SLOVAK REPUBLIC

Highlights

- **GDP growth has remained strong.** Private consumption continues to be the key driver for growth, underpinned by increasing employment and higher wages.
- **The bank levy reduction has been postponed until 2020.** Despite the original agreement to gradually reduce the bank levy once revenues reached €750 million, the government has decided to preserve the existing level at 0.2 per cent for the next four years.
- **Measures to enhance the effectiveness of government have been brought in.** A value for money concept was introduced, which comprises a review of government expenditure in the transport, healthcare and IT sectors. Under the new scheme, more emphasis is placed on carefully calculating and rationalising decisions and executing the best available alternative through projects that add the most value.

Key priorities for 2017

- **Upgrading transport infrastructure could improve labour mobility and reduce regional disparities.** Even though aggregate income per capita increased to 77 per cent (in purchasing power adjusted terms) of the EU average in 2015, significant regional disparities persist.
- **Addressing deficiencies associated with public procurement, including a further expansion of mechanisms based on market-oriented financial instruments, could lead to more efficient EU funds absorption.** Current rates of EU funds absorption lag behind regional peers. In the new EU budget, the Slovak Republic stands to benefit from the second highest allocation within the European Union of structural funds (in per capita terms), equivalent to an annual inflow of 2.6 per cent of GDP over the course of 2014-2020.
- **The legal and institutional framework for supporting sustainable energy projects should be improved.** This would help raise the share of energy from renewable sources, which at the current rate of 12 per cent is significantly below regional peers in central Europe and the Baltic states (CEB).

Main macroeconomic indicators %

	2012	2013	2014	2015	2016 proj.
GDP growth	1.7	1.5	2.6	3.8	3.2
Inflation (average)	3.7	1.5	-0.1	-0.3	-0.5
Government balance/GDP	-4.3	-2.7	-2.7	-2.7	-2.5
Current account balance/GDP	0.9	1.9	1.2	0.2	0.3
Net FDI/GDP [neg. sign = inflows]	-3.2	0.3	0.3	0.0	-0.5
External debt/GDP	77.3	84.5	83.2	84.4	n.a.
Gross reserves/GDP	n.a.	n.a.	n.a.	n.a.	n.a.
Credit to private sector/GDP	47.6	49.2	51.3	54.5	n.a.

CONTINUES

Macroeconomic performance

GDP growth strengthened in 2015 and remains robust so far in 2016. Despite a marginal deceleration in economic activity in the first half of 2016, GDP growth in the Slovak Republic remains among the highest in the CEB region. In 2015 GDP growth reached 3.8 per cent, primarily driven by impressively high investment – including in foreign-owned enterprises – and household consumption. Strong private consumption is expected to continue, underpinned by an improving labour market, rising disposable incomes and strong credit growth. Prospects for exports have further improved with construction of a new Jaguar car plant expected to start by the end of 2016. Meanwhile, investment growth was impressive in 2015 at 14 per cent but this has slowed substantially in the first half of 2016 as EU funds absorption under the new absorption cycle has been slow to take off.

Export growth has continued in 2016. Amid the global trade slow-down and the still weak recovery in the eurozone, export growth has decelerated only marginally. Over the first half of 2016, export volumes increased by almost 4 per cent, comparable with the previous year, although significantly below earlier years. Exports to Russia continued to shrink – by almost 30 per cent in value in the first half of 2016. This negative trend, however, has been more than offset by rising export demand from within the EU markets.

Long-term unemployment remains high. Despite falling unemployment, which dropped to only 9.5 per cent in August 2016, its structural component remains high. In mid-2016 the share of unemployed without jobs for more than one year was above 60 per cent, which is substantially higher than the EU average of 46 per cent. Despite long-running EU-sponsored investment programmes in the east of the country, significant regional disparities in long-term unemployment persist.

Strong household consumption will persist. This is in part due to the reduction in the VAT rates for selected food products, from 20 to 10 per cent, and the hike in the minimum wage that came into effect in 2016. Substantial domestic private investments should underpin growth this year and next. We anticipate growth of 3.2 per cent this year and next.

Major structural reform developments

The business environment is in a relatively comfortable position when compared with its regional peers. The Slovak Republic took 33rd place (out of 190 economies) in the World Bank's *Doing Business 2017* ratings. Compared with the previous edition of the survey, the country improved significantly in the "paying taxes" sub-category. It advanced by 17 places primarily because it reduced the number of tax payments (from 10 to eight), which relates to adjustments to property taxes introduced in 2015, but also because of a reduction in motor vehicles tax and smoother post-filing processes related to tax refunds, tax audits and tax appeals for local SMEs. Protecting minority investors and dealing with construction permits remain the key obstacles for doing business. The country scores best in the "trading across borders" and "registering a property" sub-categories, ranked in the first and seventh positions, respectively.

The bank levy will remain at the current level until 2020. Despite the original agreement to gradually reduce the bank levy (introduced in January 2012) once revenues reached €750 million, which is expected to happen by the end of 2016, the government in July 2016 prepared a change in the law to keep the existing level at 0.2 per cent of liabilities for the next four years. According to the National Bank of Slovakia, preserving the bank levy at the existing rate may further negatively affect banks' profitability. The levy is the highest of its type in Europe and is aimed at creating a reserve fund that could be used in a future banking crisis. In addition to the levy, banks have to contribute to the resolution fund, in line with EU legislation, of 0.05 per cent of liabilities.

CONTINUES

A new value for money programme is expected to make public spending more efficient. The government introduced the new programme in March 2016. It includes the government expenditure reviews for the transport, healthcare and IT sectors, as expenditure in these areas accounts for about 40 per cent of total government spending. There is a specialised department at the Ministry of Finance responsible for implementing the programme. The idea is to put more pressure on public administration to carefully calculate and rationalise expenditure decisions and execute the best available alternative through projects that add the most value. The first spending reviews were published in October 2016; other areas such as education, social and labour market policies and environment, which account for almost 15 per cent of GDP, are expected to be reviewed by mid-2017.

Transparency in the public sector will be enhanced. In October 2016 the government approved the Act on Registering Public Sector Partners (the so-called anti-letterbox act) in the area of public oversight of the register of final beneficiaries. It expands the scope of persons in the register to all entities that receive payments from the state, including payments from the sale of state property. Enforceability of the law should be improved by introducing deterrent penalties. In the World Economic Forum's *Global Competitiveness Report 2016-2017* corruption was highlighted as the most problematic factor for doing business, with institutions ranked only 102nd out of 138 countries, the second lowest position in the CEB region after Hungary.

Regional inequalities are being addressed. In December 2015 a law to support the least developed districts came into force. Support is based on the cooperation between public authorities, employers and civil society. Employers are exempt from paying any social and unemployment insurance over the first year of employment. Also, conditions to obtain a relocation subsidy have been liberalised: an unemployed person who decides to move more than 70 km from their permanent residency (previously 50 km) for work is eligible for a state subsidy. As of January 2016, the subsidy is calculated as 80 per cent of the costs of living, up to €250 for the first six months and dropping to €125 for a further six months. Both policies aim to reduce regional inequalities, which are caused, among other things, by a substantial lack of labour mobility between regions in the Slovak Republic.

A new SME support law was adopted. In August 2016 the government passed a new law on small and medium-sized enterprises (SMEs), which will enter into force from January 2017. The new law aims to reduce the regulatory burden on SMEs and introduce alternative forms of financing, including through EU funds. The new legislation mirrors the EU Small Business Act for Europe, which comprises a set of policy measures organised around 10 principles ranging from entrepreneurship and "responsive administration" to a greater presence of SMEs abroad. In the Slovak Republic, SMEs provide about 70 per cent of jobs and create more than 60 per cent of the country's value added, in both cases above the EU-28 average. According to the European Commission, the biggest challenge for Slovak SMEs remains the low level of internationalisation in the SME sector.

Use of EU funds has improved. Compared with its regional peers, the Slovak Republic experienced a substantial delay in managing and spending its 2007-13 EU funds. The absorption rate at the end of 2015 was below 90 per cent, although during this year it went up to 97 per cent by the end of September 2016. Learning from the failures in the previous budget, the authorities have taken steps to increase the transparency of funds management and to reduce the administrative burden. Among other things, the number of operational programmes was reduced from 14 to 9 in the current budget.