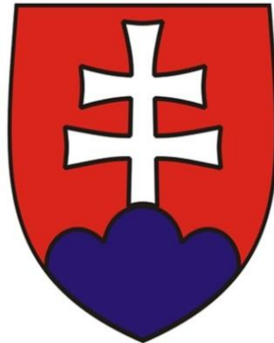

Stability Programme of the Slovak Republic for 2017 to 2020

April 2017

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Summary

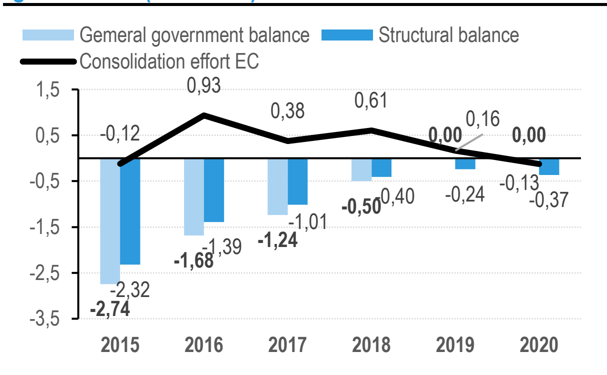
With a year-on-year increase of 3.3 %, last year was in several aspects a record-breaking one for the Slovak economy. Thanks to an extraordinarily favourable labour market development and decreasing prices, the growth of household consumption was highest since 2008. The number of working people exceeded 2.3 million, thus reaching the highest historical level. The year-on-year increase in the number of jobs reached a level of 54 thousand and the rate of long-term unemployment dropped to the historically lowest level. Slovak economy, supported by household consumption and foreign demand, will increase by 3.3 % this year too. The automotive industry, construction of the Bratislava bypass and general government will return investments in the black. The export activity will speed up and the market shares of Slovak exporters will increase. The labour market remains in excellent condition and the unemployment rate will re-write the historical minimum values. In the following years, the economy growth will accelerate, in particular thanks to new production capacities in the automotive industry. The risks of the macroeconomic forecast are balanced.

According to the notified Eurostat data, the general government deficit reached 1.68 % of GDP in 2016. In particular, the unexpected positive fiscal performance of local governments contributed to improvement in comparison with the budgetary objective at a level of 1.93 % of GDP. The positive trend of macroeconomic development and better effectiveness of collection allowed the continuing increase in tax and contribution revenues by 0.9 % of GDP. Nontax revenues also grew more significantly in comparison with the budget. The above increase in revenues was used by the government to finance the higher expenditures on investments and wage growth in general government.

The approved budgetary objective of 1.29 % of GDP remains unchanged in 2017. The estimated general government deficit, based on the latest estimate, is currently at a level of 1.24 % of GDP. The update of tax revenue forecast expects a positive influence for contributions, total taxes do not change. The latest estimate assumes higher revenues from the state dividends, savings of expenditure connected with state debt handling as well as contribution to the EU budget or EU funds correction. The risks of the latest estimate are balanced.

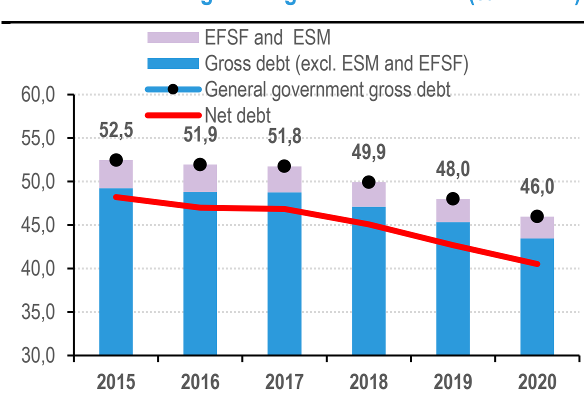
In the medium-term budgetary framework of the Slovak Republic for the years 2018 to 2020, a deficit objective of 0.5 % of GDP is set for the year 2018. The objective to reach the historically first balanced budget in 2019 does not change and balanced fiscal performance of general government is also planned for 2020. The general government's budgetary objectives are in compliance with the European and national fiscal rules. The consolidation effort last year markedly exceeded the requirements of the Stability and Growth Pact when it reached 0.93 % of GDP. A markedly better result of last year's structural balance suppresses the year-on-year consolidation effort in 2017. The evaluation of consolidation effort at a two-year horizon shows no deviation in 2017. **Next year, the structural deficit will reach 0.40 % of GDP, which will fulfil the government's objective to achieve the medium-term budgetary objective (MTO)[1] one year in advance.**

FIGURE 1 - Planned consolidation effort of the general government (% of GDP)



Source: MoF SR

FIGURE 2 - Gross general government debt (% of GDP)



Source: MoF SR

[1] For Slovakia, the MTO represents a value of the structural balance of -0.5 % of GDP.

From 2017, Slovakia will reach a surplus in the primary fiscal performance of general government, i.e. a positive balance of general government net of interest payments. Slovakia achieved a historical surplus amounting to 0.3% of GDP already last year, and from 2018 even higher surpluses are expected. Successful reduction of the primary structural balance in the previous years helped improve the long-term sustainability of the public finance in the Slovak Republic. The fiscal result for the last year and the achievement of the structurally balanced budget in 2018 will further reduce the risk of long-term sustainability. The current Eurostat's demographic projection represents another positive risk for evaluating the long-term sustainability of the public finance of Slovakia.

The gross debt of general government will further decrease. At the end of 2016, it reached a more significant drop to a level of 51.9 % of GDP, with a year-on-year decrease by 0.5 % of GDP. At the end of 2020, the gross debt will decrease to 46 % of GDP, out of the sanction bands of the constitutional Fiscal Responsibility Act. Despite a solid growth of GDP, no substantial debt decrease is expected in 2017 due to the need of higher cash for state debt refinancing. Starting from 2018, the rate of decreasing debt share in the GDP will significantly speed up due to the expected faster economy growth, revival of price level growth and expected surpluses of the primary fiscal performance of general government.

The fiscal policy will slightly affect the economic growth. In 2018, a positive influence on GDP growth amounting to 0.3 p.p. is estimated from the expected fiscal impulse 0.5 % of GDP in comparison with the no-policy-change scenario. The fiscal space is used for the priorities of government in particular in the area of capital investments and compensations of general government employees. A moderate fiscal restriction amounting to 0.3 % of GDP necessary to reach the budgetary objective in 2019 will temporarily slow down the GDP growth by about 0.2 p. p. The fiscal policy will again positively affect the economy of the Slovak Republic in 2020 and it will speed up the GDP by 0.2 p. p.

Implementation of the principles of higher value for money in public expenditure and the continuing steps improving the effectiveness of tax collection will further improve the quality of Slovak public finance. The second round of expenditure reviews is under way within the Value for Money Project. In 2017, within the budgetary process, the education, labour, social affairs and environment expenditures are under review. Execution of important investments will be preceded by an analysis of their costs and benefits. The success in the combat against tax evasion is documented by continuous decrease of VAT gap, which has decreased by more than one third in comparison with 2012, and a similar trend is followed by the corporate tax gap. An increased focus on analytical activities, a new action plan of combat against tax evasion, and the measures to strengthen the voluntary fulfilment of the tax duty represent a strategic precondition for the continuing positive development of tax collection effectiveness.

Within the existing fiscal framework, Slovakia applies several fiscal and budgetary rules. The credibility of public finance development is primarily provided by the debt brake rule and the rule of balanced budget of general government. No changes of application of national fiscal rules occurred during the year 2016. However, the government initiated a public discussion concerning the potential changes in the debt brake rule primarily with the objective to ensure the neutrality of debt criterion in managing the state's cash reserve, consideration of strategic public investments in applying sanctions and adjustment of parameters of sanction bands supporting a sustainable growth of Slovakia. Several changes, in particular with the objective to improve the quality of budgetary process, were implemented in the Budgetary Rules Act, which ensures the practical application of the medium-term budgetary objective.

1. ECONOMIC OUTLOOK AND PROJECTIONS

Last year's strong economic performance weighed favourably on the developments in the Slovak labour market. Employment reached its historical maximum, as the number of working population exceeded 2.3 million, while the rate of long-term unemployment tumbled to a historical low. This year, the Slovak economy is set to increase by 3.3 per cent, buttressed by vigorous household consumption and foreign demand. Investment should rebound on the back of several factors, including new capacities in the automotive industry, the scheduled construction of the Bratislava highway roundabout, as well as increased government spending. Export activity is expected to accelerate further, while Slovak exporting firms are to gain larger market shares. The labour market conditions will remain favourable with unemployment falling further. The economy is set to accelerate predominantly on the back on new production capacities in the automotive industry. The risks to the macroeconomic forecast are broadly balanced.

1.1 External environment

Global demand continued growing, despite the intensification of geopolitical risks. The euro area economy grew at a stable pace, proving its resilience to shocks. Economic fundamentals improved further, as euro area unemployment rate dropped below 10 per cent. Last year domestic demand (in particular, household consumption) continued to act as a primary driver underlying euro area growth. The US economy also performed favourably last year, while the Japanese economic performance was rather disappointing. The adverse developments in numerous emerging market economies seem to have bottomed out. While the Chinese economy has upheld its robust expansion pace, a slow down is expected in the medium term.

Leading indicators and foreign institutions[2] jointly point to euro area's potential – as well as that of other trading partners – to accelerate further this year. Euro area composite leading indicators have stood at five-year highs already for several consecutive months. Euro area economy should thus accelerate, mostly owing to the rebound in world trade and the positive spill overs associated with the US fiscal stimulus. The ongoing political uncertainty, however, threatens a more powerful acceleration of growth, and simultaneously constitutes the primary risk to the outlook of external environment. In particular, the negative risks to the forecast include an unclear political outlook in Europe (elections in France and Germany), the instability of the Italian banking sector, the materialisation of "Hard Brexit" scenario and its impact, as well as the threat of protectionism in international trade.

The discrepancy between EC's growth estimates for the external environment and those of MoF is at an aggregate level negligible (Table 1). The MoF SR[3] forecast in line with EC assumes growth stabilisation and a slight deceleration of euro area growth in the upcoming years. The German economy should continue growing at a pace slightly below 2 per cent. CEE countries are set to expand at a pace faster than last year in the years to come.

TABLE 1 - External assumptions for the current forecast (in %)

	MoF SR			EC		
	2016	2017	2018	2016	2017	2018
GDP growth						
EU	1.8	1.7	1.7	1.9	1.8	1.8
Eurozone	1.6	1.7	1.7	1.7	1.6	1.8
Germany	1.8	1.7	1.6	1.9	1.6	1.8
Czech Republic	2.4	2.5	2.6	2.4	2.6	2.7

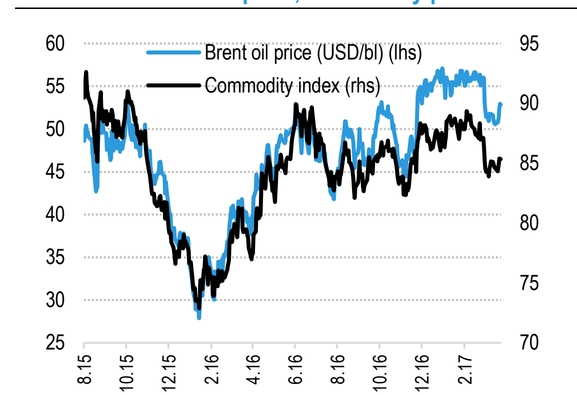
[2] European Commission (EC), International Monetary Fund (IMF) and Organisation for Economic Co-operation and Development (OECD).
[3] The forecast of the Macroeconomic Forecasts Committee pursuant to its by-laws and in compliance with Article 8 (2) of constitutional Fiscal Responsibility Act 493/2011 Coll. is considered the forecast of MoF SR

Poland	2.4	2.6	2.8	2.8	3.2	3.1
Hungary	1.6	2.4	2.3	1.9	3.5	3.2
Long-term interest rates (10Y)						
Germany	0.14	0.41	0.54	-	-	-
ECB main interest rate	0.00	0.00	0.03	-	-	-
Exchange rate (USD/EUR)	1.11	1.06	1.1	1.11	1.07	1.07
Oil price (Brent, USD/bl)	45.0	55.4	56.2	44.8	56.4	56.9
Oil price (Brent, EUR/bl)	40.1	52.1	50.8	40.4	52.8	53.2
p. m. Economic growth in Slovakia	*3.3*	*3.3*	*4.0*	*3.3*	*2.9*	*3.6*

*Source: MoF SR February 2017 *EC Winter Forecast February 2017*

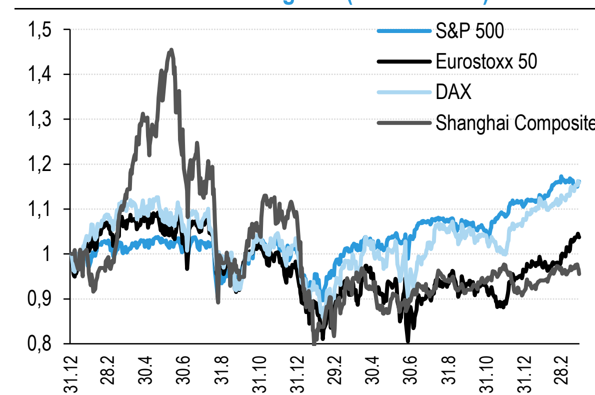
In the commodity markets the oil prices bottomed out when OPEC countries agreed to cut oil output in December last year. The agreement stabilised the prices of oil at 55 USD per barrel. In the meantime, stock markets stayed broadly calm, with the exception of an upsurge linked to the US election (excluding the Chinese stock market). The US fiscal policy is expected to provide a stimulus to the world economy, however the gains may be offset by a possible new wave of protectionism in the long run. US bond yields also rose in response to the November election. The Federal Reserve proceeded merely with a single hike in its key interest rate to a level at 0.75 per cent. US monetary policy normalisation is set to continue over the course of 2017. This should further strengthen the US dollar, which currently stands at 15-year maximum compared to the currency basket of US major trading partners. Since the Brexit referendum, the British Pound has tumbled to its minimum, traded at a level of USD 1.2 per Pound in October las year. It currently trades at USD 1.28 per Pound.

FIGURE 3 – Brent Oil price, commodity prices



Source: MoF SR, Bloomberg

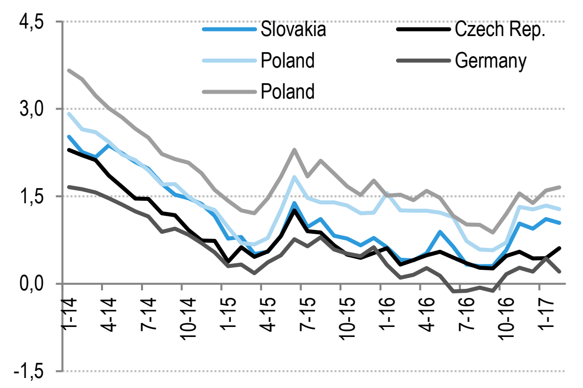
FIGURE 4 - Stock market gains (base=1.2014)



Source: MoF SR, Bloomberg

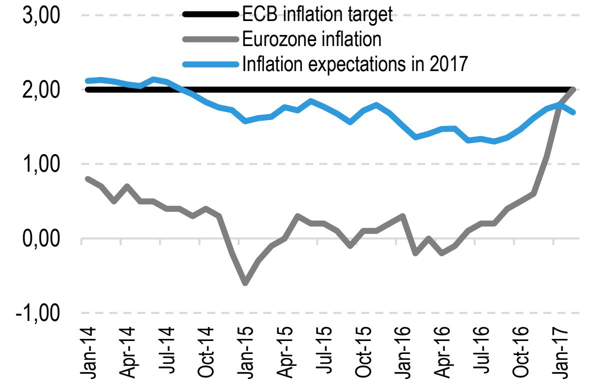
The European Central Bank (ECB) has modified the rules of its quantitative easing programme. Importantly, the volumes of monthly asset purchases have been reduced by EUR 20 bn., to EUR 60 bn. in December. Moreover, the duration of the asset purchase programme has been stretched by nine months beyond March 2017, the original foreseen Programme end date. At the long end, bond yields departed from their historical lows, signalling on the one hand positive inflation expectations, on the other hand intensifying political risks. European stock markets gained year end in response to the United States presidential election.

FIGURE 5 - 10-year government bond yields (%)



Source: MoF SR, Bloomberg

FIGURE 6 - Current inflation and expectations (%)



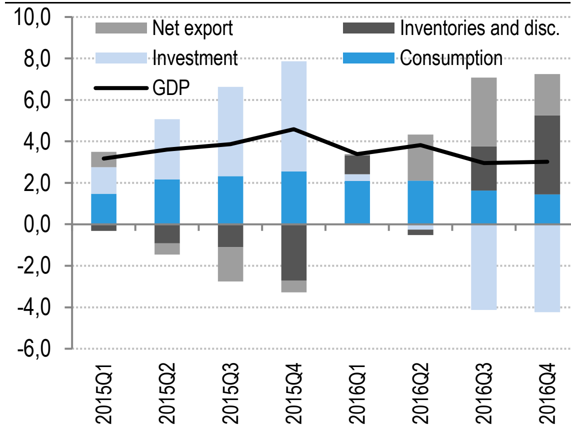
Source: ECB, Eurostat

1.2 Economic developments in Slovakia in 2016

The Slovak economy expanded by 3.3 per cent last year. Household consumption and net exports contributed to growth most significantly. Significant improvements in the labour market coupled with falling consumer prices weighed favourably on household consumption, which posted fastest growth since 2008. Exports eased somewhat, compared to the strong growth seen in 2015, owing to weaker-than-expected performance of CEE non euro area countries. Nevertheless, the automotive sector production reached new highs.

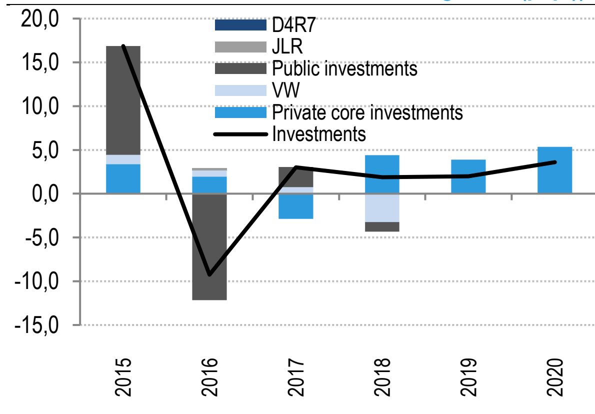
Compared to the previous year, the Slovak economy slowed down mainly as a result of lower EU Fund absorption in the new Programming Period. Gross fixed capital formation in the entire economy decreased by 9.3 per cent. The investments related to the construction of the new Jaguar Land Rover (JLR) automobile plant and the Bratislava highway roundabout (D4/R7) expected last year have been postponed to take place in the current year.

FIGURE 7 - Contributions to GDP growth (p. p.)



Source: SO SR, MoF SR

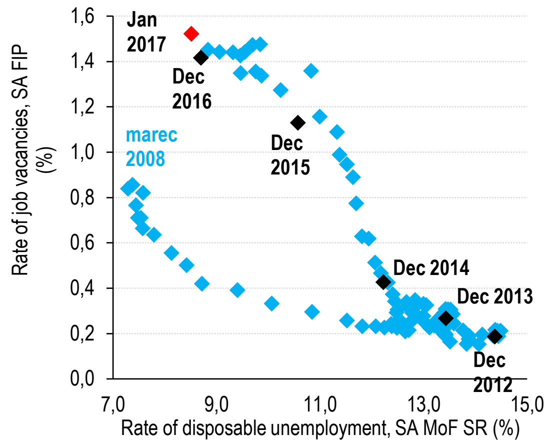
FIGURE 8 - Contributions to investments growth (p. p.))



Source: SO SR, MoF SR

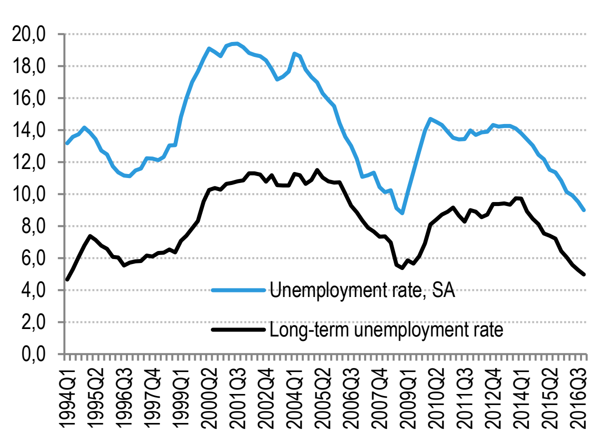
Last year was exceptionally successful in terms of labour market developments. Employment reached new historical highs, as working population (according to the ESA 2010 methodology) exceeded 2.3 mil. Jobs posted the fastest growth since the crisis, growing at 54 thousand annually, and were created across all sectors of the domestic economy. The rate of job creation (according to the COLSAF) remains at historical highs and suggests a sustained momentum in the labour market in the near term.

FIGURE 9 – Beveridge curve



Source: COLSAF, MoF SR

FIGURE 10 – Unemployment rate (LFS, in %)

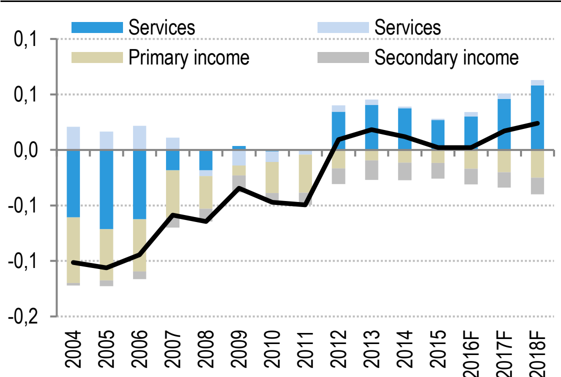


Source: SO SR, MoF SR

Employment gains supported the fall in the unemployment rate, which tumbled to a single-digit level for the first time in ten years. In 2016, 9.7 per cent of economically active population were unemployed. The year-on-year decrease in the unemployment rate was 1.7 p. p. The rate of long-term unemployed dropped to its historical lows.**Wages accelerated last year, with the nominal wage advancing by 3.3 per cent, corresponding to a 3.8 increase in real terms, the latter dynamics aided by falling consumer prices.** This development was driven mostly by the services and general government sectors, followed by industry. Wage growth outperformed that of productivity across all branches but agriculture, which caused unit labour costs to rise for the third consecutive year. This is partially linked to a buffer created before 2014 when productivity was well ahead of wage growth. Despite the dynamic unit labour costs growth seen in recent years, its level belongs to the lowest in EU28. **After hovering in surplus in the past four years, the balance of payments fell to -0.6 per cent of GDP in 2016.** The deterioration is driven mainly by the reduction in the primary income (-2.6 % of GDP) and secondary income to a lesser extent. The balance of goods and services contributed favourably to the overall balance, and to a larger extent than in the previous year. All in all, the balance of payments structure does not pose any significant risk from a macroeconomic imbalance viewpoint.

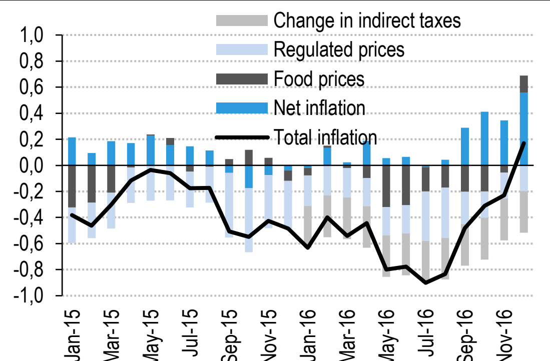
Turning to the developments in consumer inflation, the rate of annual inflation reached -0.5 per cent in 2016, owing to a number of external factors, including a reduction in regulated priced and the prices of fuels and food to a smaller extent. As regards to the prices of food, the VAT rate reduction also played a role in driving down the headline figure. Price level grew only in the services sector. Consumer price inflation hit rock bottom in July last year at -0.9 per cent, and has been moderating since then until turning positive on an annual basis at the end of the year. The turnaround was triggered mainly by a positive contribution of food and fuels, reflecting the developments in global commodity markets. Annual rate of inflation was further accelerating at the beginning of this year.

FIGURE 11 – External imbalances – CAB components (% of GDP)



Source: SO SR

FIGURE 12 - Structure of consumer inflation – contribution of components (p. p.)



Source: SO SR

1.3 Medium-term economic forecast

The current forecast assumes the Slovak economy to grow at 3.3 per cent this year, with a broad-based structure, driven by both, household consumption and foreign demand. Investment should rebound on the back of several factors, including new capacities in the automotive industry, the scheduled construction of the Bratislava highway roundabout, as well as the public sector. Export activity is set to accelerate further, exceeding the dynamics of foreign demand. Import-intensive investment growth linked to the JLR construction will speed up imports growth, which, in turn will decrease the net exports contribution in GDP growth on an annual basis. The economy is set to accelerate predominantly on the back on new production capacities in the automotive industry.

TABLE 2 - Forecast of selected indicators of the Slovak economy 2017 to 2020[4]

No.	Indicator		Actual		Forecast			
		Unit	2015	2016	2017	2018	2019	2020
1	GDP, current prices	EUR bn.	78.7	81.0	84.6	89.4	95.1	100.7
2	GDP, constant prices	%	3.8	3.3	3.3	4.0	4.4	3.8
3	Final consumption of households and NPISH[5]	%	2.2	2.9	2.5	2.7	2.9	2.9
4	Final general government consumption	%	5.4	1.6	1.6	2.0	1.9	1.4
5	Gross fixed capital formation	%	16.9	-9.3	3.0	1.9	2.0	3.6
6	Export of goods and services	%	7.0	4.8	5.6	7.3	7.7	6.2
7	Import of goods and services	%	8.1	2.9	4.2	6.0	6.3	5.5
8	Output gap (share of the potential output)	%	-0.7	-0.2	0.2	0.7	1.3	1.3
9	Average monthly wage in the economy (nominal growth)	%	2.9	3.3	3.5	4.4	4.8	5.1
10	Average employment growth, LFS	%	2.6	2.8	1.7	1.1	0.9	0.9
11	Average employment growth, ESA 2010	%	2.0	2.4	1.8	1.1	0.9	0.9
12	Average unemployment rate, LFS	%	11.5	9.6	8.4	7.6	4.9	6.2
13	Average registered unemployment rate	%	11.5	9.5	8.1	7.4	6.7	5.9
14	Harmonized index of consumer price (HICP)	%	-0.3	-0.5	1.1	1.7	1.9	2.1
15	Current account balance (share of GDP)	%	0.2	-0.6	1.7	2.4	3.2	3.7

Source: MoF SR

BOX 1 - The impact of new investments in the automotive industry on the Slovak economy – An Update

The investment of Jaguar Land Rover (JLR) constitutes the largest investment in Slovakia in in the aftermath of the crisis. Since the investment has been announced, the public authorities have gone ahead with investments related to the preparation of the JLR strategic industrial park. Moreover, new investments have been announced by potential JLR suppliers. The current update of JLR's impact on the Slovak economy incorporates all additional information in regards to the planned JLR plant. The JLR investment in the amount of EUR 1.4 bn remains unchanged, while the actual investment stage of the venture commenced at the end of 2016. We expect the re-invested funds to peak in 2018. The JLR production curve has been adjusted to reflect the past experience with other SUV production lines, however, a robust growth is nevertheless expected in the forthcoming years mirroring the strengthening global position of JLR.The assumptions about import demand, created jobs and wages remains unchanged.

TABLE 3 - Assumptions underlying the investment project and production of JLR

	2016	2017	2018	2019	2020
Investment (EUR mil.)[1]	50	400	630	303	23
Sales (EUR mil.)			500	2,300	3,700
Number of produced cars (pcs)			25,000	90,000	130,000
Model 1			25,000	65,000	75,000
Model 2				25,000	55,000
Number of jobs at JLR[1]	164	405	1,168	2,025	2,456
Number of jobs at suppliers	410	1,094	3,388	6,076	7,614

[4] The forecast for the years 2017 to 2020 was approved by the Macroeconomic Forecasts Committee in February 2017.
[5] In the following text, household consumption shall mean the consumption of households and non-profit institutions serving households (the "NPISH).

Wage costs per employee (EUR)[1]	1,621	1,657	1,693	1,730	1,768
Import intensity of the investment [2]	48 %	59 %	74 %	79 %	79 %
Import intensity of export			67 %	67 %	67 %

[1] Investor's assumptions fully taken over. [2] An import intensity of 30 % during construction is expected. An import intensity of 80% is expected for import of machines and technologies, 0% for land treatment and 100% for know-how.

Source: assumptions of IFP

The assumption in regards to the Volkswagen Bratislava (VW) investment, which is expanding its luxury SUV production capacities, remains unchanged at EUR 800 mil. Merely the investment profile has been adjusted to reflect that half of the total investment has been invested in 2016.The assumptions about the number of cars produced remain equally unchanged and embed the Slovak historical experience with the extension of luxury automotive production lines.

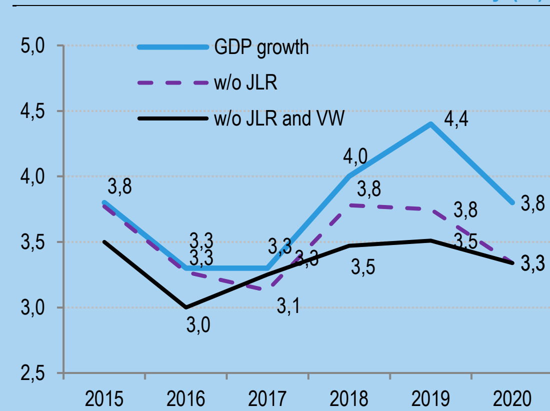
TABLE 4 - Assumptions of the investment and new production of VW

	2016	2017	2018	2019	2020
Investment (EUR mil.)	400	400			
Sales (EUR mil.)			1,000	1,600	1,600
Number of manufactured cars			50,000	80,000	80,000
Import intensity of investment	48 %	70 %			

Source: MoF SR

The entrance of the fourth auto maker in Slovakia will increase Slovak GDP growth by 1.5 pp cumulatively by 2020, which will favourably impact employment by 0.6 pp cumulatively over the forecast horizon. The expansion of VW Bratislava production capacities alone will aid growth by 0.7 pp by 2020, which will favourably impact employment by 0.2 pp cumulatively over the forecast horizon.

FIGURE 13 - Impact of new production and investment of VW and JLR on Slovak economy (%)



Source: MoF SR

TABLE 5 - Contributions of JLR and VW to year-on-year growths (p. p.)

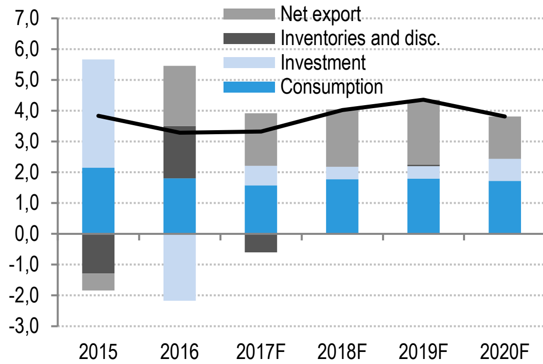
	2016	2017	2018	2019	2020
			JLR		
Investments	0.3	2.1	1.2	-1.9	-1.5
Export			0.6	1.9	1.2
Employment	0.04	0.05	0.17	0.22	0.02
GDP	0.03	0.17	0.22	0.65	0.46
			VW		
Investments	2.2	-0.1	-2.3	0	
Export			1.2	0.6	
Employment	0.02	0.02	0.12	0.03	
GDP	0.27	-0.12	0.31	0.24	

Source: MoF SR

The labour market is expected to remain strong this year, with employment (according to the ESA methodology) rising further by 1.8 per cent. More than 42 thousand new jobs are anticipated to be created in the economy, of which more than a half will be created in the services sector. The unemployment rate according to LFS will drop to 8.4 per cent, while employment growth will reach about 1 per cent in the upcoming years. The unemployment rate is set to fall to 6 per cent at the end of the forecast horizon.

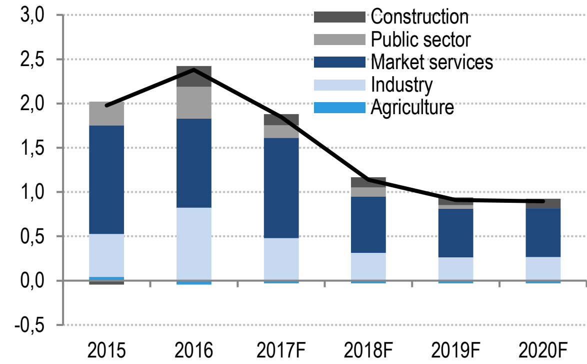
Nominal wages will advance by 3.5 per cent this year, with acceleration across all sectors except for market services, which are to lag behind slightly. Real wages growth will surpass labour productivity growth this year at 2.4 per cent. Productivity growth will improve on the back of new automotive industry production commencing in 2018, and the improvement will slightly reduce real unit labour costs.

FIGURE 14 - Contributions to GDP growth (p. p.)



Source: SO SR, MoF SR

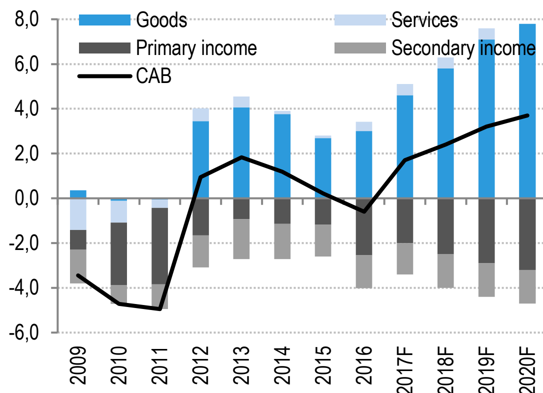
FIGURE 15 - Contributions to employment growth (p. p.)



Source: SO SR, MoF SR

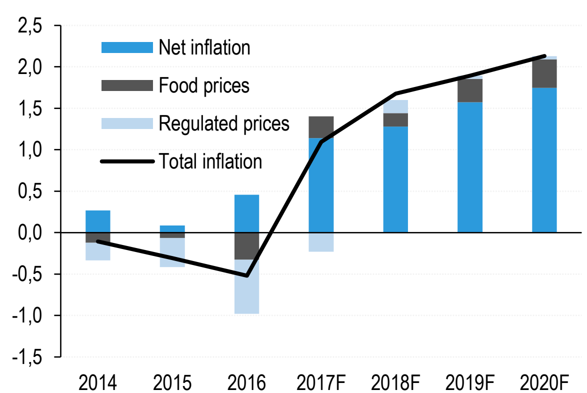
Balance of payments is expected to improve until it returns to the positive territory in the course of this year. In the upcoming years, balance of payments is to remain in surplus on the back of positive contribution of the trade balance, which will be reinforced by the new JLR production capacity. Repatriation of profits from foreign investments will deepen primary income deficit, a development which should be counteracted by an increase in the positive balance of goods. **Inflation is expected to remain in the positive territory in 2017**, with an average annual increase at 1.1 per cent. The foreseen oil price increase will feed primarily into the prices of fuel, and secondarily into those of food and services. On the other hand, regulated prices will tame price growth. Demand pull factors will create even more upward pressure on price level growth over the forecast horizon, with prices of market services expanding at most rapid pace, followed by groupings linked to energy commodities (energy, gas and heating prices). Inflation will reach the 2 per cent target in 2019, and will even exceed the target in line with the assumption of convergence of the Slovak economy.

FIGURE 16 - External imbalances – CAB components (% of GDP)



Source: NBS, MoF SR

FIGURE 17 - Structure of consumer inflation – contribution of components to CPI (in p. p.)



Source: SO SR, MoF SR

Main risks to the forecast[6]

Unclear political outlook in Europe, the materialisation of "Hard" Brexit scenario and the risk of protectionism in the world trade all pose downside risks to the forecast. The shape and form of trade relations after the exit of the UK from the EU remains an unknown even after the activation of Article 50, which formally starts the leaving process. Given the complexity of the procedure, it is quite possible that the trade deal would take concrete contours only after the actual exit of Great Britain from the EU, extending the uncertainty. The instability associated with the Italian banking sector also constitutes a downside risk, while the US fiscal expansion and the earlier exit of the Czech National Bank from its currency peg to the euro pose upside risks to our forecast. On the domestic scene, positive risks outweigh negative ones. In particular, the overheating of the Slovak labour market could exert additional pressure on the wage growth in the private sector, which could in turn translate into higher price level growth.

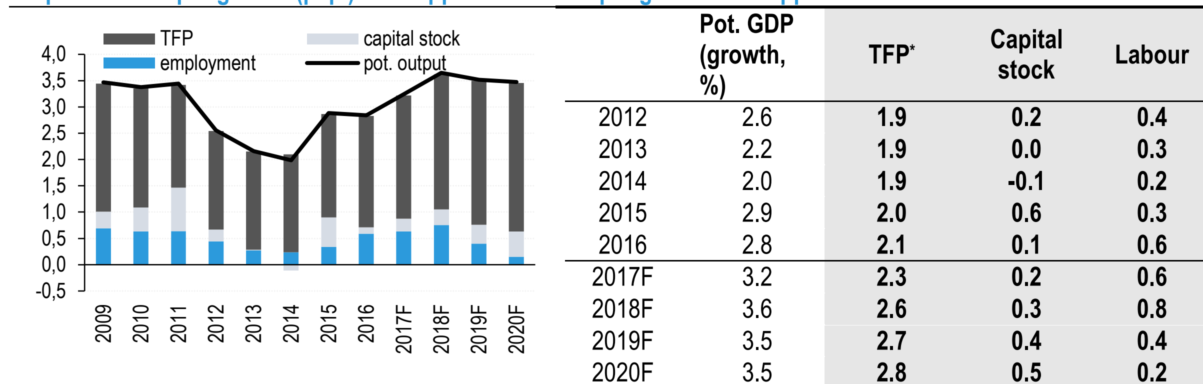
[6] Some risk scenarios are included in Chapter 3.1.

1.4 Cyclical development of the economy

Based on the MoF SR macroeconomic forecast using the EC methodology, potential output growth will accelerate to 3.2 per cent this year, reaching 3.5 per cent at the end of the forecast horizon. The main difference in the national methodology compared to that of EC is in how it treats the new JLR automotive production plant, which MoF SR treats as a supply-side shock. Better export performance would trigger faster potential output growth through TFP at the end of the forecast horizon. The EC methodology does not take to account the new production capacity as a supply-side shock, similarly as it did not reflect the buoyant TFP growth before the crisis (see BOX 2). Despite that, TFP growth constitutes the biggest contributor to potential output according to the EC methodology. In the years to come, potential employment contribution should increase owing to the favourable situation in the labour market. This effect will be however gradually wearing off towards the end of the forecast horizon due to demographics. Capital stock contribution will underperform its pre-crisis levels.

FIGURE 18 - Contributions of production factors to potential output growth (p. p.) – EC approach

TABLE 6 - Contributions of production factors to potential output growth - EC approach



	Pot. GDP (growth, %)	TFP*	Capital stock	Labour
2012	2.6	**1.9**	**0.2**	**0.4**
2013	2.2	**1.9**	**0.0**	**0.3**
2014	2.0	**1.9**	**-0.1**	**0.2**
2015	2.9	**2.0**	**0.6**	**0.3**
2016	2.8	**2.1**	**0.1**	**0.6**
2017F	3.2	**2.3**	**0.2**	**0.6**
2018F	3.6	**2.6**	**0.3**	**0.8**
2019F	3.5	**2.7**	**0.4**	**0.4**
2020F	3.5	**2.8**	**0.5**	**0.2**

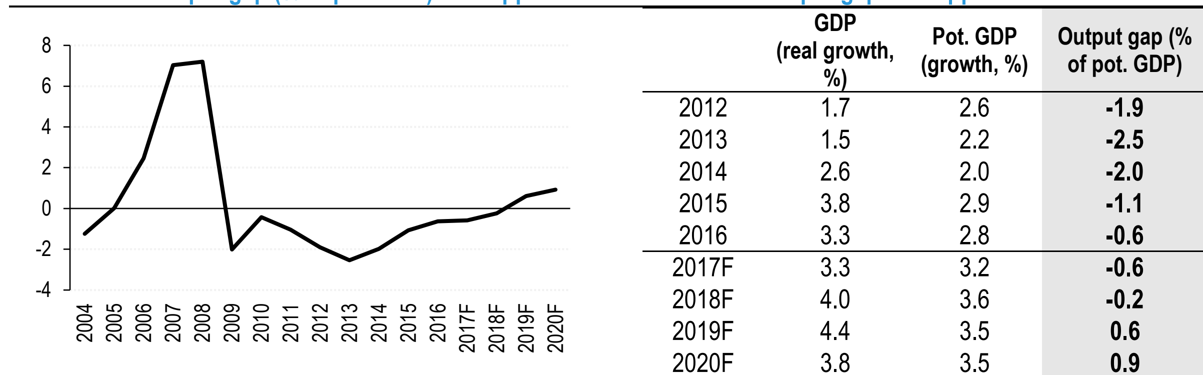
** total production factor productivity*

Source: MoF SR

The output gap is gradually closing according to the EC methodology and is set to reach -0.6 per cent of potential output in 2017, fully closing at the end of 2019. The EC methodology predicts that the Slovak economy would start overheating toward the end of the forecast horizon, owing to the foreseen rapid expansion of the Slovak economy.

FIGURE 19 - Output gap (% of pot. GDP) - EC approach

TABLE 7 - Output gap - EC approach



	GDP (real growth, %)	Pot. GDP (growth, %)	Output gap (% of pot. GDP)
2012	1.7	2.6	**-1.9**
2013	1.5	2.2	**-2.5**
2014	2.6	2.0	**-2.0**
2015	3.8	2.9	**-1.1**
2016	3.3	2.8	**-0.6**
2017F	3.3	3.2	**-0.6**
2018F	4.0	3.6	**-0.2**
2019F	4.4	3.5	**0.6**
2020F	3.8	3.5	**0.9**

Source: MoF SR

BOX 1 - Methodological differences in the calculation of potential output, EC vs. MoF SR

The potential output and output gap estimated by MoF SR are methodologically different from EC estimates. EC methodology is used to assess the structural balance of an economy in the overall quest to evaluate a country's compliance with the EU fiscal rules. The MoF SR uses its own methodology as a part of the Macroeconomic Forecast Committee, one that is used to evaluate the compliance of countries with balanced budget requirements within the framework of the Fiscal Compact. Based on MoF SR estimates, the potential output growth will accelerate somewhat, to 2.9 per cent next year, reaching 4 per cent in the medium term. The medium term estimate rests on the assumption that

the new JLR production capacity will trigger a supply-side shock, mostly through growth of production factors.

FIGURE 20 - Contributions of production factors to potential output growth (p. p.) – MoF SR approach

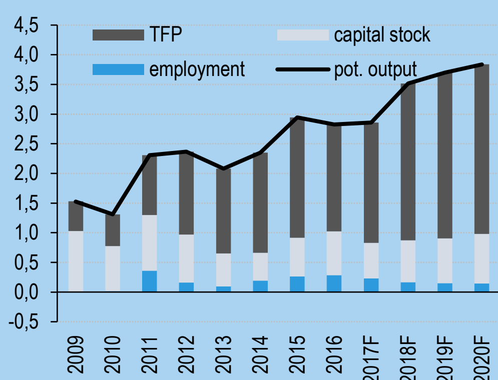


TABLE 8 - Contributions of production factors to potential output growth – MoF SR approach

	Pot. GDP (growth, %)	TFP*	Capital stock	Labour
2012	2.4	**1.4**	**0.8**	**0.2**
2013	2.1	**1.4**	**0.6**	**0.1**
2014	2.3	**1.7**	**0.5**	**0.2**
2015	2.9	**2.0**	**0.7**	**0.3**
2016	2.8	**1.8**	**0.7**	**0.3**
2017F	2.9	**2.0**	**0.6**	**0.2**
2018F	3.5	**2.6**	**0.7**	**0.2**
2019F	3.7	**2.8**	**0.8**	**0.1**
2020F	3.8	**2.9**	**0.8**	**0.1**

** total production factor productivity*

Source: MoF SR

Based on the national methodology, the output gap will close in 2017. At the same time, GDP growth will outpace potential output growth in the years to follow, leading to overheating of the economy in the medium term despite the supply-side shock. This development should ease at the end of the forecast horizon in 2020, as the growth trajectory flattens.

FIGURE 21 - Output gap (% of pot. GDP) - MoF SR approach

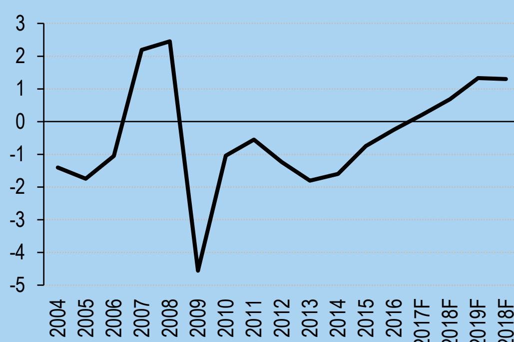


TABLE 9 - Output gap – MoF SR approach

	GDP (real growth, %)	Pot. GDP (growth, %)	Output gap (% of pot. GDP)
2012	1.7	2.4	**-1.2**
2013	1.5	2.1	**-1.8**
2014	2.6	2.3	**-1.6**
2015	3.8	2.9	**-0.7**
2016	3.3	2.8	**-0.2**
2017F	3.3	2.9	**0.2**
2018F	4.0	3.5	**0.7**
2019F	4.4	3.7	**1.3**
2020F	3.8	3.8	**1.3**

Source: MoF SR

While the two methodologies depart from the same base, differences in the methodologies of MoF SR and EC concern almost all components of the calculation. Both methodologies rest on the Cobb-Douglas production function approach, but while the MoF SR uses quarterly data in its estimations, the EC uses annual data. Another important difference stems from the different production factor elasticities/shares. While the EC uses uniform estimates – 0.63 for labour and 0.37 for capital – the MoF has estimated these shares from national accounts. Specifically, labour share is obtained as a share of compensation per employee per GDP at 0.43, and capital at 0.57 (average values for 1995 to 2010). Turning to the differences in the computation of the capital stock, the main discrepancy stems from the original value and the depreciation rate. For all new Member States (excluding the Czech Republic), the EC estimated the capital stock in 1995 as twice the GDP, and uses a common depreciation rate of 5 per cent. The MoF uses a real estimate of the capital stock from 1999 as obtained from the Statistical Office, and the depreciation rate is derived from the annual national accounts. Equilibrium employment estimates are obtained by both institutions from working-age population (using the trend of participation rates), NAIRU and hours worked. The difference comes in with the working-age population series, where MoF SR uses the population aged 15 years and above, while the EC uses population series aged from 15 to 64. Differences also apply at the level of total factor productivity (TFP), and in particular, when obtaining its trend component. While the EC uses additional information on the deployment of production capacities from soft indicators, and by applying a multidimensional filtering method, MoF SR uses a standard Hodrick-Prescott filter. It then, however, deploys and expert judgement and adjusts the estimates so that it reflects the structural changes in the economy that any statistical filter is typically unable to capture. Neither multi-dimensional filtering nor more information from soft indicators would be able to adequately capture a significant demand shock from abroad that small open economies may face or high product variability due to ongoing reforms in the period of transition, notwithstanding a uniform methodology. In fact, the excessive

output gap yielded by the EC methodology for 2007 and 2008 is not corroborated by any other macroeconomic variables such as inflation, external imbalances, or the over-estimation of unit labour costs above productivity growth, with the exception of real estate prices. Moreover, an overvaluation of the output gap in the pre-crisis period unintentionally leads to underestimating the impact of the 2009 demand shock. This may in turn result in overvaluing the positive output gap, which is set to open up thanks to the accelerated growth due to new production capacities in the automotive industry.

1.5 Forecast comparison of the MoF SR and other institutions

Other institutions' forecasts do not significantly depart from the baseline of the MoF SR. Compared to MoF SR current forecast, the OECD November forecast predicts a somewhat faster growth for the Slovak economy this year. The IMF March forecast is fully in line with MoF SR baseline. On the other hand, MoF SR growth and balance of payments forecasts for next year are more optimistic than those of both, the OECD and the IMF, as the MoF SR assumes a significant favourable impact of the new JLR automotive production plant on export performance.

TABLE 10 - Comparison of forecasts for the Slovak economy : MoF SR and other institutions

	2016	2017	2018
		Real GDP growth (%)	
MoF SR	**3.3**	**3.3**	**4.0**
Macro committee (median)	3.3	3.3	3.9
NBS	3.3	3.1	4.2
EC	3.3	2.9	3.6
OECD	3.6	3.4	3.8
IMF	3.4	3.3	3.7
		HICP (%)	
MoF SR	**-0.5**	**1.1**	**1.7**
Macro committee (median)	-0.5	1.1	1.8
NBS	-0.5	1.2	1.9
EC	-0.5	0.9	1.4
OECD	-0.5	0.8	1.4
IMF	-0.2	1.1	2.0
		Current account (% of GDP)	
MoF SR	**0.2**	**1.7**	**2.4**
Macro committee (median)	0.1	0.2	0.9
NBS	1.1	1.1	1.6
EC	1.2	1.2	1.5
OECD	-1.4	-0.7	0.3
IMF	-1.0	-0.6	2.1

Source: MoF SR (February 2017), Macroeconomic Forecasts Committee (February 2017), NBS (March 2017), EC (February 2017), OECD (November 2016), and IMF (March 2017)

2 PUBLIC FINANCE POSITION

According to the spring notification of Eurostat, the general government deficit in 2016 reached 1.68 % of GDP, less than the budgeted plan at a level of 1.93 % of GDP. The consolidation effort in the amount of 0.93 % of GDP significantly exceeded the required amount. The approved budgetary objective for 2017 remains unchanged. The historically first balanced budget is still planned for 2019, however, the forecasted trajectory of structural balance corresponds to the achievement of the medium-term budgetary objective in the form of structural deficit of 0.5 % of GDP already one year in advance, in 2018. From 2017 on, Slovakia will reach primary surplus . The gross debt of general government in 2016 recorded a higher than expected decline to a level of 51.9 % of GDP. At the end of the medium-term horizon, the gross debt will drop to 46 % of GDP, out of the sanction bands of the constitutional Fiscal Responsibility Act.

According to the notified Eurostat data, the general government deficit reached 1.68 % of GDP in 2016, surpassing the budgetary target of. In particular the unexpected positive fiscal performance of local governments contributed to improvement in comparison with the budgetary objective at a level of 1.93 % of GDP. The positive trend of macroeconomic development and better tax collection effectiveness enabled the continuing increase in tax and social and health contribution revenues by 0.9 % of GDP[7]. Nontax revenues also increased more significantly in comparison with the budget. The above increase in revenues was used by the government to finance higher expenditures on investments, wage growth in general government and to cover the negaqtive impact of EU corrections due to irregularities in drawing the European Union (EU) funds.

The approved budgetary objective of 1.29 % of GDP remains unchanged in 2017. The currently estimated general government (GG) deficit is at a level of 1.24 % of GDP. The recent tax forecast brought a positive influence on the revenue side in comparison with the budget, the development of taxes remains summarily in compliance with the budget. The state budget (SB expects higher revenues from state dividends and expenditure savings in relation to state debt service as well as contribution to the EU budget. Together, they will cover the negative impact on corrections concerning the EU Funds and the continuous shortfall of state budget tax revenues. Higher tax revenues from personal income tax and contributions improve the fiscal performance of other GG entities. The negative influence of the non-budgeted entities[8] is compensated by lower expected capital expenditure. The risks of the current fiscal estimate are balanced.

The medium-term budgetary framework of the Slovak Republic for 2018 to 2020 (fiscal framework) sets a deficit objective of 0.5 % of GDP for 2018 . Consequently, balanced budget is planned in the next years.

FIGURE 22 - Planned consolidation effort of the general government (% of GDP)

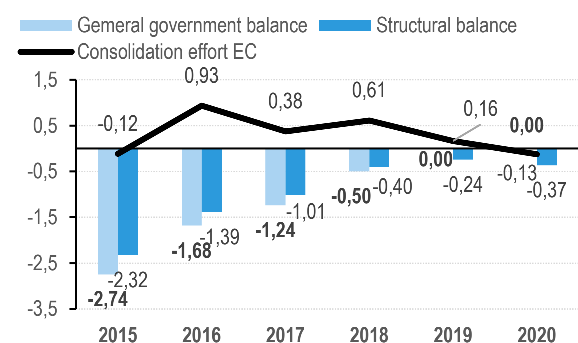
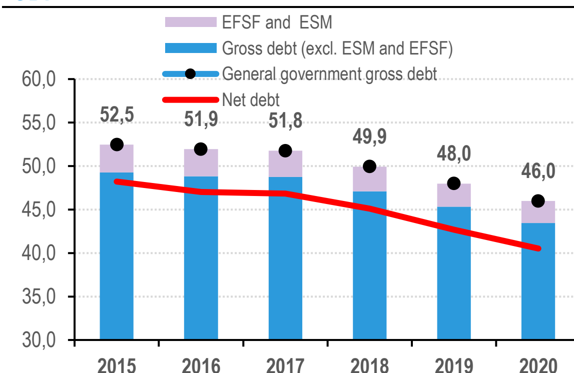


FIGURE 23 - Gross general government debt (% of GDP



Source: MoF SR

The general government's budgetary objectives are in line with the European and national fiscal rules. The consolidation effort last year markedly exceeded the requirements of the Stability and Growth Pact when it

[7] The sum of tax (D.2+D.5+D91, EUR 359 mil.) and contribution revenues from economically active population (part D.61, EUR 387 mil.).
[8] Jadrová a vyraďovacia spoločnosť a. s. (JAVYS).

reached 0.93 % of GDP. A significantly better result of last year's structural balance suppresses the year-on-year consolidation effort in 2017. Yet, there is no deviation in 2017 even froma two-year horizon assesment of consolidation effort.. **Next year, the structural deficit will reach 0.40 % of GDP, fulfilling government's objective to achieve the medium-term budgetary objective (MTO)[9] one year in advance.**

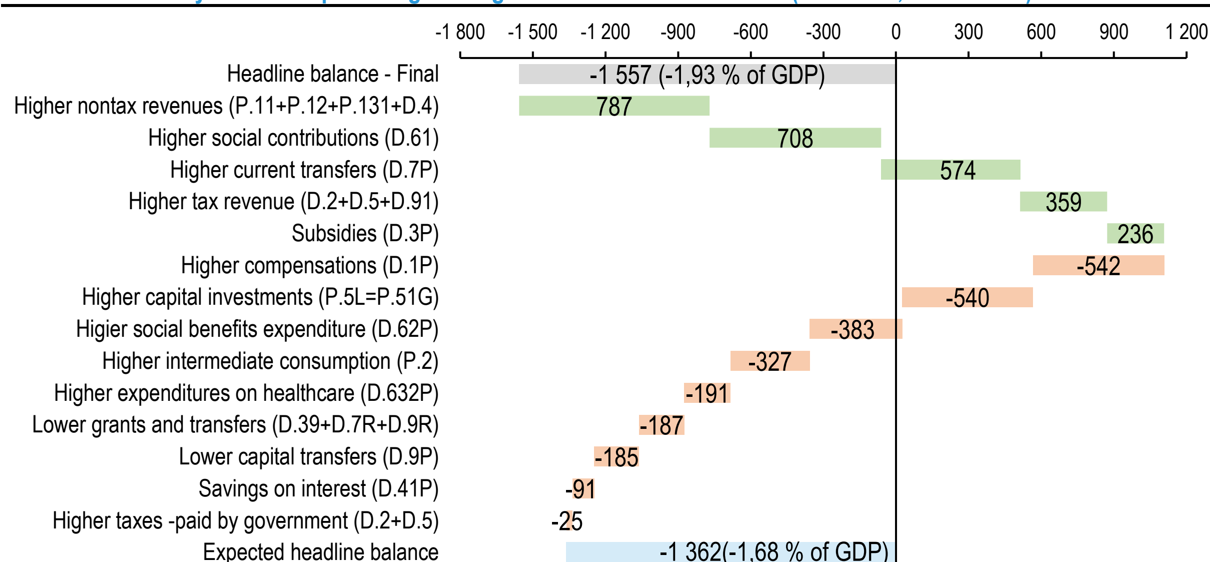
The fiscal policy will affect the economic growth only modestly. In 2018, a positive influence on GDP growth amounting to 0.3 p.p. is estimated from the expected fiscal impulse 0.5 % of GDP in comparison with the no-policy-change scenario. The fiscal space is used for the priorities of government in particular in the area of capital investments and compensations of general government employees. A moderate fiscal restriction amounting to 0.3 % of GDP is necessary to reach the budgetary objective in 2019 and it will temporarily slow down the GDP growth by about 0.2 p. p. The fiscal policy will again positively affect the economy of the Slovak Republic in 2020 and it will speed up the GDP by 0.2 p. p.

The gross debt of general government will further decrease. At the end of 2016, it reached 51.9 % of GDP, with a year-on-year decrease by 0.6 p.p.. Based on the set fiscal objectives and the commitment to achieve the MTO or the close-to-balance budgetary position, its amount at the end of the forecast horizon will be close to 46 % of GDP. Despite a solid growth of GDP, no substantial debt decrease is expected in 2017 due to the need of higher cash for state debt refinancing. Starting from 2018, the rate of decline in the debt to GDP ratio will significantly speed up due to faster economic growth, recovery of price level growth and expected primary surpluses of the general government. In 2020, the gross debt will move out of the sanction bands of the constitutional Fiscal Responsibility Act.

2.1 General government balance in 2016

According to the notified Eurostat data, the general government deficit achieved 1.68% of GDP in 2016. It was improved by 0.25 % of GDP in comparison with the set budgetary objectiveat 1.93 % of GDP.

FIGURE 24 – Analytical description of general government balance in 2016 (ESA 2010, in EUR mil.)[10]



(+) / (-) means positive/negative influence on GG deficit

Source: MoF SR

Total tax revenues (D.2+D.5+D.91) were higher by **EUR 359 mil** in comparison with the budget, which already included a reserve for more efficient tax collection[11].. (0.4 % of GDP). The main factors included higher collection

[9] For Slovakia, MTO represents the value of structural balance amounting to -0.5 % of GDP.

[10] The general government budget for 2016 did not include such entities as MH Invest I a II, Jadrová a vyraďovacia spoločnosť a. s. (JAVYS) and Železničná spoločnosť Slovensko (ŽSSK). Nor the revenues and expenditure of extra-budgetary accounts and management of universities from their business activities were budgeted.

[11] Based on the parliamentary changes, tax revenues were increased in the budget beyond the ambit of the officially approved forecast by the Tax Revenue Forecast Committee by EUR 316 million (0.4 % of GDP). The budget contained a reserve for more efficient VAT collection amounting to EUR 200 million

effectiveness for most taxes as well as a more positive macroeconomic development (BOX 3). Tax development was driven mainly by the strenghtening labour market and rising profitability of companies. Employment reached record-breaking values, when the number of working people exceeded 2.3 million (ESA methodology), a maximum in the history of Slovakia. The year-on-year increase in the number of jobs reached 54 thousand.

Thanks to the increasing collection effectiveness, corporate tax is responsible for the most positive contribution to the improved tax development (EUR 266 million). It was followed by the personal income tax (EUR 140 million) and contribution from gambling games (EUR 44 million). The special contribution in regulated industries, revenues from administrative fees, excise taxes, and real estate taxes also contributed to the positive result for 2016. Tax revenues with the exception of VAT, revenues from emission allowances (EUR -52 million) and environmental taxes on air and surface water pollution (total EUR -4 million) recorded positive development in comparison with the budget. For VAT, the year-on-year development was also considerably positive, but its comparison with the budget is distorted by the reserve incorporated in the budget for more efficient tax collection.

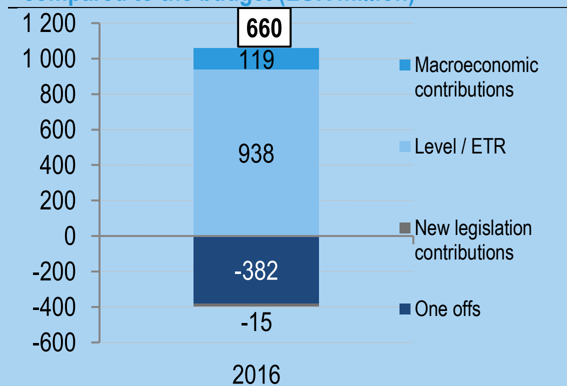
General government revenues from social contributions (D.61) were higher by EUR 708 million (0.9 % of GDP). More than one half of the increase is due to the positive development on the labour market, which resulted in higher collection of social contributions from employed people by additional EUR 387 million. The rest of the difference compared to budget is explained by the factors, without influence on the deficit result. The pension scheme of armed units (EUR 263 million[12]), which is not budgeted, contributed positively to the development of contributions. The contributions paid by the state increased by EUR 22 million, and the higher value of imputed social contributions corresponds to EUR 36 million. In all the three cases these are items, which also represent expenditures of the GG budget and have neutral influence on the GG fiscal performance.

BOX 2 – Evaluation of tax revenues for 2016, which is forecast by the Tax Revenue Forecast Committee

In compliance with its by-laws, the Tax Revenue Forecast Committee evaluates only the accrual tax revenues considered to be taxes, also in compliance with the national economic classification. Moreover, the Tax Revenue Forecast Committee does not forecast the development of the state-paid insurance with a neutral influence on the resulting GG deficit. The above revenues represented an about 4 % share in total GG tax revenues for the years 2011 to 2014. More information in the Tax Report.

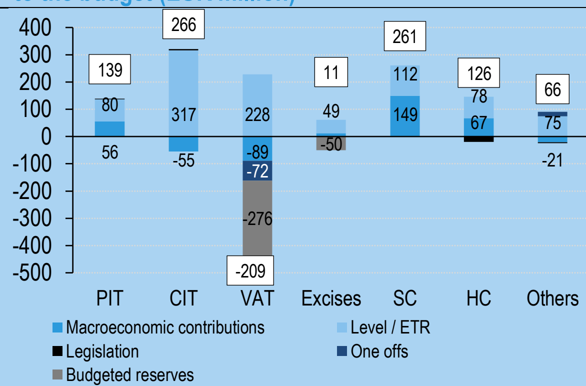
Tax revenues of general government forecast by the Tax Revenue Forecast Committee, were higher by **EUR 660 million** in comparison with the budget. Based on an analysis using the transparent methodology of the Tax Revenue Forecast Committee, the differences in the development of individual taxes can be attributed to individual factors (macroeconomic development, tax collection efficiency, new legislation or one-off factors). Looking at the result for 2016, the **growing collection efficiency is the main factor of positive development for most taxes.**

FIGURE 25 – Change of tax revenues 2016 compared to the budget (EUR million)



Source: MoF SR

FIGURE 26 - Change of tax revenues 2016 compared to the budget (EUR million)



Source: MoF SR

and a reserve for more efficient mineral oil excise tax collection amounting to EUR 50 million. Moreover, the VAT revenue did not include the introduction of a lower food VAT rate amounting to EUR 65.8 million.

[12] Total revenues of pension scheme of armed units amount to EUR 344 million, of which EUR 81 million are stated in item D.7r, which is consolidated.

CIT-corporate income tax; PIT – personal income tax; ET – excise tax; SC – social contributions; HC – health contributions

The considerably positive development of **nontax revenues** in 2016 was caused by **sales** (P.11+P.12+P.131) and **property income** (D.4R), which increased in comparison with the budget by EUR 570 million and EUR 217 million respectively. The sales for the entities that were not budgeted[13] explain the difference amounting to EUR 146 million. Another increase in nontax revenues is connected with the activities of healthcare facilities (EUR 130 million), municipalities (EUR 26 million) and the National Highway Company (EUR 20 million). The difference in the revenues from fees and payments from non-industrial and accidental sale (P.131) appertains to the entities newly included in general government, such as JAVYS (EUR 20 million), and ŽSSK (EUR 94 million). Higher **property income** is explained by the development on the item of interest revenues and dividends. Interest revenues were higher by EUR 178 million in comparison with the budget, which, however, results from the logic of budgeting of the so-called balance account of State Debt[14], and the above difference needs also to be examined in context of interests paid (see the part of interest payments). The revenues from state dividends were higher by EUR 30 million in comparison with expectations, of which EUR 26 million can be attributed to Slovenská elektrizačná a prenosová sústava (SEPS) and the other EUR 10 million were obtained by the state from other companies with its equity capital (Transpetrol, JAVYS, SPP, Západoslovenská energetika and Východoslovenská energetika).

The revenues from **grants and transfers** (D.39+D.7R+D.9R) were lower by EUR 187 million in comparison with the budget, primarily as a consequence of lower draw-down of EU resources in comparison with the budget expectations. Taking into account the fact that it is a consolidation item, where relations between GG entities are balanced, many changes in comparison with the budget (new companies in the sector or reclassification of entities to the sector based on the Eurostat's decision) and several non-budgeted titles are rather complicated to explain the detailed development of this item[15].

The expenditures on **compensations of employees** (D.1P) increased by EUR 542 million in comparison with the budget, of which EUR 156 million are explained by an increase due to the newly included entities the in the general governmentsector (in particular ŽSSK, JAVYS, and the non-budgeted expenditures on wages implemented on an extra-budgetary account). The state budget recorded an increase by EUR 189 million, of which more than EUR 74 million were represented by the resources related to the implementation of EU projects and received grants that were not budgeted. The rest is explained by the resources for the financing of SK PRES, sustainability of projects or coverage of a lack of financial resources for administrative capacities, as well as financial compensations out of wages and remunerations out of employment. Healthcare facilities (EUR 55 million), local government (EUR 51 million), public universities (EUR 48 million), and contributory organisations (EUR 45 million) also contributed to the total increase in compensations of general government sector.

Expenditures on **intermediate consumption** (P.2), increased by EUR 327 million during the year. The higher expenditures can be fully attributed to the newly included entities in the general government sector (EUR 334 million), in particular ŽSSK (EUR 215 million). Negative contributions of municipalities and public universities were compensated in self-governing regions and NDS.

In comparison with the assumption in the budget, the expenditures on **subsidies** (D.3P) decreased by EUR 236 million, which is mostly due to with the reclassification of ŽSSK to the GG sector. Due to this, the originally budgeted subsidy out of the GG sector resulted in a transfer within the GG (EUR 209 million). However, lower

[13] JAVYS, MH Invest I., MH Invest II., ŽSSK, MRÚ, including the revenues from business activities of public universities.

[14] In 2012, in accordance with Act No. 291/2002 Coll. on Treasury and on the amendment to certain acts as amended, for efficient operation of State Debt service, a separate extra-budgetary account was established (the so-called balance account of State Debt). The balance account of State Debt (i.e. the expenditure interests reduced by revenue interests) is budgeted only on the expenditure side, no interests are budgeted on the revenue side. Therefore, the budgeted data on the interests both received and paid are hereby affected and their comparison with the reality is misrepresenting. Thus, it is necessary to analyse their development in parallel on both the revenue and expenditure side, i.e. to compare the balance of the budgeted and real interests.

[15] The same applies to the item of other paid current transfers (D.7p).

subsidies in comparison with the budget went to agriculture (EUR 62 million), on the contrary, the higher subsidies (EUR 100 million)[16] to ensure performance in the public interest went to the bus transport.

Expenditures on social benefits (D.62P) increased by EUR 383 million in comparison with the budget. The main reason is that armed units pension scheme expenditures (EUR 344 million) were not included in the budget, and they were finally implemented on extra-budgetary accounts. There was a considerable increase in comparison with the budget and a year-on-year increase in the expenditures on sickness benefits (EUR 38 million) and unemployment benefits (EUR 21 million)[17]. Similarly, a higher growth in comparison with the budget (EUR 23 million) and a year-on-year increase (77 %) was reached by active measures on the labour market. On the contrary, the above development was compensated by state social benefits for the benefit in material need (EUR -65 million), and monetary benefits for disability compensation (EUR -13 million). The expenditures of **public health insurance** (D.632P) increased by EUR 191 million in comparison with the budget, of which EUR 140 million were covered by higher revenues from public health insurance.

In 2016, the development of **capital investments** (P.5L) exceeded the budgeted value by EUR 540 million. The increase was connected in particular with gross fixed capital formation of MH Invest (EUR 107 million), local governments (EUR 85 million), ŽSSK (EUR 42 million), and healthcare facilities (EUR 34 million). The change of stock of the Emergency Oil Stocks Agency contributed by EUR 13 million. The National Highway Company (NDS) affected the development of this item by acquiring non-financial assets amounting to EUR 184 million.

In comparison with the budget, **capital transfers** (D.9P) decreased by EUR 158 million. This item records, inter alia, the influence of corrections to EU Funds, which in 2016 corresponded to a level of EUR 184 million.

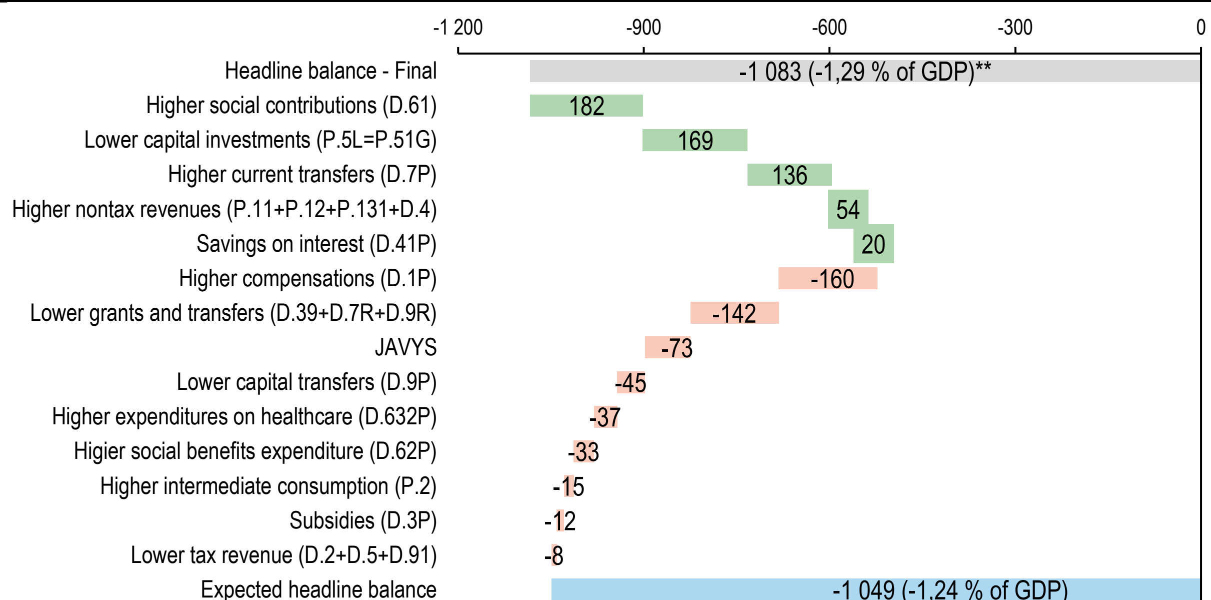
Interest payments (D.41P) were higher by EUR 91 million in comparison with the budget, which is, however, caused by the existence of the extra-budgetary balance account in the comparison base in the budget. By comparing the balances of interests paid and received in the budget and the reality for 2016, we identify a saving in the balance of interest payments of general government in the amount of EUR 88 million. The saving was achieved thanks to the monetary policy of the European Central Bank and domestic macroeconomic fundaments. The accrual costs for state debt financing[18] were lower by EUR 34 million in comparison with the budget, which was caused mainly by an increase in the received interests due to higher than expected bonuses from state bond issues. The rest of the saving is represented by other GG entities, where lower than budgeted interest payments were recorded in particular by municipalities, self-governing regions, NDS, or transport companies.

2.2 Current development in 2017

Based on the current estimate of public finance development in 2017, **the general government deficit should reach a level of 1.24 % of GDP. In comparison with the approved budget of general government for 2017 (1.29 % of GDP[19]), an improvement by 0.05 % of GDP could be achieved**. Projected fiscal outcome is based on the **current macroeconomic and tax forecast from February 2017[20]** as well as on the current estimate of development of the other revenue and expenditure items of the general government budget, which are continuously monitored[21].

[16] To a considerable extent, the difference is explained by the discrepancy in budgeting and presenting road transport expenditures in case of certain municipalities (transfers within general government and transfers or subsidies out of general government).
[17] The year-on-year development in 2016 (in 2017): 14 % (9 %) or 8 % (2.5 %)
[18] The difference between the budgeted and real accrual transfer from the state budget to the balance account of the state debt chapter.
[19] At the time between budget approval and ER, the GDP was updated, which has an influence on the update of balance level expressed in % of GDP (from 1.29 % to 1.28 %).
[20] Forecast of the Macroeconomic Forecasts Committee according to its by-laws in compliance with Article 8 (2) of constitutional Fiscal Responsibility Act No. 493/2011 Coll. and forecast of the Tax Revenue Forecasts Committee according to its by-laws of February 2017.
[21] Public Finance Management and Monitoring Committee ensures the internal process of public finance development monitoring.

FIGURE 27 - Analytical description of general government balance in 2017 (ESA 2010, in EUR million)



(+) / (-) means a positive / negative influence of the GG deficit *Source: MoF SR*

Notes: The fiscal performance of JAVYS was not budgeted, therefore, individual items of revenues and expenditures in the E are for purposes of balance development description in 2017 analytically adjusted for its fiscal performance and the influence of JAVYS is provided as a special contribution to the deficit. The respective ESA 2010 codes are provided in the brackets.

The update of the macroeconomic and tax forecast from February 2017[22] increased an estimate of tax and contribution revenues in comparison with the official November forecast[23] by EUR 176 mil. (0.2 % of GDP). Beyond the ambit of the November forecast, the approved GG budget also included the measure approved by the parliament – cancellation of the maximum assessment bases for health contribution payment[24]. In comparison with the approved GG budget, the update of taxes and contributions increased the tax and contribution revenues of GG by EUR 103 mil.[25] (0.1 % of GDP), of which taxes by EUR 27 mil. and contributions by EUR 76 mil.

Total tax revenues (D.2+D.5+D.91) of general government according to the ESA methodology are continuously lower by **EUR 8 mil.** The development of the corporate tax in 2017 (EUR -113 mil.) was negatively affected in comparison with the budget by the final result of the year 2016, growing volume of one-off tax paid and the slow-down of profitability growth. The expected tax revenues of other general government entities (EUR -32 mil.) and the withholding tax revenue (EUR -10 mil.) are also lower than budgeted. On the contrary, the continuing positive development in the revenue from indirect taxes, in particular mineral oil excise tax (EUR 18 mil.) and VAT (EUR 75 mil.), which attacks the highest values of collection efficiency since 2007, contributes to higher tax revenues. More positive expectations with respect to the favourably developing labour market concern the personal income tax, and an increase in the real state tax rate in several towns of the SR also represents a positive factor.

General government revenues from social contributions (D.61) increased in comparison with the budget by EUR 182 mil. (0.2 % of GDP). One third of the increase (EUR 76 mil.) results from the positive development on the labour market.[26] Of it, EUR 59 mil. represent the expected higher revenues from public health insurance and

[22] 45th session of the Tax Revenue Forecasts Committee.
[23] Forecast of the Macroeconomic Forecasts Committee from September 2016 and of the Tax Revenue Forecasts Committee from November 2016.
[24] Members of the Tax Revenue Forecasts Committee were informed on the change by a letter of the Committee Chairman in compliance with the by-laws of the Tax Revenue Forecasts Committee and the influence of the measure was assessed as a memorandum item within the November Tax Revenue Forecasts Committee. The above measure increased the revenue from health contributions in 2017 to 2019 by EUR 89.8 mil. to EUR 100 mil. At the same time, it caused the update of corporate and personal income tax revenue in a total amount of EUR -17.2 to -19.1 mil.
[25] The official forecast of the Tax Revenue Forecasts Committee in compliance with its by-laws does not evaluate the development of the state-paid insurance, which has a neutral influence on the resulting GG deficit, but it affects both the revenues and expenditure aggregate and does not forecast the part of the revenues, which according to the national economic classification are not considered tax revenues unlike the ESA methodology (e.g. administrative fees, contribution from gambling games, etc.).
[26] A part of the influence amounting to EUR 26 mil. comes from the update of the effect of annual accounting of the contribution allowance based on the data from the General Health Insurance Company (more in the commentary on the update of the tax forecast from February 2017).

EUR 17 mil. higher revenues of the Social Insurance Agency. The revenues of the Social Insurance Agency will increase by additional EUR 8 mil. also due to higher contributions paid by the state, which, however, have a neutral influence on the deficit. The remaining EUR 98 mil. with a neutral influence on the deficit, too, are related to re-accounting of revenues from the pension scheme of armed units pursuant to ESA 2010 principles.

Higher nontax revenues of GG, specifically **sales** (P.11+P.12) and **property income** (P.131+D.4R), total by EUR 54 mil. (0.1 % of GDP) also contribute positively to deficit development in comparison with the approved budget. The expected increase is explained by higher revenues from market production for public universities (PU) by EUR 24 mil.[27] and higher property income by EUR 29 mil. The expected higher dividend from Slovenská elektrizačná a prenosová sústava (SEPS) (EUR 20 mil.) and non-budgeted PU revenues[28] (EUR 8 mil.) cause a difference in comparison with the budget.

Due to lower transfers from the EU by EUR 149 mil., a decrease in revenues from **grants and transfers** (D.39+D.7R+D.9R) by EUR 142 mil. (0.2 % of GDP) was also recorded. The difference is explained by higher revenues from the state budget in this item.

The originally non-budgeted fiscal performance of **Jadrová a vyraďovacia spoločnosť** (JAVYS) contributes, according to the ER, to the deficit with a sum of EUR 73 mil. (0.1 % of GDP). The total expenditures at a level of EUR 105 mil. are expected in connection with the purchase of goods and services, expenditures on employees and investment activity of the company. The expected expenditures will be partially financed by own sales (EUR 21 mil.) and the received foreign grant (EUR 11 mil.). The rest should be covered by the transfer within general government from the National Nuclear Fund (NNF). JAVYS, after taking into account the transfer, reaches deficit fiscal performance in the amount of EUR 4 mil.

Expenditures on employee compensation in general government (D.1P) grow in comparison with the budget by EUR 160 mil. (0.22 % of GDP). The increase is considerably distorted as a consequence of budgeting the reserves for wage growth in items other then the economically appertaining item of compensations (BOX 4). The indexation of wages and salaries of general government employees based on the collective bargaining corresponds to an amount of EUR 148 mil. After the analytical adjustment, only the compensations of employyes of public universities (EUR 12 mil.) really grow.

BOX 3 – Analytical adjustment related to the reserve for indexation of salaries in GG

A reserve for indexation of wages and salaries of general government employees was created in the budget for 2017; it was allocated to intermediate consumption item (EUR 50 mil.) and other current transfers (EUR 98 mil.). The latest estimate (E) of public finance development already expects the use of the above reserves at the appertaining economic item of employee compensation (EUR 148 mil.), which, in simple comparison of expenditure items in the budget and E distorts the economic essence of the executed transactions in public finance. By analytical adjustment of reserves (by reclassifying them to the respective economic items) we will find out that the compensations according to the E increase only by EUR 12 mil. The intermediate consumption expenditures increase by EUR 65 mil. (in comparison with EUR 15 mil.), the savings at the other current transfers corresponds really to an amount of EUR 38 mil. (and not EUR 136 mil.).

TABLE 11 – Analytical view of reserves in the general government budget in 2017 in EUR mil.

	ESA code	Budget(1)	Adjusted budget (2)	E* (3)	(3)-(1) (see Figure 27)	Real change (3)-(2)
Total expenditures (D.1P, P.2, D.7P)		**13 977**	**13 977**	**14 017**	**39**	**39**
Compensations	**D.1P**	**7,343**	**74,91**	**7,502**	**160**	**12**
Wages and salaries		5,336	5,446	5,455	118	9
Social benefits of employers		2,006	2,045	2,048	41	3
Intermediate consumption	**P.2**	**4,717**	**4,667**	**4,733**	**15**	**65**
of which the reserve for compensations		*50*				

[27] In accordance with the Act on universities the mentioned type of revenues from business activities (catering, fee for accommodation at dormitories, administrative fees, etc.) is not budgeted.

Other current transfers	**D.7P**	**1,918**	**1,820**	**1,782**	**-136**	**-38**
of which the reserve for compensations		*98*				
Total reserves		**148**				

** E net of JAVYS influence* *Source: MoF SR*

Intermediate consumption expenditures (P.2) increase in comparison with the budget by EUR 15 mil. After taking into account the analytical adjustment related to the wage indexation reserves, the real increase of intermediate consumption expenditures represents EUR 65 mil. The increased expenditures are related to the procurement of goods and services by public universities, municipalities, and public health insurance.

Higher subsidies (D.3P) to bus transport by EUR 12 mil have also negative impact on the deficit in the ER. On the contrary, **lower expenditures connected with state debt service** (D.41P) contribute to deficit reduction by EUR 20 mil.

Total social transfers (D.6) increase in comparison with the budget by EUR 70 mil., of which **social benefits expenditures** (D.62P) by EUR 33 mil. and **public health insurance expenditures** (D.632P) by EUR 37 mil. For social benefits, the last estimate reflects higher expenditures of the Social Insurance Agency on sickness benefits and unemployment benefits.

In comparison with the budget, **other current transfers** (D.7P) **drop** by EUR 136 mil. (0.14 % of GDP) but the real effect of the saving on the GG balance, after taking into account the reserves for salary indexation, corresponds to only EUR 38 mil., of which EUR 16 mil. corresponds to the saving of contribution to the EU budget.

The decrease in capital investments (P.5L) by EUR 169 mil. (0.2 % of GDP) contributes to the reduction of GG deficit. The whole drop is explained by the lower expected investments of the National Highway Company (NDS) by EUR 174 mil., due to slower draw-down of EU funds. The rest amounting to EUR 4 mil. is explained by an increase in the investments of the Health Care Surveillance Authority.

In particular due to incorporation of EU funds corrections (EUR 32 mil.), an increase in **capital transfers** was recorded (by EUR 45 mil.).

The risks of the current estimate of the GG fiscal performance are balanced. The negative risks include possible expenditures connected with the provision of sufficient liquidity of the General Health Insurance Company and fulfilment of its recovery plan. The risks also include potentially higher capital expenditures. On the contrary, preliminary information on further improvement of tax collection efficiency beyond the ambit of the last official forecast of the Tax Revenue Forecasts Committee represent a positive risk.

2.3 Medium-term budgetary outlook for 2018 to 2020

Compared to the assumptions from the GG budget for 2017 to 2019, the MoF SR revised headline budgetary targets, yet, balanced budget in 2019 is still planned. The deficit objective for the current year remains unchanged. For 2018 and 2019, there is a slight decrease in fiscal targets cumulatively by 0.22 % of GDP. In 2018, GG deficit is expected at a level of 0.5 % of GDP. The commitment to achieve and maintain the balanced general government budget balance is kept for 2019 and 2020. **In the context of legislative requirements of the European semester[28], the set fiscal framework of the Stability Programme is considered to be national medium-term budgetary framework** (hereinafter the "fiscal framework").

TABLE 12 – Change of fiscal objectives (headline deficits) of general government (% of GDP)

	2015	2016	2017	2018	2019	2020
1. GG budget for 2015 to 2017	-2.49	-1.43	-0.39	-	-	-

[28] The requirement to publish the national medium-term budgetary framework results from Two-pack (473/2013, Article 4).

2. GG budget for 2016 to 2018	-2.49	-1.93	-0.42	0.00	-	-
3. GG budget for 2017 to 2019	-2.97	-1.93	-1.29	-0.44	0.16	-
4. Fiscal framework of GG in the Stability Programme for 2018-2020	**-2.74**	**-1.68**	**-1.29**	**-0.50**	**0.00**	**0.00**
Change compared to the GG budget 2015 to 2017 (4-1)	-0.25	-0.25	-0.90	-	-	-
Change compared to the GG budget 2016 to 2018 (4-2)	-0.25	0.25	-0.87	-0.50	-	-
Change compared to the GG budget 2017 to 2019 (4-3)	**0.23**	**0.25**	**0.00**	**-0.06**	**-0.16**	**-**

Source: MoF SR

The review of fiscal objectives in 2018 and 2019 and setting a new budgetary objective for 2020 is in compliance with the fiscal rules of the Stability and Growth Pact. Such specified deficit values correspond to the required pace of the year-on-year structural consolidation according to the preventive part of the Stability and Growth Pact. At the same time, they will lead to the achievement of **structurally balanced budget (MTO)[29] already in 2018**.

2.4 No-policy-change scenario

The no-policy-change scenario (NPC, BOX 5) defined as the development of public finance under the precondition of unchanged legislation and updated estimate of macroeconomic development, quantifies and allows assessing the measures necessary for fulfilling the budgetary objectives. The size of needed measures (or fiscal space) for the achievement of the budgetary objectives can be quantified by comparing the general government balance in the NPC scenario compared to the budgetary objective. In the next step, the effect of governmental measures (consolidation or stimulus) on the economy can be estimated by taking into account the difference of the budgeted revenues and expenditures compared to the structure in the NPC scenario (more in Chapter 2.4.1).

TABLE 13 – Total need of measures for achieving the fiscal objectives compared to NPC (ESA 2010, % of GDP)

	2018	2019	2020
1. General government balance – Fiscal framework (Stability Programme)	-0.50	0.00	0.00
2. General government balance – NPC Scenario	0.00	0.17	0.61
3. Size of measures (1-2)	-0.50	-0.17	-0.61
- year-on-year change	**-0.50**	**0.30**	**-0.45**

Source: MoF SR

The starting point for the preparation of a no-policy-change scenario is the current estimate of the general government deficit in 2017 amounting to 1.24 % of GDP. Provided that there are no changes in economic policies, in 2018 the general government would reach balanced fiscal performance (compared to a deficit of 0.5 % of GDP from the fiscal framework). In 2019 and 2020, the NPC scenario expects the achievement of nominal general government surplus amounting to 0.2 % or 0.6 % of GDP (in comparison with the balanced fiscal performance contained in the fiscal framework).

The difference in the general government balance between the fiscal framework and NPC scenario for 2018 represents -0.5 % of GDP. The identified fiscal stimulus compared to NPC is based in particular on governmental priorities in the area of capital investments and higher compensations. A similar situation occurs in 2019 and 2020, when the NPC scenario again expects a lower increase in compensations, and, with the exception for 2019, also a slower pace of growth of governmental investment expenditures. The headline targets from the fiscal framework compared to NPC contain measures of expansive character at a cumulative volume of about EUR 1.2 bn.

TABLE 14 - List of measures in the fiscal framework, 2018 to 2020 (ESA 2010, compared to NPC, impact on the balance)

	Subsector	ESA 2010	2018	2019	2020

[29] Structural deficit amounting to 0.5 % of GDP.

			mil. EUR	% of GDP	mil. EUR	% of GDP	mil. EUR	% of GDP
Total revenues			**-24**	**-0.03**	**-36**	**-0.04**	**-138**	**-0,14**
Tax revenues	S13	D.2r+D.5r+D.61r	32	0.04	38	0.04	38	0,04
Non-tax revenues	S13	P.11+P.12+P.131+D.4r	-72	-0.08	-123	-0.13	-184	-0,18
Grants and transfers	S13	D.7r	17	0.02	50	0.05	9	0,01
Total expenditures			**-426**	**-0.48**	**-128**	**-0.14**	**-481**	**-0,48**
Compensations	**S.13**	D.1	-101	-0.11	-141	-0.15	-53	-0.05
Intermediate consumption, of which	**S.13**	**P.2**	34	0.04	58	0.06	-48	-0.05
State budget (SB)			-32	-0.04	-16	-0.02	-113	-0.11
Municipalities	S1313		42	0.05	50	0.05	14	0.01
Public universities	S1311		28	0.03	33	0.03	38	0.04
Subsidies	S.13	D.3p	-7	-0.01	-4	0.00	-1	0.00
Social transfers, of which	S.13	D.62p	-57	-0.06	-45	-0.05	-46	-0.05
Recalculation of pensions	S.1311	D.62p	-50	-0.06	-47	-0.05	-45	-0.05
Other current transfers	S.13		-42	-0.05	-39	-0.04	-64	-0.06
Capital expenditures, of which	S.13		-253	-0.28	43	0.05	-269	-0.27
Transport companies of self-government	S.1313	P.51g			64	0.07	70	0.07
Investment reserves	S.1311	P.51g/D.9p	-192		-79	-0.08	-79	-0.08
Investment SB expenditures without reserves	S.1311	P.51g					-385	-0.38
Total (volume of stimulus compared to NPC)		**-**	**-450**	**-0.50**	**-164**	**-0.17**	**-619**	**-0.61**

Note (+) increase in revenues and decrease in expenditures

Source: MoF SR

BOX 4 – No-policy-change scenario preparation methodology (NPC)

The no-policy-change scenario also includes the measures, the decision on which was made before the beginning of the base year[30] (year t). It is prepared as at the date of **NPC preparation for a period covering the three-year budget of general government (t+1 to t+3)**. The NPC scenario covers all the entities of the general government in compliance with the definition according to ESA 2010, which are included in the draft GG budget.

The procedure of no-policy-change scenario preparation is as follows:

- the first step is the adjustment of the balance of revenues and expenditures in the base year (t) for one-off effects and for the items that will not repeat after the base year (i.e. in the budget horizon t+1 to t+3),
- in the next step, the balance items are identified from the base year, for which the development in the forecast period is known in advance (based on the valid legislation and measures adopted before the base year),
- the remaining balance items of the base year are forecast according to the assumptions provided in the NPC scenario

Assumptions in preparing the NPC scenario for main ESA 2010 items at a three-year horizon of the budget:

- the forecast of **tax revenues** is affected only by the macroeconomic development and existing legislation,
- **nontax revenues** are assumed in the forecast at the level of the budget or they are indexed by the nominal GDP growth,
- **compensations (wages and contributions)** are indexed by the pace of growth of the average wage in the private sector,
- **intermediate consumption (goods and services expenditures)** are indexed by the pace of growth of price level measured according to CPI,

[30] For example, when a n NPC scenario is prepared for 2018 to 2020, the base year is 2017. Such scenario should contain all the measures, the decision on which was made before the year 2017 regardless of the effective date of the measure. On the contrary, the measures, the decision on which was made during the year 2017, need to be eliminated from the base.

- **current transfer expenditures** are assumed by their type at the level of the budget, they are determined on the basis of valid legislation or indexed according to CPI and by the growth of average wage in the private sector,
- **capital expenditures (gross fixed capital formation, purchase of lands)** – the forecast pace of GDP growth adjusted for the elasticity of tax and contribution revenues to GDP will be used.

Macroeconomic assumptions necessary for the preparation of the NPC scenario are used from the current official forecast of the Macroeconomic Forecasts Committee. For purposes of NPC preparation in the Stability Programme, the expected fiscal outcome of the year 2017 is considered to be the base year, and the NPC is prepared for a horizon of years 2018 to 2020. More in the IFP Manual.

Development on the revenue side

A modest fiscal expansion is planned on the revenue side of the budget at the monitored horizon. In 2018, the revenues according to the fiscal framework are lower by EUR 24 mil. (0.03 % of GDP). The main reason is the slower growth of a part of nontax revenues (sales of healthcare facilities) in the budget, which uses a more conservative assumption of their growth in comparison with the NPC scenario. On the contrary, higher tax revenues of other entities of general government and higher grants and transfers (a decrease in the grant to transport companies in the NPC scenario) partially offset the difference from nontax revenues.

The same development compared to the NPC scenario is also expected in 2019 and in 2020, when the revenues from the fiscal framework are lower by EUR 36 mil. (0.04 % of GDP) and EUR 138 mil. (0.14 % of GDP) respectively.

BOX 5 – Tax changes that are not considered to be measures according to the manual for NPC preparation

Beyond the ambit of tax measures described in the Draft Budget Plan for 2017, additional legislative measures were adopted at the end of 2016 and subsequently incorporated in the GG Budget for 2017 to 2019. With respect to the methodology of NPC preparation, when these measures were adopted before the base year, from which the NPC scenario is prepared, the mentioned measures are not considered measures in the NPC logic. They include:

1) With effect from 1 January 2017, the original maximum assessment base (MAB) for health contributions amounting to 5-times the average wage was cancelled, and health contributions are now paid from the entire income, regardless of its amount.
2) For social contributions, the maximum assessment base was increased starting from 1 January 2017 from the amount of 5-times the average wage for the period (t-2) to 7-times the average wage for the period (t-2).
3) With effect from 1 January 2018, tax licence will be cancelled (i.e. the minimum corporate tax)

TABLE 15 – Legislative changes that are not considered to be measures for NPC purposes (% of GDP)

	2017	2018	2019
1) Abolition of ceilings for health contributions	0.09	0.09	0.09
2) Increase of ceilings for social contributions to 7 times average wage	0.07	0.07	0.06
3) Abolition of tax license as of 1.1.2018	0.00	-0.09	-0.08
Total	**0.15**	**0.06**	**0.07**

Source: MoF SR

Development on the expenditure side

The expenditures as per the fiscal framework are, significantly higher in comparison with the NPC scenario (except for the year 2019). The total expenditures for 2018 will grow faster by EUR 426 mil. (0.5 % of GDP) compared to NPC. Subsequently, in 2019, the difference will drop to EUR 128 mil. (0.1 % of GDP)

compared to NPC. In 2020, higher expenditures are expected by EUR 481 mil. compared to NPC (0.5 % of GDP).

Compensations are higher in comparison with the NPC scenario at the entire three-year horizon. The fiscal framework includes the influence of growth of salaries of pedagogic and professional employees in education in line with the Manifesto of the Government. At the same time, the fiscal framework contains the indexation of salaries of other general government employees in line with the memorandum on salary adjustment for civil servants for 2017 and 2018.

The expenditures on **intermediate consumption** in 2018 and 2019 grow slower than in the NPC scenario. The slower growth of intermediate consumption expenditures is expected in particular for municipalities and public universities.

For social benefits, NPC is based on the ER. The fiscal framework takes into account, additionally to NPC, the re-calculation of pensions to the pensioners, who retired before 2004. The difference amounts to 0.05 % of GDP.

Capital expenditures are affected mainly by reserves for significant investments and by increasing the defence expenditures. A higher growth of capital expenditures in 2018 compared to NPC is caused by reserves for significant investments, whereas in 2019, the capital expenditures are below the level of NPC. In 2020, the fiscal framework expects an increase in the defence expenditures to a level of 1.6 % of GDP. In 2019 and 2020, lower investments executed by transport companies are expected compared to NPC.

BOX 6 – One-off and temporary expenditures in 2017

In 2017, the total volume of one-off measures amounted to EUR 678 mil. (0.8 % of GDP). The biggest volume was created by investment measures (0.5 % of GDP).

TABLE 16 – List of one-off measures in 2017 for NPC needs (ESA 2010, mil. EUR and in % of GDP)

	ESA 2010	2017	2017 (in % of GDP)
Capital investments, of which:	P.5L	416	0.49
Investment priorities (reserves)	P.51g	215	0.25
MH Invest, in it:	P.51g+NP	132	0.16
MH Invest (purchase of lands)	NP	82,5	0.10
Infrastructure projects (MDV SR - SSC)	P.51g	53	0.06
Reconstruction of buildings (MPRV SR)	P.51g	16	0.02
Sport arenas	D.9p	43	0.05
EU funds corrections	D.9p	32	0.04
Sallary one-off effects	D.1	14,5	0.02
Intermediary consumption (reserve)	P.2	140	0.17
Current transfers	D.7p	19,5	0.02
One-off subsidy - SVP	D.3p	13	0.02
Total		**678**	**0.80**

Note: Ministry of Agriculture and Rural Development of the SR (MPRV SR), Ministry of Transport and Construction of the SR (MDV SR), Slovenská správa ciest (Slovak Road Administration - SSC), Slovenský vodohospodársky podnik – SVP, š. p. (Management of water courses and river basins)

Source: MoF SR

TABLE 16 - No-policy-change scenario and general government balance (ESA2010, % of GDP)

	E	NPC scenario			Fiscal framework (FR)			FR - NPC		
	2017	2018	2019	2020	2018	2019	2020	2018	2019	2020
1. Total revenues	**39.7**	**38.7**	**38.6**	**38.1**	**38.7**	**38.6**	**38.0**	**0.0**	**0.0**	**-0.1**
Tax revenues	18.4	18.2	18.0	17.8	18.3	18.0	17.8	0.0	0.0	0.0
Social security contributions	14.4	14.3	14.1	14.1	14.3	14.1	14.1	0.0	0.0	0.0

Nontax revenues	4.7	4.5	4.4	4.2	4.5	4.2	4.0	-0.1	-0.1	-0.2
Grants and transfers	2.1	1.7	2.1	2.0	1.7	2.2	2.0	0.0	0.1	0.0
2. Total expenditures	**40.9**	**38.7**	**38.4**	**37.5**	**39.2**	**38.6**	**38.0**	**0.5**	**0.1**	**0.5**
Current expenditures	37.2	36.0	35.6	34.6	36.2	35.7	34.9	0.2	0.2	0.2
Compensation of employees	8.9	8.9	8.9	8.8	9.0	9.0	8.8	0.1	0.1	0.1
Intermediate consumption	5.7	5.3	5.1	4.9	5.3	5.1	5.0	0.0	-0.1	0.0
Subsidies	0.6	0.5	0.5	0.4	0.5	0.5	0.4	0.0	0.0	0.0
Interest payments	1.3	1.3	1.2	1.1	1.3	1.2	1.1	0.0	0.0	0.0
Total social payments	18.6	18.1	17.6	17.2	18.1	17.7	17.3	0.1	0.0	0.0
- Social benefits other than social transfers in kind	13.5	13.1	12.6	12.2	13.1	12.7	12.3	0.1	0.0	0.0
- Social transfers in kind	5.0	5.0	5.0	5.0	5.0	5.0	5.0	0.0	0.0	0.0
Other current transfers	2.1	2.0	2.2	2.2	2.0	2.3	2.2	0.0	0.0	0.1
Capital expenditures	3.7	2.7	2.9	2.8	3.0	2.8	3.1	0.3	0.0	0.3
Capital investments	3.3	2.5	2.6	2.6	2.7	2.6	2.8	0.2	-0.1	0.3
- Gross fixed capital formation	3.3	2.5	2.6	2.6	2.7	2.6	2.8	0.2	-0.1	0.3
Capital transfers	0.4	0.2	0.3	0.3	0.3	0.3	0.3	0.1	0.0	0.0
3. Net lending/borrowing	**-1.2**	**0.0**	**0.2**	**0.6**	**-0.5**	**0.0**	**0.0**	**-0.5**	**-0.2**	**-0.6**

Note: minimum differences can result from rounding *Source: MoF SR*

2.4.1 The impact of fiscal policy on the economy in 2018 to 2020

The no-policy-change (NPC) scenario represents a starting point of the quantification[31] of the size of fiscal measures affecting the economy. The impact of fiscal policy on the economy in 2018 to 2020 is based on the measures necessary to achieve the budgetary objectives contained in the fiscal framework of the Stability Programme compared to NPC.

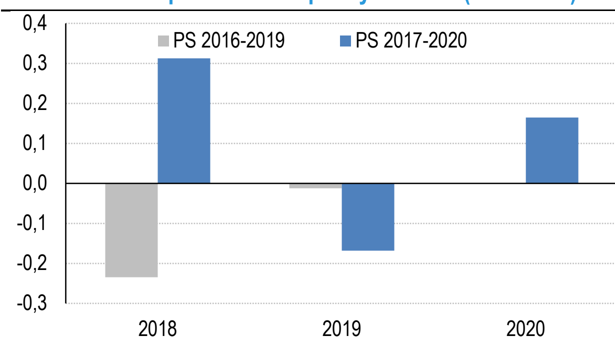
In 2018, a fiscal space amounting to 0.5% of GDP is created in comparison with the NPC scenario (Table 17), **and the fiscal impulse is concentrated in particular in investments, compensations, and social transfers**. In 2019, a year-on-year fiscal restriction at a level of 0.3 % of GDP, which will be seen in particular in general government investments, is necessary for the fulfilment of balanced budget. After the balanced budget has been achieved, in 2020 there is again fiscal expansion amounting to 0.45 % of GDP based in particular on investments and intermediate consumption of general government.

At the entire medium-term horizon, measures are almost exclusively on the expenditure side of public finance. At the entire horizon, a modest expansion occurs on the revenue side of the budget. The measures without a direct influence on the GDP were omitted from the calculations of fiscal policy impact on the economy.[32] **In 2018, a positive impact on the GDP growth is estimated at a level of 0.3 p. p. The fiscal restriction needed for the achievement of the fiscal objective in 2019 will reduce the GDP growth by 0.2 p.p. The fiscal policy will have a contractionary impact on the economy in 2020, when it will support the growth of GDP by 0.2 p. p.**

The implied fiscal multiplier in 2018 is estimated at a value of 0.6. The multiplier's value corresponds to the structure of the stimulus, which is concentrated in particular on the expenditure side of the budget - in investments, compensations, and social transfers. The decrease in general government intermediate consumption represents a contradictory action. **The estimated fiscal multiplier in 2019 is at a level of 0.6**, and it determines in particular the development of investments. **In 2020, the implied fiscal multiplier reaches a level of 0.4.** The strong growth of investments and intermediate consumption of general government is offset by a decrease in compensations and an increased import intensity of government investments.

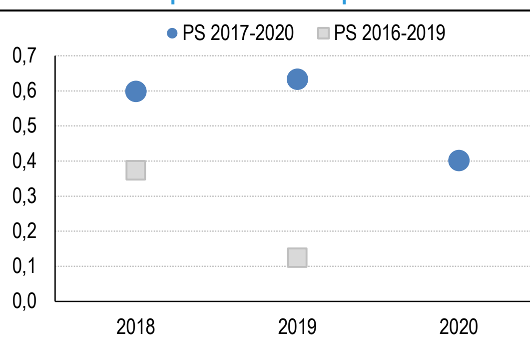
[31] Find more information on the impacts of fiscal policy in 2018 to 2020 in Annex 2.
[32] On the revenue side, it means the category of grants and transfers, which are in comparison with NPC higher by EUR 17 mil. in 2018, and by EUR 50 million and EUR 9 million in 2019 and 2020 respectively.

FIGURE 28 - Impact of fiscal policy on GDP (% of GDP)



** Stability Programme (PS) of the Slovak Republic for 2016 to 2019 Source: MoF SR*

FIGURE 29 - Implied fiscal multipliers



Source: MoF SR

2.5 Structural balance

Since 2014, the fiscal policy of the SR has been governed by the rules of the preventive part of the Stability and Growth Pact, whose objective is the achievement of the medium-term objective (MTO). For that reason, gradual year-on-year reducing of the structural balance is required; the pace is determined on the basis of the rules of the Stability and Growth Pact (the so-called required consolidation effort). The structural balance of general government expresses the result of general government fiscal performance net of cyclical and one-off effects (Annex 3).

The structural balance is a key pillar in evaluating the compliance with the European (and national) fiscal rules. Structural balance development is monitored on a regular basis, and the EC evaluates its deviation from the required consolidation effort at a one-year and two-year horizon. In evaluating the compliance, in particular the rate of deviation at a two-year horizon is considered decisive. For the purposeos of international comparability and preservation of horizontal consistency among Member States, the analytical indicators in the Stability Programme are calculated on the basis of the EC methodology.

Based on the data notified by Eurostat, the structural deficit of the SR achieved 1.39 % of GDP in 2016. Thus, the year-on-year consolidation (0.9 % of GDP) exceeded the consolidation effort required by rules (0.25 % of GDP). In comparison with the estimate from the previous Stability Programme, besides the improvement of the nominal balance, there was also a slight revision of the influence of the economic cycle towards faster closing of the output gap.

The estimated structural deficit for 2017 based on the latest estimate reaches 1.01 % of GDP, which corresponds to a year-on-year consolidation effort of 0.38 % of GDP. In comparison with the required consolidation effort (0.50 % of GDP), an insignificant deviation is reached at a one-year horizon. Thanks to higher than required consolidation effort last year, at a two-year horizon no deviation is identified.

Based on the current assumptions of the fiscal framework, the structural deficit will reach 0.40 % of GDP next year. **This will fulfil the objective of the government to achieve the medium-term budgetary objective (MTO)[33] one year in advance.** In 2019 and 2020, structural deficit amounting to 0.24 and 0.37 % of GDP respectively is expected.

TABLE 17 - Consolidation effort (ESA2010, % of GDP)

	2015	2016	2017	2018	2019	2020
1. General government balance	**-2.74**	**-1.68**	**-1.24**	**-0.50**	**0.00**	**0.00**
2. Cyclical component	-0.4	-0.3	-0.2	-0.1	0.2	0.4
3. One-off effects	0.0	0.0	0.0	0.0	0.0	0.0
4. Structural balance (1-2-3)	**-2.32**	**-1.39**	**-1.01**	**-0.40**	**-0.24**	**-0.37**

[33] For Slovakia, MTO represents the value of structural balance amounting to -0.5 % of GDP.

5. Consolidation effort according to the EC	-0.12	0.93	0.38	0.61	0.16	-0.13
Deviation (1y.)	-0.12	0.68	-0.12	MTO	MTO	MTO
Deviation (2y.)	-0.12	0.28	0.28	MTO	MTO	MTO
p.m. required consolidation according to the EC	*0*	*0.25*	*0.5*	*0.5*	*0*	*0*

Source: MoF SR

In 2016, the primary structural balance reached a historical surplus of 0.3 % of GDP, which will be repeated this year, too. From 2018, the structural primary surplus will be even higher, and its change will reflect the closing of the output gap. Thus, fiscal policy in 2018 and 2019 will have countercyclical impact on economy. At the end of the medium-term horizon, fiscal position will be slightly loosened (more in BOX 8).

BOX 7 – Fiscal position

The objective of fiscal policy is to determine budgetary objectives so that the effort to recover public finance in bad times does not create excessive consolidation pressure to the prejudice of pro-growth policies. On the other hand, in good times, it is important to utilise the positive macroeconomic development for adequate consolidation. Along with other macroeconomic policies, fiscal policy should stabilise economy and fulfil the important function of supporting the sustainable economic growth in the long term. The monitoring of the fiscal position quantifies the dependency between the change of the structural primary balance and the development of the cyclical indicator of the output gap. One of the possibilities how to practically prove the importance of this relation is to record these two indicators in four quadrants. This view allows to outline, at a longer time horizon, whether the country applies procyclical or countercyclical fiscal policy.

The basic method is to compare the change of the primary structural balance to the current level of the output gap. This approach shows how fiscal policy reacts to the economic cycle (a higher consolidation in good times or provision of a fiscal impulse during economic recession).

The other approach uses the pace of the year-on-year change of the output gap instead of monitoring the development of the output gap. The main difference is a lower sensitivity of this approach to output gap revisions, which are initiated more frequently than in the case of its change, and it also suggests the trend of economic cycle development in greater detail. A similar approach is used within the determination of required consolidation effort within the Stability and Growth Pact (SGP).

Fiscal policy in 2016 had countercyclical effect on economy while fulfilling SGP requirements (Figure 31). After the fiscal expansion in 2015, in particular thanks to accelerated draw-down of EU funds from the second programme period, the year 2016 was connected with the consolidation of public finance towards the achievement of MTO. In 2017, with the approximately unchanged output gap and achieving of primary surplus, optimisation of the rate of consolidation effort is expected. The current estimate for 2018 suggest quicker closing of the output gap in achieving structurally balanced fiscal performance. After the MTO has been reached in 2018, fiscal policy will have a stabilisation effect on economy in 2019, too, whereas at the end of the medium-term horizon fiscal position will be slightly loosened.

FIGURE 30 – Change of primary structural balance compared to output gap level (% of GDP)

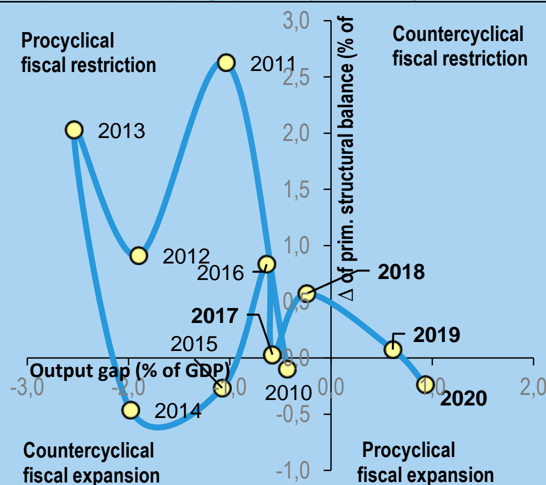
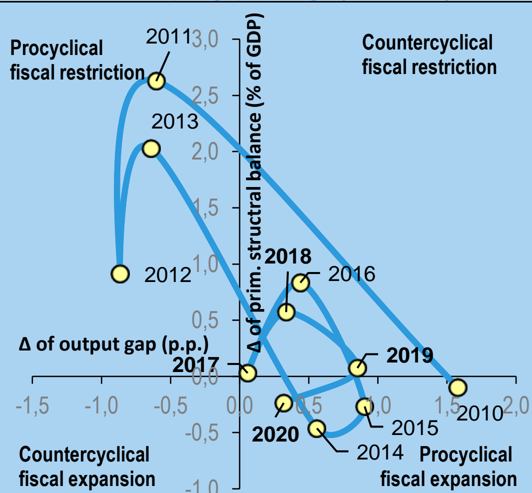


FIGURE 31 - Change of primary structural balance compared to output gap change (% of GDP)



Source: MoF SR

Source: MoF SR

Based on the result of deficit for 2016, Slovakia will achieve a surplus of the primary structural balance, which will also be achieved in the following years provided that the set objectives are observed.

TABLE 18 – Primary structural balance in the EC methodology (% of GDP)

	2015	2016	2017	2018	2019	2020
Primary structural balance	-0.5	0.3	0.3	0.9	0.9	0.7
Output gap	-1.1	-0.6	-0.6	-0.2	0.6	0.9

Source: MoF SR

Expenditure benchmark

Another pillar of the preventive part of the Stability and Growth Pact is the monitoring of expenditure benchmark, according to which the growth of expenditures net of expenditure items out of government's control, discretionary revenue[34] and one-off measures[35] can correspond to a long-term development of economy potential.[36] If the country has not achieved its medium-term budgetary objective yet, which is also the case of Slovakia till 2018, the allowed expenditure growth must also take into account the necessary adjustment towards this objective. In such case, the expenditure benchmark is adjusted for so-called convergence rate, which is based on the required consolidation effort (more in Annex 4). The advantage of the expenditure benchmark compared to the structural balance is the use of a longer series and of potential growth estimates (resulting in a more stable estimate), which is not subject to significant revisions like for output gap estimates.

In 2016, there was a year-on-year drop of total expenditures by 6.0 % that was caused in particular by correction of the development from 2015. The primary expenditure aggregate net of discretionary revenue and one-off measures (hereinafter the "expenditure aggregate") increased at constant prices in comparison with 2015 by 0.7 %, while the expenditure benchmark allowed an increase by 2.2 %. In case of deviation evaluation at a one-year horizon Slovakia reaches a positive deviation for 2016 amounting to 0.57 % of GDP.[37] In evaluating at a two-year horizon for the previous year, a significant deviation is identified in the expenditure benchmark (-0.3 % of GDP), as the drop in expenditures last year could not eliminate the single robust development of expenditures in 2015 related to EU funds draw-down.

Based on expcted fiscal accounts in 2017, the adjusted expenditures at constant prices net of discretionary revenue measures should increase by 1.6 %[38]. The expenditure benchmark allows an increase by 1.3 %. The assessment of the expenditure benchmark indicates for the year 2017 a non-significant deviation at a one-year horizon, however, **there is no deviation at a two-year horizon.**

For the development in 2018 to 2020 it is decisive to set the budgetary objectives, based on which the continuing convergence to the structurally (as well as nominally) balanced budget is expected. At a horizon of the years 2018 to 2020, the average annual growth of the expenditure aggregate is expected in the amount of 1.2 %, and reaches the pace below the average level of the expenditure benchmark (2.2 %). For that reason, **at the entire forecast horizon of 2018 to 2020, compliance with the expenditure benchmark is expected at both the one-year and two-year horizon.**

[34] Discretionary revenue measures represent additional year-on-year effects of legislative tax measures (see more in Annex 5).

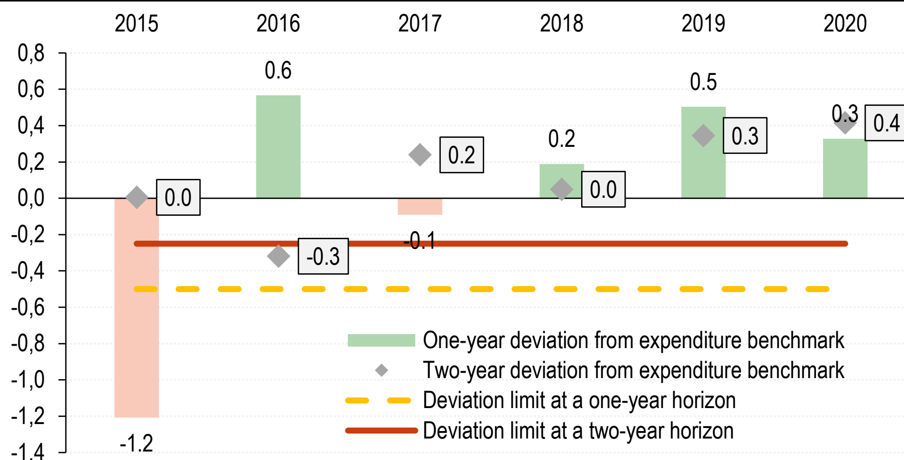
[35] In compliance with ECOFIN Decision dated 6 December 2016, the expenditure aggregate is also adjusted for revenue and expenditure one-off measures – more in the update "Specifications on the implementation of the Stability and Growth Pact and Guidelines on the format and content of Stability and Convergence Programmes".

[36] The potential of economy is expressed as a reference rate for expenditure growth, calculated as a 10-year average of potential growth.

[37] Quantification of deviation from the expenditure benchmark, which expresses the resulting deviation in % of GDP (Annex 4).

[38] In calculating the expenditure benchmark based on the latest estimate of 2017.

FIGURE 32 –Expenditure benchmark compliance (% of GDP)



Source: MoF SR, EC

2.6 General government debt

At the end of 2016, gross debt of general government achieved a value of 51.9 % of GDP[39]. There was a year-on-year decrease debt to GDP ratio by 0.5 p. p., in particular due to the solid economic growth, a lower need to finance the cash deficit, and a higher rate of repurchase of government bonds.

At a horizon of years 2017 to 2020, on conditions of fiscal framework fulfilment, the GG gross debt will further decrease in proportion to the GDP. **At the end of 2020, we expect a decrease in debt out of the sanction bands of the constitutional Fiscal Responsibility Act to a level of 46 % of GDP[40].**

In 2017, the gross debt will be stabilised approximately at a level of the year 2016 taking into account a higher need of cash deficit financing. In 2017, the current fiscal framework confirms the historical achievement of the surplus of GG primary balance[41] and its gradual increase, which with assistance of the accelerating GDP growth and more significant support of inflation development will contribute to debt reducing in proportion to the GDP.

TABLE 19 – Gross debt of general government (% of GDP, state as at 31 December)

	2015	2016	2017	2018	2019	2020
Gross debt of general government	52.5	51.9	51.8	49.9	48.0	46.0
- GG debt (without the impact of international liabilities)	47.4	47.1	47.3	45.8	44.3	42.6
- commitment under EFSF	2.4	2.3	2.2	2.1	2.0	1.9
- contributions to ESM	0.8	0.8	0.8	0.7	0.7	0.7
- debt of other general government entities	1.8	1.7	1.5	1.2	1.0	0.9
p. m. gross debt change	*-1.1*	*-0.5*	*-0.2*	*-1.8*	*-1.9*	*-2.0*
p. m. net debt	*48.2*	*47.7*	*47.6*	*45.8*	*43.3*	*43.0*

Source: MoF SR

The amount of the state budget cash deficit, which needs to be financed, is among the main factors affecting the GG debt change. In 2016, a significant decrease in the SB cash deficit was recorded; in comparison with the budget expectations, it dropped from EUR 1.97 bn. to EUR 0.98 bn. This result was caused mainly by the cash development on the expenditure side of the SB, which decreased by EUR 0.99 bn. in comparison with the budgeted amount.

[39] All the mentioned values are calculated in the methodology used in assessing the fulfilment of the Maastricht criterion for the amount of the general government gross debt – the so-called Maastricht gross debt of general government. The general government debt is expressed as a percentage share in GDP.
[40] The constitutional Fiscal Responsibility Act expects the lower limit amounting to 47 % of GDP in 2020.
[41] The primary balance represents the nominal balance of general government net of interest payments.

This year, an increase in the cash deficit of the SB is expected in comparison with the year 2016, which is related to several factors. There is a year-on-year increase in state budget cash expenditures that are not fully covered by cash revenues during the year. Moreover, in comparison with the previous year, when the cash revenues from the EU funds exceeded the EU-fund-related cash expenditures incurred, the budget expects balanced cash fiscal performance in relation to EU funds. Other factors include higher co-financing and also higher state debt service expenditures compared to the previous year.

In 2018 to 2020, the fiscal framework expects a continued decrease in the cash balance as a consequence of the accelerating consolidation of public finance with the objective to achieve balanced fiscal performance of general government in 2019. The debt development is also positively affected by the assumption of contribution of other general government entities to debt reduction. The fiscal framework expects a positive impact in particular from local governments and the National Highway Company.

No additional impacts on the general government debt are assumed from Slovakia's international commitments towards the European Financial Stability Facility (EFSF) and the European Stability Mechanism (ESM) for the years 2018 to 2020.

The calculation also includes methodical adjustments such as issue discount and bond maturity discount.[42] The total influence of these factors will negatively affect the debt since 2017 due to the prevailing influence of the higher emission discount.

TABLE 20 – Influence on the change of general government debt (contributions in EUR mil.)

	2015	2016	2017	2018	2019	2020
A. Gross debt of general government (as at 1 January)	**40,725**	**41,295**	**42,053**	**43,773**	**44,619**	**45,629**
B. Total year-on-year change of the GG gross debt	**570**	**758**	**1,720**	**846**	**1,010**	**685**
- SB deficit (cash accounting)	1,933	980	1,974	1,558	1,127	1,212
- Treasury funds used to finance state needs	-1,262	20	-295	-617	-105	-383
- commitment under EFSF	-116	0	0	0	0	0
- contributions to ESM	0	0	0	0	0	0
- issuance discount	18	44	214	43	106	28
- discount at maturity	-86	-61	-63	-5	-1	-59
- indebtedness of other GG entities	24	-93	-105	-134	-117	-114
of which: Railways of the SR (ŽSR)	0	0	0	0	0	0
of which: ŽSSK	-9	32	5	7	18	18
of which: NDS	-77	-40	-37	-37	-37	-37
of which: EOSA	0	0	0	0	0	0
of which: Transport companies of municipalities	33	-23	-3	-8	-2	-2
of which: Municipalities	138	-40	-71	-88	-86	-83
of which: Self-governing regions	6	-22	0	-5	-5	-5
- other	60	-132	-5	1	0	1
C. Gross debt of general government (as at 31 December) (A+B)	**41,295**	**42,053**	**43,773**	**44,619**	**45,629**	**46,314**
in % of GDP	**52.5**	**51.9**	**51.8**	**49.9**	**48.0**	**46.0**

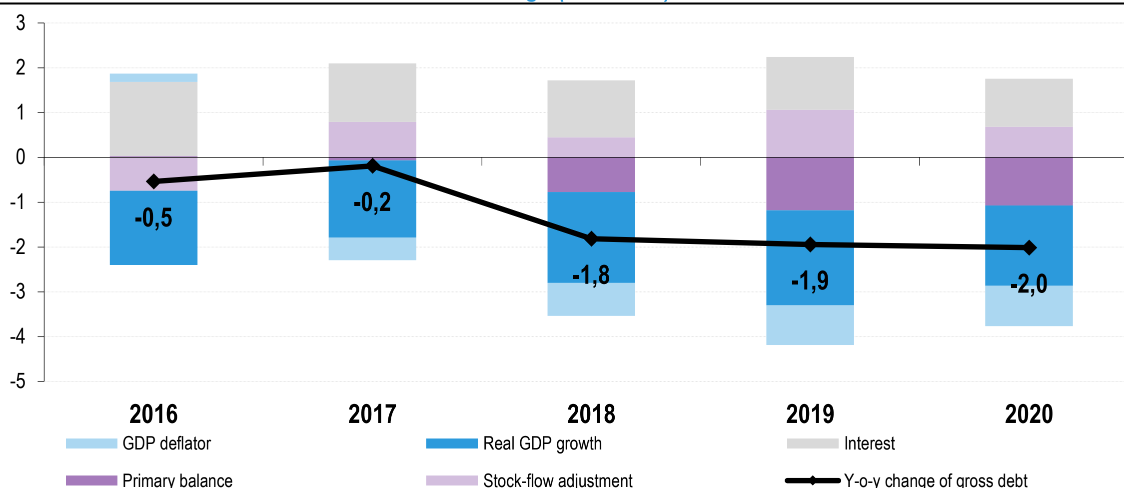
Note: Positive items increase the general government debt as at 31 December of the given year, negative items decrease the debt. *Source: MoF SR*

The analysis of contributions of main macroeconomic and fiscal indicators to the debt change is a more comprehensive tool for debt dynamics assessment according to the development of the main macroeconomic

[42] The discount on the issue of state bonds and state treasury bills increases the debt, since as at the date of bond issue, the state liabilities increase by the nominal value of the bonds. The state, however, gains a lower amount of cash (decreased by the discount). On the contrary, the discount at maturity of state bonds reduces the debt. This is due to the fact that the debt increase already occurs when bonds are issued, at the level of the nominal value of the bonds, rather than at the time of their redemption.

and fiscal indicators. From 2017, the solid growth of economy with the assistance of the accelerating price level growth will have the most significant impact on the general government debt decrease. Moreover, from 2018, the debt decrease dynamics will be able to lean on more significant surpluses of the public finance primary balance thanks to the continuing consolidation. Even despite the continuing trend of the decreasing contribution of interest payments to the debt growth, in absolute terms they will keep affecting its development negatively.[43] In comparison with the dynamics of the planned decrease in nominal deficits, the pace of indebtedness reducing at the monitored horizon will be lower, which is proved by positive contributions of stock-flow adjustment since 2017.

FIGURE 33 - Contributions of factors to the debt change (% of GDP)



Source: MoF SR

BOX 8 - Stock-flow adjustment

Stock-flow adjustment (SFA) expresses the mutual relation between the debt increase and deficit. Basically, SFA is never equal to zero, which primarily causes inequality between the change of debt value and deficit development in the respective year. The main reasons are different calculation methodologies. The general government balance represents the so-called net concept (revenues reduced by expenditures), whereas the debt represents the gross concept, i.e. not reduced by assets. At the same time, the general government balance is based on accrual data, whereas the debt amount is primarily determined by cash flows. Moreover, high SFA may also indicate statistical discrepancies.

The value of SFA is affected mainly by the change of financial assets, which is affected in particular by the expected development of free resources of the Treasury system and cash balance of individual GG entities. Positive SFA means that the general government debt (nominal) grows quicker than the deficit or decreases slower than suggested by the value of the achieved surplus. On the contrary, negative SFA means that the gross debt increase is slower in comparison with the stated deficit. In case of surplus fiscal performance, the debt with negative SFA decreases slower.

According to the current estimate, SFA will increase the debt at the horizon of years 2017 to 2020. The value of stock-flow adjustment was in 2016 more significantly affected by an increase in cash assets, in particular due to the fiscal performance of other GG entities, which was, however, offset by the reduction of the state of receivables. The difference between the cash and accrual recording in accounting also affects general government stock-flow adjustment.

TABLE 21 – Stock-flow adjustment (% of GDP)

	2016	2017	2018	2019	2020
Stock-flow adjustment	**-0.7**	**0.8**	**0.4**	**1.1**	**0.7**
1. Difference between cash and accrual data	**-0.9**	**0.5**	**0.6**	**0.5**	**0.5**
2. Change of financial assets	**0.2**	**0.4**	**0.1**	**0.7**	**0.4**
Change of GG cash	0.8	0.2	0.2	0.7	0.5

[43] In case of interest payments, it is in particular the inertial effect thanks to which the historically accumulated debt amount automatically negatively affects its further growth.

ESM	0.0	0.0	0.0	0.0	0.0
EFSF	0.0	0.0	0.0	0.0	0.0
Change of other assets (state of receivables)	-0.6	0.2	-0.1	0.0	-0.1
3. Bond issuance discount	**0.1**	**0.3**	**0.0**	**0.1**	**0.0**
4. Bond discount at maturity	**-0.1**	**-0.1**	**0.0**	**0.0**	**0.0**
5. Other	**0.0**	**-0.3**	**-0.3**	**-0.3**	**-0.3**

Source: MoF SR

Net debt

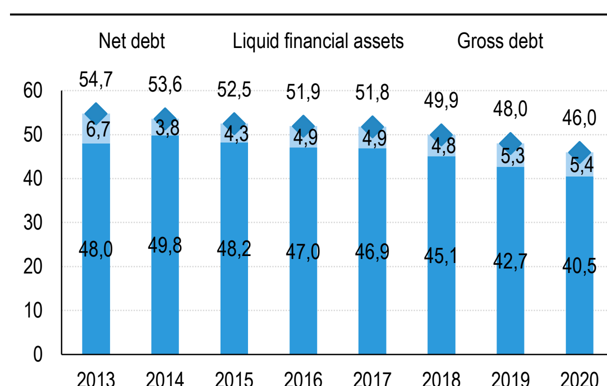
To assess the development of the real indebtedness it is also suitable to monitor the development of net debt. At present, there is no standardised methodology that would unambiguously define net debt quantification. Within the framework of the Stability Programme (SP), the concept of the gross debt net of liquid financial assets (LFA)[44], in particular the deposits on accounts of individual GG entities, is applied. The MoF SR presents the net debt defined in the EC manual for the preparation of the Stability Programme as:

Net financial debt = Maastricht (gross) debt - gold and SDR - cash - securities – quoted shares

The net financial debt calculated in such a way takes into account the cash on accounts of all general government entities[45]. Currently, the general government does not have any quoted shares, gold or SDR on the accounts.

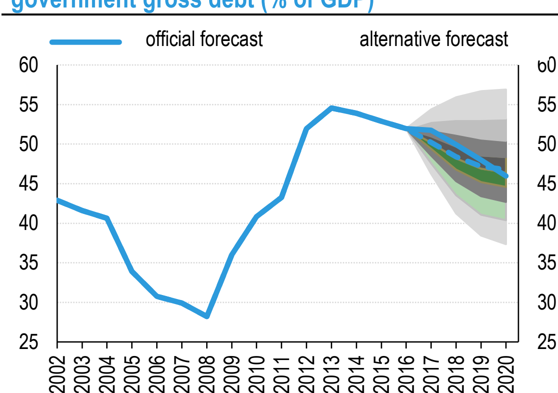
After an increase of LFA in 2015, in 2016 no essential change of its amount was recorded. At the horizon of years 2017 to 2020, under the current assumptions, the average amount of LFA at a level of 4.5 % of GDP is expected. The most significant increase is draft at the end of the forecast in particular for the reason of lower utilisation of ARDAL's cash reserve for deficit and debt financing.

FIGURE 34 – Net debt (% of GDP)



Source: MoF SR

FIGURE 35 - Stochastic forecast of the general government gross debt (% of GDP)



Source: MoF SR

Stochastic forecast of gross debt

A forecast using a stochastic model represents and alternative approach to debt forecast[46]. The official forecast of GG gross debt is in line with an independent model forecast. The alternative model forecast remains at similar

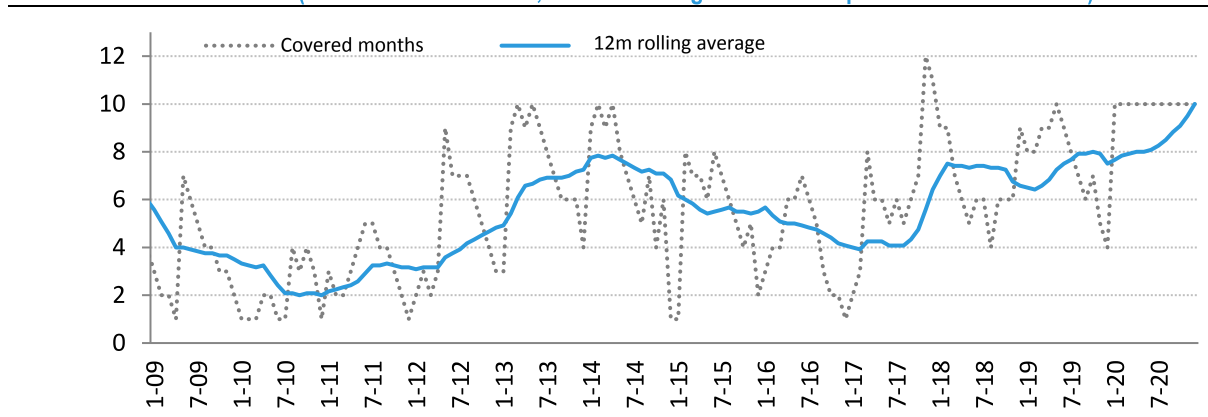
[44] Other way using a wider definition for net debt calculation was presented by Eurostat in its proposal from 2014.
[45] Municipalities do not keep an account in the Treasury.
[46] The debt is determined by its past value, interest payments, GDP growth, primary deficit and non-deficit financing. The model consists of vector autoregressions of interest rates, real GDP growth, inflation of the GDP deflator, these three variables for the EU and exchange rate. Another element is the fiscal reaction function, which determines the level of the primary deficit with respect to the debt and economic activity. A great number of random simulations of this system determine various debt trajectories, from which the probabilistic distribution of debt level in the next years will be subsequently calculated.

levels as expected in the Stability Programme for 2016 to 2019. The official forecast keeps expecting a slower decrease in debt in 2017 and 2018. Both forecasts agree that in 2020 the GG gross debt should achieve a value below 47 % of GDP. The fan chart implies that, when taking into account the uncertainty regarding the future development of economy and public finance, there is about 70 % probability of debt decrease below 50 % of GDP by 2020.

Cash reserve

Cash reserve[47] is determined for liquid coverage of States liabilities. The volatile course of the reserve is explained by the character of application of the reserve. In relative terms, the reserve shows the number of months during which all government expenditures would be covered. A relative increase in the cash reserve in 2019 to 2020 reflects the planned balanced budget.

FIGURE 36 – Cash reserve (the number of months, for which the government expenditures are covered)



Source: MoF SR

[47] The cash reserve is created by deposits deposited by the Debt and Liquidity Management Agency (ARDAL) on the interbank money market in commercial banks and on current accounts of the State Treasury in the NBS. On the other hand, the reserve is reduced by loans which ARDAL obtains on the money market for the short-term coverage of liquidity mismatch or to settle liabilities in the situation when the reserve is zero.

3 SENSITIVITY ANALYSES AND COMPARISON WITH THE PREVIOUS UPDATE

The Stability Programme of the SR is based on a baseline scenario of economic developments with exogenous assumptions about the direction of the external environment as described in Chapter 1. This section presents selected risk scenarios based on model simulations anticipating slower growth in foreign demand, and a sharp rise in interest rates through the risk premiums of Slovak bonds as well as the interbank interest rate Euribor. The slowing of foreign demand would adversely impact the economy and public debt most significantly, thereby presenting the largest risk. The rise in bonds' risk premiums and in the interbank market would merely have a mild impact on the Slovak fiscal position in contrast.

3.1 Risk scenarios

Scenario 1: Lower foreign demand

The latest MoF SR forecast assumes major trading partners' sustained pace of expansion over the short and medium term. The uncertainty surrounding multiple European elections, "Hard" Brexit scenario, and the potential wave of protectionism in the world trade remain unquantified. For Slovakia, as a small open export-oriented economy which significantly benefits from its trade links, a slow-down in a foreign demand would be hard-felt. The first scenario, therefore, posits a slower weighted import growth of its major trading partners, which would yield an annual fall in the growth of real weighted foreign demand by 1 p. p. at the entire horizon from 2017 to 2020. The reduced dynamics of foreign demand would – through reduced orders of export-oriented enterprises – immediately weigh down on export growth. The resulting lower profitability would dampen these enterprises' investment activities in comparison with the baseline scenario. In addition, lower production capacity utilisation would lead to employee lay-offs, adversely affecting household consumption and aggregate demand. The latter would ultimately reduce inflationary pressures in the economy. The impact on external imbalances would be limited, as the slowed export growth dynamics would be offset by an outage in imports, with the latter instigated by the slower growth of the export itself, and also that of household consumption and investments. Jointly, the fall in economic activity coupled with slower growth of prices and wages, as well as a higher rate of unemployment would deepen general government deficit. **Specifically, the drop in nominal GDP growth would – given lower tax revenues – adversely weigh on the fiscal deficit by between 0.1 to 0.4 per cent of GDP each year over the forecast horizon. As a result, gross debt would rise by 2.1 per cent of GDP cumulatively over the forecast horizon compared to our baseline scenario.**

TABLE 22 - Scenario 1: Slowdown of foreign demand growth by 1 p. p. in 2017 to 2020

The cumulative change in the value of individual variables compared to the baseline scenario is in p.p.

	Household consumption	**Gross fixed investment**	**GDP**	**Unemployment rate**	**CPI**	**CA balance** (% of GDP)	**GG balance** (% of GDP)	**GG debt** (% of GDP)
2017	-0.2	-0.4	-0.5	0.1	0.0	-0.2	-0.1	0.4
2018	-0.4	-0.8	-0.9	0.3	-0.3	-0.5	-0.2	0.9
2019	-0.4	-1.2	-1.2	0.5	-0.7	-0.8	-0.3	1.4
2020	-0.3	-1.4	-1.4	0.6	-1.3	-1.1	-0.4	2.1

CA – current account *Source: MoF SR*

Scenario 2: Increase in interest rates

Despite the continued upbeat sentiment in euro area economies, fears of further political risk remains intact and may materialise. Such event would increase the bond risk premiums in countries not perceived as the "core" of the euro area by investors. In addition, an abrupt exit from ECB's Asset Purchase Programme – which significantly helped reducing yields on Slovak government bonds (BOX 10) – would pose an additional downside in terms of returns. The materialisation of the latter is not very likely, however, given the recent extension of the Programme by the ECB. A more imminent risk to the revenues may be actually posed by the Italian banking sector. In the second scenario, we therefore analyse the sensitivity of the forecast to shifts in the short- and long-term interest rates by an additional 1 pp from 2017 over the forecast horizon.Interest rate hikes may thwart

access to loans of households and businesses, dampening household consumption but, above all, investment. A moderate slowdown in economic growth would follow, through the reductions in employment and real wages. The latter would again feed into a slowdown of household consumption, which, coupled with lower investment would adversely affect import growth. Overall, the described dynamics would have a positive impact on Slovakia's current account balance position. While the simulated interest rate shocks are quite high in magnitude, the impact on growth is only moderate, given the low elasticity of investment and household consumption to a change in interest rates. Consequently, the increase in government interest expense would generate an additional cost in the amount of 0.03% of GDP in 2020. **The general government debt would cumulatively increase by 0.6% of GDP by the end of the forecast horizon. The overall negative impact on the general government balance, including net interest expense of government debt, would amount to 0.1% of GDP in 2017 and to 0.2% of GDP in 2020. The results yielded by the medium-term model are consistent with the estimates obtained from synthetic control groups. The latter suggests that the quantitative easing Programme has reduced bond yields, and thus the government debt, by 0.2% of GDP cumulatively between 2014 and 2016.**

TABLE 23 - Scenario 2: Increase in short and long-term interest rates by 1 p. p. in the entire forecast

The cumulative change in the value of individual variables compared to the baseline scenario is in p.p.

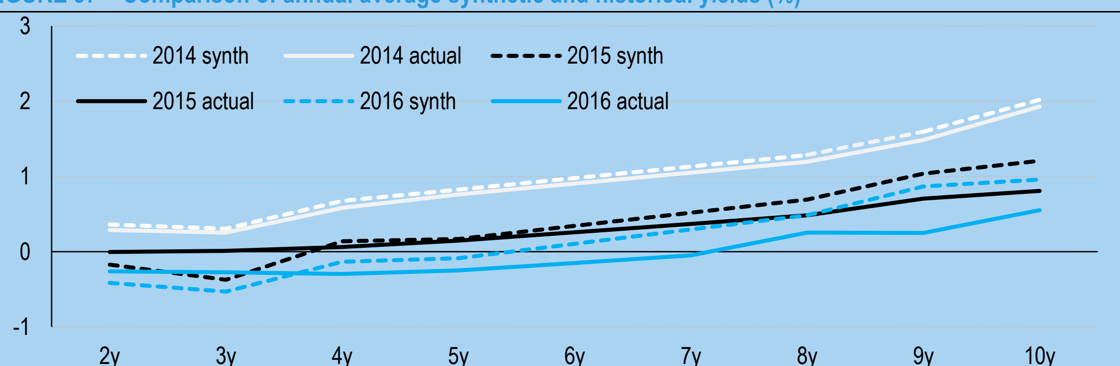
	Household consumption	**Gross fixed investment**	**GDP**	**CPI**	**CA balance** (% of GDP)	**GG interest payments** (% of GDP)	**GG balance** (% of GDP)	**GG debt** (% of GDP)
2017	-0,2	-0,2	-0,1	0,0	0,1	0,0	-0,1	0,2
2018	-0,1	-0,4	-0,1	0,0	0,1	0,1	-0,1	0,3
2019	-0,1	-0,6	-0,1	-0,1	0,1	0,0	-0,2	0,4
2020	0,0	-0,8	-0,1	-0,1	0,1	0,0	-0,2	0,6

CA – current account *Source: MoF SR*

BOX 9 –Quantitative Easing has reduced the costs of general government debt

The Asset Purchase Programme (i.e. Quantitative Easing, QE) of the ECB has flattened the yield curve of the Slovak government bonds at the entire horizon by 12 basis points on average. The QE's impact grows as bond maturity increases: the most pronounced decline (60 basis points) can be observed on the 10-year maturity. Since the announcement of the Programme in September 2014 until the end of 2016 a saving in the amount of EUR 160 mil. was accomplished. The impact of the ECB's Programme on the Slovak yield curve was estimated by the method of synthetic control groups (SCG). In the nutshell, an alternative, synthetic yield curve is created in an environment without the QE policy. In so doing, we sought a combination of non-euro area bonds so that the yield of the combined synthetic bond accurately resembles the Slovak bond yield before September 4, 2014, i.e. before the ECB's first purchase announcement. Subsequently, we took the yield of the combined synthetic bond after September 4, 2014, and used it as a counterfactual Slovak bond yield curve trajectory. This process has been iterated for all available maturities and interpolated in case of unavailability of the yield. **In order to calculate the interest payments, we have replaced the yields from the realised emissions over the period from August 1, 2014 to December 31, 2016 with synthetic yields.** This change affects the amount of the emission discount (premium), which is a part of the interest payment calculation. For new benchmark issuances, we also repriced the bond coupon on par, which means that the coupon is equal to the synthetic yield. This assumption takes into account the fact that, at higher rates, the coupon of the newly issued bonds would also be higher, resulting in higher interest costs. In this analysis, we did not revalue loans due to their relatively small share in the debt portfolio and we also abstracted from the revaluation of repurchases.

FIGURE 37 – Comparison of annual average synthetic and historical yields (%)



Source: Bloomberg, IFP

The ECB's QE policy brought about savings of interest payments in the amount of EUR 160 million between September 2014 and December 2016. The yield curve of Slovak government bonds declined by an average of 12 basis points over the reference period. The most significant decrease of around 60 basis points has been observed for maturities at around the 10 years, compared to 16 basis points for 4-year maturities in 2016. The most significant drop in the yield curve is visible at the start of the asset purchase program between 2014 and 2015.

TABLE 24 – Saving of interest payments compared to the scenario without quantitative easing

	2 014	2 015	2 016	Suma
Saving of interest payments (in EUR mil.)	23.0	75.0	61.1	159.4
Saving of interest payments (% of GDP)	0.03	0.10	0.08	0.20

Source: IFP calculation

The impact of quantitative easing on Slovak bond yields is stronger than that of other countries. The reason for this may be the small (Programme-qualifying) volume of bond issuances as well as the relatively low level of gross debt in comparison with other countries. The qualification and low liquidity effects are observed for maturities of up to 4 years where the real yield is smaller than the synthetic one. We assume that these bonds either did not qualify for the Programme, or their volume and liquidity was so small that the market did not show any interest in their purchase from the state, and a subsequent sale under the QE Programme.

Scenario 3: Investment shock

A weaker link between economic growth and investments can be observed in the whole of Europe in the aftermath of the crisis, and Slovakia is no exception to this development. According to the methodology of the MoF SR described in Chapter 1, Slovak economy is set to begin overheating already this year. The maximum utilisation of production capacities in the economy coupled with further expansion of auto-maker production capacities pose an upside risk to private investment, for instance, in the supplier network of the automotive industry. The third scenario hence models an annual increase in investment by 1 pp over the forecast horizon. Higher investment would stimulate domestic demand growth, feeding into employment and wage growth. Improved labour market would favourably weigh on real disposable income and higher consumption of households, ultimately translating into faster pace of growth. Increased wages along with increased output gap would help lifting the overall price level. Intensified household consumption along with higher investment would stimulate imports and cause the current account balance to deteriorate. Heightened economic activity, higher prices and wages and lower unemployment would improve Slovakia's general government balance position. **Specifically, the rise in nominal GDP growth would – given higher tax revenues – favourably weigh on the fiscal deficit by 0.1 per cent of GDP by 2020. As a result, gross debt would be reduced by 0.5 per cent of GDP cumulatively by 2020 compared to our baseline scenario.**

TABLE 25 - Scenario 3: Faster investment growth by 1 p. p. each year at a horizon of 2017 to 2020

The cumulative change in the value of individual variables compared to the baseline scenario is in p.p.

	Household consumption	Gross fixed investment	GDP	Unemployment rate	CPI	CA balance (% of GDP)	GG balance (% of GDP)	GG debt (% of GDP)
2017	0.1	1.0	0.1	0.0	0.0	-0.1	0.0	0.0
2018	0.1	2.0	0.3	-0.1	0.1	-0.3	0.1	-0.2
2019	0.2	3.0	0.4	-0.1	0.2	-0.4	0.1	-0.3
2020	0.2	4.0	0.5	-0.2	0.3	-0.6	0.1	-0.5

CA – current account

Source: MoF SR

3.2 Comparison with the previous update

The Stability Programme of the SR for the years 2017 to 2020 includes updated macroeconomic estimates and budgetary targets. **The general government budget target of 0.06% of GDP in 2018 and 0.16% of GDP in 2019 is slightly relaxed, compared to the previous Stability Programme commencing in 2016. The new**

targets take into account the plan to achieve balanced public finance by 2020, and guarantee the achievement of the MTO by 2018. As a consequence, the declining trajectory of forecasted gross debt moderates over the forecast horizon. Slightly higher debt-to-GDP ratios in 2018 and 2019 will follow, but will be offset by the robust growth of the economy, and compensated by a more pronounced decline outside of the sanction zone within the framework of the Budgetary Responsibility Act in 2020.

TABLE 26 - Comparison of the previous and updated forecasts

	ESA code	2016	2017	2018	2019	2020
Real GDP growth (%)						
Previous update*		3.2	3.6	4.1	4.6	-
Outcome and current update		3.3	3.3	4.0	4.4	3.8
Difference		0.1	-0.3	-0.1	-0.2	-
General government balance (% of GDP)	EDP B.9					
Previous update*		-2.13	-1.29	-0.44	0.16	-
Outcome and current update		-1.68	-1.24	-0.50	0.00	0.00
Difference		-0.45	-0.05	0.06	0.16	-
Gross general government debt (% of GDP)						
Previous update*		52.9	52.2	49.8	47.8	-
Outcome and current update		51.9	51.8	49.9	48.0	46.0
Difference		-1.0	-0.2	0.1	0.2	-

*Note: * Stability Programme of the SR for 2016 to 2019* *Source: MoF SR*

4 PUBLIC FINANCE SUSTAINABILITY

The successful reduction of the primary structural balance in previous years helped improve the long-term sustainability of public finance in the SR. The fiscal outcome for the last year and the expected structurally balanced budget in 2018 will further decrease the risk of long-term sustainability. The current demographic projection of Eurostat, which will be taken into account only in the EC Ageing Report in 2018, represents another positive change for the evaluation of long-term sustainability of public finance in Slovakia.

Measures adopted in 2016 with an impact on the long-term sustainability of the pension system:

- The Government made a one-off modification of **pension indexation**. In January 2017, the pensions were indexed by a fixed amount calculated as 2 % of the average monthly amount of the respective type of pension. Otherwise, according to the valid legislation, the pensions would increase by 0.4 % in compliance with the original legislation (10 % of wage growth for the first half-year of 2016 and 90 % of inflation). The additional costs of the measure in 2017 amount to EUR 113.6 mil.

- The Government modified the possibility of **programme withdrawal in the fully-funded pillar.** From May 2017, everybody whose income from the PAYG and fully-funder pillars, retirement rent and foreign pension is higher than the average pension[48], can make a single withdrawal of their savings .

BOX 10 – Implemented measures in the pension scheme since 2012

The pension reform from 2012 significantly helped the long-term sustainability of the pension scheme[49] and improved its balance already within a short-term horizon. The adopted reform helped suppress the growth of expenditures, which would be cumulatively higher without the adoption of the reform by as much as EUR 383.1 mil. for the years 2012 to 2017[50]. The lower costs were caused mainly by the slower indexation of pensions (EUR 354 mil.). From 2017, the dependency of the retirement age on the life expectancy will help the sustainility of the pension scheme. The automatic increase of the statutory retirement age by 76 days, applied for the first time in 2017, will bring a slower growth of pension expenditures this year by about EUR 29 mil[51].

TABLE 27 – The slower growth of pension expenditures due to pension reform in 2012 (EUR mil.)

	2014	2015	2016	2017	2018
Lower indexation (in comparison with the Swiss model of indexation[52])	5.9	60.1	104.5	183.6	268.7
Statutory retirement age increase (life expectancy)	0	0	0	29.3	29.6
Total	**5.9**	**60.1**	**104.5**	**212.9**	**298.3**
Cumulative	**5.9**	**66.0**	**170.5**	**383.4**	**681.7**

Source: MoF SR calculations

Since 2012, several measures regarding pensions have been adopted or considered, which mitigate the positive effect of the reform from 2012. A single increase in pension indexation to 2% in 2017 had the most significant influence; it increased the expenditures by EUR 113.6 mil. The measures in the area of pensions will increase the annual expenditures by EUR 214.8 mil. in 2018 compared to the legislation valid in 2012.

[48] It is an average old-age non-reduced pension granted after the year 2003, non-reduced due to the participation in the fully-funded pillar.

[49] More in the IFP commentary: Ageing will increase the expenditures, the pension reform helped.

[50] The slower growth of expenditures due to a change of indexation is calculated as a difference between the pension expenditures according to the old methodology of pension increases (the Swiss model) and the new legislation (a gradual transition to pension inflation). According to the new legislation, since 2013 pensions have been indexed to a greater extend according to inflation and less according to the wage growth (by 10 p. p every year).

[51] It is a comparison of the scenario of an increase in the statutory retirement age by 76 days and the scenario without reform from 2012. The scenario without reform includes the automatic alignment of the retirement age of men and women. We expect an extension of pension granting by 76 days for all old-age pensions except for the women, whose retirement age still converges to men and a half of early old-age pensions.

[52] Indexation valid before the reform – pensions were indexed by a half of wage growth and a half of inflation

TABLE 28 – The adopted and considered measures of the pension scheme after the reform in 2012 (EUR mil.)

Measure	2014	2015	2016	2017	2018	2019	2020
"Christmas" pension increase	9.2	9.3	9.5	9.6	9.7	9.8	9.9
Minimum pension	0	9.1	22.4	22.8	23.3	23.7	24.2
Widow's pensions alignment	0	0	7.9	8.7	9.6	10.5	11.6
Widower's pensions alignment	0	0	2.9	3.2	3.5	3.8	4.2
Higher pension indexation in 2017	0	0	0	113.6	116	117.9	120
Recalculation of pensions of pensioners, who retired before 2004 (version from the MPK of March 2017)	0	0	0	0	50.2	47.4	44.8
Total	**9.2**	**18.4**	**42.6**	**157.9**	**212.3**	**213.2**	**214.8**
Cumulative	**9.2**	**27.6**	**70.2**	**228.2**	**440.4**	**653.6**	**868.4**

Source: clauses of impacts, own calculations of the MoF SR (MPK – interdepartmental commenting procedure)

Assessment of long-term sustainability of public finance

The aim of the assessment of long-term sustainability is to assess the current situation in general government in relation to the expected growth of ageing-related general government expenditures or decrease in its revenues. With the current amount general government indebtedness, the current setting of the relevant policies (fiscal position, pension scheme, and healthcare system) should ensure the long-term sustainability so that the debt will not rise uncontrollably and remain at a secure level (also in terms of potential macroeconomic shocks). For long-term sustainability assessment, the European Commission (EC) uses the basic indicators S1 and S2.[53]

S1 indicator [54] (medium-term horizon) - shows the value of the durable adjustment of the primary structural balance required to reach the general government gross debt level of maximum 60% of GDP in 2030.

S2 indicator[55] (long term horizon) - the value represents how much primary structural balance must permanently change for the current value of future primary balances to equal the current level of gross debt. Unlike S1, the S2 indicator takes into account projections related to ageing in an infinite horizon, while the required change in the balance should ensure a non-growing level of debt.

4.1 Assessment of long-term sustainability of public finance according to the EC methodology

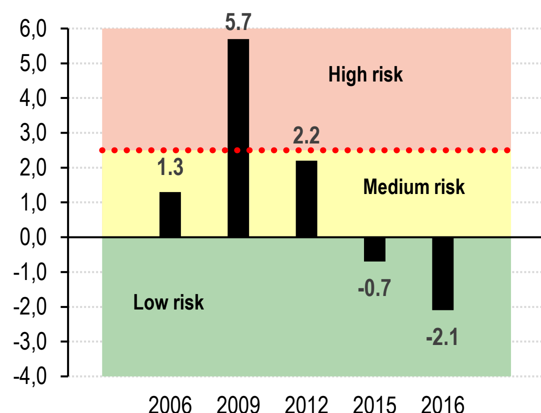
At the beginning of the year 2017, the EC published a report on the sustainability of debt[56] of general government of individual EU Member States for 2016. The monitoring also included the update of sustainability indicators based on the background data from the autumn forecast of the EC (2016).

As regards Slovakia, in 2016 **the risks of long-term sustainability were reduced** in comparison with the previous report for 2015. Thanks to the positive development of the primary structural balance and lower indebtedness Slovakia reached improvement in S1 indicator assessment by 1.4 p. p., by which it confirmed the low risk of public finance sustainability (Figure 38). In particular the assessment of risks in the long-term horizon is important for Slovakia. The demographic development and sustainability of the current pension and healthcare system represent the components with highest risk for the assessment of S2 indicator development assessment. In comparison with 2015, the EC recorded Slovakia's improvement in this area, too. The EC decreased the S2 value for Slovakia by 1.1 p. p., **therefore, its value approached the level representing a low risk** (Figure 39). The update of the development of the primary structural balance represents, also in the case of S2 assessment,

[53] European Commission - DG ECFIN (2012) 'Fiscal Sustainability Report 2012, European Economy, No 8, 2012.
[54] Risk scales for S1: low risk (<0), medium risk (0 to 2.5), and high risk (>2.5). The negative value of the indicator shows that with the preservation of the current policies, the debt value of 60 % of GDP will not be exceeded at the horizon by the target year.
[55] Risk scales for S2: low risk (<2), medium risk (2 to 6), and high risk (>6).
[56] European Commission - Debt sustainability monitor 2016, European Economy, January 2017

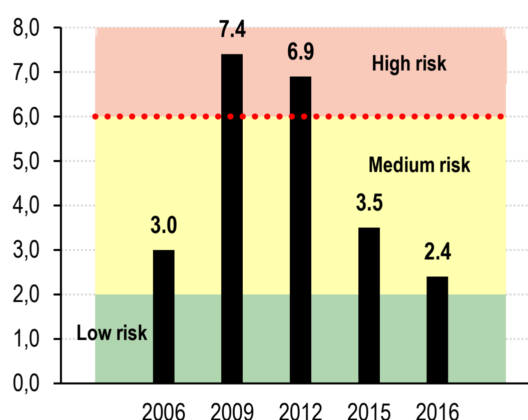
the main factor of improvement. The assessment of public finance sustainability development is carried out by the EC on a regular basis in three-year intervals in compliance with the update of the Ageing Report from 2015[57].

FIGURE 38 – S1 development according to the EC methodology



Source: EC

FIGURE 39 - S2 development according to the EC methodology



Source: EC

4.2 Assessment of long-term sustainability of public finance according to the MoF SR methodology

In the assessment, the MoF SR uses the S1 and S2 indicators according to the EC methodology. In comparison with the EC assessment in analysing the sustainability, the MoF SR works already with the latest macroeconomic assumptions and by Eurostat confirmed fiscal results for the year 2016. Another, already methodical difference in comparison with the EC is the inclusion of the impact of the fully-funded pillar on revenues and not only on expenditures. The MoF SR considers this approach as economically more appropriate because changes in fully-funded pillar systems affect not only the expenditures of pension systems, but also their revenues. The overall impact of revenues flowing in the fully funded pillar on the sustainability assessment will be moderately negative until 2030, while in the entire long-term horizon they will have slightly positive impact. The calculation of the S1 and S2 indicators takes into account the assumptions of the updated forecast cost of ageing according to the latest Ageing Report from 2015.[58]

The MoF SR analysed the sustainability indicators for three scenarios.

- **2017 scenario** is based on the forecast of debt and of the primary structural balance for 2017.
- **MTO scenario** is based on the assumption of achieving the medium-term budgetary objective in 2019 (the set MTO objective) and the corresponding level of debt and of the primary structural balance.
- **2017 scenario with debt brake** is a modifiedscenario reflecting the national legislation. It is based on the forecast of debt and of the primary structural balance for 2017, taking into account the constitutional Fiscal Responsibility Act. In this scenario, the S1 indicator is calculated based on the assumption that the debt will amount to a level of 47% of GDP in 2030[59] (in comparison with the baseline scenario with 60% of GDP).

TABLE 29 - Assumptions used in the calculation of sustainability indicators for individual scenarios

	Base year (t_0)	Structural	DEBT (t_0)	Gradual	DEBT (t_1)	Final year (t_1)

[57] European Commission - Ageing report (2015)
[58] Ageing report (2015), EC.
[59] This limit represents the second highest sanction band of the debt brake. According to the valid legislative provisions, if the debt level reaches 57% of GDP, the Government must submit a balanced budget limiting debt growth above this level to the Parliament. In compliance with Constitutional Act No. 493/2011 on fiscal responsibility, the above-mentioned limit will be annually decreased by 1 p.p. starting from 2018 until reaching the value of 47% of GDP.

		primary balance		consolidation		
2017 scenario	2017	0,3	51,8	2018 to 2020	60	2030
MTO scenario	2019	0,9	48,0	2020	60	2030
2017 scenario with debt brake	2017	0,3	51,8	2018 to 2020	47	2030

Source: MoF SR

In the medium-term horizon Slovakia is classified as a low-risk country according to the S1 indicator. In terms of the national specifics, in applying the most reflecting scenario 2017 with debt brake[60], **with the observance of the current budgetary objectives it is not necessary to adopt additional consolidation measures** to decrease in 2030 and maintain the gross debt at the limit of 47 % of GDP[61]. In comparison with the previous assessment, in this scenario a shift to the band with a low sustainability risk was recorded (Table 31).

The negative values amounting to -1.1 in the 2017 scenario or -1.8 in the scenario of MTO achievement in 2019 again confirm that for medium term, no additional consolidation measures are necessary, and also without a change of the current policies the target debt (in this case 60 % of GDP) is sustainable till 2030. Slovakia achieves favourable assessment in both scenarios in particular due to the achievement of gross debt below the level of 60 % of GDP and the forecast significant increases of costs of ageing only at a long-term horizon after the year 2030.

The assessment of Slovakia was improved also in case of a long-term horizon based on the update of the development of fiscal assumptions and macroeconomic development. Despite the improvement in comparison with the previous year the achieved value of the S2 indicator remains in the band of medium long-term sustainability risk (Table 31). The need of continuing improvement of the primary structural balance is further forced by the ever growing health and long-term care expenditures and pension expenditures, which will increase mainly after the year 2030. The scenario of MTO achievement in 2019 expects a modest shift of the S2 indicator value (Table 31).

TABLE 30 - Sustainability indicators S1 and S2 (% of GDP)[1]

	Scenario 2017	Scenario MTO (2019)	Scenario 2017 with debt brake
S1 Indicator	**-1.1** (-0.1)	**-1.8** (-1.6)	**-0.1** (0.9)
of which:			
Initial budgetary position	-0.6 (0.2)	-1.0 (-0.7)	-0.6 (0.2)
Cost of delaying adjustment	-0.1 (0.0)	0.0 (0.0)	0.0 (0.1)
Debt requirement in the final year	-0.6 (-0.5)	-1.1 (-1.1)	0.4 (0.4)
Long-term expenditures (ageing costs)	0.0 (0.0)	0.2 (0.2)	0.0 (0.0)
Revenue shortfall due to the second pillar	0.2 (0.2)	0.1 (0.1)	0.2 (0.2)
S2 Indicator	**2.6** (3.1)	**2.1** (2.2)	**-**
of which:			
Initial budgetary position	0.7 (1.2)	0.0 (0.2)	-
Pension expenditures	0.8 (0.8)	1.2 (1.1)	-
Health and long-term care expenditure	1.5 (1.6)	1.5 (1.5)	-
Education and unemployment benefits expenditure	-0.3 (-0.3)	-0.3 (-0.3)	-
Revenue shortfall due to second pillar	-0.1 (-0.1)	-0.2 (-0.2)	-

[1] Data in brackets represent the achieved values from the previous Stability Programme 2016 to 2019
Higher values represent a higher risk in terms of public finance sustainability, colours indicate the degree of risk.

Source: MoF SR

BOX 11 – Demographic forecast update

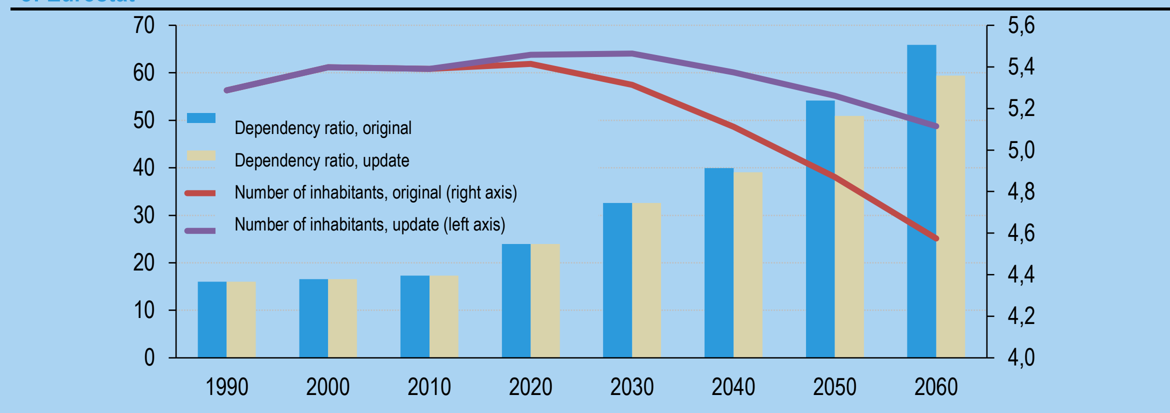
[60] This scenario respects the stricter national objectives of achieving a lower limit of debt (47 % compared to 60 % of GDP in the EC methodology).
[61] E.g. Council for Budget Responsibility (2015) and OECD (2014) consider for Slovakia a value below 50 % of GDP to be a secure level of debt.

Slovakia is among the countries with a significant impact of population ageing on public finance at a long-term horizon. Population ageing creates a challenge for the adjustment of pension scheme and public healthcare operation, as well as long-term care system financing.

According to the new demographic projection of Eurostat[62] Slovakia will counter significant population ageing. From the youngest economy in the EU (only 20 people older than 65 years to 100 people at the age of 14 to 64 years in 2015), it will change to the 8th oldest one (59 people older than 65 years to 100 economically active people). In comparison with the previous forecast, which considered the SR to be the EU country with the quickest ageing it is a relative improvement. The influence of new demography on the long-term sustainability of public finance will be evaluated in the Ageing Report 2018.

The MoF SR prepared an update of the forecast of pension expenditure representing the biggest part of the cost of ageing. In comparison with the Ageing Report from 2015, the updated demographic projection of Eurostat should improve the pension scheme balance by 1.5 % of GDP[63] in 2060. The improvement concerns both the revenues and expenditures with 0.78 % and 0.72 % of GDP respectively in 2060.

FIGURE 40 – Dependency ratio[64] and SR population (mil. persons), according to the new and original forecast of Eurostat



Source: MoF SR

[62] Eurostat published the demographic projection till 2080 in February 2017.
[63] It is an analytical scenario of the MoF SR based on the assumptions of the Ageing Report 2015, except for the demographic projection. The update demographic projection was also taken into account in the GDP development. The model best copying the GDP forecast from the European Commission was used.
[64] The ratio of population older than 65 years to the population at the age of 15 to 64 years.

5 PUBLIC FINANCE QUALITY

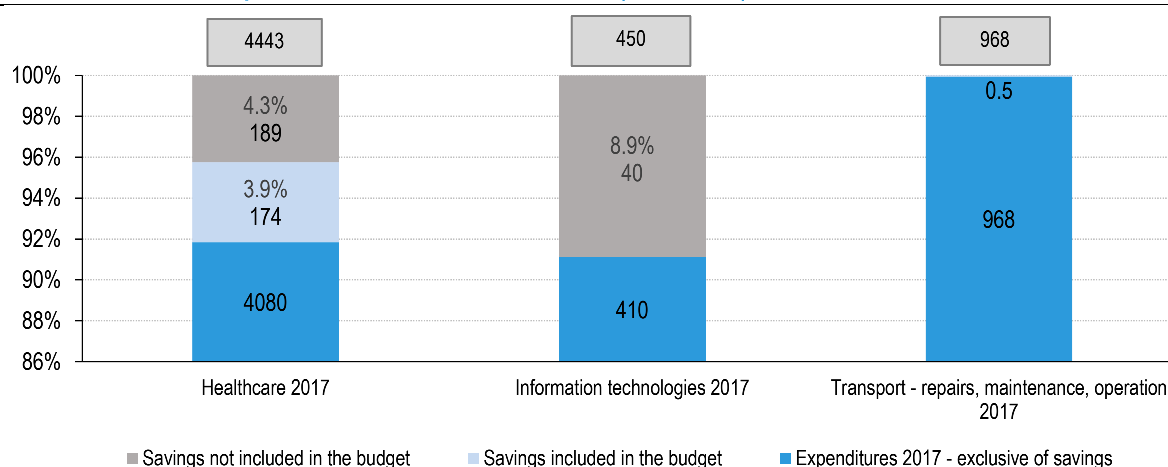
Implementation of the principles of higher value for money in public expenditures and the continuing steps improving the effectiveness of tax collection improve the quality of Slovak public finance. Expenditure review is under way within the Value for Money Project. In 2017, within the budgetary process, the education, labour, social affairs and environment expenditures are under review. A stronger role of economic assessment of important investments will support better public decisions supported by analyses. Since 2012, the gap of VAT collection has been reduced from 41.0 % of potential tax collection to 28.6 % in 2016, and the corporate tax gap copies a similar trend. An increased focus on analytical activities, a new action plan of combat against tax evasion, and the measures to strengthen the voluntary fulfilment of the tax duty (obligation) represent a strategic precondition for the continuing positive development of tax collection effectiveness.

5.1 Spending review

Since 2016, the Government's instruments for improving the efficiency of public expenditures have included the Value for Money Project. The first round of expenditure review was focused on healthcare, transport and informatisation covering about 8.6 % of GDP. The review identified potential measures of about 8.9 % of the total healthcare and informatisation expenditure. The general government budget for 2017 to 2019 includes healthcare measures amounting to EUR 174 mil. (which corresponds to 3.9 % of healthcare expenditure).

The second round of spending review is focused on the labour market and social system, education and environment. Starting from this year, the reviews will have been completed by June, which will allow taking into account the reviews in the general government budget. At the same time, assessment of significant transport investments in the amount of EUR 8 bn. is under way.

FIGURE 41- Revised expenditures and identified measures (in EUR mil.)



Source: MoF SR

BOX 12 –Spending review organisation

Strategic decisions regarding the spending review – review mandates and final reports – are made by the Government. The decisions are made in parallel with the preparation of strategic documents, i.e. the Stability Programme, Draft Budget Plan and general government budget.

The MoF SR is the sponsor and coordinator in this area. It proposes objectives, organisation, as well as the technical parameters of the review, and perform individual reviews in cooperation with competent ministries. It publishes spending review final reports by 30th of June so that it is possible to incorporate the measures into the draft budget for the next three years.

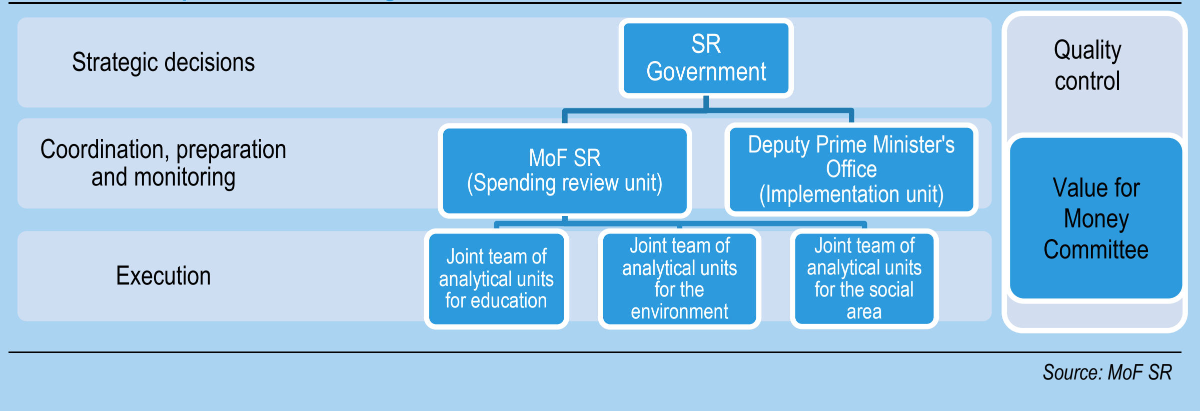
The MoF SR incorporates the identified measures from the completed review in to the draft GG budget in the

form of adjusted expenditure limits in comparison with the no-policy-change scenario as well as measureable indicators. The Government approves the reviews along with the GG budget by 15 October.

The schedule and course of fulfilment of measures are included in the implementation plans. Their fulfilment is monitored by the MoF SR (financial measures) and the Deputy Prime Minister's Office for Investments and Informatisation of the Slovak Republic (the value and provision of fulfilment). The fulfilment of the measures from the expenditure review will be assessed on a regular basis usually after the first half-year and after the end of the budget year.

The key decisions of strategic planning, initiative's output quality control and transparency is assessed by the Value for Money Committee made up of external professionals in the area of public policies.

FIGURE 42 – Expenditure review organisation



Source: MoF SR

5.2 Better investment management

The Government will unify the preparation and management of public investments. In compliance with the Value for Money principles, the assessment of benefits and costs will play a greater role in project assessment. Investment projects exceeding EUR 40 mil. are assessed by the MoF SR after they have been prepared by the submitting organisation.

The Government will unify the methodologies and process of investment project assessment. It will be based on the economic cost-benefit analysis (CBA). The currently disintegrated methodologies for CBA creation will be unified at a level of the entire central government. The projects under preparation will have to clearly define the objectives to be achieved, and the alternatives through which the objectives can be fulfilled. As many benefits and costs of each alternative as possible will be quantified financially, which will decrease the subjectiveness of the assessment. The key parameters and assumptions (discount rate, time value, etc.) will be defined in advance, thanks to which project comparability will be improved.

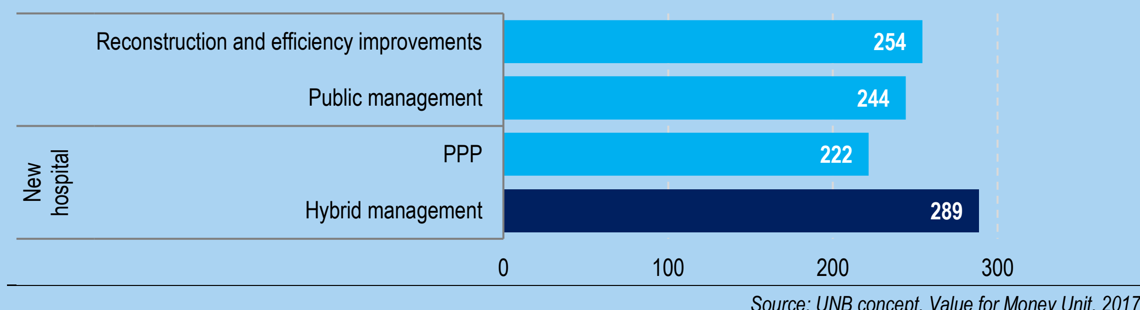
Every public investment project will mandatorily include a feasibility study regardless of the source of funding, they will also be assessed in terms of CBA by the Ministry of Finance of the SR. The feasibility study will be prepared usually at the beginning of the investment process, which will minimise the sunk costs of non-applied alternatives. The Ministry of Finance of the SR already assesses investment projects exceeding EUR 40 mil. in terms of Value for Money in the phase of feasibility study preparation and before publishing a contract notice for public procurement. In case of informatisation projects, the Ministry of Finance of the SR assesses projects exceeding EUR 10 mil.

BOX 13 – Investment assessment – a case study of new UNB (University Hospital Bratislava)

The project of new concept of University Hospital Bratislava brings value for money with a net present value of EUR 289 mil. The investment should be returned by 2032. The construction of the new hospital and its reorganisation also expects benefits from better care and reduction of avoidable mortality. **The new UNB (Rázsochy and Ružinov) is to be profitable and it is also remunerative as a separate investment.** For the success of the selected model of financing of the new UNB, contractual conditions are essential, which will motivate the healthcare manager to achieve profit while

maintaining high quality standards and care accessibility.

FIGURE 43 – Financial net present value of the alternatives of the new concept of UNB (EUR mil.)



Source: UNB concept, Value for Money Unit, 2017

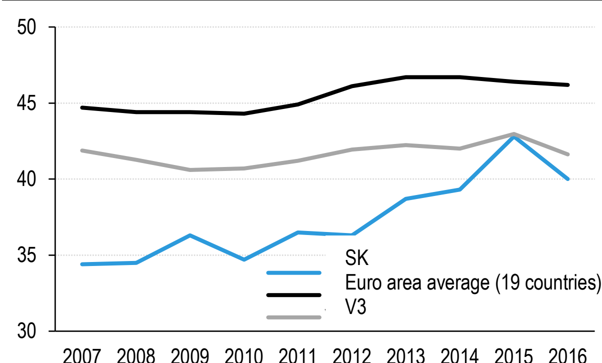
The Ministry of Finance of the SR assessed the draft reorganisation of the University Hospital Bratislava and construction of a new hospital in Bratislava with the total estimated costs of EUR 324 mil. exclusive of VAT. the new hospital should be situated at Rázsochy, the hospital at Ružinov should undergo a significant reconstruction. The project will include the conversion of the other hospitals to specialised (Staré Mesto, Podunajské Biskupice) and general (Petržalka). The Kramáre hospital should be cancelled after the completion of Rázsochy in 2023.

The project plan was submitted to government negotiation by the Ministry of Health of the SR. The MoF SR prepared an opinion on the project in terms of value for money. Based on the assessment of project objectives, demand analysis, selection of solution alternatives, economic assessment and project risks, the opinion recommended the project.

5.3 Revenue objectives of the general government budget

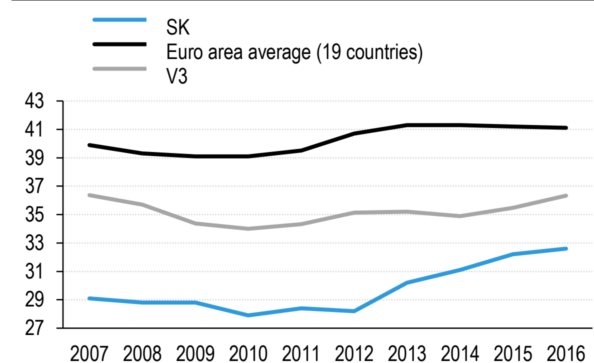
The ratio of total general government revenues to the GDP in Slovakia has been in the long term below the reference values represented by the Eurozone average and V3 countries. At the horizon of the last three years, however, the general government revenues converge to both reference averages (Figure 44), also thanks to the successful combat against tax evasion and measures adopted mainly in 2013. The year 2015 represents a specific exception, when a more significant growth of revenues was caused by accelerated draw-down from the EU funds from the end of the second programme period. Despite a partial convergence, **Slovakia further achieves the lowest ratio of tax and contribution revenues** (hereinafter the tax revenues)[65] **to the GDP in comparison with the averages of the Eurozone and the other V4 countries.**

FIGURE 44 – Revenues of GG (% of GDP)



Source: Eurostat

FIGURE 45 – Tax revenues of GG (% of GDP)



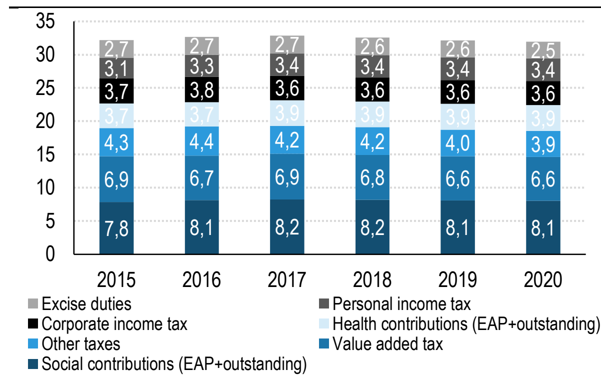
Source: Eurostat

In 2017, the share of tax revenues of general government in the GDP should reach 32.9 %. In the next years of the fiscal framework (2018 to 2020), the share will slightly decrease and in 2020 it will reach 31.9 % of GDP.

[65] Hereinafter only “tax revenues”, corresponding to the sum of ESA items (D.2REC+D.5REC+D61.REC).

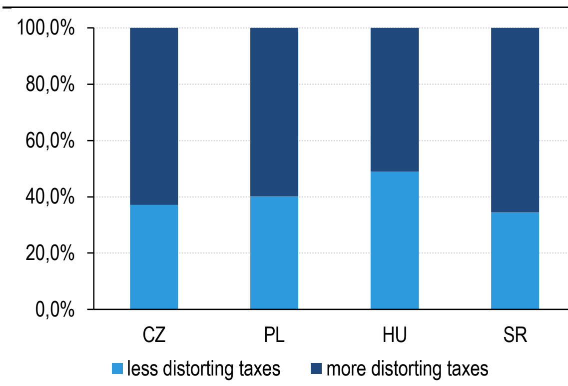
The fiscal framework expects **stable development** of personal income tax, corporate tax and health contributions in the proportion to the GDP at the entire horizon of the forecast (Figure 45). A decrease in the value added tax share in the GDP causes a slower growth of household consumption in comparison with the overall economy growth. The development of social contributions in comparison with the economy performance is affected by the gradual increase in the rate of contribution to the fully-funded pillar since 2017[66], the existence of maximum limits and minimum contributions, which logically do not allow the full transformation of wage base growth into contribution yields. **The absence of automatic indexation** of a part of tax revenues (real estate tax, excise tax collected, administrative fees and other revenues) **causes an erosion of their yield in the GDP** in the remaining years of the forecast.

FIGURE 46 – Tax to GDP ratio (% of GDP)



EAP – economically active population *Source: MoF SR*

FIGURE 47 - Tax mix according to influence of taxes on potential growth (% of tax revenues)[67]



Source: MoF SR

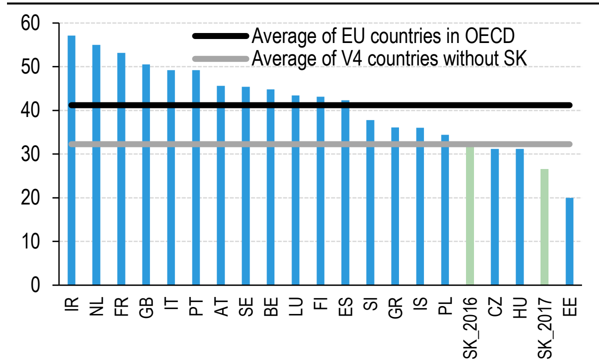
5.4.1. Competitiveness of the tax system of the SR

Slovakia is a small open economy and for its potential growth, a correctly selected tax mix is important to support and motivate the inflow of direct foreign investments. The tax mix should be considered through the influence of individual taxes on the economic growth. In this context, a stable share of taxes in terms of their influence on the economic growth[68] is expected at the horizon of the fiscal framework.

In terms of attractiveness for potential investors, the efficient taxation of labour and profit in the country is important. Several tax measures regarding the taxation of labour and capital were adopted last year; they came into effect this year. **The changes of dividends taxation will reduce the efficient taxation** in comparison with the valid legislation till 2016, and the rate of taxation of the dividends will drop below the level of taxation in the neighbouring countries of V4 (Figure 48). The changes of social contributions (cancellation of the maximum assessment base or its increase from five times to seven times the average wage) **will contribute to a higher progressivity of the tax system** but they will not affect the tax burden of employees with average wages and low-income employees. A slight increase in the burden of low-income employees (50 % of the average wage) is related to the non-indexation of the contribution allowance in health contributions (Figure 49).

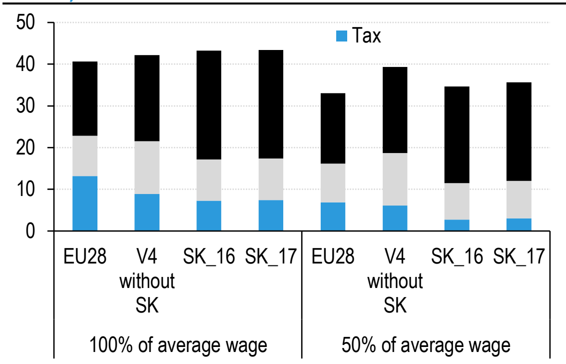
[66] It is not a tax revenue of GG.
[67] Property taxes (real estate tax), excise taxes, and environmental taxes are considered less harmful taxes in terms of economic growth. OECD (2010), Tax Policy Reform and Economic Growth, OECD Tax Policy Studies, No. 20, OECD.
[68] Slovakia achieves almost identical tax mix in terms of their influence on the economic growth in comparison with the EU average, but in comparison with the other countries there is a room for an increase in the share of less harmful taxes (Source: Tax Report of the SR).

FIGURE 48 – Effective taxation of dividends in EU (2016, 2017 also SR, in %)



Source: MoF SR

FIGURE 49 – Tax wedge, single worker, income 50 % and 100 % of the average wage in 2016 (% of labour costs)

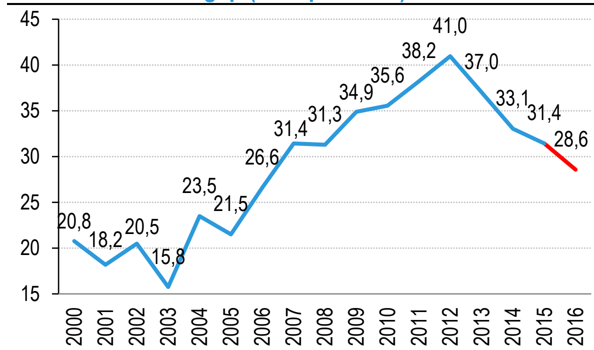


PM – average wage *Source: MoF SR*

5.4.2 Combating tax evasion

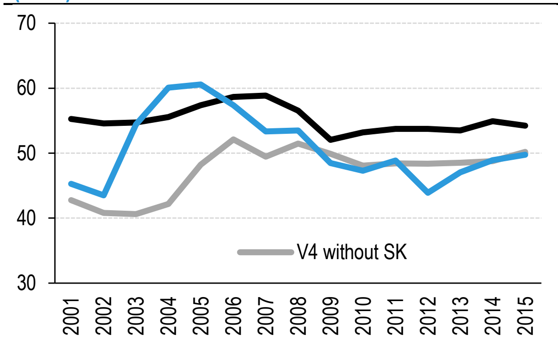
Combating tax evasion remains the key priority of the Slovak government. The initial effort was focused on the combat against VAT evasion. The measures from the three-phase action plan adopted in 2012 to 2016 helped reverse the long-term adverse development of efficiency in collection of this tax (Figure 50). The above fact is confirmed by the drop in VAT gap, which in the period from 2012 to 2016 dropped from a level of 41.0 % to 28.6 %. It is estimated in 2016 that the additional benefit of improved VAT collection efficiency due to the implemented measures for combating tax evasion corresponds to a level of 1.3 % of GDP in comparison with the year 2012.

FIGURE 50 – VAT gap (% of potential)



Source: MoF SR

FIGURE 51 - Indicator of VAT collection efficiency[69] (in %)



Source: MoF SR

The efficient corporate tax rate has been growing at a historical pace in the previous years (Figure 52), which in addition to the procyclical character of this tax[70] can be also attributed to VAT measures, which also have positive effect in the revenue from the corporate income tax[71] (Figure 53). With an effort to understand better how the reduction of tax evasion contributes to the record development of the efficient rate of the corporate tax, the MoF SR, in cooperation with the IMF, implements a pilot project of the estimate of corporate income tax gap. The preliminary results of the estimated corporate tax gap (Figure 53) confirm the original assumption of the

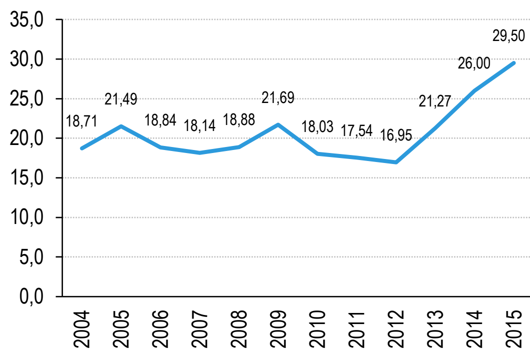
[69] The so-called VAT C-efficiency – represents the share of collected VAT in the nominal consumption multiplied by the base VAT rate. It expresses the efficiency of VAT collection in wide sense including the existing exceptions, allowances and reduced rates in value added taxation in the country (i.e. affected by the policy gap). The indicator compares the real VAT collection with the potential VAT collection in case that the whole consumption in the economy would be taxed by the basic rate.

[70] The development of corporate income tax elasticity against the macro base is procyclical, in the period after the financial crisis the efficient tax rate also decreased due to application of previous losses.

[71] The measures focused on decreasing the fraudulently applied VAT at the input in the form of duplicate or false invoices and on the elimination of unrecorded supplies to the customer will show themselves not only in the higher VAT liability but also in higher profitability, thus higher corporate income tax liability. On the contrary, the measures focused on frauds with excess VAT credits probably do not affect the revenue from the corporate income tax as the fraudulent companies mostly neither declare nor pay the tax.

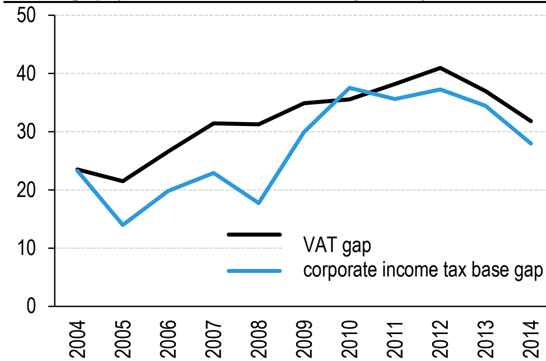
MoF SR that the measures focused on combating VAT evasion are almost directly proportionally reflected in the development of corporate tax collection efficiency.

FIGURE 52 – CIT effective tax rate (tax revenues divided by net operating surplus)



Source: MoF SR

FIGURE 53 – Comparison of VAT gap and CIT tax base gap (% of theoretical liability/base)



Source: IMF's RA-GAP

The effort of the Financial Administration of the SR (FA SR) also focuses on excise taxes, which is proved, after **the previous multi-year drop, by the stabilisation of tax gap for mineral oil tax** (see DBP 2017).

New measures for combating tax evasion (planned in 2017)

With effect from 2017, based on the update of the Action Plan, additional measures focused on combating tax evasion will be adopted. In compliance with the calls and recommendations identified by the EC, the FA SR will further support the improvement of the business environment, voluntary fulfilment of tax duties and reduction of administrative burden of clients by supporting the bidirectional electronic communication, increasing the efficiency of Call Centre services and by sending pre-filled tax returns for selected tax types.

In 2017, the implementation of the "soft warning" system is planned, which will warn the tax entities of a suspicion of involvement in fraud, of the occurrence and need to pay arrears, and of the possibility to file an additional tax return. The efficiency of recovery of arrears should also be increased thanks to the assessment of risk rate for tax debtors with the objective to obtain information for executors at one place and to speed up the recovery of arrears. In cooperation with the Slovak Banking Association, the FA SR prepares the provision of bidirectional electronic communication of executors through the direct recovery of arrears from the accounts of tax entities. At the same time, the second stage of automation of customs supervision of goods import through the system e-DOVOZ will be finalised. The planned measures also include the introduction of internal assessment of reliability of tax entities, implementation of measures increasing excise tax collection and eliminating tax evasion. The FA SR will extend the use of the ALLADIN system for the support of controls performed not only by customs but also by tax authorities, and in the area of international cooperation, it will continue to exchange data regarding tax residents.

Within the framework of the new Action Plan under preparation, in 2017 and 2018 additional measures will be adopted, which will be focused on tax fraud suppression and in particular on business environment improvement. In cooperation with other resorts of general government, an interdepartmental analytical centre will be established that will deal with financial delinquency and actively cooperate in preparing draft legislative changes to prevent tax frauds.

BOX 14 – Action plan for combating tax evasion

The drop in VAT collection efficiency in 2012, and the related tax gap increase to 41.0 % of potential revenue (EUR 3 bn.) stimulated the adoption of the action plan for combating tax evasion. Since 2012, the value added tax gap has been reduced by one third (from 41.0 % to 28.6 %).

Measures adopted in 2012 to 2016

In the first stage of the action plan in 2012, the cancellation of registration of non-communicating and non-contact tax entities was enabled, and the institute of joint and several tax liability was introduced. The amendment to the VAT Act introduced the duty to deposit the financial bond by risky persons in VAT registration, the mandatory monthly taxation period for new VAT payers for twelve months, and reduced the limit of turnover to a mandatory monthly taxation period. New crimes of tax fraud and obstruction of tax administration performance were defined. In July 2012, the pilot project "Tax Cobra" was commenced, within which the Financial Administration of the SR in cooperation with the police and Public Prosecutor's Office solve the cases of serious tax frauds.

In the second stage, the regime of tighter tax supervision over the risky entities, the duty of investment administrator to deposit the limited liability company partners' investments to a bank account was introduced. A program of fight against corruption within the FA SR was started, and with the intention to prevent fictional issuance of receipt and expenditure cash vouchers, the duty of cashless payment with a limit exceeding EUR 5 thousand was introduced.

In the third stage in 2014, the most important measure in the area of combating tax evasion was the introduction of control statement (KV), which improved the efficiency of controls of excess credits (EC). The selected data from the KV can be confronted with the data, which the taxpayer provided in the tax return. This created an effective possibility of cross check of data. The domestic transfer of tax liability to the performance beneficiary (reverse charge) was also extended to risk commodities which limited carrousel transactions with them.

In 2015, the action plan was supplemented with additional 30 measures focused in particular on a higher efficiency of identification, collection and recovery of taxes. The transfer of tax liability to the performance beneficiary for construction work, so-called domestic self-taxation (in terms of tax frauds, the building sector represents highest risks) or extension of the duty to use electronic cash registers were introduced, inter alia. Based on the experience from practice, modifications were performed in the control statement, which prevent the abuse of simplified tax documents. In addition to VAT, the effort is also focused on excise taxes (taxation of cigars and cigarillos depending on weight).

Planned measures for 2017 and 2018

Combating tax evasion is a never-ending story and the Government of the SR is going to approve a new Action Plan with measures that will be adopted in 2017 and 2018. These measures can be divided into three areas: **"pro-business" measures, whose objective is to unload administratively the business environment, measures supporting tax administration, and measures improving the control activities.**

With the objective to improve the business environment, the introduction of the possibility of payment of a part of EC without tax control is planned where tax administrator has unambiguous evidence that the claim is authorised. In comparison with the presence, only the part of the EC will be retained, which is suspicious to the administrator. Creation of an internal index of tax entity reliability is another measure that will contribute to lower burden of entrepreneurs and higher efficiency of tax administration.

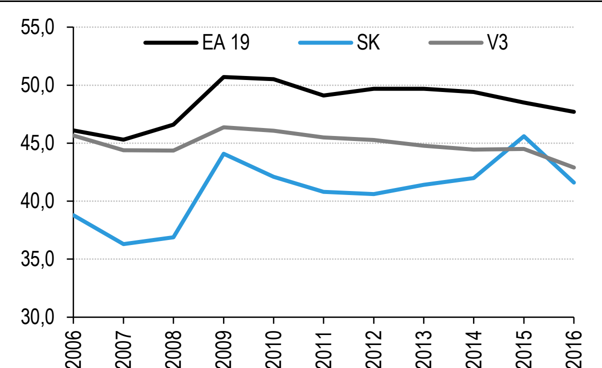
The simplification of the assessment procedure and the legal regulation for merger of business companies will contribute to more efficient tax administration performance. The objective of both measures is to prevent the abuse of company division in tax payment or artificial extension of assessment procedures.

The measures **improving tax audit** include the planned introduction of electronic cash desk (eKASA). It means on-line interconnection of electronic cash registers with the central cash register at the FA SR. The objective of this measure is to limit the non-registration of issued vouchers and to increase the efficiency of control of electronic cash registers. The extension of the super detainment order to property will allow the audit unit of the FA SR to detain property in case of a reasonable suspicion that the property is related to crime. To increase the efficiency of controls, the institute of agent is introduced, where for the most serious forms of tax crimes, a person other than a member of the police force can act as an agent.

5.4 Expenditure objectives of the general government budget according to their function[72]

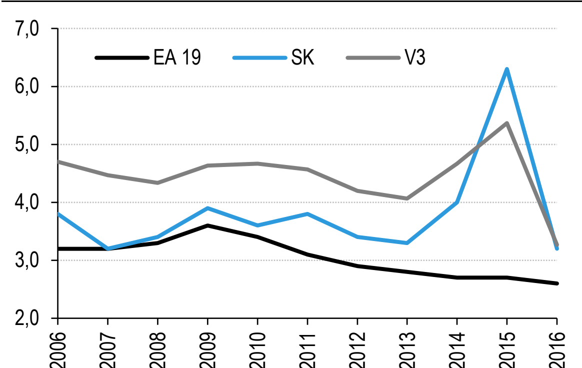
The ratio of total general government expenditures to the GDP in Slovakia has been, in the long term ,below the reference values represented by the Eurozone average and V3 countries. In the previous years the general government expenditures converged to the both reference averages (Figure 54). A high increase in 2015 was affected by the draw-down of EU resources from the second programming period. Last year, the expenditures returned to the level of 2013, suggesting the possibility of their convergence suspension. Thus, Slovakia still belongs to the European states with a lower ratio of public expenditure to the GDP. The acceleration of EU funds draw-down in Slovakia and in the remaining V4 countries led to a significant increase in public investments in 2014 and 2015. Last year meant the lowest level for capital expenditures since 2007 (Figure 55).

FIGURE 54 – GG expenditures (% of GDP)



** EA19 (Eurozone average), V3 (V4 countries without the SR)*
Source: Eurostat

FIGURE 55 – Gross fixed capital formation (% of GDP)



** EA19 (Eurozone average), V3 (V4 countries without the SR)*
Source: Eurostat

The international comparison of the structure of expenditures according to their function[73] in comparison with the other countries of V4 shows that Slovakia spends a lower share of expenditures on education, general public services and economic area.[74] **The share of expenditures in the GDP is in comparison with the average of the other V4 countries higher in healthcare and inpublic order and safety.** On the contrary, Slovakia spends a lower share of expenditures on social security. In comparison with the EU average, the difference in the share of social security expenditures is even higher due to relatively lower expenditures on long-term care and other social services[75], and also on the support and activation in unemployment.

TABLE 31 – General government expenditures according to COFOG classification

Functions	COFOG code	SK 2018 (FR)		SK 2017 (E)		V3 (2015)		EU 28 (2015)	
		% of GDP	% TE	% of GDP	% TE	% of GDP	% TE	% of GDP	% TE
1. General public services	1	5.0	12.7	5.4	13.3	6.0	13.3	6.2	13.1
2. Defence	2	1.2	3.0	1.1	2.7	1.0	2.4	1.4	2.9
3. Public order and safety	3	2.1	5.4	2.2	5.3	2.0	4.6	1.8	3.7
4. Economic area	4	3.9	9.9	4.7	11.6	6.6	14.7	4.3	9
5. Environmental protection	5	0.5	1.2	0.4	1.1	1.0	2.2	0.8	1.7
6. Housing and amenities	6	0.5	1.3	0.5	1.1	0.8	1.8	0.6	1.2
7. Healthcare	7	7.3	18.7	7.4	18.1	5.9	13.3	7.2	15.2
8. Recreation, culture and religion	8	1.0	2.6	1.0	2.4	1.5	3.4	1.0	2.2
9.Education	9	4.2	10.6	4.0	9.8	5.1	11.6	4.9	10.3
10. Social security	10	13.6	34.8	14.2	34.6	14.5	32.8	19.2	40.6

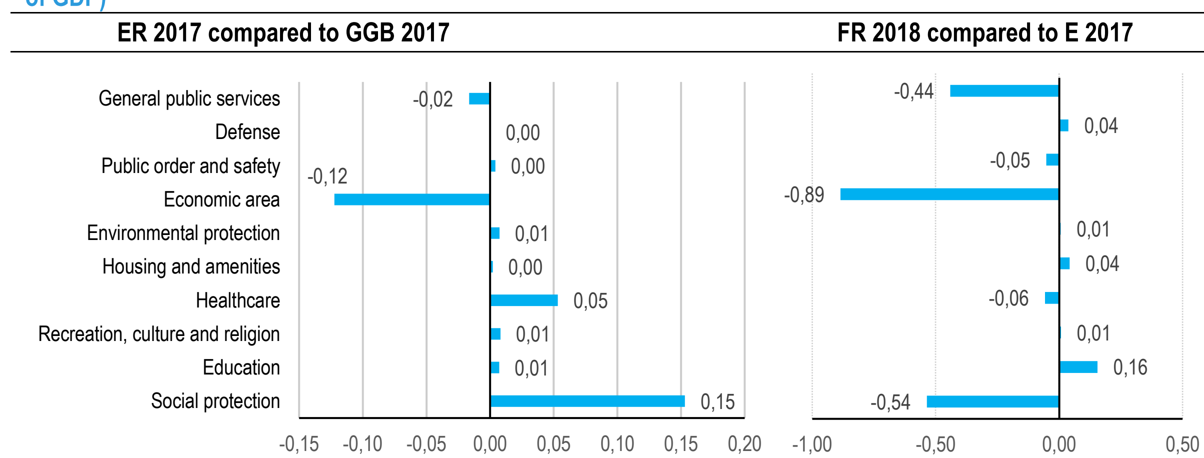
[72] Note: The methodology of expenditure recording according to the functional classification can differ among individual countries. This can cause that within the same item, different data are provided in various countries (e.g. taxed and untaxed pensions). Nor expenditures executed through the tax system (e.g. tax credit on dependent child) are taken into account by the COFOG classification.
[73] The latest available data for COFOG classification are from 2015.
[74] The change of Eurostat in the methodology of healthcare and social protection expenditure recording from 2015 has been cancelled. Thus, the expenditures were included into their original areas. The assumptions of the fiscal framework for 2017 were adjusted for this fact.
[75] E.g. care of children, people in need.

Total expenditure	TE	39.2	100	40.9	100	44.5	100	47.2	100

Note: TE – Total expenditures of general government, FR – fiscal framework, E – latest estimate *Source: MoF SR*

According to the latest estimate (E) for 2017, public expenditures are higher by 0.1 % of GDP in comparison with the approved budget. An increase in comparison with the approved budget is recorded in particular in social security and healthcare (Figure 56)[76]. On the contrary, in economic area expenditures are lower by 0.12 % of GDP in comparison with the approved budget. In the other areas, the level of expenditures is close to the level expected by the approved budget for 2017.

FIGURE 56 - General government expenditures comparison according to COFOG classification (changes in p. p. of GDP)[77]



Note: GGB – general government budget (approved by the parliament) E - latest estimate *Source: Eurostat, MoF SR*

The share of expenditures in the GDP, according to the fiscal framework for 2018, decreases in comparison with the latest estimate for 2017 by 1.7 % of GDP. The nominal expenditures grow in particular in education, healthcare, and social policy. The education expenditures grow in connection with the indexation of wages of pedagogic employees in compliance with the government priorities. The nominal expenditures in healthcare increase with respect to the expected growth of revenues from the economically active population. The year-on-year increase in nominal social policy expenditures is slower than the GDP growth, thus, their share in the GDP drops. The economic area and general public services expenditures decrease both nominally and as a share in the GDP due to slower draw-down of the EU funds, as well as lower expenditure on significant investments.

[76] The difference in social security is caused by the fact that the latest estimate for 2017 (unlike the budget) already contains the costs on the extra-budgetary account of the armed units' pension scheme. In healthcare, the difference is caused by an increase in salaries due to a rapid increase in the minimum wage and higher than expected growth of average wage in the economy. Veta o zdravotnictve sa možno vyhodí.

[77] For the needs of the Stability programme, the data for the GDP are taken from the current official forecast of the Macroeconomic Forecasts Committee from February 2017.

6 INSTITUTIONAL ASPECTS OF PUBLIC FINANCE

Within the existing fiscal framework, Slovakia applies several fiscal rules; the credibility of public finance development is primarily provided by the debt brake rule and the rule of balanced budget of general government. No changes of application of national fiscal rules occurred during the year 2016. However, the government initiated a public discussion concerning the potential changes in the debt brake rule primarily with the objective to ensure the neutrality of debt criterion in managing the state's cash reserve, consideration of strategic public investments in applying sanctions and adjustment of parameters of sanction bands supporting a sustainable growth of Slovakia. Several changes were implemented in the Budgetary Rules Act, which ensures the practical application of the medium-term budgetary objective.

The objective of the national fiscal framework is to achieve sound budgetary positions, reduce the procyclical character of fiscal policy, and increase the efficiency of public expenditures. The national framework of fiscal policy defines a set of rules, regulations, and procedures affecting the implementation of the national budgetary policy in the form of its planning, approving, monitoring, and evaluating. They include in particular the following:

1) **National fiscal rules** that produce permanent pressure on the fiscal policy through the defined binding objectives for main budgetary aggregates (public revenues, public expenditures, deficit, and debt). They contribute to the strengthening of budgetary discipline, coordination of public policies, and reduction of uncertainty regarding the future development of fiscal policy.

2) **Independent fiscal institutions** that produce independent macroeconomic forecasts, monitor and evaluate the development of fiscal policy and fulfilment of fiscal responsibility rules.

3) **Medium-term budgetary frameworks** ensuring the preparation, implementation, monitoring, and binding character of budgetary policy at a multi-year horizon.

6.1 Institutional aspects of public finance in the Slovak Republic

In the conditions of the Slovak Republic, the **following fiscal rules** are applied:

1. The rule of debt brake for general government – the Fiscal Responsibility Act introduced the government's duty to approach cautiously to the debt ratio of the whole general government from 2012. If the Maastricht (gross) debt value confirmed by Eurostat gets beyond the debt bands specified by law at the end of the year, the government shall be obliged to automatically adopt corrective measures, whose scope and character is applied depending on the amount of the achieved debt and the appertaining sanction band.

No change in comparison with the previous Stability Programme. With the objective to find constitutional majority, at the end of 2016 the government initiated a wide professional and political discussion about a reform of the constitutional Fiscal Responsibility Act. The objective of the discussion under way is to reach **debt brake neutrality in managing the general government debt by linking the sanction bands of the constitutional act to the net general government debt** instead of the gross general government debt, taking into account the strategic public investments in applying sanctions and adjustment of parameters of sanction bands supporting the economic development of Slovakia. The MoF SR consistently monitors and supports the discussion development with respect to the application of professional approach in forming this legal regulation.

BOX 15 – Assessment of the rule of debt brake for general government

On 21 October 2016, Eurostat published the result of update of the notification of gross debt of the Slovak Republic for 2015, where the resulting debt amount 52.5 % of GDP signalised that the debt limit of 50% of GDP had been exceeded. In this connection, in compliance with the Fiscal Responsibility Act (No. 493/2011 Coll.), a mechanism was started automatically, which requires for the first debt band (50 % of GDP to 53 % of GDP) that the MoF SR sends to the National Council of the Slovak Republic a written substantiation of the debt amount including the draft measures for reducing it. In compliance with the act, the MoF SR prepared and sent the substantiation of the debt amount officially to the National Council of the Slovak Republic.

2. GG balanced budget rule (Fiscal compact) – based on the ratification of the international treaty[78] that included government's commitment to the transposition of the European rules of the Stability and Growth Pact into the national legislation, an amendment to the Budgetary Rules Act was approved with effect from 2014. New budgetary duties result from the act, in particular the balanced budget rule[79] and application of the correction mechanism in case of a significant deviation from this rule.

No change in comparison with the previous Stability Programme.

BOX 16 – Assessment of fulfilling the balanced budget rule for 2015

In 2016, two assessments of fulfilling the balanced budget rule for 2015 were carried out[80]. The preliminary assessment based on the April notification of Eurostat was submitted in June 2016. The updated final assessment based on the October notification of Eurostat took place in November 2016. The MoF SR stated that in terms of overall assessment and shift of the MTO to 2019, the identified significant deviation (in 2015) from the original way to MTO achievement in 2017 did not represent the legal fulfilment of the correction mechanism application.

In evaluating the compliance with the balanced budget rules, the Council for Budget Responsibility obtained different results in terms of overall assessment, as well as structural balance result. Therefore it proposed the need of starting the correction mechanism at least in the form of limit of budgeted expenditures of general government. In compliance with the "observe and explain" principle, on 29 December 2016, the MoF SR published the Opinion on the Assessment of the Council for Budget Responsibility[83], where it explained the reasons of different assessment within the so-called "overall assessment" between the MoF SR and the Council for Budget Responsibility, and confirmed that there were no legal reasons for applying the correction mechanism.

With respect to the different interpretation[81] in applying the European (Stability and Growth Pact) and national fiscal rules (Fiscal Compact), there can be objectively different assessment of the fiscal position. The elimination of the existence of different interpretations should be solved by the publication of the methodical manual for evaluating the balanced budget rule, which is currently under preparation at the MoF SR.

3. Local government balanced budget rule – based on the Act on Budgetary Rules of Local Government from 2004, an authorised authority of local government can approve the budget for a current year virtually only with balanced or surplus fiscal performance. There is only one exception, when the possible budget deficit is financed by the transfer from the state budget, from the budget of the European Union, by using the undrawn resources from previous years or for a capital budget, also from returnable financial resources. If financial discipline is not observed, the MoF SR can decide on applying legal sanctions.

No change in comparison with the previous Stability Programme.

4. The rule of debt brake for local government - the Act on Budgetary Rules of Local Government also defines the limits regarding the debt amount of local government. If the total debt exceeds 50 % of current revenues of the previous year, the correction mechanism will be started automatically and the local government will be obliged to adopt adequate measures with the objective to reduce the debt. If the debt sum exceeds 60 % of current revenues, the MoF SR will impose a fine amounting to 5 % of the sum, by which the debt exceeded the limit of 60 % of current revenues.

[78] Treaty on Stability, Coordination and Governance in the Economic and Monetary Union.

[79] According to the legal provision, in the medium-term horizon the economy of general government has to make towards a balanced budget, which is defined as a structural deficit equal to or lower than 0.5 % of GDP. If there is a significant deviation from the medium-term objective or procedure leading to it, the government shall be obliged, based on the assessment of the MoF SR, to make decision on starting the correction mechanism.

[80] The MoF SR assessments of fulfilling the balanced budget rule for 2015 and the MoF SR opinions on the assessments of the Council for Budget Responsibility for 2015 are published at: http://www.finance.gov.sk/Default.aspx?CatID=9664.

[81] The differences result from several factors. The first is the methodology for structural balance calculation, where the national methodology is used for the purpose of the Fiscal Compact (FC) in contrast to the uniform methodology of the EC. The different assessment of heading for the MTO is another reason (a cumulative deviation on the way to the MTO in the national methodology versus one- and two-year deviation in the EC methodology). In evaluating the Fiscal Compact, a certain level of autonomy in taking into account the one-off measures, in taking into account additional factors within the overall assessment and "windfall revenues" treatment is also accepted.

No change in comparison with the previous Stability Programme.

BOX 17 – Assessment of the debt brake rule for local government

The provisions of constitutional Act No. 493/2011 and Act No. 583/2004[82], regarding the imposition of penalties to local governments in case that the debt exceeds the limit of 60 % of current revenues of the previous year came into effect on 1 January 2015. The amount of debt was assessed in such way for the first time in 2016 for the year 2015. Debt amount monitoring and imposition of fines fall under the competences of the MoF SR.

The debts of self-governing regions were below the legally specified limit in 2015. At the end of 2015, the total debt ratio of self-governing regions achieved a level of 30.5 % of current revenues of the previous year.

For municipalities, based on the data from the financial statements 207 municipalities were identified that by exceeding the debt limit of 60 % fulfilled the conditions for the imposition of a fine (+ 2 municipalities in receivership). After excluding the statutory exceptions, the duty applied to 140 municipalities. In a letter dated 20 June 2016, the MoF SR called upon 140 chief controllers of municipalities to comment on the limit overrun for 2015. For 125 municipalities, the substantiation was accepted. For 15 municipalities, it was stated that the legal debt limit had been exceeded without sufficient substantiation. Based on that, the MoF SR commenced the administration procedure to impose a fine for 15 affected municipalities. The MoF SR will inform about the result of the administration procedure after it has been finished.

5. The rule of exceeding the state budget expenditure limits – the rule limits the possibility of exceeding the approved expenditures of the state budget by maximum 1 % with the objective to finance the additionally occurred expenditure titles, which were not included in the approved State Budget Act. The mentioned exceeding, however, must not lead to an increase in the SB deficit.

No change in comparison with the previous Stability Programme.

The task of **independent fiscal institution** in Slovakia is fulfilled by the Council for Budget Responsibility (CBR). The main tasks of the CBR include the regular preparation of a report on the long-term sustainability, the assessment of fulfilment of fiscal responsibility rules and budgetary transparency rules, preparation of opinions on the legislative bills in particular in terms of consequences for the budget and long-term sustainability, and other.

No change in comparison with the previous Stability Programme.

The practical application of **medium-term budgetary frameworks** in the conditions of the Slovak Republic is ensured by the Budgetary Rules Act (Act No. 523/2004 Coll.). It defines the budget of general government as a medium-term economic tool of the state's financial policy, which is prepared annually for at least three budget years. The budgetary objectives, except for the budgeted year (t+1), in the next years (from t+2 to t+3) are not binding. The budget of general government consists of entities of central government, local government, and other general government entities, whose economic activities are comprehensively incorporated. The current budgetary legislation expects the cooperation of all relevant entities in preparing the fiscal frameworks, not only in creating the budget for the respective budget year but also for the following years. Including the law-making body (National Council of the Slovak Republic) into the preparatory process is an important aspect of the budgetary process. The MoF SR is the main creator and guarantor of budget preparation, however, the most important moment is its entry into legal force after it has been approved by the National Council of the Slovak Republic. It means an important element of credibility of medium-term budgetary frameworks for the resulting assessment of quality of medium-term budgetary frameworks.

Changes in comparison with the previous Stability Programme in the area of medium-term budgetary frameworks:

[82] The budgetary rules in Act No. 583/2004 for the local government specify, in addition to the duty to verify the observance of conditions for adoption of returnable financing resources, the duty of the chief controller of municipality or self-governing region to monitor, for the entire budget year, the state and development of the debt of the municipality or self-governing region and to report a violation of these conditions to the Ministry of Finance without undue delay.

In 2016, the MoF SR prepared an amendment to the Act on Budgetary Rules of General Government (GG), which came into effect in 2017. The most important changes affecting the quality of the fiscal framework are as follows:

- the draft GG budget is based on the GG balances specified by the Stability Programme approved by the Government of the Slovak Republic,
- the assessment of effectiveness and efficiency of expenditures was indirectly implemented in the budgetary process of GG through the duty of the entities linked to SB resources to provide data for the purpose of reviews,
- with effect from 1 January 2018, the duty to budget all the revenues and expenditures of budget and contributory organisations including the business activities ("de jure", the extra-budgetary accounts were eliminated) is introduced, which will significantly contribute to an improvement of budget transparency and continuous development monitoring quality,
- the procedure was modified for the case when the draft budget contains tax and contribution revenues that were not approved in the tax revenue forecast by the Tax Revenue Forecasts Committee[83]. Such symmetrically budgeted expenditures can only be used if the Tax Revenue Forecasts Committee confirms such additional revenues.
- the binding deadline (15 August) for the MoF SR for the submission of the draft GG budget to the Government of the SR for approval was cancelled.

BOX 18 – Assessment of national fiscal frameworks – a relative position of the Slovak Republic to the EU

For 2015, the budgetary framework of the SR was positively assessed in the area of **fiscal rules,** and the EC identifies a room for further improvement in the quality of the medium-term budgetary framework**.** The Index of national fiscal rules[84] reached the same value as in 2014 (2.5 points), which placed Slovakia among the ten best EU countries. Since 2015, local governments have been obliged to pay a fine[85] for exceeding the debt rule.

Quality of the **medium-term budgetary framework** lags behind the average of the EU but it is best from the V4 countries. The Index for Medium-Term Budgetary Frameworks[86] achieves the average of the EU (0.6 of maximum 1 point) thanks to good detail and scope of the contained information[87] and involvement of the National Council of the SR in the budgeting process. The EC sees a room for improvement in particular in strengthening the binding character of the medium-term framework as the set objectives are indicative except for the first year, and in implementing the binding expenditure ceilings.

[83] Such tax and contribution revenues not included in the forecast must be incorporated in the draft general government budget without any influence on the resulting deficit.

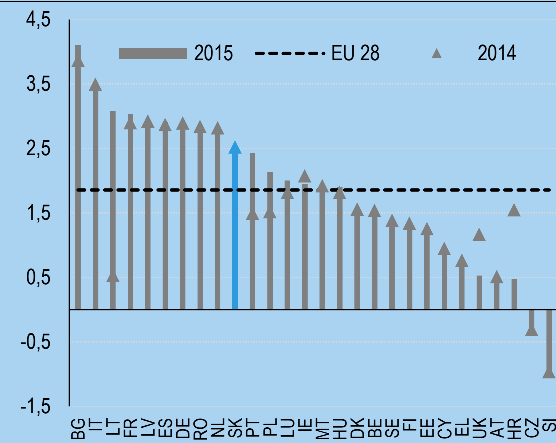
[84] The Index of National Fiscal Rules is prepared by the EC; on a regular basis, it assesses the effectiveness of several dimensions of fiscal rules (the legal basis, a room for the change of objectives and binding character of rules, the monitoring institutions, correction mechanisms, resistance to events out of government's control), whose objective is to ensure the budgetary discipline.

[85] If the total amount of debt of a municipality or self-governing region achieves 60 % of real current revenues of the previous budget year or more, the municipality or self-governing region shall be obliged to pay a fine imposed by the MoF SR and amounting to 5 % of the difference between the total debt amount and 60 % of real current revenues of the previous budget year. The state does not financially provide for and is not responsible for the solvency of the municipality or self-governing region.

[86] The medium-term budgetary frameworks allow the creation of fiscal policy beyond the ambit of the one-year horizon of budget, which does not provide sufficient basis for effective budgetary planning. According to the new methodology, this pillar assesses, inter alia, the scope of general government included in the medium-term budget, interconnection of objectives between the annual budget and medium-term budget, the coordination of the budgeting process, and involvement of the national parliament and an independent budgetary institution, and the level of medium-term budgetary framework preparation.

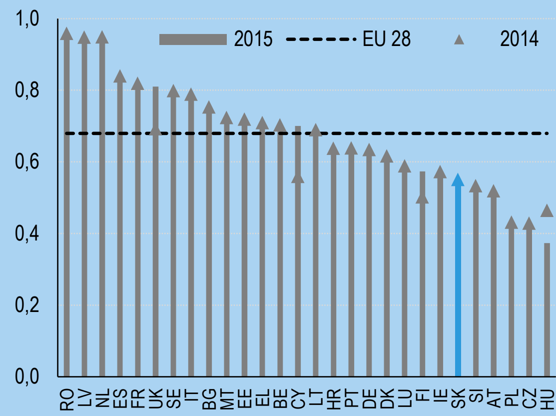
[87] The medium-term budgetary framework of the SR is reflected in the Stability Programme of the Slovak Republic.

FIGURE 57 – National fiscal rules (index)



Source: EC

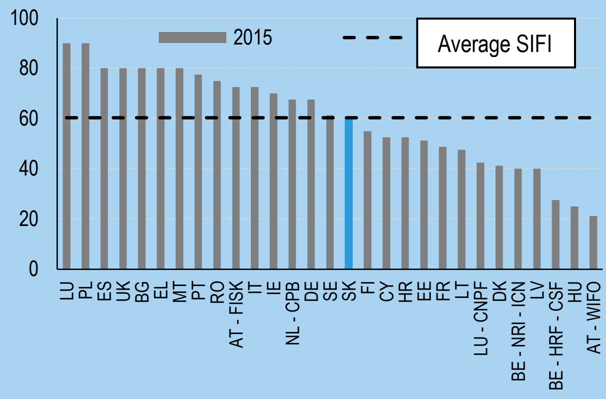
FIGURE 58 – Medium-term budgetary frameworks (index)



Source: EC

Beyond the aspect of traditional areas of evaluation of institutional aspects of public finance, in 2016 the EC introduced another index[88] evaluating the scope of activities of independent fiscal institutions in the EU. The EC evaluates the main tasks primarily performed by independent fiscal authorities within their scope of work: (1) monitoring of fiscal policy and rules; (2) macroeconomic/budgetary forecasting; (3) policy costing; (4) analysis of long-run sustainability of public finances; (5) promotion of fiscal transparency; and (6) normative recommendations on fiscal policy. In this evaluation, Slovakia is represented by the Council for Budget Responsibility, which performs its activity on the basis of the Fiscal Responsibility Act. EC evaluations for the year 2015 placed the Council for Budget Responsibility close above the average of evaluation of independent fiscal institutions in individual EU Member States[89].

FIGURE 59 – Independent fiscal institutions (index)



Source: EC

[88] SIFI – "Scope Index of Fiscal Institutions"

[89] In connection with this evaluation it has to be noted that not all Member States have established an independent fiscal authority monitoring the development of public finance. On the other hand, there are countries, in which several such institutions operate.

ANNEXES

Annex 1 – Required tables of the Stability Programme

TABLE 32 (Table 1a) - Macroeconomic prospects (ESA 2010, in EUR bn.)

	ESA code	2016 Level	2016 growth rate	2017 growth rate	2018 growth rate	2019 growth rate	2020 growth rate
1. Real GDP	B1*g	78.9	3.3	3.3	4.0	4.4	3.8
2. Nominal GDP	B1*g	81.0	2.9	4.4	5.6	6.4	5.9
Components of real GDP							
3. Private consumtion expenditure	P.3	40.9	2.9	2.5	2.7	2.9	2.9
4. Government consumption expenditure	P.3	14.7	1.6	1.6	2.0	1.9	1.4
5. Gross fixed capital formation	P.51g	16.3	-9.3	3.0	1.9	2.0	3.6
6. Changes in inventories and net acquisition of valuables (% of GDP)	P.52 + P.53	-	1.3	0.2	0.2	0.2	0.2
7. Export of goods and services	P.6	78.3	4.8	5.6	7.3	7.7	6.2
8. Import of goods and services	P.7	72.5	2.9	4.2	6.0	6.3	5.5
Contribution to real GDP growth							
8. Final domestic demand (total)		-	-0.4	2.2	2.2	2.2	2.4
9. Changes in inventories and net acquisition of valuables	P.52 + P.53	-	1.2	-0.5	0.0	0.0	0.0
10. External balance of goods and services	B.11	-	2.0	1.7	1.9	2.1	1.4

Source: MoF SR

** The forecast of government consumption is based on the February macroeconomic forecast of the MoF SR. The Macroeconomic Forecasts Committee approved the economic development forecast before publishing the outturn data for 2016. Updating of the real data creates inconsistency in the nominal GDP level for 2017–2020 approved by the Committee and the GDP level derived from the growth rate of the nominal GDP also approved by the Committee. For the purpose of the general government budget, the level of nominal GDP approved by the Committee is applicable.*

TABLE 33 (Table 1b) – Price developments (ESA 2010)

	ESA code	2016 Level	2016 growth rate	2017 growth rate	2018 growth rate	2019 growth rate	2020 growth rate
1. GDP deflator		1.0	-0.4	1.0	1.6	2.0	2.1
2. Private consumption deflator		1.1	-0.3	1.1	1.7	1.9	2.1
3. HICP		-0.5	-0.5	1.1	1.7	1.9	2.1
4. Public consumption deflator		1.1	1.3	2.0	1.9	2.0	2.1
5. Investment deflator		1.0	-0.6	1.0	1.6	2.0	2.1
6. Export price deflator (goods and services)		1.0	-1.4	1.3	1.6	1.8	2.0
7. Import price deflator (goods and services)		1.0	-1.1	1.9	1.7	1.9	2.0

Source: MoF SR

TABLE 34 (Table 1c) - Labour market developments (ESA 2010)

	ESA code	2016 Outturn	2016 growth rate	2017 growth rate	2018 growth rate	2019 growth rate	2020 growth rate
1. Employment, persons (thous.) [1]		2,321	2.4	1.8	1.1	0.9	0.9
2. Employment, hours worked (mil.)[2]		4,039	1.6	1.8	1.1	0.9	0.9
3. Unemployment rate (%)[3]			9.7	8.4	7.6	6.9	6.2
4. Labour productivity per person (EUR) [4]		33,974	0.9	1.5	2.9	3.4	2.9
5. Labour productivity per hours worked (EUR) [5]		20	1.7	1.5	2.9	3.4	2.9
6. Compensation of employees (EUR mil.)	D.1	31,627	4.6	5.2	5.5	5.8	6.0

7 Compensation per employee (EUR)	15,824	1.8	3.3	4.3	4.8	5.1

[1] Total employment, national accounts – home concept
[2] According to national accounts definition
[3] Harmonized rate according to Eurostat, status
[4] Real GDP per person employed
[5] Real GDP per hour worked

Source: SO SR, MoF SR

TABLE 35 (Table 1d) - Sectoral balances (ESA2010, % of GDP)

	ESA code	2016	2017	2018	2019	2020
1. Net lending/borrowing vis-à-vis the rest of the world	B.9	2.3	2.9	3.5	4.4	4.8
of which:						
- Balance on goods and services		3.4	5.1	6.3	7.6	8.3
- Balance of primary incomes and transfers		-3.1	-3.4	-4.0	-4.4	-4.7
- Capital account		2.0	1.2	1.2	1.2	1.2
2. Net lending/borrowing of other sectors	B.9	4.0	4.2	4.0	4.4	4.8
3. Net lending/borrowing of the general government (objectives)*	B.9	-1.7	-1.3	-0.5	0.0	0.0
4. Statistical discrepancy		-	-	-	-	-

* Final 2016

Source: MoF SR

TABLE 36 (Table 2a) - General government budgetary prospects

	ESA code	2016 level	2016 % of GDP	2017** % of GDP	2018 % of GDP	2019 % of GDP	2020 % of GDP
Net lending (B.9) by general government sub-sectors							
1. General government	S.13	-1,362	-1.68	-1.24	-0.50	0.00	0.00
2. Central government	S.1311	-1,570	-1.9	-1.7	-0.9	-0.3	-0.3
3. State government	S.1312	-	-	-	-	-	-
4. Local government	S.1313	461	0.6	0.3	0.3	0.3	0.3
5. Social security funds	S.1314	-253	-0.3	0.1	0.1	0.1	0.1
General government (S13)							
6. Total revenue	TR	32,345	40.0	39.7	38.7	38.6	38.0
7. Total expenditure	TE [1]	33,706	41.6	40.9	39.2	38.6	38.0
8. Net lending/borrowing	B.9	-1,362	-1.68	-1.24	-0.50	0.00	0.00
9. Interest expenditure	D.41	1,339	1.7	1.3	1.3	1.2	1.1
10. Primary balance	[2]	-22.8	0.0	0.1	0.8	1.2	1.1
11. One-off and other temporary measures	[3]	-35	0.0	0.0	0.0	0.0	0.0
Selected components of revenues							
12. Total taxes (12=12a+12b+12c)		14,822	18.3	18.4	18.3	18.0	17.8
12a. Taxes on production and imports	D.2	8,616	10.6	10.9	10.7	10.5	10.3
12b. Current taxes on income, wealth, etc.	D.5	6,206	7.7	7.5	7.6	7.5	7.6
12c. Capital taxes	D.91	-	0.0	0.0	0.0	0.0	0.0
13. Social contributions	D.61	11,616	14.3	14.4	14.3	14.1	14.1
14. Property income	D.4	778	1.0	0.7	0.6	0.6	0.5
15. Other	[4]	5,129	6.3	6.1	5.5	5.9	5.5
16=6. Total revenue	TR	32,345	40.0	39.7	38.7	38.6	38.0
p.m.: Tax burden (D.2+D.5+D.61+D.91-D.995)	[5]	26,438	32.7	32.9	32.6	32.1	31.9
Selected components of expenditures							
17. Compensation of employees + intermediate consumption	D.1+P.2	11,851	14.6	14.6	14.3	14.1	13.8
17a. Compensation of employees	D.1	7,399	9.1	8.9	9.0	9.0	8.8

17b. Intermediate consumption	P.2	4,452	5.5	5.7	5.3	5.1	5.0
18. Social payments	D6	15,520	19.2	18.6	18.1	17.7	17.3
of which: unemployment benefits	[6]	172	0.2	0.2	0.2	0.1	0.1
18a. Social transfers in kind	D.632	4,238	5.2	5.0	5.0	5.0	5.0
18b. Social transfers other than in kind	D.62	11,282	13.9	13.5	13.1	12.7	12.3
19.=9. Interest expenditure	D.41	1,339	1.7	1.3	1.3	1.2	1.1
20. Subsidies	D.3	376	0.5	0.6	0.5	0.5	0.4
21. Gross fixed capital formation	P.51g	2,598	3.2	3.3	2.7	2.6	2.8
22. Capital transfers	D.9	373	0.5	0.4	0.3	0.3	0.3
23. Other	[7]	1,649	2.0	2.2	2.0	2.3	2.3
24=7. Total expenditure	TE [1]	33,706	41.6	40.9	39.2	38.6	38.0
p.m.: Government consumption (nominal)	P.3	15,755	19.5	19.3	19.1	18.9	18.6

[1] Adjusted for the net flow of swap-related flows, so that TR-TE=B.9 *Source: MoF SR*
[2] The primary balance is calculated as (B.9, item 8) plus (D.41, item 9)
[3] A plus sign means a deficit-reducing one-off measure
[4] P.11+P.12+P.131+D.39+D.7+D.9 (other than D.91)
[5] Including those collected by the EU
[6] Includes cash benefits (D.621 and D.624) and in kind benefits (D.631) related to unemployment benefits
[7] D.29+D4 (other than D.41)+ D.5+D.7+P.52+P.53+K.2+D.8

TABLE 37 (Table 2b) - No-policy-change scenario (NPC)

	2017	2017	2018	2019	2020
	mil. EUR	% of GDP	% of GDP	% of GDP	% of GDP
1. Total revenue at unchanged policies	33 567	39.7	38.7	38.6	38.1
2. Total expenditure at unchanged policies	34 615	40.9	38.7	38.4	37.5

Note: The basis for the NPC purposes for 2018 to 2020 is the current estimate for 2017. *Source: MoF SR*

TABLE 38 (Table 2c) - Amounts to be excluded from the expenditure benchmark

	2016	2016	2017	2018	2019	2020
	mil. EUR	% of GDP	% of GDP	% of GDP	% of GDP	% of GDP
1. Expenditure on EU programmes fully matched by EU funds revenue	796	1.0	1.2	0.9	1.4	1.3
1.a. of it investments fully matched by EU funds revenue	507	0.6	0.8	0.5	0.6	0.6
2. Cyclical unemployment benefit expenditure not related to governmental measures (cyclical component)	6	0.0	0.0	0.0	0.0	0.0
3. Effect of discretionary revenue measures	-136	-0.2	0.2	-0.1	0.0	0.0
4. Revenue increases mandated by law	0	0.0	0.0	0.0	0.0	0.0

Source: MoF SR

TABLE 39 (Table 3) - General government expenditure by function (% of GDP)

	COFOG code	2015	2017 R	2020
1. General public services	1	6.1	5.5	4.8
2. Defence	2	1.0	1.1	1.6
3. Public order and safety	3	2.1	2.2	1.9
4. Economic affairs	4	5.8	4.9	3.8
5. Environmental protection	5	0.6	0.4	0.4
6. Housing and community amenities	6	0.5	0.5	0.7
7. Healthcare	7	7.3	7.3	7.1
8. Recreation, culture and religion	8	1.0	1.0	0.8
9. Education	9	4.1	4.0	4.3
10. Social protection	10	14.4	14.0	12.7
11. Total expenditure	**TE**	**43.0**	**40.8**	**38.0**

R – Approved budget | *Source: Eurostat, MoF SR*

TABLE 40 (Table 4) - General government debt development (% of GDP)

	ESA code	2015	2016	2017	2018	2019	2020
1. Gross debt		52.5	51.9	51.8	49.9	48.0	46.0
2. Change in gross debt ratio		-1.1	-0.5	-0.2	-1.8	-1.9	-2.0
Contributions to change in gross debt							
3. Primary balance *		1.0	0.0	-0.1	-0.8	-1.2	-1.1
4. Interest expenditures	EDP D.41	1,8	1.7	1.3	1.3	1.2	1.1
5. Stock-flow adjustment		-2.0	-0.7	0.8	0.4	1.1	0.7
of which:							
- Differences between cash and accruals		-0.9	-0.9	0.5	0.6	0.5	0.5
- Net accumulation of financial assets		-1.0	0.2	0.4	0.1	0.7	0.4
of which: revenues from privatisation		-1.0	0.0	0.0	0.0	0.0	0.0
- Valuation effects and others		-0.1	0.0	-0.1	-0.3	-0.1	-0.3
p.m. Implicit interest rate		3.4	3.2	2.6	2.6	2.5	2.4
Other relevant variables							
6. Liquid financial assets		4.3	4.9	4.9	4.8	5.3	5.4
7. Net financial debt (1-6)		48.2	47.0	46.9	45.1	42.7	40.5
8. Debt amortization (existing bonds) from previous year		-4,1	-5.9	-5.3	-3.6	-1.7	-3.0
9. Share of debt denominated in foreign currency **		3,7	3.5	3.1	2.6	2.2	2.2
10. Average maturity ***		7.0	7.0	7.6	-	-	-

** It is a contribution to the debt. Primary balance for 2017 is based on the actual data for 2017* — *Source: MoF SR*

*** Including loans*

**** It concerns the maturity of state debt as of 31 December, for 2017 it concerns average maturity as of 12 April 2017*

TABLE 41 (Table 5) - Cyclical developments

(% of GDP)	ESA code	2016	2017	2018	2019	2020
1. Real GDP growth (%)		3.3	3.3	4.0	4.4	3.8
2. Net lending of the general government*	B.9	-1.7	-1.2	-0.5	0.0	0.0
3. Interest expenditure	D.41	1.7	1.3	1.3	1.2	1.1
4. One-off and temporary measures	[1]	0.0	0.0	0.0	0.0	0.0
of which:						
Revenue measures – general government		0.0	0.0	0.0	0.0	0.0
Expenditure measures – general government		0.0	0.0	0.0	0.0	0.0
5. Potential GDP growth (%)		2.8	2.9	3.5	3.7	3.8
contributions:						
- labour		0.3	0.2	0.2	0.1	0.1
- capital		0.7	0.6	0.7	0.8	0.8
- total factor productivity		1.8	2.0	2.6	2.8	2.9
6. Output gap		-0.6	-0.6	-0.2	0.6	0.9
7. Cyclical budgetary component		-0.3	-0.2	-0.1	0.2	0.4
8. Cyclically-adjusted balance (2 - 7)		-1.4	-1.0	-0.4	-0.2	-0.4
9. Cyclically-adjusted primary balance (8 + 3)		0.2	0.3	0.9	0.9	0.7
10. Structural balance (8 - 4)		-1.4	-1.0	-0.4	-0.2	-0.4

[1] A plus sign means a deficit-reducing one-off measure — *Source: MoF SR*
* For 2017, the actual data provided.

TABLE 42 (Table 6) – Divergence from previous update

	ESA code	2015	2016	2017	2018	2019	2020
Real GDP growth (%)							
Previous update*		3.6	3.2	3.6	4.1	4.6	-
Outcome and current update		3.8	3.3	3.3	4.0	4.4	3.8
Difference		0.2	0.1	-0.3	-0.1	-0.2	-
General government net lending (% of GDP)	EDP B.9						
Previous update*		-2.97	-2.13	-1.29	-0.44	0.16	-
Outcome and current update**		-2.74	-1.68	-1.24	-0.50	0.00	0.00
Difference		0.23	0.45	0.05	-0.06	-0.16	-
General government gross debt (% of GDP)							
Previous update*		52.9	52.9	52.2	49.8	47.3	-
Outcome and current update**		52.5	51.9	51.8	49.9	48.0	46.0
Difference		-0.4	-0.9	-0.4	0.1	0.7	-

*Note: * Stability Programme of the SR for 2016–2019* *Source: MoF SR*

** For 2017, the actual data provided

TABLE 43 (Table 7) - Long-term sustainability of public finances (% of GDP)*

	2020	2030	2040	2050	2060
Total expenditure	**41.24**	**41.29**	**41.93**	**43.50**	**45.04**
Of which: Age-related expenditures	**18.27**	**18.32**	**18.96**	**20.53**	**22.07**
A. Pension expenditure	8.42	8.01	8.50	9.52	10.67
1. Social security pensions	8.00	7.60	8.10	9.10	10.20
a) Old-age and early pensions	6.20	5.70	6.00	6.90	7.90
b) Other pensions (disability, survivors)	1.70	1.70	1.90	2.10	2.10
2. Occupational pensions (if in general government)	0.38	0.39	0.39	0.39	0.44
B. Health care	6.09	6.66	7.12	7.49	7.70
C. Long-term care	0.32	0.39	0.47	0.55	0.65
D. Education	3.23	3.08	2.75	2.85	2.94
E. Other age-related expenditures	0.22	0.18	0.12	0.12	0.12
Of which: Interest expenditure	2.3	2.8	3.4	5.1	8.1
Total revenues	**38.3**	**38.0**	**38.0**	**38.2**	**38.4**
Of which: Property income (D.4)	1.0	0.9	0.9	0.8	0.8
Of which: Pension contributions	13.2	13.0	13.0	13.3	13.5
Pension reserve fund assets	-	-	-	-	-
Of which: consolidated public pension fund assets	-	-	-	-	-
Systemic pension reforms					
Social contributions diverted to voluntary private scheme	0.6	0.7	0.5	0.3	0.2
Pension expenditure paid by a voluntary private scheme	-	-	-	-	-
Assumptions					
Labour productivity growth	2.9	2.6	1.7	1.7	1.5
Real GDP growth	3.8	2.5	0.7	0.5	0.8
Participation rate males (aged 15-64)	78.3	77.4	77	78.3	79.5
Participation rate females (aged 15-64)	63.9	63.1	61.5	62	63.1
Total participation rate (aged 15-64)	71.1	70.3	69.4	70.2	71.4

Unemployment rate (aged 15-64)	12.8	10.8	7.5	7.5	7.5
Population aged 65+ of the total population (in %)	16.9	21.6	25.5	31.3	35.2

** Age-related expenditures as well as macroeconomic assumptions were updated after issuing Ageing Report 2015*

Source: MoF SR

TABLE 44 (Table 7a) - Contingent liabilities

	2015	**2016**	**2017**
	% of GDP	% of GDP	% of GDP
Public guarantees	16.9	16.0	-
of which: linked to EFSF and ESM	9.3	9.0	-

**The estimate for 2016 is preliminary and does not contain data for all entities.*

Source: MoF SR

TABLE 45 (Table 8) - Basic assumptions

	2015	**2016**	**2017**	**2018**	**2019**	**2020**
Short-term interest rate EONIA (annual average, %)	-0.11	-0.32	-0.35	-0.35	-0.29	-0.29
Long-term interest rate 10Y-SLOVGB (annual average, %)	0.82	0.54	0.98	1.25	1.57	1.74
USD/€ exchange rate (annual average) (euro area and ERM II countries)	1.11	1.11	1.06	1.10	1.13	1.18
World excluding EU, GDP growth (%)	-	-	-	-	-	-
EU GDP growth (%)	2.14	1.80	1.72	1.74	-	-
Growth of relevant foreign markets (%)	2.18	1.92	1.99	1.95	1.88	1.80
World import volumes, excluding EU (%)	-	-	-	-	-	-
Oil prices (Brent, USD/bl)	53.64	45.03	55.36	55.91	55.85	56.24

Source: Common external assumptions, MoF SR

Annex 2 - The impact of fiscal policy on the economy in 2018 to 2020

The extent of the fiscal measures is calculated compared to the no-policy-change scenario based on the expected general government balance for 2017. **In 2018, the budgetary target against the NPC scenario takes into account a fiscal impulse amounting to 0.5 % of GDP, which represents EUR 449 million.** In the following years, a fiscal impulse is also taken into account amounting to 0.2% of GDP in 2019 and to 0.6 % of GDP in 2020. This represents a cumulative impulse of measures against NPC, which means that **in terms of year-on-year changes, in 2019 we see a fiscal restriction amounting to EUR 285 million (0.3 % of GDP). In 2020, the fiscal framework expects a fiscal impulse of EUR 455 million (0.5 % of GDP).**

The volume of measures with a direct impact on GDP in 2018 amounts to EUR 466 mil. (0.5 % of GDP). Fiscal expansion is expected primarily on the expenditure side, with an increase in the expenditure connected with capital investments and capital transfers (total EUR 253 million), compensations of employees (EUR 101 million), and total social transfers (EUR 57 million, of which 50 million correspond to an increase in pensions of pensioners, who retired before a certain year). On the contrary, general government is expected to save EUR 34 million on intermediate consumption. Expansive and restrictive measures will be offset on the revenue side.

In 2019, the effect of measures with a direct impact on GDP growth is negative at a level of EUR 252 mil. (0.3 % of GDP). A decrease in capital investments and capital transfers (total EUR 296 million) and general government intermediate consumption (EUR 23 million) dominates in the structure of expenditure measures. A growth is recorded only for employee compensations as a consequence of teachers' salaries indexation (EUR 40 million). Expansive and restrictive measures will be offset on the revenue side.

In 2020, the effect of measures with a direct impact on GDP growth amounts to EUR 414 mil. (0.4 % of GDP). Fiscal expansion mainly stems from an increase on the expenditure side, in particular due to the investments (EUR 341 million) and general government intermediate consumption (EUR 105 million). A decrease in compensations (EUR 88 million) and capital transfers (EUR 29 million) act in the opposite direction. Expansive measures, in particular lower market production, slightly prevail on the revenue side.

TABLE 46 - Transmission macroeconomic channels (in mil. EUR)

	2018	2019	2020
Total	**449**	**-285**	**455**
(in % of GDP)	**0.5**	**-0.3**	**0.5**
Direct impact on GDP	**466**	**-252**	**414**
(in % of GDP)	**0.5**	**-0.3**	**0.4**
Government consumption	**146**	**58**	**78**
Intermediate government consumption	-34	-23	105
Compensation of employees	101	40	-88
Social transfers in kind (healthcare providers)	7	-9	0
Market production	72	51	61
Investments	**245**	**-299**	**311**
Government	169	-240	341
Other	76	-59	-30
Households	**185**	**31**	**-62**
Inflation	**-8**	**-3**	**-1**

Source: MoF SR

The impact of fiscal policy on main macroeconomic indicators of the Slovak economy including the secondary effects is quantified through the IFP macroeconomic model for medium-term forecasts. For grants and transfers we consider a zero multiplier, therefore the assumed direct impact on the economy is increased by 0.02 % of GDP and 0.03 % of GDP in 2018 and 2019 respectively, and lower by 0.04 % of GDP lower in 2020.

In 2018, the impact of fiscal policy on the GDP growth is positive at a level of 0.3 p. p. In 2019, the consolidation measures will reduce the growth of economy by 0.2 p.p., in 2019 the effect of fiscal policy

on GDP is again positive at a level of 0.2 p. p. The implied fiscal multiplier will reach 0.6 in 2018. This value reflects a significant increase in investments, compensations and social transfers, which is however suppressed by a drop in intermediate consumption. In the next year, a similar value of 0.63 is expected. It is driven in particular by a decrease in investments and to a smaller extent by a decrease in intermediate consumption and a slight increase in compensations. In 2020, the implied multiplier reaches a much lower value of 0.4, caused by an increased import intensity of government investments and a decrease in compensations, which prevail the influence of the increased intermediate consumption.

TABLE 47 - Impact of measures on GDP (in p.p.) according to the IFP macro model

	2017	2018	2019
measures with a direct impact on GDP	**0.5**	**-0.3**	**0.4**
contribution to a CPI change	0.0	0.0	0.0
employment	0.0	0.0	0.0
nominal wage	0.5	0.0	-0.1
gross disposable pension	0.4	0.0	-0.1
household consumption	0.3	0.0	0.0
government consumption	0.2	0.1	0.2
investments	1.8	-1.9	1.9
import	0.2	-0.2	0.2
contribution to the YoY GDP change	**0.3**	**-0.2**	**0.2**

Annex 3 - Structural balance calculation

The first step in the calculation of the **general government structural balance** requires adjusting the nominal (officially notified) general government balance so that it is net of the **cyclical component**. The cyclical component expresses the response of public finance revenues and expenditures to changes in the output gap. The size of the cyclical component depends on the size of the output gap and on the elasticity of selected revenue and expenditure categories responding to fluctuations in economic activity. The output gap calculation can lead to differing estimates of this indicator depending on the methodology used. In this case the output gap was estimated with the EC methodology with input data taken from the MoF SR forecast. In its estimation of elasticity of the general government balance to the changes in the output gap, the MoF SR fully utilizes the EC's estimates based on the OECD methodology.[90]

Secondly, the general government balance must be adjusted for is **one-off and temporary effects**. Agreed principles defined by the EC and described more closely in the IFP manual were taken into consideration in their identification.[91] Based on the available information, the below stated one-off effects may be identified in 2016. No one-off measures have been envisaged according to the EC methodology for 2017 and the remaining forecast years. In order to be consistent, we provide the structural balance in all monitored years.

One-off and temporary effects in 2016:

- **Contribution to the EU budget** – based on Council Decision 2014/335/EU (ORD 2014), calculation of European Union's own resources was revised with retroactive effect from 1 January 2014[92]. This ratified modification resulted in an additional single contribution of Slovakia to the EU budget amounting to EUR 35.2 mil.

TABLE 48 - Calculation of the structural balance and one-off measures (ESA2010, in % of GDP)

	2015	2016	2017	2018	2019	2020
1. Net lending/borrowing	**-2.74**	**-1.68**	**-1.24**	**-0.50**	**0.00**	**0.00**
2. Cyclical component	-0.4	-0.3	-0.2	-0.1	0.2	0.4
3. One-off effects	**-**	**-0.0**	**-**	**-**	**-**	**-**
- higher contribution to the EU budget	-	-0.04	-	-	-	-
4. Structural balance (1-2-3)	**-2.32**	**-1.39**	**-1.01**	**-0.40**	**-0.24**	**-0.37**

Source: MoF SR

[90] Girouard, N., André, Ch.: Measuring cyclically-adjusted budget balances for OECD countries. OECD Economics department working papers, no. 434, 2005.

[91] IFP (2014) Manual: One-off effects, http://www.finance.gov.sk/Default.aspx?CatID=9595

[92] Revenues from the following constitutes own resources entered in the budget of the EU: 1) traditional own resources (levies, duties), 2) a share of revenues from VAT of individual Member States, and 3) a share of gross national income of individual Member States

Annex 4 - Expenditure benchmark

TABLE 49 - Expenditure benchmark (ESA 2010)

		2015	2016	2017	2018	2019	2020
1. Total expenditures	mil. EUR	**35,850**	**33,706**	**34,615**	**35,028**	**36,678**	**38,233**
2. Interest payments	mil. EUR	1,379	1,339	1,106	1,137	1,124	1,080
3. Expenditures covered by EU resources (capital)	mil. EUR	2,345	507	652	427	591	591
3a. Total expenditures covered by EU resources	mil. EUR	2,789	796	1,000	792	1,375	1,333
4. Capital expenditures covered by national resources	mil. EUR	2,606	2,091	2,110	1,981	1,847	2,269
5. Smoothed capital expenditures (national resources 4-year floating average)	mil. EUR	1,944	2,061	2,215	2,197	2,007	2,052
6. Cyclical unemployment benefit expenditure	mil. EUR	10	6	6	3	-7	-11
7. Expenditures fully matched by automatic revenue increase	mil. EUR	0	0	0	0	0	0
8. Primary expenditure aggregate (1-2-3a-4+5-6-7)	mil. EUR	**31,011**	**31,535**	**32,608**	**33,312**	**34,346**	**35,614**
9. Year-on-year change of the primary expenditure aggregate (8t-8t-1)	mil. EUR	2,147	524	1,106	704	1,034	1,268
10. Change in revenues due to discretionary revenue measures	mil. EUR	139	-136	201	-61	-17	-17
11. One-off revenue measures	mil. EUR	0	0	0	0	0	0
12. One-off expenditure measures	mil. EUR	0	-35	0	0	0	0
13. Methodical adjustments[93]	mil. EUR	0	-34	0	0	0	0
14. Nominal increase in the expenditure aggregate adjusted for revenue measures ((9t-(10t-11t)+12t+13t)/8t-1)	%	7.0	1.9	2.8	2.3	3.2	3.7
15. Real increase in the expenditure aggregate adjusted for revenue measures	%	6.2	0.7	1.6	0.8	1.2	1.6
16. Expenditure benchmark (reduced reference rate of pot. GDP growth)	p. p.	2.9	2.2	1.3	1.3	2.6	2.6
17. Deviation from the expenditure benchmark (16-15)	p. p.	-3.3	1.5	-0.2	0.5	1.4	1.0
18. Deviation from the expenditure benchmark	% of GDP	**-1.2**	**0.6**	**-0.1**	**0.2**	**0.5**	**0.3**
19. Two-year deviation from the expenditure benchmark	% of GDP	**0.0**	**-0.3**	**0.2**	**0.0**	**0.3**	**0.4**
p.m. GDP deflator	*%*	*0.7*	*1.2*	*1.2*	*1.5*	*2.0*	*2.1*
p.m. convergence margin	*%*	*-1.1*	*0.0*	*0.6*	*1.3*	*1.3*	*0.0*
p. m. Nominal GDP	*mil. EUR*	*78,686*	*80,958*	*84,580*	*89,351*	*95,073*	*100,730*

Source: MoF SR

[93] Adjustment for the impact of the National Resolution Fund on total expenditures in 2016.

Annex 5 - Discretionary revenue measures

The EC methodology defines discretionary revenue measures as legislative-character measures affecting the general government revenues. They are evaluated by means of so-called additional impacts (marginal changes) of these measures. Permanent or one-off measures are distinguished. A permanent measure is recorded with an impact in the first year (at the moment when it becomes applicable) and with no additional impact in the following years. In other words, changes in the impact of the measure in the following years due to macroeconomic development are not taken into account. If different effects occur due to a postponed application of a measure, only the marginal change is recorded.[94] For one-off revenue measures, the impact is recorded only in one year and in the following year a shortfall of the same amount, i.e. the overall impact of a measure in two subsequent years is zero (for example an extraordinary contribution in the banking sector).

TABLE 50 - Discretionary measures (in EUR mil., ESA 2010)

	Overall effect						Additional effect					
Description	**2015**	**2016**	**2017**	**2018**	**2019**	**2020**	**2015**	**2016**	**2017**	**2018**	**2019**	**2020**
Bank contribution rate reduction from 2015	-42						-42					
Changes in contribution burden	-8						-8					
Changes in tax depreciation of assets	123						123					
Measures to improve the effectiveness of tax collection (ECR and pharmaceutical companies)	56						56					
Introduction of thin capitalisation rules	47						47					
Deduction of the expenditure on science and research from the tax base	-2						-2					
Audit of tax expenditures and other	12						12					
Opening of the fully-funded pillar - current impact	16						16	13				
Health contribution allowance	-62	-146	-123	-99	-78	-58	-62	-84	23	24	20	20
Act 222/2004 Coll. on VAT, loosened conditions for excess VAT credits payment within 30 days	-3,4	3,4					-3	7	-3	0		
VAT – reduced rate for selected food		-77						-77				
Increased number of cigarettes in a package from 19 to 20		5	7					5	2			
Taxation of cigars and cigarillos according to weight			21						21			
595/2003 and 580/2004 – support of investments on the capital market		-11						-11				
An increase in the consideration for the provision of services			25						25			
The rate of corporate income tax reduced to 21 %			-141						-141			
Doubled rate of special contribution in regulated industries, modification of conditions and calculation, decrease in 2019			91		52				91		-39	
Increasing the excise tax on cigarettes			30		68				30		36	
Keeping the rate of special contribution from financial institutions at 0.2 %									0			
Taxation of dividends – 7 % withholding tax				51						51		
Other – paying interest on retained excess VAT credits, more efficient tax administration			3						3			
Personal income tax - corporate income tax exemption for income of the Council for Resolving Crisis Situations			-5						-5			
Nontax revenues - gambling, a special taxation regime for insurance companies			38						38			
Lump-sum expenditures – 60 %, max. EUR 20 thous.			-13	-21					-13	-7		
Cancellation of maximum assessment base for health insurance			90	77					90	-14		
Increasing the social security assessment base (from 5- to 7-times the average wage)			67						67			
Increasing the contribution to the fully-funded pillar (by 0.25 p. p. from 2017)			-27	-59	-93	-131			-27	-32	-34	-38

[94] The following example illustrates the impact of incremental changes. The overall effect of a measure is 200. Since it is introduced in the middle of the year, the effect in the respective year is 100. In the next year, the effect rises to the whole amount 200, however, marginally only the difference between the two effects is recorded, i.e. 100. Cumulatively, the entire effect is 200, only it is distributed into two years.

Cancellation of tax licence				-83						-83		
TOTAL	**139**	**-225**	**63**	**-133**	**-51**	**-189**	**139**	**-136**	**201**	**-61**	**-17**	**-17**

Annex 6 - Macroeconomic and Tax Revenue Forecasts Committees

The Stability Programme is based on macroeconomic and tax forecasts at the horizon of years 2017 to 2020 from February 2017. The macroeconomic scenario as well as the forecast tax revenues are subject to continuous discussion, approval and expert scrutiny by committees composed of national experts from both the public and private sector. The dates for disclosing forecasts as well as the guiding principles of the committees are laid down in the Fiscal Responsibility Act.

After the February 2017 session of the Macroeconomic Forecasts Committee, all of its members assessed the medium-term macroeconomic forecast of the Ministry of Finance of the Slovak Republic as **realistic**.

TABLE 51 - Assessment of the February forecast of the MoF SR by the Macroeconomic Forecasts Committee

Committee member	**Forecast characteristics**
NBS, Infostat, UNICREDIT Bank, VÚB, Tatrabanka, SLSP, ČSOB, Sberbank	realistic
SAV	-

Source: Macroeconomic Forecasts Committee

TABLE 52 - Average forecast of Committee members* (except for the MoF SR) and the forecast of the MoF SR

	2016	**2017**		**2018**		**2019**		**2020**	
in %, unless otherwise stated		**Committee**	**MoF SR**	**Committee**	**MoF SR**	**Committee**	**MoF SR**	**Committee**	**MoF SR**
Gross domestic product, real growth	3.3	3.2	3.3	3.8	4.0	4.2	4.4	3.7	3.8
Gross domestic product in current prices; EUR billion	81.0	84.2	84.6	88.9	89.4	94.4	95.1	99.8	100.7
Final consumption of households; real growth	2.9	3.0	2.5	2.7	2.7	3.0	2.9	2.8	2.9
Final consumption of households; nominal growth	2.5	3.8	3.6	4.6	4.4	5.1	4.8	4.9	5.1
Average monthly wage; real growth	3.3	2.5	2.4	2.5	2.6	2.4	2.9	2.5	2.9
Average monthly wage; nominal growth	2.9	3.6	3.5	4.3	4.4	4.4	4.8	4.6	5.1
Employment growth (statistical reporting)	2.4	1.6	1.8	1.0	1.1	0.9	0.9	0.8	0.9
Consumer price index; average growth; CPI	-0.5	1.1	1.1	1.8	1.7	2.0	1.9	2.0	2.1
Current account balance; share of GDP	-0.6	0.2	1.7	0.9	2.4	1.8	3.2	1.5	3.7

** Macroeconomic Forecasts Committee*

Source: Macroeconomic Forecasts Committee

Tax Revenue Forecasts Committee

At the meeting of the Tax Revenue Forecasts Committee in February 2017, the MoF SR presented an updated medium-term forecast of tax revenues for 2016–2020. The medium-term forecast of tax revenues and pensions contributions of the MoF SR was indicated by all of the members as **realistic**.

TABLE 53 - Assessment of the MoF SR forecast by the Tax Revenue Forecasts Committee

Committee member	**Forecast characteristics**
NBS, Infostat, Tatra banka, ČSOB, KRRZ, SLSP, UniCredit Bank	realistic