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Slovak Republic: 2007 Article IV Consultation—Staff Report; 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 2007 Article IV consultation with the Slovak Republic, the following documents have been released and are included in this package:

- the staff report for the 2007 Article IV consultation, prepared by a staff team of the IMF, following discussions that ended on March 13, 2007, with the officials of the Slovak Republic on economic developments and policies. Based on information available at the time of these discussions, the staff report was completed on May 18, 2007. 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; and

- a Public Information Notice (PIN) summarizing the views of the Executive Board as expressed during its June 6, 2007 discussion of the staff report that concluded the Article IV consultation.

The document listed below has been or will be separately released.

Selected Issues Paper

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 2007 Article IV Consultation

Prepared by the Staff Representatives for the
2007 Consultation with the Slovak Republic

Approved by Susan Schadler and Anthony R. Boote

May 18, 2007

Executive Summary

Background: Slovakia has become one of Central Europe's strongest economic performers over the past few years. Growth prospects have shifted to a higher level, driven by productivity gains and buoyant exports. Slovakia is well poised to adopt the euro in 2009. The Maastricht inflation criterion seems within reach, and the 2007–09 budget framework is aimed at meeting the euro zone entry objective. The improved economic outlook has led to persistent appreciation pressures prompting the authorities to revalue the central parity under ERM2 in mid-March.

Challenges: Key challenges are to satisfy the test of exchange rate stability under ERM2; to ensure greater fiscal and labor market flexibility for absorbing asymmetric shocks in the monetary union; and to continue with structural reforms to sustain growth and to address the high unemployment problem.

Authorities' views: The authorities are giving priority to euro adoption but are also committed to socially inclusive growth. While recognizing the merits of a stronger counter-cyclical fiscal policy, they drew attention to the political commitments to devote additional resources to meeting social welfare goals. Labor market policies were aimed at spreading the gains from growth to low-income workers. They were concerned about the rapid pace of exchange rate appreciation and the risk of an overly strong conversion rate when the euro is adopted.

Staff views: Implementation of prudent policies have contributed to the impressive economic performance. Staff recommended a more ambitious fiscal consolidation given the strong growth outlook and challenges in fending off appreciation pressures. The rising share of non-discretionary expenditure would reduce budgetary flexibility. Recent labor market policy initiatives could increase wage drift and undermine wage flexibility. Competitiveness remains satisfactory thus far. However, further rapid appreciation of the koruna could be disruptive for small and medium-sized exporters. The NBS should use its policy instruments in a manner that will limit opportunities for one-way bets in the foreign exchange market, and lower policy interest rates.

Slovakia 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. Slovakia maintains exchange restrictions for security reasons that have been notified to the Fund.

Contents Page

I. Introduction

1. **Slovakia has become one of Central Europe's strongest economic performers over the past few years**. Sound macroeconomic management, a wide range of structural reforms, and increasing integration with the European Union (EU) have led to progressive strengthening of economic growth. However, regional inequalities have not diminished, and long-term unemployment remains high among the low-skilled and in the less-advanced regions.

2. **Slovakia entered ERM2 in November 2005, and the new coalition government formed following the June 2006 elections is committed to adopting the euro in January 2009**. The prospect appears feasible. Notwithstanding the government's emphasis on higher social spending, the 2007–09 budget framework aims at meeting the Maastricht fiscal deficit criterion in 2007 and achieving further fiscal consolidation thereafter. The near-term inflation outlook has improved, and the Maastricht reference rate seems within reach. Slovakia already meets the Maastricht criteria for long-term interest rates and the public debt ratio.

Slovak Republic: The Maastricht Criteria

	2005		2006		2007	
	Criterion	Actual	Criterion	Actual	Criterion	Forecast
Average HICP inflation (percent) 1/	2.5	2.8	2.9	4.3	3.1	1.6
Long-term interest rate (percent) 2/	5.4	3.5	6.2	4.4	6.4	4.2
General government deficit (in percent of GDP) 3/	3.0	2.8	3.0	3.4	3.0	2.9
General government debt (in percent of GDP)	60.0	34.5	60.0	30.7	60.0	29.5

Sources: Eurostat and IMF staff estimates.
1/ 1.5 percentage points above the three lowest inflation rates in the EU. For 2007, criterion based on WEO projections.
2/ Two percentage points above the rates in the three lowest inflation rate countries in the EU. For 2007, criterion is based on WEO projections and forecast represents the actual rate in March 2007.
3/ ESA 95 basis, including the second-pillar pension costs. For 2007, the forecast represents the deficit target in the budget.

One concern, however, is the considerable strengthening of the koruna since October 2006 and the persistence of appreciation pressure, prompted by a favorable economic outlook and positive investor sentiment toward the region. This could potentially pose a threat to competitiveness as well as, in the event of a sudden change in investor sentiment, complicate meeting the test of exchange rate stability under ERM2.

3. **The main challenges ahead are to manage the potential vulnerabilities in the process of euro adoption and to implement policies that will sustain strong performance in the monetary union**. Accordingly, the consultation discussions concentrated on: coping with the appreciation pressures in the foreign exchange market; ensuring greater fiscal and labor market flexibility for absorbing asymmetric shocks in the absence of a national

monetary policy; and continuing with structural reforms to sustain growth and to address the high unemployment problem and regional inequalities.

II. BACKGROUND

4. **Economic growth picked up further in 2006, bringing output close to its estimated potential**. Real GDP growth accelerated to 8¼ percent, supported by strong productivity gains. Domestic demand growth remained robust, albeit slowing in momentum, while the contribution of net foreign demand rose. Exports increased sharply, as exports of cars and durable consumer goods speeded up, and outpaced imports. However, owing to a deterioration in the terms of trade, the external current account deficit narrowed only slightly to 8¼ percent of GDP from 8½ percent of GDP in 2005. Over four-fifths of the deficit was covered by foreign direct investment (FDI) inflows (Figure 1; and Tables 1, 2, and 3).

Contributions to Growth, 2003–06
(Percentage points, unless otherwise indicated)

	2003	2004	2005	2006
Real GDP growth	4.2	5.4	6.0	8.3
Domestic demand	-1.3	6.3	8.8	6.5
Of which:				
Private consumption	0.0	2.1	3.9	3.5
Fixed investment	-0.6	1.3	4.4	2.1
Change in stocks	-1.6	2.3	0.6	0.4
Net foreign demand	5.5	-0.9	-2.8	1.7
Memorandum items:				
Real growth of exports (in percent)	15.9	7.9	13.8	20.7
Real growth of imports (in percent)	7.6	8.8	16.6	17.8
Terms of trade (percent change)	-0.2	-0.3	-0.3	-1.4
Current account balance (in percent of GDP)	-6.0	-7.8	-8.6	-8.3
Foreign direct investment (in percent of GDP)	6.5	7.2	4.4	7.6
Output gap (in percent of potential GDP)	-0.5	-0.5	-0.3	-0.1

Sources: Statistical Office of the Slovak Republic; and IMF staff estimates.

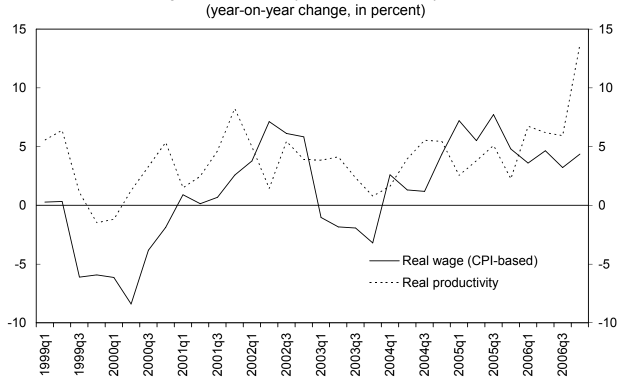
5. **The strength of the economy boosted employment, but wage pressure was subdued and profitability continued to rise**. Employment gains were concentrated in construction and market services. The unemployment rate fell sharply to 13 percent, though long-term unemployment remained stuck at around 8 percent of the labor force. Despite strengthening demand for labor, real wage increases moderated and lagged productivity gains. Thus, the share of profit in value added of non-financial enterprises rose to nearly 18 percent in 2006 from 13¾ percent in 2005. The rise in profit share was broad-based.

Unemployment Rate, 2002-06
(In percent)

	2002	2003	2004	2005	2006
Unemployment rate (total)	18.5	17.4	18.1	16.2	13.3
Short-term (less than 1 year)	7.4	6.8	7.1	5.2	3.6
Medium-term (1 to 2 years)	3.9	3.4	3.1	3.0	2.0
Long-term (more than 2 years)	7.2	7.2	7.9	8.1	7.7

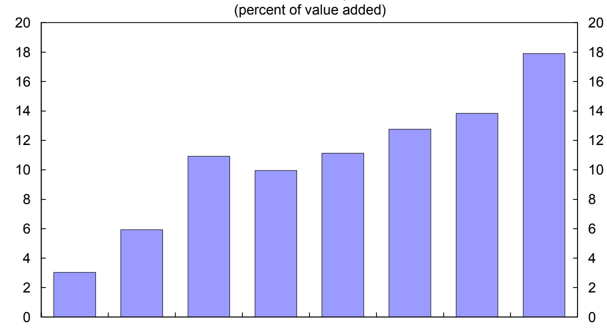
Source: Statistical Office of the Slovak Republic, Labor Force Survey.

Real Wages and Productivity for Overall Economy, 1999-2006
(year-on-year change, in percent)



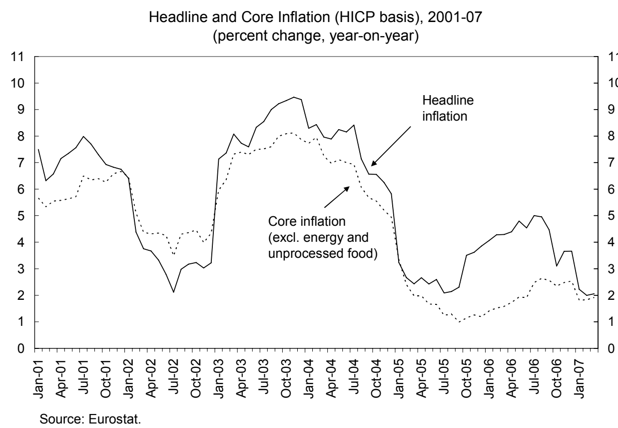
Sources: Statistical Office of the Slovak Republic; and IMF staff calculations.

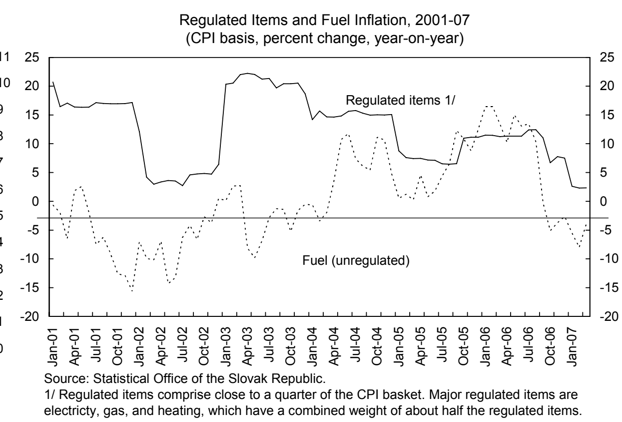
Profits of Non-financial Enterprises, 1999-2006
(percent of value added)



Source: Statistical Office of the Slovak Republic.

6. **Inflation was on an upward path for much of 2006, but this trend reversed in the fourth quarter**. Harmonized consumer price (HICP) inflation reached 5 percent (year-on-year) in July-August 2006 but declined thereafter to 2 percent in February-March 2007. Inflation developments were heavily influenced by trends in world energy prices, the unwinding of the base effects of the large increases in several regulated utility prices in October 2005, and decreases in regulated prices in January 2007 that were in part attributable to margin compression by distributors under pressure from the government.





7. **Financial market trends were influenced by mutually reinforcing domestic and global developments**. During May-July 2006, negative investor sentiment on emerging markets as well as concerns about the election outcome and course of policies led to depreciation pressures on the koruna and increases in long-term koruna rates and default risk premium on government bonds. In subsequent months, global risk aversion toward emerging markets decreased and Slovak financial assets received an extra boost as the new government affirmed its commitment to euro adoption and a flow of new information pointed to stronger-than-expected economic fundamentals. Thus, financial derivatives reverted to pricing in interest rate convergence with the euro area, and the koruna resumed an appreciation trend at a faster pace than other regional currencies (Figure 2).

8. **The National Bank of Slovakia (NBS) has been following a hybrid monetary framework focused on restraining inflation and on maintaining the exchange rate within ERM2 requirements**. Concerns about a negative inflation outlook prompted the NBS to increase its key policy interest rate in four steps in the first three quarters of 2006 by a total of 175 basis points to 4.75 percent. In July 2006, the NBS intervened heavily in the foreign exchange market to stem depreciation pressures when the koruna dropped below the central parity under ERM2. In end-December, as the koruna approached the upper edge of the ERM2 ±15 percent band, the NBS began countering appreciation pressures through verbal and direct interventions and prolonged rejection of bids during regular repo auctions, driving down interbank interest rates below policy rates. Eventually in mid-March 2007, with appreciation pressures persisting, the central parity was revalued with the approval of the EU member states by 8.5 percent to Sk35.44—below the prevailing market rate. The NBS has

continued to counter appreciation pressures since the parity revaluation and has held the koruna at around 6 percent above the new central parity. With inflation coming down markedly in the first quarter of 2007 and judging upside risks to be low, the NBS lowered its policy rate by 50 basis points in two steps since end-March (Figure 3). Because of the large capital outflows and NBS interventions to stem depreciation pressures in mid-year, gross official reserves declined in 2006 and fell further below the stock of short-term debt (Table 4). However, the reserve position has improved in 2007 owing to interventions aimed at countering appreciation pressures.

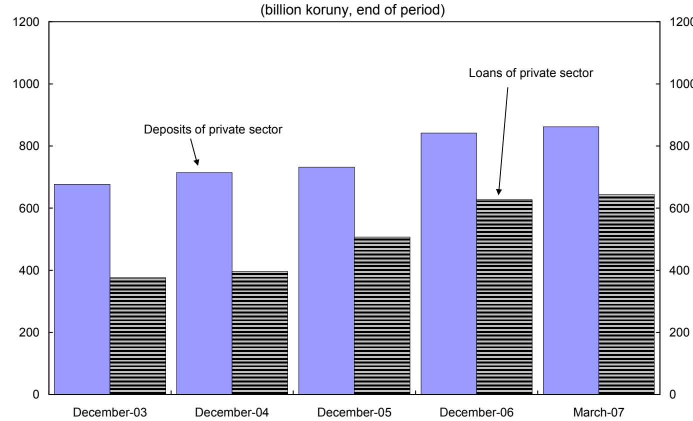
9. **With rising interest rates, credit growth eased slightly in 2006**. Credit growth in Slovakia was broadly similar to that in the slower growing neighboring countries but well below that in the Baltic countries. Unlike in several other new EU-members states, lending by Slovak banks is mainly funded by domestic deposits and is predominantly denominated in domestic currency.

Selected New EU Member States: Credit Developments, 2004-06

	2004	2005	2006
Credit to the private sector		(Percent change)	
CEEC-5			
Czech Republic	15.8	22.3	23.3
Hungary	19.2	18.8	17.3
Poland	2.9	12.6	24.3
Slovakia	6.2	26.0	22.9
Slovenia	21.0	23.6	25.7
Baltic countries			
Estonia	44.6	66.5	62.1
Latvia	47.0	64.3	64.0
Lithuania	40.3	56.1	51.4
Foreign currency loans to private sector		(Share in total loans, percent)	
CEEC-5			
Czech Republic	10.2	9.4	9.9
Hungary	39.0	45.9	49.6
Poland	23.9	25.8	27.0
Slovakia	22.8	28.2	27.1
Slovenia	36.7	51.2	56.9
Baltic countries			
Estonia	80.4	79.9	78.1
Latvia	60.9	70.0	70.9
Lithuania	58.3	65.8	52.8

Sources: International Financial Statistics; national authorities; and IMF staff estimates.

Loans and Deposits of Commercial Banks, 2003-2007
(billion koruny, end of period)



Source: National Bank of Slovakia.

10. **The fiscal outturn in 2006 was better than envisaged in the budget, but still the stance was expansionary**. The general government accounts were in a deficit of 3.4 percent of GDP, compared with 4.2 percent targeted in the budget and an outturn of 2.8 percent of GDP in 2005 (Table 5). The outturn for the state budget and Social Insurance Agency was better than envisaged, but there was slippage in the performance of other levels of general government, especially the municipalities. Accounting for net transfers from the European Union (EU), the fiscal stimulus in 2006 amounted to 1½ percent of GDP. Collections of tax and nontax revenues and social insurance contributions exceeded the budgeted levels by

about 2 percent of GDP, owing to stronger-than-expected growth in the underlying bases and one-time special factors. There also was some underspending in cofinancing of EU-funded projects because of shortfalls in drawdown of funds from the EU budget. These gains were mostly offset by higher outlays on goods and services, and increase in entitlements for pensions and health benefits, and larger subsidies to the transport sectors.

Fiscal Outcome, 2005–06
(In percent of GDP)

	2005 Budget	2005 Actual	2006 Budget	2006 Prel.
Fiscal balance, including second pillar pension costs	-3.8	-2.8	-4.2	-3.4
Fiscal balance, excluding second pillar pension costs	-3.4	-2.2	-2.9	-2.3
Primary fiscal balance, excluding second pillar pension costs 1/	-1.4	-0.1	-1.3	-1.4
Cyclically adjusted primary fiscal balance	-1.3	-0.1	-1.4	-1.5
Net transfers from the EU	1.3	0.3	1.3	0.4
Fiscal impulse including the impact of net transfers from the EU 2/	0.9	-1.3	2.4	1.5
Memorandum items:				
Real GDP growth (percent)	4.5	6.0	5.4	8.3
Fiscal balance of state budget	-4.1	-3.0	-3.5	-2.3
Fiscal balance of municipalities	0.0	0.2	0.0	-0.3

Source: Ministry of Finance.
1/ In 2005, excludes debt forgiveness (mainly to Sudan, Afghanistan and Syria) equivalent of 0.9 percent of GDP.
2/ Change in the cyclically adjusted primary balance plus the change in net transfers from the EU. Receipts from the EU budget generally have counterparts on the expenditure side. Thus, there is no effect on the fiscal deficit but there is an expansionary impact since the receipts do not withdraw resources from the private sector like normal revenue. Payments to the EU budget raise the measured deficit but do not increase domestic demand.

III. Macroeconomic Outlook

11. **Economic growth prospects appear to have shifted to a higher level**. There was consensus that the economy would likely expand faster than the 5–7½ percent assumed in the 2007–09 budget framework and the latest Convergence Programme update. Staff project real GDP growth to rise to 8¾ percent in 2007 and to moderate to 7 percent in 2009. The commencement of production and increasing capacity in several export-oriented projects, especially in the automotive and electronics industries, and increased downstream integration with domestic supply chains will be the main engines of growth. Associated capital deepening and technological enhancements should sustain robust productivity growth and enterprise profitability. Investment is expected to be buoyed by strong profits and FDI-financed projects in the pipeline and under negotiation. Private consumption growth should maintain momentum, supported by real wage increases, continuing employment gains, and favorable expectations triggered by prospective euro adoption. The contribution of net exports is

Contributions to Growth, 2006–09
(Percentage points, unless otherwise indicated)

	2006	2007	2008	2009
		Staff Projections		
Real GDP growth	8.3	8.8	7.5	7.0
Domestic demand	6.5	6.4	6.3	6.2
Of which:				
Private consumption	3.5	3.7	3.6	3.6
Fixed investment	2.1	2.2	2.1	2.1
Change in stocks	0.4	0.0	0.0	0.0
Net foreign demand	1.7	2.5	1.2	0.7
Memorandum items:				
Real growth of exports (in percent)	20.7	20.6	13.0	10.9
Real growth of imports (in percent)	17.8	17.6	11.9	10.3
Terms of trade (percent change)	-1.4	0.4	0.0	0.0
Current account balance (in percent of GDP)	-8.3	-5.3	-4.2	-3.5
Foreign direct investment (in percent of GDP)	7.6	4.1	3.5	3.1
Output gap (in percent of potential GDP)	-0.1	0.0	0.0	0.0

Sources: Statistical Office of the Slovak Republic; and IMF staff projections.

Slovakia: Comparison of Real GDP and Current Acccount Forecasts

	2006	2007	2008	2009
	Actual	Projections		
Real GDP growth (in percent)				
IMF staff	8.3	8.8	7.5	7.0
National Bank of Slovakia	8.3	8.9	7.4	6.9
Ministry of Finance 1/	8.3	7.4	5.2	5.1
Consensus Forecast 2/	8.3	8.6	6.7	...
Current account balance (in percent of GDP)				
IMF staff	-8.3	-5.3	-4.2	-3.5
National Bank of Slovakia	-8.3	-4.3	-2.7	-0.9
Ministry of Finance 1/	-8.3	-3.8	-2.7	-2.1
Consensus Forecast 2/ 3/	-8.3	-4.0	-2.5	...

Sources: National Bank of Slovakia, Ministry of Finance, Consensus Economics, and IMF staff projections.
1/ Official forecast of the 2007-09 budget framework.
2/ Consensus forecast is the mean of the forecasts of 11 institutions comprising market participants and thinktanks. Compiled in March 2007.
3/ Nominal forecast for current account is converted to ratio of GDP using IMF staff's nominal GDP projection adjusted for the Consensus Forecast for real GDP growth.

foreseen to strengthen in 2007 and remain positive in subsequent years, fueled by growing exports of cars and electronics products. Allowing for some increase in the import propensity of domestic demand, the external current account deficit is projected to narrow progressively to about 3½ percent of GDP in 2009—less upbeat than the official and consensus forecasts.

12. **Staff's growth outlook is subject to balanced risks**. On the upside, consumption demand could be higher if real wage increases and demand-side impetus financed by bank credit were greater than assumed in the staff scenario, and if household saving propensity started to fall. In the event of stronger domestic demand, the current account deficit could exceed staff projections. Downside risks to growth are a significant slowdown in major markets and higher oil prices. There should be no negative implications for the euro adoption goal if economic growth turns out lower than the staff projection since the budget is based on conservative growth assumptions.

13. **In a context of strong growth prospects and external outlook, external debt sustainability is not a concern**. Slovakia is likely to remain an attractive destination for foreign investors and record large surpluses in the financial account (Table 6). In addition, the anticipated rise in corporate saving is likely to limit debt financing. Thus, in the baseline scenario, external debt relative to GDP is projected to decline by about 13 percentage points to 43 percent in 2012. Various stress tests indicate that Slovakia's external debt dynamics should remain manageable. Even under the most adverse scenario, the debt would settle at around 63 percent of GDP over the medium term (Table 7).

14. **Barring major shocks, inflation is likely to moderate in the near term and meet the Maastricht reference rate**. The regulated utility price decreases of January 2007 will result in a significant dampening of inflation. Given the latest World Economic Outlook energy price projections and assuming that wage increases continue to lag productivity gains, staff considers the NBS's inflation projections for end-2007 (1.6 percent) and end-2008 (1.9 percent) to be realistic.[1] The projections are subject to uncertainties related to developments in world energy prices and their domestic impact and to movements in the nominal exchange rate. Upside risks to inflation are higher consumer spending, against the backdrop of zero slack in the economy, and wage pressures induced by a tighter labor market. The authorities stressed that the impact of the downward adjustments in regulated prices was sustainable in that they would not negatively affect cost recovery and the ability of the utility companies to maintain and renew their infrastructure.

[1] Subsequent to the mission, in April, the NBS lowered the end-2007 inflation projection to 1.3 percent, taking into account recent price developments.

IV. Policy Discussions

15. **The authorities are giving priority to euro adoption but are also committed to socially inclusive growth**. They were concerned about the rapid pace of exchange rate appreciation and the risk of an overly strong conversion rate when the euro is adopted. They emphasized that fiscal consolidation was a key objective and that increases in social spending would be effected within the limits imposed by the deficit targets. However, the authorities were inclined to devote additional revenues resulting from faster economic growth to meeting social welfare goals. They also have taken a number of labor market policy initiatives aimed at spreading the gains from growth to low-income earners. Staff highlighted the risk of the public expenditure structure and the labor market becoming less flexible and, to ensure a successful experience in the euro area, encouraged the authorities to orient policies toward enhancing the ability of the economy to deal with shocks.

16. **Over a number of years, the authorities have implemented policies generally in line with the Fund's advice**.

A. Monetary and Exchange Rate Policy

17. **The authorities noted that the revaluation of the central parity of the koruna was justified by Slovakia's improved economic fundamentals**. The productivity growth differential vis-à-vis the euro area had widened in 2006, and a sizeable part of the upward pressure on the exchange rate reflected productivity-driven equilibrium real appreciation. The authorities recognized that the parity revaluation entailed risks. It increased the room for further appreciation within the ERM2 band and could induce additional speculative inflows. It also increased Slovakia's vulnerability to investor sentiment turning bearish, as the cushion for accommodating depreciation had become smaller relative to that before the parity adjustment. However, the authorities were optimistic that investors would increasingly decouple the koruna from regional influences. Staff regards parity revaluation to be a pragmatic strategy, given the reasons for the upward deviations and the objective of keeping the exchange rate within the ERM2 band.

18. **The authorities expressed the view that an overshooting of the koruna from the equilibrium level was likely to undermine the competitiveness of traditional manufacturing firms as well as small and medium-sized enterprises, where productivity gains were lower**. However, staff noted the inherent difficulties of measuring equilibrium rates in transition economies and observed that competitiveness remained satisfactory according to most indicators. Strong productivity growth kept the unit labor cost-based real effective exchange rate broadly stable in 2006. Moreover, with increases in real product wages lagging productivity gains, profitability rose and continued to outpace trading partners (Figures 4 and 5). Significantly, profitability of sectors experiencing slower export growth was comparable to that of sectors with faster export growth. Slovakia's export market share has increased for all sectors in recent years, and its exports have moved up the technology

ladder at a faster pace than most regional peers (Figures 6 and 7). The pace of export market penetration is likely to be sustained over the medium term on account of commencement of production and expansion of capacity in several export-oriented projects.

19. **The NBS has persisted with foreign exchange intervention and rejection of repo bids in open market operations for containing appreciation of the koruna**. However, these efforts have succeeded in easing pressures for only limited duration. Staff encouraged the NBS to increase Slovakia's resilience to speculative capital inflows by using its policy instruments in a manner that would limit opportunities for one-way bets in the foreign exchange market. Given the favorable inflation outlook, staff recommended that the NBS lower its policy interest rates. Staff also saw merit in NBS officials communicating to market participants that the terminal conversion rate could be different from the prevailing market rate, as had been the case for Greece, Ireland, and Finland.

B. Fiscal Policy

20. **The authorities noted that the 2007–09 budget framework was aimed at meeting the euro zone entry objective**. It envisaged a general government deficit (including the second pillar pension costs) of 2.9 percent of GDP in 2007 and consolidation thereafter of ½ percent of GDP annually to 1.9 percent of GDP in 2009. Taking into account net transfers from the EU, this would imply a marginally contractionary stance every year. Fiscal consolidation would rely mainly on a reduction in expenditure in relation to GDP. However, the authorities planned higher expenditure on health care, pensions and other social spending, and agriculture. The budget incorporates marginal changes to the flat tax system that are not unduly distortionary—the VAT rate on medicine and medical devices has been lowered from 19 percent to 10 percent, and standard deductions have been reduced for higher income earners.

Fiscal Outlook, 2006–09
(In percent of GDP)

	2006		2007	2008	2009
	Budget	Prel.		Budget	
Fiscal balance, including second pillar pension costs	-4.2	-3.4	-2.9	-2.4	-1.9
Fiscal balance, excluding second pillar pension costs	-2.9	-2.3	-1.8	-1.3	-0.7
Primary fiscal balance, excluding second pillar pension costs	-1.3	-1.4	-0.2	0.2	0.7
Cyclically adjusted primary fiscal balance	-1.4	-1.5	-0.4	0.2	0.7
Net transfers from the EU	1.3	0.4	0.8	1.0	1.3
Fiscal impulse including the impact of net transfers from the EU 1/	2.4	1.5	-0.6	-0.4	-0.2
Memorandum items:					
Real GDP growth (percent) 2/	5.4	8.3	7.4	5.2	5.1

Source: Ministry of Finance.
1/ Change in the cyclically adjusted primary balance plus the change in net transfers from the EU. Receipts from the EU budget generally have counterparts on the expenditure side. Thus, there is no effect on the fiscal deficit but ther is an expansionary impact since the receipts do not withdraw resources from the private sector like normal revenue. Payments to the EU budget raise the measured deficit but do not increase domestic demand.
2/ For 2006, forecast of the 2006-08 budget framework. For 2007-09, forecast of the 2007-09 budget framework.

21. **Staff recommended a more ambitious fiscal consolidation than envisaged in the budget framework, given the strong growth outlook and challenges in fending off appreciation pressures**. This would ensure that the Maastricht criteria on inflation, the exchange rate, and the budget deficit are met by comfortable margins and in a sustainable manner. The strategy to achieve additional fiscal consolidation would not necessarily require scaling back on budgeted expenditure. Revenues are likely to exceed the budgeted levels as economic growth is anticipated to be stronger relative to the budget assumptions.

Accordingly, staff encouraged the authorities to save the revenue overperformance and ensure a better fiscal outturn. This would entail adhering to the nominal expenditure targets specified in the budget framework.

22. **Ministry of Finance officials recognized the merits of a stronger counter-cyclical fiscal policy, but drew attention to the political constraints**. Given the emphasis in the government's manifesto on enhancing welfare state measures, there would be pressure for using additional revenues resulting from faster economic growth for socially-oriented current spending. Ministry officials noted that the state budget law for 2007 limited the extent to which revenue overperformance could be spent without resorting to a supplementary budget—only up to 1 percent of the budget baseline expenditure. While this could potentially help obtain a lower-than-envisaged deficit in 2007, they did not rule out the possibility of an upward revision of the original expenditure ceilings for 2008 and 2009 when the 2008–10 budget framework is prepared on the basis of updated macroeconomic projections.

23. **Fiscal management at local government levels will have to be made consistent with the national fiscal consolidation strategy**. The authorities explained that the slippage in the fiscal performance of municipalities in 2006 was election related, and considered the risk of it recurring in 2007 to be small. However, fiscal rules applicable to local governments are based on ceilings related to their debt stock, which are currently non-binding. They do not prevent revenue overperformance from funding additional spending and do not ensure operation of automatic fiscal stabilizers. Also, there is no satisfactory mechanism in place for monitoring fiscal developments of local governments. Accordingly, staff recommended that fiscal rules applicable to local governments be amended with the aim of strengthening expenditure control and enhancing fiscal flexibility. Until these measures became effective, staff suggested use of moral suasion to avoid any borrowing for expenditures beyond the budgeted levels and to save any revenue overperformance.

24. **The expenditure program in the 2007–09 budget framework does not identify how the announced policy priorities will be sustained beyond 2007**. Some of the new social expenditure policy initiatives are not fully funded, and their full implementation would cost 0.4–0.5 percent of GDP more annually than provided for in the budget framework. The authorities indicated that higher expenditure on social policy priorities would be accommodated through efficiency gains in government spending, streamlining public administration, and stronger revenue performance. They acknowledged that a key challenge

was to contain costs in the health care system.[2] However, they downplayed staff's concern about possible increase in demand for doctor's consultations and outpatient contacts following the recent elimination of co-payments. The authorities stated that the details of public administration reform and a comprehensive medium-term expenditure program would be elaborated in the 2008–10 budget framework.

Budgetary Impact of New Expenditure Initiatives, 2006-09
(In millions of koruny, unless otherwise indicated)

	2006	2007	2008	2009
Cost of new expenditure initiatives incorporated in the expenditure plan for 2007-09				
Christmas bonus for pensioners	1,614	0	0	0
Disability pensions	600	960	337	342
Elimination of health care copayment	…	1,900	1,900	1,900
Higher health contribution on behalf of vulnerable groups	…	2,093	0	0
Bonus for first born child	…	288	294	300
Direct payments to farmers up to 70 percent of the EU-15 average	…	3,735	0	0
Investment incentives	…	2,300	0	0
Subsidies for mortgage loans	…	50	100	120
Wage increases for teachers	…	2,300	0	0
Wage increases for judges	…	154	165	173
Total				
in millions of koruny	2,214	13,780	2,796	2,835
in percent of GDP	0.1	0.8	0.1	0.1
Additional cost in case of full implementation of new expenditure initiatives				
Christmas bonus for pensioners		1,700	1,700	1,700
Higher health contribution on behalf of vulnerable groups 1/			2,236	2,391
Direct payments to farmers up to 70 percent of the EU-15 average 2/			2,784	1,418
Wage increases for teachers			2,665	3,169
Investment incentives 3/			n.a.	n.a.
Total (excluding n.a. item)				
in millions of koruny		1,700	9,385	8,678
in percent of GDP		0.1	0.5	0.4

Source: Ministry of Finance.
1/ The rate of health contribution on behalf of vulnerable groups is assumed to be kept at 4.33 percent in 2008 and 09—the same rate as in 2007.
2/ Direct payments to farmers are assumed to be kept at 70 percent of the EU-15 average in 2008 and 09.
3/ Not yet specified.

25. **Staff expressed concern that the rising share of non-discretionary expenditure would reduce budgetary flexibility**. Creating space for the growing co-financing of EU-funded projects as well as fiscal adjustment in the event of shocks would become more difficult. While acknowledging that capital expenditure can also help achieve social welfare goals, the authorities did not foresee a quick shift in the composition of expenditure.

26. **The drawdown of EU funds has fallen short of the budgeted levels**. While Slovakia compares favorably with neighboring countries in the overall absorption of EU funds, it fares poorly in the utilization of cohesion funds. The authorities noted that the current legislation on land acquisition and procedures for construction permits hindered drawdown of EU funds for infrastructure projects and needed to be urgently reviewed.

Drawdown of EU funds by categories, 2006

	EAGGF 1/	Structural Funds	Cohesion Fund	Others	Total	Total drawdown
	(in percent of budgeted level)					(in percent of GDP)
CEE-5 countries						
Czech Republic	88.4	46.7	49.9	58.6	62.5	1.1
Hungary	95.5	47.5	44.6	55.7	66.0	1.7
Poland	82.1	36.6	29.5	49.7	51.9	1.8
Slovak Republic	86.0	103.9	8.1	74.5	67.3	1.3
Slovenia	75.5	66.7	37.1	99.2	76.5	1.4
Baltic countries						
Estonia	83.9	69.2	79.1	73.6	77.0	2.9
Latvia	79.4	44.9	88.3	87.6	73.5	3.4
Lithuania	96.6	25.2	36.5	67.7	59.6	3.1

Sources: Ministry of Finance of the Slovak Republic, and IMF Working Paper "EU Funds in the New Member States: A Primer"(WP/07/77).
1/ European Agricultural Guidance and Guarantee Fund.

[2] See the accompanying Selected Issues Paper for discussion of health care spending in Slovakia.

27. **Public debt sustainability is not a concern**. At end-2006, general government debt stood at 30¾ percent of GDP. This is both within a safe range for an emerging market and below the Maastricht limit. Assuming the structural deficit trend specified in the latest Convergence Program update, the debt ratio is projected to decline by 7¾ percentage points to 23 percent of GDP by 2012. Aging-related fiscal pressure is anticipated only in the longer term, from 2020 onward. Vulnerability of debt to changes in inflation, interest rates, and the exchange rate is low (Table 8).

C. Wage and Labor Market Issues

28. **Recent labor market policy initiatives aimed at addressing income inequality could increase wage drift and undermine wage flexibility**.

- The authorities increased the minimum wage by 10 percent in October 2006, and the government manifesto calls for further increases in the minimum wage relative to the average wage. They are giving consideration to establishing formula-based guidelines for increases in the minimum wage. Staff urged the authorities to retain discretion for determining minimum wage increases and adopt a cautious stance, as the pace influenced wage negotiations in the private sector although a large part of wage setting was decentralized. Staff also noted that the introduction of an earned income credit for low-income workers would be a better option to guarantee a minimum living standard than further increases in the minimum wage. Implementation of this measure would enhance the incentive to participate in the labor market without having any negative impact on the demand for labor.

- In a reversal of the reform measure implemented in 2004, a recent amendment to the collective bargaining law has made sectoral wage agreements binding for all enterprises in the sector. Opposition parties and employer groups have petitioned the Constitutional Court on the validity of the amendment. Staff noted that the amendment would be particularly painful to smaller enterprises and would reinforce the negative effect of rapid exchange rate appreciation. It would also reduce the scope for regional wage differentiation that is desirable because of the large regional differences in employment rates. The authorities explained that the amended law allows individual firms to seek a waiver on socio-economic grounds. They also noted their intention to establish a tripartite Social Pact that would include a provision for wage moderation.

29. **The government is seeking to amend the Labor Code with the aim of increasing employee protection and aligning it to the European social model.** However, the draft legislation submitted to parliament does not have the full backing of the junior coalition partners and may be subject to change. Employers' associations and major FDI-supported enterprises remain opposed to the proposed changes, arguing that they would increase labor costs and worsen the business environment.

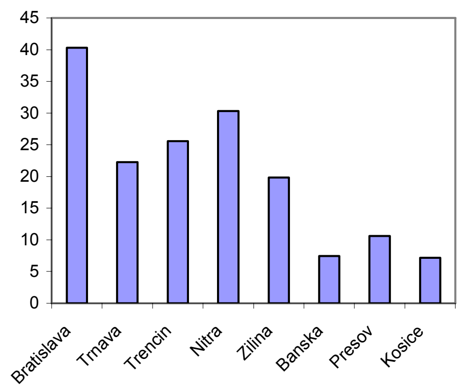
30. **Addressing regional disparities and the high unemployment problem are continuing challenges**. The benefits of rapid economic growth appears to have by-passed three regions in central and eastern Slovakia, where employment growth has been small and the unemployment rate remains sticky around 20 percent. Active labor market policy (ALMP) schemes have been less effective[3] in the three lagging regions than in the rest of the country. The authorities indicated that new ALMP tools will be added from January 2008 to raise the employability of job seekers and to increase the incentives for employers to employ disadvantaged groups. They noted that the new scheme of investment incentives was aimed at supporting job creation in the underdeveloped regions. The authorities also plan to increase investment in infrastructure in these regions, strengthen the regional transport systems, and improve the quality of tertiary and vocational education, supported by contributions from the EU.

Employment and Unemployment by Region, 2001-06

	2001	2002	2003	2004	2005	2006
Employment rate	(In percent of working population)					
Slovakia, total	56.5	56.7	57.6	56.9	57.7	59.1
Bratislava	68.5	67.1	68.2	67.6	69.6	69.7
Trnava	59.6	60.7	61.9	62.7	64.2	65.1
Trencin	59.7	60.7	62.6	62.6	62.7	64.1
Nitra	52.5	51.0	52.7	55.2	55.9	58.0
Zilina	56.2	57.8	57.7	56.5	57.4	59.3
Banska	54.5	52.6	53.1	51.0	52.8	54.2
Presov	53.1	54.6	54.8	52.9	53.7	55.5
Kosice	51.0	51.3	52.5	50.3	49.2	50.9
Unemployment rate	(In percent of labor force)					
Slovakia, total	19.2	18.5	17.4	18.1	16.2	13.3
Bratislava	8.4	8.6	6.9	8.2	5.2	4.3
Trnava	18.0	16.1	13.2	12.5	10.4	8.8
Trencin	13.4	11.3	9.2	8.6	8.1	7.0
Nitra	23.1	23.8	23.4	20.3	17.7	13.2
Zilina	18.9	17.3	17.1	17.4	15.2	11.8
Banska	22.4	25.2	23.8	26.6	23.8	21.0
Presov	22.7	20.1	20.4	22.8	21.4	18.0
Kosice	24.8	24.1	23.0	25.2	24.6	20.2

Source: Statistical Office of the Slovak Republic, Labor Force Survey.

Success Rate of Active Labor Market Policies in 2005 1/
(In percent)



Source: Ministry of Labor, Social Affairs and Family.
1/ Measured as a ratio of participants in active labor market policy programs who found a job to the total number of participants.

D. Financial Sector Issues

31. **The banking system, which is almost entirely foreign-owned, is currently healthy**. A recent FSAP update mission found that banks are adequately capitalized and profitable, and asset quality remains high (Table 9). Stress tests indicate that banks remain resilient to a range of possible adverse shocks.[4] However, continued rapid credit growth has increased banks' exposure to credit risk and their vulnerability to swings in the economic

[3] Measured in terms of raising exit rates from unemployment into employment following participation in a scheme.

[4] See the accompanying Financial Sector Stability Assessment.

cycle. NBS officials deemed risk management practices of banks to be generally adequate. Noting that the lowering of policy interest rates to counter appreciation pressures may also provide additional impetus to credit growth, staff stressed the need to closely monitor bank loan portfolios and to tighten prudential requirements if necessary.

32. **In 2006, the NBS unified supervision of the entire financial sector.** The non-bank financial sector is relatively small but growing rapidly. NBS officials indicated that the risk-based forward-looking approach of supervision was now fully operational in the non-bank financial sector. The FSAP update mission determined that the NBS is well prepared to cope with the challenges resulting from the implementation of the Basel II supervision framework from January 2007. NBS officials regularly interacted with home country supervisors at different levels, but they acknowledged the importance of improving coordination further. Staff encouraged the authorities to implement in a timely fashion the recommendations of the MONEYVAL report to improve the anti-money laundering regime.

V. Staff Appraisal

33. **Slovakia is reaping the benefits of sound policies over the past few years**. Reforms of the tax and welfare systems, financial sector, and the labor market have increased the incentives to work, improved the business climate, and enhanced the flexibility of the economy. These measures together with prudent macroeconomic management and large FDI inflows have supported progressive strengthening of economic growth and increasing export orientation, making Slovakia one of the top performers in the region. The new government's commitment to the continuation of policies aimed at ensuring euro adoption in January 2009 has secured investor confidence and should help sustain this status.

34. **Slovakia is well poised to adopt the euro, but challenges lie ahead**. The near-term inflation outlook has improved and the Maastricht reference rate seems within reach. The 2007–09 budget framework is aimed at meeting the euro zone entry objective. However, a key challenge is to satisfy the test of exchange rate stability under ERM2, as the evolution of the koruna is influenced not only by Slovakia's economic fundamentals but also by swings in investor sentiment in the region. Another challenge is to put in place adjustment mechanisms—wage and labor market flexibility and the capacity to run countercyclical fiscal policy—prior to adopting the euro. This will ensure that asymmetric shocks can be effectively absorbed in the absence of a national monetary policy. Thus, a continued focus on fiscal prudence and structural reforms will remain essential. The increased social orientation of policies that the authorities are also aiming for will need to be carefully meshed into this framework.

35. **Monetary policy priorities have shifted to containing exchange rate appreciation and keeping the rate within the ERM2 band**. Slovakia's improved economic outlook and favorable prospects for euro adoption may create a tendency for upward pressure on the currency with the potential for overshooting and volatility. The koruna's recent firming does

not appear to pose a significant threat to competitiveness. However, further rapid appreciation of the koruna could be disruptive for small and medium-sized exporters. The NBS should use its policy instruments in a manner that will limit opportunities for one-way bets in the foreign exchange market. Given the favorable inflation outlook, the NBS should lower its policy rates instead of persisting with the rejection of repo bids to contain appreciation pressures.

36. **A tighter fiscal stance than envisaged in the budget is desirable, given the robust growth prospects and the persistence of appreciation pressures**. Such a strategy would also facilitate the achievement of euro zone norms on a sustainable basis. Ensuring a better fiscal outturn will require safeguarding the revenue overperformance that is anticipated because of a stronger economic growth outlook, and adhering to the original medium-term expenditure ceilings. It will also be important to strengthen fiscal management of local governments and improve policy coordination across all levels of government.

37. **The medium-term expenditure framework should be strengthened to reflect policy objectives clearly and to enhance fiscal flexibility**. The authorities have initiated background work to increase spending efficiency and streamline public administration. It will be important to follow through with these plans in a decisive manner. However, increased socially-oriented current spending is likely to make the public expenditure structure more rigid. Capital expenditure can also help achieve social welfare goals while increasing the long-term growth potential and widening the discretionary scope for fiscal policy. More emphasis should be put on reducing income inequalities by channeling resources toward employment promotion and investment in infrastructure in underdeveloped regions. Priority should be given to eliminating the bottlenecks that hinder drawdown of EU funds for infrastructure projects, and space should be created for the growing co-financing of EU-funded projects.

38. **Wage moderation and flexibility in wage setting procedures would contribute importantly to containing inflationary pressures and safeguarding competitiveness**. In this regard, the recent legislation that extends sectoral wage agreements to all firms in the sector is worrisome. The authorities should avoid further large increases in the minimum wage as it would lead to wage drift and may harm employment prospects of low-skilled workers.

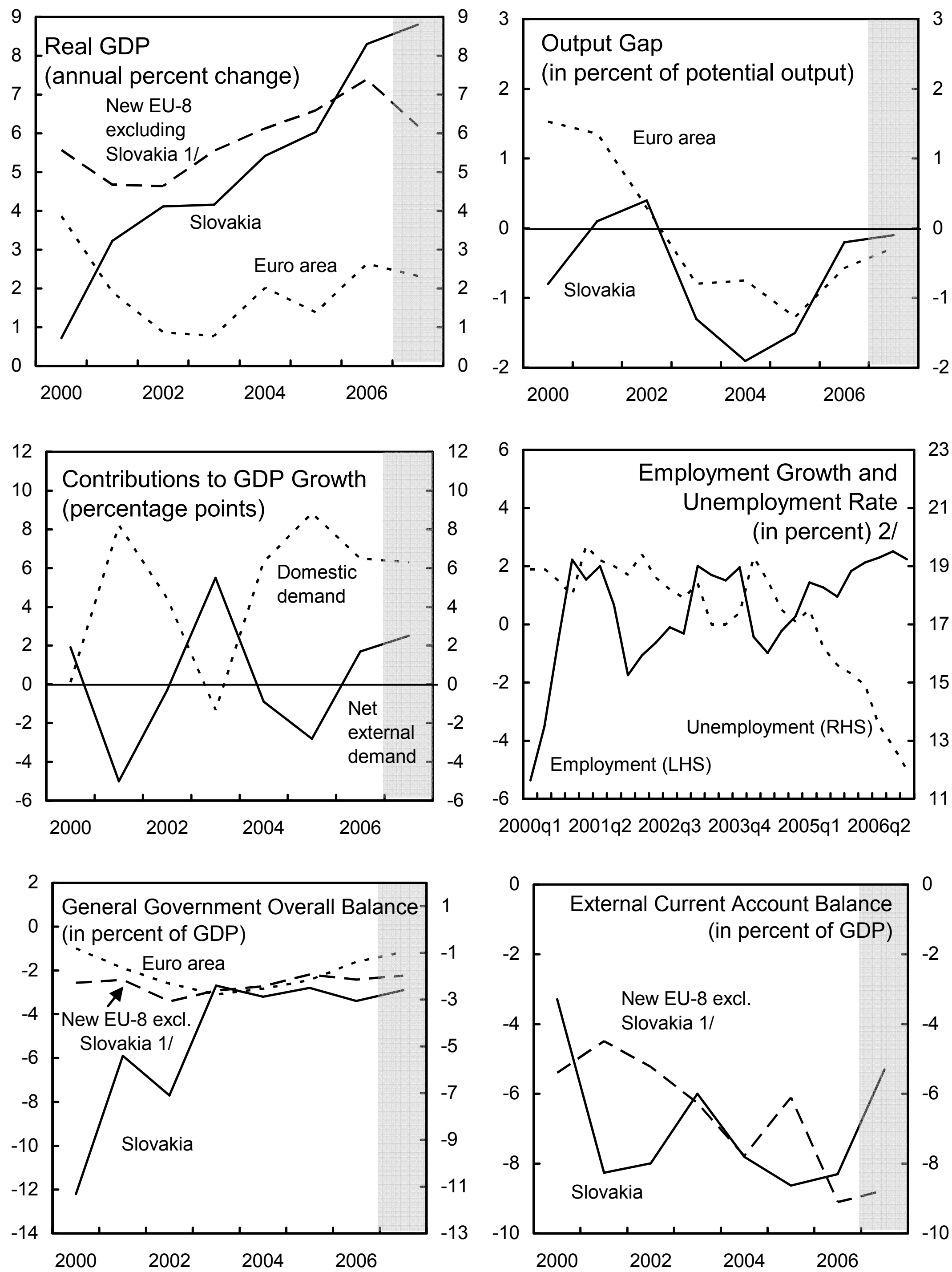
39. **Slovakia continues to face considerable challenges in the labor market**. Reforms implemented in 2003–04 and stronger GDP growth have contributed to a pick up in the employment rate, but the unemployment rate remains high among the low-skilled and in the less-advanced regions. Active labor market policy schemes have been relatively ineffective in lowering unemployment in these regions, and need to be improved. Consideration should be given to introducing earned income credit for low-income workers, with a view to stimulating job creation and further increasing incentive to work. The authorities should also

ensure that the amendments to the labor code do not lead to higher labor costs and reduce labor market flexibility.

40. **The financial system is in good health, but faces challenges**. The increasing exposure of banks to credit risk requires close monitoring. Given the high foreign ownership of banks and the recent introduction of the Basel II framework, it will be important to strengthen cooperation and exchange of information with home country supervisors, and to develop arrangements for coordinated remedial actions for dealing with problem banks. The extension of a risk-based approach of supervision to non-bank financial institutions is welcome. The NBS is encouraged to address the remaining gaps in the anti-money laundering regime, taking into account the recommendations of MONEYVAL.

41. It is recommended that the Article IV consultation with Slovakia remain on the standard 12-month cycle.

Figure 1. Slovak Republic: Economic Indicators, 2000–07

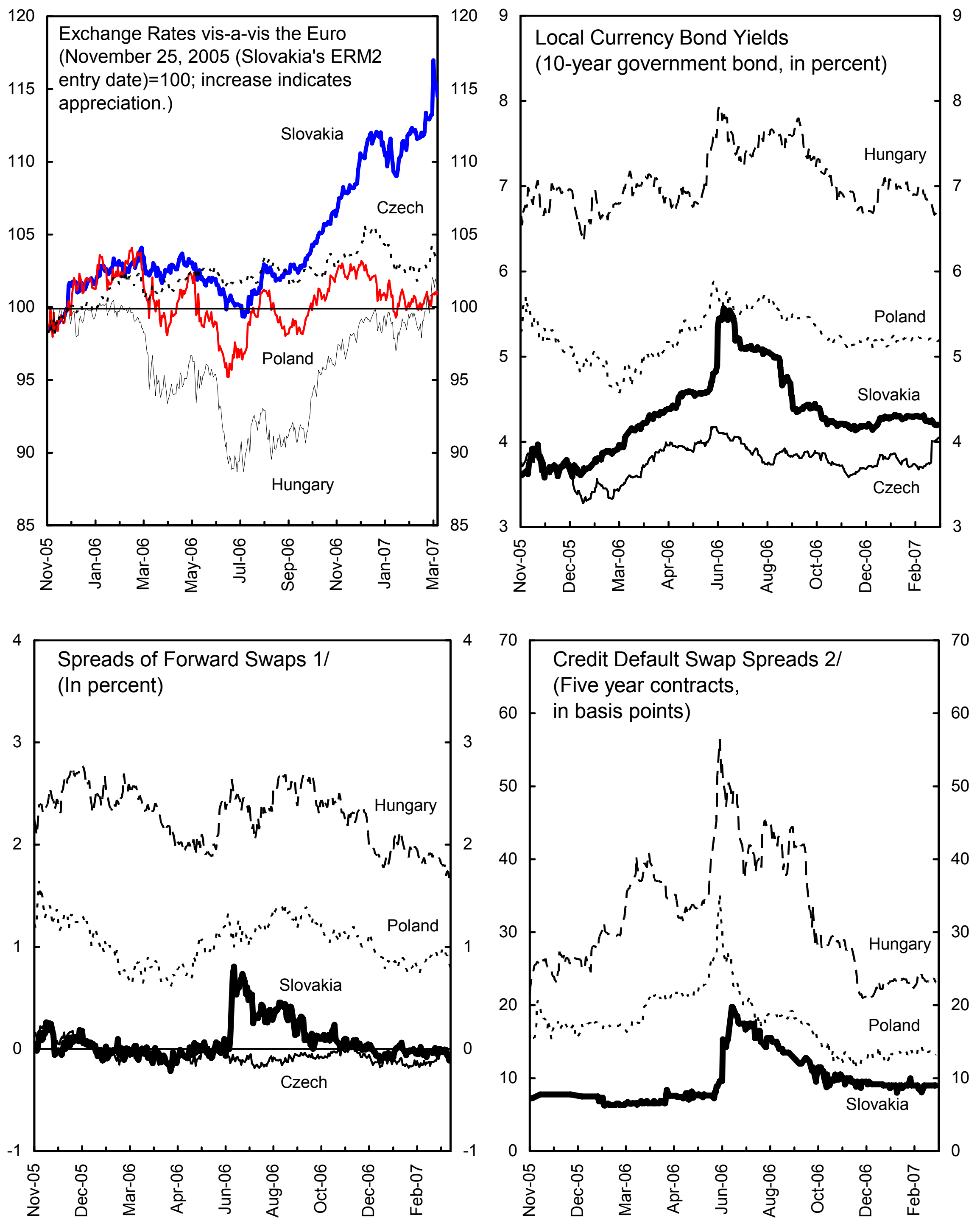


Sources: National Bank of Slovakia; Statistical Office of the Slovak Republic; World Economic Outlook; and IMF staff projections.

1/ New EU-8 include Czech Republic, Estonia, Hungary, Latvia, Lithuania, Poland, Slovakia, and Slovenia.

2/ Employment is measured on ESA 95 basis data, and unemployment data is from Labor Force Survey.

Figure 2. Visegrad-4 Countries: Financial Market Indicators, 2004-07

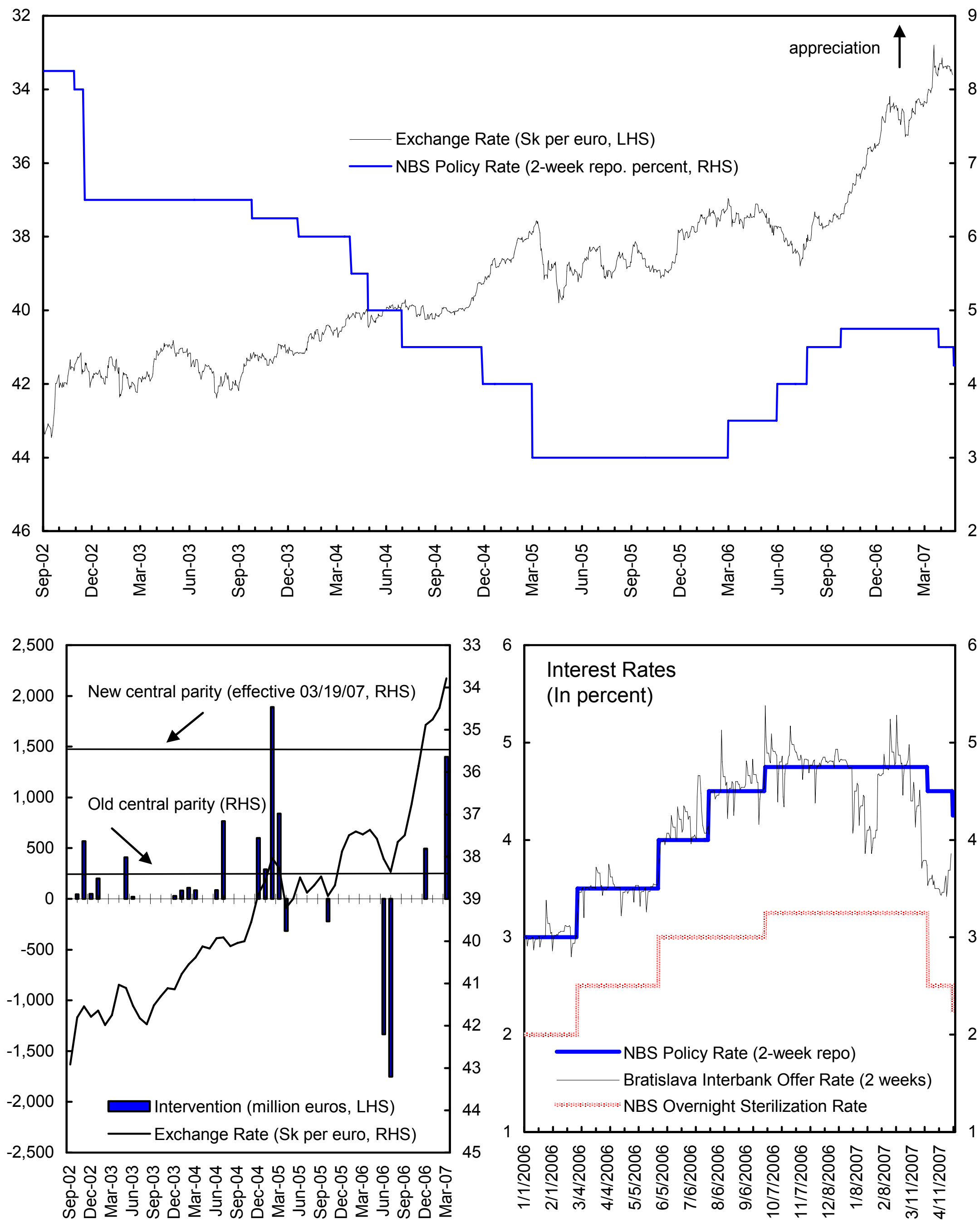


Sources: Bloomberg and Haver.

1/ Difference between 5-year local currency interest rate forward and similar euro-denominated interest rate forward.

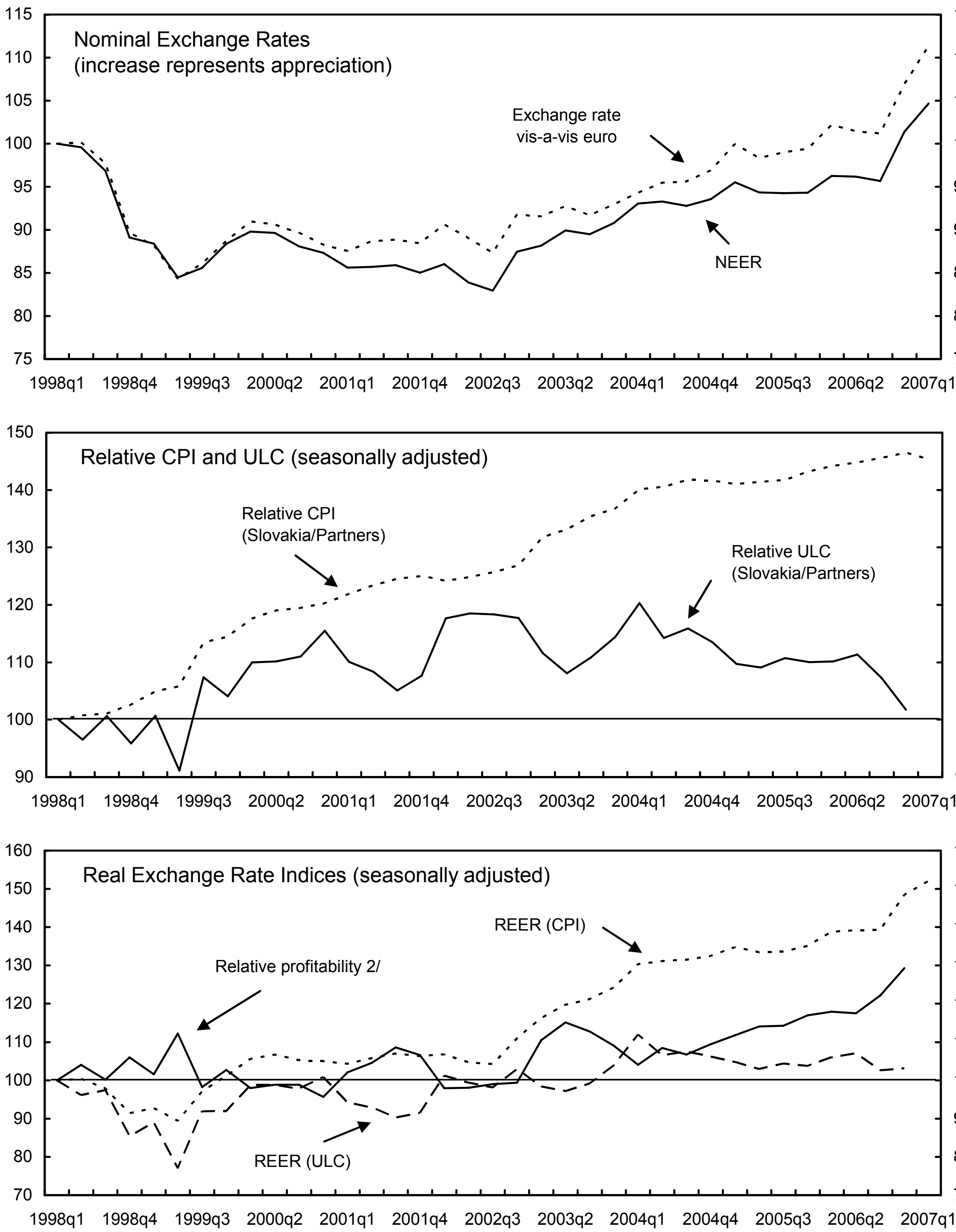
2/ Credit default swap spread is the annual premium to be paid in return for full payment by a third party in the event of default by the bond issuer.

Figure 3. Slovak Republic: Exchange Rate and Interest Rate Developments, 2002-07



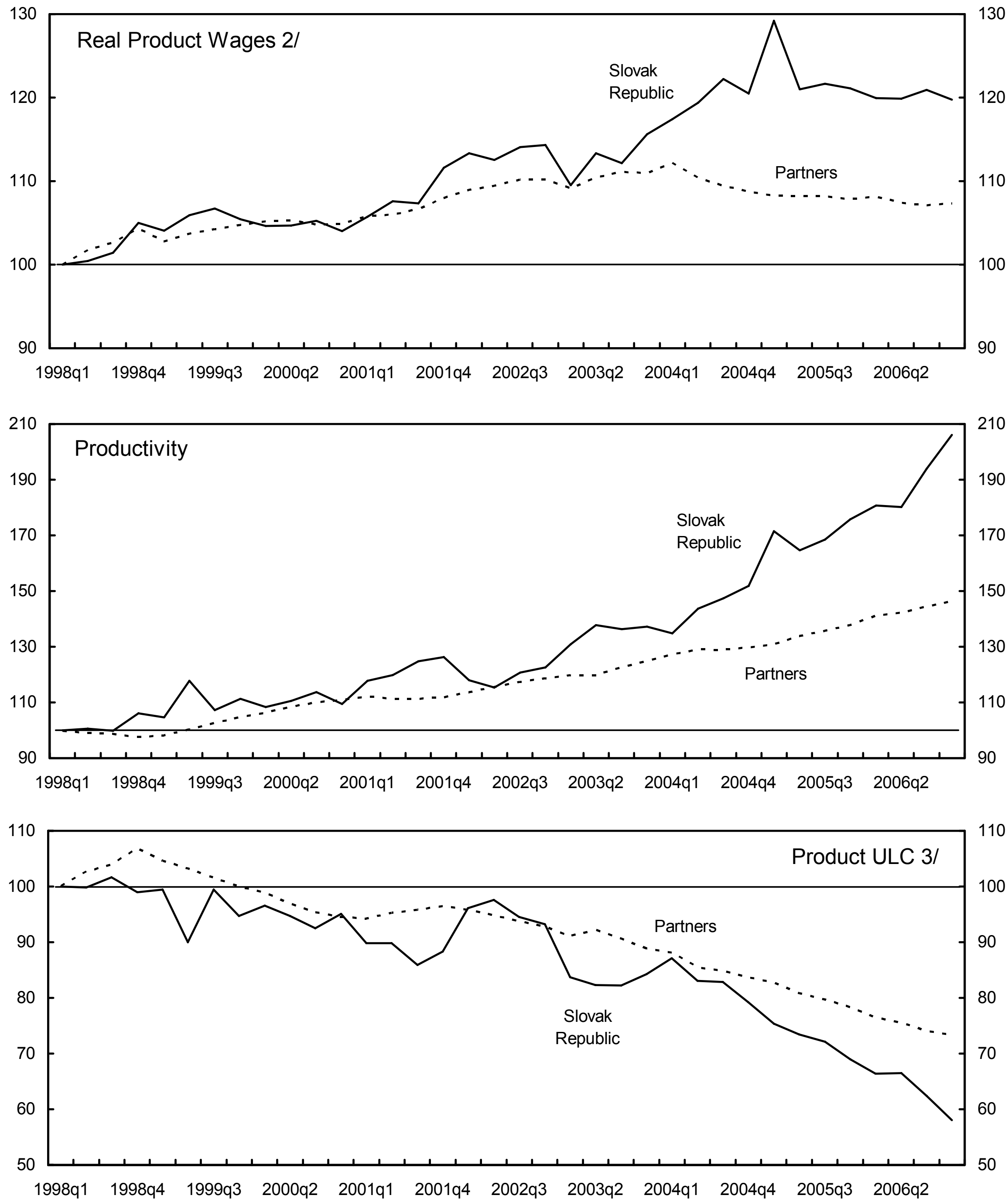
Sources: Slovak authorities; Bloomberg; and IMF staff calculations.

Figure 4. Slovak Republic: Exchange Rate Indicators, 1998-2007
(1998q1=100) 1/



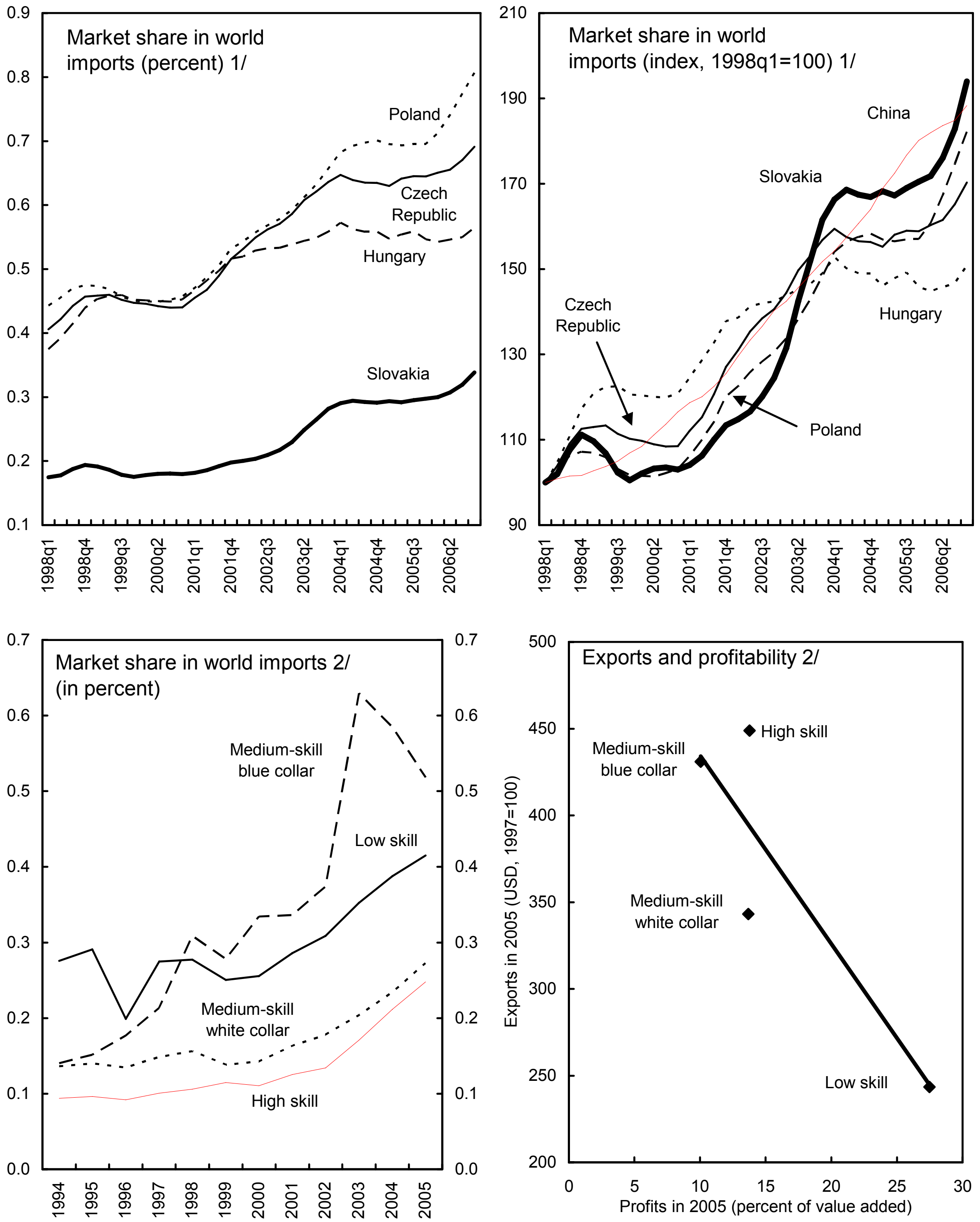
Sources: Eurostat; International Financial Statistics; and IMF staff calculations.
1/ Trade weights based on 1999-2001 data for exports of goods. Partner countries comprise: Austria, Czech Republic, France, Germany, Hungary, Italy, Netherlands, Poland, United Kingdom, and United States.
2/ Unit labor costs in trading partner countries relative to those in Slovakia, adjusted for manufacturing producer price inflation—a rough indicator of developments in relative profitability. An increase represents gain in competitiveness, vis-a-vis trading partners, assuming similar capital-labor ratios.

Figure 5. Slovak Republic: Wages, Productivity, and Product ULC in Manufacturing, 1998-2006 (1998q1=100) 1/



Sources: Statistical Office of the Slovak Republic; and IMF staff calculations.
1/ Trade weights based on 1999-2001 data for exports of goods. Partner countries comprise: Austria, Czech Republic, France, Germany, Hungary, Italy, Netherlands, Poland, United Kingdom, and United States.
2/ Defined as the ratio of nominal wages to producer price index.
3/ Defined as the ratio of real product wages to productivity.

Figure 6. Competitiveness Indicators and Export Market Shares of Slovak Republic and Selected New EU-Member States, 1998-2006

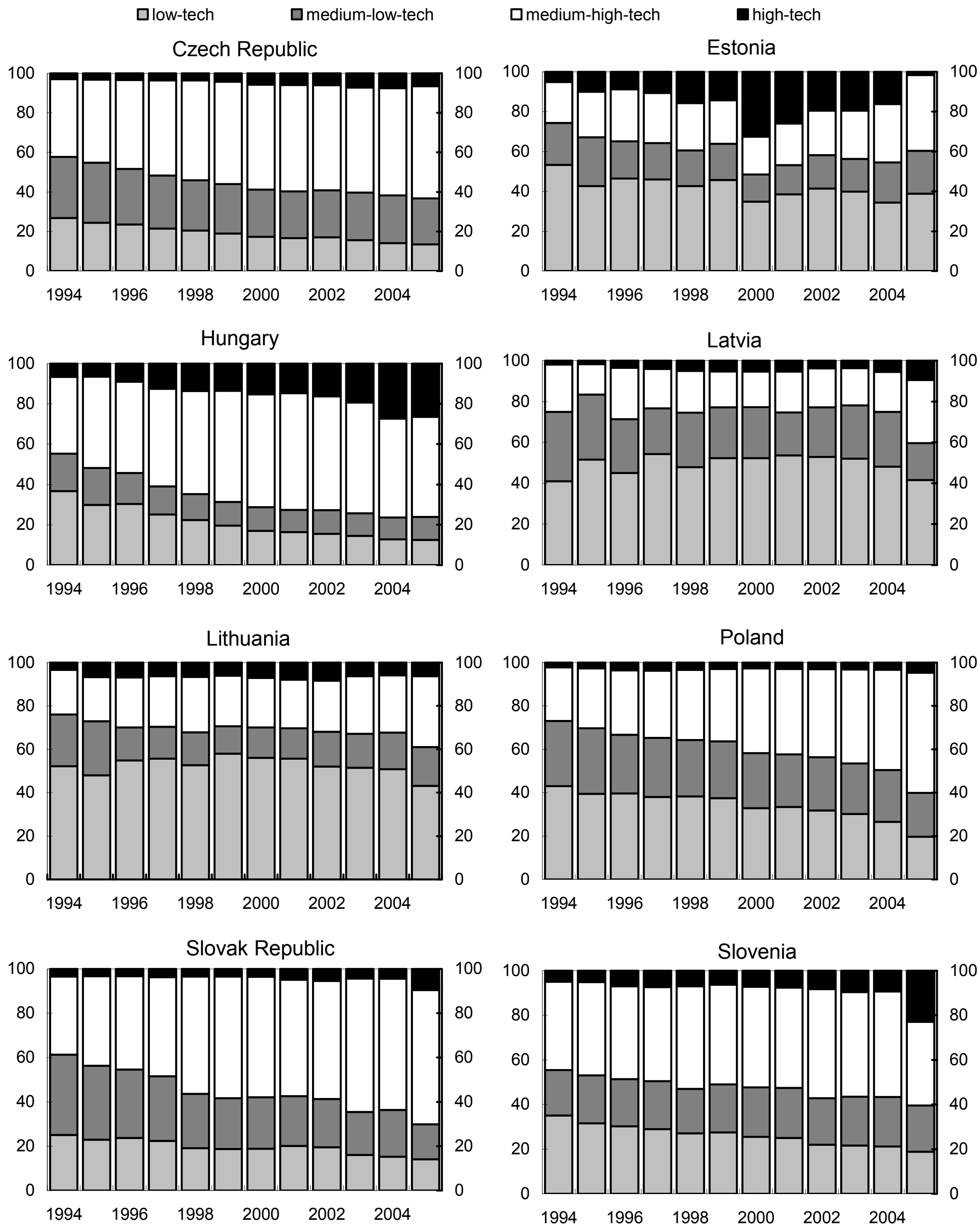


Sources: Statistical Office of the Slovak Republic; United Nations Comtrade database; Direction of Trade Statistics; and IMF staff calculations.

1/ 4-quarter moving average. Calculated as the share of exports of each individual country in the combined total world imports.

2/ The methodology used in the classification of exports is explained in the accompanying selected issues paper.

Figure 7. Selected New EU Member States: Technological Composition of Exports, 1994-2005
(Share in percent of country exports)



Sources: United Nations Comtrade database; and IMF staff calculations. Methodology is detailed in IMF Country Report 06/414.

Table 1. Slovak Republic: Selected Economic Indicators, 2002-07

	2002	2003	2004	2005	2006	2007 Proj.
	(Percent change, period average)					
Real sector						
Real GDP	4.1	4.2	5.4	6.0	8.3	8.8
Output gap (in percent of potential GDP)	-0.2	-0.5	-0.5	-0.3	-0.1	0.0
Gross industrial output (constant prices)	-1.3	9.1	11.5	4.7	9.9	...
Consumer prices						
CPI (period average)	3.3	8.5	7.5	2.7	4.5	2.3
CPI (end of period)	3.4	9.3	5.9	3.7	4.2	2.0
HICP (period average) 1/	3.5	8.4	7.5	2.8	4.3	1.8
HICP (end of period) 1/	3.2	9.4	5.8	3.9	3.7	1.6
Wages						
Nominal wages	9.3	6.3	10.2	9.2	8.0	7.1
Real wages	5.8	-2.1	2.4	6.3	3.3	4.7
Employment (ESA 95 basis)	-0.5	1.8	-0.3	1.4	2.3	2.0
Unemployment rate (annual average, in percent) 2/	18.6	17.5	18.1	16.2	13.3	11.8
	(In percent of GDP)					
Public finance (ESA 95 basis)						
General government balance 3/	-7.7	-2.7	-3.2	-2.8	-3.4	-2.9
Structural general government balance 3/	-7.5	-2.4	-3.0	-2.6	-3.4	-2.9
General government debt	43.3	42.4	41.5	34.5	30.7	29.5
	(Percent change, end of period, unless otherwise indicated)					
Money and credit						
Broad money 4/	3.4	5.6	15.0	7.8	15.3	...
Credit to enterprises and households 4/	14.8	14.8	6.2	26.0	22.9	...
Interest rates (in percent, end-of-period)						
NBS policy rate (two-week repo rate)	6.50	6.00	4.00	3.00	4.75	...
Lending rate (floating rate and up to 1 year initial rate fixation) 4/	7.5	7.2	5.4	5.8	7.8	...
Deposit rate (up to one month) 4/	4.5	4.6	3.6	2.7	4.6	...
	(In billions of U.S. dollars, unless otherwise indicated)					
Balance of payments						
Merchandise exports	14.4	21.8	27.6	32.0	41.7	53.2
Merchandise imports	16.5	22.5	29.2	34.5	44.8	55.4
Current account balance	-1.9	-2.0	-3.3	-4.1	-4.6	-3.7
(in percent of GDP)	(-8.0)	(-6.0)	(-7.8)	(-8.6)	(-8.3)	(-5.3)
Official reserves, end-period	9.2	12.1	14.9	15.5	13.4	17.6
(in months of imports of goods and nonfactor services)	(5.8)	(5.7)	(5.5)	(4.8)	(3.2)	(3.5)
Gross external debt, end-period	13.1	18.1	23.8	27.1	32.2	33.9
(in percent of GDP)	(49.4)	(50.4)	(52.4)	(59.9)	(55.6)	(48.5)
Short-term debt (in percent of GDP, original maturity basis)	16.0	21.7	23.0	33.6	26.9	23.2
Short-term debt (in percent of GDP, remaining maturity basis)	26.9	29.5	30.6	36.9	29.6	25.5
Official reserves to short-term debt (percent, remaining maturity basis)	128.9	114.7	107.4	92.9	78.0	98.7
Exchange rate						
Slovak koruna per U.S. dollar						
Period average	45.3	36.8	32.3	31.0	29.7	...
End of period	40.0	32.9	28.5	31.9	26.2	...
Slovak koruna per euro						
Period average	42.7	41.5	40.1	38.6	37.2	...
End of period	41.7	41.2	38.8	37.8	34.6	...
Nominal effective exchange rate (percent change, period average) 5/	-0.6	5.4	4.0	1.6	2.6	...
Real effective exchange rate (percent change, period average) 5/						
CPI-based	0.8	12.8	9.2	2.3	6.5	...
ULC-based	8.9	-0.8	8.4	-3.7	-1.7	...
Memorandum item:						
GDP (current prices, Sk billions)	1,111	1,213	1,355	1,471	1,636	1,822

Sources: Statistical Office of the Slovak Republic; Ministry of Finance; National Bank of Slovakia; and IMF staff calculations.

1/ The harmonized index of consumer prices (HICP) is an internationally comparable measure of inflation calculated by each member state of the European Union.
2/ ILO definition as in Labor Force Survey.
3/ In 2004, includes forgiveness of domestic debt claims on the health sector falling due, equivalent to 0.8 percent of GDP. From 2005 onward, includes second pillar pension costs.
4/ There is a break in the series in 2004. Data for 2004-2006 are in accordance with European Central Bank methodology.
5/ Trade-weighted. Partner countries comprise Austria, Czech Republic, France, Germany, Hungary, Italy, Netherlands, Poland, United Kingdom, and United States.

Table 2. Slovak Republic: Macroeconomic Framework, 2002-09

	2002	2003	2004	2005	2006	2007	2008	2009
						Staff Projections		
				(In percent of nominal GDP)				
Consumption	78.2	77.2	77.0	75.3	75.5	73.2	72.3	71.7
Nongovernment	57.9	56.7	57.8	55.4	55.4	54.3	54.2	54.4
Government	20.3	20.5	19.2	19.9	20.1	18.9	18.1	17.3
Gross capital formation	29.0	24.6	26.0	29.2	28.9	28.8	28.8	29.0
Nongovernment	25.5	22.2	23.6	26.8	27.1	27.3	27.5	27.8
Government	3.5	2.4	2.4	2.4	1.8	1.5	1.3	1.2
Fixed investment	27.3	25.0	24.1	26.8	26.4	26.4	26.4	26.6
Foreign saving 1/	8.3	6.6	7.8	8.6	8.3	5.3	4.2	3.5
Gross national saving	20.8	18.0	18.2	20.6	21.2	23.6	24.7	25.5
Nongovernment	22.9	19.3	19.6	21.5	23.1	25.4	26.3	26.9
Of which : Households	4.9	5.1	4.1	4.3	4.4	4.4	4.3	4.2
Government	-2.1	-1.3	-1.4	-1.0	-1.9	-1.9	-1.7	-1.5
Households' gross saving (percent of disposable income)	7.9	8.4	6.9	7.0	7.3	7.3	7.2	7.2
General government balance (ESA 95 basis) 2/	-7.7	-2.7	-3.2	-2.8	-3.4	-2.9	-2.4	-1.9
				(Percentage change in real term)				
GDP	4.1	4.2	5.4	6.0	8.3	8.8	7.5	7.0
Households' disposable income	4.9	0.6	2.1	7.3	6.6	6.9	6.6	6.7
Domestic demand	4.1	-1.3	6.2	8.6	6.2	6.2	6.2	6.3
Consumption	5.2	1.2	3.6	5.0	5.6	5.6	5.9	5.8
Nongovernment	5.2	0.1	3.8	7.2	6.3	6.8	6.8	6.8
Government	5.2	3.9	2.0	-0.6	4.1	2.3	3.1	2.7
Gross capital formation	1.3	-8.0	14.3	18.6	7.7	7.5	7.1	7.3
Fixed investment	0.3	-2.3	5.0	17.5	7.3	8.0	7.6	7.7
Change in stocks (contribution to GDP growth) 3/	0.3	-1.6	2.3	0.6	0.4	0.0	0.0	0.0
Exports of goods and non-factor services	4.7	15.9	7.9	13.8	20.7	20.6	13.0	10.9
Imports of goods and non-factor services	4.6	7.6	8.8	16.6	17.8	17.6	11.9	10.3
				(Percentage change)				
Memorandum items:								
Inflation (CPI, period average)	3.3	8.5	7.5	2.7	4.5	2.3	2.0	2.0
Inflation (HICP, period average) 4/	3.5	8.4	7.5	2.8	4.3	1.8	2.0	2.0
GDP deflator	4.6	4.7	6.0	2.4	2.7	2.3	2.2	2.2
Employment (ESA 95 basis)	-0.5	1.8	-0.3	1.4	2.3	2.0	1.5	1.3
Nominal wages	9.3	6.3	10.2	9.2	8.0	7.1	7.0	6.7
Real wages	5.8	-2.1	2.4	6.3	3.3	4.7	4.9	4.6
Productivity	4.7	2.3	5.8	4.6	5.8	6.7	5.9	5.6
Unit labor costs	4.4	3.9	4.1	4.4	2.0	0.4	1.1	1.1
Unemployment rate (percent, annual average) 5/	18.6	17.5	18.1	16.2	13.3	11.8	11.0	10.5
Gross domestic product (Sk billion, current prices)	1,111	1,213	1,355	1,471	1,636	1,822	2,001	2,187

Sources: Statistical Office of the Slovak Republic; and IMF staff estimates and projections.

1/ Negative of current account balance. For historical periods, foreign saving implied by national accounts data differs from the current account deficit reported in BOP statistics. The discrepancy is mainly due to different exchange rates employed in the calculations.
2/ From 2005 onward, includes second pension pillar costs. In 2004, includes forgiveness of domestic debt claims on the health sector falling due, equivalent to 0.8 percent of GDP.
3/ Includes statistical discrepancy.
4/ The harmonized index of consumer prices (HICP) is an internationally comparable measure of inflation calculated by each member state of the European Union.
5/ ILO definition as in Labor Force Survey.

Table 3. Slovak Republic: Balance of Payments, 2002-06

(In millions of U.S. dollars, unless otherwise indicated)

	2002	2003	2004	2005	2006
					Prelim.
Current account balance	-1,959	-1,971	-3,298	-4,090	-4,562
Trade balance	-2,151	-637	-1,536	-2,450	-3,083
Exports, f.o.b.	14,478	21,843	27,621	32,026	41,696
Imports, f.o.b.	-16,629	-22,480	-29,157	-34,476	-44,778
Services balance	456	237	268	320	664
Receipts	2,786	3,286	3,725	4,407	5,404
Payments	-2,330	-3,050	-3,458	-4,087	-4,740
Income balance	-456	-1,816	-2,198	-1,976	-2,088
Receipts	343	933	999	1,620	1,955
Payments	-800	-2,748	-3,197	-3,597	-4,043
Of which: Interest	-634	-536	-353	-413	-545
Current transfers	193	245	169	15	-55
Official	-12	-13	58	210	279
Private	205	258	111	-195	-334
Capital and financial account balance	5,178	1,777	4,930	5,161	1,036
Capital account	107	101	137	-18	-41
Foreign direct investment 1/	3,963	647	3,052	1,951	3,797
Of which : Reinvested earnings	0	1,476	1,535	1,219	1,275
Portfolio investment	554	-543	866	-982	1,561
Other investment	551	1,558	858	4,245	-4,119
Short-term	524	1,897	1,176	5,258	-4,747
Long-term	27	-339	-318	-1,014	628
Financial derivatives	2	15	17	-34	-162
Errors and omissions	426	1,881	1,130	-503	1,410
Overall balance	3,645	1,493	1,826	2,212	-3,220
Financing					
Gross reserves (negative indicates increase)	-3,645	-2,954	-2,763	-568	2,116
Memorandum items:					
Current account balance (in percent of GDP)	-8.0	-6.0	-7.8	-8.6	-8.3
Trade balance (in percent of GDP)	-8.8	-1.9	-3.7	-5.2	-5.6
Terms of trade (percent change)	0.9	-0.2	-0.3	-0.3	-1.4
Gross official reserves (US$ million)	9,196	12,149	14,912	15,480	13,364
In months of imports of goods and services	5.8	5.7	5.5	4.8	3.2
Total external debt	13,107	18,090	23,764	27,052	32,206
(in percent of GDP)	49.4	50.4	52.4	59.9	55.6
Short-term external debt (original maturity basis)	4,237	7,782	10,448	15,202	15,556
(in percent of GDP)	16.0	21.7	23.0	33.6	26.9
Short-term external debt (remaining maturity basis)	7,133	10,591	13,887	16,658	17,129
(in percent of GDP)	26.9	29.5	30.6	36.9	29.6
Reserves/short-term debt (percent, remaining maturity basis)	128.9	114.7	107.4	92.9	78.0
External debt service/Exports of goods and services (percent)	11.3	14.3	10.8	11.7	4.7

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

1/ In 2006, direct investment includes about US$1,050 million of privatization proceeds from the sale of shares in the domestic electricity company, Slovenske Elektrarne.

Table 4. Slovak Republic: Vulnerability Indicators, 2002-06

(In percent of GDP, unless otherwise indicated)

	2002	2003	2004	2005	2006
Financial indicators					
Public sector debt 1/	43.8	43.1	42.6	34.5	30.5
Broad money (percent change, 12-month basis) 2/	5.0	7.1	15.0	7.8	15.3
Private sector credit (percent change, 12-month basis) 2/	14.8	14.8	6.2	26.0	22.9
Of which: credit to households (percent change, 12-month basis) 2/	18.1	38.8	41.6	35.9	32.0
BRIBOR (six months, end-of-period, in percent) 3/					
Nominal	5.8	5.8	3.7	3.2	4.7
Real	2.4	-2.5	-3.6	0.4	0.2
External indicators					
Merchandise exports (percent change, 12-month basis in US$)	14.5	51.9	25.7	15.8	31.7
Merchandise imports (percent change, 12-month basis in US$)	12.6	36.2	29.0	17.9	31.6
Terms of trade (percent change, 12-month basis)	0.9	-0.2	-0.3	-0.3	-1.4
Current account balance	-7.8	-0.8	-3.6	-8.6	-8.3
Capital and financial account balance	21.6	5.3	7.5	11.9	1.9
Capital account	0.4	0.3	0.3	0.0	-0.1
Foreign direct investment	16.9	2.0	3.0	3.7	6.9
Portfolio investment	2.3	-1.7	2.1	-2.1	2.8
Other investment	2.1	4.7	2.0	10.4	-7.5
Net foreign assets (NFA) of commercial banks (in US$ billions)	0.3	-1.1	-2.3	-5.5	-2.7
Gross official reserves (in US$ billions)	9.2	12.1	14.9	15.5	13.4
Net international reserves (NIR) (in US$ billions)	8.8	11.1	14.8	15.3	13.0
Central bank short-term foreign liabilities (in US$ billions) 4/	0.0	0.9	0.0	0.0	0.0
Central bank foreign currency exposure (in US$ billions)	6.1	8.0	10.4	12.3	8.8
Short-term foreign assets of commercial banks (in US$ billions)	1.0	0.9	0.8	0.8	1.7
Short-term foreign liabilities of commercial banks (in US$ billions)	1.0	2.3	3.9	6.8	4.4
Foreign currency exposure of commercial banks (in US$ billions)	0.3	-1.1	-2.3	-5.5	-2.7
Official reserves in months of imports of goods and services	5.9	5.7	5.5	4.8	3.2
Broad money to gross official reserves (percent)	168.6	150.2	184.8	171.1	241.6
Total short-term external debt to gross official reserves (percent) 5/	77.6	87.2	93.1	107.6	128.2
Total external debt	49.4	50.4	52.4	59.9	55.6
Of which: public sector debt	14.1	14.7	15.2	12.4	13.3
Total external debt to exports of goods and services (percent)	75.9	72.0	75.8	74.3	68.3
Total external debt service payments to exports of goods and services (percent)	11.3	14.3	10.8	11.7	4.7
External amortization payments to exports of goods and services (percent)	7.7	11.5	9.0	9.4	3.1
External interest payments to exports of goods and services (percent)	3.6	2.7	1.9	2.3	1.6
Exchange rate (per US$, period average)	45.3	36.7	32.3	31.0	29.6
Real effective exchange rate (CPI-based, period average)	0.8	12.8	9.2	2.3	6.5
Real effective exchange rate (ULC-based, period average)	8.9	-0.8	8.4	-3.7	-1.7
Other indicators					
Stock market index	140.0	177.6	326.6	413.3	415.6
Foreign currency debt rating (Moody's)	A3	A3	A3	A2	A1

Sources: Data provided by the Slovak authorities; and IMF staff estimates.

1/ General government.

2/ There is a break in the series in 2004. Data for 2004-2006 are in accordance with European Central Bank methodology.

3/ Bratislava Interbank Offered Rate

4/ Includes short-term liabilities of the government.

5/ Includes medium- and long-term debt due next year.

Table 5. Slovak Republic: Fiscal Operations of the Consolidated General Government, ESA 95 basis, 2005-09

(In millions of koruny)

	2005	2006		2007	2008	2009
	Estimates	Budget	Prel.	Budget	Budget	Budget
Total revenue	544,372	568,793	589,032	624,413	655,928	700,264
Tax revenue	269,815	268,803	279,969	306,917	326,857	347,824
Personal income tax	39,388	40,184	42,211	47,028	52,355	58,009
Wage tax	33,767	34,845	36,140	40,260	45,153	50,263
Self-employment tax	5,621	5,339	6,071	6,768	7,202	7,746
Corporate profit tax	40,591	38,308	45,839	49,351	54,085	59,246
Withholding tax on capital income	3,855	4,470	4,859	4,214	4,424	4,687
VAT	117,332	121,417	124,102	134,599	142,550	151,401
Excises	54,466	51,290	48,262	57,731	59,264	60,087
Import duties, property tax and other	14,150	13,134	14,696	13,994	14,179	14,394
Social contributions	186,246	206,010	212,520	223,491	234,265	249,592
Grants and transfers	20,172	35,012	25,179	33,594	37,674	46,044
Of which: from European Union	16,855	34,185	21,850	32,036	36,982	45,050
Other revenue	68,139	58,968	71,364	60,411	57,132	56,804
Of which: interest	6,205	4,566	11,581	7,366	6,866	6,567
Total expenditure	576,367	613,203	626,201	656,977	680,255	715,032
Current expenditure	511,849	549,724	559,536	602,681	625,533	665,687
Gross wages	100,714	109,564	109,467	119,827	123,477	130,044
Wages	75,721	81,783	82,095	88,207	91,688	96,506
Employer social security contributions	24,993	27,781	27,372	31,620	31,789	33,538
Goods and services 1/	82,162	82,612	91,630	94,300	109,518	126,626
Subsidies and transfers	303,202	327,888	332,357	353,057	356,646	372,831
Agricultural subsidies	12,429	14,732	13,388	17,671	17,256	22,441
Transport subsidies	11,646	11,027	13,695	12,262	12,364	12,238
Health insurance companies	67,548	71,727	75,007	80,000	82,670	88,256
Sickness benefits	4,966	5,343	5,532	5,719	6,003	6,298
Old-age and disability pensions	104,601	111,039	115,133	124,614	130,813	136,683
Active labor market policies	3,388	4,729	3,888	3,013	1,348	258
Unemployment benefits	2,440	3,740	1,928	2,588	2,743	2,828
State benefits and social assistance	29,767	32,498	32,561	32,799	33,038	33,334
Social security contributions on behalf of certain groups	25,863	32,599	33,208	38,294	37,458	39,801
Transfers to the EU	12,767	14,105	14,664	17,296	17,793	18,064
Other subsidies and transfers	27,787	26,349	23,353	18,801	15,160	12,630
Interest	25,771	29,660	26,082	35,497	35,892	36,186
Capital spending	64,518	63,479	66,665	54,296	54,722	49,345
Capital assets	34,930	29,892	38,121	27,685	26,158	20,884
Capital transfers 2/	29,588	33,587	28,544	26,611	28,564	28,461
Revenue loss to the second pillar pensions	9,259	20,200	18,246	20,199	22,498	25,012
Fiscal balance	-41,254	-64,610	-55,415	-52,763	-46,825	-39,780
Memorandum items:						
Nominal GDP	1,471,131	1,531,400	1,636,263	1,794,663	1,919,075	2,050,499
Deficit excluding second pillar pension costs	-31,995	-44,410	-37,169	-32,564	-24,327	-14,768

Source: Ministry of Finance.

1/ Most of the EU-related spending of the 2nd program period (2007-13) funds is allocated under goods and services.
2/ In 2005, includes debt forgiveness (mainly to Sudan, Afghanistan, and Syria) amounting to Sk 13,658 million.

Table 5. Slovak Republic: Fiscal Operations of the Consolidated General Government
ESA 95 basis, 2005-09 (Continued)

(In percent of GDP)

	2005	2006		2007	2008	2009
	Estimates.	Budget	Prel.	Budget	Budget	Budget
Total revenue	37.0	37.1	36.0	34.8	34.2	34.2
Tax revenue	18.3	17.6	17.1	17.1	17.0	17.0
Personal income tax	2.7	2.6	2.6	2.6	2.7	2.8
Wage tax	2.3	2.3	2.2	2.2	2.4	2.5
Self-employment tax	0.4	0.3	0.4	0.4	0.4	0.4
Corporate profit tax	2.8	2.5	2.8	2.7	2.8	2.9
Withholding tax on capital income	0.3	0.3	0.3	0.2	0.2	0.2
VAT	8.0	7.9	7.6	7.5	7.4	7.4
Excises	3.7	3.3	2.9	3.2	3.1	2.9
Import duties, property tax and other	1.0	0.9	0.9	0.8	0.7	0.7
Social contributions	12.7	13.5	13.0	12.5	12.2	12.2
Grants and transfers	1.4	2.3	1.5	1.9	2.0	2.2
Of which: from European Union	1.1	2.2	1.3	1.8	1.9	2.2
Other revenue	4.6	3.9	4.4	3.4	3.0	2.8
Of which: interest	0.4	0.3	0.7	0.4	0.4	0.3
Total expenditure	39.2	40.0	38.3	36.6	35.4	34.9
Current expenditure	34.8	35.9	34.2	33.6	32.6	32.5
Gross wages	6.8	7.2	6.7	6.7	6.4	6.3
Wages	5.1	5.3	5.0	4.9	4.8	4.7
Employer social security contributions	1.7	1.8	1.7	1.8	1.7	1.6
Goods and services 1/	5.6	5.4	5.6	5.3	5.7	6.2
Subsidies and transfers	20.6	21.4	20.3	19.7	18.6	18.2
Agricultural subsidies	0.8	1.0	0.8	1.0	0.9	1.1
Transport subsidies	0.8	0.7	0.8	0.7	0.6	0.6
Health insurance companies	4.6	4.7	4.6	4.5	4.3	4.3
Sickness benefits	0.3	0.3	0.3	0.3	0.3	0.3
Old-age and disability pensions	7.1	7.3	7.0	6.9	6.8	6.7
Active labor market policies	0.2	0.3	0.2	0.2	0.1	0.0
Unemployment benefits	0.2	0.2	0.1	0.1	0.1	0.1
State benefits and social assistance	2.0	2.1	2.0	1.8	1.7	1.6
Social security contributions on behalf of certain groups	1.8	2.1	2.0	2.1	2.0	1.9
Transfers to the EU	0.9	0.9	0.9	1.0	0.9	0.9
Other subsidies and transfers	1.9	1.7	1.4	1.0	0.8	0.6
Interest	1.8	1.9	1.6	2.0	1.9	1.8
Capital spending	4.4	4.1	4.1	3.0	2.9	2.4
Capital assets	2.4	2.0	2.3	1.5	1.4	1.0
Capital transfers 2/	2.0	2.2	1.7	1.5	1.5	1.4
Revenue loss to the second pillar pensions	0.6	1.3	1.1	1.1	1.2	1.2
Fiscal balance	-2.8	-4.2	-3.4	-2.9	-2.4	-1.9
Memorandum items:						
Deficit excluding second pillar pension costs	-2.2	-2.9	-2.3	-1.8	-1.3	-0.7
Public debt, ESA 95 basis	34.5	...	30.7	29.5	28.1	26.2

Source: Ministry of Finance.

1/ Most of the EU-related spending of the 2nd program period (2007-13) funds is allocated under goods and services.
2/ In 2005, includes debt forgiveness (mainly to Sudan, Afghanistan, and Syria) equivalent of 0.9 percent of GDP.

Table 6. Slovak Republic: Medium-term Balance of Payments, 2005-09

(In millions of U.S. dollars, unless otherwise indicated)

	2005	2006	2007	2008	2009
			Staff Projections		
Current account balance	-4,090	-4,562	-3,673	-3,289	-3,110
Trade balance	-2,450	-3,083	-2,230	-1,819	-1,640
Exports, f.o.b.	32,026	41,696	53,173	63,106	72,624
Imports, f.o.b.	-34,476	-44,778	-55,403	-64,924	-74,264
Services balance	320	664	852	928	978
Receipts	4,407	5,404	6,290	6,986	7,677
Payments	-4,087	-4,740	-5,439	-6,058	-6,698
Income balance	-1,976	-2,088	-2,297	-2,455	-2,593
Receipts	1,620	1,955	2,119	2,271	2,434
Payments	-3,597	-4,043	-4,417	-4,726	-5,028
Of which: Interest	-413	-545	-787	-790	-758
Current transfers	15	-55	3	57	145
Official	210	279	357	432	543
Private	-195	-334	-354	-375	-397
Capital and financial account balance	5,161	1,036	7,930	5,853	5,905
Capital account	-18	-41	12	8	11
Direct foreign investment 1/	1,951	3,797	2,742	2,686	2,613
Of which: Reinvested earnings	1,219	1,275	1,442	1,532	1,663
Portfolio investment	-982	1,561	1,871	1,905	1,917
Other investment	4,245	-4,119	3,305	1,254	1,365
Short-term	5,258	-4,747	2,622	600	658
Long-term	-1,014	628	684	654	706
Financial derivatives	-34	-162	0	0	0
Errors and omissions	-503	1,410	...	...	...
Overall balance	568	-2,116	4,258	2,564	2,795
Financing					
Gross reserves (negative indicates increase)	-568	2,116	-4,258	-2,564	-2,795
Memorandum items:					
Current account balance (in percent of GDP)	-8.6	-8.3	-5.3	-4.2	-3.5
Trade balance (in percent of GDP)	-5.2	-5.6	-3.2	-2.3	-1.9
Terms of trade (percent change)	-0.3	-1.4	0.7	0.0	0.0
Gross official reserves (US$ million)	15,480	13,364	17,621	20,185	22,980
In months of imports of goods and services	4.8	3.2	3.5	3.4	3.4
Total external debt	27,052	32,206	33,928	36,833	39,365
(in percent of GDP)	59.9	55.6	48.5	46.6	44.7
Short-term external debt (original maturity basis)	15,202	15,556	16,264	17,032	17,743
(in percent of GDP)	33.6	26.9	23.2	21.5	20.1
Short-term external debt (remaining maturity basis)	16,658	17,129	17,846	18,783	20,224
(in percent of GDP)	36.9	29.6	25.5	23.8	22.9
Reserves/short-term debt (percent, remaining maturity basis)	92.9	78.0	98.7	107.5	113.6
External debt service/Exports of goods and services (percent)	11.7	4.7	4.2	3.8	3.9

Sources: National Bank of Slovakia; and IMF staff projections.
1/ In 2006, direct investment includes about US$1,050 million of privatization proceeds from the sale of shares in the domestic electricity company, Slovenske Elektrarne.

Table 7. Slovak Republic: External Debt Sustainability Framework, 2002-12

(In percent of GDP, unless otherwise indicated)

	Actual							Projections						
	2002	2003	2004	2005	2006			2007	2008	2009	2010	2011	2012	
								I. Baseline Projections						Debt-stabilizing non-interest current account 6/
External debt	49.4	50.4	52.4	59.9	55.6			**48.5**	**46.6**	**44.7**	**43.9**	**43.2**	**43.0**	**-3.3**
Change in external debt	-3.1	0.9	2.0	7.5	-4.2			-7.2	-1.9	-1.9	-0.8	-0.6	-0.2	
Identified external debt-creating flows	-14.3	-1.5	-5.9	-1.5	-6.4			-7.9	-4.5	-3.9	-2.9	-2.7	-1.7	
Current account deficit, excluding interest payments	5.5	3.9	6.5	6.9	6.1			3.2	2.5	2.1	1.4	1.3	1.6	
Deficit in balance of goods and services	6.9	1.2	3.0	4.5	4.4			2.0	1.2	0.8	0.2	-0.1	-0.4	
Exports	70.2	76.0	74.5	76.7	85.4			85.1	88.9	91.4	91.8	91.8	93.2	
Imports	77.1	77.3	77.5	81.2	89.8			87.2	90.1	92.2	92.0	91.7	92.8	
Net nondebt creating capital inflows (negative)	-16.2	-2.1	-7.0	-4.4	-6.9			-3.9	-3.4	-3.0	-2.6	-2.6	-2.5	
Automatic debt dynamics 1/	-3.6	-3.3	-5.3	-4.0	-5.5			-7.1	-3.6	-3.1	-1.7	-1.4	-0.9	
Contribution from nominal interest rate	2.4	2.1	1.4	1.7	2.2			2.0	1.7	1.4	1.6	1.5	1.4	
Contribution from real GDP growth	-1.9	-1.8	-2.4	-2.8	-4.3			-4.1	-3.2	-2.9	-2.5	-2.1	-1.4	
Contribution from price and exchange rate changes 2/	-4.1	-3.5	-4.4	-2.9	-3.4			-5.1	-2.0	-1.6	-0.9	-0.9	-0.8	
Residual, incl. change in gross foreign assets	11.2	2.4	7.9	9.0	2.2			0.7	2.6	2.0	2.1	2.1	1.5	
External debt-to-exports ratio (in percent)	70.4	66.2	70.3	78.0	65.1			56.9	52.4	48.8	47.8	47.1	46.2	
Gross external financing need (in billions of euros) 3/	6.9	8.9	12.9	13.9	22.4			23.0	23.5	24.5	24.9	25.4	26.2	
in percent of GDP	26.6	30.3	38.0	36.4	51.1			43.4	39.4	37.0	34.8	33.0	32.3	
Key macroeconomic assumptions						10-Year Historical Average	10-Year Standard Deviation							Projected Average
Real GDP growth (in percent)	4.1	4.2	5.4	6.0	8.3	4.2	2.4	8.8	7.5	7.0	6.0	5.0	3.5	6.3
Nominal external interest rate (in percent)	5.3	4.7	3.2	3.7	4.2	4.7	0.8	4.4	3.9	3.4	3.9	3.7	3.5	3.8
Growth of exports (current euros, in percent)	8.2	21.6	13.5	16.0	28.4	16.3	9.9	20.5	17.4	14.1	8.5	7.2	7.2	12.5
Growth of imports (current euros, in percent)	7.2	12.5	16.2	18.0	27.5	14.8	10.7	17.3	16.2	13.6	7.8	6.8	6.9	11.4
Current account balance, excluding interest payments	-5.5	-3.9	-6.5	-6.9	-6.1	-5.2	2.3	-3.2	-2.5	-2.1	-1.4	-1.3	-1.6	-2.0
Net nondebt creating capital inflows	16.2	2.1	7.0	4.4	6.9	5.8	4.7	3.9	3.4	3.0	2.6	2.6	2.5	3.0
								II. Stress Tests for External Debt Ratio						Debt-stabilizing non-interest current account 6/
A. Alternative scenarios														
A1. Key variables are at their historical averages in 2008-12 4/								**48.5**	**48.7**	**48.2**	**47.9**	**47.4**	**46.4**	**-7.7**
A2. Reduction in real GDP growth (relative to baseline) 5/								**48.5**	**48.1**	**47.5**	**47.5**	**47.3**	**46.8**	**-3.9**
B. Bound tests														
B1. Nominal interest rate is at historical average plus two standard deviations in 2008 and 2009.								**48.5**	**47.7**	**46.9**	**46.1**	**45.4**	**45.1**	**-3.4**
B2. Real GDP growth is at historical average minus two standard deviations in 2008 and 2009.								**48.5**	**50.2**	**51.4**	**50.3**	**49.4**	**48.9**	**-3.9**
B3. Change in euro GDP deflator is at historical average minus two standard deviations in 2008 and 2009.								**48.5**	**50.9**	**52.8**	**51.6**	**50.6**	**50.0**	**-4.0**
B4. Non-interest current account is at historical average minus two standard deviations in 2008 and 2009.								**48.5**	**53.8**	**58.9**	**57.6**	**56.5**	**56.0**	**-3.6**
B5. Combination of B1-B4 using one standard deviation shocks.								**48.5**	**57.2**	**65.9**	**64.5**	**63.4**	**62.9**	**-4.3**
B6. One time 30 percent nominal depreciation in 2008.								**48.5**	**64.9**	**61.3**	**59.6**	**58.3**	**57.3**	**-4.8**

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

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

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

4/ 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.

5/ Real GDP growth drops to 4 percent throughout 2008-12.

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

Table 8. Slovak Republic: Public Sector Debt Sustainability Framework, 2002-2012
(In percent of GDP, unless otherwise indicated)

	Actual							Projections						
	2002	2003	2004	2005	2006			2007	2008	2009	2010	2011	2012	
										I. Baseline Projections				**Debt-stabilizing primary balance 10/**
Public sector debt 1/	43.3	42.4	41.5	34.5	30.7			**29.5**	**28.1**	**26.2**	**25.2**	**24.1**	**22.9**	**-0.6**
o/w foreign-currency denominated	13.6	11.5	10.9	9.6	7.3			7.8	7.9	7.6	7.6	7.5	7.3	
Change in public sector debt	-5.6	-0.6	-1.1	-7.1	-3.7			-1.3	-1.4	-1.8	-1.0	-1.2	-1.2	
Identified debt-creating flows (4+7+12)	-15.2	-3.3	-2.7	-0.9	-3.2			-0.6	-0.6	-0.6	-1.1	-1.2	-1.3	
Primary deficit	2.0	0.3	1.0	1.1	1.8			1.1	0.6	0.3	-0.1	-0.5	-0.9	
Primary (noninterest) revenue and grants	38.8	36.7	34.6	36.4	34.9			33.3	32.2	32.1	30.1	29.9	29.8	
Primary (noninterest) expenditure	40.8	37.0	35.6	37.4	36.7			34.4	32.8	32.4	30.0	29.4	28.9	
Automatic debt dynamics 2/	-2.9	-3.2	-3.7	-0.2	-3.3			-1.4	-1.2	-0.8	-0.9	-0.6	-0.4	
Contribution from interest rate/growth differential 3/	-0.3	-1.1	-2.3	-1.5	-1.9			-1.3	-0.9	-0.8	-0.9	-0.6	-0.4	
Of which contribution from real interest rate	1.5	0.6	-0.2	0.8	0.7			1.2	1.1	1.0	0.6	0.6	0.5	
Of which contribution from real GDP growth	-1.8	-1.7	-2.1	-2.3	-2.6			-2.4	-2.0	-1.8	-1.4	-1.2	-0.9	
Contribution from exchange rate depreciation 4/	-2.6	-2.1	-1.4	1.4	-1.4			-0.1	-0.3	0.0	0.0	0.0	0.0	
Other identified debt-creating flows	-14.2	-0.4	0.0	-1.8	-1.7			-0.3	0.0	0.0	-0.1	0.0	0.0	
Privatization receipts (negative)	-14.5	-1.0	0.0	-1.1	-1.1			0.0	0.0	0.0	0.0	0.0	0.0	
Recognition of implicit or contingent liabilities	0.3	0.6	0.0	-0.7	-0.6			-0.3	0.0	0.0	-0.1	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)	9.6	2.7	1.6	-6.2	-0.6			-0.6	-0.8	-1.2	0.1	0.0	0.1	
Public sector debt-to-revenue ratio 1/	111.6	116.4	120.4	94.8	88.1			88.5	87.1	81.8	83.7	80.4	76.9	
Gross financing need 5/	14.3	13.1	14.1	11.2	9.1			8.4	7.6	6.7	5.6	5.0	4.4	
in billions of U.S. dollars	3.5	4.3	5.9	5.3	5.0	10-Year Historical Average	10-Year Standard Deviation	5.9	6.0	5.9	5.4	5.2	4.8	Projected Average
Key Macroeconomic and Fiscal Assumptions														
Real GDP growth (in percent)	4.1	4.2	5.4	6.0	8.3	4.1	2.4	8.8	7.5	7.0	6.0	5.0	4.0	6.4
Average nominal interest rate on public debt (in percent) 6/	8.2	6.3	5.7	4.6	5.1	7.4	1.9	6.7	6.4	6.2	4.4	4.4	4.4	5.4
Average real interest rate (nominal rate minus change in GDP deflator, in percent)	3.6	1.6	-0.3	2.2	2.4	2.1	2.6	4.4	4.2	4.0	2.4	2.4	2.4	3.3
Inflation rate (GDP deflator, in percent)	4.6	4.7	6.0	2.4	2.7	5.3	2.0	2.3	2.2	2.2	2.0	2.0	2.0	2.1
Growth of real primary spending (deflated by GDP deflator, in percent)	6.8	-5.6	1.4	11.6	6.1	3.5	7.7	2.1	2.6	5.4	-1.7	2.8	1.6	2.2
Primary deficit	2.0	0.3	1.0	1.1	1.8	1.9	1.4	1.1	0.6	0.3	-0.1	-0.5	-0.9	0.1
										II. Stress Tests for Public Debt Ratio				**Debt-stabilizing primary balance 10/**
A. Alternative Scenarios														
A1. Key variables are at their historical averages in 2007-11 7/								**30.9**	**30.9**	**30.8**	**32.0**	**33.1**	**34.0**	**-0.8**
A2. No policy change (constant primary balance) in 2006-11								**30.3**	**30.1**	**29.6**	**30.4**	**31.3**	**32.5**	**-0.9**
B. Bound Tests														
B1. Real interest rate is at baseline plus one standard deviations								**29.8**	**28.7**	**27.3**	**26.5**	**25.5**	**24.5**	**-0.4**
B2. Real GDP growth is at baseline minus one-half standard deviation								**30.2**	**29.7**	**29.3**	**29.8**	**30.4**	**31.3**	**-0.5**
B3. Primary balance is at baseline minus one-half standard deviation								**30.2**	**29.4**	**28.2**	**27.8**	**27.2**	**26.6**	**-0.7**
B4. Combination of B1-B3 using one-quarter standard deviation shocks								**30.1**	**29.4**	**28.2**	**27.7**	**27.1**	**26.5**	**-0.4**
B5. One time 30 percent real depreciation in 2007 9/								**33.4**	**31.8**	**29.9**	**28.7**	**27.3**	**26.0**	**-0.7**
B6. 10 percent of GDP increase in other debt-creating flows in 2007								**39.5**	**37.6**	**35.6**	**34.1**	**32.7**	**31.3**	**-0.9**

1/ Indicate coverage of public sector, e.g., general government or nonfinancial public sector. Also whether net or gross debt is used.
2/ Derived as [(r - p(1+g) - g + ae(1+r)]/(1+g+p+gp)) times previous period debt ratio, with r = interest rate; p = growth rate of GDP deflator; g = real GDP growth rate; a = share of foreign-currency denominated debt; and e = nominal exchange rate depreciation (measured by increase in local currency value of U.S. dollar).
3/ The real interest rate contribution is derived from the denominator in footnote 2/ as r - π (1+g) and the real growth contribution as -g.
4/ The exchange rate contribution is derived from the numerator in footnote 2/ as ae(1+r).
5/ Defined as public sector deficit, plus amortization of medium and long-term public sector debt, plus short-term debt at end of previous period.
6/ Derived as nominal interest expenditure divided by previous period debt stock.
7/ The key variables include real GDP growth; real interest rate; and primary balance in percent of GDP.
8/ The implied change in other key variables under this scenario is discussed in the text.
9/ Real depreciation is defined as nominal depreciation (measured by percentage fall in dollar value of local currency) minus domestic inflation (based on GDP deflator).
10/ 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.

Table 9. Slovak Republic: Financial Soundness Indicators for the Banking Sector, 2002-06

(In percent, unless otherwise indicated)

	2002	2003	2004	2005	2006
Capital Adequacy					
Regulatory capital to risk-weighted assets	21.3	22.4	18.7	14.8	13.0
Regulatory Tier I capital to risk-weighted assets	18.5	21.6	18.9	15.0	14.2
Asset Composition and Quality					
Nonperforming loans to gross loans 1/	7.9	3.7	2.6	5.0	3.2
Nonperforming loans net of provisions to capital	6.0	4.2	3.1	6.4	7.9
Sectoral distribution of outstanding loans (in percent of total loans)					
Individuals	18.1	21.7	26.7	30.3	30.2
Government	3.3	2.9	8.3	5.0	2.5
Agriculture	1.7	1.6	1.6	1.6	1.3
Manufacturing	23.8	21.1	15.8	14.6	11.1
Construction	1.7	1.4	1.6	2.2	2.5
Wholesale and retail trade	14.9	13.1	13.5	13.0	11.9
Transportation	6.7	8.1	5.1	3.9	4.7
Financial services	6.3	6.9	8.7	10.3	18.3
Other	23.4	23.2	18.7	19.1	17.3
Earnings and Profitability					
Return on assets (after tax)	1.2	1.2	1.2	1.2	1.3
Return on equity (after tax)	11.5	10.8	11.9	16.9	16.6
Interest margin to gross income	76.6	80.7	73.3	65.4	66.4
Noninterest expenses to gross income	63.7	70.0	61.2	69.1	58.3
Liquidity					
Liquid assets to total assets 2/	28.9	16.8	13.3	33.5	36.5
Liquid assets to short term liabilities	81.3	55.9	40.3	40.3	45.6
Foreign Exchange Risk					
Net open positions in foreign exchange to capital (on balance sheet)	-42.0	-59.0	-80.0	-14.4	-1.2
Net open positions in foreign exchange to capital (off balance sheet)	-35.0	6.0	40.0	-24.2	44.2
Foreign currency-denominated loans (percent of total loans)	17.1	20.7	22.8	28.2	27.1
Foreign currency-denominated liabilities (percent of total liabilities)	15.6	19.0	19.3	28.0	22.3

Source: National Bank of Slovakia.

1/ A decline in the NPL ratio in 2006 is partly due to a change in the methodology for calculating NPLs.
2/ In 2006, liquid assets include government bonds in holding-to-maturity portfolio.

INTERNATIONAL MONETARY FUND

SLOVAK REPUBLIC

Staff Report for the 2007 Article IV Consultation—Informational Annex

Prepared by the European Department

May 18, 2007

Contents | Page

Appendix I. Slovak Republic: Fund Relations

(As of April 27, 2007)

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

II. **General Resources Account**:

	SDR Million	%Quota
Quota	357.50	100.00
Fund Holdings of Currency	357.50	100.00
Reserve Position	0.00	0.00

III. **SDR Department**:

	SDR Million	%Allocation
Holdings	0.94	N/A

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

V. **Financial Arrangements**:

Approval Type	Expiration Date	Amount Approved Date	Amount Drawn (SDR Million)	(SDR Million)
Stand-by	07/22/1994	03/21/1996	115.80	32.15

VI. **Projected Obligations to Fund**: None

VII. **Exchange Rate Arrangement**:

The currency of the Slovak Republic is the Slovak koruna (Sk). Slovak Republic joined the ERM2 on November 28, 2005 at the central parity of Sk 38.455 per euro. Since ERM2 entry, the koruna has appreciated and the central parity was revalued to Sk 35.4424 per euro with effect from March 19, 2007. The exchange rate stood at Sk 33.667 per euro on April 27, 2007. The exchange rate regime is currently classified as pegged exchange rate within horizontal band. Slovak Republic aims to adopt the euro in January 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 for approval (see most recently, EBD/07/38, 3/23/2007) 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 February 28–March 13, 2007. The mission met with Minister of Finance Počiatek, National Bank of Slovakia (NBS) Governor Šramko, Minister of Economy Jahnátek, other senior government and NBS

officials, parliamentarians, and representatives of financial institutions, think tanks, trade unions and employers' association.
The mission comprised Messrs Banerjee (head), Konuki, Dalgic (all EUR), and Lugaresi (FAD expert). Messrs Kiekens (Executive Director for Slovakia), Jakoby (Advisor to the Executive Director for Slovakia), Rosenberg, and Tirpak (both from Regional Representative Office in Warsaw) participated in the discussions.

A joint press briefing was held at the end of the mission. The mission's concluding statement was published on the IMF website. The authorities have agreed to the publication of the staff report.

The previous consultation with the Slovak Republic was concluded on March 20, 2006 (IMF Country Report No. 06/119). The chairman's summing up of the discussion was circulated as SUR06/33.

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 will be circulated to the Executive Board together with the staff report for the 2007 Article IV Consultation.

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).

Slovak Republic: Technical Assistance, 2000–2007[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	Multisector 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.

Appendix II. Slovak Republic: 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[2] 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. However, the 2004 data ROSC mission reported some difficulties in fully reconciling the balance of payments with the national accounts, monetary, and government finance statistics.

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. Following the fast development of chain stores, which are not fully captured in surveys, the authorities consider that retail sales and the level of consumption might be biased (especially if compared to VAT receipts), and wage statistics also might be biased.

[2] 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.gove.sk).

5. In the enterprise sector, it would be very useful if the line ministries produced systematic accounts of the financial positions of the public enterprises under their purview.

Fiscal Sector

6. 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 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.

7. 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 1996–05, and on an accrual basis for 2003–05.

External Sector

8. The monthly balance of payments are provided in a timely manner. The balance of payments is compiled and disseminated quarterly on a cumulative basis during the year; however, dissemination on a cumulative basis does not follow best practice. Weekly reports of information on gross international reserves are timely. Moreover, the NBS revised in 2002 its methodology for reporting foreign exchange reserves in line with IMF guidelines and STA technical recommendations to include the valuation of gold at market prices and to change the reporting of repo operations and gold swaps. Also, the reporting of foreign exchange reserves by commercial banks has been revised to include selected long-term assets in the item "foreign exchange reserves." Banks are now reporting their arbitrage transactions accurately. Improvements have also been made in reporting nonresidents' claims and liabilities in domestic currency. Remaining problem areas include: (i) the measurement of inward portfolio investment; (ii) the need for more detailed and timely information on publicly guaranteed external debt; (iii) more timely reporting of information on external debt, including short-term debt; (iv) the recording of most interest payments on a cash basis; and (v) the need to improve data compilation on the composition of exports.

Monetary Sector

9. Monetary statistics are of good quality, and are reported on a timely basis to the Fund. The 2004 data ROSC mission found that the two sets of monetary data compiled by the National Bank of Slovakia (NBS)—the national monetary statistics (NMS), for internal use, and the harmonized monetary statistics (HMS), submitted to international organizations—are broadly in line with the IMF Monetary and Financial Statistics Manual. One exception was the treatment, in the NMS, of government's foreign liabilities as part of the NBS foreign liabilities, with a counterpart adjustment in NBS claims on the government.

In response to the mission's comments, the authorities changed this treatment to exclude government foreign liabilities from NBS foreign liabilities. Another exception was the exclusion of money market funds from the NMS, but the authorities started including these funds as a memorandum item in the NMS. A third exception is that market valuation is not applied to certain financial instruments under both the NMS and HMS.

SLOVAK REPUBLIC: TABLE OF COMMON INDICATORS REQUIRED FOR SURVEILLANCE

(As of May 5, 2007)

	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]	Data Quality – Accuracy and reliability[8]
Exchange Rates	05/05/2007	05/05/2007	D	D	D		
International Reserve Assets and Reserve Liabilities of the Monetary Authorities[1]	03/31/2007	04/11/2007	M	M	M		
Reserve/Base Money	03/31/2007	04/11/2007	M	M	M	LO, LO, O, LO	O, O, O, O, O
Broad Money	03/31/2007	04/11/2007	M	M	M		
Central Bank Balance Sheet	04/10/2007	04/20/2007	10 Day	10 Day	10 Day		
Consolidated Balance Sheet of the Banking System	03/31/2007	04/11/2007	M	M	M		
Interest Rates[2]	04/2007	05/01/2007	M	M	M		
Consumer Price Index	03/2007	04/11/2007	M	M	M	O, O, O, O	LO, O, LO, O, O
Revenue, Expenditure, Balance and Composition of Financing[3] – General Government[4]	2006	04/03/2007	A	A	A	O, O, O, O	O, O, O, O, NA
Revenue, Expenditure, Balance and Composition of Financing[3] – Central Government	04/2007	05/02/2007	M	M	M		
Stocks of Central Government and Central Government-Guaranteed Debt[5]	12/31/2006	02/25/2007	Q	Q	Q		
External Current Account Balance	01/2007	04/25/2007	M	M	M	O, O, LO, LO	O, O, O, O, O
Exports and Imports of Goods and Services	02/2007	04/10/2007	M	M	M		
GDP/GNP	Q4/2007	03/08/2007	Q	Q	Q	O, O, LO, LO	LO, O, LO, O, LO
Gross External Debt	01/31/2007	04/25/2007	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.

INTERNATIONAL MONETARY FUND
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IMF Executive Board Concludes 2007 Article IV Consultation with the Slovak Republic

On June 6, 2007, the Executive Board of the International Monetary Fund (IMF) concluded the Article IV consultation with the Slovak Republic.[1]

Background

Economic performance strengthened further in 2006. Real GDP growth accelerated to 8¼ percent supported by strong productivity gains. Domestic demand remained robust, while the contribution of net foreign demand rose. Exports increased sharply, as exports of cars and durable consumption goods speeded up, and outpaced imports. However, because of a deterioration of terms of trade, the external current account narrowed only marginally to 8¼ percent of GDP. Much of the external deficit was covered by inflows of foreign direct investment.

Strong economic growth boosted employment and the unemployment rate fell sharply to 13¼ percent. Despite the strengthening labor demand, real wage increases moderated and lagged productivity gains. Thus, profitability continued to rise.

Inflation was on an upward path for much of 2006, but this trend reversed in the fourth quarter. Harmonized consumer price inflation reached 5 percent in July-August 2006 but declined subsequently to 2 percent in February-April 2007. Inflation developments were influenced by

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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.

trends in world energy prices, the unwinding of the base effects of the large increases in regulated utility prices in October 2005, and decreases in regulated prices in January 2007.

The National Bank of Slovakia (NBS) has been following a hybrid monetary framework focused on restraining inflation and on maintaining the exchange rate within the Exchange Rate Mechanism 2 (ERM2) requirements. Concerns about a negative inflation outlook prompted the NBS to raise its policy interest rate in four steps by a total of 175 basis points during the first three quarters of 2006. During May-July 2006, negative investor sentiment on emerging markets and concerns about the election outcome and courses of policies led to depreciation pressures on the koruna. In July 2006, the NBS intervened heavily in the foreign exchange rate market to stem depreciation pressures when the koruna dropped below the central parity under ERM2.

Favorable growth and export performance and positive investor sentiment toward the region led to appreciation pressures from October 2006 onward. In end-December, as the koruna approached the upper edge of the ERM2 band, the NBS began countering appreciation pressures through interventions and prolonged rejection of bids during repo auctions. Eventually in mid-March 2007, with appreciation pressures persisting, the central parity was revalued with the approval of the European Union member states by 8.5 percent. The NBS has continued to counter appreciation pressures since the parity revaluation and has held the koruna at around 6 percent above the new central parity. With inflation declining markedly in the first quarter of 2007 and judging upside risks to be low, the NBS lowered its policy rate by 50 basis points in two steps since late March.

The general government deficit in 2006, estimated at 3.4 percent of GDP, was smaller than envisaged in the budget. Collections of tax and non-tax revenues and social insurance contributions surpassed the budgeted levels. There was also some underspending in cofinancing of EU-funds projects because of shortfalls in drawdown of funds from the EU budget. These gains were mostly offset by higher outlays on goods and services, pensions and health benefits, and transport subsidies.

Growth is projected to remain strong during 2007–09. The commencement of production and increasing capacity in export-oriented projects and increased downstream integration with domestic supply chains will be the main engines of growth. The current account deficit is expected to narrow progressively over the medium term. Slovakia is well poised to adopt the euro in January 2009. Barring major shocks, the Maastricht inflation criterion seems within reach, and the 2007–09 budget framework aims at meeting the euro zone objectives.

Executive Board Assessment

Executive Directors commended Slovakia’s strong economic performance in recent years, which was underpinned by prudent macroeconomic management, a wide range of structural reforms, and increasing integration with the EU. Directors welcomed the new government’s commitment to continue policies aimed at ensuring euro adoption in January 2009.

Looking forward, Directors concurred that Slovakia is well poised to adopt the euro, although several challenges remain. Chief among them are to satisfy the test of exchange rate stability under ERM2, to enhance fiscal and labor market flexibility to allow the economy to absorb shocks in the monetary union, and to continue with structural reforms to sustain growth and further reduce unemployment. Directors also noted that the authorities' objective of socially inclusive growth would need to be coordinated with the policy framework for euro zone entry and strong performance in the monetary union.

Directors agreed that the current level of competitiveness was satisfactory. However, they observed that the favorable prospects for growth and euro adoption may generate further currency appreciation pressure with potential for volatility and overshooting. Directors encouraged the NBS to conduct its policy, and its communications with market participants, in a manner that would limit opportunities for one-way bets in the foreign exchange market. Given the favorable inflation outlook, some Directors also saw scope for prudently lowering the policy interest rate. However, a number of other Directors stressed the need for caution in considering further easing monetary policy, noting that there are still risks for the inflation outlook given that the economy is operating at or near full capacity, and that the interest rate spread to the euro area is already low.

Directors recommended a more ambitious fiscal consolidation than envisaged in the 2007-2009 budgetary framework, to ensure that fiscal policy remains consistent with the Maastricht deficit limit, to contain potential re-emerging inflationary pressures, and to counter further currency appreciation pressures. They called on the authorities to save revenue windfalls, and to adhere to the existing medium-term expenditure ceilings. Directors stressed the need to bolster the fiscal management of local governments and to improve policy coordination among different levels of government, to ensure achievement of the national fiscal consolidation objective.

Directors highlighted the importance of strengthening the medium-term expenditure framework. They welcomed the initiation of background work by the authorities to increase spending efficiency and to streamline public administration, and, in this context, called for efforts to increase efficiency and contain costs in the health care system. Given that higher socially-oriented current spending would reduce expenditure flexibility, Directors recommended putting greater emphasis on infrastructure spending and on employment promotion in the underdeveloped regions of Slovakia.

Directors emphasized that wage moderation and flexibility in wage-setting procedures are essential to restrain inflation and maintain competitiveness. In this regard, the recent legislation that extended sectoral wage agreements to all firms in the sector was a source of concern. Directors also cautioned against further large increases in the minimum wage, as they could lead to wage drift and worsen employment prospects for low-skilled workers.

In view of the still high unemployment rate among the low-skilled and in the less-developed regions, Directors saw a need to improve the effectiveness of active labor market policy schemes. They also stressed the importance of ensuring that the labor code amendments under consideration would not raise labor costs and reduce labor market flexibility. Directors encouraged the authorities to give consideration to introducing an earned-income tax credit for low-income workers, as this would enhance job creation and increase incentives to work.

Directors welcomed the finding that Slovakia's financial system is generally sound and resilient to adverse shocks, while supporting continued efforts to further enhance financial institution supervision. They called for close monitoring of banks' loan portfolios, as continued rapid credit growth has increased banks' exposure to credit risks. Given the high foreign ownership of banks, further strengthening of cooperation with home country supervisors should also remain a priority. Directors commended the strengthening of the regime against money laundering and terrorism financing, and encouraged the authorities to move expeditiously to address the remaining gaps.

Public Information Notices (PINs) form part of the IMF's efforts to promote transparency of the IMF's views and analysis of economic developments and policies. With the consent of the country (or countries) concerned, PINs are issued after Executive Board discussions of Article IV consultations with member countries, of its surveillance of developments at the regional level, of post-program monitoring, and of ex post assessments of member countries with longer-term program engagements. PINs are also issued after Executive Board discussions of general policy matters, unless otherwise decided by the Executive Board in a particular case.

Slovak Republic: Selected Economic Indicators, 2002–07

	2002	2003	2004	2005	2006	2007 Proj.
	(Percent change, period average)					
Real sector						
Real GDP	4.1	4.2	5.4	6.0	8.3	8.8
Output gap (in percent of potential GDP)	-0.2	-0.5	-0.5	-0.3	-0.1	0.0
Gross industrial output (constant prices)	-1.3	9.1	11.5	4.7	9.9	...
Consumer prices						
CPI (period average)	3.3	8.5	7.5	2.7	4.5	2.3
HICP (period average) 1/	3.5	8.4	7.5	2.8	4.3	1.8
Wages						
Nominal wages	9.3	6.3	10.2	9.2	8.0	7.1
Real wages	5.8	-2.1	2.4	6.3	3.3	4.7
Employment (ESA 95 basis)	-0.5	1.8	-0.3	1.4	2.3	2.0
Unemployment rate (annual average, in percent) 2/	18.6	17.5	18.1	16.2	13.3	11.8
	(In percent of GDP)					
Public finance (ESA 95 basis)						
General government balance 3/	-7.7	-2.7	-3.2	-2.8	-3.4	-2.9
Structural general government balance 3/	-7.5	-2.4	-3.0	-2.6	-3.4	-2.9
General government debt	43.3	42.4	41.5	34.5	30.7	29.5
	(Percent change, end of period, unless otherwise indicated)					
Money and credit						
Broad money 4/	3.4	5.6	15.0	7.8	15.3	...
Credit to enterprises and households 4/	14.8	14.8	6.2	26.0	22.9	...
Interest rates (in percent, end-of-period)						
NBS policy rate (two-week repo rate)	6.50	6.00	4.00	3.00	4.75	...
Lending rate (floating rate and up to 1 year initial rate fixation) 4/	7.5	7.2	5.4	5.8	7.8	...
Deposit rate (up to one month) 4/	4.5	4.6	3.6	2.7	4.6	...
	(In billions of U.S. dollars, unless otherwise indicated)					
Balance of payments						
Merchandise exports	14.4	21.8	27.6	32.0	41.7	53.2
Merchandise imports	16.5	22.5	29.2	34.5	44.8	55.4
Current account balance	-1.9	-2.0	-3.3	-4.1	-4.6	-3.7
(in percent of GDP)	(-8.0)	(-6.0)	(-7.8)	(-8.6)	(-8.3)	(-5.3)
Official reserves, end-period	9.2	12.1	14.9	15.5	13.4	17.6
(in months of imports of goods and nonfactor services)	(5.8)	(5.7)	(5.5)	(4.8)	(3.2)	(3.5)
Gross external debt, end-period	13.1	18.1	23.8	27.1	32.2	33.9
(in percent of GDP)	(49.4)	(50.4)	(52.4)	(59.9)	(55.6)	(48.5)
Exchange rate						
Nominal effective exchange rate (percent change, period average) 5/	-0.6	5.4	4.0	1.6	2.6	...
Real effective exchange rate (percent change, period average) 5/						
CPI-based	0.8	12.8	9.2	2.3	6.5	...
ULC-based	8.9	-0.8	8.4	-3.7	-1.7	...
Memorandum item:						
GDP (current prices, Sk billions)	1,111	1,213	1,355	1,471	1,636	1,822

Sources: Statistical Office of the Slovak Republic; Ministry of Finance; National Bank of Slovakia; and IMF staff calculations.

1/ The harmonized index of consumer prices (HICP) is an internationally comparable measure of inflation calculated by each member state of the European Union.

2/ ILO definition as in Labor Force Survey.

3/ In 2004, includes forgiveness of domestic debt claims on the health sector falling due, equivalent to 0.8 percent of GDP. From 2005 onward, includes second pillar pension costs.

4/ There is a break in the series in 2004. Data for 2004-2006 are in accordance with European Central Bank methodology.

5/ Trade-weighted. Partner countries comprise Austria, Czech Republic, France, Germany, Hungary, Italy, Netherlands, Poland, United Kingdom, and United States.