costs could help underpin debt sustainability….

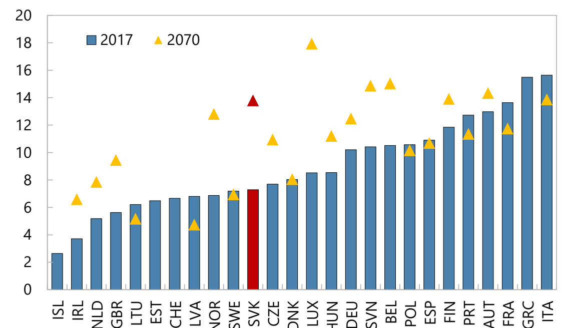
10-year Bond Yield
(End-of-Period, Percent)



Source: Bloomberg.

… fiscal consolidation would be needed given Slovakia's long-term pension cost challenges.

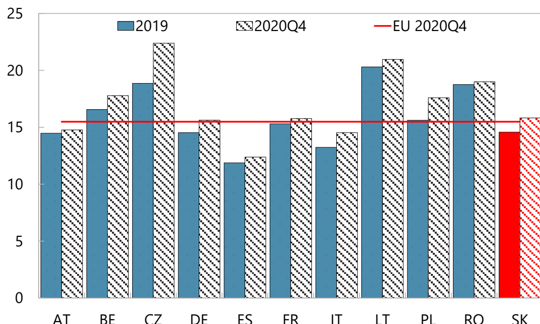
Public Pension Spending
(Percent of GDP)



Sources: OECD; and European Commission 2018 Ageing Report.

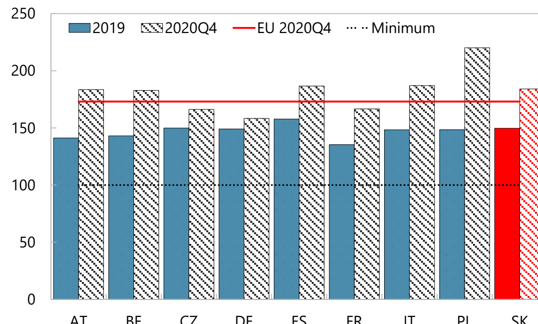
Figure 5. The Slovak Banking Sector in a Cross-Country Perspective

Slovak banks have sound capital adequacy…



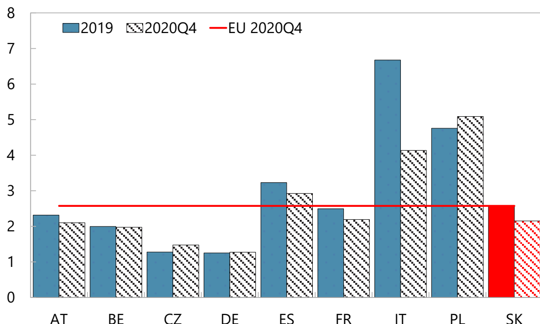
Source: European Bank Authority

… and adequate liquidity buffers supported by a large deposit base.



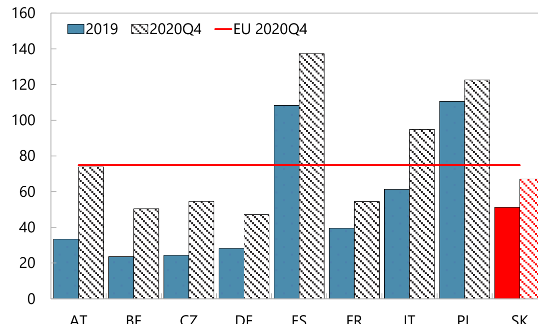
Source: European Bank Authority

NPLs decreased during the pandemic and remain lower than the EU average…



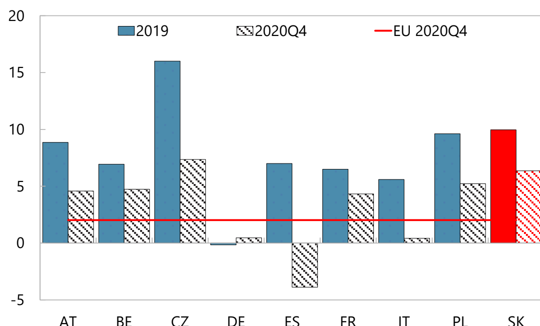
Source: European Bank Authority

… while the cost of risk increased in line with other banks in the EU.



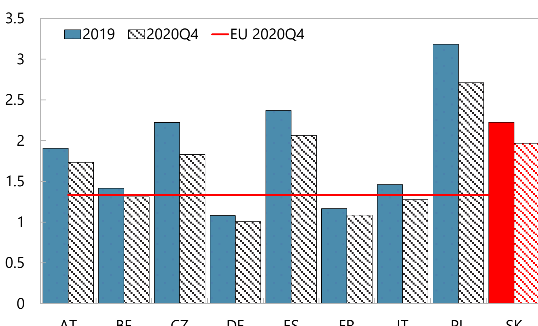
Source: European Bank Authority

While return on equity (ROE) is more than twice the EU average, profitability has decreased during the crisis…



Source: European Bank Authority

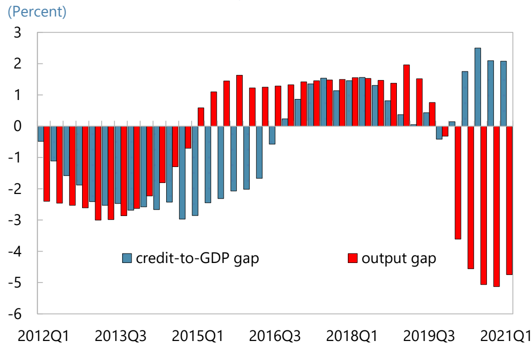
…. and is challenged by net interest margin compression.



Source: European Bank Authority

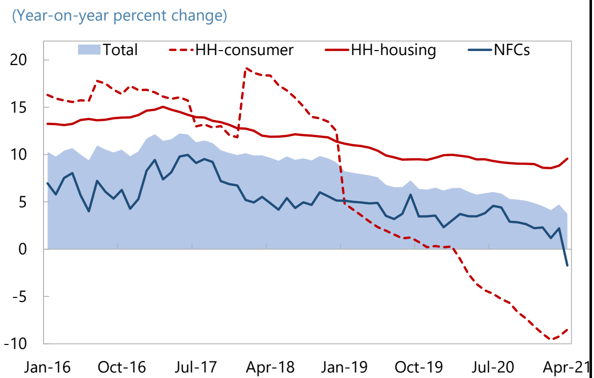
Figure 6. Credit Developments

The credit cycle is running ahead of the business cycle supported by financial sector policies.



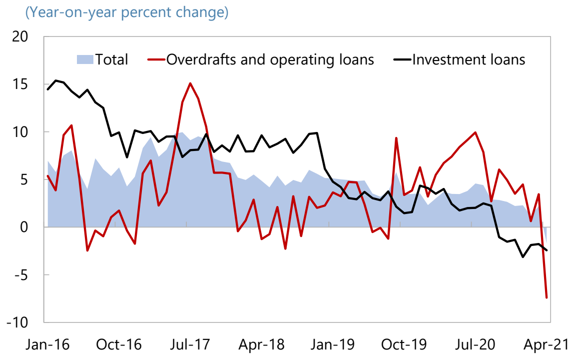
Sources: Haver Analytics; WEO; and IMF staff calculations.
Note: The computation of the credit gap follows EBA methodology.

Credit growth remained resilient fueled by mortgage lending while household consumer loans contracted



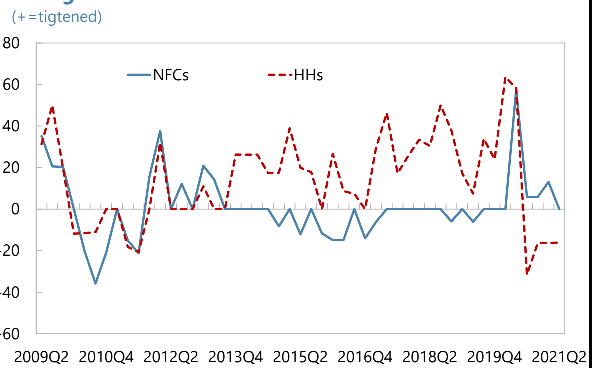
Sources: Haver Analytics; and IMF staff calculations.

For corporates, investment loan growth decelerated during the pandemic.



Sources: Haver Analytics; and IMF staff calculations.

Banks expect further easing of credit standards for mortgage loans but tightening for loans to corporates

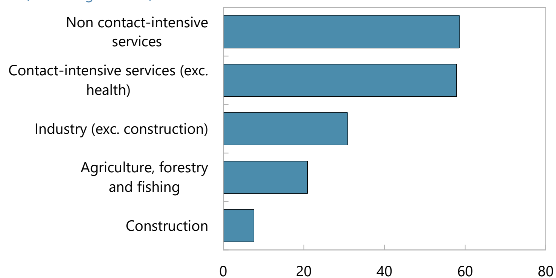


Source: ECB lending survey.

Figure 7. The Unequal Impact of the Pandemic

Women's high involvement in contact-intensive services leaves them vulnerable to a protracted crisis.

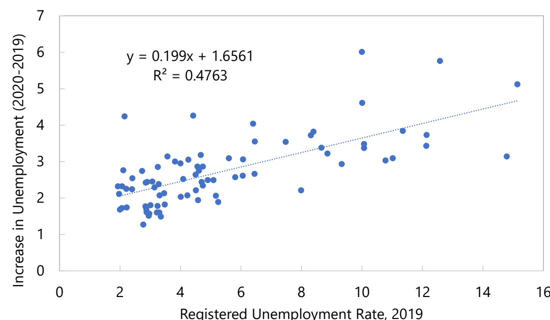
Female Employment by Industry, 2019
(Percentage female)



Sources: Eurostat; and IMF staff calculations.
Note: Contact-intensive (exc. health) services include wholesale and retail trade; repair of motor vehicles and motorcycles; transportation and storage; accommodation and food service activities; education; arts, entertainment and recreation; other service activities.

Unemployment increased more in regions that already had high unemployment rates before the pandemic.

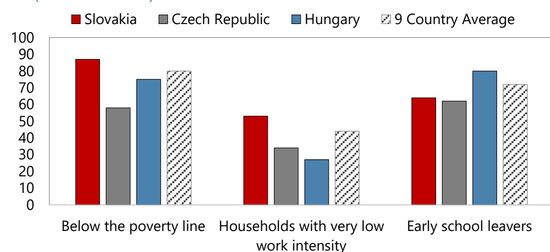
Registered Unemployment across Slovak Districts



Sources: Slovak Statistical Office; and IMF staff calculations.

The Roma population is vulnerable to the crisis due to high rates of poverty, weak labor market attachment and low educational attainment…

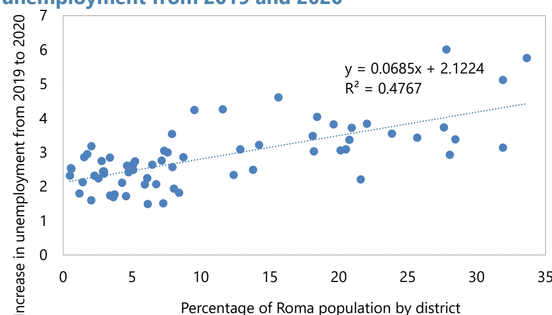
Selected Indicators of Social Exclusion of Roma, 2016 1/
(Percent of total)



1/Reflects survey results covering 34 thousand individuals in 9 EU member states. Households with very low work intensity are those with working-age members working less than 20 percent of their potential during the previous 12 months. Early school leavers are individuals aged 18-24 not in upper secondary education or vocational training.
Sources: Country authorities; and the EU Agency for Fundamental Rights.

… and concentration in the east of the country, where the increase in unemployment was largest.

Percentage of Roma population by district and increase in unemployment from 2019 and 2020

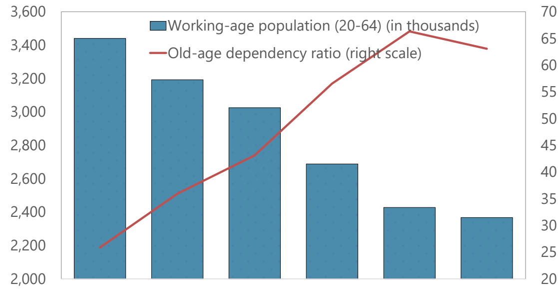


Sources: Atlas of Roma communities (2013); Slovak Statistical Office; and IMF staff calculations.

Figure 8. The Need for Human Capital Investment

The projected decline in working-age population intensifies the need for greater investment in human capital to boost effective labor supply.

Slovakia: Demographic Projections

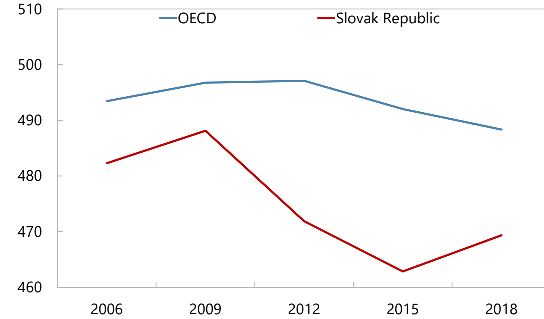


Source: European Commission, The 2021 Ageing Report: Underlying Assumptions and Projection Methodologies.

Gaps in educational outcomes have widened over time…

PISA Scores

(Average of mean scores in science, reading and mathematics)

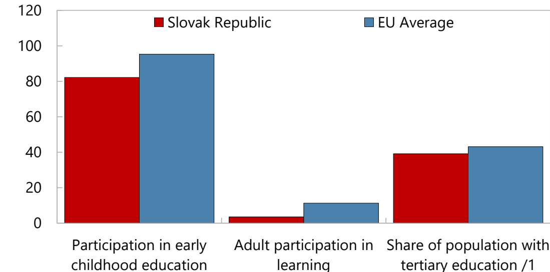


Sources: OECD Economic Survey: Slovak Republic, February 2019.

…and participation in non-compulsory education is lower than the EU average.

Participation in Early Childhood Education, Adult Training and Tertiary Education

(Percent)



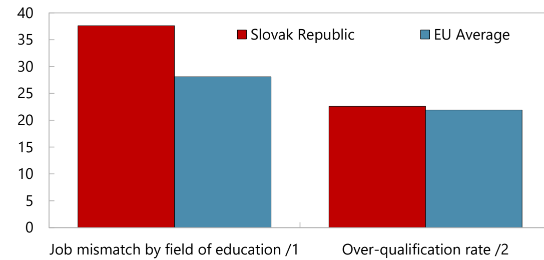
Sources: Eurostat; OECD; and IMF staff calculations.

1/ The EU average includes only EU countries in the OECD.

There is a significant degree of mismatch between the workforce skills and market needs.

Qualification and Education Mismatches

(Percent)



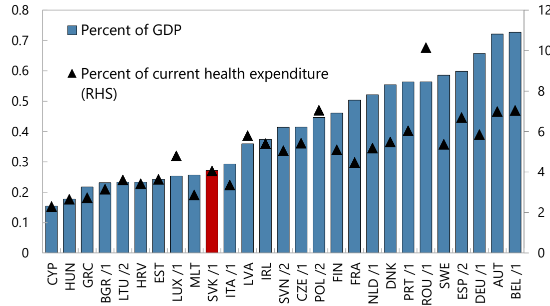
Source: Eurostat; and IMF staff calculations.

1/ Percent of workers aged 15-34 whose current occupation is in a field different from that of their highest educational attainment.

2/ Percent of workers with tertiary education whose occupation does not require it.

Sizable healthcare capital expenditures envisioned in the RRP can help make up for investment gaps…

Capital Expenditure on Health, 2018



Source: OECD/European Union (2020), "Health at a Glance: Europe 2020: State of Health in the EU Cycle", OECD Publishing.

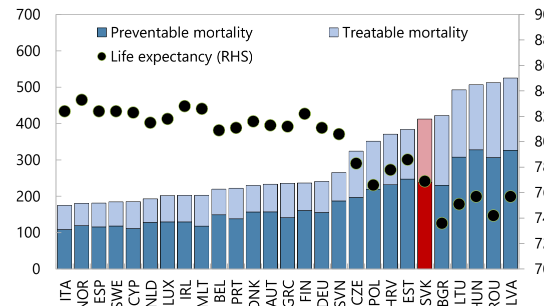
1/ Refers to gross fixed capital formation in ISIC 86: Human health activities.

2/ Refers to gross fixed capital formation in ISIC Q: Human health and social work activities.

…which could help bring health outcomes closer to EU peers.

Preventable and Treatable Deaths, 2017

(Per 100K residents; years)



Source: Eurostat.

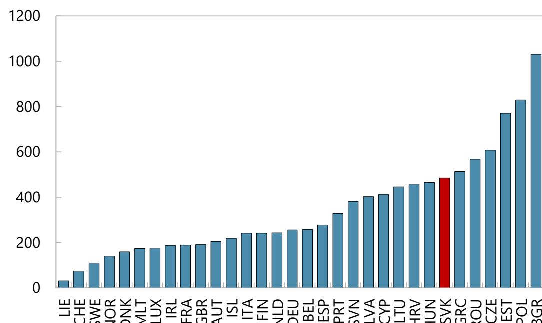
Note: Life expectancy as of 2020.

Figure 9. The Green and Digital Transition

Due to its large manufacturing sector, Slovakia's production is relatively carbon intensive.

Greenhouse Gas Emissions

(CO2 equivalent tonnes per euro of GDP, 2018)

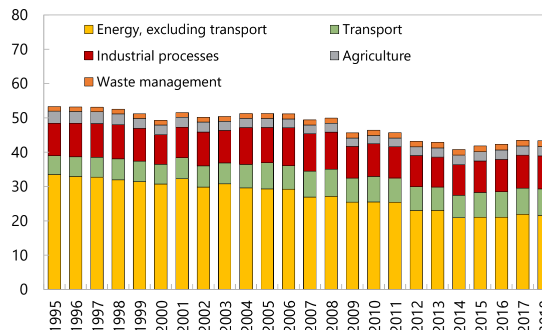


Sources: Eurostat; and IMF staff calculations.

There has been progress with reducing emissions but achieving carbon-neutrality by 2050 will be challenging.

Greenhouse gas emissions by source

(CO2 equivalent, million tonnes)

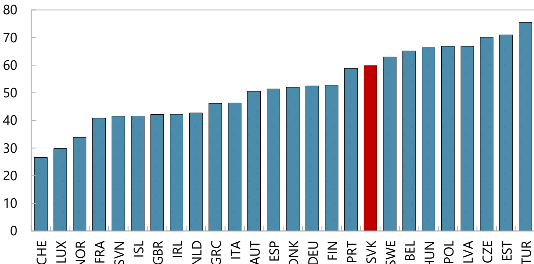


Source: Eurostat.

Slovakia falls short of pricing carbon emissions in line with benchmarks…

Carbon pricing gap

(Percentage)

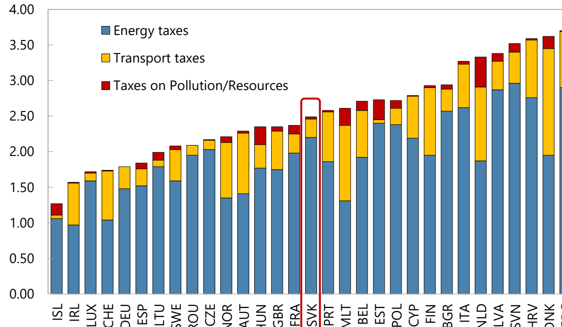


Sources: Effective Carbon Rates (2018), OECD.
Note: The carbon pricing gap measures how much countries fall short of pricing carbon emissions in line with a €30 benchmark. The difference between the benchmark and the actual effective carbon rate (ECR) is presented as a percentage (i.e., if the ECR is at least as high as the benchmark, the gap is zero, and if the ECR is zero, the gap is 100 percent).

…and there is scope to increase certain types of environmental taxation.

Environmental Tax Revenue, 2018

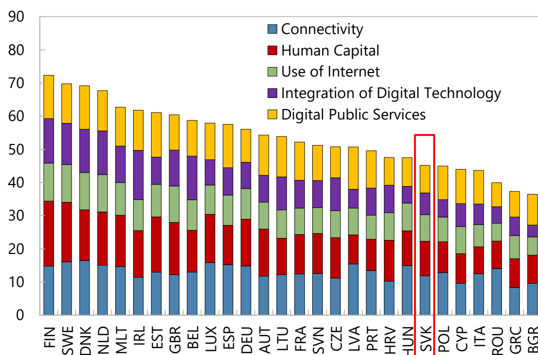
(Percent of GDP)



Source: Eurostat.

Digital access and connectivity lag behind other EU countries…

Digital Economy and Society Index, 2020

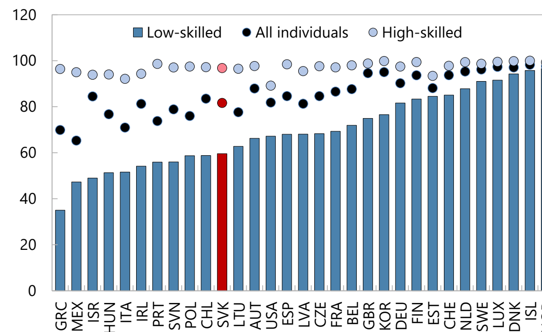


Source: European Commission.

…as does the use of internet, particularly among low-skill individuals.

OECD: Use of Internet, 2017

(Share of Individuals aged 16-74)



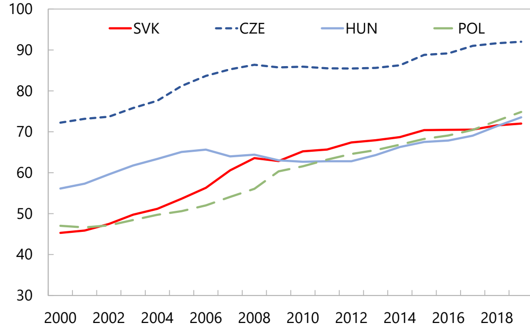
Sources: OECD; and IMF staff calculations.

Figure 10. Boosting Productivity

Boosting productivity is needed to accelerate convergence, which has slowed in recent years.

GDP per Capita PPP

(Percent, EU = 100)

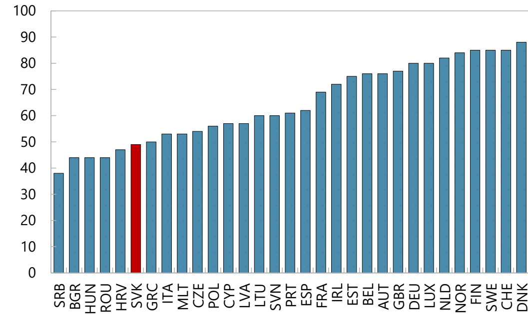


Sources: World Bank, WDI database; and IMF staff calculations.

Below-average perception of governance quality indicates institutional gaps.

Corruption Perceptions Index, 2020

(Score scale of 0 -highly corrupt- to 100 -very clean)

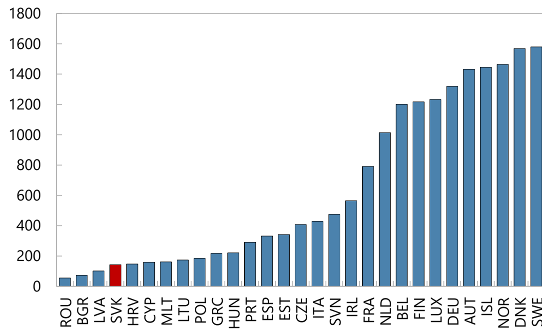


Source: Transparency International.

Expenditure in R&D is low relative to other EU countries…

Expenditure in R&D, 2019

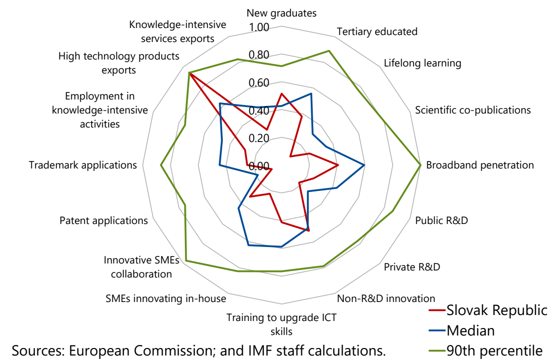
(Euros per capita)



Source: Eurostat.

…contributing to relatively poor innovation performance, which limits possibilities to move towards higher value-added activities.

European Innovation Scoreboard, 2018



Sources: European Commission; and IMF staff calculations.

Table 1. Slovak Republic: Summary of Economic Indicators, 2018–26

	2018	2019	2020	2021	2022	2023	2024	2025	2026
				Projections					
	(Annual percentage change, constant prices, unless noted otherwise)								
Output/Demand									
Real GDP	3.7	2.5	-4.8	4.7	4.9	4.0	3.2	2.9	2.6
Domestic demand	3.3	3.7	-5.6	3.0	6.8	4.8	2.6	2.5	2.0
Public consumption	0.1	4.6	0.3	2.2	2.1	3.7	3.1	2.1	2.7
Private consumption	3.9	2.7	-1.2	0.3	5.9	3.3	3.0	3.2	2.1
Gross fixed capital formation	2.7	6.6	-12.0	3.7	11.9	9.9	1.4	1.1	1.4
Exports of goods and services	4.6	0.8	-7.6	11.5	4.2	5.2	5.1	4.6	4.5
Imports of goods and services	4.0	2.1	-8.5	10.1	6.1	6.0	4.6	4.3	4.0
Potential Growth	3.6	3.0	0.8	3.1	3.3	3.0	2.9	2.8	2.4
Output gap	1.5	1.0	-4.6	-3.1	-1.5	-0.5	-0.2	-0.2	0.0
Contribution to growth									
Domestic demand	3.0	3.7	-5.4	3.1	6.5	4.7	2.6	2.4	2.0
Public consumption	0.0	0.8	0.0	0.4	0.4	0.7	0.5	0.4	0.5
Private consumption	2.2	1.5	-0.7	0.2	3.3	1.9	1.7	1.8	1.2
Gross fixed capital formation	0.6	1.4	-2.6	0.8	2.4	2.1	0.3	0.2	0.3
Inventories	0.2	0.0	-2.1	1.8	0.5	0.1	0.1	0.1	0.0
Net exports	0.6	-1.2	0.6	1.6	-1.6	-0.7	0.6	0.5	0.6
Prices									
Inflation (HICP)	2.5	2.8	2.0	1.3	1.9	2.1	2.1	2.1	2.0
Inflation (HICP, end of period)	1.9	3.2	1.6	1.6	1.8	2.1	2.1	2.1	2.0
Core inflation	2.2	2.5	2.4	1.9	1.6	1.8	2.0	2.0	2.0
GDP deflator	2.0	2.5	2.4	1.2	2.2	2.2	2.3	2.2	2.2
Employment and wages									
Employment	2.0	1.0	-1.9	-0.3	0.8	0.3	0.1	0.0	0.0
Unemployment rate (Percent)	6.5	5.8	6.7	7.3	6.6	6.2	6.0	5.9	5.8
Nominal wages	6.2	7.8	3.7	4.8	4.6	4.5	4.4	4.3	4.3
	(Percent of GDP)								
Public Finance, General Government									
Revenue	40.7	41.3	41.6	41.8	41.6	42.5	40.4	40.4	40.2
Expenditure	41.7	42.7	47.8	50.6	46.5	46.6	43.7	43.1	42.9
Overall balance	-1.0	-1.3	-6.1	-8.8	-4.9	-4.1	-3.3	-2.8	-2.8
Primary balance	0.2	-0.3	-5.1	-7.9	-4.0	-3.2	-2.5	-1.9	-1.9
Structural balance (Percent of potential GDP)	-1.7	-1.8	-2.1	-4.2	-4.2	-3.9	-3.2	-2.7	-2.8
General government debt	49.7	48.2	60.3	63.0	65.0	63.7	62.8	62.5	62.4
Monetary and financial indicators	(Percent)								
Credit to private sector (Growth rate)	9.2	6.6	4.8	6.5	7.8	6.9	6.1	5.7	5.4
Lending rates	1.5	1.4	1.1	...	...	...	...	...	...
Balance of payments	(Percent of GDP)								
Trade balance (goods)	-0.3	-1.0	0.6	1.5	0.2	-0.3	0.2	0.5	1.0
Current account balance	-2.2	-2.7	-0.4	-0.6	-1.6	-2.2	-1.8	-1.4	-0.7
Gross external debt	114.9	112.4	121.2	118.1	115.0	113.6	112.5	111.8	112.0
Saving and investment balance	(Percent of GDP)								
Gross national savings	20.9	20.7	18.0	17.7	19.3	19.8	20.8	20.6	21.1
Private sector	19.4	19.2	16.4	16.3	18.0	18.6	19.6	19.5	20.0
Public sector	1.4	1.4	1.5	1.4	1.3	1.2	1.2	1.1	1.1
Gross capital formation	23.1	23.4	18.3	18.3	21.0	22.0	22.6	22.0	21.8
Memo item									
Nominal GDP (Millions of euros)	89,357	93,900	91,555	97,037	104,080	110,693	116,863	122,908	128,881

Sources: National Authorities and IMF staff projections.

Table 2. Slovak Republic: Statement of Operations of the General Government, 2018–26

	2018	2019	2020	2021	2022	2023	2024	2025	2026
				Projections					
				(Millions of euros)					
Revenue	**36,389**	**38,818**	**38,110**	**40,547**	**43,328**	**47,004**	**47,193**	**49,604**	**51,759**
Taxes	17,100	18,058	17,283	17,984	19,144	20,437	20,833	22,162	23,459
Personal income tax	3,218	3,535	3,470	3,799	4,067	4,424	4,624	4,864	5,100
Corporate income tax	2,943	2,848	2,301	2,393	2,537	2,680	2,685	3,073	3,442
VAT	6,319	6,830	6,827	6,876	7,462	8,065	8,368	8,801	9,230
Excises	2,810	2,839	2,752	2,918	3,057	3,180	3,101	3,262	3,420
Other taxes	1,809	2,006	1,933	1,999	2,020	2,088	2,055	2,162	2,267
Social contributions	13,347	14,315	14,473	15,581	16,019	16,955	17,825	18,749	19,661
Grants	1,242	1,620	1,630	1,946	3,081	4,373	3,086	2,964	2,630
o/w EU Grants		931	910	1,455	2,597	3,937	2,631	2,486	2,128
Other revenue	4,701	4,825	4,725	5,036	5,084	5,238	5,448	5,730	6,009
Expenditure	**37,290**	**40,066**	**43,719**	**49,116**	**48,445**	**51,546**	**51,082**	**53,033**	**55,310**
Expense	33,899	36,636	40,389	45,283	43,794	46,220	46,295	48,796	51,146
Compensation of employees	8,368	9,609	10,464	10,782	10,809	11,081	11,325	11,875	12,411
Use of goods and services	5,010	5,258	5,514	7,262	7,038	8,063	7,789	8,288	8,651
Interest	1,210	1,163	1,135	975	1,007	1,061	1,083	1,143	1,236
Subsidies	879	928	1,237	1,583	1,316	1,501	1,300	1,405	1,488
Grants and transfers	1,638	1,712	1,777	2,343	2,590	2,753	2,404	2,527	2,653
Social benefits	16,336	17,442	19,372	21,870	20,761	21,421	22,138	23,284	24,417
Other expense	458	524	892	470	273	339	257	275	290
Net acquisition of nonfinancial assets	3,392	3,430	3,329	3,833	4,651	5,326	4,787	4,237	4,164
o/w Defense spending 1/		196	289	230	711	1,252	1,204	737	827
Gross Operating Balance	2,490	2,181	-2,279	-4,736	-466	783	898	808	612
Net lending(+)/borrowing(-) 2/	**-902**	**-1,249**	**-5,609**	**-8,569**	**-5,117**	**-4,543**	**-3,889**	**-3,428**	**-3,552**
				(Percent of GDP)					
Revenue	**40.7**	**41.3**	**41.6**	**41.8**	**41.6**	**42.5**	**40.4**	**40.4**	**40.2**
Taxes	19.1	19.2	18.9	18.5	18.4	18.5	17.8	18.0	18.2
Personal income tax	3.6	3.8	3.8	3.9	3.9	4.0	4.0	4.0	4.0
Corporate income tax	3.3	3.0	2.5	2.5	2.4	2.4	2.3	2.5	2.7
VAT	7.1	7.3	7.5	7.1	7.2	7.3	7.2	7.2	7.2
Excises	3.1	3.0	3.0	3.0	2.9	2.9	2.7	2.7	2.7
Other taxes	2.0	2.1	2.1	2.1	1.9	1.9	1.8	1.8	1.8
Social contributions	14.9	15.2	15.8	16.1	15.4	15.3	15.3	15.3	15.3
Grants	1.4	1.7	1.8	2.0	3.0	4.0	2.6	2.4	2.0
o/w EU grants		1.0	1.0	1.5	2.5	3.6	2.3	2.0	1.7
Other revenue	5.3	5.1	5.2	5.2	4.9	4.7	4.7	4.7	4.7
Expenditure	**41.7**	**42.7**	**47.8**	**50.6**	**46.5**	**46.6**	**43.7**	**43.1**	**42.9**
Expense	37.9	39.0	44.1	46.7	42.1	41.8	39.6	39.7	39.7
Compensation of employees	9.4	10.2	11.4	11.1	10.4	10.0	9.7	9.7	9.6
Use of goods and services	5.6	5.6	6.0	7.5	6.8	7.3	6.7	6.7	6.7
Interest	1.4	1.2	1.2	1.0	1.0	1.0	0.9	0.9	1.0
Subsidies	1.0	1.0	1.4	1.6	1.3	1.4	1.1	1.1	1.2
Grants and transfers	1.8	1.8	1.9	2.4	2.5	2.5	2.1	2.1	2.1
Social benefits	18.3	18.6	21.2	22.5	19.9	19.4	18.9	18.9	18.9
Other expense	0.5	0.6	1.0	0.5	0.3	0.3	0.2	0.2	0.2
Net acquisition of nonfinancial assets	3.8	3.7	3.6	4.0	4.5	4.8	4.1	3.4	3.2
o/w Defense spending 1/		0.2	0.3	0.2	0.7	1.1	1.0	0.6	0.6
Gross Operating Balance	2.8	2.3	-2.5	-4.9	-0.4	0.7	0.8	0.7	0.5
Net lending(+)/borrowing(-)	**-1.0**	**-1.3**	**-6.1**	**-8.8**	**-4.9**	**-4.1**	**-3.3**	**-2.8**	**-2.8**
Memorandum items:									
Primary balance	0.2	-0.3	-5.1	-7.9	-4.0	-3.2	-2.5	-1.9	-1.9
Structural primary balance (Percent of potential GDP)	-0.5	-0.7	-1.1	-3.3	-3.3	-3.0	-2.3	-1.8	-1.9
Structural balance (Percent of potential GDP)	-1.7	-1.8	-2.1	-4.2	-4.2	-3.9	-3.2	-2.7	-2.8
Cyclically-adjusted balance (Percent of potential GDP)	-1.7	-1.8	-3.9	-7.2	-4.2	-3.9	-3.2	-2.7	-2.8
One-off measures 2/	0.0	0.0	-1.9	-3.1	0.0	0.0	0.0	0.0	0.0
Gross public debt	49.7	48.2	60.3	63.0	65.0	63.7	62.8	62.5	62.4
GDP at current market prices (Millions of euros)	89,357	93,900	91,555	97,037	104,080	110,693	116,863	122,908	128,881

Sources: National Authorities and IMF staff projections.

1/ Reflects the accrual recording for the acquistion of military equipment in line with ESA methodology with delivery starting 2022.

2/ Mainly Covid-19 related measures.

Table 3. Slovak Republic: Balance of Payments, 2018–26

	2018	2019	2020	2021	2022	2023	2024	2025	2026
				Projections					
				(Millions of euros)					
Current account	**-1,973**	**-2,547**	**-327**	**-547**	**-1,674**	**-2,399**	**-2,049**	**-1,692**	**-964**
Trade balance (goods)	-239	-979	595	1,475	252	-380	205	666	1,342
Exports, f.o.b.	75,142	75,657	69,651	81,237	84,148	89,251	95,520	101,716	108,197
Imports, f.o.b.	75,381	76,636	69,057	79,762	83,897	89,630	95,315	101,050	106,855
Services balance	928	1,226	1,067	1,295	1,189	1,174	1,309	1,430	1,578
Receipts	10,228	11,009	8,861	10,296	10,657	11,289	12,066	12,833	13,636
Payments	9,300	9,783	7,794	9,002	9,468	10,115	10,756	11,403	12,058
Primary income balance	-1,603	-1,929	-1,455	-2,439	-2,625	-2,820	-3,069	-3,262	-3,450
Credit	3,689	3,718	3,398	3,662	3,831	3,965	4,025	4,143	4,258
Debit	5,292	5,646	4,852	6,100	6,456	6,784	7,093	7,404	7,708
Secondary income balance	-1,059	-866	-534	-879	-489	-374	-495	-526	-434
Credit	1,012	1,082	1,181	1,292	1,401	1,527	1,542	1,605	1,664
Debit	2,071	1,949	1,715	2,170	1,891	1,901	2,036	2,131	2,098
Capital account	**860**	**673**	**1,056**	**1,868**	**1,911**	**2,048**	**2,128**	**1,893**	**1,568**
Financial Account	**-2,175**	**-1,059**	**1,183**	**1,320**	**237**	**-351**	**79**	**201**	**604**
Direct investment, net	-1,146	-2,050	1,894	-1,291	-1,249	-1,328	-1,403	-1,475	-1,547
Assets	760	16	1,681	776	833	886	935	983	1,031
Liabilities	1,906	2,067	-213	2,067	2,082	2,214	2,338	2,459	2,578
Portfolio investment, net	3,803	332	2,686	-699	-1,053	1,060	1,181	766	803
Assets	4,486	2,088	4,303	2,450	2,567	2,690	2,841	2,959	3,084
Liabilities	683	1,757	1,616	3,148	3,620	1,630	1,660	2,193	2,281
Other investment, net	-6,254	-894	-4,795	3,285	2,512	-109	275	884	1,322
Assets	2,377	-610	391	3,783	4,059	4,318	4,325	4,549	6,059
Liabilities	8,630	285	5,185	499	1,547	4,426	4,050	3,664	4,737
Financial derivatives, net	6	94	51	25	26	26	26	26	26
Reserve assets	1,415	1,460	1,347	0	0	0	0	0	0
Errors and omissions	-1,062	815	454	0	0	0	0	0	0
Net International Investment Position	**-62,228**	**-62,227**	**-60,437**	**-59,117**	**-58,880**	**-59,232**	**-59,153**	**-58,951**	**-58,347**
External Debt	**102,701**	**105,517**	**110,925**	**114,572**	**119,739**	**125,795**	**131,505**	**137,362**	**144,379**
				(Percent of GDP)					
Current account	**-2.2**	**-2.7**	**-0.4**	**-0.6**	**-1.6**	**-2.2**	**-1.8**	**-1.4**	**-0.7**
Trade balance (goods)	-0.3	-1.0	0.6	1.5	0.2	-0.3	0.2	0.5	1.0
Exports, f.o.b.	84.0	80.6	76.1	83.7	80.9	80.6	81.7	82.7	83.9
Imports, f.o.b.	84.2	81.6	75.4	82.2	80.6	81.0	81.5	82.2	82.9
Services balance	1.0	1.3	1.2	1.3	1.1	1.1	1.1	1.2	1.2
Receipts	11.4	11.7	9.7	10.6	10.2	10.2	10.3	10.4	10.6
Payments	10.4	10.4	8.5	9.3	9.1	9.1	9.2	9.3	9.4
Primary income balance	-1.8	-2.1	-1.6	-2.5	-2.5	-2.5	-2.6	-2.7	-2.7
Credit	4.1	4.0	3.7	3.8	3.7	3.6	3.4	3.4	3.3
Debit	5.9	6.0	5.3	6.3	6.2	6.1	6.1	6.0	6.0
Secondary income balance	-1.2	-0.9	-0.6	-0.9	-0.5	-0.3	-0.4	-0.4	-0.3
Credit	1.1	1.2	1.3	1.3	1.3	1.4	1.3	1.3	1.3
Debit	2.3	2.1	1.9	2.2	1.8	1.7	1.7	1.7	1.6
Capital account	**1.0**	**0.7**	**1.2**	**1.9**	**1.8**	**1.8**	**1.8**	**1.5**	**1.2**
Financial Account	**-2.4**	**-1.1**	**1.3**	**1.4**	**0.2**	**-0.3**	**0.1**	**0.2**	**0.5**
Direct investment, net	-1.3	-2.2	2.1	-1.3	-1.2	-1.2	-1.2	-1.2	-1.2
Portfolio investment, net	4.2	0.4	2.9	-0.7	-1.0	1.0	1.0	0.6	0.6
Other investment, net	-7.0	-1.0	-5.2	3.4	2.4	-0.1	0.2	0.7	1.0
Financial derivatives, net	0.0	0.1	0.1	0.0	0.0	0.0	0.0	0.0	0.0
Reserve assets	1.6	1.6	1.5	0.0	0.0	0.0	0.0	0.0	0.0
Errors and omissions	-1.2	0.9	0.5	0.0	0.0	0.0	0.0	0.0	0.0
Net International Investment Position	**-69.5**	**-66.3**	**-66.0**	**-60.9**	**-56.6**	**-53.5**	**-50.6**	**-48.0**	**-45.3**
External Debt	**114.7**	**112.4**	**121.2**	**118.1**	**115.0**	**113.6**	**112.5**	**111.7**	**112.0**

Sources: National Bank of Slovakia and IMF staff projections.

Table 4. Slovak Republic: Financial Soundness Indicators for the Banking Sector, 2013–20

	2013	2014	2015	2016	2017	2018	2019	2020
Capital adequacy /1								
Regulatory capital to risk-weighted assets	16.5	17.3	17.8	18.0	18.8	18.4	18.2	19.6
Regulatory Tier 1 capital to risk-weighted assets	14.4	16.0	16.5	16.2	16.8	16.7	16.7	18.0
Capital to assets	11.7	11.9	11.5	10.8	10.7	10.5	10.4	10.4
Asset quality /1								
Nonperforming loans to gross loans	5.1	5.3	4.9	4.4	3.7	3.1	2.9	2.7
Nonperforming loans net of provisions to capital	13.1	15.8	13.9	11.8	9.1	6.9	7.3	6.6
Earnings and Profitability /1								
Return on assets (after tax)	1.3	1.2	1.3	1.4	1.1	1.1	1.0	0.6
Return on equity (after tax)	10.7	10.4	11.2	13.0	10.1	10.1	9.5	5.9
Interest margin to gross income	78.4	85.6	90.9	67.2	74.4	72.8	71.5	64.2
Noninterest expenses to gross income	63.7	66.5	70.8	54.4	60.7	59.6	62.1	55.5
Liquidity /1								
Customer deposits to total (noninterbank) loans	113.0	110.3	111.0	105.7	101.6	99.7	98.3	98.0
Liquidity coverage ratio (LCR)				201.1	195.5	161.0	149.7	163.3
Liquid assets to total assets	36.2	34.1	34.2	31.7	29.7	27.0	24.0	26.4
Liquid assets to short-term liabilities	49.1	46.0	45.9	42.1	39.5	35.4	31.9	35.9
Sectoral distribution of loans to total loans /1								
Residents	91.6	91.0	93.6	94.0	94.1	93.4	93.7	93.6
Deposit-takers	0.0	0.0	0.1	0.2	0.1	0.0	0.0	0.0
Central bank	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Other financial corporations	2.3	1.9	1.9	1.9	2.1	1.5	1.7	1.3
General government	2.3	2.3	2.2	1.7	1.5	1.6	1.6	1.5
Nonfinancial corporations	36.2	33.4	33.7	32.4	31.4	30.2	29.4	29.7
Other domestic sectors	50.7	53.5	55.7	57.8	59.0	60.1	60.9	61.0
Nonresidents	8.4	9.0	6.4	6.0	5.9	6.6	6.3	6.4
Other indicators								
Nonfinancial corporation debt (in percent of GDP)	85.3	89.1	86.6	92.6	94.0	89.7	88.5	91.2
Households debt (in percent of GDP)	33.2	35.6	37.9	40.9	43.2	44.6	45.8	48.3
Households debt (in percent of disposable income)	57.3	62.3	65.6	69.3	72.5	72.3	74.2	76.5
Gross asset position in financial derivatives to capital	3.7	5.4	4.3	3.4	2.7	3.0	4.1	5.6
Gross liability position in financial derivatives to capital	4.8	6.6	5.5	4.4	3.4	3.4	4.1	5.3
Trading income to total income	3.5	5.3	5.5	7.3	5.8	2.7	1.8	5.2
Personnel expenses to noninterest expenses	38.6	39.3	44.3	42.7	43.5	44.7	45.5	47.6
Spread between reference lending and deposit rates (basis points)	379.3	369.4	343.4	294.7	287.0	272.0	247.0	233.0
Foreign currency-denominated loans to total loans	1.1	1.9	1.8	1.7	1.6	1.4	1.5	1.2
Foreign currency-denominated liabilities to total liabilities	3.9	4.2	3.8	3.3	3.5	3.2	2.9	3.2
Net open position in equities to capital	14.4	12.6	12.6	11.9	11.3	11.1	13.5	12.1
Net open position in foreign exchange to capital	2.2	3.7	2.5	0.9	1.0	0.8	5.5	-0.1

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

1/ Data under 2020 shows data as of 2020Q3.

Annex I. Authorities' Response to Past IMF Policy Recommendations

IMF 2019 Article IV Recommendations	Authorities' Response
Fiscal Policy	
Avoid new expansionary measures given the already significant commitments and the need to build up fiscal space.	Prior to the onset of the pandemic, some expansionary measures were introduced including the thirteenth pension, higher parental, and student benefits.
To avoid pro-cyclical consolidation, consider recalibrating the growth-related escape clause to debt rules to accommodate less drastic shocks.	The proposed amendments to the debt rules envisage growth-related escape clause to accommodate less drastic shocks.
The capping of the retirement age at 64 will raise long-term pension expenditure.	The retirement age cap was removed in the December 2020 constitutional amendment.
Strengthen the mandate of the Value for Money implementation unit.	The implementation unit of the Value for Money has established itself as a high-profile team at the heart of government, and the regular publication of its reports ensures ongoing follow-up at the most senior levels.
Consider removing preferential tax treatment of housing-related capital gains and link real-estate taxation to the market value of the property.	The Recovery and Resilience Plan (RRP) envisages an increase in property taxation.
Structural Reforms	
Create better synergies between higher education and future skill needs. Strengthen science-business linkages. Consolidate the public research system to improve coordination and ensure full use of EU funds for R&D.	Authorities have taken some initial steps, like the creation of a new Accreditation Agency and an increase in the amount of R&D tax deductions. The RRP includes wider reforms, including the introduction of a system of periodic evaluation of scientific performance, new standards and criteria for accreditation, and the concentration of educational and research capacities through mergers into larger units.
Provide a more enabling government through increasing regulatory predictability, raise the independence of the judiciary, and minimize conflict of interest in the public administration.	The new construction legislation would improve the expeditiousness of construction permission proceedings. The constitutional amendment on judicial reforms passed in December 2020 dictates that the term of office of constitutional judges will be adjusted to ensure that judges are replaced gradually, thereby preventing a single governing party or coalition from filling the court with its own nominees.
Strengthen ALMPs to reintegrate the long-term unemployed, including targeted measures for the Roma Population.	Introduction of LMPs aimed at reducing youth unemployment, including subsidies for businesses hiring young unemployed (however, this program was suspended in spring 2020 due to the pandemic), and

	changes in legislation to facilitate hiring workers of age 15+. A permanent Kurzarbeit scheme will be introduced in 2022 to strengthen the safety net. In order to make inclusion of the Roma more effective, a new Strategy for Equality, Inclusion and Participation of the Roma until 2030 was approved in April 2021, which prioritizes employment, education, health and housing.
Increase availability of childcare to support female employment.	Compulsory pre-school entry from age 5 as of 2021 and expansion of childcare facilities. The RRP envisages the introduction of a legal right to a place in pre-primary education from age 3, and investment to reduce barriers to access to school, including improving the access to education for marginalized Roma communities.
Invest in transport and digital infrastructure.	The RRP envisages large investments in digital infrastructure to widen access to fast internet, develop an electronic public administration, and improve digital infrastructure in schools to allow for an early digital education. The RRP also includes ambitious improvements to sustainable transport, including upgrading and electrification of railways, building new or upgrading tram and trolley lines, and increasing public transport connections, among others.
Financial Sector	
Building societies should be required to increase the NPL coverage ratio.	
Introduce a cap on the share of uncollateralized loans in total loans by building societies.	
Consider imposing non-zero Pillar II capital guidance for less systemic institutions in 2019 and introducing a risk weight add-on on housing loans to require banks to better internalize credit risks, which can be complemented with a floor on risk weights.	Pillar II capital guidance has been introduced for less systemic institutions.
The bank levy should be allowed to expire in 2021.	The bank levy was first doubled for 2020 and subsequently cancelled starting July 2020.
Strengthen the AML/CFT framework, including to improve disciplinary processes, step-up bank employee trainings, strengthen measures to support anti-corruption efforts, and enhance operational independence and effectiveness of the Financial Intelligence Unit.	A new AML/CFT supervision section was established in March 2020 in the NBS to strengthen on-site supervision and coordinate AML supervision. The Financial Intelligence Unit has set up working groups to implement corrective action (with regard to MONEYVAL recommendations). In September 2020 an amendment to the AML/CFT Act was approved to transpose the 5th AML Directive into law.

Annex II. Policy Measures in Response to COVID-19

(Percent of GDP)

Measure	Description of Measure	2020	2021 Planned
Wage subsidies ("First Aid")	i) Employment retention allowance for closed enterprises, at 80% (increased to 100% from February 2021) of gross wage (since October 2020, changed to total labor costs including contributions paid by the employer on behalf of the employee), max. €880 per month (increased to €1,100 from October 2020); ii) allowances to self-employed persons, a flat-rate allowance depending on the decrease in revenues, max €540 (increased to €810 from October 2020 and to €870 from February 2021); iii) employment retention allowance for enterprises struck by the crisis, 80% (increased to 100% from February 2021) of gross wage (starting October 2020, changed to total labor costs), maximum €880 (increased to €1,100 from October 2020), or a flat-rate allowance depending on the decrease in revenues, max €540 (increased to €810 from October 2020 and to €870 from February 2021); and iv) allowance to contract workers, single-person companies, and self-employed person (without social security contributions), flat-rate allowance of €210 (increased to €315 from October 2020 and to €360 from February 2021). The initial coverage period was March–July 2020, with the expiration date extended multiple times, to June 2021.	0.8	1.1
Sickness and nursing benefits	Payment of sick leave in quarantine or leave to take care of a sick family member for employees, 55% of salary. The benefits will be temporarily increased to 75% of the employee's gross salary for April 2021 only, to motivate people to comply with quarantine measures.	0.3	0.3
Health care expenditures	Covid screening test, remuneration of front-line workers, other increased expenditures in healthcare.	0.4	0.8
Extending unemployment benefits	Extension of unemployment benefits after the maximum duration. The first round took place between March and August 2020, the second round took place between March and May 2021.	0.03	0.1
Rental subsidies	Rental subsidies to businesses closed because of Covid containment measures. The subsidy will be equal to the rent reduction given by the landlord, subject to a limit of 50% of the rent. If the reduction from the landlord is below 50%, the state pays the same amount and the rest is to be paid by the tenant in instalments over max. 48 months. The assistance was later extended to owners of shops and restaurants who had to shut down their operations or significantly reduce their activities due to the Covid crisis.	0.04	0.1
Aid to the tourism and gastronomy sector	For businesses in the tourism and gastronomy sector that had a decrease in net turnover more than 40%.		0.2
Other expenditure measures	Kindergartens job retention, remuneration of front-line employees, support for job seekers, economic mobilization measures etc.	0.4	0.5
Tax relief	Mainly waiver of social security contributions of employers and self-employed persons for April for closed business, and application of loss carried forward from years 2015−18 to income reported in the corporate income tax return for 2019.	0.1	0.01
Reserves for 2021	Provision for additional expenditure due to COVID-19 in the 2021 budget		0.7
Total (above-the-line, general government)		**2.1**	**3.6**
Tax deferrals			
Deferment of taxes and levies (without impact on the deficit)	Deferral of the employer and self-employed persons' social security contribution in the event of a decrease in sales by more than 40% for March, May–July, December 2020 and January−March 2021 to end-June 2021. Deferment of corporate income tax (CIT) advances in the event of a decrease in sales by more than 40%; Delay of income tax returns (CIT and PIT).	0.5	0.1
Public credit guarantees	Scheme 1 (Export-Import Bank): SMEs (excluding micro firms) and large firms; loans between 2m and 20m Scheme 2 (SIH NDF I): SMEs (including micro firms) and large firms; max 2m Scheme 3 (SIH NDF II): SMEs (including micro firms); max 2m Restrictions: the loans cannot be used to refinance existing liabilities. Caps: the maximum loan amount is capped by 25% of turnover or twice the wage bill with some exemptions.	1.1	0.5
Debt moritoria	According to Act No 67/2020 and amended by Act No 75/2020 and by Act No 96/2020, a creditor which is a bank or a foreign bank branch shall, at the request of a debtor, authorizes the deferral of payments for the period specified in the deferral request, which shall not exceed nine months from the date of the next outstanding loan payment due after the date of submission of the deferral request. A debtor may request the deferral of payments of the same loan at most once during the pandemic period. this measure was extended to March 2021 in line with EBA's reactivation of its guidance on legislative and non-legislative moratoria published in Dec 2020.	0.5	0.1
Total (below-the-line, general government)		**2.2**	**0.7**

Source: 2021 Stability Program (updated with revised 2020 GDP data).

Annex III. External Sector Assessment

Overall Assessment: The external position of the Slovak Republic is assessed to be broadly in line with the level implied by its medium-term fundamentals and desirable policies in 2020.

The current account deficit fell sharply in 2020, driven mainly by a strong export performance due to high foreign demand for durables in 2020H2. As the economy recovers, the current account deficit is expected to widen from 2021 to 2023. Large public investments in the context of the NGEU program will further increase demand for imports, but this will be more than offset by EU funding. In the outer years, the current account deficit is expected to narrow owing to strong export performance.

Foreign Assets and Liabilities: Position and Trajectory

Background. The net international investment position (NIIP) of the Slovak Republic stood at around -66 percent of GDP at end-2020. Both gross assets and gross liabilities increased during 2020, the former driven by FDI and other investments, and the latter driven mainly by an increase in general government debt due to the large 2020 fiscal deficit. Gross liabilities were at 175 percent of GDP, while gross assets at 109 percent of GDP in 2020.

Assessment. The negative NIIP does not imply notable risks to external sustainability. Strong export growth and significant inflows of EU funds (both from the Next Generation EU Recovery Plan and structural and cohesion funds), combined with robust nominal GDP growth, are expected to bring the NIIP down to -45 percent of GDP by 2026. In addition, the large share of long-term, local-currency-denominated and FDI external liabilities reduces the vulnerability to capital outflows.

2020 (% GDP)	NIIP: -66	Gross Assets: 109	Debt Assets: 82	Gross Liab.: 175	Debt Liab.: 121

Current Account

Background. The current account deficit (CAD) narrowed to 0.4 percent of GDP in 2020. Both imports and exports contracted sharply during the first wave of the COVID-19 pandemic. However, exports rebounded rapidly in the second half of the year on the back of strong demand for consumer durables in trading partners, while imports remained relatively more subdued. Primary income outflows also fell in 2020, reflecting lower returns on past foreign investments during the crisis. The CAD is expected to progressively widen from 2021 to 2023 as imports and primary income outflows recover with the economic expansion. Higher public investment will also contribute to an increase in the CAD but will be offset by EU grants. In the outer years, the current account deficit is projected to narrow due to strong export growth.

Assessment. The EBA light CA model suggests a cyclically adjusted norm of -1.2 percent of GDP for 2020. The actual cyclically-adjusted CA balance is estimated at -0.6 percent of GDP. An additional COVID-19 related adjustment of -0.6 percentage points is warranted to reflect lower oil prices, a sharp decline in tourism, and a global consumption shift from services to goods due to the pandemic. With the COVID-19 adjustment, the cyclically-adjusted CA balance is equal to the norm, implying no CA and REER gaps. Therefore, staff assesses the Slovak Republic's external position as broadly consistent with fundamentals.

Slovak Republic: Model Estimates for 2020 (in percent of GDP)

	CA model	REER model
CA-Actual	**-0.4**	
Cyclical contributions (from model) (-)	0.2	
COVID-19 adjustor (+) 1/	-0.6	
Adjusted CA	**-1.2**	
CA Norm (from model) 2/	**-1.2**	
Adjusted CA Norm	**-1.2**	
CA Gap	**0.0**	**-5.1**
o/w Relative policy gap	2.8	
Elasticity	-0.67	
REER Gap (in percent)	**0.0**	**7.6**

1/ Additional cyclical adjustment to account for the global consumption shift from services to goods (-0.34 percent of GDP) and the temporary impact of the pandemic on oil trade (-0.46 percent of GDP) and on tourism balances (0.21 percent of GDP).
2/ Cyclically adjusted, including multilateral consistency adjustments.

Real Exchange Rate

Background. Both CPI- and ULC-based real effective exchange rate (REER) appreciated slightly in 2020 compared with 2019 reflecting higher inflation and wage growth in the Slovak Republic relative to trading partners.

Assessment. The REER EBA-lite approach points to a sizable overvaluation of 7.6 percent. Given that the estimated overvaluation in this approach is mostly driven by large residuals, staff relies on the CA approach for assessment of the external position. Overall, staff assesses the real exchange rate to be broadly around its equilibrium value.

Capital and Financial Accounts: Flows and Policy Measures

Background. The capital account is expected to continue to display significant inflows through the forecasting period as Slovakia receives sizable EU funds from the NGEU Recovery Plan and structural and cohesion funds. Meanwhile, foreign direct investment, which displayed net inflows in all but two of the previous 10 years, sharply reversed in 2020 in the context of the COVID-19 pandemic, with net outflows totaling 2.1 percent of GDP. This was offset by portfolio investment inflows into government debt, mainly due to debt issued by the government to cover its deficit.
In March 2021, in the context of an amendment to the Critical Infrastructure Act, the Slovak Republic introduced a new screening mechanism for FDI in strategic industries for national security reasons.

Assessment. FDI inflows are expected to resume starting in 2021 as investor interest picks up with the economic recovery and newly announced investments in the automotive sector take place. The dominance of FDI in capital inflows mitigates risks from sudden changes in market sentiment. Significant inflows of EU funds are expected to further improve the Slovak Republic's external position. Regarding the amendment to the Critical Infrastructure Act, staff recommends that FDI restrictions on the basis of national security be used sparingly and judiciously.

FX Intervention and Reserves Level

Background. The euro has the status of a global reserve currency.

Assessment. Reserves held by euro area economies are typically low relative to standard metrics, but the currency is free floating.

Annex IV. Risk Assessment Matrix[1]

	Source of Risks	Relative Likelihood	Time Horizon	Expected Impact	Policy Response
Global	**Unexpected shifts in COVID-19 pandemic.** • **Downside.** ➢ **Asynchronous progress.** Limited access to, and longer-than-expected deployment of, vaccines in some countries—combined with dwindling policy space—prompt a reassessment of their growth prospects (for some Emerging and Frontier Markets triggering capital outflows, depreciation and inflation pressures, and debt defaults). ➢ **Prolonged pandemic.** The disease proves harder to eradicate (e.g., due to new virus strains, short effectiveness of vaccines, or widespread unwillingness to take them), requiring costly containment efforts and prompting persistent behavioral changes rendering many activities unviable. For countries with policy space, prolonged support—while needed to cushion the economy—exacerbates stretched asset valuations, fueling financial vulnerabilities. For those with limited space, especially EMs, policy support is insufficient.	Medium Medium	Short Term	**High** Extended containment measures lead to prolonged uncertainty and require the downsizing of some sectors of the economy. This leads to a rise in bankruptcies and the need for reallocation of resources towards less contact-intensive industries, generating a deeper long-term scarring. Weakening of financial intermediaries' balance-sheets restricts the flow of credit.	• Maintain public health measures, ensure adequate resources for the health system and accelerate vaccine rollout. • Use available fiscal space to provide targeted support to vulnerable households and affected but viable businesses.
	• **Upside.** ➢ **Faster containment.** Pandemic is contained faster than expected due to the rapid production and distribution of vaccines, boosting confidence and economic activity.	Medium		**High** Restoration of confidence and activity boost demand leading to a faster-than-expected recovery.	• Gradually phase-out of support to avoid undermining the recovery. • Adopt macroeconomic policies and structural reforms to raise potential output, boost resilience, protect the vulnerable, and make the economy more digital and green.
	Sharp rise in global risk premia exposes financial and fiscal vulnerabilities. A reassessment of market fundamentals (e.g., in response to adverse COVID-19 developments) triggers a widespread risk-off event. Risk asset prices fall sharply and volatility spikes, leading to significant losses in major non-bank financial institutions. Higher risk premia generate financing difficulties for leveraged firms (including those operating in unviable activities) and households, and a wave of bankruptcies erode banks' capital buffers. Financing difficulties extend to sovereigns with excessive public debt, leading to cascading debt defaults.	Medium	Short to Medium Term	**High** Tightening financial conditions deepen the economic downturn. Higher risk premium for sovereigns reduces fiscal space to provide policy support.	• Continue to extend debt maturity to reduce roll-over needs in the event of an increase in premiums. • Accelerate absorption of available EU funds to finance COVID-related measures and public investment. • Set a credible path for fiscal consolidation for the medium-term, without withdrawing support prematurely. • Provide liquidity support to viable firms and recalibrate macro-prudential policies as necessary to ensure the smooth flow of credit.
	Widespread social discontent and political instability. Social tensions erupt as the pandemic and inadequate policy response cause socio-economic hardship (unemployment, poverty, and shortages and higher prices of essentials—often exacerbating pre-existing inequities), or due to unequal access to vaccines. Growing political polarization and instability weaken policymaking and confidence.	High		**Medium** Prolonged containment measures, associated with rising unemployment and corporate bankruptcies, could increase tensions in society, lead to disruptive protests, and challenge policymaking.	• Provide targeted support to the most vulnerable groups, including though ALMPs to ensure inclusive recovery. • Accelerate policies to facilitate the reallocation of factors of production while providing an adequate social safety net.

[1] The Risk Assessment Matrix (RAM) shows events that could materially alter the baseline path (the scenario most likely to materialize in the view of IMF staff). The relative likelihood is the staff's subjective assessment of the risks surrounding the baseline ("low" is meant to indicate a probability below 10 percent, "medium" a probability between 10 and 30 percent, and "high" a probability between 30 and 50 percent).

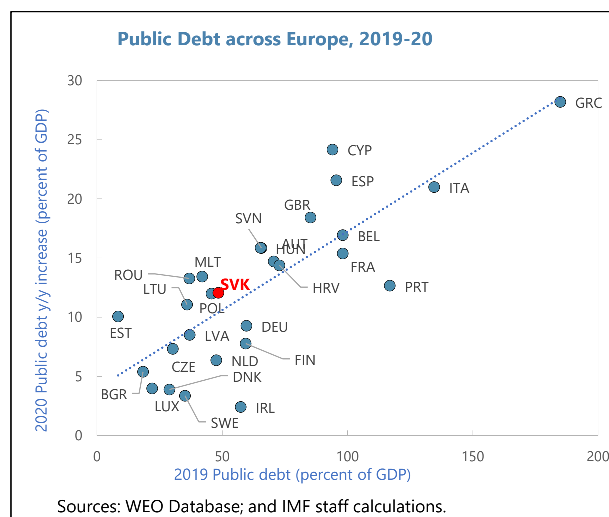
	Source of Risks	Relative Likelihood	Time Horizon	Expected Impact	Policy Response
Global	**Widespread social discontent and political instability.** Social tensions erupt as the pandemic and inadequate policy response cause socio-economic hardship (unemployment, poverty, and shortages and higher prices of essentials—often exacerbating pre-existing inequities), or due to unequal access to vaccines. Growing political polarization and instability weaken policymaking and confidence.	High		**Medium** Prolonged containment measures, associated with rising unemployment and corporate bankruptcies, could increase tensions in society, lead to disruptive protests, and challenge policymaking.	• Provide targeted support to the most vulnerable groups, including though ALMPs to ensure inclusive recovery. • Accelerate policies to facilitate the reallocation of factors of production while providing an adequate social safety net.
	Accelerating de-globalization. Despite renewed efforts to reach multilateral solutions to existing tensions, geopolitical competition leads to further fragmentation. Reshoring and less trade reduce potential growth.	Medium	Short to Medium Term	**High** The Slovak Republic has relied on an export-led growth model through specialization and integration in the global value chains of select industrial products (e.g. cars). A retreat from multilateralism and globalization would significantly impact its growth potential.	• Accelerate structural reforms, including by leveraging EU funds, to boost productivity and competitiveness, move up the value chain and diversify export products and destinations. • Engage in support for the multilateral rules-based trade system and advocate trade liberalization.
Local	**Deeper scarring of household and corporate balance sheets and labor markets.** The structural shift triggered by the pandemic leads to widespread bankruptcies as broad-based policy support is phased out. Job losses become more persistent or permanent.	Low /Medium	Short to Medium Term	**High** Bankruptcies and job losses lead to destruction of firm-specific physical and human capital, eroding the economy's potential though the relatively small reliance of the Slovak economy on the more-affected services sector mitigates the macroeconomic impact. Impaired corporate solvency affects the balance sheet of the financial sector leading to credit tightening and potential macro-financial doom-loops.	• Extend targeted policy support for the labor market and the corporate sector until the recovery is firmly under way. • Consider solvency support for viable firms in affected sectors, including through equity-like instruments. • Adjust financial sector regulations to maintain the smooth flow of credit.
	Property market downturn as a result of worsening economic conditions and damaged household balance-sheets.	Low /Medium	Short to Medium Term	**High** Sharp reversal in the real estate market after years of rapid price growth could lead to an increase in NPLs and tightening credit conditions, given banks' large exposure to housing mortgages.	• Continue close monitoring of financial conditions and recalibrate macro-prudential policies as needed. • Adjust financial sector regulations to maintain the flow of credit.
	Auto sector fails to adjust to shift to electric vehicles and increased automation. Increasing automation erodes Slovakia's competitive advantage as a source of low-cost skilled industrial labor. Slovakia's competitiveness is further deteriorated by the limited fragmentation in electric car production processes, curtailing the scope for supply-chain-based expansion.	Low /Medium	Medium Term	**High** Loss of competitiveness and shrinking market share of Slovak auto exports threaten the country's growth model, lowering potential growth and wages.	• Use EU funds to invest in education and upskilling strategies that take into account rapidly changing skill demands. • Boost spending on R&D and increase its efficiency to move up value chains.
	Structural reforms in education, innovation, public administration and digitalization implemented in the context of the NGEU program boost long-term economic growth.	Low /Medium	Long Term	**High** Improvements in educational quality, upskilling of workers and a tighter link between businesses and educational/research institutions allow the Slovak Republic to move up value chains. A narrowing of the perceived gaps in institutional quality and public efficiency boost productivity growth.	

Annex V. Debt Sustainability Analysis

A. Public Debt Sustainability Analysis

General government debt increased from 48.2 percent of GDP in 2019 to 60.3 percent of GDP in 2020 as a result of the large fiscal deficit, sizable decline in economic activity in the context of the COVID-19 pandemic, and accumulation of liquid assets. Over the medium term, the debt-to-GDP ratio is projected to first rise moderately from the 2020 level but subsequently decline under the baseline scenario. Debt sustainability benefits from a lower projected effective interest rate and above-potential growth. However, debt could increase steadily over the medium term under various shocks, suggesting the prudence of pursuing a gradual reduction in the fiscal deficit once an expansion is well underway.

1. Background. After increasing by 26 percent of GDP between 2008 and 2013 to reach 55 percent, Slovakia's public debt gradually declined to 48.2 percent of GDP by 2019. In the 2019 debt sustainability analysis (DSA), the debt level was projected to continue its gradual decline to 45 percent of GDP over the medium term. However, the pandemic contributed to a sharp deterioration in the fiscal deficit, which rose from 1.3 percent of GDP in 2019 to 6.1 percent of GDP in 2020, with public debt jumping by more than 12 percentage points to 60.3 percent of GDP. Almost 80 percent of the increase in debt in 2020 took place through long-term instruments. The government's liquid assets also rose markedly, leading to a smaller increase in net debt.



Sources: WEO Database; and IMF staff calculations.

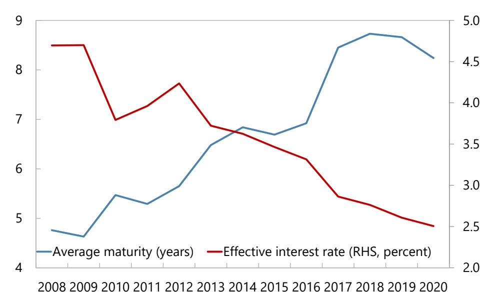
2. Baseline forecast assumptions. The baseline fiscal scenario is based on the 2021 Stability Program, augmented to include staff's assumed Next Generation EU (NGEU) grants disbursement for the Slovak Republic and related expenditure (Box 1). No offsetting measures or consolidation effort are assumed in the baseline. After contracting by 4.8 percent in 2020, real GDP is projected to surpass its 2019 level by end-2021. An anticipated boost in spending financed by the EU funds under the 2013–20 cycle and the new NGEU grants are projected to increase growth in 2022–23, but the growth rate would decline over 2024–26 due to base effects and the phasing out of spending under the previous EU cycle. Since 2011, staff's growth projections have been optimistic on average, similar to the median forecast bias of other countries.

3. Baseline Projections.

- **Fiscal deficit.** Staff projects the primary fiscal deficit to rise from 5.1 percent of GDP in 2020 to 7.9 percent in 2021, as fiscal policy continues to support the recovery amid new waves of infections, on the back of a strong rebound in activity and a partial withdrawal of the emergency package. The primary deficit is projected to decline to 1.9 percent of GDP in 2026, which is also the debt-stabilizing level.

- **Maturity risks.** The average maturity of public debt has been generally rising since the global financial crisis, standing at 8.2 years at end-2020. In 2020, T-bills accounted for slightly more than 20 percent of total new government securities issued. For 2021, we assume that 2 billion new T-bills will be issued (as announced by Slovakia's Debt and Liquidity Management Agency). For later years, we assume that T-bills account for 15 percent of total government securities issued. We assume new sovereign bonds have an average maturity of 10 years.

Average Maturity and Effective Interest Rate



Sources: The Slovakia Debt and Liquidity Management Agency.

- **Interest rates.** Despite rising average maturity, the effective interest rate has been on a declining trend since the global financial crisis, dropping from 4.7 percent in 2008 to 2.5 percent in 2020. More recently, the spread over the 10-year Germany sovereign bond has declined from a peak of 114 basis points in April 2020 to 27 basis points in April 2021, underpinned by the ECB's accommodative monetary stance. The sovereign yields are projected based on the projection for German sovereign yields, with the spread gradually rising to the average 2010–20 levels by 2026. The effective interest rate is expected to decline from 2.5 percent in 2020 to 1.5–1.6 percent during 2022–26, as maturing debt is replaced by new debt with lower interest rates.

- **Debt and gross financing needs.** The debt level is projected to increase by 2.8 percent of GDP in 2021 to 63 percent of GDP, reflecting the continued sizable fiscal deficit. The debt-to-GDP ratio is projected to decline slightly after peaking in 2022 to 62.4 percent of GDP by 2026, underpinned by favorable interest-growth dynamics. Under the baseline, the gross financing needs of the government would remain below 11½ percent of GDP.

4. Fan Charts. The symmetric fan charts, which assume symmetric upside and downside risks, indicate that the debt-to-GDP ratio could drop to 58 percent by 2026 with a 25 percent probability. On the other hand, the upper bands indicate that the debt ratio could increase to 67 percent by 2026 with a 25 percent probability. In a more stringent exercise, assuming only downside shocks to interest rates and GDP growth, there is a 25 percent chance that debt-to-GDP could increase to 70.5 percent of GDP in the medium term.

5. Shocks and Stress Tests. Relative to the baseline, Slovakia's debt dynamics would worsen in case of negative shocks to growth, interest rates and public finances. In a scenario in which all

negative shocks are combined, debt could reach 74.9 percent of GDP in 2026 (compared to 62.4 percent under the baseline).

- **Growth shocks.** Under this scenario, real GDP growth rates in 2022–23 are assumed to be one standard deviation (3.0 percentage points) lower than in the baseline. The collapse in growth in 2020 is more than one and a half times the standard deviation of growth rates, making this a particularly large shock. Lower growth rates are assumed to also lead to lower inflation/GDP deflator and, with a higher deficit-to-GDP ratio, a higher interest rate. Public debt would increase to about 70 percent of GDP by 2026 under this scenario. Gross financing needs would peak in 2023 and decline afterwards.

- **Primary balance shock.** Under an assumed deterioration in the primary balance by 1.1 percentage points in 2022 and 0.3 percentage points in 2023, public debt would increase slightly to 65.2 percent of GDP in 2026.

- **Interest rate shock.** This scenario assumes an increase of 436 basis points in interest rate throughout the projection period (with real interest rate projected at the highest level reached over 2011−20). The deterioration in public debt is back-loaded, as old debt gradually matures and new debt is contracted at higher interest rate. Public debt would reach 65.5 percent of GDP by 2026, with gross financing needs at 12.2 percent of GDP.

- **Real exchange rate shock.** This scenario assumes a 14 percent nominal exchange rate depreciation in 2022, calibrated to emulate the maximum historical movement of the exchange rate in the last 10 years. The impact on the stock of the public debt and gross financing needs would be marginal, reflecting the very low share of public debt in foreign currency (3 percent in 2020).

- **Combined macro-fiscal shock.** This scenario combines shocks to real growth, the interest rate, the exchange rate, and the primary balance. Under this scenario, debt would reach 69.1 percent of GDP in 2022 and 74.9 percent by 2026. Gross financing needs would peak at 15.4 percent of GDP in 2023.

- **Contingent liability.** In response to the pandemic, the authorities introduced multiple loan guarantees programs to help support credit intermediation. The announced programs total EUR 4.02 billion and guarantee up to 80−90 percent of the loan value. The usage, however, has been lower, at about 1.04 billion as of end-2020 (1.1 percent of GDP). The DSA does not explicitly incorporate these guaranteed programs. If we assume 60 percent of the used guarantees are called, it would amount to 0.7 percent of 2020 GDP.

6. **Debt Sustainability Analysis Risk Assessment (Heat map).** The heat map highlights risks associated with the large total external financing requirements (56 percent of GDP in 2020), mainly reflecting high short-term external debt. “Currency and deposits” liabilities of the National Bank of Slovakia (NBS), influenced mainly by transactions of other central banks or other institutions which are participating in Target 2 payment system, account for about half of the total short-term external

debt. "Loan" liabilities of the NBS, accounting for 13 percent of the short-term external debt, are connected mainly with repurchase agreements, reflecting the active investment policy of the NBS. Gross external financing needs are also boosted by a high level of intra-company FDI loans (15 percent of total short-term external debt), which tend to be more stable. While the share of public debt held by non-residents is relatively high (58 percent), this risk is mitigated by the important role of institutional investors, which tend to be more long-term investors. The ECB also plays a backstop role. The ECB holdings of Slovak government securities through the public sector purchase program amount to about 38 percent of total government debt (66 percent of government external debt).

Figure V.1. Public Sector Debt Sustainability Analysis—Baseline Scenario

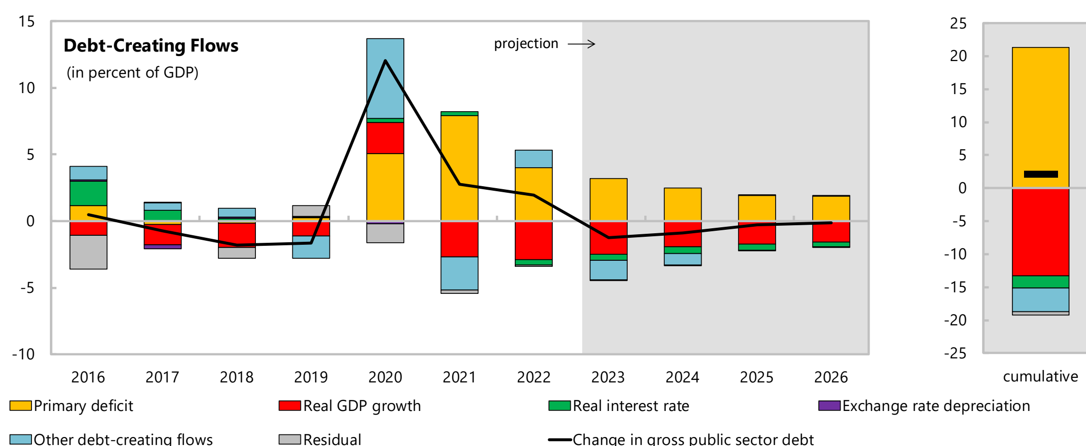
(in percent of GDP unless otherwise indicated)

Debt, Economic and Market Indicators [1/]

	Actual			Projections						As of June 02, 2021		
	2010-2018 [2/]	2019	2020	2021	2022	2023	2024	2025	2026	Sovereign Spreads		
Nominal gross public debt	50.0	48.2	60.3	63.0	65.0	63.7	62.8	62.5	62.4	EMBIG (bp) 3/		27
Public gross financing needs	8.1	1.3	6.1	11.5	8.8	11.0	10.3	11.3	10.5	5Y CDS (bp)		46
Net public debt	45	43	49	56	57	58	57	57	58			
Real GDP growth (in percent)	3.1	2.3	-4.8	4.7	4.9	4.0	3.2	2.9	2.6	Ratings	Foreign	Local
Inflation (GDP deflator, in percent)	0.7	2.5	2.4	1.2	2.3	2.2	2.3	2.2	2.2	Moody's	A2	A2
Nominal GDP growth (in percent)	3.8	4.9	-2.5	6.0	7.3	6.4	5.6	5.2	4.9	S&Ps	A+	A+
Effective interest rate (in percent) [4/]	3.5	2.6	2.5	1.8	1.6	1.6	1.5	1.6	1.6	Fitch	A	A

Contribution to Changes in Public Debt

	Actual			Projections							
	2010-2018	2019	2020	2021	2022	2023	2024	2025	2026	cumulative	debt-stabilizing primary balance [9/]
Change in gross public sector debt	1.5	-1.6	12.1	2.8	1.9	-1.3	-0.9	-0.3	-0.1	2.1	
Identified debt-creating flows	2.1	-2.4	13.5	3.0	2.0	-1.2	-0.8	-0.2	-0.1	2.7	
Primary deficit	1.9	0.3	5.1	7.9	4.0	3.2	2.5	1.9	1.9	21.4	-1.9
Primary (noninterest) revenue and grants	39.0	41.2	41.4	41.7	41.6	42.4	40.3	40.3	40.1	246.4	
Primary (noninterest) expenditure	40.9	41.4	46.5	49.6	45.6	45.6	42.8	42.2	41.9	267.7	
Automatic debt dynamics [5/]	-0.1	-1.0	2.5	-2.4	-3.3	-2.9	-2.4	-2.2	-1.9	-15.2	
Interest rate/growth differential [6/]	-0.2	-1.1	2.6	-2.4	-3.3	-2.9	-2.4	-2.2	-1.9	-15.2	
Of which: real interest rate	1.2	0.0	0.3	0.3	-0.4	-0.5	-0.5	-0.4	-0.4	-1.9	
Of which: real GDP growth	-1.4	-1.1	2.4	-2.7	-2.9	-2.5	-1.9	-1.7	-1.6	-13.3	
Exchange rate depreciation [7/]	0.1	0.1	-0.2	…	…	…	…	…	…	…	
Other identified debt-creating flows	0.3	-1.7	6.0	-2.5	1.3	-1.5	-0.9	0.0	0.0	-3.5	
Privatization/Drawdown of Deposits	0.3	-1.7	6.0	-3.5	1.3	-1.1	-0.5	0.0	0.0	-3.7	
Contingent liabilities	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	
Other stock-flow adjustments	0.0	0.0	0.0	1.0	0.0	-0.4	-0.4	0.0	0.0	0.2	
Residual, including asset changes [8/]	-0.6	0.8	-1.4	-0.3	-0.1	-0.1	-0.1	-0.1	-0.1	-0.6	



Source: IMF staff.

1/ Public sector is defined as general government.

2/ Based on available data.

3/ Long-term bond spread over German bonds.

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

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

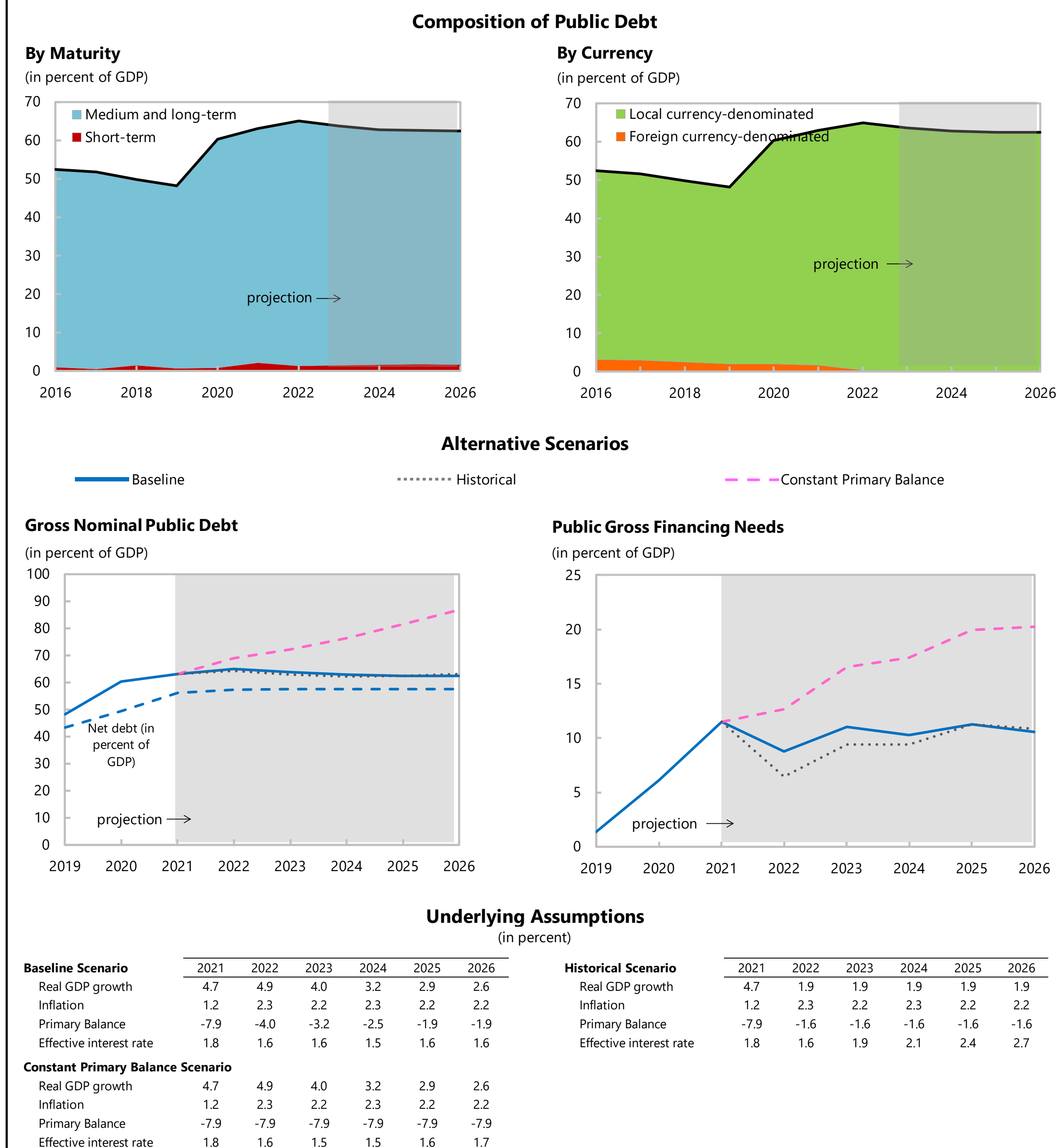
6/ The real interest rate contribution is derived from the numerator in footnote 5 as $r - \pi(1+g)$ and the real growth contribution as -g.

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

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

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

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

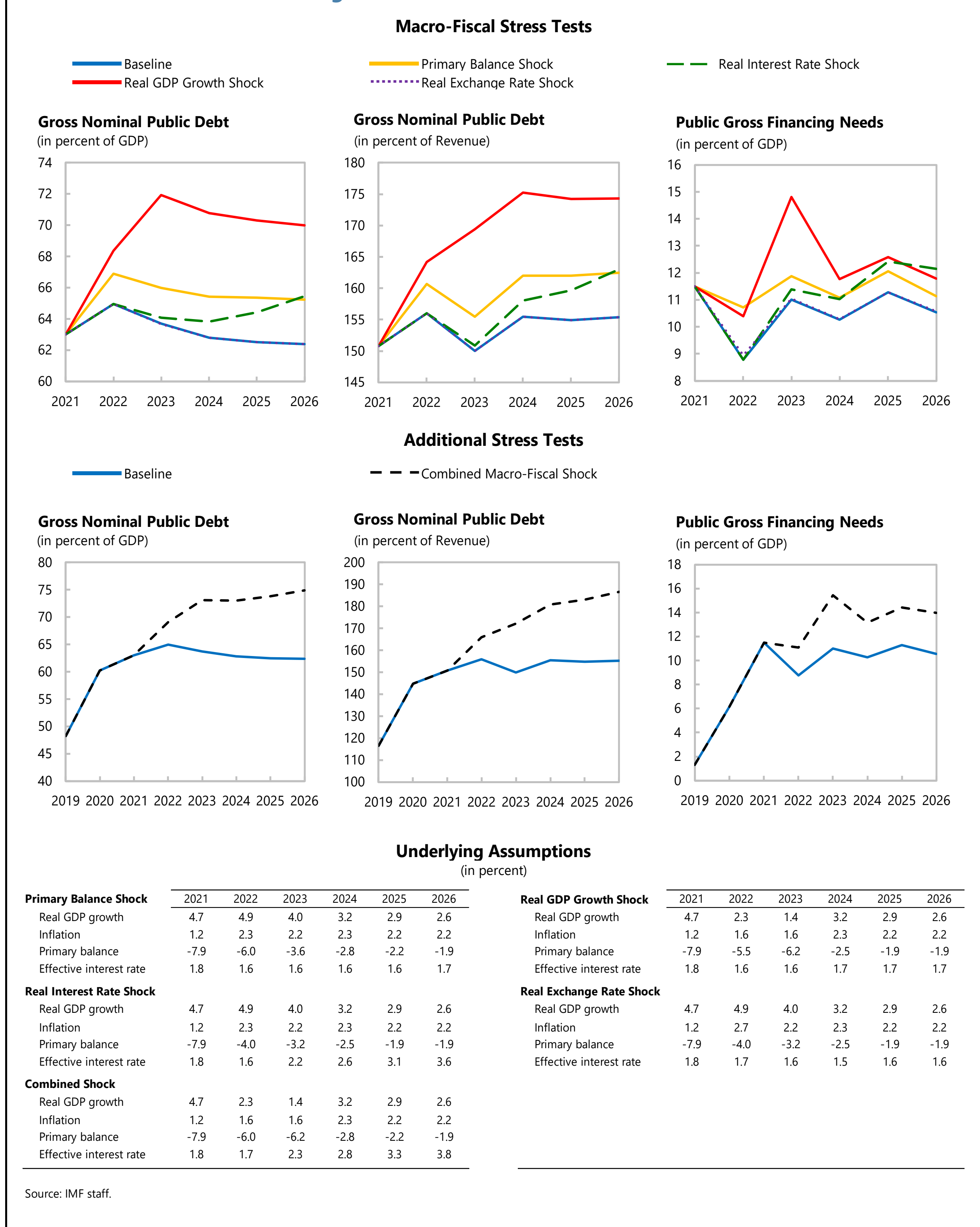


Baseline Scenario	2021	2022	2023	2024	2025	2026
Real GDP growth	4.7	4.9	4.0	3.2	2.9	2.6
Inflation	1.2	2.3	2.2	2.3	2.2	2.2
Primary Balance	-7.9	-4.0	-3.2	-2.5	-1.9	-1.9
Effective interest rate	1.8	1.6	1.6	1.5	1.6	1.6
Constant Primary Balance Scenario						
Real GDP growth	4.7	4.9	4.0	3.2	2.9	2.6
Inflation	1.2	2.3	2.2	2.3	2.2	2.2
Primary Balance	-7.9	-7.9	-7.9	-7.9	-7.9	-7.9
Effective interest rate	1.8	1.6	1.5	1.5	1.6	1.7

Historical Scenario	2021	2022	2023	2024	2025	2026
Real GDP growth	4.7	1.9	1.9	1.9	1.9	1.9
Inflation	1.2	2.3	2.2	2.3	2.2	2.2
Primary Balance	-7.9	-1.6	-1.6	-1.6	-1.6	-1.6
Effective interest rate	1.8	1.6	1.9	2.1	2.4	2.7

Source: IMF staff.

Figure V.3. Public DSA—Stress Tests



Underlying Assumptions
(in percent)

Primary Balance Shock	2021	2022	2023	2024	2025	2026
Real GDP growth	4.7	4.9	4.0	3.2	2.9	2.6
Inflation	1.2	2.3	2.2	2.3	2.2	2.2
Primary balance	-7.9	-6.0	-3.6	-2.8	-2.2	-1.9
Effective interest rate	1.8	1.6	1.6	1.6	1.6	1.7
Real Interest Rate Shock						
Real GDP growth	4.7	4.9	4.0	3.2	2.9	2.6
Inflation	1.2	2.3	2.2	2.3	2.2	2.2
Primary balance	-7.9	-4.0	-3.2	-2.5	-1.9	-1.9
Effective interest rate	1.8	1.6	2.2	2.6	3.1	3.6
Combined Shock						
Real GDP growth	4.7	2.3	1.4	3.2	2.9	2.6
Inflation	1.2	1.6	1.6	2.3	2.2	2.2
Primary balance	-7.9	-6.0	-6.2	-2.8	-2.2	-1.9
Effective interest rate	1.8	1.7	2.3	2.8	3.3	3.8

Real GDP Growth Shock	2021	2022	2023	2024	2025	2026
Real GDP growth	4.7	2.3	1.4	3.2	2.9	2.6
Inflation	1.2	1.6	1.6	2.3	2.2	2.2
Primary balance	-7.9	-5.5	-6.2	-2.5	-1.9	-1.9
Effective interest rate	1.8	1.6	1.6	1.7	1.7	1.7
Real Exchange Rate Shock						
Real GDP growth	4.7	4.9	4.0	3.2	2.9	2.6
Inflation	1.2	2.7	2.2	2.3	2.2	2.2
Primary balance	-7.9	-4.0	-3.2	-2.5	-1.9	-1.9
Effective interest rate	1.8	1.7	1.6	1.5	1.6	1.6

Source: IMF staff.

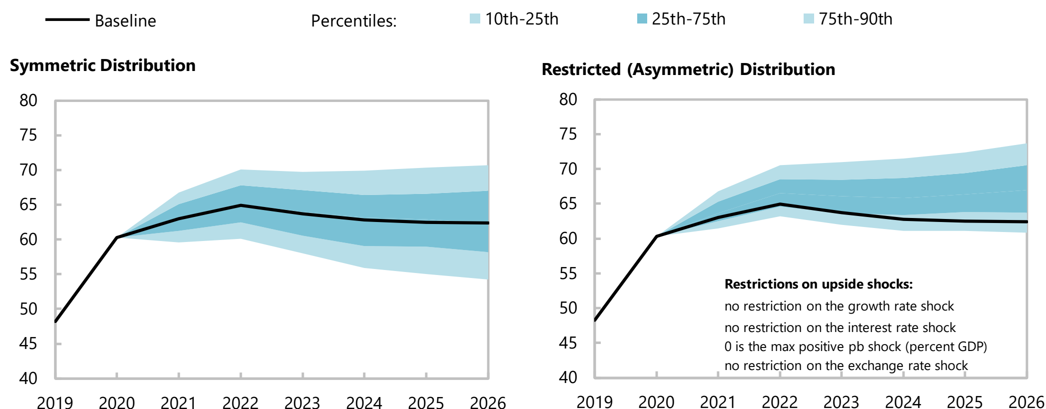
Figure V.4. Public DSA Risk Assessment

Heat Map

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

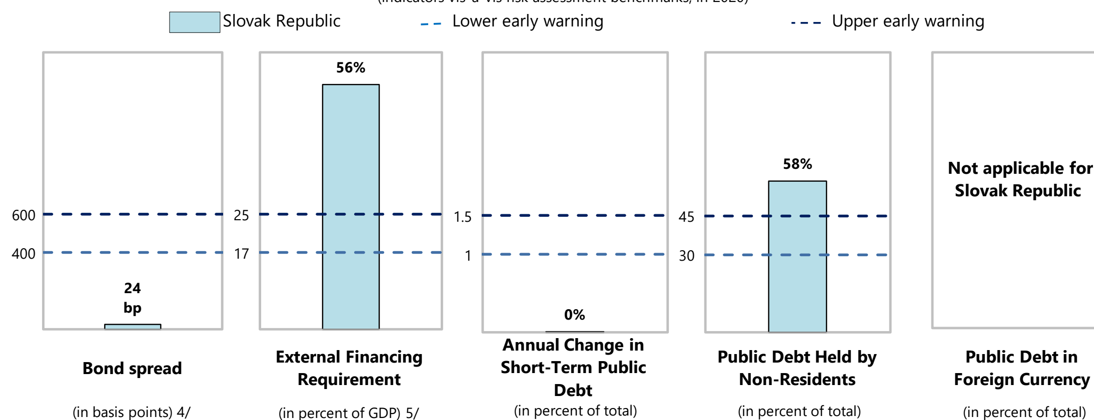
Evolution of Predictive Densities of Gross Nominal Public Debt

(in percent of GDP)



Debt Profile Vulnerabilities

(Indicators vis-à-vis risk assessment benchmarks, in 2020)



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:

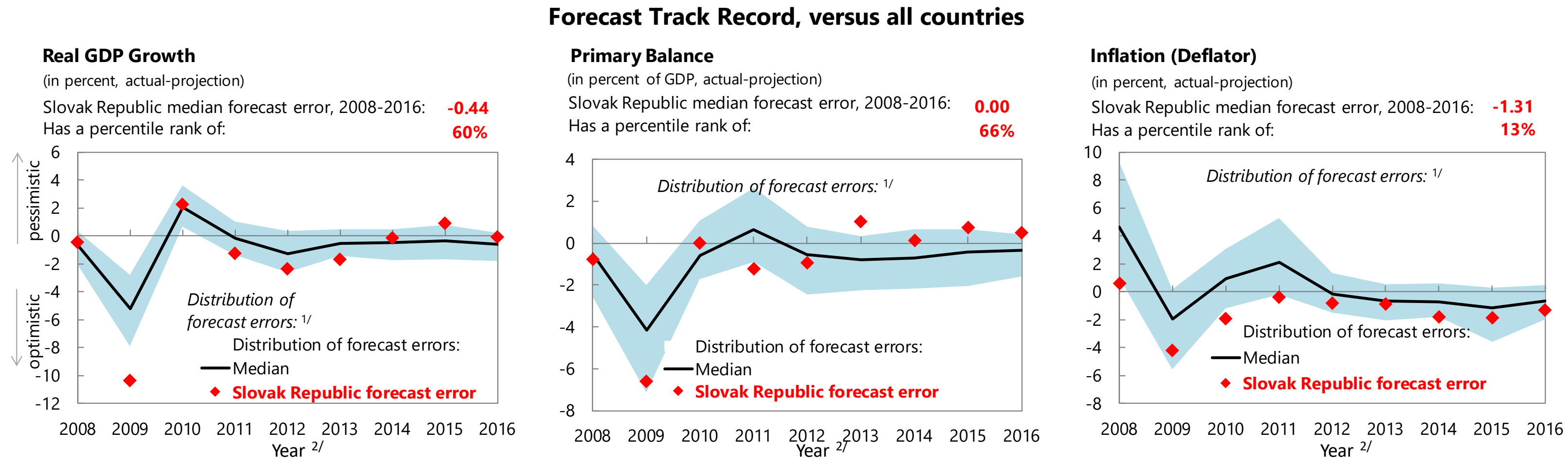
400 and 600 basis points for bond spreads; 17 and 25 percent of GDP for external financing requirement; 1 and 1.5 percent for change in the share of short-term debt; 30 and 45 percent for the public debt held by non-residents.

4/ Long-term bond spread over German bonds, an average over the last 3 months, 05-Dec-20 through 05-Mar-21.

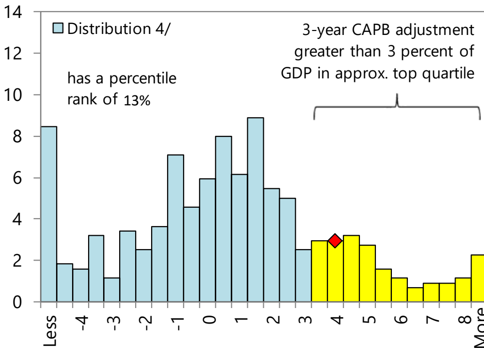
5/ External financing requirement is defined as the sum of current account deficit, amortization of medium and long-term total external debt, and short-term total external debt at the end of previous period.

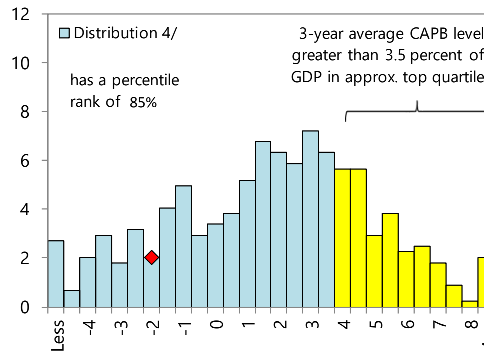
Figure V.5. Public DSA—Realism of Baseline Assumptions

Forecast Track Record, versus all countries

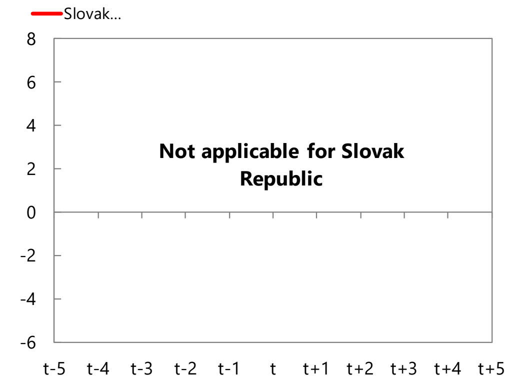


Assessing the Realism of Projected Fiscal Adjustment





Boom-Bust Analysis [3]



Source : IMF Staff.

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

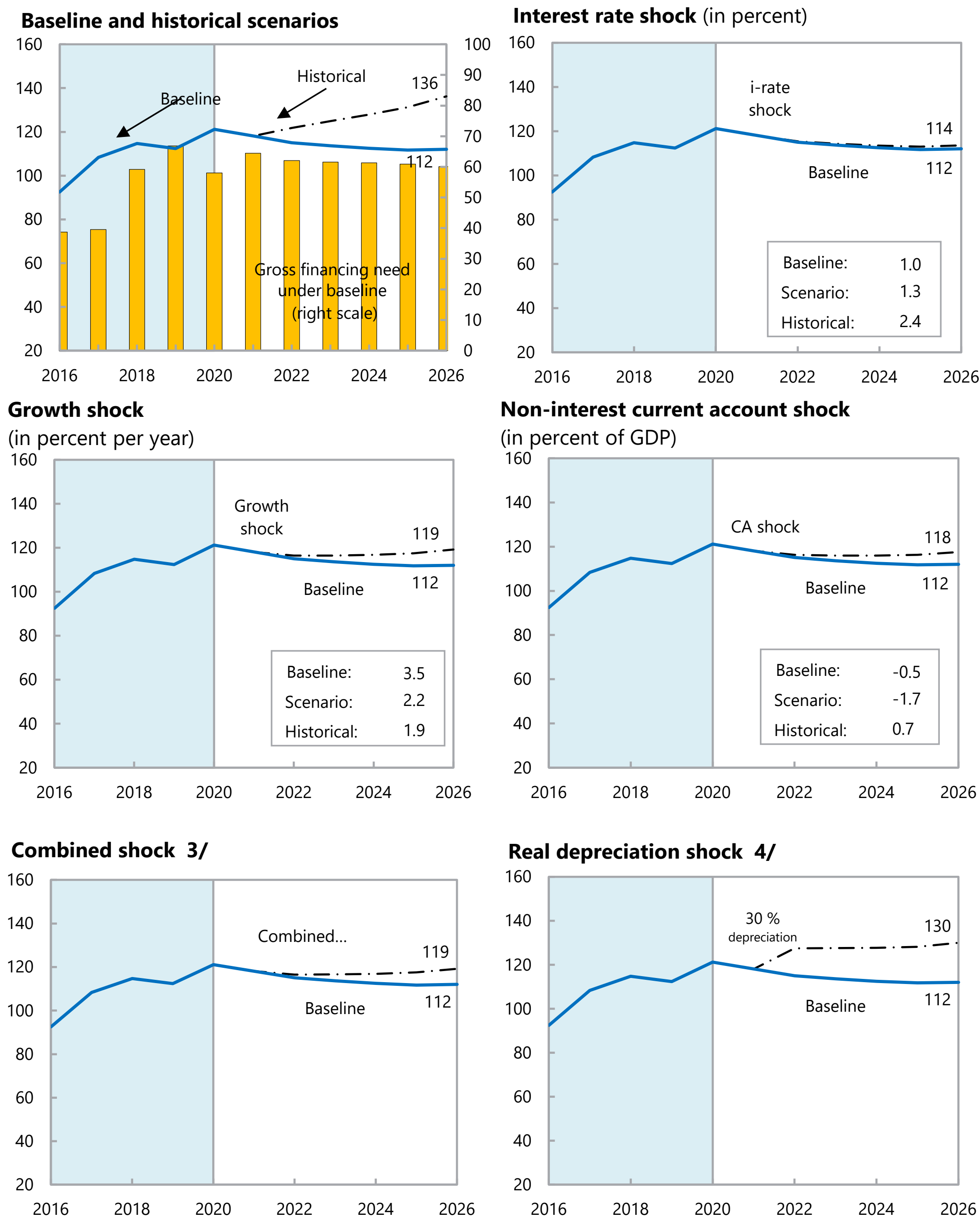
2/ Projections made in the spring WEO vintage of the preceding year.

3/ Not applicable for Slovak Republic, as it meets neither the positive output gap criterion nor the private credit growth criterion.

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.

Figure V.6. External Debt Sustainability: Bound Tests 1/2/

(External debt in percent of GDP)



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

Table 1. Country: External Debt Sustainability Framework, 2016-2026

(In percent of GDP, unless otherwise indicated)

	Actual							Projections						
	2016	2017	2018	2019	2020			2021	2022	2023	2024	2025	2026	**Debt-stabilizing non-interest current account 6/**
1 **Baseline: External debt**	92.5	108.3	114.7	112.4	121.2			**118.1**	**115.0**	**113.6**	**112.5**	**111.7**	**112.0**	**-5.3**
2 Change in external debt	8.0	15.8	6.4	-2.4	8.8			-3.1	-3.1	-1.4	-1.1	-0.8	0.3	
3 Identified external debt-creating flows (4+8+9)	0.4	-4.3	-4.6	-4.5	3.8			-6.0	-4.9	-3.3	-2.8	-2.9	-3.2	
4 Current account deficit, excluding interest payments	0.8	0.0	0.4	0.9	-1.4			-0.7	0.5	1.1	0.7	0.4	-0.3	
5 Deficit in balance of goods and services	-2.1	-1.7	-0.8	-0.3	-1.7			-2.8	-1.4	-0.7	-1.3	-1.7	-2.3	
6 Exports	97.2	90.1	99.0	93.0	80.4			93.7	91.0	90.7	92.0	93.2	94.5	
7 Imports	95.1	88.5	98.2	92.7	78.7			90.8	89.6	90.0	90.7	91.5	92.3	
8 Net non-debt creating capital inflows (negative)	-0.8	-2.8	-1.3	-2.3	2.0			-1.3	-1.1	-1.1	-1.1	-1.1	-1.2	
9 Automatic debt dynamics 1/	0.3	-1.5	-3.7	-3.2	3.2			-4.1	-4.2	-3.3	-2.4	-2.1	-1.8	
10 Contribution from nominal interest rate	2.0	1.8	1.9	1.8	1.7			1.3	1.1	1.1	1.0	1.0	1.0	
11 Contribution from real GDP growth	-1.8	-2.4	-4.0	-2.6	5.0			-5.3	-5.4	-4.4	-3.4	-3.1	-2.8	
12 Contribution from price and exchange rate changes 2/	0.1	-0.9	-1.6	-2.3	-3.5			...	...	...	...	...	...	
13 Residual, incl. change in gross foreign assets (2-3) 3/	7.6	20.1	11.1	2.1	5.0			3.0	1.9	1.9	1.7	2.1	3.5	
External debt-to-exports ratio (in percent)	95.2	120.2	115.9	120.9	150.7			126.1	126.4	125.2	122.2	119.9	118.5	
Gross external financing need (in billions of US dollars) 4/	33.1	39.5	60.3	69.8	64.7			76.8	79.8	84.4	88.8	92.7	95.9	
in percent of GDP	38.7	39.5	59.2	66.9	58.1	10-Year	10-Year	64.5	62.1	61.6	61.3	60.9	60.1	
Scenario with key variables at their historical averages 5/								**118.1**	**121.8**	**124.9**	**127.9**	**131.2**	**136.2**	**-1.3**
Key Macroeconomic Assumptions Underlying Baseline						Historical Average	Standard Deviation							
Real GDP growth (in percent)	2.1	3.0	3.8	2.3	-4.8	1.9	2.6	4.7	4.9	4.0	3.2	2.9	2.6	
GDP deflator in US dollars (change in percent)	-3.6	13.6	-1.9	0.1	12.1	0.5	8.3	2.1	3.0	2.4	2.4	2.2	2.2	
Nominal external interest rate (in percent)	2.4	2.3	1.8	1.6	1.6	2.4	0.7	1.1	1.0	1.0	1.0	0.9	1.0	
Growth of exports (US dollar terms, in percent)	4.1	8.6	11.9	-3.8	-7.7	3.2	10.3	24.5	4.9	6.3	7.1	6.5	6.3	
Growth of imports (US dollar terms, in percent)	3.1	9.0	13.0	-3.3	-9.3	2.9	10.1	23.3	6.6	7.1	6.5	6.0	5.7	
Current account balance, excluding interest payments	-0.8	0.0	-0.4	-0.9	1.4	0.7	2.4	0.7	-0.5	-1.1	-0.7	-0.4	0.3	
Net non-debt creating capital inflows	0.8	2.8	1.3	2.3	-2.0	1.1	1.7	1.3	1.1	1.1	1.1	1.1	1.2	

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

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

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

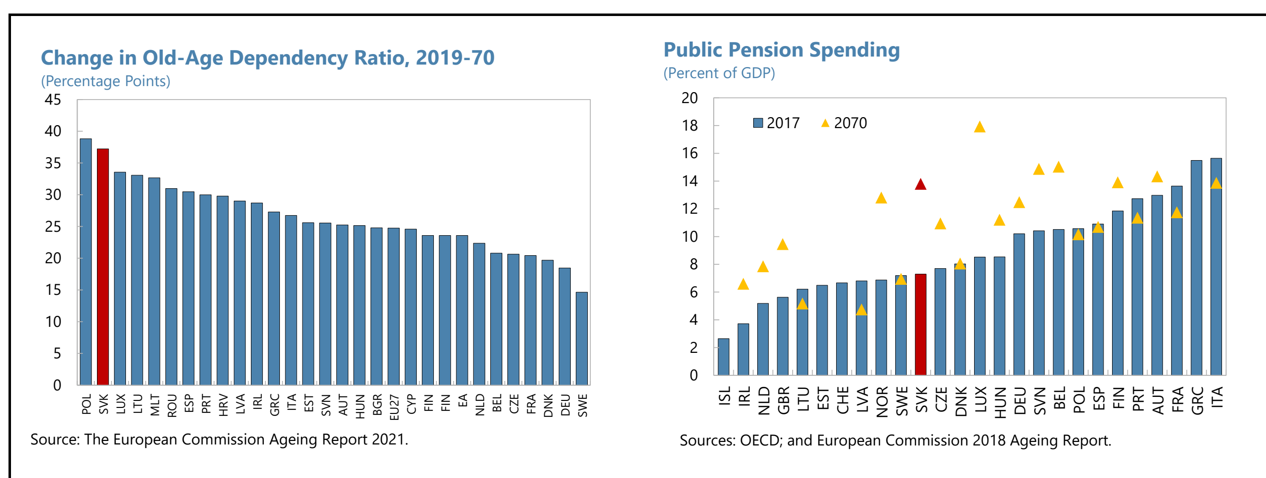
4/ Defined as current account deficit, plus amortization on medium- and long-term debt, plus short-term debt at end of previous period.

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

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

Annex VI. Slovakia's Pension System: Recent Reforms and Challenges[1]

1. **Slovakia faces significant long-term challenges due to rapid population ageing.** Life expectancy increased from 72.5 years in 1998 to 77.8 years in 2019. Meanwhile, Slovakia's old-age dependency ratio—the population aged 65 or older divided by the working-age population—is projected to increase from 25.9 percent in 2019 to 63.1 percent in 2070, representing one of the largest increases in the EU. In turn, the rising pension needs of the ageing population would also require Slovakia to face one of the highest increases in public pension expenditures in the coming years.



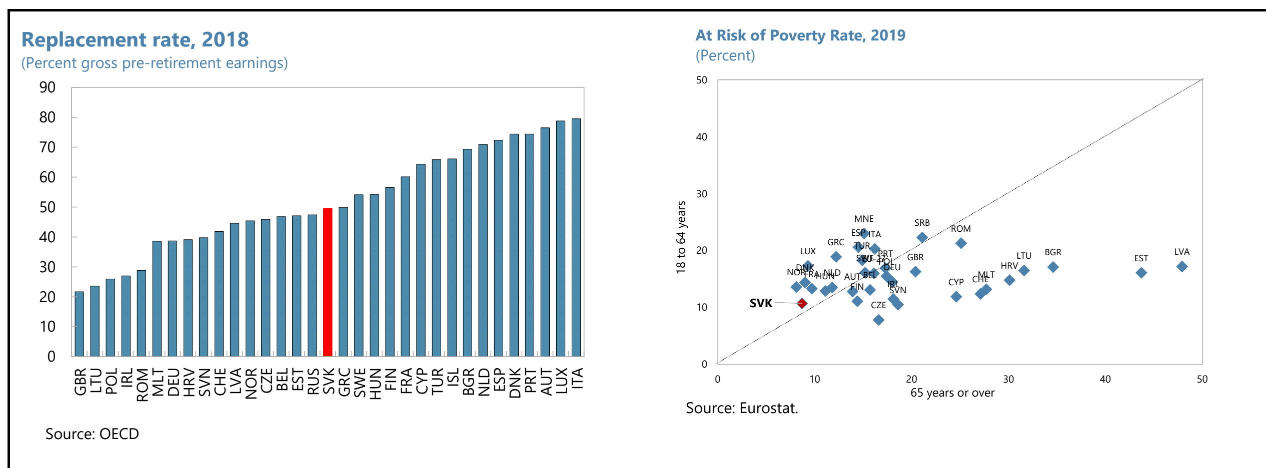
2. **The Slovak pension system consists of three pillars with a dominant public Pay-As-You-Go (PAYG) first pillar.** The first pillar is a mandatory defined benefit system based on a point system. Pension benefits mainly depend on average earnings and years of contribution.[2] The second pillar is a voluntary individual account scheme, with defined-contribution and private pension management.[3] The third pillar is a voluntary private scheme with defined-contribution and tax preferences.

3. **Under the current pension system, Slovakia has a relatively generous pension benefit level while contributions to the public pension system are among the lowest in the EU.** An average pensioner in Slovakia receives 50 percent of his or her average wage, higher than the euro area average of 46 percent. This contributes to a relatively strong support to the income of pensioners. The elderly poverty rate in Slovakia is below the EU average and lower than the poverty rate for the whole population. On the other hand, Slovakia's contribution rate is about 3 percentage points lower than the EU average, and without reform this gap is projected to persist until 2070.

[1] Prepared by Larry Cui and Yi Wu. We thank Daniel Baksa, Csaba Feher, and Zuzsa Munkacsi for insightful discussions and contributions.

[2] There is also a separate public defined-benefit pension scheme for armed forces and police.

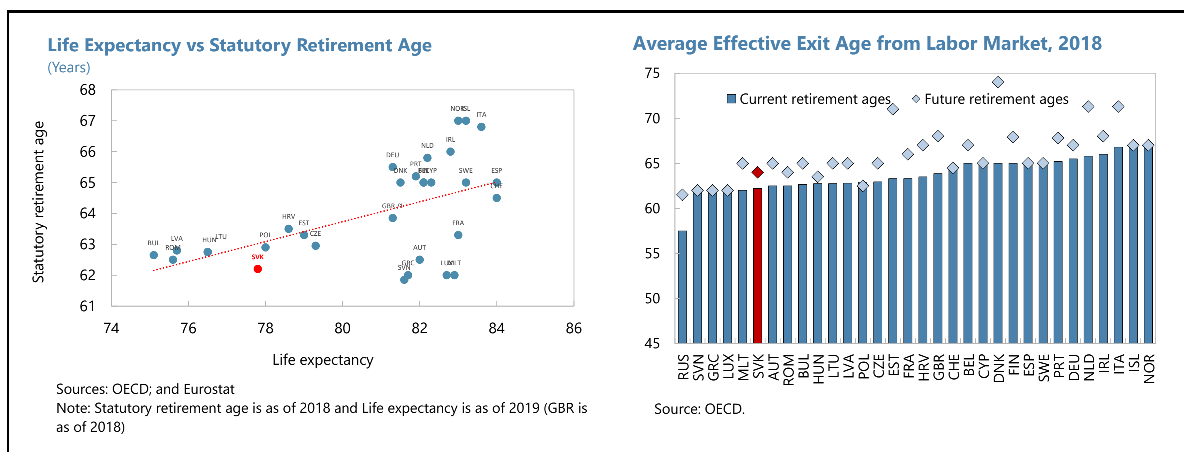
[3] This started as mandatory with no opt-out but experienced several subsequent changes: first to voluntary in 2008, then to mandatory with opt-out in 2012, and back to voluntary in 2013 with the option to defer entry until the age of 35.



4. The Slovak Republic has undertaken significant reforms to its pension system in the past 20 years. The 2004 reform established a new universal three-pillar system to replace the earlier reliance on a public PAYG system that faced severe sustainability challenges (World Bank 2004). A major reform in 2012 significantly improved the sustainability of the pension system, mainly by unifying the retirement age and indexing it to life expectancy, moving pension indexation to inflation-only, and raising the assessment base for contributions (Ministry of Finance 2020, IMF 2017). However, policy changes in 2019 significantly undermined earlier gains in strengthening the sustainability of the pension system.

5. Pension reforms in 2019 significantly raised long-term pension expenditure.

- The statutory retirement age, previously indexed to life expectancy, was capped at 64 years through a 2019 constitutional amendment and an amendment to the Social Insurance Act[4]. Therefore, under the current system, by 2050, Slovakia's retirement age would be well below the level that is commensurate with life expectancy when compared to other European countries. In addition, women's retirement age, which was supposed to converge to men's retirement age by 2024, was reduced for mothers by six months for every child up to three children. Slovakia has one of the lowest effective retirement ages among EU countries (62 years in 2018).



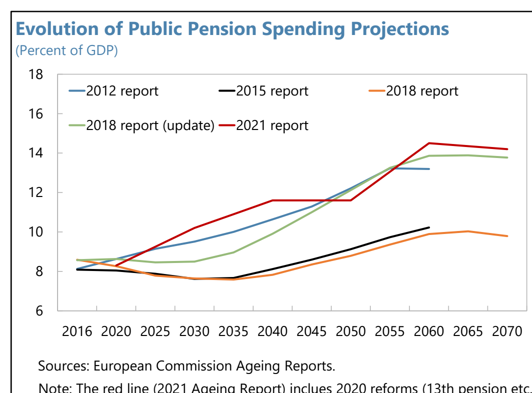
[4] Amendment 321/2019 (https://www.aspi.sk/products/lawText/1/56345/1/2?vtextu=annex%203×lice=null#c_215646).

- The minimum pension was increased by 17 percent by changing the calculation basis from 136 percent of the subsistence level to 33 percent of the economy-wide average wage. 13.1 percent of pensioners were receiving the minimum pension as of February 2021.

- The Christmas bonus was doubled (to a maximum of 200 euros). Furthermore, eligibility was loosened from pensioners with 60 percent of average national wage to 65 percent. The Christmas bonus is progressive with its value decreasing with higher pensions.

- The reduction of the first pillar benefit for those who participate in the second pillar was lowered, resulting in higher public pension expenditures.

- As a result of these changes, official estimates suggest that public old-age pension spending would rise from 8.3 percent of GDP in 2019 to 13.8 percent of by 2070 (Country Fiche on 2018 pension projections of the Slovak Republic, December 2020 Update, Table 23). The significant savings achieved by the 2012 pension reform (reflected in the 2015 and 2018 Ageing Reports) were entirely reversed by the 2019 constitutional amendment.



6. The policy changes in 2019 would also have significant macroeconomic consequences. The automatic link between the retirement age and changes in life expectancy, introduced by the 2012 pension reform, implied that the effective retirement age could increase to above 67 years by 2070. Staff estimates that the capping of the retirement age at 64 (a cap expected to become binding by 2045) would lower the supply of labor by over 10 percent in 2070, implying a 5.8 percent lower output (assuming a simple Cobb-Douglas production function with a labor share of 0.56). Using a dynamic general equilibrium model with overlapping generations calibrated to the Slovak economy, Baksa, Munkacsi, and Nerlich (2020) find that per capita GDP would be 6.4 percent lower in 2070 with retirement age capped at 64 compared to a scenario in which retirement age rises with life expectancy.

7. Pension policy changes in 2020 would on balance further raise pension spending.

- A thirteenth pension was introduced in February 2020 to replace the Christmas bonus, set at the level of average pension (460 euros) and covering all pensioners. The benefit amount was subsequently lowered to a maximum of 300 euros and decreasing with higher pensions (minimum 50 euros). It nevertheless would still lead to a doubling of the previous expenditure on the Christmas bonus.

- Previously, mothers with children had a guaranteed lower retirement age than men (6 months for each child) only once the retirement age for men hit the age cap in 2030. Before then, the retirement age reduction for mothers is set to be often less than 6 months per child. The 2020 changes retroactively lowered the retirement age of mothers from 2019, raising pension expenditure until 2030.

- The level of minimum pensions will be frozen at the 2020 level between 2021 and 2024, after which its indexation to the average wage will resume.

- As a result of these changes, pension expenditure for 2070 is projected to increase from the projected 13.8 percent of GDP to 14.2 percent of GDP.

8. Ongoing pension reforms send mixed messages. The constitutional amendment on judicial reform passed in December 2020 contains some pension policy changes, setting the following principles (to take effect in 2023):

- The abolishment of the retirement age ceiling of 64.

- The introduction of a parental pillar, allowing working children to transfer part of their social security contribution directly to their parents.

- Allowing retirement once a certain number of years of working has been reached.

- The principle that having children should not negatively affect one's pension benefits; currently if a mother is taking maternity leave, the state uses minimum wage to calculate the contribution to the first pillar. This has a negative impact on the mother's pension benefits since people usually earn more than the minimum wage.

9. It is encouraging that the authorities have committed to restore the link between retirement age and life expectancy in the Recovery and Resilience Plan. The details of the above reforms will be worked out in the forthcoming constitutional amendment on pension and subsequent amendments to the Social Insurance Act. The authorities also envisage making the entry into the second pillar automatic for workers under the age of 35 with the possibility to opt out and introducing a default investment strategy based on the life-cycle principle.

10. For ongoing pension reforms, the priority should be ensuring long-term pension sustainability. Given the sizable fiscal pressures under the current system, fiscal costs and long-term pension sustainability should be a core consideration. Re-linking the retirement age to life expectancy would not only significantly lower fiscal costs[5] but would have a positive macroeconomic impact by limiting the projected decline in the labor force, which the retirement age cap had exacerbated. The authorities should also seek to minimize the cost of the parental bonus given the large fiscal cost that it may entail.

[5] Analysis by the Ministry of Finance indicates that this could lower pension expenditure by 2.3 percent of GDP by 2070.

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INTERNATIONAL MONETARY FUND

SLOVAK REPUBLIC

STAFF REPORT FOR THE 2021 ARTICLE IV CONSULTATION—INFORMATIONAL ANNEX

June 4, 2021

Prepared By | European Department

CONTENTS

FUND RELATIONS 2

STATISTICAL ISSUES 5

FUND RELATIONS

(As of March 31, 2021)

Membership Status: Joined January 01,1993; Article VIII

General Resources Account:	SDR Million	Percent of Quota
Quota	1,001.00	100.00
Fund holdings of currency	753.48	75.27
Reserve position	247.52	24.73
Lending to the Fund		

SDR Department:	SDR Million	Percent of Allocation
Net cumulative allocation	340.48	100.00
Holdings	314.90	92.49

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				
	2021	2022	2023	2024	2025
Principal					
Charges/Interest	0.01	0.02	0.02	0.02	0.02
Total	0.01	0.02	0.02	0.02	0.02

Exchange Rate Arrangement:

The exchange rate arrangement of the euro area is free floating. The Slovak Republic participates in a currency union (EMU) with 18 other members of the EU and has no separate legal tender. The euro, the common currency, floats freely and independently against other currencies.
The Slovak Republic has accepted the obligations of Article VIII, Sections 2, 3, and 4 and maintains an exchange system that is free of restrictions on the making of payments and transfers for current international transactions, other than those imposed for security reasons, based on UN Security Council Resolutions and Council of the European Union Regulations, and which have been notified to the Fund under the procedures set forth in Executive Board Decision No. 144-(42/51).

Article IV Consultation:

The Slovak Republic is on a standard 12-month consultation cycle. The previous consultation with the Slovak Republic was concluded on July 12, 2019 (IMF Country Report No. 19/220).

FSAP Participation and ROSCs:

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

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

Technical Assistance: See the attached table.

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

Slovak Republic: Technical Assistance, 2000–21[1]		
Department	**Timing**	**Purpose**
MCM	February 2000	Mission on pros and cons, and modalities of moving to an inflation targeting framework, operational issues (money markets and policy instruments), and dealing with potential problems posed by capital inflows for monetary operations
	December 2001	Long-term resident expert on banking supervision
	May 2002	Two missions on inflation modeling
FAD	April 2000	Tax administration
	February 2001	Tax administration (follow-up)
	April 2001	Public Finance Management (follow-up)
	August 2001	Tax administration: Installation of resident expert to advise on establishment of Large Taxpayer Unit (LTU)
	August 2001–August 2002	Regular visits by FAD consultant on establishment of LTU
	December 2001	Tax administration follow-up, tax investigation/fraud issues
	June 2002	Mission to prepare Report on the Observance of Standards and Codes (ROSC), Fiscal Transparency Module
	February 2003	Tax policy
	March 2003	Tax administration
	May 2003	Expenditure policy
	December 2013	VAT gap analysis
	November 2015	Expenditure review workshop
	December 2015	VAT gap follow-up and excise gap analysis
	April 2016	Expenditure review
	November 2016	Tax efficiency Expenditure review
	March 2017	Corporate income tax gap
	May 2017	Expenditure review
	November 2017	Cost-benefit analysis of transport investment projects Expenditure review (follow-up)
	April 2018	TADAT
	April 2018	International taxation
	May 2018	Expenditure review (preparing baselines)
	November 2018	Expenditure review
	February 2019	Public Investment Management Assessment
	July 2019	Expenditure review
	September-December 2020	Fiscal rules and budget reforms
	October 2020	Technical review of the Spending Review Process
	April-September 2021	Expenditure review (National Transport Modeling)
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

(As of May 21, 2021)

I. Assessment of Data Adequacy for Surveillance

General: Coverage, periodicity, and timeliness of data provided to the Fund are adequate for surveillance purposes.

National Accounts: All data on national accounts follow the ESA 2010.

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

External Sector Statistics: External sector statistics are generally of good quality and are reported on a timely basis to the Fund following the standard of the sixth edition of the Balance of Payments and International Investment Position Manual (BPM6). Official BPM6 basis data are available back to 2004.

Monetary and Financial Statistics: The ECB reporting framework is used for monetary statistics, and data are reported to the IMF through a "gateway" arrangement with the ECB. The arrangement provides an efficient transmission of monetary statistics to the IMF and for publication in the International Financial Statistics (IFS). Monetary statistics for the Slovak Republic published in the IFS cover data on central bank and other depository corporations (ODCs) using Euro Area wide and national residency criteria. The Slovak Republic also reports data on some key series and indicators of the Financial Access Survey (FAS), including two indicators of the United Nations' Sustainable Development Goals.

Financial Sector Surveillance: The Slovak Republic participates in the IMF's Coordinated Direct Investment Survey (CDIS) and Coordinated Portfolio Investment Survey (CPIS) databases, and reports all core and encouraged financial soundness indicators (FSIs) for deposit takers, except for large exposures and spread between highest and lowest interbank rate. The authorities also report two FSIs for other financial corporations and one FSI for real estate markets.

II. Data Standards and Quality

The Slovak Republic subscribed to the Special Data Dissemination Standard Plus on September 16, 2019. The Slovak Republic received an IMF mission in 2004 to produce a Data module of the Reports on Observance of Standards and Codes (data ROSC) through which the IMF assesses in detail the quality of the statistical systems of its member countries. A full report was published in 2005 and is available at: https://dsbb.imf.org/dqrs/reports-on-the-observance. The Slovak Republic is subject to the statistical requirements and timeliness and reporting standards of Eurostat and the European Central Bank (ECB).

Table 1. Slovak Republic: Table of Common Indicators Required for Surveillance
(As of May 21, 2021)

	Date of Latest Observation	Date Received	Frequency of Data [6/]	Frequency of Reporting [6/]	Frequency of Publication [6/]
Exchange Rates	Current	Current	D	D	D
International Reserve Assets and Reserve Liabilities of the Monetary Authorities [1/]	April 2021	May 2021	M	M	M
Reserve/Base Money	April 2021	May 2021	M	M	M
Broad Money	April 2021	May 2021	M	M	M
Central Bank Balance Sheet	April 2021	May 2021	M	M	M
Consolidated Balance Sheet of the Banking System	April 2021	May 2021	M	M	M
Interest Rates [2/]	Current	Current	D	D	D
Consumer Price Index	April 2021	May 2021	M	M	M
Revenue, Expenditure, Balance and Composition of Financing [3/] — General Government [4/]	2020	April 2021	A	A	A
Revenue, Expenditure, Balance and Composition of Financing [3/] —Central Government	April 2021	May 2021	M	M	M
Stocks of Central Government and Central Government-Guaranteed Debt [5/]	2020Q4	April 2021	Q	Q	Q
External Current Account Balance	March 2021	May 2021	M	M	M
Exports and Imports of Goods and Services	March 2021	May 2021	M	M	M
GDP/GNP	2021Q1	May 2021	Q	Q	Q
Gross External Debt	2020Q4	March 2021	Q	Q	Q
International Investment Position [7/]	2020Q4	March 2021	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.