Office Memorandum

To: Members of the Executive Board — August 26, 2014

From: The Secretary

Subject: **Slovak Republic—Statement by the European Central Bank Representative**

Attached for the **information** of Executive Directors is a statement by the European Central Bank representative for the Executive Board discussion on the Slovak Republic, to be held on Wednesday, August 27, 2014.

Att: (1)

Other Distribution:
Department Heads

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August 26, 2014

Statement by the ECB Representative on the Slovak Republic

(Preliminary)

Executive Board Meeting

August 27, 2014

We thank staff for the set of comprehensive reports and Messrs. Prader and Jakoby for their informative Buff statement. We associate ourselves with the views expressed by Mr. Snel in his gray and would like to make a few additional points.

We broadly agree with staff on the **macro economic outlook** for Slovakia. We see small upside risks to the projected employment growth and domestic demand in the short term horizon, on the back of the positive developments in the labour market in the first part of 2014 and the overall improved confidence in the Slovak economy. On the medium term horizon, we also see some upside risks to the pace of economic recovery, coming from a possible upturn in domestic demand after its prolonged weakness and given a vibrant export sector.

We consider that the direct impact on external trade of recent sanctions imposed by EU on Russia and of associated retaliatory measures will be limited, as the bulk of Slovakia's trade and financial flows are taking place with EU countries, mainly with the euro area. Although Russia accounts for a small share of Slovak exports (less than 4%), Slovakia is very dependent on energy imports from Russia (around 87%). We believe that some minor indirect negative effects on exports might materialize, to the extent that bigger euro area countries are negatively affected by the geopolitical tensions.

Although some measures have been taken and the labour market has shown some sign of improvement in early 2014, mutually reinforcing **structural reforms** are still needed to restore an efficient functioning of the labour market. Policy actions necessary to bring the unemployment rate down could include: (i) reducing the high tax wedge that discourages firms from hiring and low skilled people to work, (ii) strengthening education and vocational training and improving the match between the labour market needs and educational offer, (iii) increasing spending for active market policies.

We broadly concur with the staff assessment as regards recent **fiscal developments**. The authorities delivered a remarkable reduction in the government deficit by more than 5% of GDP since 2009, which permitted the timely correction of the excessive deficit in 2013. However, the adjustment partly relied on low-quality and one-off measures. As a result, durable fiscal measures are still needed to achieve a sound fiscal position. We thus support the staff calls for a continued fiscal adjustment. We agree that strengthening revenue collection through measures to reduce tax evasion and fraud should remain a priority in order to reduce the use of across-the-board fiscal measures. However, we do not share staff's critical assessment of the strengthened national fiscal framework and the newly established debt rule in particular. Appropriateness of some elements of the framework, like speed of adjustment or the expenditure bias, may be revisited, but preferably only after some experience with the framework has been gathered. In this respect, the Fiscal Compact explicitly requires euro area Member States to enshrine EU commitments in national law.

As regards the **financial sector**, Slovakian banks are well-capitalised and remain in a good position to increase the supply of loans to the private sector if consumption and investment pick up. We observe an expansion in lending to households given the rapid rise in the household debt to disposable income ratio in the last years. Nevertheless, we believe this risk is still relatively contained as Slovakian households remained the second least indebted in the euro area at the end of 2013. Moreover, house price growth has remained subdued in recent years albeit with some marked regional differences.