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**Slovak Republic: 2012 Article IV Consultation—Staff Report; Informational Annex; and Public Information Notice on the Executive Board Discussion**

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 2012 Article IV consultation with Slovak Republic, the following documents have been released and are included in this package:

- The staff report for the 2012 Article IV consultation, prepared by a staff team of the IMF, following discussions that ended on May 29, 2012, with the officials of Slovak Republic on economic developments and policies. Based on information available at the time of these discussions, the staff report was completed on June 25, 2012. 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.

- The Informational Annex, completed on 6/25/12

- A Public Information Notice (PIN) summarizing the views of the Executive Board as expressed during its July 11, 2012 discussion of the staff report that concluded the Article IV consultation.

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

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# SLOVAK REPUBLIC

## STAFF REPORT FOR THE 2012 ARTICLE IV CONSULTATION

June 25, 2012

## KEY ISSUES

**Context**: Slovakia enjoyed one of the strongest recoveries in the region, but challenges remain. Despite robust growth, unemployment is still in double digits. The large crisis-related fiscal stimulus has yet to be fully reversed and public debt remains on a rising trajectory. The banking system has weathered the crisis well, but nonperforming loans have been slow to come down. The outlook is clouded by global economic uncertainty, particularly risks from the euro area crisis.

**Fiscal policy**: A significant consolidation in 2011 improved the fiscal position, but further retrenchment will be needed to ensure public debt sustainability. While the government's deficit reduction plans are broadly appropriate, policies should be prepared to let automatic stabilizers work and complementary reforms will be needed to ensure durable fiscal consolidation.

**Financial sector policy:** The banking system is sound, but risks call for continued supervisory vigilance. Safeguarding financial system soundness requires curtailing risks in real-estate lending by harmonizing the housing lending regulations and a speedy resolution of nonperforming loans, including by removing tax obstacles. Enhanced collaboration with home supervisors is essential to mitigate external risks.

**Structural reform:** Promoting vibrant and inclusive growth will require addressing persistent social and regional economic imbalances. Reducing unemployment through effective implementation of the Labor Code reforms and better-targeted vocational training and tertiary education should be a top priority. Creating a more welcoming business climate by removing regulatory impediments should attract productive investment and support sustainable growth.

Approved By
**Rodrigo Valdés and Thomas Dorsey**

The mission took place in Bratislava from May 16 to 29, 2012. The team comprised Mmes. Zakharova (head) and Dao, and Messrs. Grigoli, Lutz, and Mehrez, and was assisted at headquarters by Messrs. De Guzman and Winnekens, and Ms. Baptista. Mr. Jakoby (Senior Advisor to the Executive Director) accompanied the mission and Mr. Kiekens (Executive Director) attended the concluding meeting.

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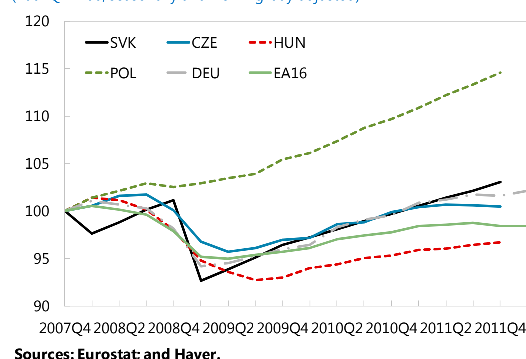
# RECENT DEVELOPMENTS AND OUTLOOK

*Slovakia enjoyed one of the strongest recoveries in the region, reflecting its prudent policies and sound economic fundamentals—including continued external competitiveness, a still-moderate government debt ratio, a sound banking system, as well as strong trade linkages with Germany. However, economic outlook is clouded by spillovers from the euro area crisis and other external risks.*

## A. An Export-Led Recovery

1. **Strong external demand has supported a healthy economic expansion.** Following a deep but short recession in 2009, real GDP increased 4.2 percent in 2010 and 3.3 percent in 2011, driven by a surge in net exports. Supported by solid trading partner growth, particularly in Germany, exports volumes increased by almost 11 percent in 2011. The robust performance of net exports offset the contraction in domestic demand amid fiscal consolidation and volatile consumer confidence (Figure 1). The strong economic performance continued into the first quarter of 2012 on the back of expanded auto production. All in all, Slovakia's post-crisis economic performance has been among the strongest in the euro area, with real GDP surpassing its pre-crisis peak in the last quarter of 2011.

**Evolution of Real GDP During the Crisis**
(2007Q4=100, seasonally and working-day adjusted)

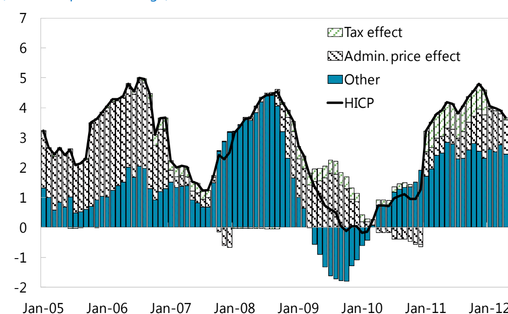



Sources: Eurostat; and Haver.

2. **But the strong growth has yet to make a dent in unemployment**. The unemployment rate—which surged during the crisis by 5 percentage points to over 14 percent—declined only slightly to 13¾ percent in April 2012. Unemployment is particularly high in less developed regions, contributing to an already large regional income disparity.

3. **Financial sector conditions continued to strengthen.** Banks' profitability increased, while capital adequacy and liquidity ratios are healthy. Banks' reliance on domestic deposits as a source of funding shielded them from the region-wide deleveraging, supporting a modest expansion in credit. Spillovers from the developments in the euro area have been manageable—equity prices fell and CDS spreads have widened, but compared to neighboring countries, foreign bank funding has been resilient, while private capital inflows rebounded in 2011 (Figure 2).

**Contributions to Inflation**
(12-month percent change)

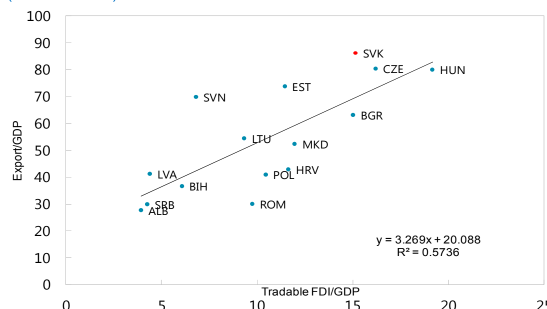



**Sources: Eurostat; and IMF staff calculations.**

4. **Temporary factors have pushed inflation up.** Despite the still-negative output gap, inflation surged to 4.9 percent in November 2011 on the back of tax and administered price increases and a global rise in energy prices. As the one-off factors ebbed, inflation eased to 3.4 percent in May 2012, but remains among the highest in the EU (Figure 3).

5. **Slovakia's economy remains competitive.** Over the past few years, exports of goods increased by an average of 15 percent per annum, swinging the current account into a small surplus in 2011. At the same time, Slovakia continued gaining market share, especially in the EU. CGER estimates based on the external sustainability approach and the macroeconomic balance approach suggest that the exchange rate is somewhat undervalued, reflecting a current account position above the level required to stabilize external debt and above its norm. The above-norm current account position reflects persistent weak domestic demand against the backdrop of still-elevated structural unemployment. The equilibrium exchange rate approach indicates overvaluation, likely reflecting the trend appreciation in the CPI-based REER in the context of real convergence. Meanwhile, the REER based on unit labor costs in manufacturing has declined to its pre-crisis levels and is in line with its historical average. Other indicators, such as wages in relation to labor productivity and the level of economic development, indicate that competitiveness has been preserved (Figure 4). On balance, staff view the REER to be slightly undervalued.

**Export and FDI in the tradable sectors, 2007**
(Percent of GDP)




**Sources: IMF WEO; and WIIW Database for Foreign Direct Investment.**

6. **The external position appears broadly stable.** Slovakia's net international investment position is moderate at negative 65 percent of GDP and is largely comprised of foreign direct investment (FDI) liabilities. The vast majority of inward FDI is from EU trading partners and is sizably invested in tradables, likely benefiting export performance. At the same time, the share of short-term financial liabilities at about 10 percent of the total is low (Figure 5). Finally, external debt dynamics appear to be relatively robust to shocks (Table A2, Figure A2).

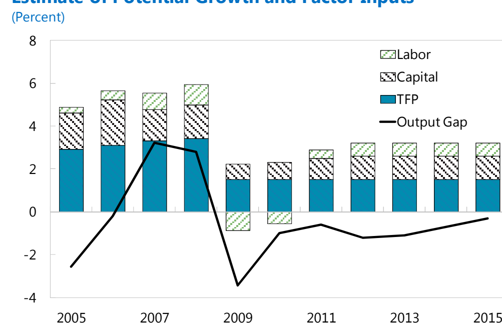
## B. Outlook and Risks

***Staff's views***

7. **The outlook is for a modest slowdown in growth in the short run and continued moderate expansion over the medium term.** Given the strong trade linkages with Germany and its projected temporary slowdown, Slovakia's real GDP growth is expected to slow from 3.3 percent in 2011 to 2.6 percent in 2012 (Box 1). Growth is projected to pick up to about 3½ percent in the medium term as the external environment strengthens and domestic demand gathers pace. As the

base effects fade and in the absence of further supply shocks, inflation should ease to below 3 percent by the end of this year. Unemployment is projected to gradually decline over the medium term, as the output gap closes and structural reforms aimed at increasing employment take root.

**Estimate of Potential Growth and Factor Inputs**
(Percent)



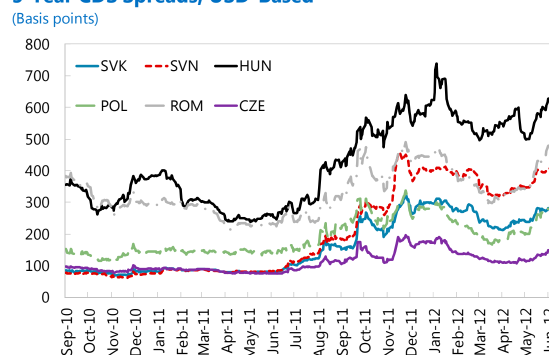

Sources: Eurostat; Haver; and IMF staff estimates.

8. **Risks to this outlook are tilted to the downside.**

- **The euro area stress remains a key external risk.** Severe euro area stress and an associated economic downturn would reduce demand for Slovak exports with significant adverse implications for growth. The predominantly foreign-owned banking system could be affected through deleveraging by parent banks, although this is mitigated by substantial local funding. An intensification of the crisis could widen Slovak government bond spreads, tightening credit conditions and reducing the value of banks' assets. This, combined with higher NPLs as growth slows would weaken banks' balance sheets and fuel adverse real-financial loops. At the same time, since the recent recovery in employment has been largely driven by export-led sectors, a decline in external demand would likely increase an already high unemployment rate. Other external risks include higher energy prices (Annex I).

- **Domestically, the most important risk stems from a loss of confidence in the authorities' commitment to fiscal consolidation.** This is amplified by the already elevated CDS spreads. A loss of market confidence would further increase funding costs and result in tighter credit conditions, reducing investment and private consumption. The large financing need of the government, coupled with sizable holdings of government bonds by banks—a third of which are marked-to-market—would fuel adverse feedback loops between sovereign risk and bank balance sheets, further weighing on credit and economic activity. Against this backdrop, it is encouraging that the government financing needs for the remainder of 2012 have been met.

**5-Year CDS Spreads, USD-Based**
(Basis points)




Source: Bloomberg.

***Authorities' views***

9. **While sharing the overall view that the economy will go through a moderate slowdown in coming quarters, the authorities argued that the risks to the economic outlook are primary in the external environment.** Spillovers from the euro area crisis could increase spreads on Slovak government bonds—despite Slovakia's still moderate public debt ratio, the significant fiscal consolidation to date, and sound banking sector—weakening banks' balance sheets and weighing on credit and economic activity.

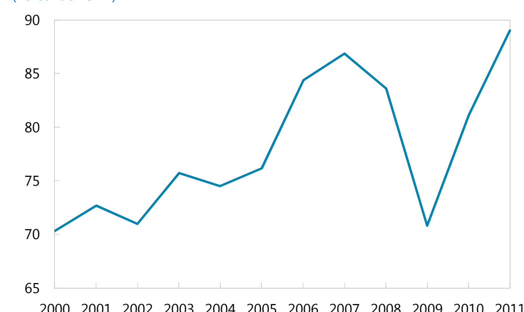
## Box 1. Slovak Republic: Interconnectedness With the EU

**Slovakia's economy has become increasingly connected with the EU.** Real economic convergence in the past half decade has been facilitated by EU membership through free trade and open capital markets. Slovakia's real income per capita has increased from less than one-half of the EU average in 1995 to about three-quarters in 2010. Increased financial and trade integration promoted greater specialization and improved productivity and business practices through inward FDI in manufacturing and financial services. But these cross-border linkages have also left the economy more open to external spillovers.

***Trade***

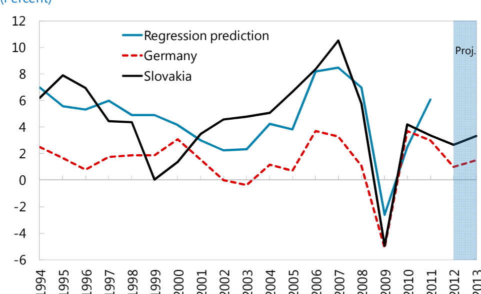
**Trade integration has been key to Slovakia's economic convergence.** The share of exports of goods and nonfactor services in GDP has surged from 50 percent in the mid-1990s to about 90 percent in 2011, with Germany and the Czech Republic as the main trading partners. Slovakia has also gained from significant inward FDI, which cumulated from 15 percent of GDP in 2000 to almost 60 percent in 2010 (Figure 5). By transferring more productive capital and business practices, FDI contributed to economic growth through capital deepening and total factor productivity growth.

**Exports of Goods and Services**
(Percent of GDP)




Sources: NBS; SOSR; Haver Analytics; and IMF staff calculations.

**Real GDP Growth**
(Percent)




Source: IMF staff estimates and calculations.

**Slovakia's growth prospects are becoming more closely tied to those in Germany.** Economic cycles have become increasingly synchronized, especially during the 2009 downturn and subsequent rebound. A simple regression of Slovak growth on cotemporaneous growth in Germany and lagged Slovak growth accounts for the bulk of the former's variation, with a coefficient on the German growth variable in excess of one, suggesting sizable spillover effects.

**Going forward, the growing interconnectedness with Germany should continue to favorably influence Slovakia's economy.** Germany benefitted from robust domestic demand and exports in recent years, while the EU has been weighed down by the lagging performance of its southern members as they address enduring imbalances. Barring adverse external developments, this trend is expected to continue, which should partly shield the increasingly open Slovak economy from regional economic cycles. Nonetheless, the economy depends on some cyclical industries, which might amplify the impact of a global downturn.

***Financial sector***

**The banking sector is dominated by Austrian, Italian, and to a lesser extent Belgian and Czech subsidiaries.** Foreign branches and domestic banks make up less than 10 percent of the market share (Figure 8). Slovak subsidiaries are among the most profitable and financially independent entities within each parent group, and the largest parent banks are on track to meet the EBA capital requirements in June. Assets and liabilities in foreign currencies are negligible, as are holdings of foreign sovereign and corporate bonds.

**The importance of foreign bank funding to domestic credit is limited.** Although most banks are foreign subsidiaries, they use domestic deposits as the main source of funding and their reliance on external flows, including from parent banks, is limited. Indeed, the average loans-to-deposit ratio stands at 90 percent. Nevertheless, risks to financial stability from spillovers through credit and other channels exist and call for continued supervisory vigilance and close cross-border cooperation with home supervisors (see Annex IV).

# MITIGATING RISKS AND LAYING THE FOUNDATION FOR STRONGER GROWTH

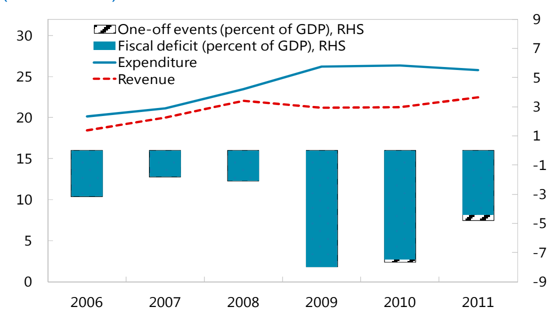
*The policy discussions focused on how Slovakia could mitigate risks and lay the foundation for stronger growth (Annex II). Further fiscal consolidation anchored in a sound medium-term framework would put public finances on a sustainable footing. Strong oversight of the financial sector and close cross-border supervisory cooperation would maintain financial stability. And better functioning labor market and a more welcoming business climate would boost employment and attract private investment, promoting more inclusive and vibrant growth.*

## A. Durable Fiscal Consolidation to Support Sound Public Finances

*While Slovakia's public debt ratio is still relatively moderate, in the absence of further fiscal consolidation the debt ratio will remain on a rising trajectory and become increasingly vulnerable to shocks. The government's commitment to continued fiscal consolidation is therefore welcome. Policies should be accommodative of shocks and not inhibit growth, while complementary measures will be needed to ensure durable deficit reduction.*

10. **A significant fiscal consolidation effort reduced the 2011 deficit by 3 percentage points to 4¾ percent of GDP.** Consolidation was achieved by cutting government spending on social benefits, capital expenditure, wages, and goods and services. Expenditures, as a share of GDP, declined by 2.7 percentage points to 37.4 percent—still some 2 percentage points above their pre-crisis level. Revenue remained roughly unchanged as higher VAT and personal income tax receipts more than offset lower grants and transfers. The underlying deficit, excluding one-off payments to the Railway Company and hospitals to cover prior years' deficits (0.9 percent of GDP) and one-off revenues (0.6 percent of GDP), declined by over 3 percentage points to 4.4 percent of GDP. Despite the sizable deficit reduction, general government debt climbed another 3 percentage points, to 44 percent of GDP at end-2011 (Figure 6).

**Revenue, Expenditure and Deficit**
(Billions of euros)




Sources: IMF WEO; and IMF staff calculations.

11. **The new government affirmed its commitment to continued deficit reduction.** In 2012, the adjustment pace slowed down amid the election cycle and unbudgeted expenditures as a result of the replenishment of the strategic oil reserve, overspending in the Regional Operational Program, and wage increases in the health sector (0.3 percent of GDP). The overall general government deficit is projected at 4½ percent of GDP. The new government, which took office in April, plans to reduce the deficit to below 3 percent of GDP by 2013, in line with the target set by the Excessive Deficit

Procedure (EDP). The planned measures include a shift of pension contributions from the second to the first pillar yielding additional revenue for the budget, introduction of a progressive personal income tax, an increase in the corporate income tax rate from 19 to 23 percent, and an extension of the special bank levy on corporate deposits to retail deposits.

Deficit Reduction Measures
(Percent of GDP)

| Measure | 2013 |
|---|---|
| Revenue | 1.8 |
| Shift of pension contributions from 2nd to 1st pillar | 0.6 |
| CIT rate increase | 0.4 |
| PIT reform | 0.3 |
| Bank levy | 0.1 |
| Temporary levy on enterprises in regulated sectors | 0.1 |
| Changes in taxation of self-employed and workers on temporary contracts | 0.1 |
| Expenditure | 0.3 |
| Targeting social benefits | 0.1 |
| Other | 0.2 |
| Total | 2.1 |

Source: National Authorities.

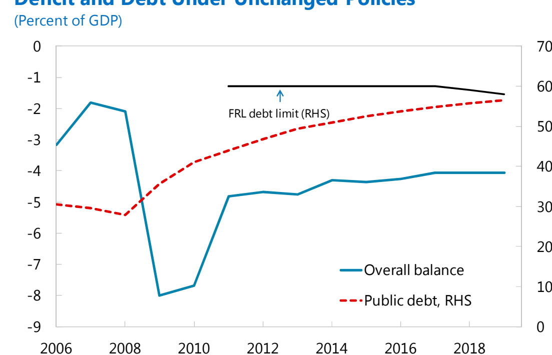
12. **Slovakia has committed to a 0.5 percent of GDP structural deficit objective in the medium term under the European Fiscal Compact (FC).** The FC requires that after meeting the EDP threshold of headline deficit of 3 percent of GDP by 2013, Slovakia implement a minimum structural fiscal adjustment of ½ percent of GDP per year until it reaches its medium-term objective (MTO) which has been set at 0.5 percent of GDP structural deficit. Staff's estimates suggest that implementing these policies would reduce the debt-to-GDP ratio to about 41 percent by 2018 and further to 30 percent by 2025.

13. **The medium-term framework has been strengthened by fiscal responsibility legislation.** The fiscal responsibility law (FRL), adopted with broad political support, sets a limit on public debt of 60 percent of GDP by 2017, which will be reduced by one percentage point of GDP each year to reach 50 percent of GDP in 2027 (Box 2).

***Staff's views***

14. **The government's deficit reduction plans are likely to succeed in lowering the deficit to below 3 percent of GDP by 2013—a target that staff considers appropriate—and policies should be prepared to let automatic stabilizers work.** Since the shift in pension contribution would have a negligible impact on growth, and the tax multipliers seem to be low[1], the planned measures would not unduly constrain growth. If growth turns out lower than expected, automatic stabilizers should be allowed to operate. At the same time, if growth surprises on the upside, the higher revenue should be saved to facilitate the adjustment. Stabilizing the debt at 40 percent of GDP in the long run—a level that would leave room for the expected increase in ageing-related expenditures and other priority spending—would require a structural fiscal effort of some ½ percent of GDP after 2013 (Figure 7). Remaining on course with fiscal consolidation is particularly important given public debt vulnerability to shocks (Figure A1).

**Deficit and Debt Under Unchanged Policies**
(Percent of GDP)




Sources: IMF WEO; and IMF staff calculations and estimates.

[1] OECD "The Effectiveness and Scope of Fiscal Stimulus", OECD Economic Outlook, Interim Report 2009/2 (Table 3.8).

**Box 2. Slovak Republic: Fiscal Responsibility Law**

**On December 8, 2011 the Slovak Republic adopted a fiscal responsibility law (FRL) with broad political support in the parliament.** The law—which came into effect on March 1, 2012 —includes rules and procedures relating to three budget principles: stability, accountability, and transparency.

**Stability**. The principle of stability is underpinned by a debt rule. The FRL sets a limit on public debt at 60 percent of GDP until 2017 (consistent with the Maastricht criteria). Starting in 2018, the debt ceiling will be gradually reduced by one percentage point of GDP each year to reach 50 percent of GDP by 2027. A set of automatic enforcement mechanisms has been defined if the ratio of debt to GDP approaches 10 percentage points below the debt ceiling. These, in order, include: an open letter of the Minister of Finance (for a debt ratio between 50 and 53 percent of GDP), a government reform package (between 53 and 55 percent of GDP), expenditure freeze (between 55 and 57 percent of GDP), a balanced budget requirement (between 57 and 60 percent), and a confidence vote (when the debt ratio exceeds 60 percent of GDP). The FRL allows for escape clauses which will suspend the sanctions envisaged for a debt ratio higher than 55 percent of GDP for a period of three years. These include a major recession, a banking system bailout, a natural disaster, and international guarantee schemes.

**Accountability**. The law also foresees the establishment of a Fiscal Council with the mandate to (i) evaluate fiscal performance with respect to the fiscal rules, (ii) perform long-term sustainability analysis, (iii) analyze the fiscal impact of draft legislation, and (iv) monitor fiscal performance.

**Transparency**. The FRL limits the room for creative accounting by improving the coverage of fiscal information. It covers a broad definition of the public sector, including state-owned enterprises, public-private partnerships and other implicit and contingent liabilities. Transparency will also be enhanced by allowing the two independent forecasting committees to periodically disclose the information they typically produce.

**Operational aspects.** The law defines a sustainability indicator that the Fiscal Council calculates every year, which aims to ensure that public debt does not exceed 50 percent of GDP in the long term. The correction mechanism will operate through the constitutional expenditure ceilings, which will be defined by ordinary law and set in nominal terms for the next four fiscal years. Under the law, a strict no bail-out clause is envisaged at the local government level when the debt to current revenue ratio exceeds 60 percent.

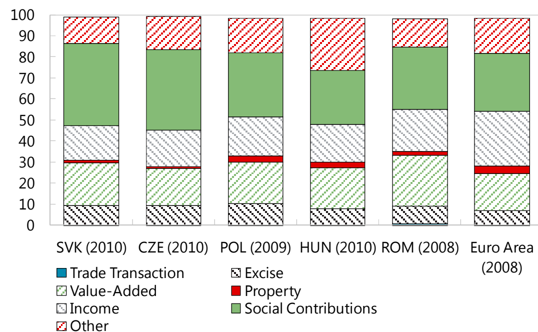
15. **While the focus on boosting revenue is broadly appropriate, complementary measures will be needed to ensure a durable fiscal adjustment.**

- **Composition of the adjustment.** Following a sizable expenditure-based consolidation in 2011, the room for additional spending cuts without fundamental public sector reforms is limited, necessitating focus on revenue measures in the short run. The planned shift of pension contributions substantially increases future government pension obligations. In this regard, the authorities' intention to combine this with a parametric reform of the first pillar is welcome. However, it is essential that the reform be underpinned by an actuarial analysis to ensure the system's financial solvency. The proposed increase in direct taxes may reduce incentives to invest, underscoring the need for a more welcoming investment climate. The temporary levy on regulated enterprises could increase contingent liabilities of the government by reducing profitability, and the bank levy could discourage financial intermediation. The envisaged numerous changes to the tax system could raise collection risks in light of the relatively weak tax administration.

- **Tax system.** The tax system is overly complex, reducing economic efficiency and undermining revenue collection. The social security contribution system is particularly onerous. It includes eighteen contribution rates, three different assessment bases, and a large number of discretionary allowances and exemptions. Reflecting nonstandard exemptions and collection difficulties, the VAT efficiency is among the lowest in the region. Tax collection is performed by multiple agencies, increasing coordination costs for tax administration. Addressing these issues is essential. The planned unification of maximum assessment bases for health and social insurance contributions should aid in simplifying the system. Streamlining exemptions and harmonizing assessment bases would increase efficiency and mobilize additional revenue, while easing tax compliance. Unifying the collection of taxes and social contributions has the potential to improve revenue collection.

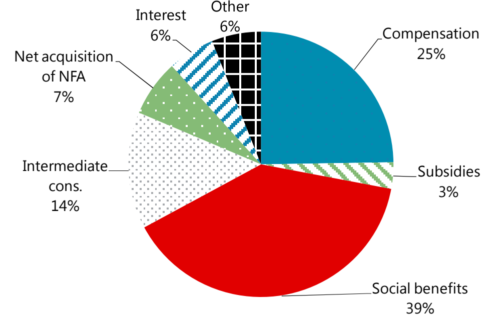
- **Budget flexibility.** Slovakia's budget structure has become increasingly rigid, complicating fiscal consolidation. Committed expenditure (such as interest payments, social benefits, and subsidies), which usually requires a law to be changed, comprises over half of government spending. The share of social benefits in total expenditure is particularly high. Increasing budget flexibility would thus require a comprehensive reform of social benefits and contributions.

**Revenue Composition**
(Percent of tax revenues)




Source: IMF staff estimates.

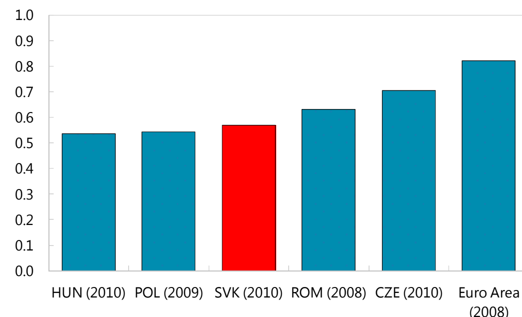
**Expenditure Composition: Euro Area**
(average 2005-2009, in percent of total expenditures)




Source: Eurostat

16. **Over the medium term, considerable budgetary savings could be achieved by strengthening the VAT collection and the efficiency of health spending.** In particular, lifting the VAT efficiency up to euro area levels—by removing nonstandard exemptions and improving tax administration—could generate some 1½ percent of GDP in additional revenue. And bridging half of the gap in the efficiency of health spending between Slovakia and countries on the efficiency frontier—including through increased private sector participation and greater cost-sharing—could generate some 1¾ percent of GDP in expenditure savings (Annex III). The savings could be used to further reduce debt, to

**VAT Efficiency**
(VAT receipts to consumption ratio, divided by VAT rate)




Source: IMF staff estimates.

improve the quality of health outcomes, and to finance the much-needed improvements to public infrastructure in less developed regions of the country.

17. **While the new FRL is a step in the right direction, there is scope to further strengthen the fiscal framework.** The Slovak FRL is broadly in line with best international practice: it enhances transparency and accountability, covers a broad definition of government, and includes credible enforcement mechanisms. However, making the FRL fully operational requires anchoring the budget in a sound medium-term fiscal framework. Moreover, extending the FRL debt limit to cover public entities, including hospitals, would further reduce fiscal risks.

***Authorities' views***

18. **The 2012 deficit target of 4.6 percent of GDP will be met.** With some of the measures taking effect in the last quarter of 2012, the unbudgeted expenditure incurred in the first half of the year are expected to be fully offset. In the event that revenues turn out higher than expected, these will be used to finance the much-needed active labor market policies aimed at boosting employment.

19. **The government is committed to meeting the 2.9 percent of GDP deficit target in 2013.** Following extensive consultations with social partners, the planned measures enjoy broad public support and the consolidation package will be implemented in full. The impact on growth will be limited by the relatively growth-friendly nature of the measures. After reaching the deficit target in 2013, the consolidation will continue albeit at a more moderate pace in line with the country's commitments under the EDP and the FC.

20. **Implementation risks are low.** The shift of pension contributions from the second to the first pillar will be accompanied by a set of parametric reforms to the first pillar—including linking the retirement age with demographic trends, changing the pension indexation, and limiting the accrual of pension benefits for higher earners. An actuarial study to estimate the impact of the planned reforms on the financial position of the pension system will be prepared. Improving the business climate is given high priority. The bank levy is unlikely to discourage financial intermediation in the short run as it would largely be absorbed by banks' profits. The Fiscal Council which will be set up under the FRL will monitor contingent liabilities.

21. **Plans are underway to improve expenditure and revenue efficiency.**

- **Health expenditure.** The goal is to improve health outcomes, while containing costs. Ongoing reforms aimed at tightening reference pricing for pharmaceuticals and standardizing the reimbursement for medical procedures classified by diagnosis treatment should help lower health costs. Savings from these reforms will be used to improve health outcomes.

- **Public administration.** Significant efficiency gains are expected from streamlining the number of regional offices, centralizing the public procurement, harmonizing public employee compensation, and standardizing administration processes at the regional level.

- **Tax collection efficiency.** The unification of revenue administration has been postponed to 2014, following technical problems with new information systems. The government is finalizing a set of legislative changes to improve the collection of VAT and reduce tax evasion. Regular internal audits of tax collection offices are also expected to fight tax evasion. A detailed analysis taking stock of current tax expenditures will be included in the 2013 budget documentation.

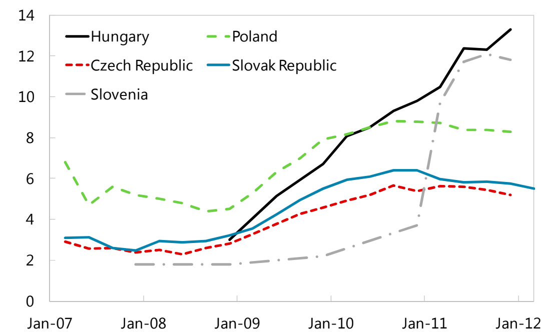
## B. Strong Oversight to Promote Financial Stability

*The banking system has weathered the crisis relatively well, but risks call for continued supervisory vigilance. Safeguarding financial system soundness requires a speedy resolution of nonperforming loans and managing risks in real estate lending. Enhanced collaboration with home supervisors is essential to mitigating external tensions. Financial deepening is key to channeling investment to its most efficient uses.*

### *Background*

22. **Banks' profitability and soundness continued to improve**. Nonperforming loans, in particular to households, have started to come down and provisions have declined. Buttressed by lower provisioning costs and higher net interest income, bank profits surged by 34 percent in 2011. This allowed banks to boost capital and liquidity ratios, and finance a modest expansion in credit. Credit grew by 8.7 percent in nominal terms in 2011, compared to 3.8 percent in 2010, and slowed down slightly to 7.3 percent at end-April 2012. Profit growth slowed down in the second half of 2011, as renewed financial stress in the euro area pushed up bond yields, reducing banks' portfolio valuation. Regulatory capital stood at 15 percent and core tier 1 capital at 13 percent of risk-weighted assets in 2012Q1. Banks took advantage of the ECB's latest long-term refinancing operation (LTRO) to partially replace interbank and parent funding.

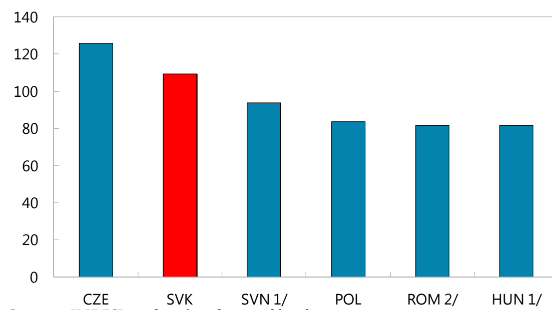
**Non-Performing Loans in Central Europe**
(Percent of total loans)




**Sources: IMF FSI; and National authorities.**

23. **Despite the dominance of foreign ownership, banks' reliance on foreign funding is low, mitigating cross-border risks.** Close to 99 percent of the banking system's assets are foreign-owned. However, bank assets are largely comprised of domestic loans and government securities, and banks rely mainly on domestic deposits to finance their operations (Figure 8). As a result, the system's dependence on wholesale and parent-bank funding is contained, and private

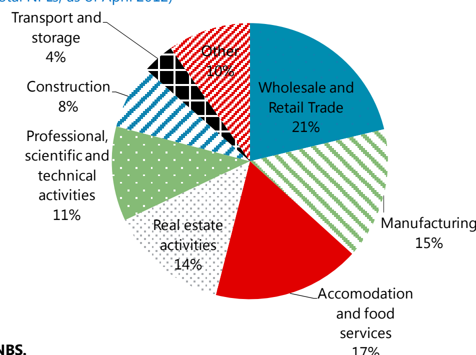
**Deposit to Loan Ratio - 2011Q4**
(In percent)



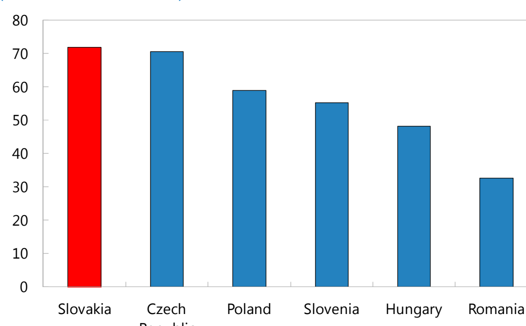

**Sources: IMF FSI; and national central banks.**
1/ As of 2011Q3.
2/ As of April 2012.

credit is resilient to changes in foreign funding (Annex IV).

24. **Nevertheless, vulnerabilities remain.** While total NPLs have declined, corporate NPLs remain high and stood at some 7.5 percent of total loans in 2012Q1, 4 percentage points above their pre-crisis level. Banks are exposed to delinquent loans in non-tradable services sectors, which are likely to continue weighing on banks' portfolios until domestic demand improves. While the pace of correction of residential property prices has slowed, banks are also exposed to the still-weak and highly leveraged commercial real estate and construction sectors. Meanwhile, the new bank levy on corporate deposits is likely to weigh on banks' profits. At the same time, the recent amendments to the Act on Bankruptcy and Restructuring increase incentives for timely NPL restructuring and curtail opportunities for speculative manipulation of bankruptcy proceedings.




25. **The buildup of risks in housing loans is of concern.** The banking system's total exposure to the housing market, at 72 percent of total retail loans, is higher than elsewhere in the region. Close to 60 percent of credit growth in the last 5 years has gone into housing. And while traditional mortgage loans have been flat during the past two years, the less-stringently regulated "other housing loans"—which are not backed by mortgage bonds and are not subject to the regulatory limit on the loan-to-value ratio—have surged. As a result, the average loan-to-value (LTV) ratio of new housing loans as well as its dispersion have risen (Figure 9).




26. **Moreover, the banking system is exposed to external spillovers.** The euro area crisis spillovers could increase Slovak government bond spreads. This combined with sizable bank holdings of Slovak bonds would weaken banks' balance sheets, fueling adverse real-financial feedback loops. A further slowdown of euro area growth would also pass through to the Slovak economy and increase NPLs. Cross-country estimates for the region suggest an increase in NPLs of 1 percentage point is associated with a 0.4 percentage point lower credit supply growth.[2] Other risks stem from a potentially disorderly deleveraging by parent banks, manifested in liquidity withdrawal

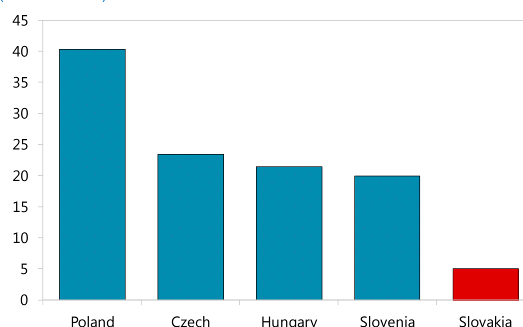
[2] See Report of *Working Group on NPLs in Central, Eastern and Southeastern Europe* by the European Banking Coordination "Vienna Initiative", March 2012.

or curtailing of subsidiaries' lending by parent banks—particularly if they come under pressure to quickly raise capital and liquidity ratios.

27. **These risks are partly mitigated by domestic and cross-border initiatives.** The NBS recently took steps to strengthen regulatory requirements for bank capital and liquidity ratios and introduced restrictions on dividend distributions (Box 3). The supervisor closely monitors intra-group transfers and enforces limits on exposure to parent banks. Banks are largely in compliance with core Basel III capital and liquidity requirements, and major parent banks are also on track to fulfill the recent EBA capital requirements for June 2012. While, the NBS actively participates in cross-border stability groups with key home supervisors, the recently revived Vienna Initiative (Vienna 2) could offer further scope for cross-border cooperation. Finally, LTRO recently launched by the ECB helped ease liquidity strains of parent banks.

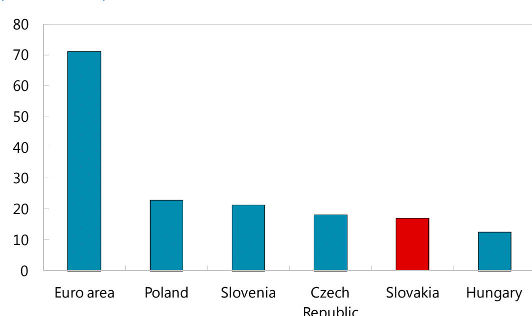
28. **The non-bank financial sector in Slovakia is relatively small.** The sector—comprised of insurance, pension, investment and mutual funds—is relatively undersized, holding assets of 26 percent of GDP, compared to the average of 230 percent of GDP in the euro area, and 35 percent of GDP in the region. Securities markets remain relatively underdeveloped. Corporate bond issuance is marginal (less than 1 percent of banks' assets), the secondary market for government bonds is thin, and stock market capitalization is low compared to peers.

**Stock Market Capitalization, December 2010**
(Percent of GDP)



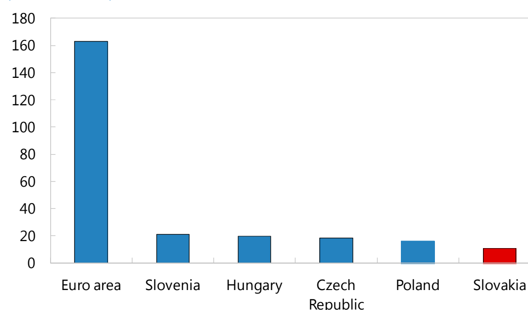

Sources: Bloomberg; and IMF staff estimates.

**Total Assets of Insurance and Pension Funds 1/**
(Percent of GDP)




Sources: ECB; and IMF WEO.
1/ As of 2011Q4.

**Total Assets of Other Non-Bank Financial Intermediaries 1/**
(Percent of GDP)




Sources: ECB; and IMF WEO.
1/ As of 2011Q4. Excludes money market funds.

## Box 3. Slovak Republic: Implications of Cross-Border Regulation Mechanisms

**NBS stabilization package**: On January 16, 2012, the NBS issued a package of recommendations to enhance banking sector stability and create buffers. These include: core Tier 1 ratio of at least 9 percent, the maximum loan-to-stable-funding (LTSF) ratio of 110 percent, and dividend distribution restriction following the schedule:

| *Core tier 1 (CT1) ratio (in % of RWA)* | *Minimum of profits to be retained (in %)* |
|---|---|
| CT1 < 9.625 | 100 |
| 9.625 ≤ CT1 < 10.25 | 80 |
| 10.25 ≤ CT1 < 10.875 | 60 |
| 10.875 ≤ CT1 < 11.5 | 40 |
| CT1 > 11.5 | No minimum |

**Basel III**: The comprehensive set of reforms aimed at strengthening the regulation, supervision and risk management of banks target both the micro-prudential aspects for individual banks as well as the systemic macro-prudential risks at the global level. Key figures for capital adequacy and liquidity requirements are:

- Common equity, net of deductions, should be at least 7 percent of risk-weighted assets (RWA), comprising a minimum of 4.5 percent equity and a capital conservation buffer of 2.5 percent.
- When credit growth implies a buildup of systemic risk, a counter-cyclical buffer of up to 2.5 percent will be imposed.
- Have a liquidity coverage ratio (LCR) of at least 100 percent (comprising assets convertible to cash at any time sufficient to withstand a 30-day stressed funding scenario) by 2015.
- Have a long-term net stable funding ratio (NSFR) of at least 100 percent (available relative to required stable funding) by 2018.
- Subject the leverage ratio (T1/Exposure) to a floor of 3percent (preliminary value).

**Vienna 2**: Given the emergence of renewed financial stress resulting from the sovereign debt crisis, a refocused Vienna Initiative (Vienna 2 or Vienna Plus) is being launched to address in particular:

- The impact on the region of the latest standards on bank capital and liquidity (Basel III). This also includes assessment of the cross-border impact of recent recapitalization plans submitted to the EBA.
- Challenges emerging Europe faces in managing non-performing loans (NPL).
- Looking forward, the framework should also support measures for crisis prevention, for example through support to host supervisors in developing local capital markets to ease reliance on foreign funding.

Currently the NBS is not part of the Vienna Initiative, but has been engaging with Austrian and Italian supervisors in bilateral cross-border stability groups.

**EBA Bank recapitalization of parent banks**: The formal recommendation resulting from the second EU-wide stress test requires banks to:

- Build up an exceptional and temporary capital buffer against sovereign debt exposures to reflect market prices as at the end of September 2011.
- Additionally, establish capital buffers such that the Core Tier 1 capital ratio reaches 9 percent by June 2012.

Plans for recapitalization were submitted by banks in January 2012. Banks are encouraged to use private sources to enhance capital, including retained earnings, reduced bonus payments and issuance of common equity. Only limited sale of assets to prevent widespread deleveraging will be accepted.

The following table summarizes implications of these initiatives for domestic and parent banks:

**(continued)**

| Framework | Relevant issues/rule | Implication for domestic and parent banks |
| --- | --- | --- |
| **NBS Stabilization package** | Core Tier 1 ≥ 9 percent. | As of 2012 Q1, all banks have a T1 ratio above 9 percent, with average T1 being 14percent and average CT1 at 13 percent. |
| | Ratio of Loans to stable funds < 110 percent. | Average in 2012 Q1 is 82 percent. |
| | Limit on profit distribution conditional on CT1. | Less than 25 percent of banks (by net assets) likely affected, but banks retained on average 50 percent of profits in 2011 anyway. |
| **Basel III** | Common equity tier 1 at 7-9.5 percent and Tier 1 at 8.5-11 percent (incl. capital conservation buffer and depending on counter-cyclical buffer). | Average T1 is 14 percent, with only 10percent (in net asset value) of banks with T1 below 12 percent. |
| | LCR and NSFR of min. 100 percent. | Average LCR and NSFR around 100 percent as of 2012 Q1. |
| **EBA** | Capital buffer against sovereign exposure. | All participating parent banks in compliance. |
| | Core Tier 1 ≥ 9 percent. | All participating parent banks already or on track to compliance. |

***Staff's views***

29. **Strong fundamentals and effective supervisory oversight have helped Slovakia's banking system weather the crisis well.** Thanks to a largely deposit-funded banking model, prudent liquidity and capital buffers, and limited foreign assets, Slovak banks have emerged from the crisis relatively intact. However, lingering risks call for continued supervisory vigilance. In this regard, the recent steps by NBS to strengthen bank capital and liquidity buffers are welcome.

30. **Going forward, safeguarding financial system soundness would require addressing the remaining risks.**

- A speedy resolution of NPLs would strengthen banks' balance sheets and support a sustainable expansion of credit. This could be facilitated by shortening and simplifying legal proceedings, and removing tax obstacles, such as allowing losses settled out-of-court be tax deductible without a lengthy waiting period. In this regard, the recent amendments to the Act on Bankruptcy and Restructuring, which give both debtors and creditors a more proactive role in restructuring and insolvency frameworks, should contribute to faster NPL resolution going forward.

- Harmonizing the housing lending regulations would stem further buildup of risks. Subjecting all types of housing loans to the same regulatory limit on LTV ratio would ensure loan quality and help prevent excessive risk taking.

31. **Close cooperation with home supervisors is essential to mitigating cross-border risks.** The authorities' bilateral engagement in cross-border stability groups is welcome. Reaching out more broadly to engage in multilateral platforms, when opportunity arises, would further strengthen cross-border cooperation. In this regard, the Vienna Initiative offers a platform to obtain information and influence parent banks' cross-border transactions to the extent that they affect domestic financial stability. It also provides a forum to exchange best practices and coordinate NPL resolution strategies when parent and subsidiary banks are jointly involved.

32. **Over the medium term, policies should be geared toward promoting deeper financial markets.** Investment restrictions for the second pillar pension funds should be further relaxed to enlarge the investor base for domestic equity and debt securities. Frequent legislative changes to pension funds regulation should be avoided to promote regulatory stability conducive to developing long-term investment strategies. The development of a secondary market for government bonds could be facilitated by focusing on benchmark instruments, increasing issuance size, and establishing a system of primary dealers.

***Authorities' views***

33. **Ample capital and liquidity buffers put banks in a strong position to deal with shocks to economic activity as confirmed by the central bank's stress tests.** The developments in real estate lending are closely monitored and if deemed destabilizing, regulatory limits on the LTV ratio of "other housing loans" could be introduced. Moreover, frequent monitoring of liquidity and capital levels should prevent large, destabilizing fund withdrawals by parent banks. Notwithstanding, domestic subsidiaries' ratings could be affected should their parent banks' implicit support be deemed weaker, as was the case with the recent downgrade of an Italian subsidiary.

## C. Structural Reforms for a Vibrant and Inclusive Growth

*Slovakia has made important progress in real income convergence over the past decade. Continuing gains would need to be supported by comprehensive structural reforms to reduce social and economic imbalances and promote strong and inclusive growth.*

***Background***

34. **Further progress in Slovakia' impressive gains in real income convergence would require addressing persistent social and economic divergences (Figures 10-11).**

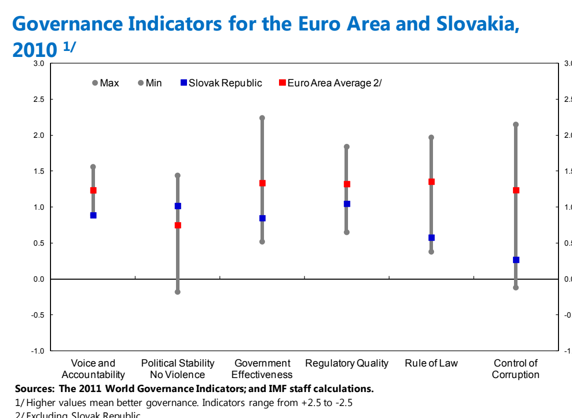
- **Labor market.** Despite recent modest gains, employment has yet to recover to its pre-crisis level. Labor participation lags that in most EU economies, inhibiting growth in real incomes. Unemployment remains high, especially among the young and the low-skilled and in less

developed regions. Long-term unemployment has been the highest in the EU for the last decade, reflecting persistent skill and geographic mismatches.

- **Education and innovation.** Despite relatively high PISA scores, Slovakia's tertiary educational attainment has failed to keep up with most OECD peers and vocational training is increasingly lagging labor market needs perpetuating skill mismatches and hampering further productivity gains. Moreover, notwithstanding the benefits of inward FDI, Slovakia remains an "innovation user."

- **Business environment.** Slovakia's regulatory burden—as measured by the IBRD's "Doing Business" survey—is relatively high compared to its peers, particularly when it comes to starting a business, investor protection, contract enforcement, and paying taxes.

**Governance Indicators for the Euro Area and Slovakia, 2010 1/**




Sources: The 2011 World Governance Indicators; and IMF staff calculations.
1/ Higher values mean better governance. Indicators range from +2.5 to -2.5
2/ Excluding Slovak Republic

35. **The authorities are addressing these issues through ongoing reforms.** The 2011 reform of the Labor Code aims to promote employment by reducing hiring and firing costs and supporting workplace flexibility. Active labor market policies are under review to improve their cost effectiveness and efficiency, with particular emphasis on disadvantaged job seekers. In education, reforms have focused on promoting greater social inclusion and linking vocational training more closely with labor market needs. Policies to enhance innovation include financial incentives to encourage R&D by small- and medium-sized enterprises. Measures to minimize start-up barriers, improve the legal environment, and reduce regulatory burden are underway to create a more welcoming business climate.

***Staff's views***

36. **Boosting employment is key to inclusive growth.** Reducing unemployment, particularly among the less-skilled, the youth, and in the less developed regions should be a top priority. Effective implementation of the Labor Code reform will aid this effort. In education, better-targeted tertiary education and vocational training would spur innovation and help reduce skill mismatches, especially when supported by more occupationally-oriented curricula, with stronger involvement of employers—a message emphasized by both domestic employers and foreign direct investors.

37. **Mutually reinforcing structural reforms are needed to reduce regional disparities.** Regional development could be enhanced through continued policies to improve infrastructure in less developed regions to employ underused labor resources, promote investment opportunities, and facilitate mobility. An easing of rental housing market regulations could also help in this regard. Employment incentives could be enhanced by differentiating labor costs by region according to the cost of living, including by supplementing lower future increases in minimum wages with mean-tested social benefits and targeted reductions in social insurance contributions. Addressing the

long-standing issues, such as lingering corruption and weak property and contract rights enforcement, would reinforce ongoing efforts to improve the business climate. Ensuring the full use of the anti-money laundering (AML) framework could also help in this regard.

***Authorities' views***

38. **Tackling the high unemployment level is an important priority.** It is too early to assess the effectiveness of the revised Labor Code in increasing employment. Reforms are being planned in education at vocational and tertiary levels, in consultation with employers to address their needs.

39. **Addressing continued regional economic disparities remains on the top of the authorities' agenda.** Efforts are underway to improve regional infrastructure, especially transport links, with continued recourse to public-private partnerships for areas not eligible for EU structural funds. The government intends to offer financial incentives for the construction of rental public housing projects. Reforms are being planned to improve the business environment, including through public sector administration reforms, improved public procurement practices, and greater recourse to "e-government". Progress will be assessed vis-à-vis the IBRD's "Doing Business" metrics. The authorities are currently analyzing the recommendations of the MONEVAL's report on the Slovak Republic's compliance with the AML/CFT standard and legislative changes are being considered.

## STAFF APPRAISAL

40. **The economy is expected to continue growing at a healthy pace.** Slovakia enjoyed one of the strongest recoveries in the region, reflecting its sound economic fundamentals and prudent policies. Amid a worsened external environment, growth is expected to slow from 3.3 percent in 2011 to 2.6 percent in 2012. This relatively benign slowdown reflects strong trade linkages with Germany, continued external competitiveness, a still-moderate government debt ratio, and a sound banking system. Growth is projected to pick up to about 3½ percent over the medium term as the external environment strengthens.

41. **However, risks to this outlook are mostly to the downside.** An intensification of the euro area crisis would spill over to Slovakia through trade and financial channels, reducing growth and weakening banks' balance sheets. Domestically, the main risk stems from a loss of market confidence in the government's commitment to fiscal consolidation.

42. **Policies should focus on mitigating risks and promoting growth.** Durable fiscal consolidation and continued strong oversight of the financial sector should help allay risks. The government's economic program now being elaborated provides an opportunity to put in place the needed reforms to promote vibrant and inclusive growth.

43. **The deficit reduction plans are appropriate, but policies should not inhibit growth.** The planned measures would be sufficient to lower the deficit to below 3 percent of GDP in 2013, while

not unduly constraining economic expansion. If activity turns out weaker than expected, policies do not need to counterbalance the resulting revenue shortages. At the same time, if growth surprises on the upside, the higher revenue should be saved to facilitate the adjustment.

44. **Complementary reforms are essential to ensure a durable fiscal adjustment.** Underpinning the planned changes to the pension system by actuarial analysis is important to ensure financial solvency of the system. Since the increase in direct taxes may reduce incentives to invest, the government's intention to continue improving the investment climate is welcome.

45. **In the medium term, sizable savings could be achieved by improving tax administration and expenditure efficiency.** The planned unification of revenue collections would aid in this regard. The government's plans to increase efficiency in health spending are welcome, while the planned reform of public administration could result in additional efficiency gains. The savings could be used to reduce debt, to improve the quality of public sector outcomes, and to finance improvements to public infrastructure.

46. **There is scope to further strengthen the fiscal framework.** The recently adopted fiscal responsibility legislation is broadly in line with best international practices and could be further strengthened by anchoring the budget in a sound medium-term fiscal framework. Including in the budget information on finances of public entities would improve the monitoring of fiscal risks. The planned stocktaking of tax expenditures would help to better prioritize the use of budget resources.

47. **The banking system is sound, but continued supervisory vigilance is needed to safeguard financial stability.** The recent steps by the NBS to strengthen bank capital and liquidity buffers are welcome. Subjecting all types of housing loans to the same LTV ratio would help prevent excessive risk-taking. Removing tax obstacles would speed up NPL resolution. The recent amendments to the Act on Bankruptcy and Restructuring would also encourage timely restructuring. Enhanced cooperation with home supervisors is essential to mitigate the cross-border risks.

48. **Promoting deeper financial markets would bring economic gains by enhancing investment efficiency and broadening access to finance.** This could be facilitated by relaxing investment restrictions for the Pillar II pension funds and by developing a secondary market for government bonds.

49. **Boosting employment should be a top priority.** Effective implementation of the reformed Labor Code should aid in this regard. Better-targeted vocational training would reduce skill mismatches. A sharper focus on market needs in tertiary education could spur innovation and increase productivity.

50. **Addressing persistent regional economic imbalances calls for mutually reinforcing structural reforms.** The government's plans to facilitate regional development by improving infrastructure are welcome. Employment incentives could be increased by differentiating labor costs by region according to the cost of living, including by supplementing lower future increases in minimum wages with means-tested social benefits and targeted reductions in social insurance

contributions. Measures to enlarge the rental housing market could help improve labor mobility. Placing greater emphasis on addressing lingering corruption and strengthening the rule of law, would reinforce the ongoing efforts to improve the business climate.

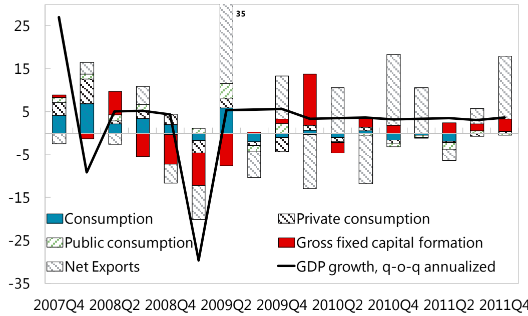
51. It is recommended that the next Article IV consultation take place on the standard 12-month cycle.

## Figure 1. Slovak Republic: Real Sector Developments, 2005–11

*The economy continued growing at a steady pace...*

### Contributions to GDP Growth

(Percent, quarter-on-quarter annualized)

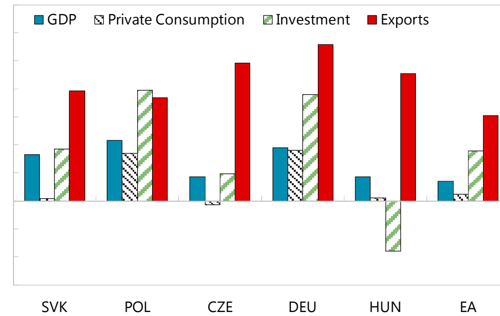



**Sources: Eurostat; Haver Analytics; and IMF staff calculations.**

*...supported by solid trading partner growth.*

### Growth, 2011

(Percent change)

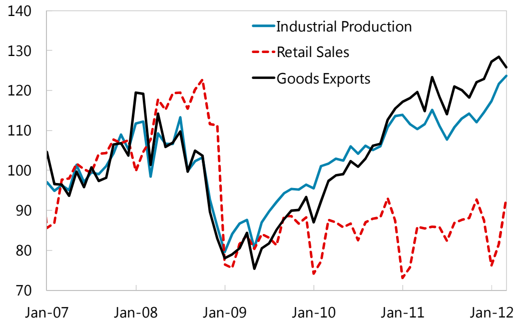



**Sources: Eurostat; Haver Analytics; and IMF staff calculations.**

*Growth was export-led...*

### Industrial Production, Retail Trade and Exports

(2007=100)

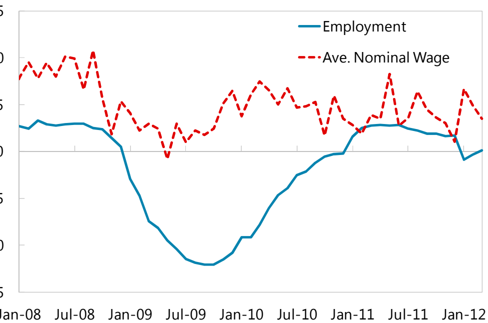



**Sources: SOSR; Eurostat; and Haver.**

*...amid weak employment creation and moderate wage growth...*

### Wages and Employment

(Year-on-year percent change)

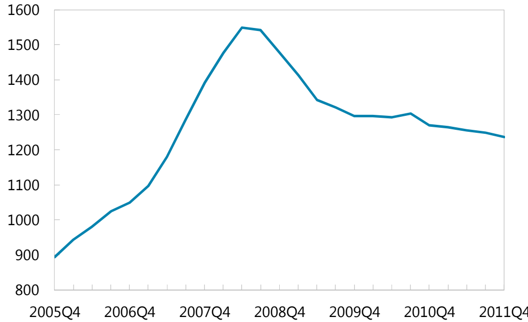



**Sources: SOSR; Eurostat; and Haver.**

*...and continued correction in the housing market.*

### Property Prices

(Euros per square meter)

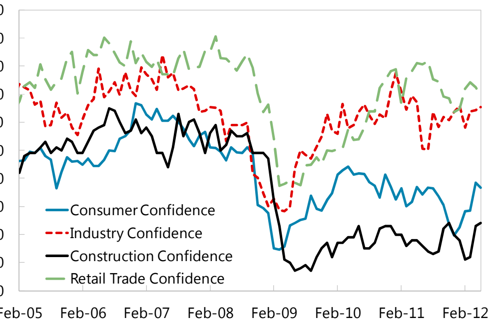



**Source: NBS.**

*Domestic confidence indicators improved earlier this year.*

### Confidence Indicators

(Percent balance, seasonally adjusted)

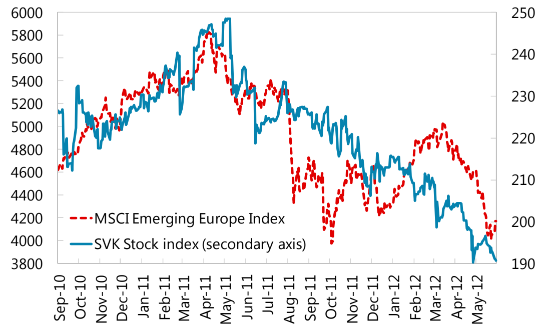



**Sources: SOSR; ECB; and Haver.**

## Figure 2. Slovak Republic: Spillovers from the Euro Area Turmoil

*Equity prices dropped in the wake of euro area turmoil…*

**Equity Price Indices**

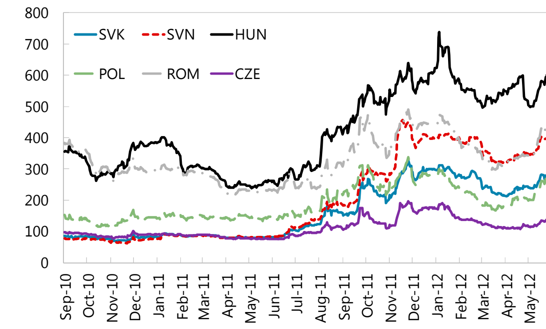



**Source: Bloomberg.**

*…and CDS spreads have widened.*

**5-Year CDS Spreads, USD-Based**

(Basis points)

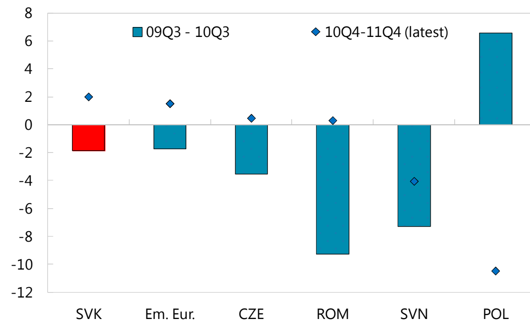



**Source: Bloomberg.**

*But foreign bank funding remained relatively stable…*

**Change in Total Foreign Claims**

(Percent change)

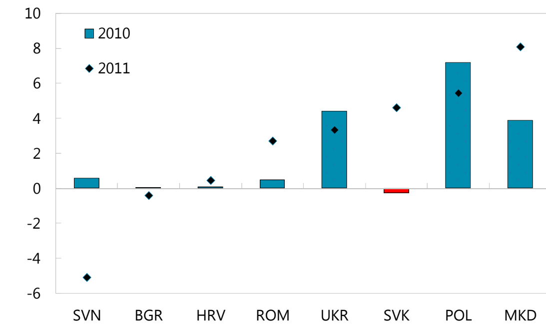



**Sources: BIS Consolidated Banking Statistics, May 2012.**

*…and capital inflows have increased.*

**Net Private Capital Inflow**

(Percent of GDP)

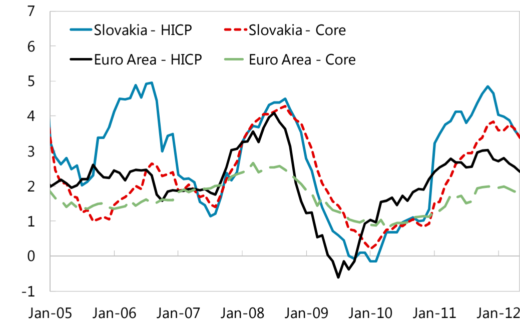



**Sources: BPTS; IMF WEO; and IMF staff estimates.**

## Figure 3. Slovak Republic: Inflation and Monetary Developments, 2005–11

*Inflation surged above the euro area average…*

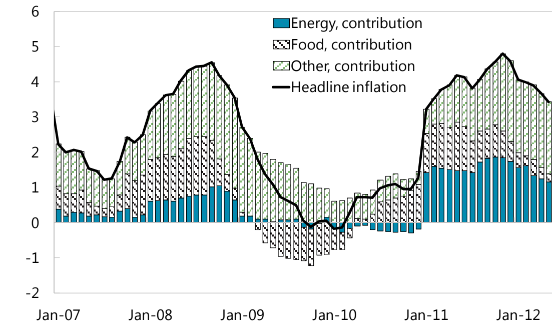
**Headline and Core Inflation**
(Percent change)




**Sources: Eurostat; and Haver Analytics.**

*…led by energy prices and a VAT rate hike.*

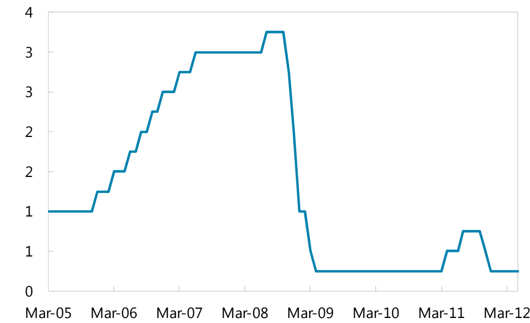
**Contributions to Inflation**
(Percent)




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

*Despite low policy interest rates…*

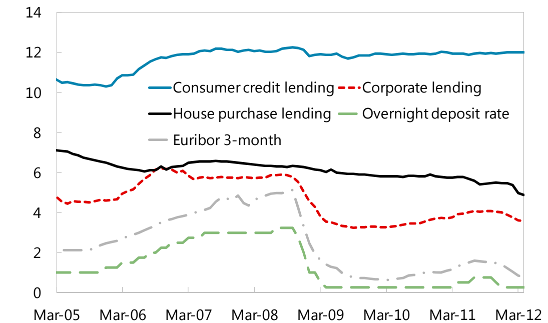
**Policy Interest Rate**
(Percent)




**Sources: ECB; and Haver Analytics.**

*…lending rates have not come down for consumers.*

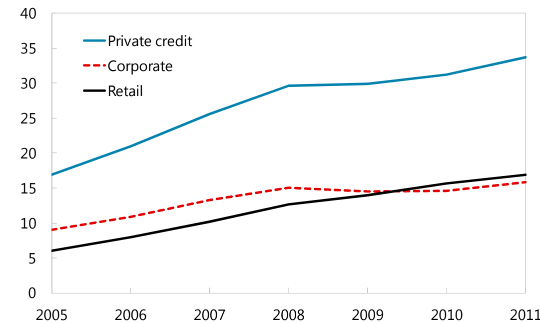
**Lending Rates**
(Percent)




**Sources: NBS; ECB; and Haver Analytics.**

*But credit is gradually increasing…*

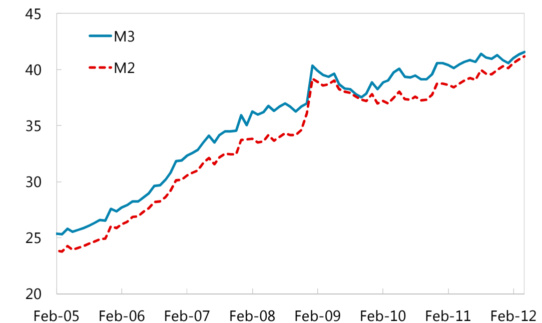
**Credit to Private Sector**
(Billions of euros)




**Source: NBS.**

*…on the back of an expanding money supply*

**Money Supply**
(Billions of euros)

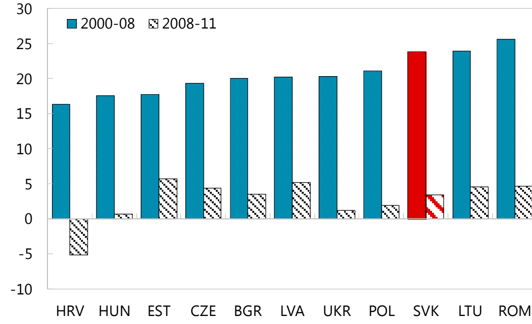



**Sources: NBS; and Haver Analytics.**

# Figure 4. Slovak Republic: Competitiveness Indicators, 1995–2011

*Export growth was high in the run-up to the crisis...*

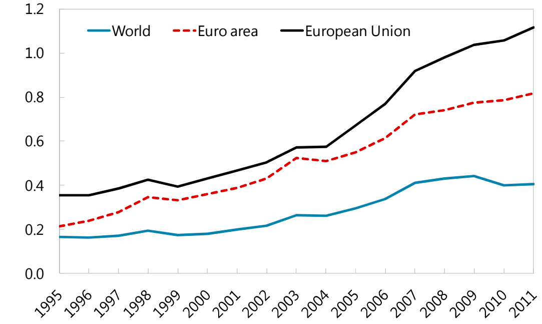
**Exports Compound Annual Growth Rates**
(Percent)




**Sources: IMF WEO; and IMF staff calculations.**

*...and export market shares have increased.*

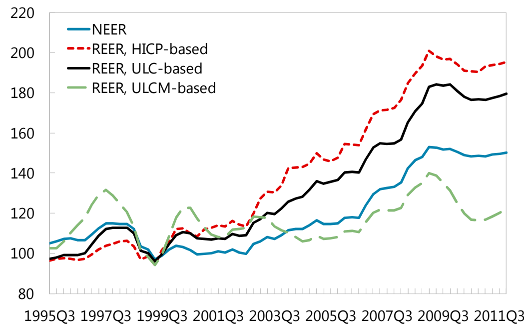
**Slovak Export Shares**
(Percent of destination's total imports)




**Sources: IMF DTTS; and IMF staff calculations.**

*Real effective exchange rates have stabilized...*

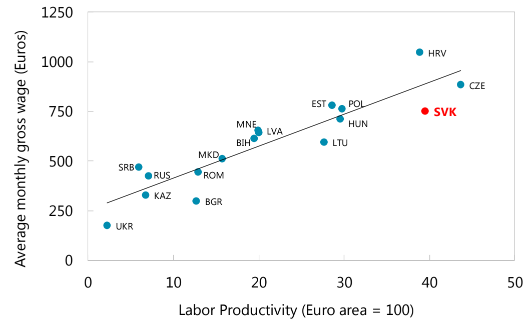
**Nominal and Real Effective Exchange Rates**
(1999=100)




**Source: Eurostat.**

*...and wages remain competitive relative to productivity...*

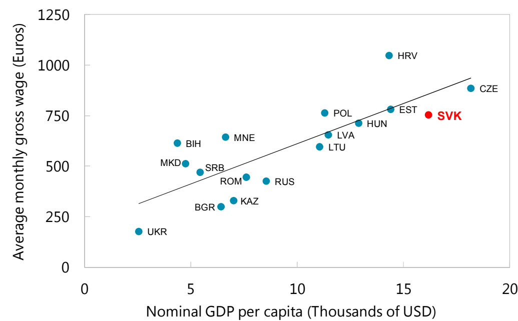
**Labor Productivity and Wages, 2009**




**Sources: Haver Analytics; IMF WEO; and IMF staff calculations.**

*...as well as to the level of development...*

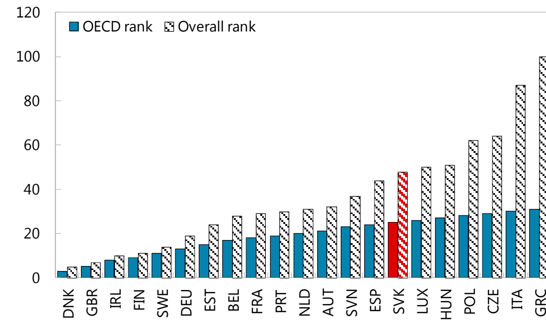
**GDP Per Capita and Wages, 2009**




**Sources: Haver Analytics; IMF WEO; and IMF staff calculations.**

*...while the business environment can be further bolstered.*

**Doing Business, 2011**
(Ranked from 1 (best) to 31 economies for OECD and 183 overall)

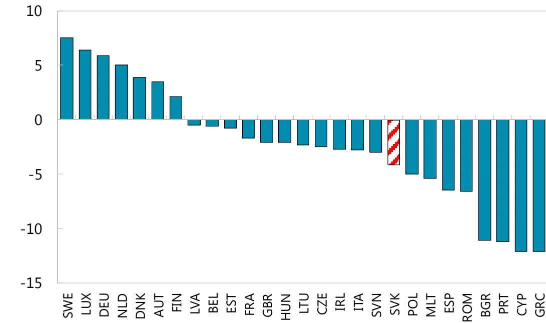



**Source: OECD.**

## Figure 5. Slovak Republic: External Developments, 2000–11

*Slovakia's current account deficit has been moderate...*

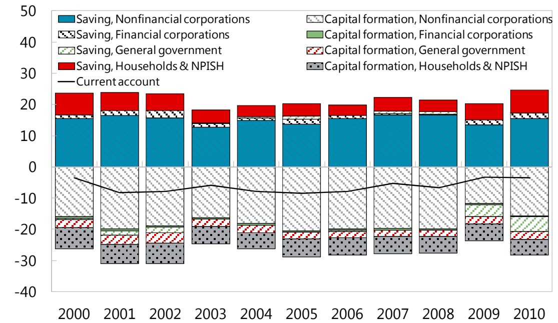
**3-Year Average of Current Account Balance, 2010**
(Percent of GDP, 3-year average)




**Source: Eurostat.**

*...with private sector saving partly offsetting government dissaving.*

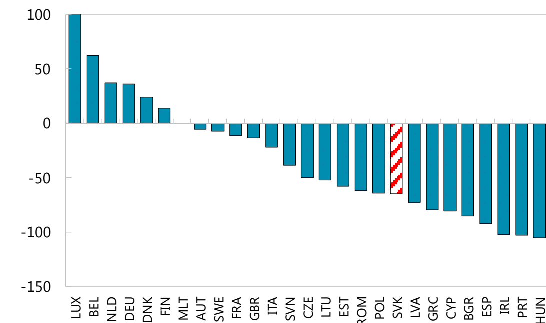
**Gross Sectoral Saving and Investment Balances**
(Percent of GDP)




**Sources: Eurostat; IMF WEO; and IMF staff calculations.**

*The NIIP is also not unusually large...*

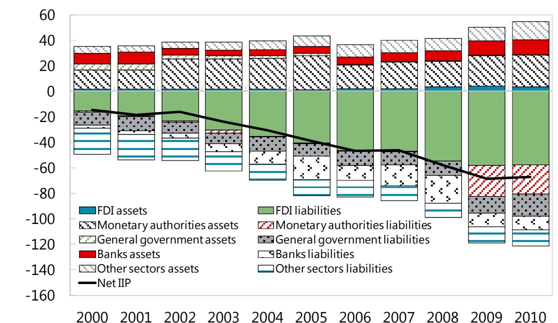
**Net International Investment Positions, 2011**
(Percent of GDP)




**Source: Eurostat.**

*...with the deterioration reflecting increased inward FDI.*

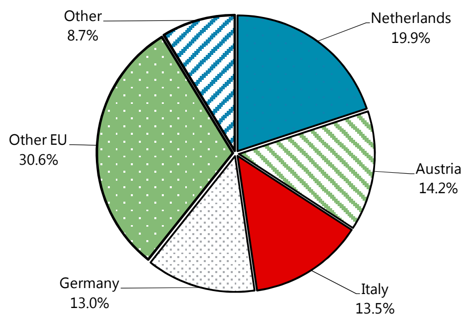
**Net International Investment Position by Institution**
(Percent of GDP)




**Sources: IMF BPTS; and IMF staff calculations.**

*The vast majority of inward FDI is from EU partners...*

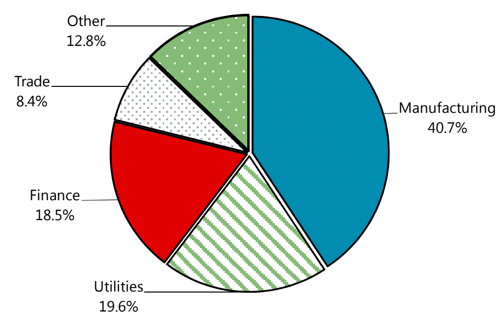
**Slovakia: Inward FDI Positions by Country, end-2008**
(Percent of total)




**Sources: NBS; and IMF staff calculations.**

*...and is substantially invested in tradables.*

**Slovakia: Inward FDI Positions by Sector, end-2007**
(Percent of total)



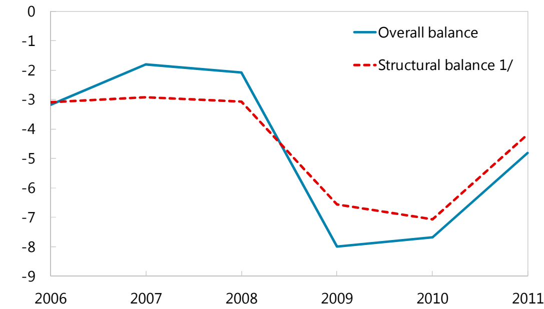

**Sources: NBS; and IMF staff calculations.**

## Figure 6. Slovak Republic: Fiscal Indicators, 2006–11

*A sizable fiscal consolidation…*

**Slovakia: Fiscal Balance**

(Percent of GDP)



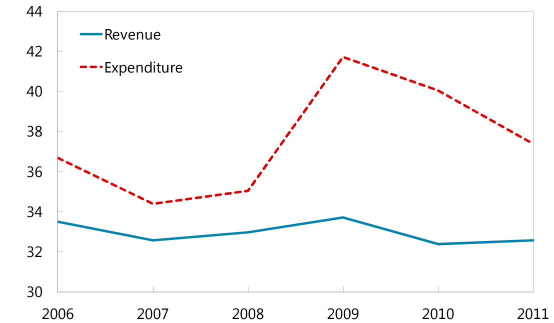

**Sources: IMF WEO; and IMF staff calculations.**

1/ In percent of potential GDP.

*…supported by expenditure cuts…*

**Slovakia: Revenue and Expenditure**

(Percent of GDP)

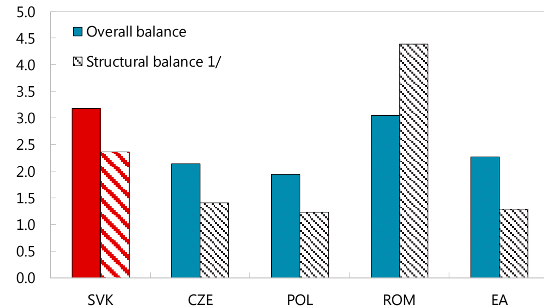



**Sources: Eurostat; and Haver Analytics.**

*…was relatively large…*

**Change in Overall and Structural Balances, 2009-11**

(Percent of GDP)



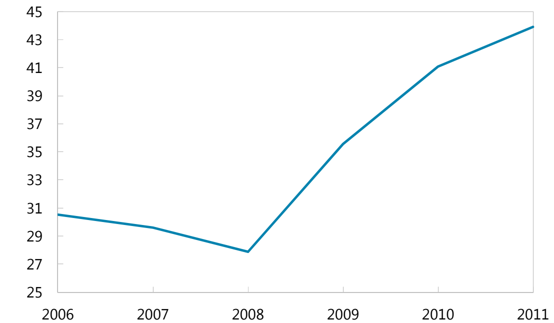

**Sources: IMF WEO; and IMF staff calculations.**

1/ In percent of potential GDP.

*…but has yet to make a dent in public debt…*

**Slovakia: Gross Debt**

(Percent of GDP)

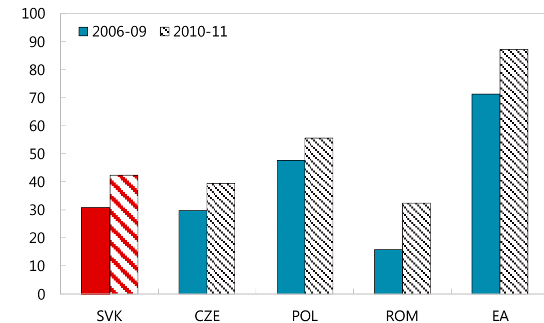



**Sources: IMF WEO; and IMF staff calculations.**

*…which, at any rate, is moderate.*

**Gross Debt**

(Percent of GDP)

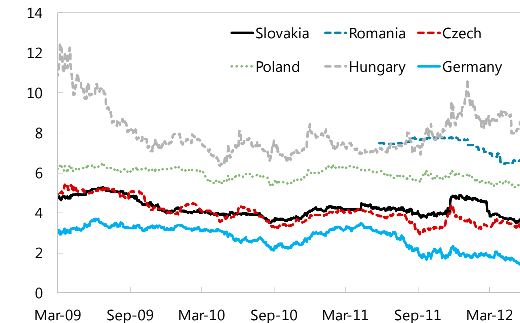



**Sources: IMF WEO; and IMF staff calculations.**

*Government yields have come down recently.*

**10-Year Government Yields**

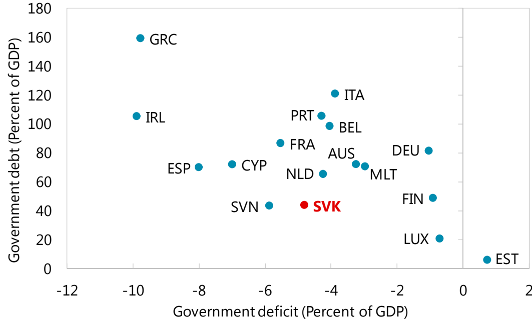
(Percent)




**Source: Bloomberg.**

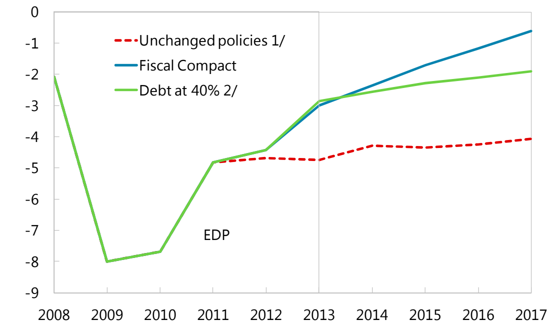
## Figure 7. Slovak Republic: Fiscal Adjustment Scenarios, 2008–17

*While Slovakia's debt is still moderate, the deficit is high.*



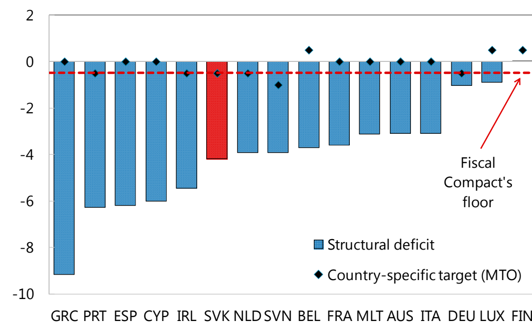

Sources: IMF WEO; and IMF staff calculations.

*The authorities intend to reduce the deficit to under 3 percent of GDP by 2013.*



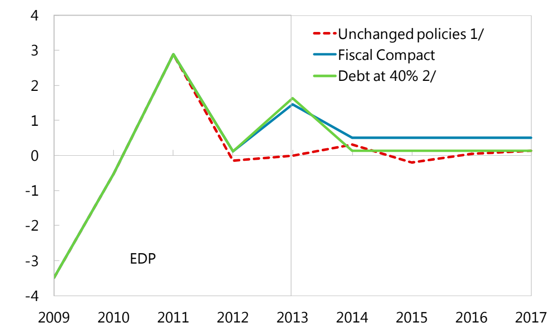

Sources: IMF WEO; and IMF staff calculations.

*Slovakia's medium-term objective under the Fiscal Compact...*



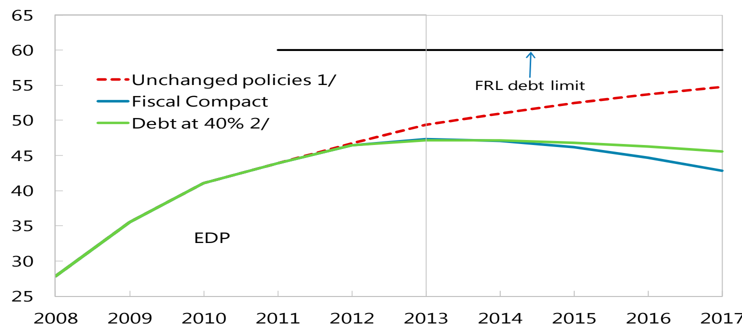

Sources: IMF WEO; and IMF staff calculations.

*...implies a larger fiscal effort...*




Sources: IMF WEO; and IMF staff calculations.

*...than needed to stabilize the debt at 40 percent of GDP.*



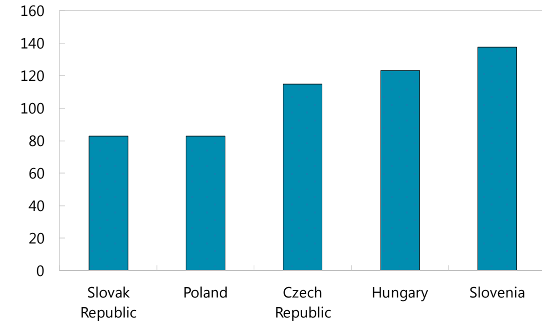

Sources: IMF WEO; and IMF staff calculations.

1/Based on staff's revenue projections and on expenditures in 2012–15 budget, including unbudgeted expenditure in 2012 (0.3 percent of GDP).
2/ The projections for 2012–13 are based on the authorities' plans to reduce the overall deficit to 2.9 percent of GDP by 2013. After 2013, the projections assume an additional adjustment of about 0.5 percent of GDP to stabilize public debt at 40 percent of GDP in the long run.

## Figure 8. Slovak Republic: Selected Financial Indicators, 2005–11

*The banking system is not very large...*

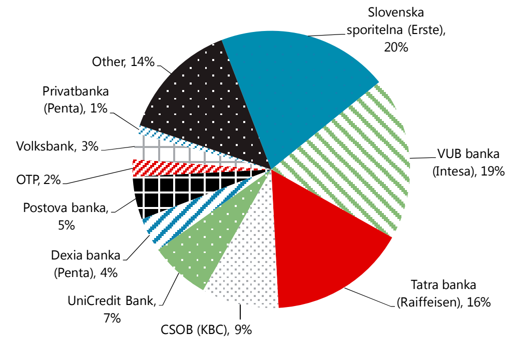
**Banks' Assets, 2010**
(Percent of GDP)




**Source: Raiffeisen.**

*...and dominated by subsidiaries of foreign banks.*

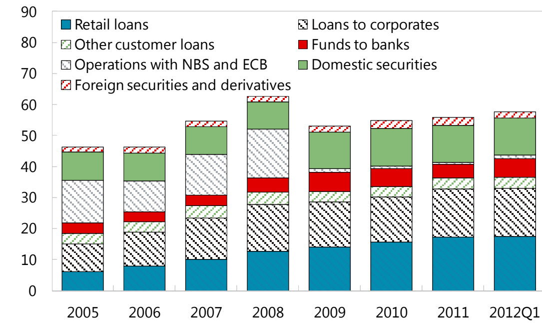
**Distribution of Banking Sector Assets, June 2011**




**Source: Raiffeisen Research.**

*Banks' assets are dominated by domestic loans and government bonds...*

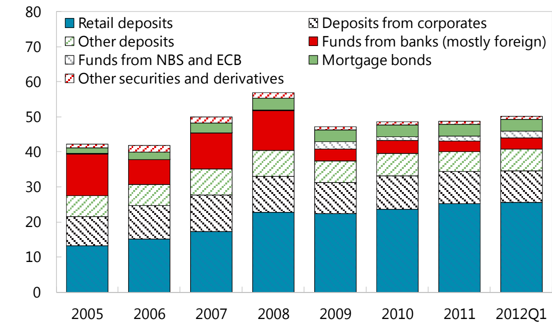
**Banks' Assets**
(Billions of euros)




**Source: NBS.**

*...while funding maintains a stable and high share of domestic deposits.*

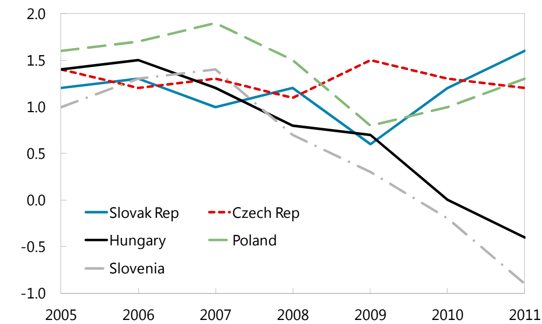
**Banks' Liabilities**
(Billions of euros)




**Source: NBS.**

*Profits continue to increase after dipping in 2009...*

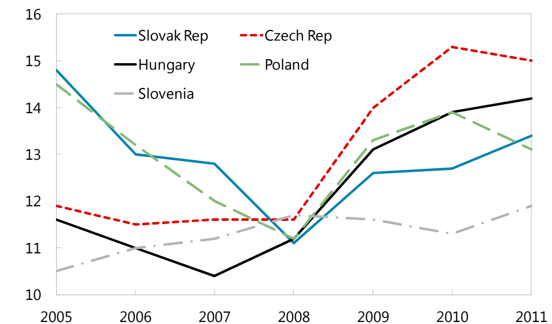
**Return on Assets**
(Percent)




**Source: IMF GFSR.**

*...and capitalization has strengthened significantly.*

**Regulatory Capital to Risk-Weighted Assets**
(Percent)

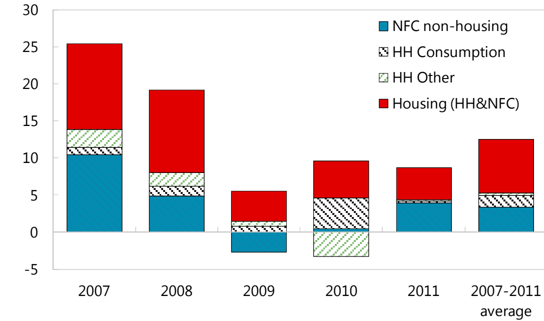



**Source: IMF GFSR.**

## Figure 9. Slovak Republic: Banks' Exposure to Housing Loans

*The bulk of credit growth has gone into housing.*

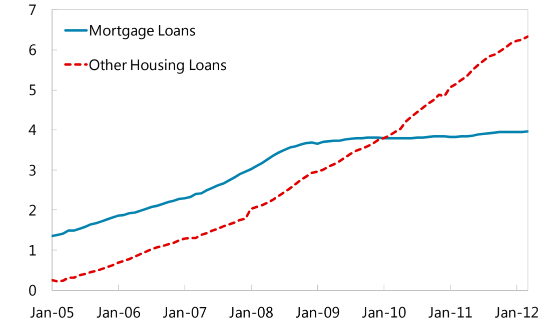
### Contribution to Annual Loan Growth by Sector
(Percentage points)




**Sources: NBS; ECB; Haver Analytics; and IMF staff estimates.**

*The less regulated "other housing loans" have surpassed traditional mortgages,*

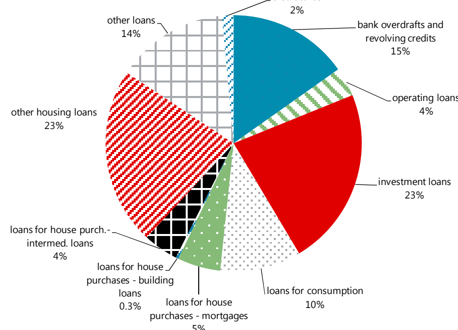
### Mortgage Loans and Other Housing Loans
(Billions of euros)




**Source: NBS.**

*...making up a lion's share of total NPLs...*

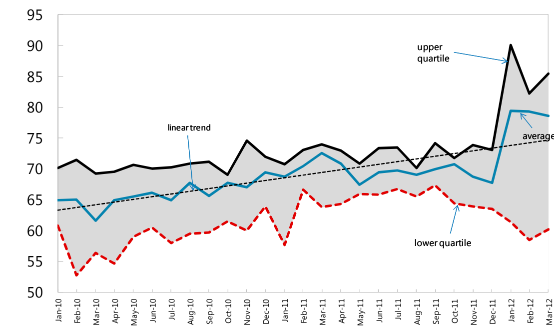
### Distribution of NPLs by Loan Type, as of March 2012
(Percent of total)




**Source: NBS.**

*...and driving up the average Loan-To-Value ratio.*

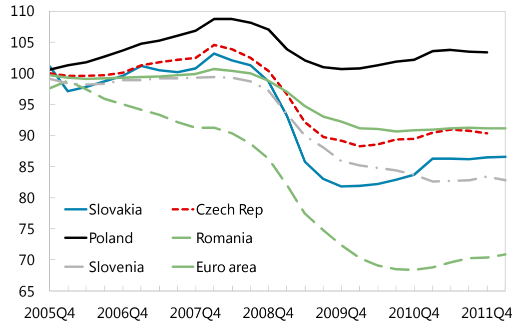
### Loan to Value Ratio
(Percent of new loans)




**Source: NBS.**

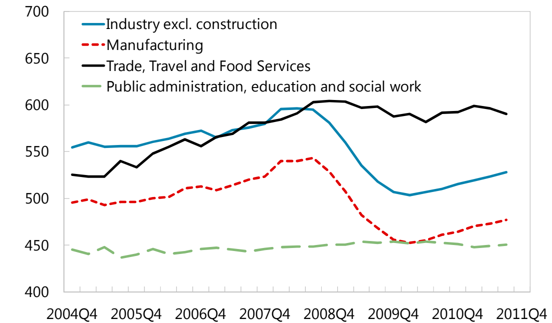
## Figure 10. Slovak Republic: Labor Market Indicators, 2005–11

*Employment has not fully recovered…*



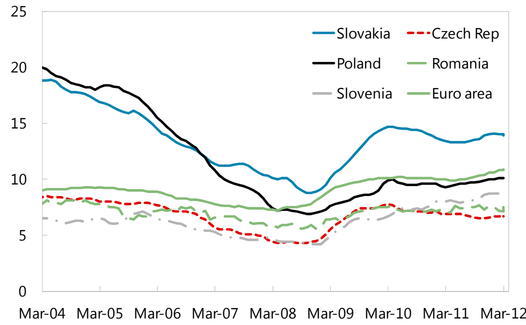

Sources: Eurostat; and Haver Analytics.

*… despite a pick-up in export-led sectors.*



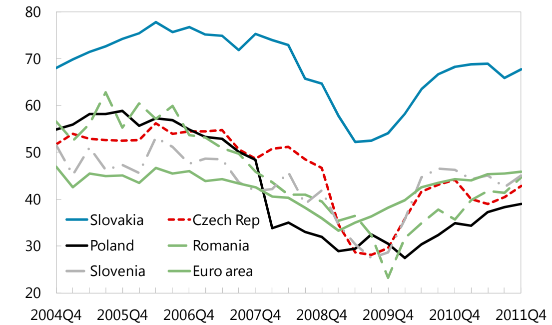

Sources: Eurostat; and Haver Analytics.

*Unemployment remains high…*



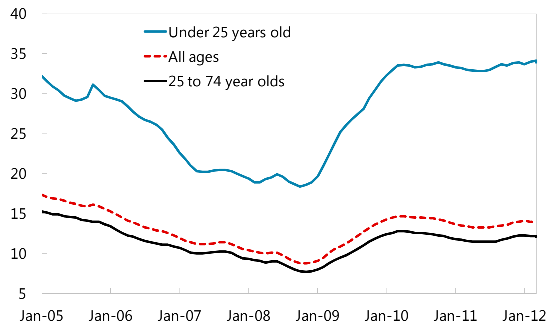

Sources: Eurostat; and Haver.

*… and is becoming entrenched.*



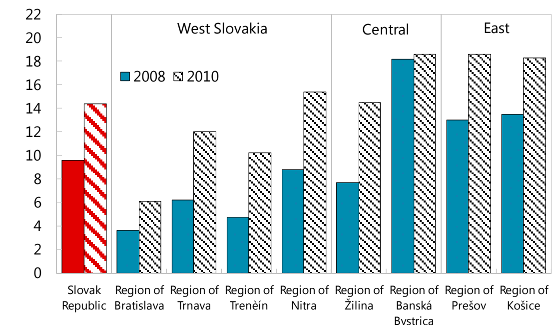

Sources: Eurostat; and Haver Analytics.

*Youth unemployment soared…*




Sources: Eurostat; and Haver Analytics.

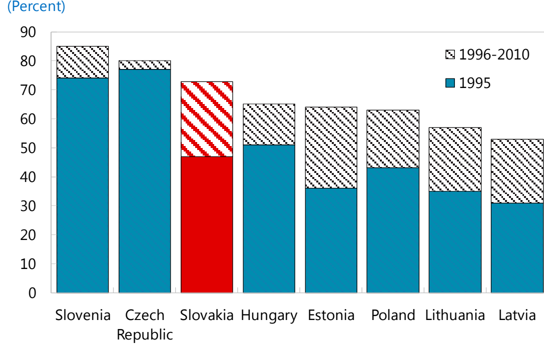
*…while East/West disparities persist.*




Source: Central Office of Labour, Social Affairs and Family.

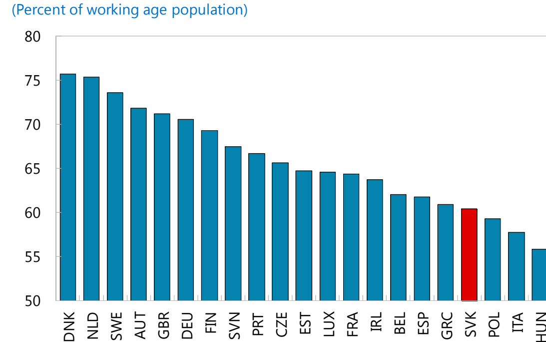
## Figure 11. Slovak Republic: Structural Indicators

*Slovakia has experienced an above average degree of real income convergence...*



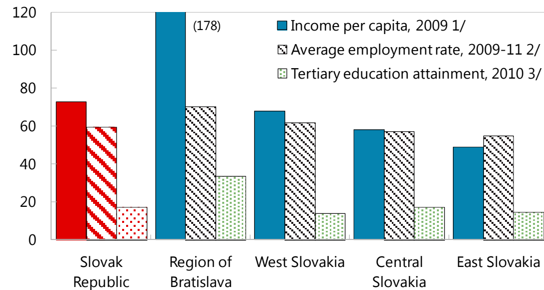

Sources: Eurostat; and IMF staff calculations.

*... but its labor potential remains underutilized.*



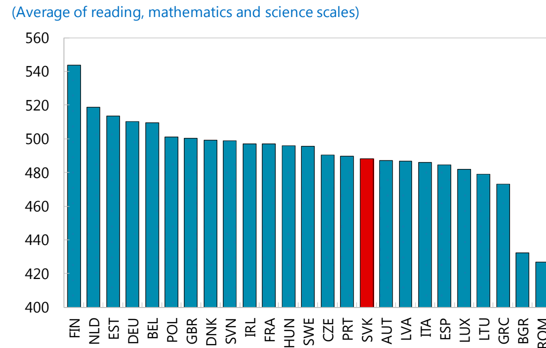

Source: OECD Employment and Labour Market Statistics database.

*In addition, development remains geographically uneven...*



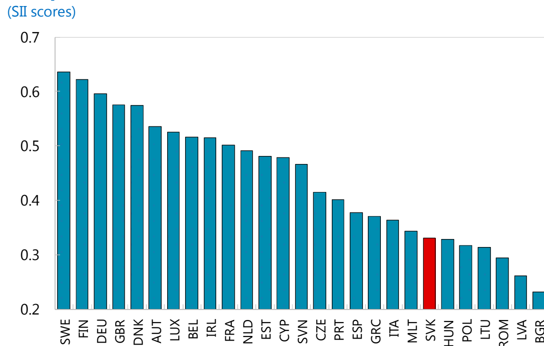

Sources: Eurostat; and Slovak Statistical Office.
1/ Percent of EU27.
2/ Weighted average for OECD countries (2008-10) is 65.3.
3/ Average for European Union is 25.9.

*... and education levels lag.*



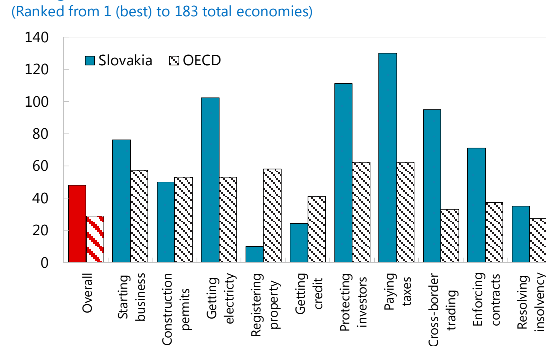

Source: OECD PISA 2009 database.

*Slovakia also remains an 'innovation user'...*




Source: European Union.

*... while regulatory impediments may hamper longer-term growth.*




Source: IBRD Doing Business 2012: Slovakia.

## Table 1. Slovak Republic: Selected Economic Indicators, 2008–17

Population (in million): 5.4
Per capita income ($): 16,830
Quota (current; millions SDR/% of total): 427.5 / 0.18
Literacy / poverty rate 1/: 99 / 20.6
Main products and exports: Transport equipment, machinery and electric equipment
Key export markets: Germany, Czech Republic

| | | | | | Projections | | | | | |
|---|---|---|---|---|---|---|---|---|---|---|
| | 2008 | 2009 | 2010 | 2011 | 2012 | 2013 | 2014 | 2015 | 2016 | 2017 |
| | (Annual percentage change, constant prices, unless noted | | | | | | | | | |
| Real GDP | 5.8 | -4.9 | 4.2 | 3.3 | 2.6 | 3.3 | 3.6 | 3.6 | 3.6 | 3.6 |
| Domestic demand | 5.7 | -7.4 | 4.5 | -1.5 | 0.7 | 2.0 | 2.8 | 3.1 | 3.2 | 3.3 |
| Public consumption | 6.1 | 6.1 | 1.1 | -3.5 | 1.3 | 1.4 | 2.0 | 2.0 | 2.1 | 2.1 |
| Private consumption | 6.1 | 0.2 | -0.7 | -0.4 | 0.2 | 1.2 | 2.1 | 2.3 | 3.0 | 3.0 |
| Gross capital formation | 4.7 | -30.2 | 22.1 | -2.7 | 1.4 | 4.2 | 5.0 | 5.8 | 4.5 | 4.7 |
| Exports of goods and services | 3.1 | -15.9 | 16.5 | 10.8 | 4.4 | 7.0 | 6.1 | 5.6 | 5.5 | 5.5 |
| Imports of goods and services | 3.1 | -18.1 | 16.3 | 4.5 | 3.3 | 6.0 | 5.6 | 5.4 | 5.4 | 5.4 |
| Output Gap | 2.8 | -3.4 | -1.0 | -0.6 | -1.2 | -1.1 | -0.7 | -0.3 | -0.2 | 0.0 |
| Potential Growth | 6.2 | 1.2 | 1.6 | 2.9 | 3.2 | 3.2 | 3.2 | 3.2 | 3.4 | 3.5 |
| Prices | | | | | | | | | | |
| Inflation (HICP) | 3.9 | 0.9 | 0.7 | 4.1 | 4.0 | 2.3 | 2.8 | 2.8 | 2.8 | 2.8 |
| Inflation (HICP, end of period) | 3.5 | 0.1 | 1.3 | 4.7 | 2.9 | 2.1 | 2.8 | 2.8 | 2.8 | 2.8 |
| Employment and wages | | | | | | | | | | |
| Employment | 3.2 | -2.8 | -2.0 | 1.5 | -0.2 | 0.8 | 1.0 | 1.2 | 1.1 | 1.0 |
| Nominal wages | 7.6 | 2.8 | 5.1 | 3.7 | 4.5 | 4.5 | 5.2 | 5.3 | 5.3 | 5.3 |
| Unemployment rate (percent) | 9.6 | 12.1 | 14.4 | 13.5 | 13.8 | 13.6 | 12.9 | 12.1 | 11.3 | 10.6 |
| | (Percent of GDP) | | | | | | | | | |
| Public Finance, General Government | | | | | | | | | | |
| Revenue | 33.0 | 33.7 | 32.4 | 32.6 | 32.6 | 34.1 | 33.8 | 33.7 | 33.7 | 33.7 |
| Expenditure | 35.0 | 41.7 | 40.0 | 37.4 | 37.0 | 36.9 | 36.5 | 36.3 | 36.3 | 36.3 |
| Overall balance | -2.1 | -8.0 | -7.7 | -4.8 | -4.4 | -2.9 | -2.7 | -2.7 | -2.6 | -2.6 |
| Primary balance | -0.8 | -6.6 | -6.3 | -3.2 | -2.8 | -1.1 | -0.9 | -0.9 | -0.8 | -0.8 |
| Structural balance (percent of potential GDP) | -3.1 | -6.6 | -7.1 | -4.2 | -4.1 | -2.5 | -2.4 | -2.6 | -2.6 | -2.6 |
| General government debt | 27.9 | 35.6 | 41.1 | 43.9 | 46.5 | 47.2 | 47.3 | 47.3 | 47.3 | 47.2 |
| | (Percent) | | | | | | | | | |
| Monetary and financial indicators | | | | | | | | | | |
| Bank credit to private sector (growth rate) | 15.6 | 1.0 | 4.3 | 8.6 | | | | | | |
| Lending rates 2/ | 6.8 | 5.7 | 5.9 | 5.9 | | | | | | |
| Deposit rates 3/ | 0.7 | 0.3 | 0.2 | 0.3 | | | | | | |
| Government 10-year bond yield | 4.7 | 4.7 | 3.9 | 4.4 | | | | | | |
| | (Percent of GDP) | | | | | | | | | |
| Balance of payments | | | | | | | | | | |
| Trade balance (goods) | -1.1 | 1.5 | 1.2 | 3.5 | 3.8 | 4.3 | 4.7 | 5.3 | 5.6 | 5.6 |
| Current account balance | -6.6 | -2.6 | -2.5 | 0.1 | -0.3 | -0.2 | -0.2 | -0.2 | -0.2 | -0.3 |
| Gross external debt | 56.5 | 72.2 | 74.9 | 75.4 | 70.5 | 65.5 | 60.2 | 55.3 | 50.7 | 46.5 |

Sources: National Authorities; and IMF staff calculations.
1/ Percent of population aged 15 and over who can read and write. At-risk-of-poverty rate in percent of total populatic
2010. At risk-of-poverty are persons with an equivalised disposable income below the risk-of-poverty threshold, whicl
set at 60 % of the national median equivalised disposable income (after social transfers).
2/ Loans of up to one year, non-housing new loans to households.
3/ Average of interest rates on new overnight deposits from households and nonfinancial corporations.

## Table 2. Slovak Republic: Fiscal Operations of the Consolidated General Government, 2006–17

(Percent of GDP)

| | | | | | | | Projections | | | | | |
|---|---|---|---|---|---|---|---|---|---|---|---|---|
| | 2006 | 2007 | 2008 | 2009 | 2010 | 2011 | 2012 | 2013 | 2014 | 2015 | 2016 | 2017 |
| Total revenue | 33.5 | 32.6 | 33.0 | 33.7 | 32.4 | 32.6 | 32.6 | 34.1 | 33.8 | 33.7 | 33.7 | 33.7 |
| Tax revenue | 17.2 | 17.2 | 16.9 | 15.9 | 15.5 | 16.1 | 16.1 | 17.0 | 17.0 | 17.0 | 17.0 | 17.0 |
| Indirect taxes, of which | 11.2 | 11.1 | 10.5 | 10.4 | 10.2 | 10.4 | 10.4 | 10.4 | 10.4 | 10.4 | 10.4 | 10.4 |
| VAT | 7.3 | 6.6 | 6.8 | 6.6 | 6.3 | 6.7 | 6.6 | 6.5 | 6.4 | 6.4 | 6.4 | 6.4 |
| Excises | 2.9 | 3.5 | 2.7 | 2.8 | 2.9 | 2.9 | 2.9 | 2.9 | 2.9 | 2.9 | 2.9 | 2.9 |
| Property tax and other | 0.3 | 0.3 | 0.3 | 0.3 | 0.3 | 0.3 | 0.3 | 0.3 | 0.3 | 0.3 | 0.3 | 0.3 |
| Direct taxes, of which | 6.1 | 6.2 | 6.4 | 5.5 | 5.4 | 5.6 | 5.6 | 6.5 | 6.5 | 6.5 | 6.5 | 6.5 |
| Personal income tax | 2.5 | 2.6 | 2.7 | 2.4 | 2.3 | 2.5 | 2.5 | 3.0 | 3.0 | 3.0 | 3.0 | 3.0 |
| Self-employment tax | 0.3 | 0.3 | 0.3 | 0.1 | 0.1 | 0.1 | 0.1 | 0.1 | 0.1 | 0.1 | 0.1 | 0.1 |
| Corporate profit tax | 2.9 | 3.0 | 3.1 | 2.5 | 2.6 | 2.6 | 2.6 | 3.0 | 3.0 | 3.0 | 3.0 | 3.0 |
| Property tax and other | 0.1 | 0.1 | 0.1 | 0.1 | 0.1 | 0.1 | 0.1 | 0.1 | 0.1 | 0.1 | 0.1 | 0.1 |
| Social contributions, of which | 11.9 | 11.9 | 12.2 | 12.9 | 12.6 | 12.5 | 12.5 | 13.0 | 13.0 | 13.0 | 13.0 | 13.0 |
| Actual social contributions | 11.8 | 11.7 | 12.1 | 12.7 | 12.4 | 12.3 | 12.3 | 12.8 | 12.8 | 12.8 | 12.8 | 12.8 |
| Employer contributions | 6.3 | 6.3 | 6.7 | 6.9 | 6.9 | 6.6 | 6.7 | 7.2 | 7.2 | 7.2 | 7.2 | 7.2 |
| Employee contributions | 2.8 | 2.8 | 2.9 | 3.0 | 3.2 | 2.9 | 2.9 | 2.9 | 2.9 | 2.9 | 2.9 | 2.9 |
| Voluntary SC Self-employed or nonemployed | 2.7 | 2.7 | 2.4 | 2.8 | 2.3 | 2.8 | 2.8 | 2.8 | 2.8 | 2.8 | 2.8 | 2.8 |
| Imputed social contributions | 0.1 | 0.1 | 0.1 | 0.1 | 0.2 | 0.2 | 0.2 | 0.2 | 0.2 | 0.2 | 0.2 | 0.2 |
| Non-tax revenues | 2.9 | 2.8 | 2.3 | 2.6 | 2.2 | 2.2 | 2.3 | 2.2 | 1.9 | 1.8 | 1.8 | 1.8 |
| Sales | 1.3 | 1.2 | 1.1 | 1.2 | 1.2 | 1.2 | 1.2 | 1.1 | 1.1 | 1.1 | 1.1 | 1.1 |
| Other current revenue | 1.6 | 1.5 | 1.2 | 1.4 | 1.0 | 0.9 | 1.2 | 1.1 | 0.8 | 0.7 | 0.7 | 0.7 |
| Grants and transfers, of which | 1.5 | 0.7 | 1.6 | 2.4 | 2.1 | 1.8 | 1.7 | 1.9 | 2.0 | 1.9 | 1.9 | 1.9 |
| from the European Union | 0.3 | 0.4 | 0.4 | 0.9 | 1.0 | 1.1 | 1.3 | 1.5 | 1.5 | 1.4 | 1.4 | 1.4 |
| | | | | | | | | | | | | |
| Total expenditure | 36.7 | 34.4 | 35.0 | 41.7 | 40.0 | 37.4 | 37.0 | 36.9 | 36.5 | 36.3 | 36.3 | 36.3 |
| Current expenditure | 33.7 | 31.7 | 32.0 | 37.2 | 36.4 | 34.7 | 34.8 | 34.2 | 33.8 | 33.4 | 33.3 | 33.2 |
| Compensation of employees, of which | 7.4 | 6.8 | 7.0 | 7.9 | 7.7 | 7.1 | 6.6 | 6.6 | 6.6 | 6.6 | 6.6 | 6.6 |
| Wages | 5.6 | 5.1 | 5.2 | 5.9 | 5.7 | 5.3 | 4.9 | 4.9 | 4.9 | 4.9 | 4.9 | 4.9 |
| Employer social security contributions | 1.8 | 1.7 | 1.7 | 2.0 | 2.0 | 1.9 | 1.7 | 1.7 | 1.7 | 1.7 | 1.7 | 1.7 |
| Intermediate consumption | 5.7 | 4.6 | 4.5 | 5.4 | 4.9 | 4.3 | 4.2 | 4.2 | 4.2 | 4.1 | 4.1 | 4.1 |
| Taxes | 0.1 | 0.2 | 0.1 | 0.1 | 0.1 | 0.1 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 |
| Subsidies | 1.3 | 1.2 | 1.7 | 1.6 | 1.4 | 1.2 | 1.3 | 1.1 | 1.0 | 1.0 | 0.9 | 0.9 |
| Agricultural subsidies | 0.1 | 0.2 | 0.4 | 0.5 | 0.3 | 0.0 | 0.2 | 0.1 | 0.0 | 0.0 | 0.0 | 0.0 |
| Transport subsidies | 0.8 | 0.8 | 0.9 | 0.8 | 0.9 | 0.0 | 1.0 | 0.9 | 0.9 | 0.8 | 0.8 | 0.7 |
| Other | 0.4 | 0.2 | 0.4 | 0.3 | 0.2 | 1.2 | 0.1 | 0.1 | 0.1 | 0.1 | 0.1 | 0.2 |
| Interest | 1.5 | 1.4 | 1.2 | 1.4 | 1.3 | 1.6 | 1.7 | 1.8 | 1.8 | 1.8 | 1.8 | 1.8 |
| Social benefits | 16.3 | 16.1 | 16.1 | 19.0 | 19.5 | 18.5 | 18.5 | 18.0 | 18.0 | 17.8 | 17.7 | 17.6 |
| Social benefits other than D.631 | 11.9 | 11.6 | 11.4 | 13.8 | 14.2 | 13.6 | 13.2 | 13.0 | 13.0 | 12.8 | 12.7 | 12.6 |
| Social transfers in kind (Healthcare) | 4.4 | 4.5 | 4.7 | 5.2 | 5.3 | 4.9 | 5.3 | 5.0 | 5.0 | 5.0 | 5.0 | 5.0 |
| Other current transfers, of which | 1.5 | 1.4 | 1.4 | 1.8 | 1.6 | 1.9 | 2.6 | 2.5 | 2.3 | 2.3 | 2.3 | 2.3 |
| Transfers to the EU budget | 0.8 | 0.8 | 0.8 | 1.0 | 0.8 | 0.8 | 0.8 | 0.8 | 0.8 | 0.8 | 0.7 | 0.7 |
| Transfer of 2% of income tax to the third sector | 0.1 | 0.1 | 0.1 | 0.1 | 0.1 | 0.1 | 0.1 | 0.1 | 0.1 | 0.1 | 0.0 | 0.0 |
| Capital expenditures | 3.0 | 2.7 | 3.1 | 4.5 | 3.6 | 2.6 | 2.2 | 2.7 | 2.6 | 2.9 | 3.0 | 3.1 |
| Capital investments | 1.9 | 1.7 | 1.7 | 2.3 | 2.6 | 2.1 | 1.4 | 1.8 | 1.8 | 2.1 | 2.2 | 2.3 |
| Capital transfers | 1.1 | 1.0 | 1.4 | 2.2 | 1.1 | 0.5 | 0.9 | 1.0 | 0.8 | 0.8 | 0.8 | 0.8 |
| | | | | | | | | | | | | |
| General government balance | -3.2 | -1.8 | -2.1 | -8.0 | -7.7 | -4.8 | -4.4 | -2.9 | -2.7 | -2.7 | -2.6 | -2.6 |
| Primary balance | -1.7 | -0.4 | -0.8 | -6.6 | -6.3 | -3.2 | -2.8 | -1.1 | -0.9 | -0.9 | -0.8 | -0.8 |
| Structural balance (percent of potential GDP) 1/ | -3.1 | -2.9 | -3.1 | -6.6 | -7.1 | -4.2 | -4.1 | -2.5 | -2.4 | -2.6 | -2.6 | -2.6 |
| Gross public debt | 30.5 | 29.6 | 27.9 | 35.6 | 41.1 | 43.9 | 46.5 | 47.2 | 47.3 | 47.3 | 47.3 | 47.2 |
| | | | | | | | | | | | | |
| *Memorandum items:* | | | | | | | | | | | | |
| General government balance (excluding one-off events) 1/ | -3.2 | -1.8 | -2.1 | -8.0 | -7.5 | -4.4 | -4.5 | -2.9 | -2.7 | -2.7 | -2.6 | -2.6 |
| GDP at current market prices | 55002 | 61450 | 66843 | 62795 | 65744 | 69058 | 72100 | 75555 | 79975 | 84705 | 89766 | 95187 |

Sources: National Authorities; and IMF staff calculations.

1/ One-off events include revenue and expenditure items in 2010 (-0.2 percent of GDP); in 2011 (-0.4 percent of GDP), including payments to the state railways and hospitals (0.9 percent of GDP); and VAT revenue from a PPP project in 2012 (0.1 percent of GDP).

## Table 3. Slovak Republic: Statement of Operations of the General Government, 2006–17

(Percent of GDP)

| | 2006 | 2007 | 2008 | 2009 | 2010 | 2011 | 2012 | 2013 | 2014 | 2015 | 2016 | 2017 |
|---|---|---|---|---|---|---|---|---|---|---|---|---|
| | | | | | | | Projections | | | | | |
| Revenue | 33.5 | 32.6 | 33.0 | 33.7 | 32.4 | 32.6 | 32.6 | 34.1 | 33.8 | 33.7 | 33.7 | 33.7 |
| Taxes | 17.2 | 17.2 | 16.9 | 15.9 | 15.5 | 16.1 | 16.1 | 17.0 | 17.0 | 17.0 | 17.0 | 17.0 |
| Personal income tax | 2.5 | 2.6 | 2.7 | 2.4 | 2.3 | 2.5 | 2.5 | 3.0 | 3.0 | 3.0 | 3.0 | 3.0 |
| Corporate income tax | 2.9 | 3.0 | 3.1 | 2.5 | 2.6 | 2.6 | 2.6 | 3.0 | 3.0 | 3.0 | 3.0 | 3.0 |
| VAT | 7.3 | 6.6 | 6.8 | 6.6 | 6.3 | 6.7 | 6.6 | 6.5 | 6.4 | 6.4 | 6.4 | 6.4 |
| Excises | 2.9 | 3.5 | 2.7 | 2.8 | 2.9 | 2.9 | 2.9 | 2.9 | 2.9 | 2.9 | 2.9 | 2.9 |
| Other taxes | 1.6 | 1.6 | 1.6 | 1.5 | 1.4 | 1.4 | 1.4 | 1.6 | 1.7 | 1.7 | 1.7 | 1.7 |
| Social contributions | 11.9 | 11.9 | 12.2 | 12.9 | 12.6 | 12.5 | 12.5 | 13.0 | 13.0 | 13.0 | 13.0 | 13.0 |
| Grants | 0.3 | 0.4 | 0.4 | 0.9 | 1.0 | 1.1 | 1.3 | 1.5 | 1.5 | 1.4 | 1.4 | 1.4 |
| Other revenue | 4.0 | 3.1 | 3.4 | 4.1 | 3.3 | 2.9 | 2.7 | 2.6 | 2.4 | 2.4 | 2.3 | 2.3 |
| Expenditure | 36.7 | 34.4 | 35.0 | 41.7 | 40.0 | 37.4 | 37.0 | 36.9 | 36.5 | 36.3 | 36.3 | 36.3 |
| Expense | 34.8 | 32.6 | 33.3 | 39.4 | 37.5 | 35.3 | 35.7 | 35.2 | 34.6 | 34.2 | 34.1 | 34.0 |
| Compensation of employees | 7.4 | 6.8 | 7.0 | 7.9 | 7.7 | 7.1 | 6.6 | 6.6 | 6.6 | 6.6 | 6.6 | 6.6 |
| Use of goods and services | 5.7 | 4.6 | 4.5 | 5.4 | 4.9 | 4.3 | 4.2 | 4.2 | 4.2 | 4.1 | 4.1 | 4.1 |
| Interest | 1.5 | 1.4 | 1.2 | 1.4 | 1.3 | 1.6 | 1.7 | 1.8 | 1.8 | 1.8 | 1.8 | 1.8 |
| Subsidies | 1.3 | 1.2 | 1.7 | 1.6 | 1.4 | 1.2 | 1.3 | 1.1 | 1.0 | 1.0 | 0.9 | 0.9 |
| Grants | 0.9 | 0.9 | 0.9 | 1.1 | 0.9 | 0.8 | 0.8 | 0.9 | 0.8 | 0.9 | 0.8 | 0.7 |
| Social benefits | 16.3 | 16.1 | 16.1 | 19.0 | 19.5 | 18.5 | 18.5 | 18.0 | 18.0 | 17.8 | 17.7 | 17.6 |
| Other expense | 1.8 | 1.7 | 2.0 | 3.0 | 1.9 | 1.7 | 2.6 | 2.6 | 2.3 | 2.2 | 2.3 | 2.3 |
| Net acquisition of nonfinancial assets | 1.9 | 1.7 | 1.7 | 2.3 | 2.6 | 2.1 | 1.4 | 1.8 | 1.8 | 2.1 | 2.2 | 2.3 |
| Gross Operating Balance | -1.3 | -0.1 | -0.4 | -5.7 | -5.1 | -2.7 | -3.1 | -1.1 | -0.8 | -0.5 | -0.4 | -0.3 |
| Net lending (+)/borrowing (-) | -3.2 | -1.8 | -2.1 | -8.0 | -7.7 | -4.8 | -4.4 | -2.9 | -2.7 | -2.7 | -2.6 | -2.6 |
| Net financial transactions | -3.1 | -1.7 | -2.2 | -8.1 | -8.4 | -4.8 | -4.4 | -2.9 | -2.7 | -2.7 | -2.6 | -2.6 |
| Net acquisition of financial assets | -2.4 | 0.7 | -0.4 | -1.8 | 0.1 | -0.7 | -0.7 | -0.4 | -0.4 | -0.4 | -0.4 | -0.4 |
| Currency and deposits | 0.1 | 1.4 | 0.2 | -2.0 | -0.3 | -1.3 | -1.2 | -0.8 | -0.7 | -0.7 | -0.7 | -0.7 |
| Debt securities | -0.1 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 |
| Loans | -0.2 | -0.2 | 0.0 | 0.1 | 0.0 | 0.5 | 0.4 | 0.3 | 0.3 | 0.3 | 0.3 | 0.3 |
| Equity and investment fund shares | -1.8 | -0.4 | -0.2 | 0.3 | -0.2 | -0.2 | -0.2 | -0.1 | -0.1 | -0.1 | -0.1 | -0.1 |
| Other financial assets | -0.3 | -0.1 | -0.4 | -0.2 | 0.7 | 0.3 | 0.3 | 0.2 | 0.2 | 0.2 | 0.2 | 0.2 |
| Net incurrence of liabilities | 0.7 | 2.4 | 1.8 | 6.3 | 8.5 | 4.1 | 3.8 | 2.4 | 2.3 | 2.3 | 2.2 | 2.2 |
| Currency and deposits | 0.1 | 0.1 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 |
| Debt securities | 1.8 | 2.0 | 1.3 | 6.0 | 6.9 | 3.1 | 2.9 | 1.9 | 1.7 | 1.7 | 1.7 | 1.7 |
| Loans | -1.2 | -0.2 | 0.0 | -0.1 | 0.2 | 1.1 | 1.0 | 0.6 | 0.6 | 0.6 | 0.6 | 0.6 |
| Other liabilities | 0.0 | 0.6 | 0.5 | 0.4 | 1.4 | -0.1 | -0.1 | -0.1 | -0.1 | -0.1 | -0.1 | -0.1 |
| *Statistical discrepancy (nonfin. vs fin. accounts)* | *-0.1* | *-0.1* | *0.1* | *0.1* | *0.7* | *0.0* | *0.0* | *0.0* | *0.0* | *0.0* | *0.0* | *0.0* |
| *Memorandum items:* | | | | | | | | | | | | |
| Primary balance | -1.7 | -0.4 | -0.8 | -6.6 | -6.3 | -3.2 | -2.8 | -1.1 | -0.9 | -0.9 | -0.8 | -0.8 |
| Net lending/borrowing (excluding one-off events) 1/ | -3.2 | -1.8 | -2.1 | -8.0 | -7.5 | -4.4 | -4.5 | -2.9 | -2.7 | -2.7 | -2.6 | -2.6 |
| Structural balance (percent of potential GDP) 1/ | -3.1 | -2.9 | -3.1 | -6.6 | -7.1 | -4.2 | -4.1 | -2.5 | -2.4 | -2.6 | -2.6 | -2.6 |
| Gross public debt | 30.5 | 29.6 | 27.9 | 35.6 | 41.1 | 43.9 | 46.5 | 47.2 | 47.3 | 47.3 | 47.3 | 47.2 |
| GDP at current market prices | 55,002 | 61,450 | 66,843 | 62,795 | 65,744 | 69,059 | 72,100 | 75,555 | 79,975 | 84,705 | 89,766 | 95,187 |

Sources: National Authorities; and IMF staff calculations.

1/ One-off events include revenue and expenditure items in 2010 (-0.2 percent of GDP); in 2011 (-0.4 percent of GDP), including payments to the state railways and hospitals (0.9 percent of GDP); and VAT revenue from a PPP project in 2012 (0.1 percent of GDP).

## Table 4. Slovak Republic: General Government Financial Balance Sheet, 2006–11

(In millions of euros, unless otherwise indicated)

| | 2006 | | | | 2007 | | | 2008 | | | 2009 | | | 2010 | | | 2011 | | |
|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|
| | Opening balance | Trans-actions | OEF | Closing Opening balance | Trans-actions | OEF | Closing Opening balance | Trans-actions | OEF | Closing Opening balance | Trans-actions | OEF | Closing Opening balance | Trans-actions | OEF | Closing Opening balance | Trans-actions | OEF | Closing Opening balance |
| Net worth and its changes | .... | .... | .... | .... | .... | .... | .... | .... | .... | .... | .... | .... | .... | .... | .... | .... | .... | .... | .... |
| Nonfinancial assets | .... | .... | .... | .... | .... | .... | .... | .... | .... | .... | .... | .... | .... | .... | .... | .... | .... | .... | .... |
| Net Financial Worth: | -2,467 | -1,706 | 622 | -3,551 | -1,063 | 144 | -4,470 | -1,487 | -97 | -6,054 | -5,081 | 48 | -11,087 | -5,518 | 62 | -16,543 | -3,306 | 0 | -19,849 |
| Financial Assets | 16,494 | -1,311 | 28 | 15,211 | 438 | 69 | 15,718 | -281 | -97 | 15,340 | -1,106 | 47 | 14,281 | 61 | 62 | 14,404 | -491 | 0 | 13,913 |
| Currency and deposits | 2,577 | 51 | 192 | 2,820 | 857 | -38 | 3,639 | 113 | -94 | 3,658 | -1,242 | 46 | 2,462 | -209 | 62 | 2,315 | -903 | 0 | 1,412 |
| Debt securities | 194 | -76 | 30 | 148 | -8 | 172 | 312 | -1 | -1 | 310 | -5 | 0 | 305 | -1 | 0 | 304 | -1 | 0 | 303 |
| Loans | 1,434 | -118 | -34 | 1,282 | -110 | 0 | 1,172 | 30 | 0 | 1,202 | 67 | 0 | 1,269 | -31 | 0 | 1,238 | 333 | 0 | 1,571 |
| Equity and inv. fund shares | 9,339 | -989 | 443 | 8,793 | -227 | -65 | 8,501 | -125 | -1 | 8,375 | 203 | 0 | 8,578 | -140 | 0 | 8,438 | -128 | 0 | 8,310 |
| Other financial assets | 2,950 | -179 | -603 | 2,168 | -74 | 0 | 2,094 | -298 | -1 | 1,795 | -129 | 1 | 1,667 | 442 | 0 | 2,109 | 208 | 0 | 2,317 |
| Liabilities | 18,961 | 395 | -594 | 18,762 | 1,501 | -75 | 20,188 | 1,206 | 0 | 21,394 | 3,975 | -1 | 25,368 | 5,579 | 0 | 30,947 | 2,815 | 0 | 33,762 |
| Currency and deposits | 0 | 69 | 0 | 69 | 48 | 0 | 117 | -9 | 0 | 108 | -24 | -1 | 83 | -12 | 0 | 71 | 30 | 0 | 101 |
| Debt securities | 14,237 | 992 | -1 | 15,228 | 1,216 | -67 | 16,377 | 867 | -1 | 17,243 | 3,779 | 0 | 21,022 | 4,551 | 0 | 25,573 | 2,143 | 0 | 27,716 |
| Loans | 3,399 | -668 | -977 | 1,754 | -134 | -49 | 1,571 | -1 | 1 | 1,571 | -61 | 0 | 1,510 | 108 | 0 | 1,618 | 732 | 0 | 2,350 |
| Other liabilities | 1,325 | 2 | 384 | 1,711 | 371 | 41 | 2,123 | 349 | 0 | 2,472 | 281 | 0 | 2,753 | 932 | 0 | 3,685 | -90 | 0 | 3,595 |
| *Memorandum items:* | | | | | | | | | | | | | | | | | | | |
| Net financial worth (in % of GDP) | -5.0 | | | -6.5 | | | -7.3 | | | -9.1 | | | -17.7 | | | -25.2 | | | -28.7 |
| Financial assets (in % of GDP) | 33.4 | | | 27.7 | | | 25.6 | | | 22.9 | | | 22.7 | | | 21.9 | | | 20.1 |
| o/w foreign financial assets (%) | 5.2% | | | 3.8% | | | 4.8% | | | 4.4% | | | 6.3% | | | 6.9% | | | 6.4% |
| Liabilities (in % of GDP) | 38.4 | | | 34.1 | | | 32.9 | | | 32.0 | | | 40.4 | | | 47.1 | | | 48.9 |
| o/w foreign liabilities (%) | 19.5% | | | 16.3% | | | 24.3% | | | 24.6% | | | 29.3% | | | 20.8% | | | 21.6% |
| GDP nominal prices | 49,314 | | | 55,002 | | | 61,450 | | | 66,843 | | | 62,795 | | | 65,744 | | | 69,059 |

Sources: National Authorities; and IMF staff calculations.

## Table 5. Slovak Republic: Medium-term Balance of Payments, 2006–17

(Millions of euros, unless otherwise indicated)

| | | | | | | | Projections | | | | | |
|---|---|---|---|---|---|---|---|---|---|---|---|---|
| | 2006 | 2007 | 2008 | 2009 | 2010 | 2011 | 2012 | 2013 | 2014 | 2015 | 2016 | 2017 |
| Current account balance | -4,316 | -3,240 | -4,433 | -1,627 | -1,637 | 38 | -187 | -124 | -144 | -164 | -144 | -280 |
| Trade balance (goods) | -2,562 | -725 | -758 | 946 | 778 | 2,442 | 2,749 | 3,246 | 3,776 | 4,496 | 4,984 | 5,338 |
| Exports, f.o.b. | 40,892 | 47,351 | 49,522 | 39,721 | 48,272 | 56,408 | 59,601 | 64,412 | 69,122 | 74,356 | 79,532 | 84,930 |
| Imports, f.o.b. | -43,454 | -48,076 | -50,280 | -38,775 | -47,494 | -53,966 | -56,852 | -61,166 | -65,346 | -69,860 | -74,548 | -79,592 |
| Services balance | 721 | 412 | -493 | -1,026 | -757 | -381 | -1,132 | -1,189 | -1,240 | -1,280 | -1,348 | -1,438 |
| Receipts | 5,301 | 5,729 | 6,000 | 4,342 | 4,393 | 4,746 | 5,895 | 6,370 | 6,836 | 7,354 | 7,866 | 8,400 |
| Payments | -4,580 | -5,317 | -6,493 | -5,368 | -5,150 | -5,127 | -7,027 | -7,560 | -8,077 | -8,634 | -9,214 | -9,837 |
| Income balance | -2,422 | -2,559 | -2,289 | -870 | -1,249 | -1,680 | -1,430 | -1,780 | -2,230 | -2,880 | -3,230 | -3,580 |
| Receipts | 2,026 | 1,989 | 2,393 | 2,267 | 2,324 | 2,417 | 2,567 | 2,617 | 2,667 | 2,717 | 2,867 | 2,917 |
| Payments | -4,472 | -4,571 | -4,688 | -3,138 | -3,573 | -4,097 | -3,997 | -4,397 | -4,897 | -5,597 | -6,097 | -6,497 |
| Current transfers | -54 | -368 | -893 | -676 | -422 | -353 | -373 | -400 | -450 | -500 | -550 | -600 |
| Capital and financial account balance | 1,450 | 6,245 | 5,946 | 2,524 | 516 | 3,731 | 187 | 124 | 144 | 164 | 144 | 280 |
| Capital account | -40 | 377 | 806 | 464 | 1,018 | 865 | 885 | 905 | 925 | 945 | 965 | 985 |
| Direct foreign investment | 4,122 | 2,444 | 2,236 | -656 | 150 | 1,189 | 1,673 | 1,756 | 1,833 | 1,909 | 1,983 | 2,056 |
| Reinvested earnings | 933 | 586 | 558 | -201 | | | | | | | | |
| Portfolio investment | 1,601 | -585 | 1,671 | -1,773 | -1,193 | -174 | -144 | -114 | -84 | -54 | -24 | 6 |
| Other investment | -4,073 | 3,961 | 1,352 | 4,222 | 647 | 1,895 | -2,227 | -2,423 | -2,530 | -2,636 | -2,780 | -2,767 |
| Reserve assets 1/ | 2,592 | -3,186 | 113 | 567 | 0 | ... | ... | ... | ... | ... | ... | ... |
| Errors and omissions | 2,866 | -3,005 | -1,436 | -898 | 1,121 | -3,769 | ... | ... | ... | ... | ... | ... |
| Memorandum items: | (Percent of GDP, unless otherwise indicated) | | | | | | | | | | | |
| Current account balance | -7.8 | -5.3 | -6.6 | -2.6 | -2.5 | 0.1 | -0.3 | -0.2 | -0.2 | -0.2 | -0.2 | -0.3 |
| Trade balance (G&NFS) | -3.3 | -0.5 | -1.9 | -0.1 | 0.0 | 3.0 | 2.2 | 2.7 | 3.2 | 3.8 | 4.1 | 4.1 |
| Merchandise export volume (percent change) | 22.1 | 15.1 | 3.6 | -15.2 | 18.9 | 11.3 | 4.4 | 7.0 | 6.1 | 5.6 | 5.5 | 5.5 |
| Value (percent change) | 23.5 | 14.9 | 4.6 | -20.6 | 19.5 | 16.1 | 7.1 | 8.1 | 7.3 | 7.6 | 7.0 | 6.8 |
| Merchandise import volume (percent change) | 19.0 | 8.6 | 1.5 | -19.0 | 20.4 | 5.2 | 3.3 | 6.0 | 5.6 | 5.4 | 5.4 | 5.4 |
| Terms of trade (percent change from previous year) | -5.0 | -2.7 | -6.0 | 5.5 | ... | ... | ... | ... | ... | ... | ... | ... |
| Income balance | -4.4 | -4.2 | -3.4 | -1.4 | -1.9 | -2.4 | -2.0 | -2.4 | -2.8 | -3.4 | -3.6 | -3.8 |
| Current transfers | -0.1 | -0.6 | -1.3 | -1.1 | -0.6 | -0.5 | -0.5 | -0.5 | -0.6 | -0.6 | -0.6 | -0.6 |
| Total external debt (billion of euros) | 24.5 | 30.1 | 37.7 | 45.3 | 49.3 | 52.0 | 50.8 | 49.5 | 48.2 | 46.8 | 45.5 | 44.3 |
| Total external debt (percent of GDP) | 51.0 | 54.6 | 56.5 | 72.2 | 74.9 | 75.4 | 70.5 | 65.5 | 60.2 | 55.3 | 50.7 | 46.5 |
| GDP (millions of euros) | 55,002 | 61,450 | 66,843 | 62,795 | 65,744 | 69,059 | 72,100 | 75,555 | 79,975 | 84,705 | 89,766 | 95,187 |

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

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

## Table 6. Slovak Republic: Financial Soundness Indicators for the Banking Sector, 2008–11

(Percent, unless otherwise indicated)

| | 2008 | 2009 | 2010 | 2011 |
|---|---|---|---|---|
| Capital Adequacy | | | | |
| Regulatory capital to risk-weighted assets | 11.1 | 12.6 | 12.7 | 13.4 |
| Regulatory Tier 1 capital to risk-weighted assets | 10.7 | 11.4 | 11.6 | 12.4 |
| Capital to assets | 8.2 | 9.6 | 9.7 | 10.8 |
| Asset Composition and Quality | | | | |
| Nonperforming loans to gross loans | 2.5 | 5.3 | 5.8 | 5.6 |
| Nonperforming loans net of provisions to capital | 6.7 | 14.3 | 16.7 | 15.5 |
| Customer deposits to total (noninterbank) loans | 98.9 | 116.1 | 116.6 | 109.4 |
| Earnings and Profitability | | | | |
| Return on assets (after tax) | 1.2 | 0.6 | 1.2 | 1.5 |
| Return on equity (after tax) | 15.4 | 6.7 | 12.6 | 14.5 |
| Interest margin to gross income | 65.9 | 76.8 | 75.9 | 73.9 |
| Noninterest expenses to gross income | 57.3 | 62.3 | 57.5 | 52.5 |
| Liquidity | | | | |
| Liquid assets to total assets | 52.1 | 43.4 | 40.9 | 37.4 |
| Liquid assets to short-term liabilities | 65.0 | 57.3 | 56.5 | 52.9 |
| Sectoral distribution of loans to total loans | | | | |
| Residents | 95.6 | 93.4 | 93.6 | 93.6 |
| Deposit-takers | 0.3 | 0.1 | 0.0 | 0.0 |
| Central bank | 22.2 | ... | ... | ... |
| Other financial corporations | 4.6 | 4.2 | 2.9 | 2.8 |
| General government | 1.9 | 2.6 | 3.2 | 2.9 |
| Nonfinancial corporations | 36.1 | 44.1 | 42.2 | 41.6 |
| Other domestic sectors | 30.5 | 42.5 | 45.3 | 46.2 |
| Nonresidents | 4.4 | 6.6 | 6.4 | 6.4 |
| Geographical distribution of loans to total loans | | | | |
| Domestic economy | 97.4 | 93.4 | 93.6 | 93.6 |
| Advanced economies, excluding China | ... | 2.3 | 2.7 | 2.9 |
| Other emerging market and developing countries, including China | 2.6 | 4.3 | 3.7 | 3.5 |
| Africa | | | | |
| Of which: Sub-Sahara | | | | |
| Central and Eastern Europe | 2.6 | 4.3 | 3.7 | 3.5 |
| Commonwealth of Independent States and Mongolia | | | | |
| Developing Asia, including China | | | | |
| Middle East | | | | |
| Western Hemisphere | | | | |
| Other indicators | | | | |
| Gross asset position in financial derivatives to capital | 17.5 | 9.0 | 7.6 | 8.0 |
| Gross liability position in financial derivatives to capital | 17.9 | 10.4 | 9.4 | 9.1 |
| Trading income to total income | 12.4 | 1.5 | 2.9 | -4.1 |
| Personnel expenses to noninterest expenses | 38.3 | 38.5 | 38.6 | 40.1 |
| Spread between reference lending and deposit rates (basis points) | 428.0 | 430.0 | 395.0 | 376.5 |
| Spread between highest and lowest interbank rates (basis points) | | | | |
| Foreign-currency-denominated loans to total loans | 21.7 | 2.8 | 3.2 | 4.1 |
| Foreign-currency-denominated liabilities to total liabilities | 9.6 | 10.5 | 9.6 | 9.1 |
| Net open position in equities to capital | 9.6 | 10.5 | 9.6 | 9.1 |
| Net open position in foreign exchange to capital | -19.5 | -0.1 | -1.2 | -1.7 |

Source: National Bank of Slovakia, IMF FSI Database.

## Table A1. Slovak Republic: Public Sector Debt Sustainability Framework, 2007–17

(In percent of GDP, unless otherwise indicated)

| | Actual | | | | | Projections | | | | | | |
|---|---|---|---|---|---|---|---|---|---|---|---|---|
| | 2007 | 2008 | 2009 | 2010 | 2011 | 2012 | 2013 | 2014 | 2015 | 2016 | 2017 | **Debt-stabilizing primary balance 9/** |
| **Baseline: Public sector debt 1/** | 29.6 | 27.9 | 35.6 | 41.1 | 43.9 | **46.5** | **47.2** | **47.3** | **47.3** | **47.3** | **47.2** | **-0.9** |
| o/w foreign-currency denominated | 0.0 | 0.0 | 0.1 | 0.1 | 0.1 | 2.0 | 1.9 | 1.8 | 1.7 | 1.7 | 1.7 | |
| Change in public sector debt | -0.9 | -1.8 | 7.7 | 5.5 | 2.8 | 2.6 | 0.7 | 0.1 | 0.0 | 0.0 | -0.1 | |
| Identified debt-creating flows (4+7+12) | -1.4 | -0.3 | 9.8 | 6.1 | 2.8 | 2.6 | 0.7 | 0.1 | 0.0 | 0.0 | -0.1 | |
| Primary deficit | 0.5 | 0.7 | 6.6 | 6.3 | 3.2 | 2.8 | 1.1 | 0.9 | 0.9 | 0.8 | 0.8 | |
| Revenue and grants | 32.4 | 33.0 | 33.7 | 32.4 | 32.6 | 32.6 | 34.1 | 33.8 | 33.7 | 33.7 | 33.7 | |
| Primary (noninterest) expenditure | 32.9 | 33.7 | 40.3 | 38.7 | 35.8 | 35.4 | 35.1 | 34.7 | 34.6 | 34.5 | 34.5 | |
| Automatic debt dynamics 2/ | -1.8 | -1.0 | 3.2 | -0.2 | -0.4 | -0.2 | -0.3 | -0.8 | -0.9 | -0.9 | -0.9 | |
| Contribution from interest rate/growth differential 3/ | -1.8 | -1.0 | 3.2 | -0.2 | -0.4 | -0.2 | -0.3 | -0.8 | -0.9 | -0.9 | -0.9 | |
| Of which contribution from real interest rate | 1.0 | 0.5 | 1.7 | 1.2 | 0.9 | 0.9 | 1.1 | 0.8 | 0.8 | 0.7 | 0.7 | |
| Of which contribution from real GDP growth | -2.9 | -1.6 | 1.5 | -1.4 | -1.3 | -1.1 | -1.5 | -1.6 | -1.6 | -1.6 | -1.6 | |
| Contribution from exchange rate depreciation 4/ | 0.0 | 0.0 | 0.0 | 0.1 | 0.0 | ... | ... | ... | ... | ... | ... | |
| Other identified debt-creating flows | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | |
| Privatization receipts (negative) | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | |
| Recognition of implicit or contingent liabilities | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | |
| Other (specify, e.g. bank recapitalization) | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | |
| Residual, including asset changes (2-3) 5/ | 0.5 | -1.5 | -2.1 | -0.6 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | |
| Public sector debt-to-revenue ratio 1/ | 91.4 | 84.5 | 105.5 | 126.9 | 134.8 | 142.6 | 138.6 | 139.8 | 140.4 | 140.3 | 140.1 | |
| **Gross financing need 6/** | 1.8 | 2.1 | 12.5 | 13.3 | 10.5 | 9.9 | 9.8 | 9.4 | 9.1 | 9.1 | 9.1 | |
| in billions of U.S. dollars | 1.4 | 2.0 | 10.9 | 11.6 | 10.1 | 9.4 | 9.7 | 9.9 | 10.1 | 10.6 | 11.2 | |
| **Scenario with key variables at their historical averages 7/** | | | | | | **46.5** | **48.0** | **49.6** | **51.0** | **52.5** | **53.9** | **-1.1** |
| **Scenario with no policy change (constant primary balance) in 2012-2017** | | | | | | **46.5** | **48.9** | **50.8** | **52.6** | **54.4** | **56.2** | **-1.1** |
| **Key Macroeconomic and Fiscal Assumptions Underlying Baseline** | | | | | | | | | | | | |
| Real GDP growth (in percent) | 10.5 | 5.8 | -4.9 | 4.2 | 3.3 | 2.6 | 3.3 | 3.6 | 3.6 | 3.6 | 3.6 | |
| Average nominal interest rate on public debt (in percent) 8/ | 5.0 | 5.0 | 4.8 | 4.0 | 4.0 | 3.9 | 4.0 | 4.0 | 4.0 | 4.0 | 4.0 | |
| Average real interest rate (nominal rate minus change in GDP deflator, in percent) | 3.8 | 2.1 | 5.9 | 3.5 | 2.4 | 2.2 | 2.6 | 1.8 | 1.8 | 1.7 | 1.7 | |
| Nominal appreciation (increase in US dollar value of local currency, in percent) | 15.8 | 1.2 | 9.5 | -9.5 | -0.3 | ... | ... | ... | ... | ... | ... | |
| Inflation rate (GDP deflator, in percent) | 1.1 | 2.9 | -1.2 | 0.5 | 1.6 | 1.7 | 1.4 | 2.2 | 2.2 | 2.3 | 2.3 | |
| Growth of real primary spending (deflated by GDP deflator, in percent) | 3.8 | 8.5 | 13.7 | 0.1 | -4.3 | 1.3 | 2.6 | 2.3 | 3.2 | 3.5 | 3.6 | |
| Primary deficit | 0.5 | 0.7 | 6.6 | 6.3 | 3.2 | 2.8 | 1.1 | 0.9 | 0.9 | 0.8 | 0.8 | |

1/ General government gross debt.

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

3/ The real interest rate contribution is derived from the denominator in footnote 2/ as $r - \pi (1+g)$ and the real growth contribution as -g.

4/ The exchange rate contribution is derived from the numerator in footnote 2/ as $\alpha\varepsilon(1+r)$.

5/ For projections, this line includes exchange rate changes.

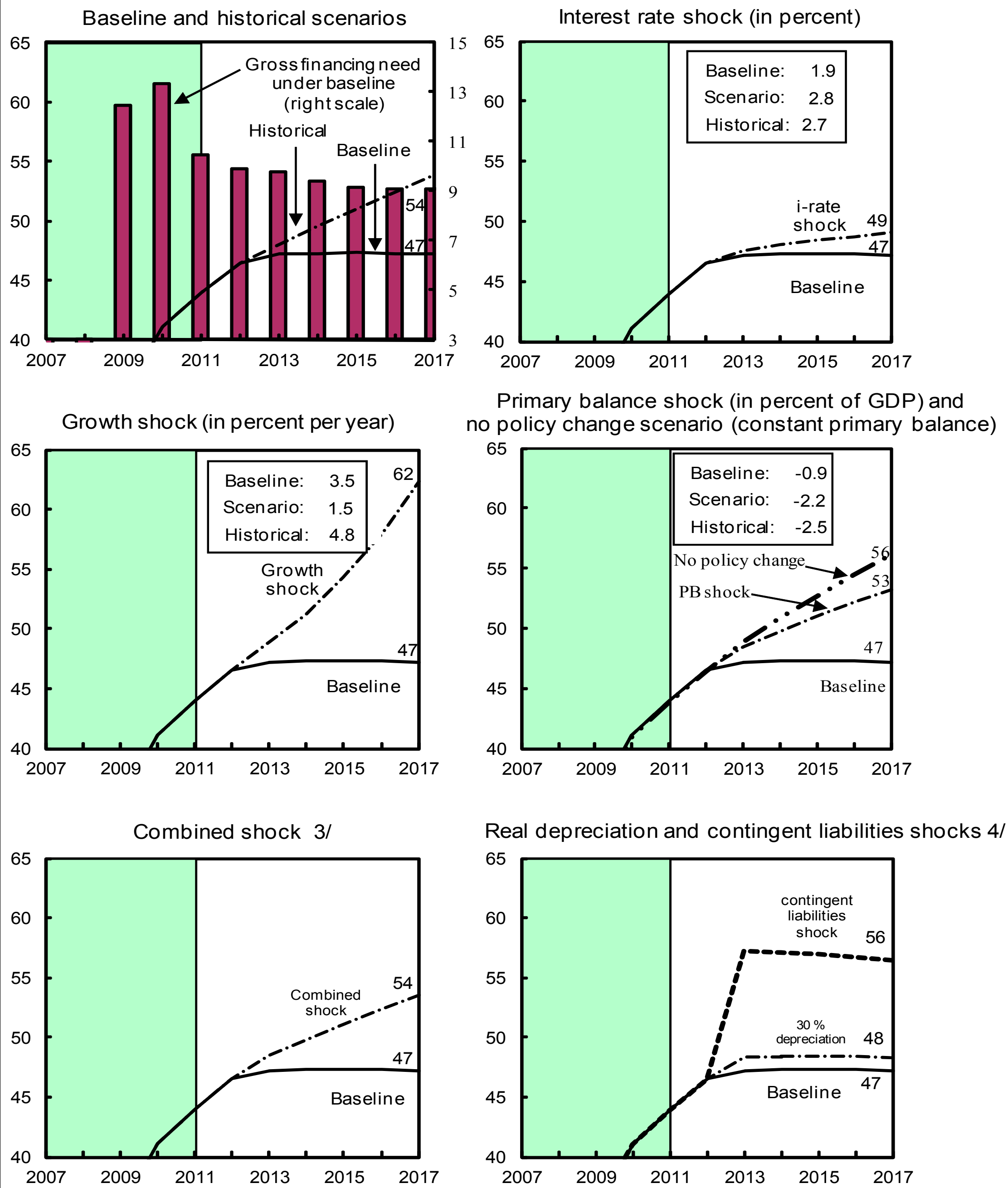
6/ Defined as public sector deficit, plus amortization of medium and long-term public sector debt, plus short-term debt at end of previous period.

7/ The key variables include real GDP growth; real interest rate; and primary balance in percent of GDP.

8/ Derived as nominal interest expenditure divided by previous period debt stock.

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

**Figure A1. Slovak Republic: Public Debt Sustainability: Bound Tests 1/ 2/**
**(Public debt in percent of GDP)**




Sources: International Monetary Fund, country desk data, and staff estimates.
1/ Shaded areas represent actual data. Individual shocks are permanent one-half standard deviation shocks. Figures in the boxes represent average projections for the respective variables in the baseline and scenario being presented. Ten-year historical average for the variable is also shown.
2/ For historical scenarios, the historical averages are calculated over the ten-year period, and the information is used to project debt dynamics five years ahead.
3/ Permanent 1/4 standard deviation shocks applied to real interest rate, growth rate, and primary balance.
4/ One-time real depreciation of 30 percent and 10 percent of GDP shock to contingent liabilities occur in 2010, with real depreciation defined as nominal depreciation (measured by percentage fall in dollar value of local currency) minus domestic inflation (based on GDP deflator).

# Table A2. Slovak Republic: External Debt Sustainability Framework, 2007–17

(In percent of GDP, unless otherwise indicated)

| | Actual 2007 | 2008 | 2009 | 2010 | 2011 | 10-Year Historical Average | 10-Year Standard Deviation | Projections 2012 | 2013 | 2014 | 2015 | 2016 | 2017 | Debt-stabilizing non-interest current account 6/ |
|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|
| **Baseline: External debt** | 49.0 | 56.5 | 72.2 | 74.9 | 75.4 | | | **70.5** | **65.5** | **60.2** | **55.3** | **50.7** | **46.5** | **-3.5** |
| Change in external debt | 4.5 | 7.5 | 15.7 | 2.7 | 0.4 | | | -4.9 | -5.0 | -5.3 | -4.9 | -4.6 | -4.2 | |
| Identified external debt-creating flows (4+8+9) | -11.2 | -7.2 | 7.1 | 2.0 | -9.2 | | | -4.6 | -4.9 | -4.9 | -4.7 | -4.5 | -4.2 | |
| Current account deficit, excluding interest payments | 3.9 | 5.3 | 1.2 | 1.1 | -1.6 | | | -1.4 | -1.6 | -1.6 | -1.6 | -1.6 | -1.5 | |
| Deficit in balance of goods and services | 0.5 | 1.9 | 0.1 | 0.0 | -3.0 | | | -2.2 | -2.7 | -3.2 | -3.8 | -4.1 | -4.1 | |
| Exports | 86.4 | 83.1 | 70.2 | 80.1 | 88.6 | | | 90.8 | 93.7 | 95.0 | 96.5 | 97.4 | 98.0 | |
| Imports | 86.9 | 84.9 | 70.3 | 80.1 | 85.6 | | | 88.6 | 91.0 | 91.8 | 92.7 | 93.3 | 94.0 | |
| Net non-debt creating capital inflows (negative) | -5.1 | -3.7 | -0.2 | -0.6 | -2.3 | | | -2.9 | -2.9 | -2.8 | -2.8 | -2.7 | -2.7 | |
| Automatic debt dynamics 1/ | -10.0 | -8.8 | 6.1 | 1.5 | -5.3 | | | -0.4 | -0.4 | -0.4 | -0.3 | -0.1 | 0.0 | |
| Contribution from nominal interest rate | 1.4 | 1.4 | 1.4 | 1.3 | 1.6 | | | 1.7 | 1.8 | 1.8 | 1.8 | 1.8 | 1.7 | |
| Contribution from real GDP growth | -3.5 | -2.2 | 3.0 | -3.0 | -2.3 | | | -2.0 | -2.2 | -2.2 | -2.1 | -1.9 | -1.8 | |
| Contribution from price and exchange rate changes 2/ | -7.9 | -7.9 | 1.7 | 3.2 | -4.6 | | | ... | ... | ... | ... | ... | ... | |
| Residual, incl. change in gross foreign assets (2-3) 3/ | 15.7 | 14.7 | 8.7 | 0.7 | 9.6 | | | -0.3 | -0.1 | -0.4 | -0.3 | -0.1 | 0.0 | |
| External debt-to-exports ratio (in percent) | 56.7 | 68.0 | 102.9 | 93.5 | 85.1 | | | 77.6 | 69.9 | 63.4 | 57.3 | 52.0 | 47.4 | |
| **Gross external financing need (in billions of US dollars) 4/** | 15.7 | 25.4 | 27.6 | 15.8 | 18.4 | | | 19.6 | 18.7 | 18.6 | 18.5 | 18.3 | 18.3 | |
| in percent of GDP | 20.9 | 26.9 | 31.5 | 18.1 | 19.1 | | | 20.6 | 18.8 | 17.8 | 16.7 | 15.7 | 14.9 | |
| **Scenario with key variables at their historical averages 5/** | | | | | | | | **70.5** | **62.1** | **54.3** | **47.2** | **40.9** | **35.2** | **-9.3** |
| **Key Macroeconomic Assumptions Underlying Baseline** | | | | | | | | | | | | | | |
| Real GDP growth (in percent) | 10.5 | 5.8 | -4.9 | 4.2 | 3.3 | 4.8 | 4.0 | 2.6 | 3.3 | 3.6 | 3.6 | 3.6 | 3.6 | |
| GDP deflator in US dollars (change in percent) | 21.6 | 19.2 | -2.9 | -4.3 | 6.6 | 11.6 | 11.0 | -3.8 | 1.5 | 1.8 | 1.8 | 1.8 | 1.7 | |
| Nominal external interest rate (in percent) | 4.1 | 3.5 | 2.3 | 1.9 | 2.3 | 4.9 | 2.8 | 2.2 | 2.7 | 2.9 | 3.1 | 3.4 | 3.6 | |
| Growth of exports (US dollar terms, in percent) | 38.2 | 21.2 | -22.0 | 13.9 | 21.8 | 20.3 | 18.2 | 1.2 | 8.1 | 6.9 | 7.1 | 6.4 | 6.2 | |
| Growth of imports (US dollar terms, in percent) | 33.7 | 23.2 | -23.6 | 13.6 | 17.7 | 18.5 | 16.8 | 2.2 | 7.7 | 6.5 | 6.4 | 6.2 | 6.2 | |
| Current account balance, excluding interest payments | -3.9 | -5.3 | -1.2 | -1.1 | 1.6 | -3.6 | 2.7 | 1.4 | 1.6 | 1.6 | 1.6 | 1.6 | 1.5 | |
| Net non-debt creating capital inflows | 5.1 | 3.7 | 0.2 | 0.6 | 2.3 | 5.6 | 4.8 | 2.9 | 2.9 | 2.8 | 2.8 | 2.7 | 2.7 | |

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

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

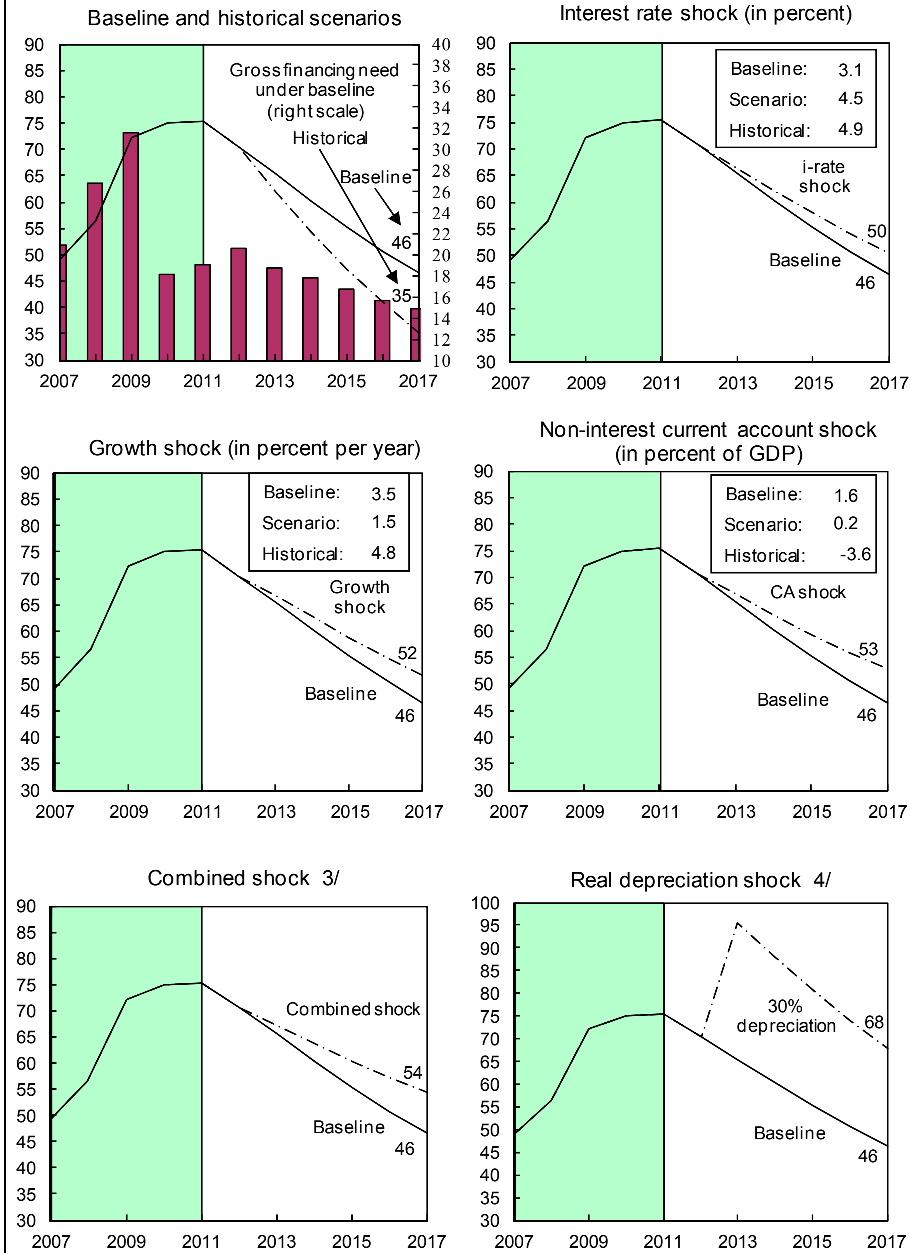
3/ For projection, line includes the impact of price and exchange rate changes.

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

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

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

Figure A2. Slovakia: External Debt Sustainability: Bound Tests 1/ 2/
(External debt in percent of GDP)




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

## Annex I. Risk Assessment Matrix[1]

| Sources of Risks | Relative Likelihood | Impact if Realized |
|---|---|---|
| **1. Strong intensification of the euro area crisis** | **Medium**<br>• Deleveraging and fiscal drag could affect the outlook for the euro area with potential knock-on effects on the financial sector and increased volatility. | **High**<br>• Severe euro area stress and an associated economic downturn would reduce demand for Slovak exports with negative knock-on effects on growth.<br>• Slovak banks have limited direct exposure to the most vulnerable euro zone sovereigns, but could lose some funding from their parent banks. This combined with higher NPLs as growth slows and a lower value of mark-to-market sovereign bonds would weaken banks' balance sheets.<br>• Since the recent recovery in employment has been largely driven by export-led sectors, a decline in external demand would increase an already high unemployment rate. |
| **2. A loss of confidence in the authorities' commitment to fiscal consolidation.** | **Medium**<br>• Staff estimates that under unchanged policies, the deficit will plateau at around 4 percent of GDP and public debt will continue rising, exceeding 50 percent of GDP by 2014 and 60 percent of GDP by 2019. | **Medium**<br>• A loss of confidence in the authorities' commitment would increase interest rates and CDS spreads and result in tighter credit conditions, reducing investment and private consumption. |
| **3. A substantial and prolonged increase in oil prices.** | **Low**<br>• Geopolitical instability could trigger an oil price shock. | **Medium**<br>• A sharp increase in oil prices would increase manufacturing costs and hurt exports.<br>• This risk is mitigated by the specialization of Slovak car manufacturing in small, energy efficient vehicles, demand for which may rise as gasoline prices increase. |

[1] The RAM shows events that could materially alter the baseline path—the scenario most likely to materialize in the view of the staff.

## Annex II. Authorities' Response to Past IMF Policy Recommendations

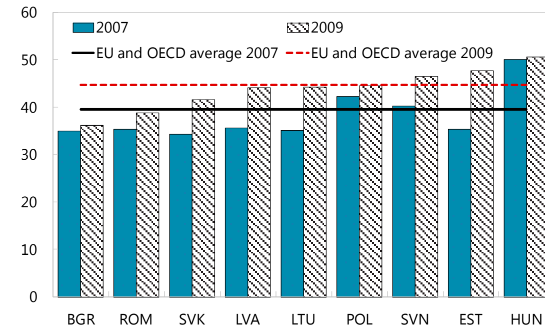
| IMF 2011 Article IV Recommendations | Authorities' Response |
| --- | --- |
| **Fiscal policy**<br>The 2011 frontloaded fiscal consolidation efforts are appropriate and fiscal consolidation should continue with the aim of reducing the deficit to below 3 percent of GDP by 2013. | **Broadly consistent**<br>The size of the adjustment in 2011 was in line with IMF recommendations. Although the pace of the adjustment slowed in 2012, the new government is committed to reducing the deficit to below 3 percent of GDP in 2013 and presented a set of appropriate measures. |
| **Financial sector policy**<br>Strengthening supervision is essential, particularly with respect to cross border risks, and to the mortgage market. | **Broadly consistent**<br>The authorities have continued to enhance supervision, strengthened regulatory requirements for bank capital and liquidity ratios and introduced restrictions on retained earnings. However, no significant steps have been taken to harmonize the regulations on housing loans. |
| **Structural reforms**<br>Reducing the high unemployment rate would require a range of policy actions including enhancing labor market policies, better targeting education to market needs, improving transport infrastructure and fostering the development of the private rental market. | **Marginally consistent**<br>The authorities have adopted and are planning a number of structural reforms to boost employment, reduce regional disparities, and improve the business climate. The Labor Code was reformed to reduce administrative burdens and hiring and firing costs. Plans are being formulated to improve the linkages between education and employment at the vocational and tertiary levels. |

## Annex III. Expenditure Efficiency in the Slovak Republic[1]

*The size of Slovakia's government is relatively small, but expenditures have been rising in real terms and the structure of the budget has become more rigid over time. Cross-country analysis suggests that the recent increases in health expenditure have not always translated into improved social outcomes. The analysis indicates that budgetary savings of some 3½ percent of GDP could be achieved by improving expenditure efficiency without compromising the quality of the service delivery.*

1. **The size of Slovakia's government is relatively small compared to peers.** While government expenditure shrank from 52.1 to 34.3 percent of GDP during 2000–07, the fiscal stimulus imparted during the financial crisis, and a simultaneous decline in nominal GDP, brought it back up to 41 percent of GDP in 2010. Nonetheless, given the generalized expenditure increase across countries, Slovakia remains well below the EU and the OECD average.

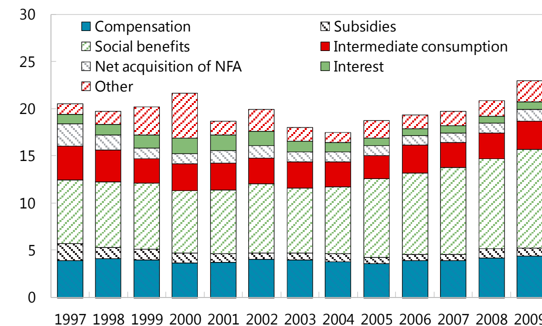
**Total Expenditure**
(Percent of GDP)




Sources: IMF WEO; and IMF staff calculations.

2. **However, public expenditure has increased in real terms, while becoming more skewed toward social benefits.** This increase was exacerbated by the crisis-related upsurge in Slovakia's public expenditure, which was more than double of the average increase in the European countries during 2007–09. The share of social benefits in total spending has also increased and is 6 percentage points of GDP higher than in other EU and OECD countries.

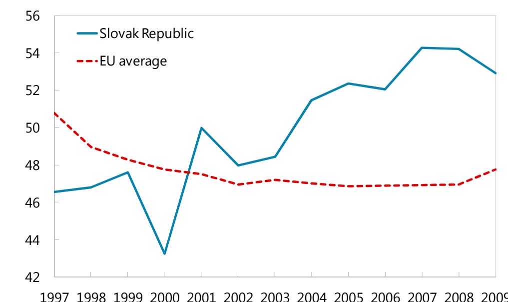
**Real Expenditure**
(Billions of SKK)




Sources: Eurostat; and IMF WEO.

3. **Moreover, the structure of expenditure has become more rigid.** The share of committed expenditure (such as interest payments, social benefits, and subsidies) rose from 47 percent of total expenditure in the late 1990s to 53 percent in 2009—well above the European average. Since committed expenditures usually require a law to be changed, they limit the scope for discretionary changes in the

**Committed Expenditure**
(Percent of total expenditure)




Sources: Eurostat; and IMF WEO.

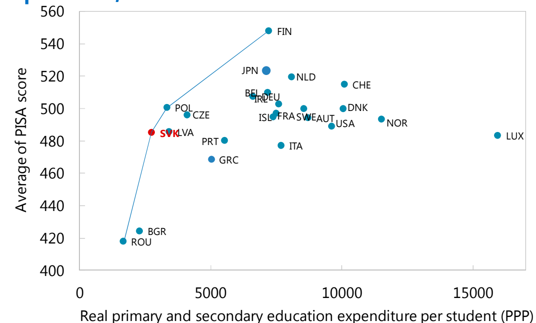
[1] Prepared by Francesco Grigoli.

budget, complicating fiscal consolidation.

4. **Cross-country analysis indicates that Slovakia's public expenditure has become less efficient over time.** The analysis implies that substantial budgetary savings can be achieved without undermining the quality of service delivery. Expenditure efficiency is assessed by applying a Data Envelopment Analysis (DEA) to education and health expenditure in the OECD and EU countries. Based on cross-country data, the DEA model estimates the efficiency frontier for each type of expenditure, by comparing the conversion rates of public spending into socially valuable outcomes (such as literacy in education and longer life in health). The countries defining the frontier are the most efficient in using public spending to achieve socially beneficial outcomes. Slovakia's conversion rate is then compared to that of other countries, while its distance from the frontier determines the size of potential savings.

- **Education**. Slovakia spends significantly less on education compared to other EU-OECD countries (3.8 against 5.1 percent of GDP during 2005-09). Moreover, education spending dropped in 2008 in the wake of the crisis. Cross-country analysis of primary and secondary education spending (amounting to 2.3 percent of GDP in 2008) and outcomes suggests that Slovakia has been one of the most efficient countries in the use of resources dedicated to primary and secondary education. The text figure displays the relationship between real public expenditure per student in primary and secondary education and the average PISA scores over the 2005–09 period.[2] Slovakia places on the efficiency frontier defined also by Poland, Romania, and Finland. Furthermore, similar analysis conducted for 2000–04 suggests that the efficiency of education spending remained high over time.

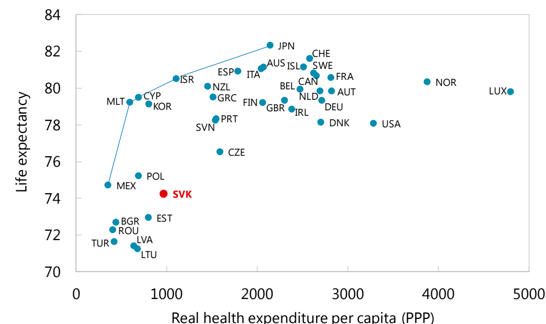
**Efficiency of Primary and Secondary Education Expenditure, 2005-2009**




Sources: Eurostat; OECD; and IMF WEO.

- **Health**. Slovakia spends around 5.4 percent of GDP on health care, below the EU-OECD average. And health outcomes, measured as life expectancy and infant mortality are among the worst in the peer group. During 2003–04, Slovakia introduced reforms to enhance the role of the private sector in the health system. However, many of these reforms were reversed in 2006 and the expected improvements in

**Efficiency of Health Expenditure, 2005-2008**




Sources: WDI; and IMF WEO.

[2] The Program for International Student Assessment (PSIA) is a triennial OECD survey of the knowledge and skills of 15-year-old students—an age at which students in most countries are near the end of their compulsory time in school. The PISA ranks countries according to their performance in reading, mathematics, and science by their mean score in each area.

efficiency did not materialize. The text figure shows the scatter plot of health expenditures per capita against life expectancy in 2005–08. Cyprus, Malta, Mexico, Israel, and Japan define the efficiency frontier. The analysis suggests that Slovakia is less efficient than the sample average and could use 64 percent less resources to achieve the same output in health care. This implies a potential savings of 3½ percent of GDP. Applying the same analysis to the previous five-year period points to a worsening of the Slovak efficiency score over time. During 2000-04, the potential budgetary savings are estimated at 3 percent of GDP—0.5 percent of GDP less than during 2005-09.

5. **Overall, the above analysis implies potential budgetary savings of 3½ percent of GDP through improvements in expenditure efficiency.** Cross-country experience suggests a number of reforms that could be implemented to increase expenditure efficiency. While the education sector makes an efficient use of resources, additional efficiency gains could be achieved by making the budget more responsive to educational needs. For example, a falling number of students in primary and secondary education could result in significant savings, which could be used to improve the effectiveness of education and to target students in most need (including through greater education/employment linkages). This could be facilitated by taking a medium-term approach to the budget (as in the Czech Republic, Estonia, and Romania), which would help to allocate resources more efficiently through multi-year goal-setting and planning. In the health sector, reforms aimed at a greater involvement of the private sector (as in Australia, Canada, and France), enhanced competition (as in Germany and Japan), and increased cost sharing and strengthened cost-effective incentives for practitioners (as in Germany and Finland) would improve efficiency.

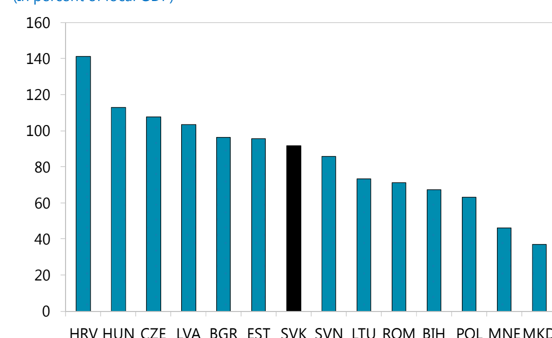
## Annex IV. Cross-Border Financial Linkages[1]

*Given the high share of domestic deposits in banks' liabilities, Slovakia's private credit and GDP growth are relatively resilient to changes in foreign funding. However, the banking system is exposed to a number of external risks, including a worsening of the euro area crisis, deleveraging by parent banks, and asset price impairment triggered by widening sovereign bond spreads. Prudent regulation, international supervisory coordination as well as strong economic policies are essential to mitigate these risks.*

### *Reliance on foreign funding*

1. **The banking sector is largely foreign-owned.** Almost 99 percent of the banking sector's assets are controlled by subsidiaries or branches of foreign banks. The total exposure of BIS-reporting banks to Slovakia, through branches, subsidiaries and direct cross-border credit, is close to 100 percent of GDP, slightly above the median of the broad CESEE region. Local subsidiaries of mainly Austrian, Italian, and Belgian parent banks make up most of the market, leaving less than 10 percent of the system's assets under control of foreign branches and domestic banks.

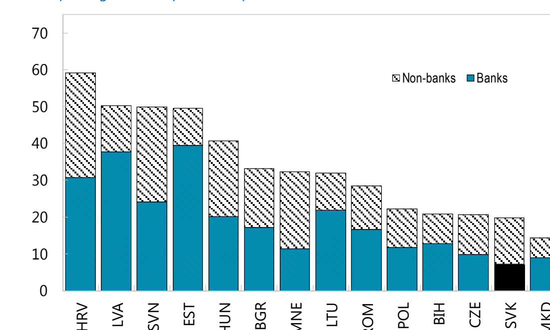
**BIS-reporting banks' exposure in CESEE, 2011:Q4**
(In percent of local GDP)




Source: BIS Consolidated Banking Statistics, May 2012.

2. **However, the overall reliance on foreign funding is low.** With foreign subsidiaries almost entirely funded by local deposits, the effective reliance on foreign funding is around 20 percent of GDP. Moreover, most of the cross-border bank funding is between parents and subsidiaries, which has proved more stable than funding between unaffiliated banks or wholesale funding. Banks' exposure to foreign funding is just 7 percent of GDP, compared to an average of 10 percent of GDP in the region. The nonbank sector appears more dependent on foreign funding, but not out of line with other countries in the region, with exposure at around 13 percent of GDP. Some 26 percent of government bonds are held by nonresidents, and a large share of multi-national corporations operating in Slovakia are funded by loans from abroad.

**CESEE: Funding from BIS-reporting banks, 2011:Q4**
(BIS-reporting banks' exposure, in percent of local GDP)

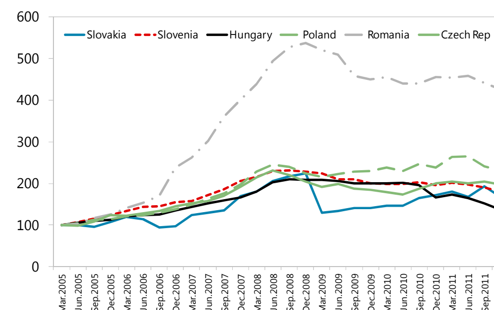



Sources: BIS Locational Banking Statistics; IMF WEO; and IMF Staff calculations.

[1] Prepared by Mai Chi Dao.

3. **Funding from foreign banks to Slovakia has been growing at a more moderate pace than elsewhere in the region.** Following Slovakia's entry into the euro zone in 2009, foreign funding fell sharply, partly because there was a prior build-up of exposure in expectation of currency appreciation and an interest rate increase. With the euro adoption in 2009 Q1, a large share of the exposure was rolled back, but gradually resumed thereafter and remained largely stable.

**Funding from BIS-reporting banks in CESEE: 2005-11**
(Exchange rate adjusted, 2005=100)




Source: BIS Locational Banking Statistics, May 2012.

### *Credit spillovers and real-financial linkages*

4. **Given its strong linkages with Europe, Slovakia's economy could be affected by cross-border spillovers.** Thus, it is important to quantify the strength of possible spillover effects from the various channels of cross-border transmission. For example, a withdrawal of foreign funds could reduce domestic credit, with negative knock-on effects on domestic demand and GDP.

5. **Staff estimates show that private credit is relatively resilient to changes in foreign funding.** An increase in foreign funding by 1 percentage point of GDP is associated with a 0.1 ppt increase in domestic private credit relative to GDP in the same quarter, somewhat lower than the corresponding estimate for the CESEE region (at 0.4 ppt). After a year, the pass-through is less than 0.5 ppt for Slovakia and 0.8 ppt for the region.[2] The result for Slovakia is summarized by plotting the path of the implied cumulative dynamic multiplier from foreign funding to private credit.

6. **This relative resilience is largely explained by the dominant role of domestic deposits in bank funding.** In fact, the deposit-to-loan ratio of the Slovak banking sector has been largely stable, exceeding 100 percent, and is among the highest in the region. The high deposit-to-loan ratio also explains the large difference between the total foreign claims from the consolidated banking statistics and effective reliance on foreign funding indicated by the locational banking statistics of the BIS.

### *Other cross-border spillover channels and risks*

7. **Slovakia's financial system is exposed to a number of external risks:**

- **Intensification of the euro area crisis.** The strong trade and financial linkages with the Euro area imply that a slowdown in economic activity of trading partners could have significant knock-on effects on Slovakia's growth. Lower external demand and corporate profitability will likely increase NPLs, weakening banks' balance sheets. The subsequent increase in risk aversion, accompanied by tighter lending standards could lead to an adverse feedback loop between the real and the financial

[2] For regional estimates, see *Regional Economic Outlook: Europe*, October 2011, Chapter 4.

sectors. The effects of a credit crunch could be severe given the lack of funding substitutes (through bond or equity issuance) for firms.

- **Asset price impairment**. Apart from the potential effect on domestic credit, an intensification of the euro zone debt crisis could widen bond spreads across all countries in the euro area, despite of the relatively sound economic fundamentals in Slovakia. This, in turn, could weaken banks' balance sheets, potentially raising the need for more capital, while at the same time increasing the costs for doing so.

- **Withdrawal of liquidity by parent banks**. Although banks in Slovakia appear to be adequately capitalized and maintain a stable liquidity buffer, possible intra-group transactions could increase liquidity risks, particularly given the prevalence of foreign ownership of the banking sector.

***Possible mitigating factors***

8. **These risks could be substantially mitigated by a number of domestic factors and external initiatives:**

- **Adequate domestic financial sector supervision.** Regulatory measures, strengthened recently by requirements for enhanced capital, liquidity ratios, and restrictions on retained earnings, provide an appropriate framework to mitigate risks (see Box 3). Going forward, strict enforcement of existing regulatory requirements and closer cross-border collaboration with home supervisors would help alleviate the risks and safeguard the stability of the financial system.

- **LTRO.** The three-year longer term refinancing operations (LTRO) extended by the ECB in December 2011 and February 2012 against a broadened set of collateral provided euro area banks with a large liquidity injection and eased funding strains. Although the LTRO scheme is not a principal source of liquidity for Slovak banks, it was used to replace interbank and non-resident deposits, reducing the cost and increasing stability of the liquidity positions. The scheme also provides support to euro area parent banks, which benefits Slovakia by mitigating banks' group-wide deleveraging pressures and improving investor confidence in the region.

- **Vienna 2.** The recent re-launching of the Vienna Initiative, by involving major stakeholders of emerging Europe's financial system and with a strong focus on cross-border cooperation, represents an important mitigating factor, provided consistent implementation of agreed principles can be ensured.

- **Strong economic fundamentals.** The relatively stable and profitable banking sector, as well as solid macroeconomic performance, differentiates Slovakia favorably in terms of investor confidence compared to other markets in the region—potentially promoting more stable capital flows. This underscores the importance of maintaining sound economic policies, including sustainable public finances and structural reforms supportive of employment and growth.

INTERNATIONAL MONETARY FUND

# SLOVAK REPUBLIC

## STAFF REPORT FOR THE 2012 ARTICLE IV CONSULTATION—INFORMATIONAL ANNEX

June 26, 2012

Prepared By European Department

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# FUND RELATIONS

*(As of April 30, 2012)*

I. **Membership Status**: Joined 1/01/1993; Article VIII

II. **General Resources Account:**

| | SDR Million | Percent of Quota |
|---|---|---|
| Quota | 427.5 | 100 |
| Fund holdings of currency | 288.5 | 67.48 |
| Reserve position | 139.01 | 32.52 |
| Lending to the Fund | 53.43 | |

III. **SDR Department**:

| | SDR Million | Percent of Allocation |
|---|---|---|
| Net cumulative allocation | 340.48 | 100 |
| Holdings | 326.26 | 95.83 |

IV. **Outstanding Purchases and Loans**: None

V. **Financial Arrangements**:

| Type | Date of Arrangement | Expiration Date | Amount Approved (SDR Million) | Amount Drawn (SDR Million) |
|---|---|---|---|---|
| Stand-by | 7/22/1994 | 3/21/1996 | 115.8 | 32.15 |

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

| | Forthcoming | | | | |
|---|---|---|---|---|---|
| | **2012** | **2013** | **2014** | **2015** | **2016** |
| Principal | | | | | |
| Charges/Interest | 0.02 | 0.02 | 0.02 | 0.02 | 0.02 |
| Total | 0.02 | 0.02 | 0.02 | 0.02 | 0.02 |

VII. **Exchange Rate Arrangement:**

The currency of the Slovak Republic is the euro, which was adopted on January 1, 2009.

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

VIII. **Article IV Consultation:**

The consultation discussions were held in Bratislava during May 16-29, 2012. The mission met with Minister of Finance Kažimír, National Bank of Slovakia (NBS) Governor Makúch, Minister of Interior Kaliňák, other senior government and NBS officials, and representatives of financial institutions, think tanks, trade unions, and employers' associations.

The team comprised Mmdes. Zakharova (head) and Dao, and Messrs. Grigoli, Lutz, and Mehrez, and was assisted at headquarters by Messrs. De Guzman and Winnekens, and Ms. Baptista. The mission's concluding statement was published on the IMF website on May 29, 2012.

The previous consultation with the Slovak Republic was concluded on May 31, 2011 (IMF Country Report No. 11/122).

IX. **FSAP Participation and ROSCs:**

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

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

X. **Technical Assistance:** See the attached table.

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

**Table 1. Slovak Republic: Technical Assistance, 2000–12 1/**

| Department | Timing | Purpose |
|---|---|---|
| MFD | February 2000 | Mission on pros and cons, and modalities of moving to an inflation targeting framework, operational issues (money markets and policy instruments), and dealing with potential problems posed by capital inflows for monetary operations |
| | December 2001 | Long-term resident expert on banking supervision |
| | May 2002 | Two missions on inflation modeling |
| FAD | April 2000 | Tax administration |
| | February 2001 | Tax administration (follow-up) |
| | April 2001 | Public Finance Management (follow-up) |
| | August 2001 | Tax administration: installation of resident expert to advise on establishment of Large Taxpayer Unit (LTU) |
| | August 2001–August 2002 | Regular visits by FAD consultant on establishment of LTU |
| | December 2001 | Tax administration follow-up, tax investigation/fraud issues |
| | June 2002 | Mission to prepare Report on the Observance of Standards and Codes (ROSC), Fiscal Transparency Module |
| | February 2003 | Tax policy |
| | March 2003 | Tax administration |
| | May 2003 | Expenditure policy |
| STA | February 2000 | National accounts and price statistics |
| | March 2001 | Multi sector mission |
| | July 2003 | Government finance statistics |
| | February–March 2004 | Data ROSC Mission |

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

# STATISTICAL ISSUES

1. **Coverage, periodicity, and timeliness of data provided to the Fund are adequate for surveillance purposes.** From the point of view of macroeconomic analysis and policy making, significant data improvements have been made in recent years, particularly in the national accounts. A data ROSC mission during February–March 2004 found that the integrity, methodological soundness, and reliability of the data were satisfactory, despite some shortcomings in the data revision policy. The main issues remaining are: (i) weaknesses in the data on prices and volumes of imports and exports; (ii) a lack of timely data on the general government operations; and (iii) slow compilation cycle of the annual national accounts and lack of proper benchmarking of quarterly data. The Slovak Republic subscribes to the Special Data Dissemination Standard (SDDS) since 1996 and observes or exceeds all related standards.

2. **With regard to timeliness and public access, the authorities in general follow a free and open data publication policy.** Data are promptly released to news services, and are also published regularly in various monthly and quarterly statistical publications, and on the Internet[1] according to a pre-announced schedule. Data on core surveillance variables are provided regularly to the Fund, and with minimal lags: a week or less for foreign exchange reserves; a day for monthly state budget implementation data; 10 days to a month for consumer prices, reserve money, broad money, and interest rates; two months for foreign trade data; and about three months for other fiscal, balance of payments, and national accounts data.

### *Real Sector and Prices*

3. **Significant progress has been made in the compilation of the national accounts statistics.** However, the quarterly national accounts data on expenditures exhibit weaknesses and there is a significant statistical discrepancy between the supply side and the demand side. An important outstanding issue is the compilation of reliable price deflators for imports and exports that would enable better decomposition into volume and price changes. The unit value trade price indices—on which the national accounts trade price deflators are based—are published with long delays and are not appropriately adjusted for quality changes. The statistical authorities are aware of these issues and improvements are pending.

4. In the public enterprise sector, the line ministries could usefully produce systematic accounts of the financial positions of the public enterprises under their purview.

### *Fiscal Sector*

5. **General government statistics are compiled annually in accordance with the methodology of the ESA95, and disseminated on the Ministry of Finance (MOF) website.** In accordance with the EU *acquis communautaire,* the authorities report semi-annually on general government net lending/borrowing on ESA95 basis. Monthly reconciliation of government operations above and below-the-line is restricted to

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[1] Data are available on the website of the Slovak Statistics Office (www.statistics.sk), the National Bank of Slovakia (NBS) (www.nbs.sk), and the ministry of finance (MoF) (www.finance.gov.sk).

state budget transactions on a cash basis. A modern treasury system has been operating since January 2004. The new system has improved fiscal control and public debt management by allowing the recording of expenditures at the planning and commitment stages.

6. **The MOF has converted its fiscal accounts to ESA95 standards.** The MOF compiles Government Finance Statistics according to the *Government Finance Statistics Manual 2001* (*GFSM 2001*) analytical framework; data are available and disseminated on a cash basis for 1996–2005, and on an accrual basis for 2003–09.

### *External Sector*

7. External sector statistics are of good quality, and are reported on a timely basis to the Fund. However, the errors and omissions in the Balance of Payment statistics are relatively large. The statistical authorities are aware of this issue and are addressing it.

### Monetary Sector

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

**Table 2. Slovak Republic: Common Indicators Required for Surveillance**

(As of June 5, 2012)

| | Date of latest Observation | Date received | Frequency of Data 6/ | Frequency of Reporting 6/ | Frequency of Publication 6/ | Memorandum Items: Data Quality-Methodological soundness 7/ | Memorandum Items: Data Quality-Accuracy and reliability 8/ |
|---|---|---|---|---|---|---|---|
| Exchange Rates | 6/5/2012 | 6/5/2012 | D | D | D | | |
| International Reserve Assets and Reserve Liabilities of the Monetary Authorities 1/ | 5/30/2012 | 6/1/2012 | W | W | W | | |
| Reserve/Base Money | 3/31/2012 | 4/27/2012 | M | M | M | | |
| Broad Money | 3/31/2012 | 4/27/2012 | M | M | M | | |
| Central Bank Balance Sheet | 4/30/2012 | 5/11/2012 | M | M | M | | |
| Consolidated Balance Sheet of the Banking System | 4/30/2012 | 5/31/2012 | M | M | M | | |
| Interest Rates 2/ | 6/5/2012 | 6/5/2012 | D | D | D | | |
| Consumer Price Index | 4/30/2012 | 5/16/2012 | M | M | M | | |
| Revenue, Expenditure, Balance and Composition of Financing – General Government 3,4/ | 2011 | 3/31/2012 | A | A | A | LO, LO, LO, O | O, O, O, O, NA |
| Revenue, Expenditure, Balance and Composition of Financing – Central Government 3/ | 5/31/2012 | 6/1/2012 | M | M | M | | |
| Stocks of Central Government and Central Government-Guaranteed Debt 5/ | 3/31/2012 | 5/16/2012 | Q | Q | Q | | |
| External Current Account Balance | 5/30/2012 | 5/31/2012 | M | M | M | O, O, LO, O | LO, O, LO, O, LO |
| Exports and Imports of Goods and Services | 4/30/2012 | 5/31/2012 | M | M | M | | |
| GDP/GNP | 2011Q4 | 3/3/2012 | Q | Q | Q | O, O, LO, LO | LO, O, LO, O, LO |
| Gross External Debt | 2011Q4 | 3/30/2012 | M | M | M | | |
| International Investment Position 9/ | 30-Apr | 5/31/2012 | M | M | M | | |

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

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

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

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

5/ Including currency and maturity composition.

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

7/ Reflects the assessment provided in the data ROSC (published on May 17, 2005, and based on the findings of the mission that took place during February 18–March 3, 2004) for the dataset corresponding to the variable in each row. The assessment indicates whether international standards concerning concepts and definitions, scope, classification/sectorization, and basis for recording are fully observed (O), largely observed (LO), largely not observed (LNO), or not observed (NO).

8/ Same as footnote 7, except referring to international standards concerning source data, statistical techniques, assessment and validation of source data, assessment and validation of intermediate data and statistical outputs, and revision studies.

9/ Includes external gross financial asset and liability positions vis a vis nonresidents.

INTERNATIONAL MONETARY FUND

*Public Information Notice*

EXTERNAL
RELATIONS
DEPARTMENT

Public Information Notice (PIN) No. 12/78
FOR IMMEDIATE RELEASE
July 17, 2012

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

## IMF Executive Board Concludes 2012 Article IV Consultation with the Slovak Republic

On July 11, 2012 the Executive Board of the IMF concluded the Article IV consultation with the Slovak Republic, and considered and endorsed the staff appraisal.[1]

### Background

Strong exports supported a healthy economic expansion with real GDP growing 3.3 percent in 2011. The robust performance of net exports offset the contraction in domestic demand amid fiscal consolidation and volatile consumer confidence. The strong economic performance continued into the first quarter of 2012 on the back of expanding auto production. All in all, Slovakia's post-crisis economic performance has been among the strongest in the euro area, with real GDP surpassing its pre-crisis peak in the last quarter of 2011.

However, the strong growth has yet to put a dent in unemployment. The unemployment rate—which surged during the crisis by 5 percentage points to over 14 percent—declined only slightly to 13¾ percent in April 2012. Unemployment is particularly high in less developed regions, contributing to an already large regional income disparity.

Despite the still-negative output gap, inflation surged to 4.7 percent in 2011 on the back of an increase in tax and administered price and a global rise in energy prices. As these one-off factors ebbed, inflation eased to 3.4 percent in May 2012, but remains among the highest in the EU.

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[1] Under Article IV of the IMF's Articles of Agreement, the IMF holds bilateral discussions with members, usually every year. A staff team visits the country, collects economic and financial information, and discusses with officials the country's economic developments and policies. On return to headquarters, the staff prepares a report, which forms the basis for discussion by the Executive Board. At the conclusion of the discussion, the Managing Director, as Chairman of the Board, summarizes the views of Executive Directors, and this summary is transmitted to the country's authorities. An explanation of any qualifiers used in summing ups can be found here: http://www.imf.org/external/np/sec/misc/qualifiers.htm.

Financial sector conditions continued to strengthen. Banks' profitability increased, and capital adequacy ratios rose to 15 percent of risk-weighted assets throughout 2011. Banks' reliance on domestic deposits as a source of funding shielded them from the developments in the euro area, including a region-wide deleveraging, and supported a modest expansion in credit.

A frontloaded fiscal consolidation reduced the 2011 headline deficit by 3 percentage points to 4¾ percent of GDP. The underlying fiscal deficit, excluding one-off payments, declined to 4.4 percent of GDP. Despite the sizable deficit reduction, public sector debt climbed up another 3 percentage points, reaching 44 percent of GDP at the end of 2011. A fiscal responsibility law, which sets limits on public debt—60 percent of GDP until 2017 and gradually declining to 50 percent of GDP by 2027—was adopted in December 2011 with broad political support.

The growth outlook is for a modest slowdown in 2012 and a moderate expansion over the medium term. Reflecting a worsened external environment, Slovakia's real GDP growth is expected to slow to 2.6 percent in 2012, before picking up to 3¼ percent next year as external environment strengthens. As the base effects fade and in the absence of further supply shocks, inflation would ease to below 3 percent by the end of the year. However, the euro zone stress remains a key external risk. Renewed severe strains in Europe could precipitate a global downturn and reduce demand for Slovak exports with significant adverse implications for growth.

**Executive Board Assessment**

Executive Directors commended the prudent macroeconomic policies and sound fundamentals that have underpinned a strong recovery for the Slovak economy. However, Directors considered that external risks, high fiscal deficits, and the double-digit unemployment rate pose significant policy challenges for the period ahead. They concurred that further fiscal adjustment, heightened oversight of the financial sector, and stepped up structural reforms remain essential to mitigate downside risks and bolster growth prospects.

Directors supported the authorities' consolidation strategy to achieve fiscal sustainability. They considered that the planned measures appear to strike the appropriate balance between safeguarding fiscal solvency and supporting economic activity. More broadly, Directors encouraged the authorities to develop a robust medium-term fiscal framework, building on the recently adopted Fiscal Responsibility Law. In this regard, Directors welcomed the government's plans to reform the public administration, strengthen tax administration, and increase the efficiency of public spending, including on healthcare. They also stressed the importance of safeguarding the solvency of the pension system by grounding prospective changes on actuarial analysis.

Directors noted that the banking system appears sound, but emphasized the need for continued supervisory vigilance. They welcomed recent steps to strengthen banks' capital and liquidity buffers, but stressed that enhanced cooperation with home supervisors is essential to curb cross-border risks. Directors also recommended subjecting all types of housing loans to the

same prudential norms to help prevent excessive risk-taking, while removing tax obstacles that could delay the resolution of non-performing loans.

Directors underscored the importance of deeper structural reforms, in particular to boost employment and address regional disparities. They noted that an effective implementation of the reformed labor code could help reduce unemployment, and welcomed plans to foster the development of disadvantaged regions. Improving vocational education and the incentives to work would help address labor markets rigidities. Directors also welcomed the authorities' intention to further strengthen the business climate to attract investment.

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**Slovak Republic: Selected Economic Indicators, 2008–13**

Population (in millions): 5.4
Per capita income ($): 16,830
Quota (current; millions SDR/% of total): 427.5 / 0.18
Literacy / poverty rate 1/: 99 / 20.6
Main products and exports: Transport equipment, machinery and electric equipment
Key export markets: Germany, Czech Republic

| | | | | | Projections | |
|---|---|---|---|---|---|---|
| | 2008 | 2009 | 2010 | 2011 | 2012 | 2013 |
| | (Annual percentage change, constant prices, unless noted otherwise) | | | | | |
| Real GDP | 5.8 | -4.9 | 4.2 | 3.3 | 2.6 | 3.3 |
| Domestic demand | 5.7 | -7.4 | 4.5 | -1.5 | 0.7 | 2.0 |
| Public consumption | 6.1 | 6.1 | 1.1 | -3.5 | 1.3 | 1.4 |
| Private consumption | 6.1 | 0.2 | -0.7 | -0.4 | 0.2 | 1.2 |
| Gross capital formation | 4.7 | -30.2 | 22.1 | -2.7 | 1.4 | 4.2 |
| Exports of goods and services | 3.1 | -15.9 | 16.5 | 10.8 | 4.4 | 7.0 |
| Imports of goods and services | 3.1 | -18.1 | 16.3 | 4.5 | 3.3 | 6.0 |
| Output Gap | 2.8 | -3.4 | -1.0 | -0.6 | -1.2 | -1.1 |
| Potential Growth | 6.2 | 1.2 | 1.6 | 2.9 | 3.2 | 3.2 |
| Prices | | | | | | |
| Inflation (HICP) | 3.9 | 0.9 | 0.7 | 4.1 | 4.0 | 2.3 |
| Inflation (HICP, end of period) | 3.5 | 0.1 | 1.3 | 4.7 | 2.9 | 2.1 |
| Employment and wages | | | | | | |
| Employment | 3.2 | -2.8 | -2.0 | 1.5 | -0.2 | 0.8 |
| Nominal wages | 7.6 | 2.8 | 5.1 | 3.7 | 4.5 | 4.5 |
| Unemployment rate (percent) | 9.6 | 12.1 | 14.4 | 13.5 | 13.8 | 13.6 |
| | (Percent of GDP) | | | | | |
| Public Finance, General Government | | | | | | |
| Revenue | 33.0 | 33.7 | 32.4 | 32.6 | 32.6 | 34.1 |
| Expenditure | 35.0 | 41.7 | 40.0 | 37.4 | 37.0 | 36.9 |
| Overall balance | -2.1 | -8.0 | -7.7 | -4.8 | -4.4 | -2.9 |
| Primary balance | -0.8 | -6.6 | -6.3 | -3.2 | -2.8 | -1.1 |
| Structural balance (percent of potential GDP) | -3.1 | -6.6 | -7.1 | -4.2 | -4.1 | -2.5 |
| General government debt | 27.9 | 35.6 | 41.1 | 43.9 | 46.5 | 47.2 |
| | (Percent) | | | | | |
| Monetary and financial indicators | | | | | | |
| Bank credit to private sector (growth rate) | 15.6 | 1.0 | 4.3 | 8.6 | | |
| Lending rates 2/ | 6.8 | 5.7 | 5.9 | 5.9 | | |
| Deposit rates 3/ | 0.7 | 0.3 | 0.2 | 0.3 | | |
| Government 10-year bond yield | 4.7 | 4.7 | 3.9 | 4.4 | | |
| | (Percent of GDP) | | | | | |
| Balance of payments | | | | | | |
| Trade balance (goods) | -1.1 | 1.5 | 1.2 | 3.5 | 3.8 | 4.3 |
| Current account balance | -6.6 | -2.6 | -2.5 | 0.1 | -0.3 | -0.2 |
| Gross external debt | 56.5 | 72.2 | 74.9 | 75.4 | 70.5 | 65.5 |

Sources: National Authorities; and IMF staff calculations.

1/ Percent of population aged 15 and over who can read and write. At-risk-of-poverty rate in percent of total population, 2010. At risk-of-poverty are persons with an equivalised disposable income below the risk-of-poverty threshold, which is set at 60 % of the national median equivalised disposable income (after social transfers).

2/ Loans of up to one year, non-housing new loans to households.

3/ Average of interest rates on new overnight deposits from households and nonfinancial corporations.