International Monetary Fund

IMF Executive Board Concludes 2013 Article IV Consultation with the Slovak Republic

Press Release No. 13/310
August 15, 2013

On August 2, 2013, the Executive Board of the International Monetary Fund (IMF) concluded the Article IV consultation with the Slovak Republic[1] and considered and endorsed the staff appraisal without a meeting on a lapse-of-time basis.[2]

Following a sharp downturn in 2009 in the context of the global economic and financial crisis, Slovakia emerged as one of the fastest growing economies in the EU, supported in particular by substantial foreign investment in the auto sector and subsequent exports. Growth slowed to 2 percent in 2012 as the impact of exceptionally large investments in 2011 faded. For 2013, the growth forecast is 0.6 percent, reflecting especially the weakening external environment. Domestic demand has been held back by persistently high unemployment—around 14 percent, with about two-thirds of this long-term, and an especially high rate among Slovakia's youth (around 35 percent).

Slovakia has reduced its fiscal deficit substantially since 2009, reaching a deficit of 4.3 percent of GDP in 2012, and enjoys moderate public and private debt levels. Inflation fell to 1.6 percent in June 2013, record trade and current account surpluses were recorded in 2012, and the banking system remains sound with healthy levels of capital and liquidity.

Executive Board Assessment

In concluding the 2013 Article IV consultation with the Slovak Republic, Executive Directors endorsed the staff's appraisal, as follows:

After a strong recovery in the wake of the global crisis, the Slovak economy is expected to continue growing, but at a significantly slower pace in 2013. The Slovak Republic has been among Europe's most dynamic economies in recent years, largely due to sizeable foreign investment in the auto sector that led to rapidly rising exports, much faster growth than most others in the region, and limited vulnerabilities. Spillover risks are materializing, however, with weaker demand expected from trading partners, especially in Europe. This, coupled with still anemic domestic demand, has worsened the near-term outlook.

Risks are tilted to the downside. Domestic demand is expected to slowly recover but will remain restrained for some time due to ongoing fiscal adjustment as well as high unemployment. If prolonged, high unemployment risks negatively affecting growth, fiscal consolidation, and debt ratios, as well as long-term labor participation and productivity. If weakness in Europe is deeper or more drawn out than expected, this could reduce export demand and contribute to uncertainty holding back investment. Integration into international supply chains has brought great opportunities, but can also amplify risks from trade shocks, underscoring the importance over the medium term of new sources of growth and export diversification.

Addressing very high unemployment—particularly youth and long-term unemployment—should be a top priority. Efforts underway to strengthen education, training, and active labor market policies (ALMPs) including targeting to disadvantaged groups are welcome, but are still at an early stage. Public employment services should be strengthened and funding for ALMPs—which was increased in the 2013 budget—should be a priority even amidst budget consolidation. Effective use of EU Funds will be especially important in these areas. Steps to streamline administrative burdens for businesses are also welcome, and should be complemented by action to achieve a more stable, open, and predictable business climate with respect to labor regulations, the legal environment, procurement practices, and corruption.

Slovakia has demonstrated its strong commitment to sustainable public finances but further progress is needed. The fiscal deficit has come down substantially since 2009 and important structural reforms have been implemented, such as those that strengthen the pension fund’s finances, but other sources of revenue or savings have been temporary or have affected valuable projects such as those financed by EU Funds. Slovakia’s gross public debt, which includes contributions to support other euro area members and a healthy level of cash balances, remains manageable. However, to avoid economically harmful effects from debt rising above thresholds under the FRA (Forward Rate Agreement) as well as to comply with EU targets, substantial additional adjustment measures will be needed for a number of years.

The 2013 fiscal deficit target is achievable, but automatic stabilizers should be allowed to operate if risks to growth materialize. Provisions in the 2013 budget, additional steps taken so far, and the government’s readiness to take further measures that would have little macroeconomic impact suggest the 2013 target can be met. There are risks to this scenario, including the possibility of still weaker growth or difficulties controlling public wages and local government budgets. And should growth further disappoint, automatic stabilizers should be allowed to operate to avoid a further drag on output when growth is weakest.

Efforts should focus on identifying high quality fiscal measures for 2014 and over the medium term. Further fiscal consolidation is needed to ensure medium-term debt sustainability, and in light of EU rules and a domestic debt brake that would mandate an overly sharp move to balance the budget. In addition to maintaining the current VAT rate, adjustment efforts should focus on improving VAT collection efficiency and reducing tax evasion, introducing a property value-based real estate tax, and improving spending efficiency. Moving more quickly to a higher retirement age and potentially raising the overall age target would improve the long-term sustainability of the pension system.

A traditional banking model and prudent supervisory approach have contributed to a sound banking system. Slovakia's banking sector is liquid and well capitalized, with low and well-provisioned nonperforming loans (NPLs), although a weaker economic outlook could have effects on credit quality. Bank taxes have risen at a time when the operating environment is weak and credit to firms is declining, hitting profits. The levy should be lowered to be more in line with other countries in Europe and the proceeds allocated to a more well-defined special resolution fund. The size of the banking system has facilitated close supervision (and risks are low), but the current supervisory framework could be enhanced through a more well-specified intervention and resolution framework, in line with expected European directives and banking union developments.

Slovak Republic: Summary of Economic Indicators, 2010–14

				Projections	
	2010	2011	2012	2013	2014
	(Annual percentage change, constant prices, unless noted otherwise)				
Output/Demand					
Real GDP	4.4	3.2	2.0	0.6	2.3
Domestic demand	3.9	1.4	-3.1	-1.2	1.7
Public consumption	1.0	-4.3	-0.6	-0.9	1.2
Private consumption	-0.7	-0.5	-0.6	-0.5	0.9
Gross fixed capital formation	6.5	14.2	-3.7	-2.1	2.4
Exports of goods and services	16.0	12.7	8.6	2.3	4.2
Imports of goods and services	14.9	10.1	2.8	0.8	3.3
Output Gap	-0.8	-0.5	-1.2	-2.5	-2.2
Potential Growth	1.6	2.9	2.7	1.9	2.0

Contribution to growth					
Domestic demand	3.6	1.2	-3.2	-0.9	1.2
Public consumption	0.2	-0.8	-0.1	-0.2	0.2
Private consumption	-0.4	-0.3	-0.3	-0.3	0.5
Gross fixed capital formation	1.3	3.0	-0.9	-0.5	0.5
Inventories	2.5	-0.7	-1.9	0.0	0.0
Net exports	0.7	2.0	5.2	1.5	1.0
Prices					
Inflation (HICP)	0.7	4.1	3.7	1.7	2.0
Inflation (HICP, end of period)	1.3	4.6	3.4	1.7	2.1
GDP deflator	0.5	1.6	1.4	1.5	1.4
Employment and wages					
Employment	-1.5	1.8	0.1	-0.5	0.1
Nominal wages	5.1	3.7	4.1	2.1	2.9
Unemployment rate (percent)	14.5	13.6	14.0	14.6	14.7
			(In percent of GDP)		
Public Finance, General Government 1/					
Revenue	32.3	33.3	33.1	34.5	32.9
Expenditure	40.0	38.3	37.4	37.4	36.6
Overall balance	-7.7	-5.1	-4.3	-2.9	-3.8
Primary balance	-6.3	-3.5	-2.5	-0.9	-1.7
Structural balance (percent of potential GDP)	-7.2	-4.8	-4.4	-3.5	-3.4
General government debt	41.0	43.3	52.1	55.3	57.5
excl. EFSF and ESM contributions	41.0	43.0	49.7	52.1	54.0
			(In percent)		
Monetary and financial indicators					
Bank credit to private sector (growth rate)	4.8	8.6	2.9		
Lending rates 2/	4.6	4.7	4.4		
Deposit rates 3/	1.2	1.6	1.4		
Government 10-year bond yield	3.9	4.4	3.4		

Slovak Republic: Summary of Economic Indicators, 2010–14 (continued)

Projections

	2010	2011	2012	2013	2014
	(In percent of GDP)				
Balance of payments					
Trade balance (goods)	1.2	1.4	5.1	5.7	6.4
Current account balance	-3.7	-2.1	2.3	2.3	3.1
Gross external debt	75.6	75.2	73.5	71.8	68.7

Sources: National Authorities and IMF staff estimates.

1/ No policy change scenario – i.e., it assumes no fiscal measures beyond those expected in 2013. The staff report for the 2013 Article IV Consultation includes a text table with an active policy scenario.

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

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

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[1] Under Article IV of the IMF's Articles of Agreement, the IMF holds bilateral discussions with members, usually every year. A staff team visits the country, collects economic and financial information, and discusses with officials the country's economic developments and policies. On return to headquarters, the staff prepares a report, which forms the basis for discussion by the Executive Board.

[2] The Executive Board takes decisions under its lapse-of-time procedure when the Board agrees that a proposal can be considered without convening formal discussions.

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