

Slovak Republic: 2001 Article IV Consultation—Staff Report; Staff Statement; Public Information Notice on the Executive Board Discussion; and Statement by the Authorities of the Slovak Republic

Under Article IV of the IMF's Articles of Agreement, the IMF holds bilateral discussions with members, usually every year. In the context of the 2001 Article IV consultation with the Slovak Republic, the following documents have been released and are included in this package:

- the staff report for the 2001 Article IV consultation, prepared by a staff team of the IMF, following discussions that ended on **May 9, 2001**, with the officials of the Slovak Republic on economic developments and policies. **Based on information available at the time of these discussions, the staff report was completed on July 12, 2001.** The views expressed in the staff report are those of the staff team and do not necessarily reflect the views of the Executive Board of the IMF.
- a Fund staff statement of **July 27, 2001**, updating information on recent economic developments.
- a Public Information Notice (PIN), which summarizes the **views of the Executive Board as expressed during its July 27, 2001, discussion** of the staff report that concluded the Article IV consultation.
- a statement by the authorities of the Slovak Republic.

The document(s) listed below have been or will be separately released.

Selected Issues and Statistical Appendix

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SLOVAK REPUBLIC

Staff Report for the 2001 Article IV Consultation

Prepared by the Staff Representatives for the
2001 Consultation with the Slovak Republic

Approved by Jacques R. Artus and Shigeo Kashiwagi

July 12, 2001

- Consultation discussions were held in Bratislava during February 28–March 13 and May 2–9.
- The staff team consisted of Messrs. Fernández-Ansola (Head), Christou, Kuijs, and Klyuev (EP) (all EU1), Mr. Srinivasan (PDR), and Mr. Song (MAE). Ms. La Torre and Ms. Phillips (both EU1) assisted the missions. Mr. Courtney (World Bank) participated in some meetings.
- The mission met with Deputy Prime Minister Mikloš (Economic Affairs), Minister Schmögnerová (Finance), central bank Governor Jusko and Vice-Governor Kohútiková, other senior officials, members of Parliamentary Committees, and trade union and private sector representatives. Mr. Sipko, assistant to Mr. Kiekens, participated in the meetings.
- The Slovak Republic accepted the obligations of Article VIII, Sections 2, 3, and 4 of the Articles of Agreement on October 1, 1995 and maintains an exchange system free of restrictions on the making of payments and transfers for current international transactions. Relations with the Fund are discussed in Appendix I, and those with the World Bank in Appendix II.
- Slovakia meets the Special Data Dissemination Standards (SDDS) specifications for coverage, periodicity, and timeliness of the data, and for the dissemination of the advance release calendars. In general, data quality is sufficient for macroeconomic analysis. Some areas of concern (see Appendix III on statistical issues) have been addressed by a recent multisector mission by the Fund's Statistics Department.
- Slovakia ratified the 1997 OECD Convention Against the Bribery of Foreign Public Officials in International Business Transactions on February 11, 1999, and the convention came into force on September 1 of the same year. The government is currently preparing an amendment to the Criminal Code—to be submitted to Parliament next year—to bring it into line with several international treaties.
- The Slovak authorities have consented to the publication of this report.
- The principal authors of this report were Messrs. Fernández-Ansola and Christou.

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I. INTRODUCTION

1. In concluding the last consultation on July 21, 2000, Executive Directors highlighted the progress made by the Slovak authorities in stabilizing the economy and accelerating structural reform. They noted that continuation of the government's efforts should pave the way for sustained economic improvement and accession to the European Union (EU), and emphasized that key priorities were to protect and consolidate macroeconomic stability. Directors urged the authorities to take further steps to strengthen the supervision and regulation of the banking system, and to complete the privatization of state-owned banks and enterprises.

2. Although policy in the Slovak Republic is based on a delicate balance of forces within the governing coalition (comprising five parties and/or groups representing a wide spectrum of political views), the government is firmly committed to reform and early EU accession. Slovakia's image abroad has continued to improve: the country joined the OECD in December 2000, and accession talks with the EU have been progressing well.¹ These developments have added to overall market confidence: spreads on Slovakia's five-year eurobonds have declined to approximately 120 basis points compared with over 200 basis points a year ago, while the exchange rate has appreciated against the euro since January.

3. Since December 2000, the Slovak authorities and the staff of the IMF have been pursuing a close dialogue on policies designed to consolidate macroeconomic stability and accelerate structural reforms. In May, this culminated in an agreement on a program to be monitored by Fund staff. Fund management supported this agreement, and the authorities have indicated that—coinciding with the staff's reviews of the program—they will report publicly on its implementation. The Statement of Economic Policies describing this program, which was approved by the Slovak cabinet in May and circulated to the Board on May 29, 2001 (SM/01/154), has been posted on the IMF external website and widely disseminated by the Slovak authorities.²

II. ECONOMIC BACKGROUND AND OUTLOOK FOR 2001

A. Record Since 1993

4. *The Slovak economy has been unusual among transition countries for its ability to rebound very quickly from the economic disruption caused by abandoning central planning and declaring independence.* The economy experienced negative growth only

¹ As of end-June 2001, Slovakia had closed 19 out of 29 chapters of accession negotiations with the EU, which placed it on a par with other advanced accession countries.

² This program will provide the macroeconomic framework for an Enterprise and Financial Sector Adjustment Loan from the World Bank, which will be considered by the Bank Board on August 2, 2001.

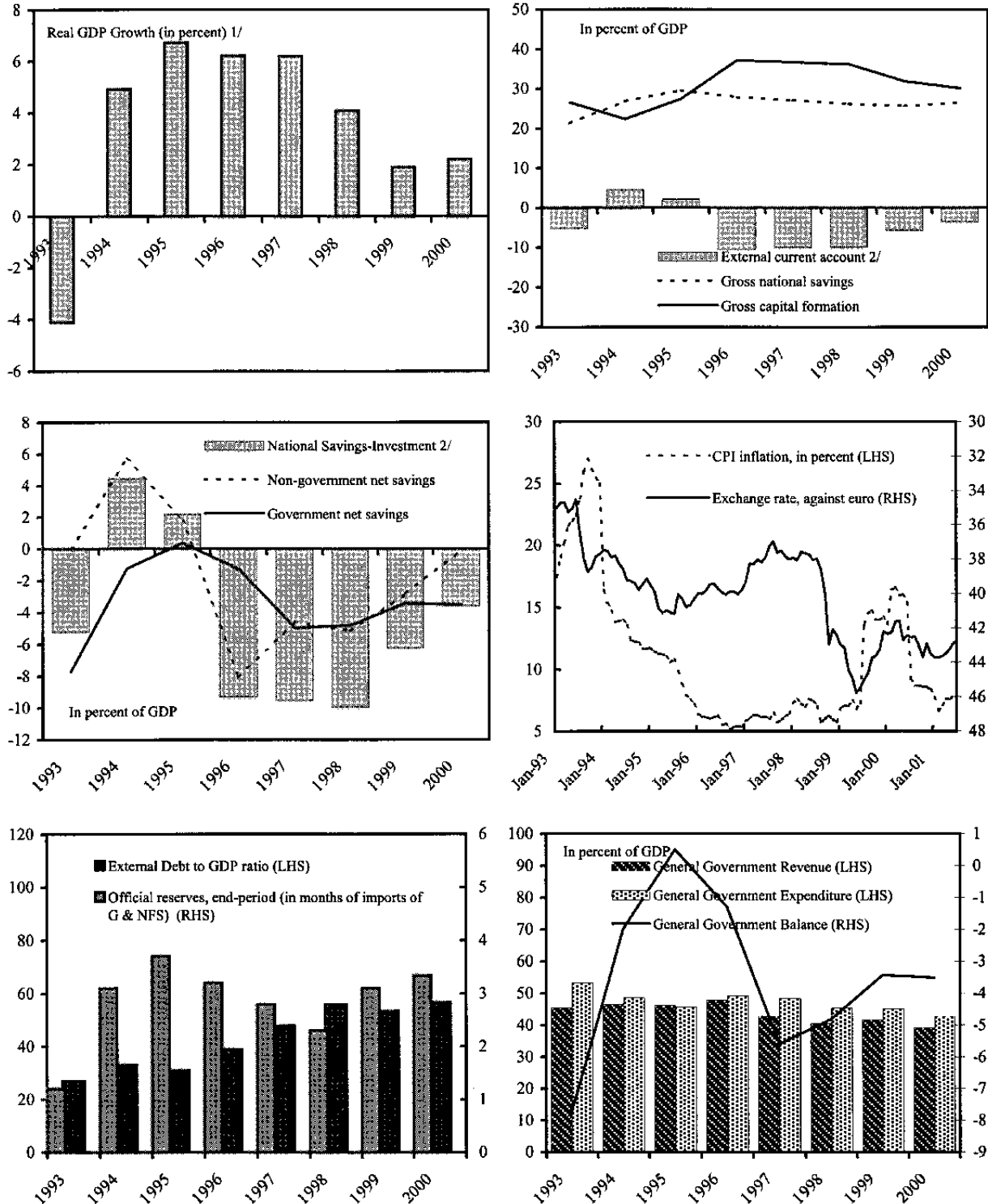
during the first year after the dissolution of the Czechoslovak federation, in 1993. Since then, the average rate of growth has been about 5 percent, and inflation has never exceeded 14 percent, its peak in 1999 following large increases in administered prices (Figure 1). The lowering of tariff barriers, progress in restructuring the economy, the reorienting of trade to OECD markets, and the quick adjustment to the loss of fiscal resources in 1994–95 all contributed to Slovakia's economic vigor. Despite the high growth, however, the unemployment rate—which had jumped to about 15 percent in 1994–95—never fell below 12 percent.

5. ***This impressive performance, however, concealed macroeconomic imbalances that brought the Slovak economy under a cloud of vulnerability in 1998*** (Table 1). In particular, during 1996–1998, the high rates of growth were based primarily on an unsustainable fiscal expansion, and on an investment boom that coexisted with a progressive weakening of domestic savings (see Figure 1). The rapid but fairly balanced expansion of 1994–95 had thus turned into generalized overheating as early as the end of 1996. This showed up first in the external accounts, as would be expected in a small open economy with a largely exchange rate-based monetary regime. The external current account shifted from a surplus of over 2 percent of GDP in 1995 to a deficit of over 10 percent of GDP in 1996–98. The large and growing deficits went hand in hand with a rise in the ratio of external debt to GDP, with a substantial share of this debt accounted for by short-term obligations. As a result, in 1998 the major credit-rating agencies downgraded Slovakia's sovereign debt to below investment grade, and spreads on government borrowing became large and volatile: ***Slovakia began to appear vulnerable*** (Table 2).

6. ***The measured fiscal deficits in 1996–98 substantially underestimated the extent of the fiscal problem in Slovakia during this period.*** Political interference in most credit decisions by state-owned banks was planting the seeds of the serious bad loan problems that would emerge later on, and government guarantees for domestic and foreign borrowing by state-owned enterprises accumulated to reach nearly 20 percent of GDP in 1998. A significant share of the latter went to finance unprofitable projects, and still represents a substantial burden on the budget. These quasi-fiscal activities contributed to the weakening of Slovakia's economic outlook and proved to be the Achilles' heel of the 1996–98 expansion.

7. ***Amid these signs of vulnerability, the present government assumed office in October 1998, and embarked on policies to restore macroeconomic balances and lay the basis for sustainable economic growth.*** The overheating in 1996–98 was ultimately reflected in severe exchange rate pressures in August and September 1998, the abandonment in October 1998 of the former exchange rate band, and a subsequent currency depreciation of significant magnitude (see Figure 1). The reaction of the new government was fairly orthodox, addressing first the fiscal imbalance, and, to some extent, the previous quasi-fiscal activities. An ambitious fiscal plan introduced in 1999 was based on expenditure cuts—including the postponement of some major investment projects and a freeze in civil service wages—on increases in the lower VAT rate and excises, as well as a temporary import surcharge and significant adjustments in administered prices to bring them more into line with costs. The authorities also began a serious effort to reform the financial sector, another source of vulnerability, and reduce politically motivated lending; to exercise more control

Figure 1. Slovak Republic: Selected Indicators, 1993–2001



Sources: Slovak authorities; and staff estimates.

1/ The growth rate for 1993 is based on data according to the old national accounts methodology.

2/ In most years, there are small discrepancies between the national saving-investment gap (from national accounts data) and the external current account (from balance of payments data).

over public enterprises; and to control the activities of extra-budgetary funds, which had been operating without much government supervision until then. Monetary policy was geared to lowering inflation, and the exchange rate was allowed to float with minimum intervention in the market by the central bank.

8. ***The fiscal tightening and developments in the nongovernment sector led to a sharp fall in domestic demand in 1999, but a strong improvement in net trade performance partly offset their impact on aggregate demand.*** In these circumstances, balance of payments difficulties eased considerably—the external current account deficit narrowed from 10 percent of GDP to 5.0 percent of GDP—and official reserves strengthened (see Figure 1). Labor market conditions slackened further, and as the unemployment rate reached 18 percent, wage pressures moderated. Although headline inflation had risen to 14 percent at end-1999, core inflation remained low. The exchange rate began to appreciate during the second half of 1999 as the tighter macroeconomic policy stance began to take hold and the central bank shifted its operation of monetary policy from an exchange-rate-based framework toward one that gave more prominence to lowering inflation.

9. ***Policies to fully restore macroeconomic balances continued in 2000.*** Administered prices were adjusted further, and the fiscal deficit was held to 3.5 percent of GDP (Table 3). In this context, inflation continued to fall in line with the informal targets set by the central bank. The fiscal consolidation and increases in administered prices, however, were taking their toll on domestic demand, which continued to fall during the first three quarters of the year as real incomes contracted sharply. The buoyancy of exports kept GDP growth positive in 2000—albeit still low by the standards of 1994–98—while also contributing to a further narrowing of the current account deficit (Figures 1 and 2; and Table 4).

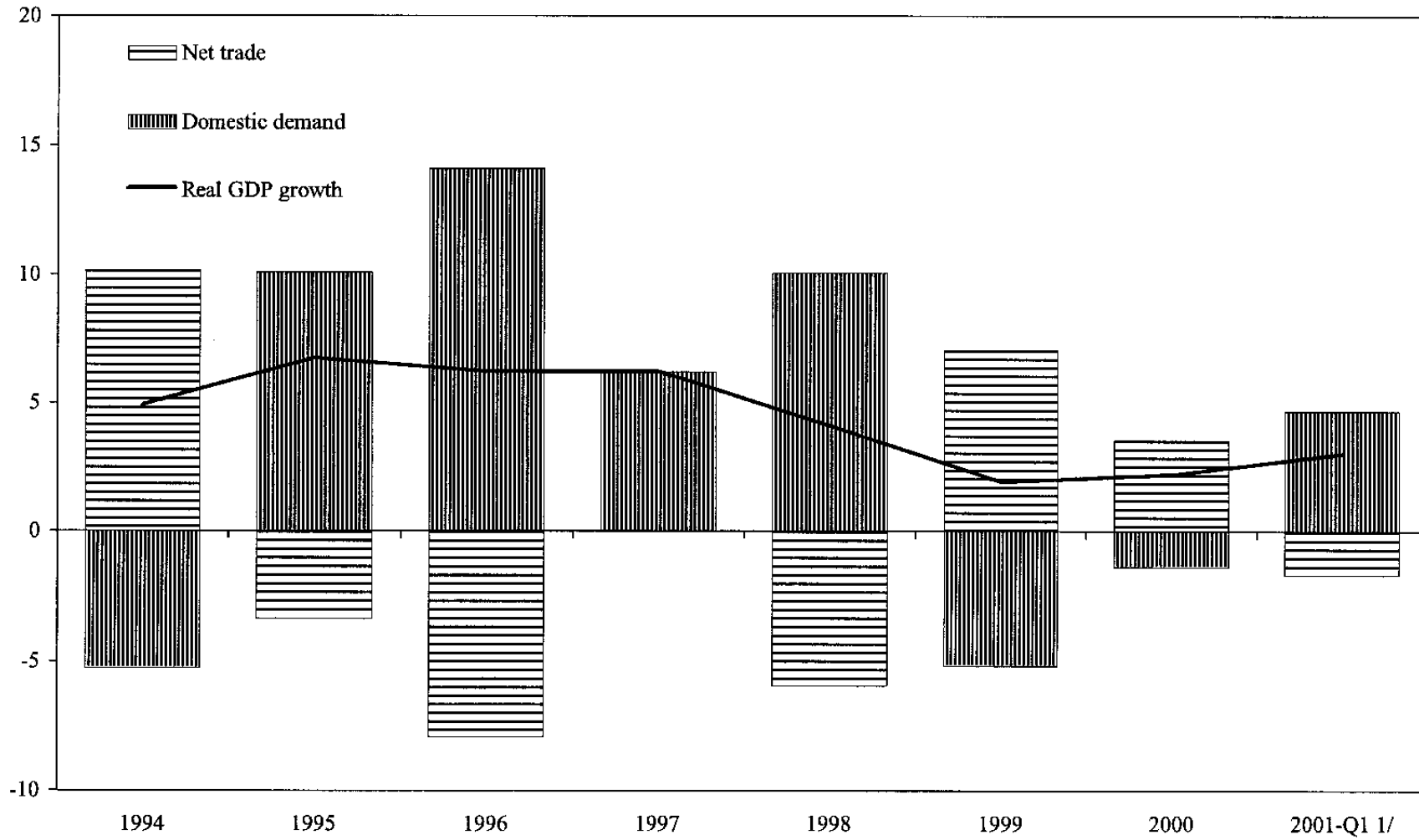
10. ***An unwelcome side effect of the slow growth in recent years has been a further rise in unemployment.*** After a decline in the second half of 2000, mainly attributable to the operation of temporary public work programs, the unemployment rate returned to levels close to 18 percent in early 2001 (Figure 3). Unemployment reflects the contraction in output during the early years of transition when many enterprises lost their markets; enterprise restructuring, together with continued growth of the labor force; and also, to a large extent, disincentives to work in the formal market because of the generosity of social benefits compared with the minimum wage,³ and high payroll taxes.

B. Economic Setting in Spring 2001

11. ***At the time of the staff's discussions in May, the economy appeared to be recovering nicely, the budget was on track, and inflation still subdued.*** The authorities were implementing a modestly expansionary budget. Data for the first five months of 2001 suggest

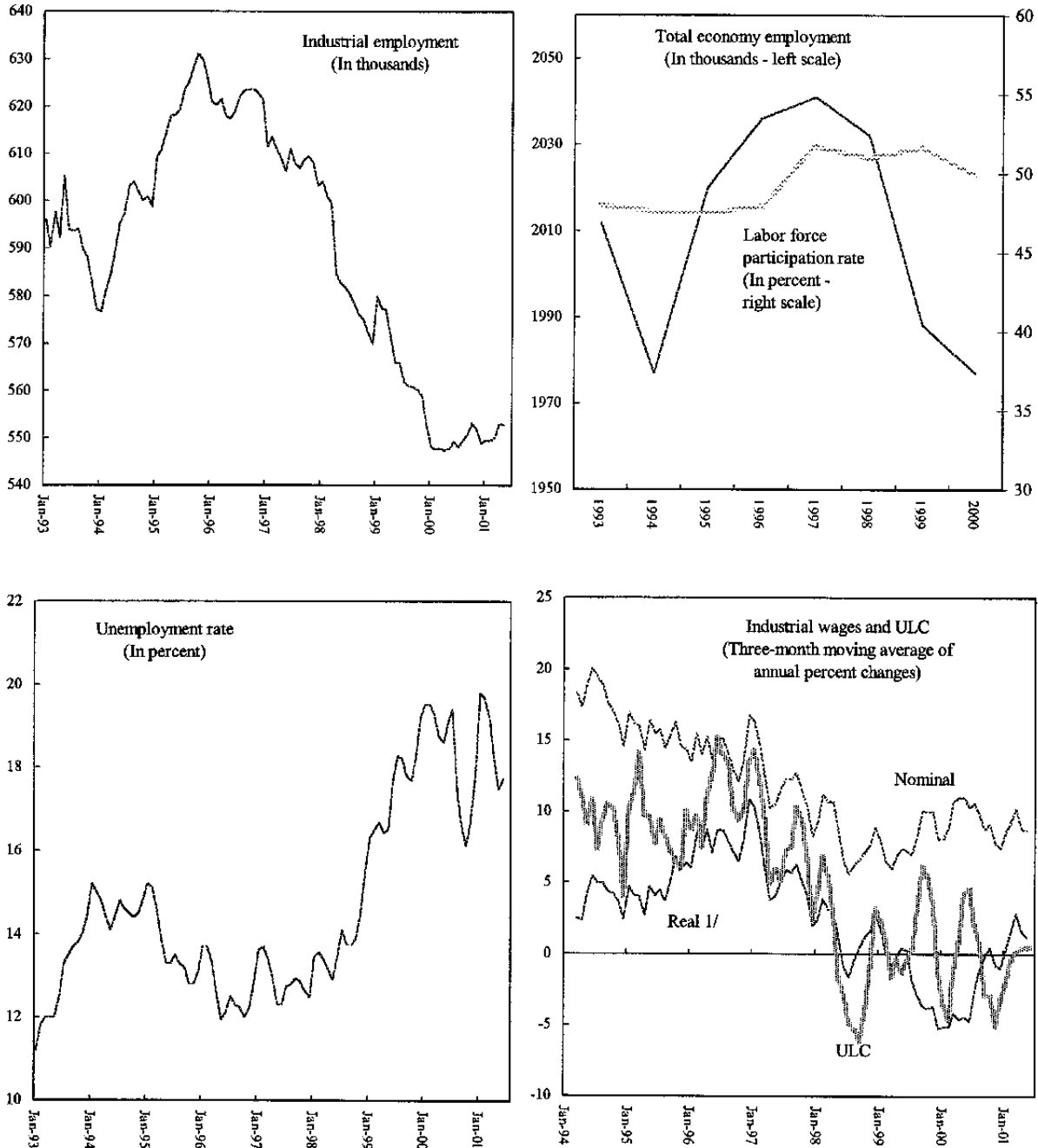
³ Benefits could exceed the minimum wage by a substantial amount. A recent World Bank study (Slovak Republic: Poverty, Employment and Labor Market Study—May 2001) found significant disincentives to work for different types of households, particularly for families with children and individuals with low earnings potential.

Figure 2. Slovak Republic: Contributions to Real GDP Growth, 1994–2001
(In percent)



Sources: Slovak authorities; and Fund staff estimates.
1/ Contributions to growth 2001 Q1/ 2000 Q1

Figure 3. Slovak Republic: Labor Market Indicators, 1993–2001



Sources: Slovak authorities; and Fund staff estimates.

1/ Deflated by the CPI.

that the authorities are on track to meet the 3.9 percent of GDP general government deficit target for the year, as tax revenues have exceeded projections in the budget by a slight margin, and the government has shown spending restraint. With fiscal policy easing slightly, monetary policy, which loosened considerably in 2000, turned neutral during the second quarter of 2001. Interest rates—which were cut by 2½ percentage points in several steps since the beginning of 2000 to 7½ percent⁴—have remained stable since March.

12. *The authorities' policy stance, together with exogenous factors, had the following effects through May* (Box 1):

Box 1. Real Economy Indicators, 2000–01								
(In constant prices, year-on-year change, in percent, unless otherwise indicated)								
	2000				2001			
	Q1	Q2	Q3	Q4	Q1	April	May	June
Real GDP	1.5	1.9	2.5	2.9	3.0	...	...	...
Domestic demand	-2.5	-5.8	-1.5	4.8	4.6	...	...	...
Private consumption	-6.4	-7.7	-1.9	2.4	4.0	...	...	...
Fixed investment	0.5	-8.0	7.1	-0.5	16.2	...	...	...
Industrial sales	6.0	1.9	9.6	10.0	10.4	11.0	...	...
Business confidence in industry 1/	2.9	7.6	11.0	13.2	11.4	2.7	12.7	11.7
Retail sales 2/	-0.1	0.3	3.5	7.7	7.1	3.5	...	...
Construction	...	...	...	...	10.3	5.8	0.2	...
CPI inflation	15.5	15.8	8.8	8.5	7.1	7.6	7.6	8.0
Employment	-2.9	-2.1	-0.9	0.2	1.3	...	...	...
Trade balance (US\$ million)	-173	-71	-144	-501	-396	-142	-161	...

Sources: Slovak authorities; and staff estimates.

1/ Balance representing the difference between answers expressing an increase and a decrease in percent.
2/ Data for 2000 was calculated by deflating the nominal figures with the core CPI index.

⁴ Average of sterilization and refinancing rates offered by the NBS. The one-month interbank rate fell from 10 percent in January 2000 to 7.7 percent in March 2001, and has remained stable since then.

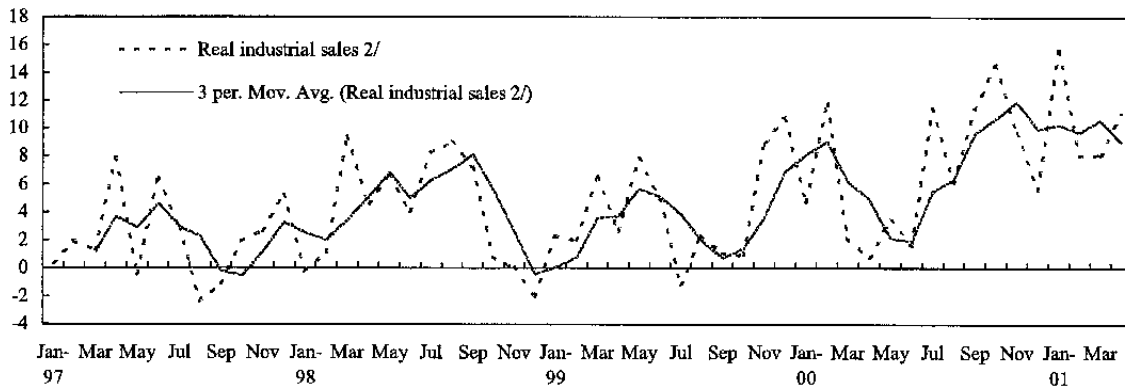
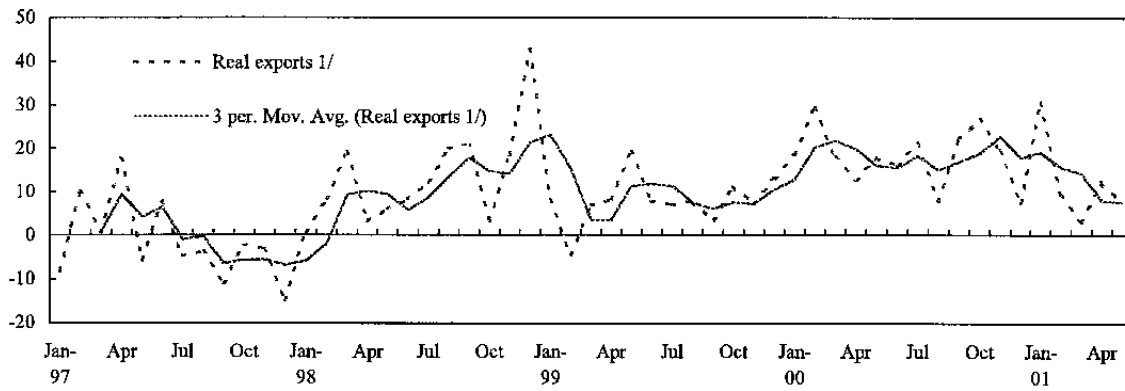
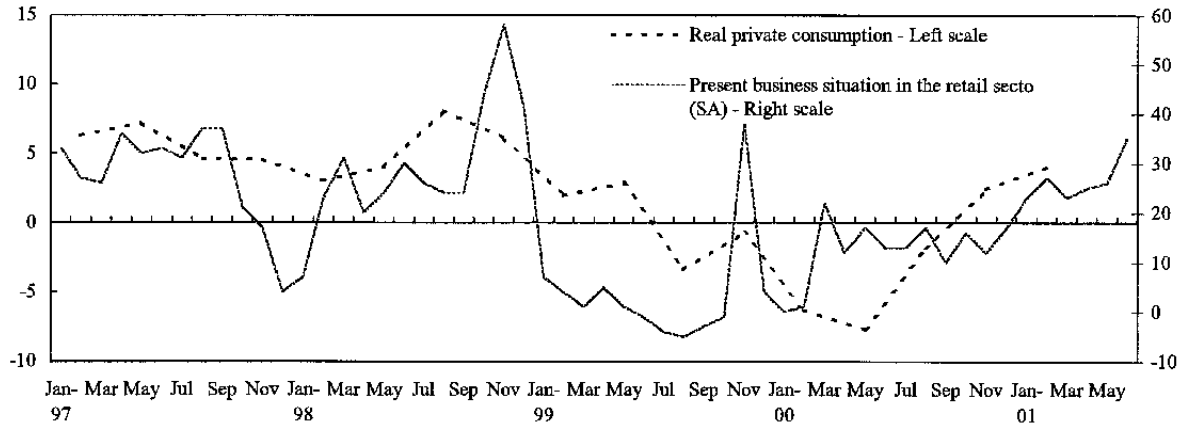
- ***A rebound of domestic economic activity, and a deceleration of export growth:*** retail sales and industrial sales registered year-on-year increases (in real terms) of 6 percent and 10.5 percent, respectively, in the first four months of the year. In real terms, construction increased by 7.8 percent year-on-year in January–May. Real export growth decelerated to 12 percent year-on-year during the same period from 18 percent in 2000, primarily reflecting the weakening of Slovakia’s external environment (Figure 4).
- ***A gradual strengthening of the exchange rate since early 2001.*** While appropriate from the standpoint of containing inflation and apparently reflecting longer term productivity trends, this development has raised concerns domestically because of its possible contribution to the recent deceleration of export growth. The real exchange rate has appreciated by about 4 percent in CPI and unit labor cost terms since end-2000, but still remains at about the same level of a year ago (Figure 5).
- ***The continued fall in inflation.*** Despite a fuel- and food-price-related blip in recent months, year-on-year inflation remained within the indicative inflation band set by the central bank.
- ***A widening of the external current account deficit.*** In recent months, imports have surged rather sharply, while exports, as noted, have continued to increase at a slower pace. Although this deficit is expected to be financed largely by foreign direct investment—and reflects in part a surge in imports of equipment and technology—the widening of the current account increases external vulnerability.
- ***A continuation in net capital inflows.*** The central bank has been sterilizing most of these inflows—particularly those related to privatization—but the final cost of these operations for the year as a whole remains uncertain.

C. Prospects, Policies, and Risks for 2001

13. ***The staff’s baseline macroeconomic framework,*** which is in line with the projections underlying the 2001 budget, estimates output growth of 3 percent in 2001 and a decline in inflation to 6.7–8.2 percent at end-year. Although the external current account deficit is projected to widen to 5.4 percent of GDP, Slovakia’s external position is still anticipated to strengthen, with an increase in official reserves to the equivalent of more than four months of imports of goods and services and a decline in the ratio of external debt to GDP. To achieve these objectives a general government budget deficit of 3.9 percent of GDP is targeted for the year, as noted, and monetary policy will be geared to sustaining disinflation (Box 2).

14. ***The key risk for the near-term outlook arises mainly from potential domestic pressures on the balance of payments.*** Some disquieting signals were already evident in the data for the first five months of the year, which showed a wider-than-expected merchandise trade deficit. In addition, the authorities and the staff anticipated that household consumption

Figure 4. Slovak Republic: Indicators of Economic Activity, 1997–2001
(Year-on-year growth)

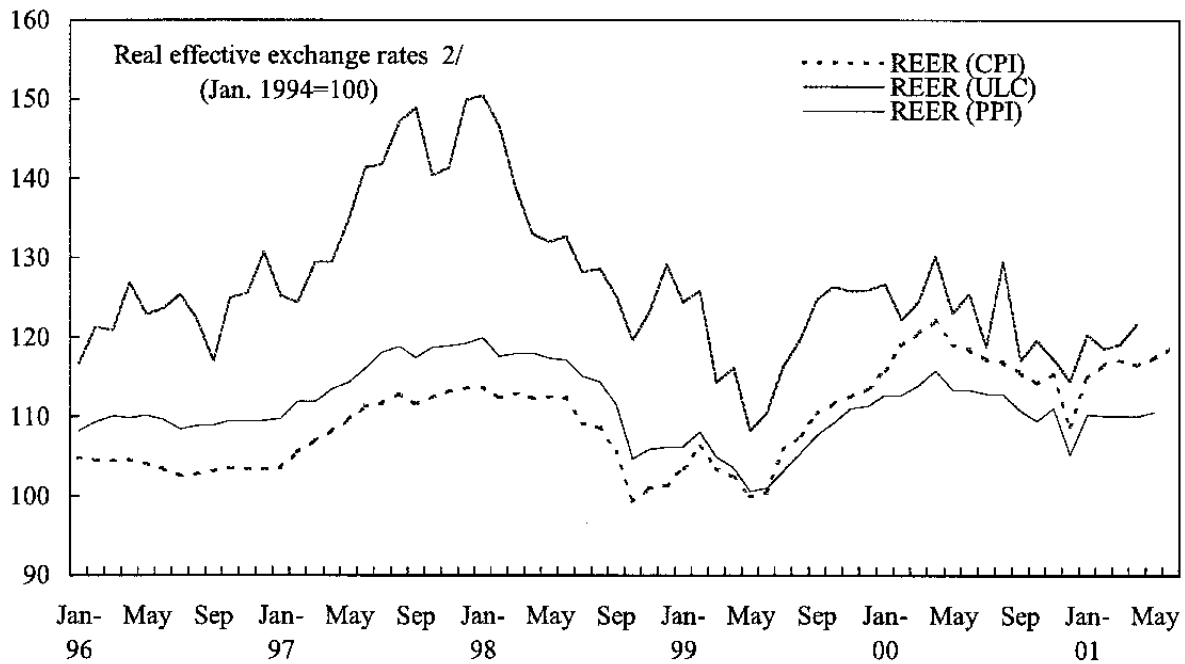
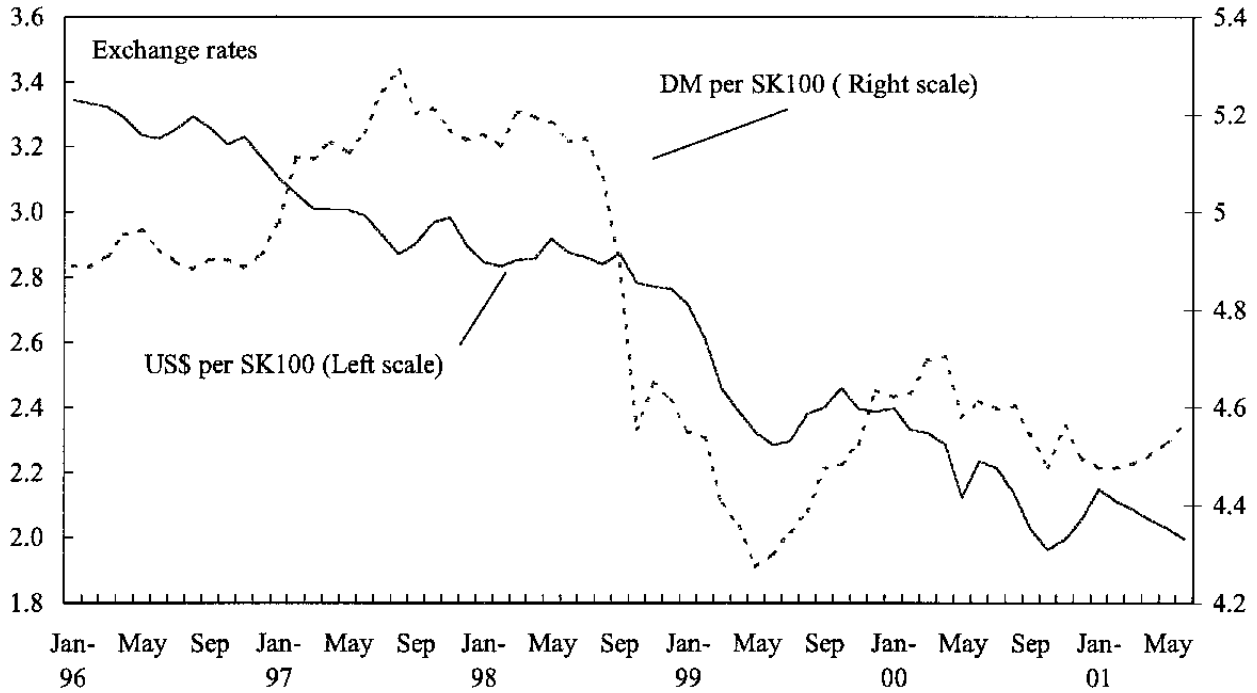


Source: Slovak authorities; and Fund staff estimates.

1/ Deflated with the PPI index.

2/ The data for 1997 refers to growth of industrial output.

Figure 5. Slovak Republic: Exchange Rate Indicators, 1996–2001 1/



Sources: Slovak authorities; and Fund staff estimates.

1/ An increase denotes appreciation.

2/ Calculated using Slovakia's seven main trading partners, which accounted for 77 percent of the country's exports in 1999.

Box 2. Macro Framework, 2001–02

	2001	2002
(Year-on-year growth, in percent)		
Real GDP	3.0	4.4
Private consumption	5.0	4.9
Gross capital formation	6.9	4.6
CPI inflation (e-o-p)	7.0	5.8
Real wages in industry	2.3	1.5
(In percent of GDP)		
Current account deficit	-5.4	-5.2
Fiscal deficit	-3.9	-3.4
External debt	54.0	51.3

would rise because of significant increases in real incomes, and one-off repayments of bonds during the rest of the year.⁵ Both agreed that investment would also recover, especially if interest rates continue at their present level or fall. Under this scenario the external current account deficit is expected to widen further, although it would still be more than financed by foreign direct investment (FDI). However, the final size of the deficit will depend on the households' use of the extra liquidity obtained from the bond repayments and on the fiscal stance during the second half of the year. The current macroeconomic framework projects a sharp deceleration of exports in 2001 based on anticipated external developments. Nevertheless, the external environment could exacerbate the pressure on the external accounts and slow economic growth through an even larger than expected slowdown in export market growth.

D. Progress in Structural Reforms

15. *On the structural side, the authorities have gone ahead with their plans to privatize the main state-owned banks and prepare other companies for privatization.* Following the restructuring of the main state-owned banks and the removal of bad loans from their portfolios, the government divested itself of substantial holdings in the banking sector. Specifically, in late 2000, Slovenska Sporitelňa, the largest commercial bank, was sold to a

⁵ Individuals are estimated to hold about Sk 15 billion (1.5 percent of GDP) in National Property Fund (NPF) bonds, which will be repaid during the second half of 2001. These bonds were issued in lieu of vouchers for the second wave of voucher privatization, so that citizens would be able to get cash instead of property.

strategic foreign investor, and very recently the government has approved the sale of Všeobecná úverová banka (VUB), the second-largest commercial bank, to another strategic foreign investor. Progress in the privatization of Investičná a rozvojová banka (IRB), a third large state-owned bank, has been slower. Significant steps have been made on enterprise restructuring and privatization: the government has decided to sell the minority stake and management control rights in the gas company; international tenders have been opened for the sale of the state's largest insurance company and the government's stake in Transpetrol, the oil pipeline operator; the restructuring of the electricity company prior to privatization has begun; and there is an agreement on the sale of the state's stake in the major mobile phone operator.

16. *In other structural areas, however, steps have been more hesitant, and much remains to be done.* Although macroeconomic balance was basically restored by mid-2001, some of the root causes of the original imbalances—structural in nature—remain in place. Tackling them, which the authorities have recently begun to do in earnest, will be essential to reduce vulnerabilities and to have sustainable macroeconomic policies. The public sector deficit reflects both inadequate spending priorities and deficiencies in tax collection. Efforts to strengthen bank supervision have been very slow to start. The health system, which is overburdened with debt, remains inefficient and a drag on the budget. The pension system, still unreformed despite lengthy debates about the need to overhaul it, has turned from surpluses a few years ago, to growing deficits, and has required increasing budget transfers year after year. Poorly targeted and administered social benefits, and high taxes on labor create disincentives to seek formal employment. Much-needed restructuring of public enterprises has begun only recently. Although the legal framework has been strengthened substantially, its implementation remains weak.

III. POLICY DISCUSSIONS

A. Overview

17. *Officials reaffirmed that they intend to carry through to conclusion the economic reform agenda under the staff-monitored program, while acknowledging the constraints imposed by a tense political climate.* To this end, the cabinet approved a comprehensive approach to Slovakia's economic problems contained in its Statement of Economic Policies (SM/01/154). This approach is based on three interdependent pillars: consolidating the fiscal position in a way consistent with ambitious medium-term objectives (a general government deficit of 2 percent of GDP by 2005); gearing monetary policy to continued disinflation; and intensifying structural reforms, with an emphasis on reforms that will help fiscal consolidation and reduce Slovakia's vulnerabilities. Within the context of a difficult political environment, the authorities intend this program to provide a rudder for their domestic policy initiatives, as well as a strong signal to the international community about their commitment to economic reform.

18. *The authorities agreed with the assessment of the risks to the 2001 economic outlook, but remained confident about the strength of the Slovak economy.* With regard to the external risks, they were confident that ongoing enterprise restructuring and labor market reform would make the Slovak economy more resilient in dealing with temporary foreign

shocks.⁶ As to the domestic risks, they would be ready to take action as needed. The authorities and the staff agreed that there is considerable uncertainty regarding the impact of the redemption of NPF bonds, which will be paid with privatization receipts, on domestic demand. Although the budget deficit will not be affected by this operation, the redemption will represent a liquidity injection that could have effects on aggregate demand, and also possibly put pressure on the external accounts, depending on the behavior of bondholders. Both the authorities and the mission were of the view, however, that since liquidity-constrained residents were already able to trade their bonds in the secondary market, a significant part of the yet-to-be-redeemed bonds would be saved rather than spent.

19. ***The policy discussions confirmed a general agreement that further fiscal consolidation—supported by fiscal structural reform—was the central policy requirement over the next several years.*** Indeed, together with creating the conditions for strong employment growth and further reducing inflation, fiscal consolidation and structural measures to support this consolidation are the thrust of the government's economic strategy. In practice, however, an issue emerged during the program discussion about the speed of fiscal consolidation, and the proper balance of fiscal and monetary policies to ensure sustained macroeconomic stability. This debate in turn has revealed some differences in view on the priority to assign to deficit reduction in 2001 and 2002, particularly given the need to lower very high unemployment and underpin domestic economic activity, which until recently remained fairly weak. Sub-themes of this discussion were the uses of privatization revenues—since they are intimately connected with the fiscal stance in 2001 and 2002—and the need to contain the external current account deficit to about 5 percent of GDP. *Against this background, the discussions focused on the proper policy mix for the period ahead and on the speed of fiscal consolidation, as well as on how to deal with the challenge posed by unemployment.*

20. ***The further strengthening of the financial system*** was seen as key by all, but some differences of view arose among the authorities concerning how to proceed with the strengthening of bank supervision. Although the balance sheets of the largest banks have been cleaned of the bulk of nonperforming loans that were not provisioned, strong bank supervision remains key for the future of the banking system.

B. Fiscal Policy

21. ***As noted, the government intends to contain the general government deficit to 3.9 percent of GDP in 2001.*** This represents an expansion of 0.4 percent of GDP over the 2000 outturn, and is based on a reduction in expenditures relative to GDP that would be more than offset by lower projected tax revenue, also relative to GDP (Box 3). The former is based on moderate public sector wage increases, and reforms to contain social transfers through stricter eligibility requirements for transfers to households, a reduction in subsidies to enterprises, and strengthened control over public investment expenditure. The latter reflects mainly the full-year impact of the reduction of the corporate income tax and the

⁶ See the accompanying Selected Issues paper for a discussion on enterprise restructuring.

Box 3. General Government Operations

(In percent of GDP, unless otherwise indicated)

	1999 Outcome	2000 Estimate	2001 Staff Projections
Revenue	41.6	39.1	35.8
Tax revenue	33.7	34.2	30.9
Non-tax revenue	8.0	4.9	4.9
Expenditure	41.9	42.0	39.3
Current expenditure	38.2	37.4	35.9
Capital expenditure	3.8	4.6	3.4
Net lending	3.1	0.6	0.4
Overall balance	-3.4	-3.5	-3.9
Memorandum items:			
Real GDP growth (in percent)	1.9	2.2	3.0
Public debt	23.6	25.2	26.9

removal of the import surcharge. The authorities believe that this fiscal policy should continue to provide needed support to economic activity, and be consistent with a sustainable external current account and with achieving a deficit target of 2 percent of GDP by 2005—a key medium-term fiscal objective. In the authorities' view, these benefits outweigh the costs of possibly stretching the use of scarce domestic financial resources, and thus crowding out credit to the nongovernment sector, particularly since they believe that such credit is currently constrained by other factors (bank restructuring) (Table 5).

22. *The staff supported the authorities' plans, but cautioned that the slightly expansionary fiscal stance could stretch monetary policy, and perhaps even crowd out investment and exports.* Specifically, the size of the fiscal deficit, including the use of privatization revenues, and the projected volume of capital inflows would make it difficult to attain the objectives of keeping inflation low and not endangering competitiveness. To some degree, recent inflows accommodated by the policy stance are already prompting upward pressures on the exchange rate. Sustained and substantial appreciation of the exchange rate would not be desirable at this juncture, as it would crowd out exports that are already decelerating, and result in a further widening of the external current account deficit. While acknowledging that there were some risks to the approach they were proposing, the authorities were confident that they would manage to attain the macroeconomic objectives of the program within the current framework of fiscal and monetary policies. On balance, they preferred to maintain the fiscal stance contained in the 2001 budget, but affirmed their readiness to adjust policies as needed, particularly if the risks pointed out by the mission should materialize. The staff agreed with this approach, and suggested that the authorities monitor developments carefully and stand ready to rebalance the policy mix toward a tighter fiscal stance if persistent upward pressure on the exchange rate posed a challenge to

macroeconomic management.⁷ In light of the medium-term objective of fiscal consolidation, which the mission supported, the staff also noted that it would be easier to tighten fiscal policy now that the economy is on the upswing.

23. *The staff also stressed the importance of ensuring achievement of the authorities' plans.* In this regard, a first requirement would be to strictly control expenditures, particularly in those areas where there have been repeated overruns in the past. Given recent experience, the authorities are fully aware of the potential to exceed budgeted expenditures, and thus have introduced quarterly expenditure ceilings under the staff-monitored program; these ceilings have been approved by cabinet through a government resolution. It is reassuring that monetary data on the position of the government indicate that the deficit target for the first half of the year under the program is achievable, and that expenditure data for the first quarter confirm that the expenditure ceiling was met (Table 6).

24. *The staff remains concerned, however, about expenditure pressures that are emerging.* These relate to overruns in social benefits associated with recent changes in the legislation for the housing and child allowances, as well as with the possible adjustment in the subsistence minimum income and higher-than-assumed unemployment. Additional pressures could materialize if an increase in pensions is enacted before confirmation of a trend on better-than-expected collection of contributions, and if certain infrastructure projects that were contingent on better-than-budgeted tax revenue are started regardless of the revenue outcome. In light of these pressures, the staff advised the authorities to pursue a cautious wage policy to avoid exceeding budget targets and to give signals of wage moderation in the private sector. The government should also stand ready to curtail discretionary spending if necessary.

25. *Earlier staff estimates projecting substantially higher-than-budgeted revenues have been confirmed for some taxes, but revenue data through May showed a mixed picture for others.* Although tax revenues were slightly higher than budgeted, they fell short of the more optimistic projections of the staff and the authorities. In particular, even though VAT collections were buoyant, as expected, personal income taxes are now projected to be slightly below budget. The authorities agreed with this assessment, and are redoubling their efforts to collect taxes through better tax administration (Box 4).

26. *In this context, the authorities indicated, and the staff agreed, that proposals in Parliament for reducing taxes could compromise the fiscal target for next year and the medium-term objective of continued fiscal consolidation.* Both parties shared the view that following the recent reduction in the corporate income tax rate to 29 percent, the scope for further reduction was quite limited. The staff noted that a reduction in payroll taxes would probably have more priority, as a growing divergence between taxes on capital and labor could create a further disincentive for the hiring of workers in the formal market. Nonetheless, it recommended a very cautious approach to tax policy at this stage, including

⁷ The staff-monitored program contains an expenditure ceiling, which, combined with higher-than-budgeted revenues, would lead to such a tighter fiscal stance.

Box 4. Structural Fiscal Reforms

The authorities' medium-term fiscal plans are underpinned by important structural fiscal reforms, to which they reaffirmed their commitment (SM/01/154).

- A **reformed pension system** will be based on three pillars: a pay-as-you-go system, a fully funded private system, and a voluntary supplementary insurance system, also fully funded. Work on the second pillar will start in early-2002, and the transition to the new system will be paid for with privatization revenues. In addition, an amendment to the social insurance act—to be adopted by end-2001 and expected to come into force in early-2003—will substantially improve the financial situation of the current pension insurance system, including through a gradual increase of the retirement age. Moreover, following a thorough audit of the Social Insurance Agency's operations, concrete measures will be taken to improve the efficiency of the Agency's administrative fund, and a project on the unified collection of contributions—being prepared in cooperation with the World Bank—will be implemented.
- The authorities plan to tighten eligibility criteria for **state and social assistance benefits**, and streamline the administration of these benefits with the objective of reducing administrative costs and preventing fraud. To this end, a higher degree of harmonization and coordination across different programs as well as a simplification of the rules governing those programs are needed. Better data linkages and faster information flows between different agencies and programs would also be useful.
- In parallel with the implementation of a comprehensive reform of the **health care** sector, reform measures in 2001 aim to improve the efficiency and quality of health care services, contain costs, and stop the growth in the sector's debt. The authorities are committed to taking measures to enhance the efficiency of health insurance, including through a review of the existing health insurance system and the establishment of a supplementary system. They will introduce incentives in medical practices to reduce the cost of medical procedures and pharmaceuticals, and co-payments for medical services. As part of the overall health care reform, the government will define an optimal network for institutional healthcare facilities, and for primary and secondary outpatient care. To this end, steps will be taken to ensure that no additional debts are incurred by health facilities, and that these facilities operate within the budget constraint imposed by the transfers envisaged in the 2001 budget.
- **Public finance management and tax administration** reforms aim, respectively, to enhance financial control over all sections of the general government and public enterprises, and to comprehensively modernize the management and enforcement of tax collections. A new state treasury system, which is currently being piloted in a number of units under the Ministry of Finance, should become a strong instrument of financial control when it is finally implemented in 2002. Ten out of 12 extra-budgetary funds will be brought on budget by end-2001, and their operations will be absorbed by line ministries starting in 2002. In addition, the government plans to strictly control the issuing of new state guarantees and has committed to an overall quarterly ceiling for 2001, with the ceiling declining in subsequent years. Based on technical assistance from the Fund, tax administration is being reorganized with the goals of improving core tax administration functions, reducing the number of local tax offices, introducing a single-level direct management in the tax administration, and reinforcing the headquarters' management capacity. The next phase of the strategy will be the establishment of a large tax-payer unit in Bratislava, a structural benchmark under the staff-monitored program.
- Firm steps have been taken to eliminate **quasi-fiscal deficits** associated with the operation of public enterprises. In addition to the strict control over government guarantees, *transfers* to the railways, a state-owned company with persistent financial losses, will be made contingent on a restructuring program aimed at eliminating these losses. All other large state-owned enterprises are being restructured and will be privatized soon (paragraph 38).
- The **decentralization** of fiscal activities, which responds to a large extent to a political imperative, will transfer a substantial amount of expenditure to the local and regional levels. The staff advised strict government control over the borrowing by local and regional governments, which the authorities intend to allow exclusively for investment purposes. Any borrowing beyond a certain limit to be established in the Act on Budgetary Rules will require prior approval by the Ministry of Finance. This will help ensure consistency between local government budgetary positions and medium-term fiscal objectives.

postponing further tax cuts until improvements in tax collection resulting from better administration and the broadening of the tax base were well established. The authorities agreed with this assessment, noted that they had strongly been resisting calls for tax cuts, and informed the staff that Parliament had decided to put a moratorium on tax cut discussions until September.

27. ***The government believes that for the credibility of policy, it is essential to establish a clear medium-term path for fiscal consolidation.*** To this end, the authorities have announced targets for the overall fiscal deficit through 2005, which are designed to consolidate macroeconomic stability over the medium term (Box 5). Fiscal consolidation over the next five years should lead to a deficit of 2 percent of GDP by 2005, and make room for private investment without straining the external current account.⁸ Such a fiscal stance would result in a stable public debt-to-GDP ratio, which at 28 percent is low, and be consistent with a substantial reduction of government guarantees. The fiscal targets are to be achieved primarily through expenditure reduction. The staff welcomed this emphasis, and reiterated the need to reduce the tax rates on formal labor. It also noted the need for advancing technical preparation of expenditure cuts as well as medium-term planning of reforms. The government is preparing a public sector reform, including civil service reform, through which it expects to achieve significant savings, while decentralizing part of the government's activities. It also sees scope for reduction in social benefit expenditures through better targeting of programs, and in health care and education spending through an increase in their efficiency. All of these reforms have been outlined under the staff-monitored program (see Box 4).

28. ***As part of their plan to reach a deficit of 2 percent of GDP by 2005, the authorities are targeting a general government deficit of 3.4 percent of GDP in 2002.*** This target is appropriate. Nevertheless, the staff see a risk that the sequencing of fiscal adjustment to reach the longer term goals of fiscal consolidation may be incongruent with the political cycle. With elections scheduled for September 2002, a more front-loaded fiscal consolidation would have led to a more practicable medium-term path of fiscal policy. As it stands, the tightening of fiscal policy in 2002, although feasible, will have to be carried out amid the political uncertainties of an election year. In the authorities' view, the tightening of the fiscal stance in 2002 will be feasible with the economy in a strong upswing, while the relatively easier stance of fiscal policy in 2001 was needed to support domestic economic activity at a time when output growth was almost certain to be below potential. These benefits outweighed the potential costs of the political risks to fiscal consolidation, which the authorities acknowledged. The staff agreed with the authorities' position, especially in light of Slovakia's prospects for early EU accession, which have focused the minds of the government and the opposition on key policies, notably fiscal consolidation.

⁸ Current account considerations and overall external debt dynamics provide the main rationale for the authorities' medium term fiscal objective. The costs of financial sector restructuring, pension reform, and payments for called guarantees also were taken into account when formulating fiscal policy in Slovakia (see staff study on the challenges for fiscal policy in Central European countries (SM/01/120)).

Box 5. Medium-Term Economic Outlook

Medium-Term Framework, 2002–05
(Annual growth in percent, unless otherwise indicated)

	2002	2003	2004	2005
GDP (real)	4.4	5.2	5.3	5.4
Domestic demand (real)	4.5	5.2	5.3	5.3
Private consumption	4.9	5.0	5.2	5.4
Gross capital formation	4.6	6.0	5.8	5.7
General government balance (in percent of GDP)	-3.4	-2.9	-2.6	-2.0
Public debt to GDP ratio	27.8	28.2	28.3	27.8
Current account balance (in percent of GDP)	-5.2	-4.9	-4.7	-4.3
External debt to GDP ratio	51.3	48.1	44.4	40.8
Consumer inflation (end-year)	5.8	4.5	4.1	3.8
Real wages in industry (CPI based)	1.5	2.9	3.2	3.5
Productivity growth in industry	7.5	7.5	7.5	7.5
Employment growth, whole economy	1.0	1.2	1.2	1.3
Unemployment, percent of labor force	17.4	16.9	16.3	15.6

Prospects beyond 2001 appear favorable assuming a continuation of structural reforms already in train, maintenance of macro-economic stability, and robust FDI inflows. In the staff's scenario of convergence with the EU, real GDP growth in 2002–05 is projected at 4½–5½ percent (see Table 7). With labor market flexibility and strong growth, unemployment is projected to decline to 15.6 percent by 2005. Real incomes are projected to strengthen based on substantial productivity increases, and headline inflation is expected to fall to below 4 percent by 2005. Key considerations underlying this macroeconomic framework are:

- Private investment ratios are assumed to rise marginally, from 27 percent of GDP in 2001 to 28 percent of GDP in 2005. Although the investment ratio is already relatively high, the need for renewal and augmentation of the capital stock remains substantial. With the private savings ratio assumed to remain unchanged—as it has been in 1997–2000—the private sector's savings-investment balance would become slightly more negative. A gradual reduction of the general government deficit over the next 5 years, to 2 percent of GDP by 2005, would maintain the strength of investment, and make room for it, without straining the external sector.
- With robust productivity growth (7.5 percent per annum, down from 10 percent in 2000) and real wage increases expected to be restrained by slack in the labor market, unit labor costs will be contained in 2002–05. This will allow the projected trend appreciation of the koruna, while maintaining competitiveness. Exports and imports are projected to grow at 7–7½ percent, in line with the growth in external and domestic demand, respectively. The external current account deficit would narrow to 4¼ percent of GDP by 2005. With non-debt creating capital inflows gaining momentum, the ratio of external debt to GDP would be kept on a decidedly downward trend, while international reserves would increase to the equivalent of six months of imports of goods and services.

29. *The authorities expect substantial privatization receipts in the period ahead, which will be used to enhance fiscal sustainability.* Privatization receipts in 2001, which could exceed 10 percent of GDP, will be used to retire government liabilities, with the exception of a small amount to finance development projects within the overall expenditure and deficit ceilings approved by the government. There was agreement to use future privatization receipts exclusively to reduce state debt and finance the planned pension reform. Nevertheless, the staff see a risk that the abundance of these resources could lead to nontransparent uses, loss of financial control, and a weakening of the fiscal stance. Recognizing these risks, the authorities intend to tighten legislation on the use of privatization receipts, and ensure the transparent operation of the National Property Fund.

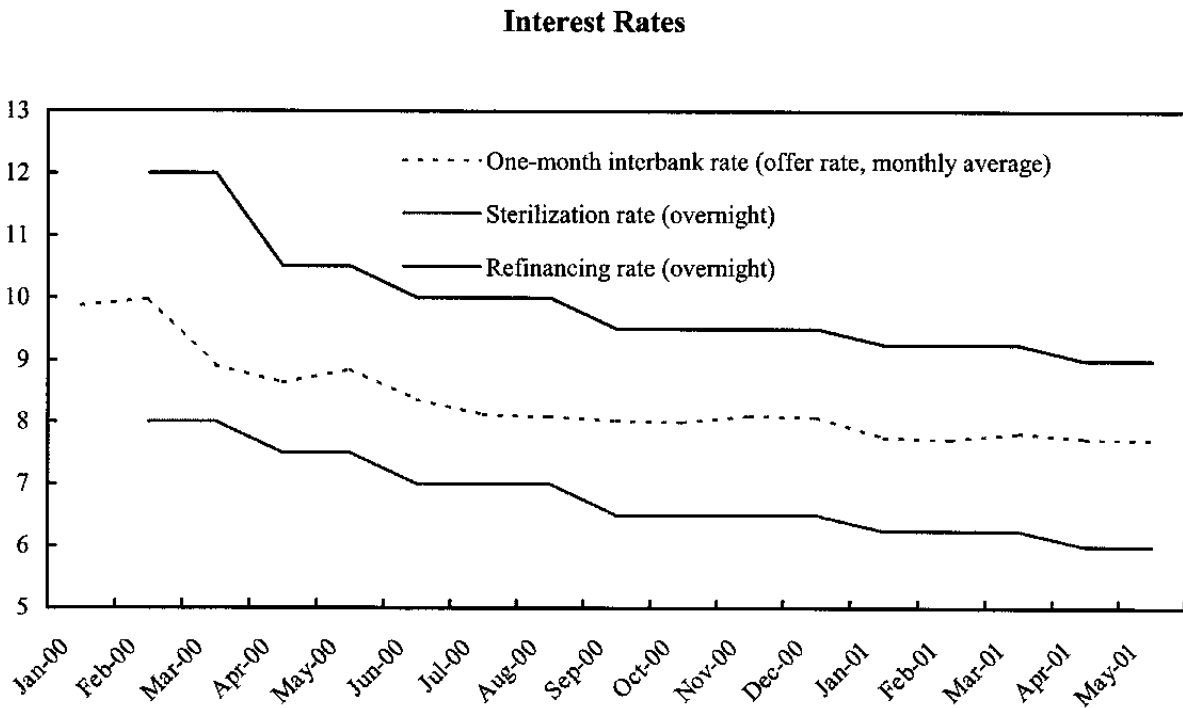
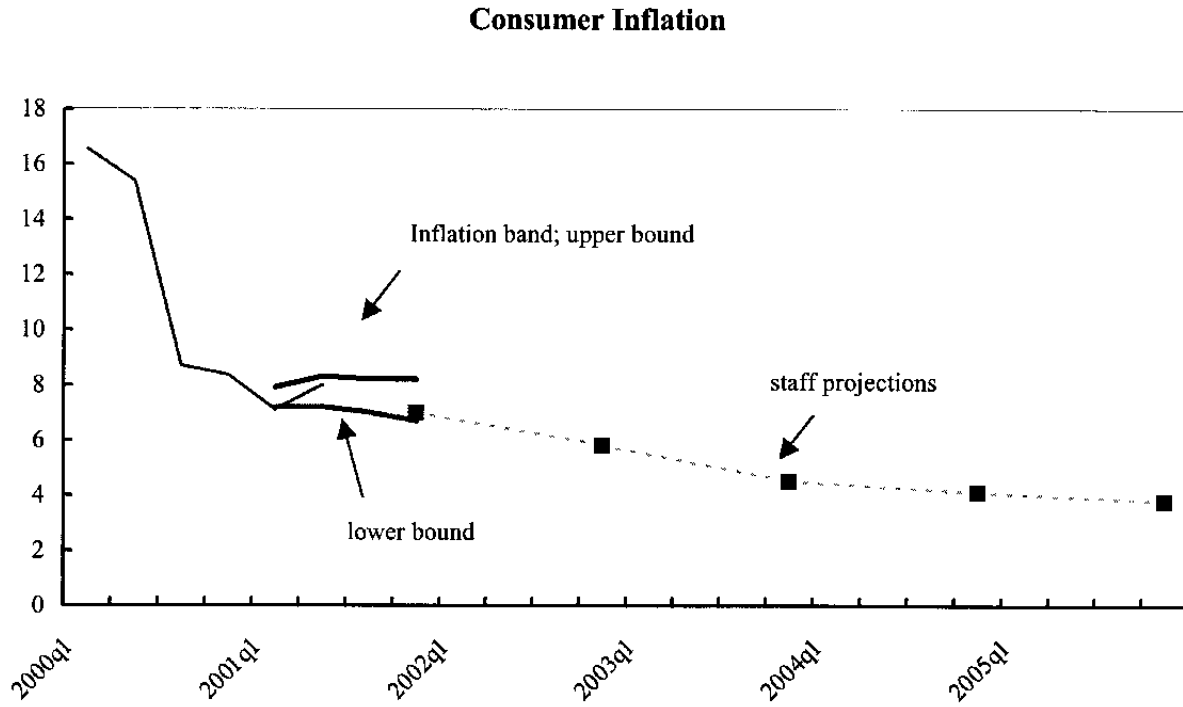
C. Monetary and Exchange Rate Policies

30. *The authorities will continue to gear monetary policy toward sustaining their disinflation effort.* Although the National Bank of Slovakia (NBS) does not plan to move to a formal inflation targeting regime, its monetary policy decisions will be taken mainly on the basis of public inflation benchmarks (Figure 6).⁹ The NBS, however, does not envisage reaching EU inflation levels before 2005. The staff agreed that in the meantime the convergence of Slovakia's relative price structure to that of its EU neighbors will require slightly higher inflation and a real appreciation of the koruna. The NBS is of the view that as long as fiscal restraint is maintained, anchored by strict adherence to the expenditure ceiling, and wage increases remain moderate, there should be no significant pressures on inflation and the exchange rate in the period ahead. Data for the first five months of the year support the view that inflation remains restrained. The NBS thus felt reasonably comfortable, and the staff concurred, that the end-year inflation outcome would be within the informal inflation band.

31. The NBS intends to intervene in the foreign exchange market exclusively to avoid sharp oscillations in the exchange rate—a position that the staff supported. In doing so, the NBS would not oppose long-term trends in the Slovak currency driven by productivity developments. These policy intentions have been reflected in the intervention data for the first half of the year: the NBS has not intervened in the foreign exchange market, except for an operation in January when it supplied a modest amount of foreign exchange to prevent some large transactions from having too great an impact on the exchange rate in a relatively thin market. The staff agreed that Slovakia's floating exchange rate regime in conjunction with the absence of an explicit central bank commitment to a range for the exchange rate is consistent with the authorities' emphasis on inflation as the dominant consideration for monetary policy. Despite the recent appreciation, the exchange rate still appears appropriately competitive: vis-à-vis the euro, at end-June, the koruna had appreciated by 3.8 percent since early January, but the nominal effective exchange rate was substantially weaker than a year ago (Figure 5). The real effective exchange rate in unit labor cost terms at

⁹ For 2001, the band is 6.7–8.2 percent for end-period headline inflation. This band will serve as an informal guide for monetary policy, and if inflation approaches the limits of the band, the NBS will take action to reassess its policies, including consultation with the Fund staff.

Figure 6. Slovak Republic: Monetary Policy, 2000–05



Sources: National Bank of Slovakia, Slovak Statistical Office, and staff estimates.

end-June was roughly the same as it was a year ago and export performance has been very good, despite a recent deceleration of exports.

32. *All parties agreed that following the interest rate cut of 2½ percentage points—to 7½ percent¹⁰—during the 15 months up to March 2001, the NBS should follow a “wait and see” approach, and not cut interest rates further until there is more conclusive evidence of a substantial decline in actual and expected inflation.* Indeed, present trends in the external current account that reflect primarily domestic demand pressures suggest that a further easing of monetary policy is not advisable at this time. The staff argued that if domestic pressures intensify, notably through a realization of the fiscal risks, and the current account deficit widens further, a tightening of the monetary stance could be envisaged. However, the mission’s view was that the policy response to external pressures caused by domestic demand should center around a rebalancing of the policy mix toward a tighter fiscal stance. The authorities did not disagree with this, but noted that the room for fiscal maneuver was limited.

D. Bank Soundness and Banking Supervision¹¹

33. *Although the main prudential regulations are being met, the mission expressed some concerns about bank soundness.* A sizeable amount of bad loans was carved out from the largest banks’ balance sheets, but nonperforming loans still exceeded 15 percent of total loans at end-2000 according to NBS classification.¹² A stricter international classification standard would probably increase this share. While two-thirds of the bad loans are covered by provisions, the staff indicated that this persistent asset quality problem could have future fiscal implications. The authorities noted that, following the restructuring of the large state-owned banks last year, the ratio of non-performing loans had declined substantially, and thus they considered the banking system to be sound. Clearly, there has been a noticeable improvement in commercial banks’ financial situation, but the financial system will need to be supervised very closely in the future to avoid a recurrence of problems associated with bad loans.

34. *In this context, all parties agreed that it is key to strengthen banking supervision, and the authorities are exploring alternatives for its permanent institutional location.* Thus far, bank supervision has been very weak because of insufficient legal enforcement power and a shortage of qualified supervision resources. It has relied heavily on off-site monitoring

¹⁰ Average of the sterilization and refinancing rates offered by the NBS, compared with a two-week repo rate of 7¾ percent.

¹¹ See the accompanying Selected Issues paper for more details on the banking sector.

¹² The ratio of nonperforming loans to total loans declined from 23.7 percent at end-1999 to 15.2 percent at end-2000. The Capital Adequacy Ratio was 12.5 percent at end-2000, and the average return on assets of Slovak commercial banks improved from -3.7 percent in 1999 to 1.4 percent in 2000.

based on figures reported by banks, which are likely to be distorted. The authorities recognize this problem, and are keen on strengthening bank supervision through better on-site examination and more focus on early detection of problem banks. There were differences of view among them on the permanent location of bank supervision: some officials argued that it should stay at the NBS, which is committed to implementing the supervisory development plan, while others believed that it was better to transfer it to a new financial market authority that would supervise all financial activities, including banking. The staff did not take a position regarding the institutional location of bank supervision but emphasized that any setup should guarantee independent bank supervision of the highest quality, while stressing the urgent need to bring prudential norms, including loan classification, up to international standards. On a preliminary basis, the authorities decided in May to maintain bank supervision at the NBS until at least October 2002. This should give the NBS a chance to advance the implementation of the plan agreed upon with the World Bank.

E. Unemployment

35. *Unemployment is manifestly a problem.* It could become a permanent condition for many in the absence of measures aimed at dealing with distortions that have accentuated the unemployment problem. While economic growth and structural policies that encourage private sector development—particularly foreign direct investment and growth in the small and medium-size enterprises—will have a positive impact on employment, persistently high unemployment is an indication of rigidities in the labor market itself. Research into the nature of these rigidities indicates that a large share of unemployment has been long-term and characterized by wide regional variation, with the highest unemployment concentrated in eastern Slovakia. Cyclical unemployment has compounded the problem. The authorities' strategy to deal with it aims at increasing labor market flexibility through the promotion of a variety of alternative work arrangements, including part-time and temporary jobs, and greater geographic mobility of the labor force. The government also expects that the rationalization of the system of social benefits will create conditions for motivating job search, and has taken measures to improve the employability of particular groups, such as the long-term unemployed, the young, the disabled, and ethnic minorities.

36. *The staff agreed that the unemployment issue was pressing and underscored the importance of eliminating labor market rigidities.* Given the largely structural nature of unemployment, the staff welcomed the authorities' efforts to increase labor market flexibility and mobility, but suggested more decisive steps in the simplification of procedures for hiring and dismissing workers. It is appropriate to place emphasis on ways to address mismatching problems through improving the employability of the labor force, and to support job creation by small and medium-sized entrepreneurs. At the same time, the mission insisted on the necessity of limiting the disincentive effects of the generous social assistance system on job search, and of rationalizing and better targeting the social safety net. The mission welcomed measures to restrict the informal hiring of workers, but expressed concerns that these might not provide sufficient incentives for shifting from informal to formal employment. In this regard, narrowing the large tax wedge is an important priority that should be addressed as soon as the fiscal situation permits.

F. Other Structural Policies

37. ***The authorities are keen to make progress on other structural policies, which are key to the sustainability of economic reform, to foreign direct investment, and to EU accession.***

38. ***In light of the authorities' goal to increase the role of the private sector, restructuring and privatization of state-owned enterprises are perhaps the foremost issues.*** Although, as noted earlier, substantial progress has been made in the privatization of large state-owned banks,¹³ the process of privatizing large state-owned enterprises in the gas and electricity sectors has just begun. The authorities reiterated their commitment to adhere to the schedule for the privatization of the gas company and Transpetrol in 2001. Moreover, a major reform of the electricity sector in 2001 will aim at transforming the sector before privatizing its assets by 2003. As a first step, distribution will be separated from electricity generation, and the process of privatization of 49 percent of shares in each of the three new distribution units will start during the second half of this year. Regarding the railway company, a reform program is underway to separate the transport and trade activities from the main company, which will retain only the railroad. The government believes that this step would create conditions for the liberalization of rail transport. Finally, the government has concrete plans for the reform of the bus transport system, and its privatization.

39. ***Although the authorities have made substantial progress in improving the overall legal framework, poor implementation has been a constraint on domestic entrepreneurial activity and foreign direct investment.*** Over the past few years Slovakia has developed a strong core of highly efficient, internationally competitive enterprises that have set the standard for the rest of the economy, but their dynamism has not extended to most of the remaining enterprises. It is thus key to future development to raise the standards of the latter group. The ongoing improvements in legislation,¹⁴ if forcefully implemented, will lead to the restructuring or closure of nonviable enterprises while forcing the rest to adopt a high standard of corporate governance. This in turn should facilitate access to bank loans and ties with foreign partners, thus invigorating the corporate sector. The authorities agreed with this assessment, and reaffirmed their determination to improve the functioning of bankruptcy courts and, more generally, of the legal system.

40. ***Slovakia's trade regime is very open but further progress will be required to make it consistent with EU requirements.*** Slovakia is ranked "1" on the Fund's index of trade restrictiveness, which denotes the most open regime. Moreover, the authorities are working on making their tariff and trade regime consistent with EU requirements.

¹³ The main remaining bank in state hands is the Investičná a rozvojová banka (IRB), which the authorities plan to privatize this year.

¹⁴ Bringing Slovak Accounting Standards in line with International Accounting Standards, reforming the collateral regime, amending the Commercial Code, and drafting of a new Securities Law.

IV. STAFF APPRAISAL

41. ***Slovakia has attained considerable economic achievement since independence, and is a country with substantial promise.*** After eight years of independence, it is now a steadily growing economy. Fiscal discipline is being restored, and will remain essential to reinstate macroeconomic balance on a sustainable basis. The rapidly improving export performance, in tandem with continuing wage moderation and a strong competitiveness position, augurs well for balanced economic growth. Overall, the achievements are beginning to be recognized by the international community, and the country is making good progress in its negotiations to join the EU. The factors behind Slovakia's promise are also considerable. The labor force is well educated and resourceful; the country's geographical location gives it prime access to western European markets; and the capital stock is being modernized quickly, notably through foreign direct investment.

42. ***There are risks, though, that such promise will not become reality if Slovakia postpones essential reforms because they are difficult to implement.*** The foremost risk is that fiscal consolidation could be delayed. Without a sustained improvement in public sector savings, either the heavy reliance on external savings will have to continue, with the possibility of balance of payments problems down the road, or private investment will be crowded out, postponing the needed renewal of the capital stock. Another important risk is the deferral of further financial sector strengthening, which is key for continued private-sector-led growth of the Slovak economy.

43. ***Therefore, it will be necessary for the government to pursue with zeal its strategy of fiscal consolidation, disinflation, and structural reform.*** The policies envisaged by the authorities comprehensively address the main deficiencies of the Slovak economy, and the time frame for reforms and disinflation under the staff-monitored program is appropriately ambitious. It needs to be implemented in a forceful and timely fashion, particularly measures in the fiscal and related structural areas, to enhance Slovakia's early EU accession prospects. Ultimately, success in implementing the government's strategy will depend on the concerted and timely completion of reforms, and the coordinated and integrated use of the instruments of policy.

44. ***Nowhere is the implementation of this strategy more critical than in the fiscal area.*** Fiscal imbalances have been at the core of Slovakia's problems in the past, and it is essential that the deficit targets for 2001 and 2002 be achieved. The authorities' emphasis on containing expenditures is appropriate, and the government should carry through fully with plans to contain the wage bill and social transfers, reduce subsidies and official guarantees to enterprises, and strengthen control over investment expenditure. The government should ensure that fiscal decentralization is done in a way consistent with this emphasis, and supports overall fiscal consolidation. The controls envisaged by the Ministry of Finance are a good first step, but by no means can they ensure the success of decentralization. The Slovak authorities should take steps to improve regional and local government management capacity prior to the devolution of new fiscal responsibilities from the central government. The use of privatization revenue should be limited to paying down debt and reforming the pension system, and should be firmly outlined in legislation containing checks and balances that ensure transparency.

45. ***The 2001 and 2002 budgets can, however, be considered as only the first installment in a medium-term strategy of fiscal consolidation.*** The external current account deficit is large and widened during the first half of the year, and an appropriately tight fiscal stance to secure macroeconomic balance and inflation targets will be needed as domestic demand recovers. Given the emphasis on expenditure reduction, the targeted decline in fiscal deficits through 2005 needs to be backed by a detailed multiyear plan, with concrete measures and a timetable. For the desired adjustment to be sustainable, measures must be permanent and focus on the largest categories of spending, which are primarily entitlements related to transfers to households: social transfers and health care. Reforms in these areas will begin under the staff-monitored program, aiming at controlling the growth of spending and indebtedness, improving the efficiency in the provision of services, and enhancing their quality. It is essential that the government start the process without delay, and strictly adhere to the agreed timetable.

46. ***While the government progresses toward achieving its fiscal objectives, monetary policy will remain the main anchor for disinflation in the period ahead.*** During the transition to higher rates of growth it will be essential to ensure that disinflation remains on the intended track. This will require that interest rates remain significantly positive in real terms over the medium term, along with a steadfast pursuit of fiscal consolidation. Tensions that may arise in the short term between a fiscal policy supportive of domestic activity and a monetary policy targeted to disinflation should be resolved by tightening the former, so as to not crowd out investment, and, particularly, exports.

47. ***Slovakia's goal of early EU accession requires that fiscal consolidation and disinflation be accompanied by ambitious structural reforms.*** There have been marked achievements in this area: the liberalization of trade; the improvements in the legal framework and corporate governance; and the promotion of economic competition and efficiency. Progress was also made in enterprise and bank restructuring and privatization. The government is appropriately focusing future reform on increasing the role of the private sector and of foreign direct investment. In this context, the privatization of the remaining large state-owned enterprises needs to be accelerated, and the energy sector needs to adopt reforms to improve its efficiency, including the creation of a more competitive business environment. It will be also key for the government to enhance the implementation of the legal framework, which has been updated virtually to EU standards, and intensify efforts to improve the functioning of the court system. All of these reforms, though, will need a strong financial system and a reformed labor market to promote sustained growth.

48. ***The development of a dynamic corporate sector will depend on access to credit from a healthy banking system.*** Following the restructuring of the large state-owned banks and privatization of the two largest banks, a variety of steps are needed to further strengthen the financial sector. The authorities should adhere to their plan for the privatization of the remaining state-owned banks, notably IRB, which should improve efficiency and competition in the financial sector. Forceful implementation of the new banking act will help reduce vulnerabilities in the financial system. But the foremost means to avoid a repeat of the bad loan problem is the institutional enhancement of banking supervision. The government appears committed to it, but has shown some hesitation in deciding on the definite

institutional setup of banking supervision. Any further delays are bound to raise questions about Slovakia's commitment to it.

49. ***With unemployment at an all-time high, the authorities' policies will not be perceived as a success if they fail to create employment.*** Rapid balanced growth from these policies will be essential. But the authorities will need to address rigidities in the labor market itself, even if economic growth quickly reaches its potential. Increasing labor market flexibility, together with rationalizing the system of social benefits and improving its administration, will be key to improving incentives for seeking work and job creation. Over the medium term, as the fiscal situation permits, a reduction in the payroll taxes should address distortions in the labor market and help boost employment.

50. ***Slovakia's statistical base is adequate for surveillance.*** With an eye to enhancing the conduct and monitoring of economic policies, the authorities should continue to improve the statistical base in a number of areas—notably trade statistics, consolidated general government operations, and public enterprises—drawing on the recommendations by the recent multisector technical assistance mission from the Statistics Department.

51. Slovakia's decision to publish this Article IV staff report is welcome. It is recommended that the next Article IV consultation be held on the standard 12-month cycle.

Table 1. Slovak Republic: Selected Economic and Financial Indicators, 1998–2005

	1998	1999	2000	2001 Staff Proj. 1/	2002 Staff Proj.	2003 Staff Proj.	2004 Staff Proj.	2005 Staff Proj.
(Percent change, period average)								
Real sector								
Real GDP	4.1	1.9	2.2	3.0	4.4	5.2	5.3	5.4
Consumer prices								
Period average	6.7	10.7	12.0	7.2	6.0	4.6	4.3	4.0
12 months to end of period	5.6	14.2	8.4	7.0	5.8	4.5	4.1	3.8
Gross industrial output (constant prices)	3.6	4.1	6.9	7.0	7.0	7.0	7.0	7.0
Real wages in industry								
PPI-based	4.7	4.0	0.4	4.1	...	...	...	...
CPI-based	1.3	-2.8	-2.9	2.3	...	...	...	...
Employment in industry	-4.1	-3.0	-3.0	-2.5	...	...	...	...
Unemployment rate, period average	14.0	17.5	18.2	...	...	...	...	...
Real effective exchange rate 2/								
CPI-based	-1.4	-2.0	9.6	2.8	4.5	3.4	3.5	3.5
ULC-based	-6.8	-11.3	1.9	-2.2	0.6	0.8	0.9	1.0
(in percent of GDP)								
General government finances								
Revenue	40.5	41.6 3/	39.2	35.9	35.4	35.0	34.8	34.7
Expenditure	45.3	45.1 3/	42.7	39.8	38.8	38.0	37.4	36.7
Balance 4/	-4.8	-3.4	-3.5	-3.9	-3.4	-2.9	-2.6	-2.0
State budget balance	-2.2	-1.7	-1.7	-3.8	-3.3	-2.8	-2.4	-1.8
(Percent change, end of period, unless otherwise indicated)								
Money and credit								
Net domestic assets	10.9	9.5	6.2	4.5	...	...	...	...
Credit to enterprises and households	5.8	4.6	0.3	7.5 5/	...	...	...	...
Broad money	4.2	11.4	15.5	14.9	...	...	...	...
Interest rates (in percent, end-of-period)								
Lending rate (short-term)	18.9	16.4	10.7	...	...	...	...	...
Deposit rate (one-week)	16.2	12.1	6.0	...	...	...	...	...
Velocity	1.0	-1.4	-5.6	-4.4	...	...	...	...
(US\$ billion, unless otherwise indicated)								
Balance of payments								
Merchandise exports	10.7	10.2	11.9	12.9	14.0	15.2	16.5	17.8
(percent change)	(11.2)	(-4.9)	(16.8)	(8.3)	(8.6)	(8.4)	(8.3)	(8.0)
Merchandise imports	13.1	11.3	12.8	14.3	15.5	16.7	18.1	19.6
(percent change)	(11.6)	(-13.6)	(13.4)	(11.3)	(8.4)	(8.2)	(8.2)	(8.2)
Trade balance	-2.4	-1.1	-0.9	-1.3	-1.4	-1.5	-1.6	-1.8
Current account	-2.1	-1.0	-0.7	-1.1	-1.2	-1.3	-1.4	-1.4
(percent of GDP)	(-10.0)	(-5.0)	(-3.5)	(-5.4)	(-5.2)	(-4.9)	(-4.7)	(-4.3)
Official reserves, end-period	2.9	3.4	4.1	5.7	6.9	8.2	9.5	10.8
(in months of imports of G & NFS)	(2.3)	(3.1)	(3.3)	(4.2)	(4.7)	(5.2)	(5.5)	(5.8)
(in percent of broad money)	(23.8)	(27.5)	(31.8)	(37.8)	...	...	...	...
Gross reserves of banking system	6.0	4.4	5.6	7.5	...	...	...	...
Gross external debt, end-period 6/	11.9	10.5	10.9	11.2	11.9	12.6	13.0	13.4
Gross external debt, end-period (in percent of GDP) 6/	55.9	53.4	56.7	54.0	51.3	48.0	44.4	40.7
Short-term debt (end-of-period) 7/	5.8	4.5	3.4	3.2	3.1	3.0	3.0	2.9
Short-term debt (end-of-period) 8/	4.6	2.7	2.4	2.3	2.1	2.0	2.0	1.9
Official reserves to short-term debt (in percent) 8/	112.2	127.2	253.6	430.0	608.1	792.4	965.1	1150.4
Memorandum items:								
GDP, current prices (Sk billions)	750.8	815.3	887.2	971.9	1073.0	1180.8	1297.0	1421.2
Exchange rate (Sk/U.S. dollar)								
Period average	35.2	41.4	46.2	...	...	...	...	...
End of period	36.9	42.3	47.4	...	...	...	...	...
Public debt (percent of GDP) 9/	23.7	23.6	25.2	26.9	27.8	28.2	28.3	27.8

Sources: Slovak Statistical Office; and IMF staff calculations.

1/ On the basis of government's expenditure plans as outlined in the 2001 budget and staff projections for revenue.

2/ Calculated for trade partners of Germany, France, Austria, Italy, Czech Republic, Poland, and Hungary.

3/ Includes Sk 23.5 billion in exceptional NBS profits used for the equity injection into banks.

4/ Overall balance, excluding privatization proceeds and guarantees.

5/ The base number--for December 2000--is adjusted for impact of bank restructuring transactions in January and March 2000 (see table 4).

6/ Excludes domestic currency denominated debt.

7/ Short-term debt is defined so as to include MLT debt due in the subsequent year.

8/ Short-term debt is defined so as to exclude MLT debt due in the subsequent year.

9/ For 2001 and further, this excludes 11 percent of GDP in bank recapitalization bonds issued in the first quarter of 2001.

Table 2. Slovak Republic: Vulnerability indicators
(In percent of GDP, unless otherwise indicated)

	1996	1997	1998	1999	2000	Latest Data 2001	Date
Financial indicators							
Public sector debt 1/	23.6	21.8	23.7	23.6	25.3	...	
Broad money (percent change, 12-month basis)	...	8.8	4.2	11.4	15.5	13.2	May
Private sector credit (percent change, 12 month basis)	...	2.2	5.8	4.6	0.3	4.3	May
Domestic credit to GDP	71.0	68.3	72.5	70.6	68.8	...	
Bond yield at issue (1-5 years, annual average)	8.6	18.9	23.2	17.0	9.5	7.8	June
Bond yield at issue, real (1-5 years, annual average) 2/	2.8	12.8	16.5	11.0	3.8	...	
External Indicators							
Exports (percent change, 12-month basis in US\$) 3/	2.9	9.5	11.2	-4.9	16.8	10.4	May
Imports (percent change, 12-month basis in US\$) 3/	26.3	5.6	11.6	-13.6	13.4	19.0	May
Terms of Trade (percent change, 12 month basis)	-7.6	-1.6	5.9	-1.5	-1.0	...	
Current account balance	-10.6	-9.6	-10.0	-5.7	-3.5	...	
Capital and financial account balance	11.0	9.0	9.1	7.7	7.9	...	
Portfolio investment, net	0.5	0.1	3.7	3.2	4.4	...	
MLT credits + short term credits	9.5	8.5	3.9	1.0	-6.4	...	
Direct investment, net	1.0	0.5	1.5	3.5	10.0	...	
Net Foreign Assets (NFA) of commercial banks (in US\$ billions)	0.2	0.5	0.7	0.6	1.0	...	
Gross official reserves (in US\$ billions)	3.5	3.3	2.9	3.4	4.1	3.8	May
Net International Reserves (NIR) (in US\$ billions)	...	...	3.8	4.1	5.3	...	
Central Bank short-term foreign liabilities (in US\$ billions) 4/	0.0	0.2	0.0	0.0	0.0	...	
Central Bank foreign currency exposure (in US\$ billions)	1.8	1.5	0.4	0.7	1.2	...	
Short term foreign assets of commercial banks (in US\$ billions) 5/	2.2	3.2	3.1	1.1	1.5	...	
Short term foreign liabilities of commercial banks (in US\$ billions) 5/	1.4	2.2	2.1	0.3	0.3	...	
Foreign currency exposure of commercial banks (in US\$ billions)	0.2	0.5	0.7	0.6	1.0	...	
Official reserves in months of imports GS	3.2	2.9	2.3	3.1	3.3	3.1	May
Reserve money to (gross official) reserves (percentage)	79.2	84.0	84.2	80.9	58.8	...	
Broad money to (gross official) reserves (percentage)	373.6	396.7	438.0	363.7	314.7	...	
Total short term external debt to gross official reserves (percentage)	55.6	69.7	89.1	78.6	39.4	...	
Total external debt	38.8	47.8	55.9	53.4	56.7	...	
o/w: Public sector debt	23.6	28.7	33.4	...	...	...
Total external debt to exports GS (in percent)	64.9	82.7	91.4	86.3	76.9	...	
Total external debt service payments to exports GS	14.7	13.8	13.9	16.3	15.9	...	
Exchange rate (per US\$, period average)	30.7	33.6	35.2	41.4	46.2	50.1	June
REER depreciation (-) (12 month basis; CPI-based)	0.1	6.1	-1.4	-2.0	9.6	0.2	June
Financial Market Indicators (end-year)							
Stock market index	178	183	94	77	92	100	June
Foreign currency debt rating (Moody's)	...	...	...	Ba1	Ba1	Ba1	April
Spread of (5 year benchmark) bond (basis points) 6/	...	...	...	248	181	105	June

1/ Includes liabilities of extra-budgetary funds.

2/ From 1999 onwards, core inflation is used to deflate nominal interest rates.

3/ Merchandise trade.

4/ Includes short term liabilities of the government.

5/ Short term assets and liabilities of commercial banks are affected by "window dressing" operations amounting to US\$2 billion in 1997 and 1998, (and US1 billion in 1996) involving offsetting claims and liabilities of two Slovak subsidiaries of foreign banks with their parents.

6/ 5 year DM denominated eurobond, over German 5 year bund.

Table 3. Slovak Republic: Fiscal Operations of the Consolidated General Government, 1999-2001 1/

(In millions of koruny)

	1999		2000		2001		
	Budget	Outcome	Authorities' Target	Budget	Estimate	Budget 2/	Staff Projection 3/
Total revenue	314,622	339,472 4/		324,061	347,615	336,701	348,624
Tax revenue	273,240	274,620		285,674	303,925	290,703	300,826
Personal income tax	45,970	46,108		43,188	41,295	46,614	45,478
Corporate profit tax	28,637	22,999		25,725	26,351	19,881	21,191
Social security contributions	103,347	101,311		106,820	115,737	117,950	117,950
VAT	58,000	58,938		62,906	70,577	64,950	73,913
Excises	24,200	25,164		27,000	28,453	28,750	29,613
Import duties and surcharge	5,274	12,534		12,050	13,181	4,080	4,078
Other	7,812	7,566		7,985	8,332	8,478	8,603
Nontax revenue	41,382	64,852 4/		38,387	43,691	45,998	47,798
Total expenditure	339,153	341,895		358,572	373,036	372,916	382,551
Current expenditure	306,260	311,085		326,699	338,579	348,110	349,045
Gross wages	58,097	55,837		58,992	59,729	62,944	62,944
Other goods and services	43,711	44,713		44,795	48,021	50,991	49,419
Social transfers	110,907	117,168		122,217	123,274	129,846	132,354
Health care	43,923	43,646		44,053	48,600	51,408	51,408
Subsidies	25,146	26,258		30,640	35,263 5/	28,224	28,224
Interest	24,477	23,464		26,002	23,693	24,695	24,695
Investment expenditure	32,893	30,809		31,873	34,457	24,806	33,506
Financial balance	-24,531	-2,423 4/		-34,510	-25,421	-36,215	-33,927
Net lending (excluding privatization proceeds and guarantees)	989	25,563 6/		3,340	5,800	3,922	3,922
Overall balance (excluding privatization proceeds and guarantees)	-25,520	-27,986	-28,000	-37,851	-31,221 7/	-40,137 8/	-37,849
of which:							
State budget	-19,000	-14,088	-18,000	-22,100	-14,775	-37,201	-37,195
Rest of general government	-6,520	-13,898	-10,000	-15,751	-16,446	-2,935	-653
of which:							
Local authorities	-580	-1,415	0	-4,149	-1,683	-2,282 9/	0
Social security system	-3,620	-7,791	-5,500	-7,058	-1,627	-3,409	-3,409
State funds	-2,320	-3,685	-4,500	-4,544	-3,403	2,756	2,756
NPF and other projects	0	-1,007	0	0	-9,734	0	0
Memorandum items:							
Overall balance (including guarantees and bank restructuring costs)	...	-32,156	...	...	-44,094	...	-57,539
Public debt 10/	...	192,325	...	...	224,246	...	262,095

Sources: Ministry of Finance; and staff estimates and projections.

1/ Excludes the impact of operations pertaining to the restructuring of the banking system, unless otherwise indicated.

2/ Based on the budget approved by Parliament, the latest financial plans of the extra-budgetary and social security funds, the most recent budgets of local governments, and assuming that additional spending related to Article 12 does not take place. It is also assumed that the budget NPF is balanced.

3/ Incorporates staff projections of revenue and expenditure, including additional spending related to Article 12 to be financed from better-than-budgeted revenue. Also assumes that the budget of local governments and the NPF are balanced.

4/ Includes Sk 23.5 billion in exceptional NBS profits used for equity injections into banks.

5/ Includes Sk 4.1 billion subsidy to the railways, which is also included under social security contribution revenue of the Health and Pension Funds.

6/ Includes Sk 23.5 billion equity injections into banks.

7/ Includes additional expenditure financed from privatization receipts.

8/ Does not include expenditure (Article 12) contingent on better-than-budgeted revenue or spending associated with the use of privatization receipts.

9/ According to the budgets prepared by the local governments. The budget document assumed balanced budgets.

10/ For 2001, excludes Sk 105 billion (11 percent of GDP) in bank recapitalization bonds issued in the first quarter of 2001.

Table 3 (Concluded). Slovak Republic: Fiscal Operations of the Consolidated General Government, 1999-2001 1/

(In percent of GDP)

	1999		2000		2001		
	Budget	Outcome	Authorities' Target	Budget	Estimate	Budget 2/	Staff Projection 3/
Total revenue	38.7	41.6 4/		37.6	39.1	35.1	35.8
Tax revenue	33.6	33.7		33.1	34.2	30.3	30.9
Personal income tax	5.7	5.7		5.0	4.6	4.9	4.7
Corporate profit tax	3.5	2.8		3.0	3.0	2.1	2.2
Social security contributions	12.7	12.4		12.4	13.0	12.3	12.1
VAT	7.1	7.2		7.3	7.9	6.8	7.6
Excises	3.0	3.1		3.1	3.2	3.0	3.0
Import duties and surcharge	0.6	1.5		1.4	1.5	0.4	0.4
Other	1.0	0.9		0.9	0.9	0.9	0.9
Nontax revenue	5.1	8.0 4/		4.4	4.9	4.8	4.9
Total expenditure	41.7	41.9		41.5	42.0	38.8	39.3
Current expenditure	37.7	38.2		37.9	38.1	36.3	35.9
Gross wages	7.1	6.8		6.8	6.7	6.6	6.5
Other goods and services	5.4	5.5		5.2	5.4	5.3	5.1
Social transfers	13.6	14.4		14.2	13.9	13.5	13.6
Health care	5.4	5.4		5.1	5.5	5.4	5.3
Subsidies	3.1	3.2		3.6	4.0 5/	2.9	2.9
Interest	3.0	2.9		3.0	2.7	2.6	2.5
Investment expenditure	4.0	3.8		3.7	3.9	2.6	3.4
Financial balance	-3.0	-0.3 4/		-4.0	-2.9	-3.8	-3.5
Net lending (excluding privatization proceeds and guarantees)	0.1	3.1 6/		0.4	0.7	0.4	0.4
Overall balance (excluding privatization proceeds and guarantees)	-3.1	-3.4	-3.0	-4.4	-3.5 7/	-4.2 8/	-3.9
of which:							
State budget	-2.3	-1.7	-2.0	-2.6	-1.7	-3.9	-3.8
Rest of general government	-0.8	-1.7	-1.1	-1.8	-1.9	-0.3	-0.1
of which:							
Local authorities	-0.1	-0.2	0.0	-0.5	-0.2	-0.2 9/	0.0
Social security system	-0.4	-1.0	-0.6	-0.8	-0.2	-0.4	-0.4
State funds	-0.3	-0.5	-0.5	-0.5	-0.4	0.3	0.3
NPF	0.0	-0.1	0.0	0.0	-1.1	0.0	0.0
Memorandum items:							
Overall balance (including guarantees and bank restructuring costs)	...	-3.9	...	...	-5.0	...	-5.9
Public debt 10/	...	23.6	...	...	25.2	...	26.9

Sources: Ministry of Finance; and staff estimates and projections.

1/ Excludes the impact of operations pertaining to the restructuring of the banking system, unless otherwise indicated.

2/ Based on the budget approved by Parliament, the latest financial plans of the extra-budgetary and social security funds, the most recent budgets of local governments, and assuming that additional spending related to Article 12 does not take place. It is also assumed that the budget NPF is balanced.

3/ Incorporates staff projections of revenue and expenditure, including additional spending related to Article 12 to be financed from better-than-budgeted revenue. Also assumes that the budget of local governments and the NPF are balanced.

4/ Includes Sk 23.5 billion in exceptional NBS profits used for equity injections into banks.

5/ Includes Sk 4.1 billion subsidy to the railways, which is also included under social security contribution revenue of the Health and Pension Funds.

6/ Includes Sk 23.5 billion equity injections into banks.

7/ Includes additional expenditure financed from privatization receipts.

8/ Does not include expenditure (Article 12) contingent on better-than-budgeted revenue or spending associated with the use of privatization receipts.

9/ According to the budgets prepared by the local governments. The budget document assumed balanced budgets.

10/ For 2001, excludes Sk 105 billion (11 percent of GDP) in bank recapitalization bonds issued in the first quarter of 2001.

Table 4. Slovak Republic: Balance of Payments 1998–2005
(In millions of U.S. Dollars, unless otherwise indicated)

	1998	1999	2000	2001	2002	2003	2004	2005
	Staff Projections							
Current account balance	-2124	-979	-694	-1113	-1206	-1289	-1371	-1420
Trade Balance	-2353	-1092	-898	-1346	-1429	-1512	-1618	-1786
Exports, f.o.b.	10720	10229	11914	12908	14024	15209	16471	17787
Imports, f.o.b.	-13074	-11321	-12812	-14254	-15453	-16720	-18089	-19573
Services balance	20	218	439	423	465	509	497	473
Receipts	2295	2063	2247	2434	2644	2868	3049	3234
Payments	-2275	-1845	-1807	-2011	-2180	-2359	-2552	-2761
Income balance	-157	-301	-353	-310	-344	-389	-351	-208
Receipts	437	300	269	358	407	485	520	591
Payments	-595	-601	-622	-668	-750	-873	-871	-799
<i>Of which: Interest</i>	-531	-561	-575	-575	-602	-628	-661	-618
Current transfers	367	196	118	120	103	103	100	100
Official	-1	0	-3	0	0	0	0	0
Private	368	196	121	120	103	103	100	100
Capital account balance	2000	1924	1398	2810	2341	2590	2678	2671
Capital transfers	71	160	91	115	71	71	71	71
Direct foreign investment	314	756	1914	2507	1700	2000	2200	2310
Portfolio investment	793	623	837	314	350	300	250	250
Credit extended (net)	167	16	-84	0	0	0	0	0
Credits received (net)	629	285	-261	-29	420	318	207	90
Disbursements	1843	1511	1543	931	1296	1279	1208	1100
Amortisation	-1214	-1226	-1804	-960	-876	-961	-1001	-1010
Short term capital (net)	27	84	-1098	-96	-200	-100	-50	-50
Errors and omissions (Inc. valuation changes)	-171	-390	74	0	0	0	0	0
Overall balance	-295	555	779	1696	1135	1301	1307	1251
Financing	292	-555	-779	-1697	-1135	-1301	-1307	-1251
Gross reserves (- = increase)	362	-502	-652	-1697	-1135	-1301	-1307	-1251
Use of Fund credit	-70	-53	-127	0	0	0	0	0
Financing gap	3	0	0	0	0	0	0	0
Memorandum items								
Current account balance (in percent of GDP)	-10.0	-5.0	-3.6	-5.4	-5.2	-4.9	-4.7	-4.3
Gross official reserves (US\$ million)	2923.3	3425.2	4076.8	5744.9	6908.3	8209.1	9516.3	10767.4
In months of imports of goods and services	2.3	3.1	3.3	4.2	4.7	5.2	5.5	5.8
Total external debt (US\$ millions)	11901.9	10517.9	10885.7	11170.5	11940.6	12559.0	13016.1	13356.2
(in percent of GDP)	55.9	53.4	56.7	53.9	51.2	47.9	44.3	40.8
Short term external debt (US\$ million)	4604.5	2706.0	2410.2	2314.0	2114.0	2014.0	1964.0	1914.0
Short term external debt adjusted (US\$ million) 1/	5830.9	4510.3	3370.2	3189.9	3074.6	3014.9	2973.9	2923.9
Reserves/short term debt (percent) 1/	50.1	75.9	121.0	180.1	224.7	272.3	320.0	368.3
Reserves/Broad money (percent) 1/	21.8	26.9	31.8	41.0	44.1	46.9	53.3	59.3
MLT External debt service/exports of goods and servic	13.9	15.0	17.7	10.0	8.9	8.8	8.5	7.7
GDP (US\$ millions)	21309.6	19706.1	19203.5	20708.5	23327.5	26212.9	29371.0	32760.4

Sources: Data provided by Slovak authorities and staff estimates

1/ Short term external debt is defined so as to include MLT repayments due the next year.

Table 5. Slovak Republic: Monetary Survey, 1999-2001 1/
(in actual exchange rates)

	1999 Dec	2000 Dec	2000 Dec	2001 Mar	2001 Dec
		Excluding Jan & March transfers 2/	Including Jan & March transfers 2/	Outcome	06/01 Staff Projection
	(in Sk billion)				
Net foreign assets, NIR definition 3/	49.2	104.1	104.1	101.6	184.6
Position of banks viz-a-viz non residents in Sk	...	17.8	17.8	22.6	17.8
Bonds held by non-residents	-2.8	-11.0	-11.0	-22.7	-23.0
Net foreign assets 3/	54.9	110.9	110.9	101.5	179.4
Net domestic assets (M3) 4/	492.3	522.6	522.6		
Net domestic assets (M2)	471.7	497.1	497.1	511.7	519.3
Domestic credit	575.6	610.6	622.0	631.4	652.6
Net credit to government	165.2	200.1	305.1	310.0	342.9
From banking system	58.6	54.3	159.3	148.6	176.7
State bonds and T bills held by banks	91.1	91.6	196.6		222.6
Other credit from banking system	-32.4	-37.3	-37.3		-45.9
Foreign financing	93.0	133.4	133.4	144.2	153.8
In foreign currency 5/	90.2	122.4	122.4	121.5	130.8
In Sk denominated bonds	2.8	11.0	11.0	22.7	23.0
Non-bank domestic financing 6/	13.6	12.4	12.4	17.1	12.4
Net credit to Property Fund	1.2	0.1	0.1	2.9	-30.9
Credit to enterprises and households 7/	409.2	410.4	316.8	318.5	340.6
In domestic currency	358.5	363.1	269.5	268.2	293.3
In foreign currency	50.7	47.3	47.3	50.3	47.3
Other items, net (M3) 8/	-83.3	-88.0	-99.4	-91.5	
Other items, net (M2), of which:	-103.9	-113.5	-124.9	-119.7	-133.2
M3	547.2	633.5	633.5	641.4	724.3
Other commitments to clients	7.0	13.1	13.1	11.1	13.1
State bonds and T bills held by non-bank subjects	13.6	12.4	12.4	17.1	12.4
Broad Money (M2) 9/	526.6	608.0	608.0	613.2	698.8
Koruna Broad Money	450.5	513.7	513.7	518.6	598.4
Currency	57.5	67.0	67.0	64.9	78.1
Deposits	469.1	541.0	541.0	548.3	620.7
of which: in foreign currency	76.0	94.4	94.4	94.6	100.4 10/

Table 5 (concluded). Slovak Republic: Monetary Survey, 1999-2001
(in actual exchange rates)

	1999	2000	2000	2001	2001
	Dec	Dec	Dec	Mar	Dec
Memorandum items (year-on-year percentage change, unless otherwise indicated)					
NDA, SPM definition 10/	477.3	503.9	503.9	511.6	514.2
OIN (M2), conventionally measured (Sk billion) 11/	8.3	39.1	27.7	41.5	27.8
Credit to miscellaneous debtors (Sk billion)	18.1		16.8		
Nominal GDP growth			9.0		9.9
M2	11.4		15.5		14.9
Change in M2 velocity, in %, Q4 (NSA)	-1.4		-5.6		-4.4
Koruna M2			14.0		16.5
M2-base money multiplier	4.5		5.4		5.70
Currency-deposits ratio	0.123	0.124	0.124		0.126
M3					
Net domestic assets	18.2		6.2		-0.6
NC to government (fiscal deficit), (Sk billion) 12/			34.3		37.8 13/
NC to NPF, in Sk billion. 12/					-30.9
Credit to enterprises and households	5.6		2.6		7.5
Change NIR NBS (US\$ million) 12/			948		1688
Change NFA banking system (US\$million)			1032		1821
Exchange rate (Sk/US\$) e-o-p	42.3		47.4		...

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

1/ Based on the Monetary Program underlying the staff monitored program, but updated in line with recent developments.

2/ In January 2001, privatization bonds equivalent to Sk 83.7 billion were issued, with which Sk 72.3 billion bank credit to the Slovak Konsolidation Agency (an enterprise) and Sk 11.4 billion bank credit to the Konsolidation bank were repayed. In March, a similar transaction took place for VUB, which decreased credit to enterprises by Sk 21.3 billion, and increased credit to the government by a similar amount.

3/ NFA is reduced by Sk 15 billion because of change in status of CSOB related claim (see also footnote 7).

4/ Assumes NFA is the same for M2 and M3.

5/ $Stock(t) = \text{revalued stock}(t-1) + \text{flow of new lending}$.

6/ Includes T bills held by non-bank subjects and non-residents (the data on T bills is not disaggregated).

7/ Excluding claims of banks on clients for non-bank services, but adding the Sk 15 billion CSOB related claim (see footnote 2).

8/ Calculated assuming that M3 concept of domestic credit is same as M2 concept.

9/ $M2 = M3 - \text{state bonds and T bills held by non-bank subjects and - "other commitments to clients"}$.

10/ M2 - NFA (NIR definition)

11/ M2 - NFA (NIR definition) - banking system credit to government - credit to NPF - credit to enterprises and households.

12/ Cumulative within year.

13/ Assumes that Article 12 expenditures are undertaken only to the extent that tax revenues are higher than budgeted.

Bank restructuring and expenditures on called guarantees are assumed to be financed from privatization revenues.

Table 6. Slovak Republic: Quarterly Indicators of Economic Performance 1/

	Actual, level		Cumulative flows from December 2000			
	December 31, 2000	March 31, 2001		June 30, 2001	September 30, 2001	December 31, 2001
		Program	Actual				Program
Fiscal targets						
Ceiling on general government deficit/net credit to the government 2/a/ (in millions of Slovak koruny)	30,249	5,988	-200	11,787	33,990	37,849
Ceiling on general government expenditures b/ (in millions of Slovak koruny)	362,557	90,038	86,383	192,808	292,836	392,142
Monetary targets						
Floor on net International Reserves of the National Bank of Slovakia c/ (in millions of US\$) 3/	3,753	-69	-71	92	318	1,762
Ceiling on net Domestic Assets of banking system d/ (in millions of Slovak koruny) 4/	503,900	9,700	8,200	10,400	25,200	4,800
Other						
Ceiling on contracting or guaranteeing by the government of external debt, 1-12 year maturity (in millions of Slovak koruny) 5/	...	6,500	0	19,950	19,950	21,950
Ceiling on contracting or guaranteeing by the government of short-term debt (less than 1 year maturity, excluding normal import credits) (in millions of Slovak koruny)	...	0	0	0	0	0

Sources: National Bank of Slovakia, and Ministry of Finance.

1/ Definitions of the concepts to be measured are set out in the Technical Memorandum of Understanding.

2/ Adjusted so as to include the impact of the January 2001 and March 2001 transfer of privatization bonds to banks (Sk 83.7 billion and Sk 21.3 billion, respectively).

3/ At fixed cross exchange rates of end-December 2000.

4/ Foreign currency component valued at fixed exchange rates and fixed cross rates of end-December 2000.

5/ The target ceiling has been adjusted for June through December to reflect actual foreign borrowing (euro 100 million equalling to Sk 4.35 billion) by the NPF in April.

a/ The limits on net credit to the government for March, June, and September will be adjusted upward by the amount of any shortfall in privatization receipts to be used for the retirement of debt of the health and pension funds.

b/ The limit on general government expenditure will be adjusted upward for unforeseen expenditure associated with natural disasters, and statutory expenditure of up to Sk 1.5 billion.

c/ The floor on the net international reserves of the NBS will be adjusted downward (upward) to reflect cumulative downward (upward) deviations from program assumptions about privatization revenues, and disbursements from the World Bank under the EFSAL.

d/ The ceiling on net domestic assets of the banking system will be adjusted downward (upward) to reflect cumulative upward (downward) deviations from program assumptions about privatization revenues, and disbursements from the World Bank under the EFSAL. The ceiling will also be adjusted to take account of the possible effects on the banking system data of the removal of the license of the Slovak Konsolidation Bank.

Table 7. Slovak Republic. Medium-Term Macroeconomic Framework, 1998–2005

	1998	1999	2000	2001 1/	2002	2003	2004	2005
	Staff projections							
(In percent)								
Real GDP growth	4.1	1.9	2.2	3.0	4.4	5.2	5.3	5.4
Inflation (CPI)	6.7	10.7	12.0	7.2	6.0	4.6	4.3	4.0
Inflation (CPI, e-o-p)	5.6	14.2	8.4	7.0	5.8	4.5	4.1	3.8
Core inflation (e-o-p)	5.2	7.0	4.6	4.1	3.9	3.7	3.5	3.4
Inflation (GDP deflator)	5.1	6.6	6.5	6.4	5.8	4.6	4.3	4.0
(In billions of koruny, current prices)								
Gross Domestic Product	751	815	887	972	1073	1181	1298	1422.1
Factor income (net)	-6	-12	-15	-15	-16	-18	-16	-9
Gross national income	745	803	872	957	1057	1164	1282	1413
Current transfers (net)	13	8	5	6	5	5	4	4
Gross national disposable income	758	811	877	963	1062	1168	1287	1417
Net exports of GNFS	-82	-44	-22	-43	-44	-45	-50	-57
Domestic demand	833	859	909	1015	1118	1226	1347	1479
Consumption	561.8	599.1	642.3	707.9	778.2	850.2	932.0	1022.0
Non-government	395.4	436.3	469.0	526.4	582.1	637.8	700.6	770.2
NPISH	5.0	4.1	4.6	4.8	5.2	5.6	6.1	6.7
Government	161.4	158.7	168.7	176.7	190.9	206.8	225.2	245.1
Gross national savings	196.4	211.9	234.9	255.0	284.0	318.1	354.5	395.4
Non-government	188.5	209.0	236.1	254.8	283.7	312.2	343.4	375.6
Government	7.9	2.8	-1.3	0.2	0.2	5.9	11.1	19.8
Gross capital formation	271.3	259.8	267.0	307.3	339.5	376.3	415.2	457.0
Non-government	227.3	229.0	237.0	269.3	302.6	335.8	371.0	408.6
Government	44.0	30.8	30.0	38.0	36.9	40.5	44.3	48.4
Savings-Investment gap ("current account")	-74.9	-47.9	-32.1	-52.3	-55.5	-58.2	-60.7	-61.6
Non-government net savings	-38.8	-20.0	-0.9	-14.5	-18.9	-23.7	-27.5	-32.9
Government net savings	-36.1	-28.0	-31.2	-37.8	-36.7	-34.5	-33.1	-28.6
(In percent of GDP)								
Gross national income	99.3	98.5	98.3	98.5	98.5	98.5	98.8	99.4
Gross national disposable income	101.0	99.5	98.9	99.1	99.0	98.9	99.1	99.7
Net exports of GNFS	-11.0	-5.3	-2.5	-4.5	-4.1	-3.8	-3.8	-4.0
Consumption	74.8	73.5	72.4	72.8	72.5	72.0	71.8	71.9
Non-government	52.7	53.5	52.9	54.2	54.2	54.0	54.0	54.2
Government	21.5	19.5	19.0	18.2	17.8	17.5	17.4	17.2
Gross national savings	26.2	26.0	26.5	26.2	26.5	26.9	27.3	27.8
Non-government	25.1	25.6	26.6	26.2	26.4	26.4	26.5	26.4
Government	1.1	0.3	-0.1	0.0	0.0	0.5	0.9	1.4
Gross capital formation	36.1	31.9	30.1	31.6	31.6	31.9	32.0	32.1
Non-government	30.3	28.1	26.7	27.7	28.2	28.4	28.6	28.7
Government	5.9	3.8	3.4	3.9	3.4	3.4	3.4	3.4
Savings-Investment gap ("current account")	-10.0	-5.9 2/	-3.6	-5.4	-5.2	-4.9	-4.7	-4.3
Non-government net savings	-5.2	-2.4	-0.1	-1.5	-1.8	-2.0	-2.1	-2.3
Government net savings	-4.8	-3.4	-3.5	-3.9	-3.4	-2.9	-2.6	-2.0
(annual percentage change, constant prices)								
GDP	4.1	1.9	2.2	3.0	4.4	5.2	5.3	5.4
Domestic demand	9.5	-4.6	-1.3	5.3	4.5	5.2	5.3	5.4
Consumption	5.3	-2.2	-2.7	3.6	4.5	4.9	5.0	5.2
Non-government	5.3	0.1	-3.4	5.0	4.9	5.0	5.2	5.4
Government	4.0	-6.9	-0.9	0.1	3.3	4.6	4.4	4.7
Gross capital formation	19.3	-9.7	1.8	8.9	4.6	6.0	5.8	5.7
Non-government	24.4	-5.3	3.1	7.8	6.2	6.1	5.9	5.7
Government	-3.0	-34.3	-8.7	19.2	-8.2	4.8	4.9	5.3
Exports of GNFS	12.2	3.4	15.9	7.5	7.5	7.3	6.8	7.2
Imports of GNFS	19.9	-6.1	10.2	10.5	7.6	7.2	6.7	7.0

Sources: Slovak authorities; and staff estimates and projections.

1/ On the basis of government's expenditure plans as outlined in the draft 2001 budget and staff projections for revenue.

2/ The 1999 S-1 gap implied by national accounts is different from the current account reported in BOP statistics.

Slovak Republic: Fund Relations
(As of June 15, 2001)

- I. **Membership Status:** Joined: 01/01/1993; Article VIII
- II. **General Resources Account:**
- | | <u>SDR Million</u> | <u>%Quota</u> |
|---------------------------|--------------------|---------------|
| Quota | 357.50 | 100.0 |
| Fund Holdings of Currency | 357.50 | 100.0 |
- III. **SDR Department:**
- | | <u>SDR Million</u> | <u>%Allocation</u> |
|----------|--------------------|--------------------|
| Holdings | 0.47 | N/A |
- IV. **Outstanding Purchases and Loans:** None
- V. **Financial Arrangements:**
- | <u>Type</u> | <u>Approval Date</u> | <u>Expiration Date</u> | <u>Amount Approved (SDR Million)</u> | <u>Amount Drawn (SDR Million)</u> |
|-------------|----------------------|------------------------|--------------------------------------|-----------------------------------|
| Stand-by | 07/22/1994 | 03/21/1996 | 115.80 | 32.15 |
- VI. **Projected Obligations to Fund:** None
- VII. **Exchange Rate Arrangement:**
- The currency of the Slovak Republic is the Slovak koruna, created on February 8, 1993 upon dissolution of the currency union with the Czech Republic. A single exchange rate applies to all transactions within the convertible currency area. The currency was floated on October 1, 1998. The exchange rate stood at Sk50.466 per U.S. dollar and Sk43.030 per euro on June 15, 2001.
- VIII. **Article IV Consultation:**
- Last consultation with the Slovak Republic concluded on July 21, 2000 (SM/00/149, July 7, 2000).
- IX. **Technical Assistance:** See the attached table.
- X. **Resident Representative Post:** The post in Bratislava was closed in September 1997.

Slovak Republic: Technical Assistance, 1991–2001¹

Department	Timing	Purpose
MAE	April 1991 September/October 1991 February/March 1992	Mission to the State Bank of Czechoslovakia; design of monetary policy instruments and operating procedures; and development of foreign exchange operations and the legal framework for central and commercial banking and the reorganization of the State Bank
	May 1991 and December 1992	Staff visits on monetary instruments
	Through September 1991	Regular visits by experienced central banker
	December 1992	Mission to the newly-established Slovak Central Bank: monetary instruments, operations and analysis, foreign exchange operations, and banking supervision
	Since January 1993	Several expert visits on banking supervision
	January 1993	Expert visit on foreign exchange operations
	February 1993	Staff visit on monetary operations and analysis
	March 1993	Mission on payments and clearing systems, central bank accounting, and central bank organization
	June 1993	Expert visit on monetary projections and analysis
	November 1993	Expert visit on monetary operations and analysis
	Since November 1993	Resident advisor on banking supervision, co-sponsored by the EC-PHARE
	February/March 1994	Mission on monetary analysis and operations, foreign exchange operations, banking supervision and regulation, central bank accounting, clearing and payment system, and central bank organization
	May 1994	Advise to the NBS Governor, visit by senior advisor
	September 1994	Advise to the NBS Governor, visit by senior advisor
	January 1995	Expert visit on organizations and methods
	January 1995	Mission on issues in monetary and foreign exchange operations, banking supervision, payments, accounting, legal, and organization and management
	May 1995	Mission on issues in monetary and foreign exchange operations, banking supervision, payments, accounting, legal, and organization and management
December 1995	Expert visit on monetary operations and research	
April 1997	Mission on the banking law, monetary policy implementation, coordination between monetary operations and government debt management, and research work done by the NBS	

¹With the exception of the MAE mission in December 1992, technical assistance in 1991–92 was delivered to the Czech and Slovak Federal Republic.

Department	Timing	Purpose
	October 1997	Mission on monetary statistics compilation procedures, and classification of bank accounts in monetary statistics
	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
FAD	February and July 1991	Advice on the design of new corporate and personal income taxes
	May and September 1991	Advice on policy and administrative aspects of the introduction of VAT
	Since December 1991	Regular visits by FAD consultant on VAT administration
	March 1992	Advice on administration (particularly VAT)
	April 1992	Examination of public financial management
	April 1993	Follow-up mission on public financial management
	May 1993	Mission on tax policy and administration
	June 1994	VAT administration, visit by expert
	March/April 1998	Tax and customs administration, and administration of social security contributions
	September/October 1999	Review macro fiscal management and system for monitoring and consolidating fiscal operations; review legislative and institutional setting for public expenditure management; and assess progress in establishing state treasury
	April 2000	Tax administration
	February 2001	Tax administration follow up
	April 2001	Public Finance Management follow up
LEG	April and July 1991	Assistance with the drafting of new corporate and personal income tax laws
	October 1991	Assistance with the drafting of income tax and VAT laws
	January 1992	Assistance with the drafting of the tax administration law
	March 1992	Follow-up visit by consultant focusing on the income tax and tax administration laws
	May 1993	Assistance with revision of tax reform legislation
	September 1993	Assistance with income tax legislation
	May 1995	Assistance with drafting of the foreign exchange act, and acceptance of Article VIII obligations
STA	June 1991	Mission on government finance statistics

Department	Timing	Purpose
	September 1991	Mission on balance of payments statistics
	May 1993	Mission on monetary statistics
	December 1993	Mission on balance of payments statistics
	January 1994	Mission on government finance statistics
	February 1994	Mission on money and banking statistics
	November 1994	Mission on money and banking statistics
	November 1995	Mission on national accounts statistics
	November/December 1995	Mission on balance of payments statistics
	October 1997	Mission on money and banking statistics
	September/October 1998	Mission on Dissemination Standards Bulletin Board
	February 1999	Mission on money and banking statistics
	February 2000	Mission on national accounts and price statistics
	March 2001	Multisector mission

Slovak Republic-Relations with the World Bank
(As of June 2001)

The Slovak Republic became a member of the World Bank on January 1, 1993, by joint succession with the Czech Republic to the membership of the Czech and Slovak Federal Republic.

A Structural Adjustment Loan (SAL) (US\$450 million), approved in June 1991 with Czechoslovakia, was fully disbursed. The Czech and Slovak Republics assumed repayment obligations in the ratio of 2:1. World Bank lending to Slovakia after independence was limited to two operations. A US\$55 million telecommunications loan, approved in May 1993, helped to strengthen the international and domestic long-distance networks, and, in recent years sector privatization. An Economic Recovery Loan of US\$80 million, approved in November 1993, provided support to the country's fiscal and structural adjustments associated with the shocks following the breakup of the Federation. The loan supported reforms in four areas: (a) fiscal retrenchment; (b) strengthening and diversifying the fiscal sector; (c) continued privatization, private sector development, and enterprise restructuring; and (d) a more efficient social safety net.

A comprehensive Country Economic Memorandum (CEM) which evaluated the transformation progress of Slovakia's economy and the main EU accession challenges was completed in early 1998.

Since late 1998, when a new Government took office, the Bank's program of assistance expanded significantly. Initial support focused on reforms in the enterprise and financial sectors. An anti-corruption diagnostic was conducted to identify pocket areas of corruption and support the government's anti-corruption reform program, and the Bank provided technical support to public sector reform and undertook assessments of public procurement and financial accountability. Assistance was also initiated in the social sectors; a social sectors expenditures review and an assessment of poverty in the context of a study on employment and growth are being completed. Support for reforms in social protection are being supported through the preparation of a Social Benefits Administration Reform Project.

A first Bank Group Country Assistance Strategy (CAS) for Slovakia was presented to the Board in February 2001. The overall strategic objective of the CAS is to put Slovakia on a path of rapid and sustained convergence with its Western European neighbors and improve living conditions, particularly among the vulnerable segments of the population. A program of lending and non-lending support would focus on: (i) completing transformation reforms, restoring high growth, and maintaining economic stability; (ii) strengthening governance and institutions; and (iii) improving social security, enhancing human development and meeting environmental standards. The CAS envisages IBRD/IFC commitments in the order of \$500 million for the next three years in the base case, and about \$850 million in the high case. An Enterprise and Financial Sector Adjustment Loan for € 200 million has been negotiated, and preparation of a Social Benefits Administration Reform Project, a Public Finance Reform Project, a Judicial Reform Project, and a Health Sector Project are underway.

IFC has also expanded its activities, with initial focus on the financial sector and enterprise restructuring. It is also providing advice on foreign investment and improving the business climate in general. MIGA has several guarantees outstanding.

SLOVAK REPUBLIC: STATISTICAL ISSUES

1. From the point of view of macroeconomic analysis and policy making, the quality of the data, in particular of the national accounts, has improved in recent years. The main issues remaining are (i) the lack of reliable data on prices and volume of imports and exports, (ii) a lack of timely data on the overall operations of the general government, (iii) inconsistencies between government accounts and national accounts on government consumption, and (iv) the absence of comprehensive data on public and private enterprises. Slovakia has subscribed to the Special Data Dissemination Standard (SDDS), meets the SDDS specifications for coverage, periodicity, and timelines of the data, and for the dissemination of the advance release calendars, and its metadata are posted on the Fund's Dissemination Standards Bulletin Board on the Internet.

2. With regard to timeliness and public access, the authorities in general follow a free and open data publication policy. Data are promptly released to news services, and are also published regularly in various monthly and quarterly statistical publications, and on the Internet¹ according to a pre-announced schedule. Changes in definitions and coverage, however, often diminish the usefulness of published data. Data on core surveillance variables are provided regularly to the Fund, and with minimal lags: a week or less for exchange rates and foreign exchange reserves; three weeks or less for general government financing and detailed state budget implementation data; ten days to a month for consumer prices, reserve money, broad money, and interest rates; two months for foreign trade data; and about three months for other fiscal, balance of payments, and national accounts data.

Real sector and prices

3. Much progress has been made in the elaboration of the Slovak national accounts statistics. However, output estimates for the last few years may yet have to be revised in the future. An important outstanding issue is the construction of reliable price deflators for imports and exports that would enable better decomposition into volume and price changes. The unit value trade price indices—on which the national accounts trade price deflators are based—are currently not appropriately adjusted for quality changes. Although the problem is recognized by the statistical authorities, it is at present unclear what they intend to do to correct the problem. In addition, the contribution of the government sector to consumption and value added is difficult to reconcile with fiscal data.² Finally, very strong seasonality in stock building complicates analysis.

¹Data are available on the web site of the Slovak Statistics Office (www.statistics.sk), the National Bank of Slovakia (www.nbs.sk), and the Ministry of Finance (www.finance.gov.sk).

²The Slovak Statistics Office (SSO) has indicated that a change in the methodology to derive government consumption that was carried out for the 1999 data will be carried out for previous periods only at the time of a general revision of the national accounts.

4. In the area of consumer price indices, it is important that historical data are produced for core inflation.

5. In the enterprise sector, it would be very useful if the line ministries produced systematic accounts of the financial positions of the public enterprises under their purview. It would also be helpful if the authorities provided more detailed data on privatization transactions.

Fiscal sector

6. General government statistics are compiled annually in accordance with the methodology of the 1986 *Manual on Government Finance Statistics (GFSM)* for internal use, publication in the *GFS Yearbook*, and dissemination on the MOF website in compliance with the SDDS. In accordance with the EU *acquis communautaire* the authorities report semi-annually on general government net lending/borrowing. Monthly reconciliation of government operations above and below-the-line is restricted to budget transactions. The cash transactions of the extrabudgetary, social security, and municipal governments can only be reliably measured from below-the-line, which is the method employed in monitoring the operations of general government under the Fund's SMP. The authorities will improve the coverage of central government by absorbing ten of the twelve extrabudgetary funds in the 2002 budget. The introduction of a modern treasury system in 2002 is expected to improve fiscal control by providing a means of recording expenditures at the planning and commitment stages. This will enable the treasury to monitor and control the creation of arrears. However, the MOF has indicated that the coverage of monthly data will be difficult to improve further because of the political pressure to preserve the operational independence of the privatization funds and municipalities, and the (about to be established) regional governments. The recent multisector STA mission recommended that the authorities implement the classifications and reporting concepts of the revised *2001 GFS Manual* in the new treasury system.

External sector

7. The Slovak Republic provides balance of payments statistics in a timely manner. The balance of payment statements are presented in two formats, an analytical presentation and the standard presentation, and are reported on a quarterly basis. Banks are now reporting their arbitrage transactions accurately. Improvements have also been made in reporting nonresidents' claims and liabilities in Slovak koruny. Information on external debt, including short-term debt, is reported on a timely basis. Some problem areas remain, including: (a) the measurement of inward portfolio investment; (b) the need for more detailed and timely information on publicly guaranteed external debt; and (c) the need to improve data compilation on the composition of exports to enable the assessment of export behavior (e.g., by being able to exclude re-exports with low value added). A March 2001 STA mission recommended the adoption of a conduct survey for obtaining data on transportation, travel,

and direct investment, and provided model survey forms for this purpose. The mission also found deviations from the *BPM5* in recording NBS gold swaps . In addition, repurchase agreements (repos) with foreign governments and multilateral organizations are excluded from the BOP statistics. The mission recommended that gold swaps and repos should be treated as collateralized loans and recorded on a gross basis.

Monetary sector

8. Monetary statistics are of good quality, and are reported on a timely basis to the Fund. An STA mission that went to Bratislava in March 2001 noted that data sources for monetary statistics are being progressively adapted to meet the European Central Bank requirements, including for the valuation of financial instruments based on fair values. The mission recommended corrections in the treatment of securities that underlie repurchase agreements; in the classification of data items reported in unclassified assets and liabilities; and in the coverage of the banking systems' position with the general government. In particular, the mission recommended that monetary accounts should exclude data relating to transfer of securities used as a collateral for repurchase agreements; holdings of NBS bills by commercial banks should be separately identified to facilitate a consistency check of positions between NBS and the commercial banks; Slovak Consolidation Agency (SKA) should be classified, starting from the date of its registry, as a unit of general government rather than as a nonfinancial public enterprise; gold swaps should be treated as collateralized loans and recorded on a gross basis; and, repurchase agreements between banks and the National Property Fund, which is considered part of general government, should be treated as collateralized loans and separately identified.

Slovak Republic: Core Statistical Indicators
(as of June 29, 2001)

	Exchange Rates	International Reserves	Central Bank Balance Sheet 1/	Reserve/ Base Money	Broad Money	Interest Rates 2/	Consumer Price Index	Exports/ Imports	Current Account Balance	Government Balance	GDP/GNP	External Debt
Date of Latest Observation	6/29/01	6/20/01	6/10/01	6/20/01	5/30/01	6/29/01	5/01	5/01	3/01	5/01	Q1/00	3/01
Date Received	6/29/01	6/22/01	6/20/01	6/30/01	5/14/01	6/29/01	6/20/01	6/28/01	6/28/01	6/01/01	6/14/01	6/28/01
Frequency of Data 3/	D	W	M	O 4/	M	D	M	M	M	M	Q	M
Frequency of Reporting 3/	D	W	M	O 4/	M	D	M	M	M	M	Q	M
Source of data 5/	N	N	N	N	N	N	N	N	N	A	N	N
Mode of Reporting 6/	E	E	E	E	E	E	E	E	E	E	E	E
Confidentiality 7/	C	C	C	C	C	C	C	C	C	C	C	C
Frequency of Publication 3/	D	W	M	O 4/	M	D	M	M	M	M	Q	M

1/ In addition to the complete balance sheet published monthly, three times per month a "10-day return" is published.

2/ Interbank rates. Deposit and lending rates are reported on a monthly basis. T-bill and government bond rates are reported at issue.

3/ D=daily; W=weekly; M=monthly; Q=quarterly; O=other.

4/ Reported three times per month.

5/ A = Central Bank, Ministry of Finance, or other official agency; N=Official Publication or Press Release.

6/ E = Electronic Data Transfer.

7/ C = Unrestricted use.

Statement by the IMF Staff Representative
July 27, 2001

1. This statement provides information on the performance under the staff-monitored program (SMP; SM/01/154, 5/29/01) and macroeconomic developments that has become available since the issuance of the staff report (SM/01/220, 7/13/01). This information does not alter the thrust of the staff appraisal.
2. Based on preliminary information, all structural benchmarks for end-June under the SMP were observed, with the exception of government approval of a timetable for the gradual increase in the retirement age.¹ The staff also has received information showing that the fiscal program is in line with the SMP. Monetary survey data show that the ceiling on net credit to government was observed as of end-June; however, additional information will be needed to ascertain observance of all other financial benchmarks under the program.²
3. Confirming the trends and assessment presented in the staff report, recent information continues to point to relatively buoyant economic activity: industrial sales remained strong, with a year-on-year rise in real terms of 8 percent in May, while retail sales were more subdued, growing by about 2.2 percent. Unemployment remained practically unchanged in June at 17.7 percent, reflecting a decline in employment in construction—production in the sector was flat in May—offset by higher employment in industry. Imports surged in the first five months of 2001 by 21 percent in real terms year-on-year, while the pace of exports slowed. The widening of the external current account underscores the need to achieve the government's fiscal targets.
4. The Slovak koruna has remained strong, showing virtually no effect from recent turmoil in emerging markets. The National Bank of Slovakia left interest rates unchanged at its monthly monetary meeting last week.

¹ Although the Ministry of Labor has approved a timetable for the gradual increase of the retirement age, the government has still not endorsed such a timetable pending the results of discussions between representatives of the unions, the business sector, and the government, which should be concluded soon.

² Financial benchmarks under the SMP comprise ceilings on the general government deficit, the general government expenditures, the net domestic assets of the banking system, and the contracting and guaranteeing of external debt by the government, and a floor on the net international reserves of the central bank.



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IMF Concludes 2001 Article IV Consultation with the Slovak Republic

On July 27, 2001, the Executive Board of the International Monetary Fund (IMF) concluded the Article IV consultation with the Slovak Republic.¹

Background

Although the Slovak economy rebounded quickly from the economic disruption caused by abandoning central planning and declaring independence—with the economy growing on average 5 percent in 1993-98—macroeconomic imbalances brought the Slovak economy under a cloud of vulnerability in 1998. At the same time, despite high growth, the unemployment rate never fell below 12 percent.

The present government assumed office in October 1998 amidst signs of vulnerability, including a substantial depreciation of the currency upon its forced flotation. It embarked on policies to restore macroeconomic balances and lay the basis for sustainable economic growth. An ambitious fiscal plan introduced in 1999 was based on expenditure cuts, and increases in indirect taxes and administered prices. At the same time, the authorities began a serious effort to reform the financial sector, another source of vulnerability.

The fiscal tightening, a reduction in households' purchasing power and hardening budget constraints led to a sharp declines in domestic demand in 1999 and 2000, but a strong improvement in net trade performance partly offset their impact on aggregate demand, and GDP grew around 2 percent per year in 1999-2000. In these circumstances, balance of

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. 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. This PIN summarizes the views of the Executive Board as expressed during the July 27, 2001, Executive Board discussion based on the staff report.

payments difficulties eased considerably: the external current account deficit narrowed to 3.5 percent of GDP in 1998 from 10 percent of GDP in 2000 and official reserves increased. An unwelcome side effect of the slow growth in 1999-2000 has been a further rise in unemployment, to close to 18 percent in early 2001.

Data for the first half of 2001 suggest that economic growth was picking up, the budget was on track, and inflation still subdued, although the current account deficit started to widen. The tentative recovery of domestic demand at the end of 2000 seemed to have carried over into 2001, and although the unemployment rate remained high in the first quarter, employment increased year-on-year for the first time since 1997. Data for the first months indicate that headline and core inflation remained within the indicative band set by the NBS for 2001, which aims at headline inflation of 6.7–8.2 percent by end-2001.

On the structural side, the authorities have gone ahead with their plans to privatize the main state-owned banks, and prepare for privatization the large state-owned enterprises. The government divested itself of substantial holdings in the banking sector, and has made progress toward the restructuring and divestiture of the gas and electricity companies, the oil transportation company, and remaining holdings in the banking sector. The government's agenda for the future includes reforms in the health, pension, and social benefits systems, as well as in the tax system, and public enterprise restructuring. The authorities' strategy to deal with high unemployment centers around increasing labor market flexibility, rationalizing the social benefits system, and improving the employability of vulnerable groups.

Executive Board Assessment

Directors commended the authorities for the progress made over the last two years in reducing large macroeconomic imbalances, observing that balance of payments difficulties have eased considerably and fiscal discipline is being restored. They considered that the challenge in the period ahead was to implement the strategy of fiscal consolidation, disinflation, and structural reform in a determined fashion. In this connection, Directors welcomed the authorities' adoption of an ambitious economic program—to be monitored by the staff²—that addresses comprehensively the main weaknesses of the Slovak economy and will allow a successful completion of the EU accession process. Directors urged the authorities to implement the program in a forceful and timely fashion.

In order to relieve external current account and inflation pressures, Directors encouraged the authorities to make every effort to achieve their fiscal deficit targets for 2001 and 2002. They supported the authorities' emphasis on restraining expenditures, and encouraged them to resist pressures for additional spending in the run-up to the September 2002 elections. In particular, Directors stressed the need to contain the wage bill and social transfers, reduce transfers and state guarantees to enterprises, and strengthen control over investment expenditure. On the revenue side, Directors advised the authorities to resist calls for tax cuts until improvements in tax collections from better administration were established. While welcoming the decentralization of fiscal responsibilities planned by the Slovak government, Directors stressed the importance of imposing

² See <http://www.imf.org/external/np/Loi/2001/svk/01/index.htm>.

controls to limit local government borrowing and of improving these governments' administrative capacity prior to the devolution of fiscal responsibilities from the central government.

Directors expressed concern that the large anticipated flows of privatization revenues could lead to nontransparent uses, loss of financial control, and an expansionary fiscal stance. Therefore, they recommended that the authorities adopt legislation to ensure that privatization receipts will be used exclusively to retire debt and reform the pension system, and to monitor the uses of privatization revenues closely.

Directors agreed that to strengthen the credibility of policies aimed at securing macroeconomic balance and the inflation targets, a clear medium-term path for fiscal consolidation was essential. They commended the authorities for announcing targets for the overall fiscal deficit through 2005 that should make room for private investment without straining the current account. Given that these targets are to be achieved primarily through expenditure restraint, Directors noted the need for advancing technical preparation for expenditure cuts as part of a well-articulated plan of fiscal reforms. They therefore urged the authorities to prepare a detailed multiyear fiscal plan, building on their commitments under the staff-monitored program.

Directors supported the authorities' intention to use published inflation benchmarks to guide their monetary policy decisions. They agreed that the koruna remains appropriately competitive, and, given the government's anti-inflationary stance, considered that the exchange rate should continue to float freely, with only exceptional intervention by the central bank to avoid sharp oscillations in the koruna. In order to bring inflation down further, Directors agreed that, along with fiscal consolidation, monetary policy should aim at keeping real interest rates significantly positive over the medium term. Looking ahead, Directors pointed out that tensions may arise between a fiscal policy supportive of domestic activity and a monetary policy targeted on disinflation. Should these arise, they should be resolved by tightening fiscal policy, so as not to crowd out private investment and weaken external competitiveness.

Directors welcomed recent progress in strengthening the banking system, including efforts to privatize the state-owned banks and to strengthen banking supervision. They emphasized the importance of completing this process, and of moving ahead with enhancing the supervisory and regulatory framework of the banking system to avoid a recurrence of the bad loan problem. They cautioned that further delays in deciding on an appropriate institutional set-up for banking supervision might raise questions about the authorities' determination to enhance such supervision.

Directors welcomed the government's focus on increasing the role of the private sector and of foreign direct investment, including through recent efforts to accelerate enterprise restructuring and privatization. They urged the authorities to adhere to their plans to privatize assets in the energy sector, which should be reformed to improve efficiency and develop a competitive environment.

Directors noted with concern the persistently high level of unemployment. While the closure of nonviable enterprises and the elimination of redundancies was responsible for the jump in unemployment in the early years of transition, Directors considered that this situation could have been ameliorated over time by job creation in the new private sector. However, private enterprise hiring has been rather sluggish, reflecting, to a large extent, rigidities in the labor market, notably an inflexible labor code and still-high payroll taxes. Thus, Directors welcomed the authorities' efforts to increase labor market flexibility, but recommended more decisive steps to simplify hiring and

dismissal procedures. They also noted the need to limit the generous social assistance in order to reduce the disincentives to job search, and to rationalize and better target the social safety net. Over the medium term, as the fiscal situation permits, a reduction in payroll taxes would help boost labor demand.

Directors were encouraged that the Slovak Republic subscribes to the Special Data Dissemination Standard, and commended the authorities for the good quality of the data.

Public Information Notices (PINs) are issued, (i) at the request of a member country, following the conclusion of the Article IV consultation for countries seeking to make known the views of the IMF to the public. This action is intended to strengthen IMF surveillance over the economic policies of member countries by increasing the transparency of the IMF's assessment of these policies; and (ii) following policy discussions in the Executive Board at the decision of the Board.

Slovak Republic: Selected Economic Indicators

	1997	1998	1999	2000
	(Percent, change, period average)			
Real sector				
Real GDP	6.2	4.1	1.9	2.2
Consumer prices				
Period average	6.1	6.7	10.7	12.0
12 months to end of period	6.4	5.6	14.2	8.4
Gross industrial output (constant prices)	2.2	3.6	4.1	6.9
Real wages in industry				
PPI-based	6.4	4.7	4.0	0.4
CPI-based	4.7	1.3	-2.8	-2.9
Employment in industry	-2.0	-4.1	-3.0	-3.0
Unemployment rate, period average	12.9	14.0	17.5	19.3
Real effective exchange rate 1/				
CPI-based	6.1	-1.4	-2.0	9.6
ULC-based	9.7	-6.8	-11.3	1.9
	(Percent of GDP)			
General government finances				
Revenue	42.8	40.5	41.6 2/	39.2
Expenditure	48.4	45.3	45.1 2/	42.7
Balance 3/	-5.6	-4.8	-3.4	-3.5
State budget balance	-2.6	-2.2	-1.7	-1.7
	(Percent change, end of period, unless otherwise indicated)			
Money and credit				
Net domestic assets	8.7	10.9	9.5	6.2
Credit to enterprises and households	2.2	5.8	4.6	0.3
Broad money	8.8	4.2	11.4	15.5
Interest rates (in percent, end-of-period)				
Lending rate (short-term)	21.6	18.9	16.4	10.7
Deposit rate (one-week)	17.1	16.2	12.1	6.0
Velocity	4.4	1.0	-1.4	-5.6
	(US\$ billion, unless otherwise indicated)			
Balance of payments				
Merchandise exports	9.6	10.7	10.2	11.9
(percent change)	(9.5)	(11.2)	(-4.9)	(16.8)
Merchandise imports	11.7	13.1	11.3	12.8
(percent change)	(5.6)	(11.6)	(-13.6)	(13.4)
Trade balance	-2.0	-2.4	-1.1	-0.9
Current account	-2.0	-2.1	-1.0	-0.7
(percent of GDP)	(-10.0)	(-10.0)	(-5.0)	(-3.5)

Slovak Republic: Selected Economic Indicators

	1997	1998	1999	2000
Official reserves, end-period	3.3	2.9	3.4	4.1
(in months of imports of G & NFS)	(2.9)	(2.3)	(3.1)	(3.3)
(in percent of broad money)	(25.2)	(23.8)	(27.5)	(31.8)
Gross reserves of banking system	6.5	6.0	4.4	5.6
Gross external debt, end-period	9.8	11.9	10.5	10.9
Gross external debt, end-period (in percent of GDP)	47.8	55.9	53.4	56.7
Short-term debt (end-of-period) 4/ 5/	3.5	3.8	4.5	3.4
Short-term debt (end-of-period) 4/ 6/	2.3	2.6	2.7	2.4
Official reserves to short-term debt (in percent) 4/ 6/	143.4	112.2	127.2	253.6
Memorandum items:				
GDP, current prices (Sk billions)	686.1	750.8	815.3	887.2
Exchange rate (Sk/U.S. dollar)				
Period average	33.6	35.2	41.4	46.2
End of period	34.8	36.9	42.3	47.4
Public debt (percent of GDP)		23.7	23.6	25.3

Sources: Slovak Statistical Office; and IMF staff calculations.

1/ Calculated for trade partners of Germany, France, Austria, Italy, Czech Republic, Poland, and Hungary.

2/ Includes Sk 23.5 billion in exceptional NBS profits used for the equity injection into banks.

3/ Overall balance, excluding privatization proceeds and guarantees.

4/ Debt and gross reserves are reduced by US\$2 billion in 1997 and 1998 to take into account offsetting claims and liabilities of two Slovak subsidiaries of foreign banks with their parent companies.

5/ Short-term debt is defined so as to include MLT debt due in the subsequent year.

6/ Short-term debt is defined so as to exclude MLT debt due in the subsequent year.

**Statement by Willy Kiekens, Executive Director and Juraj Sipko, Assistant to
Executive Director for the Slovak Republic
July 27, 2001**

The Slovak authorities wish to thank Mr. Fernández-Ansola and his team for their advice and recommendations for future policies. The discussions with the staff have been most encouraging. My authorities are also grateful for the comprehensive technical assistance provided by the Fund and the World Bank in recent years.

The constructive dialogue maintained by the Slovak authorities and the Fund, including Slovakia's staff-monitored program (SMP), has assisted the authorities in developing a consistent macroeconomic and structural reform strategy and arriving at a broad consensus on the way forward. This consensus has greatly strengthened confidence in the authorities' willingness and ability to make the tough decisions needed to address the major challenges of macroeconomic stabilization and restructuring the financial and real sectors.

The Slovak Republic does not presently need financial assistance from the Fund, but would be encouraged by a positive assessment of its progress and achievements till now. The SMP will provide the macroeconomic framework for an Enterprise and Financial Sector Adjustment Loan (EFSAL) from the World Bank, which will be considered by the Bank Board on August 2, 2001. Slovakia's Memorandum of Economic and Financial Policies (MEFP) under the SMP focuses mainly on fiscal consolidation, acceleration of restructuring, and preparations for EU accession.

Slovakia's achievements in the period 1999-2000 include a resumption of economic growth, a decreasing public deficit, continued lowering of inflation, a shrinking current account deficit, and growing foreign exchange reserves. In addition, the authorities are making efforts to strengthen the supervision of the financial sector. During the year 2000, Slovakia joined the OECD.

Real Sector Development

The main target set by the MEFP approved this May is to put the Slovak economy on a sustainable path and accelerate Slovakia's progress toward EU accession. The stringent fiscal measures adopted two years ago are now bearing fruit in the form of economic growth.

Despite the slowdown in the EU countries, which are Slovakia's main market, the Slovak economy is recovering. Economic growth increased from 1.9 percent in 1999 to 2.2 percent in 2000, and is expected to reach 3.2 percent this year. This growth is fueled by domestic demand, especially increased household consumption and higher real wages. In addition, increasing fixed investments, mostly financed by capital inflows, are reinforcing economic growth.

During the first six months of 2001, the trade balance deteriorated slightly. Exports were affected by the slowdown in the EU countries, while imports grew with the elimination of

import surcharges, increased domestic demand, and increased foreign direct investment. This worsening of the trade balance creates little risk of external imbalances, however, as the current account deficit is mostly financed by the FDI.

Fiscal Policy

The authorities regard continued fiscal adjustment as the cornerstone of their medium-term policy aimed at achieving sustainable growth and preparing for EU accession. They are committed to increasing revenues while restraining expenditures. Implementation of the budget through June has been consistent with these objectives: revenues were slightly higher than expected, while expenditures were held to about 85 percent of the ceiling under the SMP.

To increase the transparency and efficiency of the public finances, the number of extra-budgetary funds will be cut from 12 to two at the beginning of the next year. Slovakia is also benefiting from a comprehensive program of technical assistance from the World Bank, aimed at improving the management of the public finances.

The government is preparing its preliminary budget proposal for next year. The present aim is to reduce the general government deficit from this year's target of 3.9 percent of GDP to 3.4 percent in 2002. The authorities join the staff in anticipating strong budgetary pressures in the coming year—an election year—but remain committed to the steadfast implementation of fiscal consolidation.

Having acknowledged in May 2001 the paramount importance of fiscal consolidation, the Ministry of Finance has prepared a Medium-Term Financial Strategy for the period 2001-2004, which forms part of Slovakia's Pre-Accession Economic Program with the EU. This strategy will be set forth in the annex to the state budget for 2002. The general government deficit will gradually be reduced (excluding bank restructuring costs) from 3.4 percent of GDP in 2002 to 2.6 percent in 2004.

The authorities are paying special attention to unemployment. Even though unemployment decreased from 18.2 percent last year to a 17.7 percent by June of this year, it is still a major concern for the authorities and imposes heavy burden on the budget. The authorities agree with the staff that the absence of measures against distortions in the labor market has worsened the employment problem, and are responding with comprehensive and appropriate countermeasures. These measures focus on promoting a variety of alternative work arrangements and increasing the geographic mobility of the labor force, and the government is looking into additional ways to increase labor market flexibility.

Monetary and Exchange Rate Policies

Monetary policy during 2000 was conducted under conditions of continuing macroeconomic stabilization. The current account deficit and the fiscal deficit were reduced, the exchange rate was relatively stable, and inflation behaved well. Monetary aggregates were strongly

affected by the restructuring of the credit portfolios of selected commercial banks, and by the privatization of several major Slovak companies. As to monetary policy, the authorities agree with the staff that the main goal should remain the lowering of inflation. In the view of the authorities, the recent tendency toward appreciation of the koruna is in line with developments in the productivity of the Slovak economy. The National Bank of Slovakia (NBS) intends to let the exchange rate float almost freely, with only exceptional intervention in the market to avoid sharp oscillations in the value of the koruna.

The deterioration of the trade balance during the first half of this year forced the Central Bank to revise, in May, its monetary program for 2001. The program now aims at achieving a core inflation rate of 3.6-5.3 percent, accompanied by headline inflation of 6.7-8.2 percent. Under this program the current account deficit is expected to reach 5 percent of GDP, which is larger than last year, due to the import of technology. This deficit will be financed by FDI. Strong revenues expected from privatization during the second half of the year, and the National Bank of Slovakia is already preparing to sterilize them. The revised program assumes that the broad money will grow by about 15.9 percent this year.

New Legislation for Banking Supervision

The Slovak authorities, in close cooperation with the World Bank, have prepared an EFSAL which will focus on the restructuring the three largest state-owned banks, and on strengthening banking regulation and supervision, reforming the deposit insurance system, and resolving troubled small- and medium-size banks.

To this end, and to increase the accountability of the National Bank of Slovakia in the area of bank supervision, the parliament approved several amendments to the Central Bank Law, to take effect from July 1, 2001, which will strengthen the NBS's regulatory authority. The amendments also eliminate the role of the Finance Ministry in banking supervision, reinforce legal protections for NBS bank supervisors, and allow NBS supervisors to share information with the other supervisory agencies.

In addition to amending the Central Bank law, the authorities have prepared, in close collaboration with the World Bank, a new Banking Law. This law aims at eliminating the weaknesses of present banking legislation and improving banking regulation, including governance rules, enforcement powers, and standardized accounting and auditing rules. The new Banking Law is fully compatible with EU legislation and directives, especially those pertaining to the establishment of credit institutions, specifying capital adequacy ratios, and so on. This Law is expected to be approved by parliament in September of this year. Another legislative amendment changes the rules and procedures of bank closure and deposit insurance to avoid abuses, improve market discipline, and increases the long-term viability of the deposit insurance fund. This legislation is also fully compatible with EU directives.

Restructuring and Privatization

Under the EFSAL, the reform of the enterprise sector will focus mainly on improving the legal framework for debt collection and bankruptcy, workouts for a large number of bad assets, and improve the legal framework for corporate governance. The latter will govern the regulation and supervision of the securities markets and insurance companies: a new law is currently being prepared to ensure the legal, regulatory, and budgetary independence of these activities. This law is likely to pass Parliament during the second half of 2001. In addition, Parliament will adopt amendments of the Commercial Code by fall 2001. The new Securities Act will strengthen disclosure requirements and establish rules against insider trading. Laws governing the regulation of brokers and dealers, and the registration of securities, will be approved by Parliament at the beginning of 2002.

Since Slovakia's last Article IV consultation, considerable progress has been made with restructuring and privatizing enterprises and banks. The authorities, in close cooperation with the World Bank, have prepared the three largest state-owned banks for restructuring and privatization. At the end of last year, the Slovak Savings Bank was sold to the Erste Bank from Austria. In July 2001, the second largest commercial bank--the General Credit Bank--was sold to a strategic foreign investor, IntesaBCI from Italy. To respond to the staff, the Investment and Development Bank and the Bank of Slovakia will be privatized in September 2001, and the Slovak Insurance Company is scheduled to be privatized in the first quarter of 2002.

The first half of this year saw the privatization of the largest Slovak company, Eastern Slovakia Steel Company, through a sale to US Steel. The authorities also intend to privatize the Slovak Gas Company, Transpetrol; Slovak Western; the Central and Eastern Energy Utility Companies; Slovak Navigation and Ports; Slovak Curative Spa Piešťany; and Slovak Bus Transport. All are scheduled to be privatized during the second half of 2001. In addition, Slovak Power Plants--the non-nuclear power producer--is slated for privatization in July 2002.

Foreign direct investment is crucial to Slovakia's sustainable growth in the medium and long terms. The authorities have built an institutional framework and created, in July 2000, the Slovak Agency for the Development of Investment and Trade (SARIO). In addition, tax incentives have been approved for foreign investors. Last year was a very good year for capital inflows to the Central and East European countries, and Slovakia was the second largest recipient of FDI.

Conclusion

Since the fall of 1998, when the present government came to power, Slovakia has succeeded with macroeconomic stabilization and begun implementing a far-reaching restructuring and privatization program. Despite the slowdown in the EU countries, Slovakia's economy is rebounding. The authorities are determined to maintain their strategy for achieving sustainable growth and preparing for EU accession, by continuing the fiscal consolidation in the medium term, accelerating the restructuring, and adopting measures to gradually decrease

unemployment, and by continuing to reform the social benefits system and public administration.