Ministry of Finance of the Slovak Republic

STABILITY PROGRAMME OF THE SLOVAK REPUBLIC FOR 2009 - 2012

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INTRODUCTION

Members of the euro area are required to prepare stability programmes each year, while the other European Union members prepare convergence programmes. Preparation of stability and convergence programmes forms an integral part of the Stability and Growth Pact and, after approval by national governments, they are submitted to the European Commission and the European Council. The purpose of the programmes is to present the development of fiscal position in medium-term horizon, expected economic developments, and a description of budgetary and other economic policy measures taken to achieve the goals of the programme. Slovakia is submitting its second stability programme, which updates the stability programme of April 2009.

Following Slovakia's accession to the euro area, the main goals of the Slovak government in the area of macroeconomic policies have narrowed down to the area of fiscal policy, which represents the main tool for influencing the development of real economy should internal or external shocks occur. The recent global economic crisis, the consequences of which required flexible and targeted reaction in the form of anti-crisis measures, underscored the importance of fiscal policy.

The fiscal policy in 2009 reflected the recommendations of the European Commission outlined in the "European Economic Recovery Plan" of 26 November 2009, approved by European Council on 11-12 December 2008. The countries whose fiscal situation made it possible were encouraged to leave the free play of automatic stabilisers in 2009 and stimulate their economies through budgetary measures which should have been timely, targeted and temporary.

However, the expected stabilisation and gradual macroeconomic improvements from 2010 are already creating conditions for the return on the path of fiscal consolidation. The 2010-2012 consolidation objectives of the Slovak government take account of the Council (ECOFIN) Conclusions of 20 October 2009 on coordinated strategy for exiting from fiscal stimulus measures in the European Union (exit strategies), as well as the consequences of placing Slovakia under the excessive deficit procedure, which is governed by Article 126 of the Treaty on the Functioning of the European Union (Treaty) and Council Regulation (EC) No 1467/97 on speeding up and clarifying the implementation of the excessive deficit procedure. Slovakia belongs to countries that have committed itself to start with fiscal consolidation in 2010 and, at the same time, it is one out of nine EU member countries that is, according to the European Commission's autumn forecast (November 2009), projected to reduce the deficit in 2010.

The economic downturn had a direct negative impact on the general government deficit in 2009. According to the current estimates, the deficit is expected to expand from the budgeted 2.1% to 6.3% of GDP, which is above the Treaty reference value (3% of GDP). As a consequence of that development, the European Commission initiated excessive deficit procedure for Slovakia, which the Council formally opened on 2 December 2009. Along with Slovakia, the excessive deficit procedure has been opened for 8 other member countries. By the end of 2009, the total of 20 EU members was under this procedure.

The stability programme presents a strategy which, in a medium-term, should lead to the abrogation of the excessive deficit procedure. The ultimate goal remains unchanged: to achieve a sound fiscal position which ensures long-term sustainability of public finances. The main objectives of the Stability Programme of the Slovak Republic until 2012:

- Fiscal targets for the next years are influenced by the initial fiscal position of 2009. The objective of the previous stability programme to resume fiscal consolidation in 2010 remains unchanged: the general government deficit of 6.3% of GDP in 2009 is expected to fall to 5.5% of GDP in 2010. In the medium run, the government has two key fiscal objectives. Assuming that the economy will develop in line with the scenario presented in this programme, the first objective is to reduce general government deficit to 3% of GDP by 2012 and thus comply with the recommendations related to the excessive deficit procedure. Should macroeconomic developments exceed expectations, the government commits itself to consolidate public finances at a faster pace. The second objective is to continue the ambitious consolidation effort also beyond

2012 in order to achieve a balanced budget no later than by 2015, which is the basic prerequisite to ensuring long-term sustainability of public finances. This target reflects the provisions of the Stability and Growth Pact and takes into account implicit liabilities related to population ageing,

- The present Stability Programme of the Slovak Republic until 2012 contains less ambitious fiscal targets than those presented in the stability programme of April 2009, particularly because the economic downturn in 2009 was steeper than projected. On the other hand, the pace of structural consolidation is more ambitious and will reach an average of 0.9% of GDP in the following three years, which is by 0.4% of GDP faster than under original assumptions.

The standard deadline for the submission of stability programmes to the Commission was 1 December 2009. Because of the opening of the excessive deficit procedure against several Member States, including Slovakia, and given the fact that the Council adopted final recommendations at its meeting on 2 December 2009, the Commission has decided to postpone the deadline until 31 January 2010. The Stability Programme of the Slovak Republic for 2009–2012 is based on the general government budget approved by the government on 30 September 2009 and by the national parliament on 4 November 2009. For this reason, the Council recommendations could not be incorporated into the binding fiscal strategy presented in the budget. Nevertheless, the stability programme was prepared at a time when the draft of Council recommendations under 126(7) of the Treaty setting the deadline to correct excessive deficit by the end of 2013, as well as recommendations for corrective measures, were available. Hence, the fiscal strategy until 2012, as presented in the stability programme, already reflects Council recommendations. The approved general government budget assumes deficit reduction to 3% of GDP by 2012, which is one year ahead of the Council's recommendation.

The Stability Programme of the Slovak Republic for 2009–2012 contains a special chapter (Chapter I.4) on the excessive deficit procedure, where the government describes specific steps leading to the correction of the excessive deficit. The stability programme does not include a chapter on institutional aspects of public finances, as no major changes have taken place compared to the previous stability programme.

The stability programme, once approved by the Slovak government, is submitted to the national parliament. The content and the format of the document fully respect the guiding principles issued by the European Commission. The guiding principles are based on the *"Specifications on the Implementation of the Stability and Growth Pact"* and the *"Guidelines on the Format and Content of Stability and Convergence Programmes"*. These documents were approved in 2005 with a view to improving the implementation of the Stability and Growth Pact, which is an essential part of the macroeconomic framework of the Economic and Monetary Union. The stability programme reflects the latest amendment of these documents from November 2009 which requires from member states to take into account the implicit liabilities related to population ageing in formulating their medium-term objectives. The Stability Programme of Slovakia also takes account of the deliberations, documents and recommendations of the Economic and Financial Committee.

I. OVERALL POLICY FRAMEWORK AND OBJECTIVES

The objectives of the Slovak government's economic policy have been set in reaction to the current economic crisis, yet the underlying priority remains the same - to ensure that sound economic growth remains sustainable in the long run which is a necessary condition to further increase the standard of living and speed up the process of catching up with the advanced EU Member States. Accession of the Slovak Republic to the euro area and the loss of independent monetary policy have increased the importance of pursuing a responsible fiscal policy focusing on consolidation and effective operation of automatic stabilisers, as well as the importance of structural policies aimed at increasing market flexibility and potential economic growth.

I.1. Fiscal policy

The main medium-term fiscal objectives are influenced by the consequences which the global economic crisis has had on the general government budget in 2009. Slovakia expects its 2009 general government deficit to increase to 6.3% of GDP. This increase fully reflects the impacts of adverse economic development, the free play of automatic stabilisers, and the measures taken by the government to stimulate economic growth.

The fiscal policy strategy assumes the resumption of fiscal consolidation already in 2010, and the government is committed to continue consolidation also in the years to come until a balance budget is reached. In the medium run, the government has two basic fiscal objectives. Assuming that the economy develops in line with the baseline economic scenario presented in this programme, the first objective is to reduce general government deficit to 3% of GDP by 2012 and thus comply with the recommendations related to the excessive deficit procedure. The second objective is to continue the ambitious consolidation effort also beyond 2012 in order to achieve a balanced budget no later than by 2015, which is the basic prerequisite to ensuring long-term sustainability of public finances. Slovakia belongs to countries that have committed itself to start with fiscal consolidation in 2010 and, at the same time, it is one out of nine EU member countries that is, according to the European Commission's autumn forecast (November 2009), projected to reduce the deficit in 2010.

The pace of consolidation set by the government is more ambitious than that presented in the previous stability programme, particularly because the economic crisis has led to a permanent loss of a part of the potential output and thereby automatically deepened the structural deficit of general government. The Ministry of Finance estimates that the negative impact which the loss of potential output due to the crisis has had on the general government balance will be as high as 4.3% of GDP in 2011. Since the current budget assumes the 2011 deficit at 4.2% of GDP, it is correct to conclude that, had it not been for the crisis, the current policy setup would have produced a balance or even a slight surplus in the general government budget. The value of 4.3% of GDP thus represents the additional consolidation effort necessary to bring the structural position back to the originally planned level.

I.2. Monetary policy

Price stability remains the main monetary policy objective following Slovakia's accession to the EMU. The European Central Bank defines price stability as inflation below or near the level of 2%. It is however obvious that during the period of Slovakia's real and nominal convergence, a slightly higher rate of inflation may be expected due to the absence of the exchange rate channel. From the long-term perspective, a responsible fiscal policy and structural policies aimed at enhancing flexibility of the labour market and of the market in goods and services will be particularly essential to ensuring price stability in Slovakia in the long term.

I.3. Structural policies

In response to the deteriorating development of the real economy and in line with the appeal formulated in the European Economic Recovery Plan of November 2008, the Slovak government adopted a package of anti-crisis measures to support the real economy. The measures represent a structural policy reaction to the crisis. The purpose of the measures is to avoid a deep recession, prevent an employment slump and restore economic growth as soon as possible. The measures are clearly targeted, temporary, and their implementation period is precisely defined. These anti-crisis measures are described in greater detail in the Implementation Report for the National Reform Programme of the Slovak Republic for 2008-2010 from October 2009.

At the same time, the Slovak government continues to implement the medium-term measures defined in the National Reform Programme, which constitutes a set of concrete and clearly specified measures adopted primarily in reaction to the European Council conclusions and its specific recommendations for Slovakia. The implementation of these measures contributes towards potential economic growth, sound economic development and, ultimately, improving the living standard of the citizens.

I.4. Slovakia under the Excessive Deficit Procedure

The Excessive Deficit Procedure ("EDP") is governed by Article 126 of the Treaty on the Functioning of the European Union and by Council Regulation on speeding up and clarifying the implementation of the excessive deficit procedure. The EDP sets the criteria, sequence of steps and time limits for the European Council (ECOFIN) to adopt a decision on the existence of an excessive deficit. The excessive deficit procedure is triggered when the actual or planned government deficit[1] exceeds the reference value of 3% of GDP, except for situations when:

- the deficit has declined substantially and continuously and reached a level that comes close to the reference value of 3% of GDP; a deficit of up to 3.5% of GDP can be considered as coming close to that value, or
- the excess over the reference value of 3% can be considered exceptional and temporary as long it results from an unusual event outside the control of the Member State concerned and which has a major impact on its fiscal position, or from a severe economic downturn; also in this situation, the deficit must remain close to the 3% value. However, the excess shall only be considered temporary if budgetary forecasts by the Commission indicate that the general government deficit will fall below the reference value following the end of the unusual event or the severe economic downturn.

The Commission's spring forecast projected the general government deficit in Slovakia at 4.7% of GDP in 2009, thus exceeding the reference value. Slovakia confirmed this by a letter to the Commission dated on 25 August 2009 confirming that the general government deficit would exceed 6% of GDP. The Ministry of Finance of the Slovak Republic notified its latest official estimate of the 2009 general government deficit in the regular deficit and debt reporting to Eurostat as of 1 October 2009, projecting the deficit at 6.3% of GDP.

Subsequently, the Commission prepared a report which the Economic and Financial Committee discussed at its session on 27-28 October 2009. In the case of Slovakia, the Commission did not challenge the fact that the deficit was exceptional, resulting from an economic downturn and measures adopted in line with the European Economic Recovery Plan (EERP). However, the excess could not be considered as being close to the 3 % of GDP reference value and, according to the Commission's forecasts, the deficit is not likely to fall below 3% next year. The Economic and Financial Committee endorsed the Commission's opinion on the existence of an excessive deficit in the Slovak Republic. By having done so, all formal requirements have been met for the Commission to be obliged to initiate an excessive deficit procedure for Slovakia. The aforementioned facts were further confirmed by the Commission's autumn forecasts of 3 November 2009.

In line with the conclusions, the Commission prepared the following set of recommendations which the Council adopted on 2 December 2009:

1) Recognising that stimulus measures financed through reallocation within the budget amounting to 0.4% of GDP in 2009 were an adequate response to the European Economic Recovery Plan, and that consequently the worsening of the fiscal position in 2009 resulted from the free play of automatic stabilisers, the Slovak government should put an end to the excessive deficit by 2013;

[1] When initiating the launch of an EDP, apart from the deficit reference value the Commission also considers the general government debt reference value (60% of GDP). Given the current budgetary situation in Member States, including Slovakia, non-compliance with the deficit criterion was the decisive factor in triggering the EDP.

2) The Slovak authorities should bring the general government deficit below 3 % of GDP in a credible and sustainable manner by taking action in a medium-term framework. Specifically, to this end, the Slovak authorities should:
    a. implement the deficit reducing measures in 2010 as planned in the draft budget for 2010–2012,
    b. ensure an average annual fiscal effort of 1 % of GDP over the period of 2010–2013,
    c. specify the measures that are necessary to achieve the correction of the excessive deficit by 2013 and accelerate the reduction of the deficit if economic or budgetary developments turn out better than currently expected;
3) To limit risks to the adjustment, Slovakia should strengthen the enforceability of its medium-term budgetary framework as well as improve the monitoring of the budget execution throughout the year, in particular to avoid expenditure overruns compared to budget plans.

The Slovak authorities should report on progress made in the implementation of these recommendations in a separate chapter in the updates of the stability programmes which will be prepared between 2010 and 2013.

Slovakia does not object to its inclusion under the EDP since the current fiscal situation justifies such a move. Slovakia views the EDP primarily as an instrument necessary to exert coordinated pressure on fiscal consolidation and prudent fiscal policies in all EU member states. Given the current macroeconomic situation and its consequences for the fiscal position in the years ahead, Slovakia views the present situation in relation to the ongoing EDP as being exceptional for two main reasons:

- The general government deficit reference value is defined as an overall general government deficit without taking into account the influence of current macroeconomic developments, i.e. the cyclical component of the budget. Throughout the period covered by the stability programme, the Ministry of Finance estimates a negative output gap which has an adverse impact on the general government budget and increases the overall general government deficit. When assessing compliance with the deficit reference value, this component of the budget may only be disregarded in a stable macroeconomic situation, but not in a situation where the economy is exposed to shocks, such as the current economic crisis. According to the estimates of the Ministry of Finance, the cyclical component will increase the general government deficit by 0.8% of GDP in 2011 and by 0.4% of GDP in 2012.

- As a consequence of the economic crisis, a part of the potential output has been irreversibly lost, which automatically deteriorated the structural deficit of general government. The Ministry of Finance estimates that because of the loss in potential output, the 2009 structural deficit increased by 2.5% of GDP and will increase by 4.3% of GDP in 2011 compared to the pre-crisis scenario. Hence, the fiscal consolidation is more demanding and requires more time to accomplish.

Slovakia considers the deadline for correcting its excessive deficit by 2013 adequate. In comparison with Council recommendations the Slovak government has set itself a more ambitious targets and plans to eliminate the excessive deficit by 2012, i.e. one year earlier. The faster pace of the excessive deficit correction is consistent with the key objective of the government's fiscal policy, which is to ensure long-term sustainability of public finances, particularly against the backdrop of population ageing. The approved general government budget for 2010–2012 envisages gradual reductions in the general government deficit, starting from 2010 and reaching the value of 3% of GDP in 2012. For this target to be achieved, a structural consolidation effort of almost 0.9% of GDP per year will be required. Should macroeconomic developments exceed expectations, the government commits itself to consolidate public finances at a faster pace.

The consolidation strategy of the Slovak government is based on:
- the phasing out of the anti-crisis measures which were introduced as temporary (until end-2010) and whose aggregate impact on general government balance over 2009-2010 represented 1.0% of GDP;
- annual cut-backs on general government expenditure, mainly in the area of government consumption, and limitation of capital expenditure to 1.2% of GDP in 2010, with a moderate decline to 0.7% of GDP by 2012. The resulting savings will be essential to setting ambitious consolidation targets, while most of the

pressure on making public spending more efficient will spill over and generate further savings also beyond 2012;
- the anticipated acceleration of economic growth, from 1.9% in 2010 to 5.4% in 2012, and
- expenditure policies, envisaging a slower indexation of key expenditures compared to GDP growth rates.

The Slovak government, in line with its priorities, maintains an adequate rate of increase in expenditures for three priority areas, namely social security, healthcare and education, without adopting new expenditure policies that might have a negative future impact on the general government balance.

TAB 1 - Reaction of the Slovak government to EU Council recommendations

Recommendation	Reaction
Excessive deficit should be corrected by 2013.	Under general government budget objectives, excessive deficit should be corrected already in 2012.
The deficit reducing measures should be implemented in 2010 as planned in the general government budget for 2010–2012,	The objective of the government is resume fiscal consolidation in 2010 and the measures are planned accordingly.
Annual average fiscal consolidation effort should reach 1% of GDP over the period of 2010–2013.	The average consolidation effort during 2010–2012 is expected to reach 0.9% of GDP annually. This pace of consolidation tallies with the calculation by the Commission of the consolidation effort necessary to correct the excessive deficit. The difference of 0.1% of GDP represents a round-up done by the Commission for the purposes of drafting EU Council recommendations.
The Slovak government should specify the measures necessary to achieve the correction of the excessive deficit by 2013 and accelerate the reduction of the deficit if economic or budgetary developments turn out better than currently expected;	Consolidation strategy assumes the termination of anti-crisis measures, annual cut-backs on general government expenditures and slower indexation of key expenditure items compared to GDP growth; the strategy is based on the baseline economic scenario presented in this programme. Should macroeconomic developments exceed expectations, the government undertakes to consolidate public finances at a faster pace.
To limit risks to the adjustment, Slovakia should strengthen the enforceability of its medium-term budgetary framework as well as improve the monitoring of the budget execution throughout the year, in particular to avoid expenditure overruns compared to budget plans.	Slovakia has a good track record in consolidating public finance in line with the defined targets, confirmed by the success in accomplishing its budgetary objectives. The impacts of the recent economic crisis have necessitated a revision of fiscal targets, since the setup of the medium-term budgetary framework failed to provide adequate response to unfavourable cyclical developments. For this reason, the Slovak government is planning to review and strengthen the role of the national fiscal rules.

I.5. Strengthening the national fiscal rules

Slovakia has a good track record in consolidating public finances in line with the defined targets, confirmed by the success in accomplishing the 2004-2008 budgetary objectives. The first medium-term objective, set out in the first Convergence Programme of May 2004, was to bring the deficit below 3% of GDP by 2007 and thereby meet the Maastricht criterion for the adoption of the single euro currency. The better-than-projected budget execution in the past years had been achieved also thanks to the better-than-expected macroeconomic development which increased tax revenues and reduced the deficit of general government.

TAB 2 - General government balance (ESA 95, % of GDP)

	2004	2005	2006	2007	2008
Budget	-4.0	-3.8	-4.2	-2.9	-2.3
Outcome[1] (comparable methodology with the budget)	-3.0	-2.4	-3.4	-2.3	-1.7
Outcome[1] (methodology change[2])	-2.4	-2.2	-2.9	-2.3	-1.7
p.m. Outcome (as notified by Eurostat on 1 October 2009)	*-2.4*	*-2.8*	*-3.5*	*-1.9*	*-2.3*

Note: 1 - figure net of one-off effects that were not assumed in the budget *Source: Ministry of Finance*

2 - as of April 2007, methodology of tax revenue reporting has changed which affected the reported GG balances. Outcomes for 2007 and 2008 are reported in this methodology.

Albeit the macroeconomic development and tax revenues overtook the assumptions formulated in 2004, the medium-term consolidation targets were not adjusted accordingly. Against the backdrop of the original and given the better macroeconomic development less ambitious consolidation targets, the higher tax revenue automatically led to an increase in expenditures. The current crisis has had an exceptionally adverse impact on public finances in all countries, which poses a major consolidation challenge for all prudent governments. For this reason, the Slovak government is contemplating the adoption of the following fiscal rules:

1. Expenditure ceilings

The purpose of introducing expenditure ceilings is to strengthen the enforceability of the multi-annual general government budget, including the extension of the period for which budgetary framework is prepared. Instead of being limited to state budget only, the expenditure ceilings should be set at a consolidated aggregate level, local governments excluding. The period for which multi-annual budgets are compiled would be extended from three to four years and the expenditure ceilings would be adjusted depending on the level of ambition in the consolidation effort of the government concerned. Such rules would also contain a certain degree of flexibility to react to unexpected events or negative economic shocks.

2. Upper limit on general government debt

The upper limit would represent the maximum admissible amount of debt to be laid down in a constitutional act. Debt represents the sum of all government liabilities and can thus also capture operations which are not necessarily reflected in the general government balance. This rule should be invoked as an "emergency brake", since other fiscal rules are not capable of covering all possible situations that have a potential of deteriorating the fiscal position.

3. Standards for information disclosure in the budget preparation and execution

In line with best practices and in compliance with a project for the introduction of a unified accounting and reporting system in the general government, which is currently underway, the standards for information disclosure in the budget preparation and execution will be improved, with particular emphasis on the concept of net worth.

With the aim of improving the timeliness, availability and quality of the data on budget execution, provided by the local and regional government entities in the course of the year, consideration will be given to interconnecting the IT systems operated by local and regional governments with the central state budget information system, which would enable to obtain timely information needed to adopt the measures necessary to reach fiscal objectives.

I.6. Measures enhancing the efficiency of general government

Besides strengthening the national fiscal rules, the Slovak government intends to adopt specific measures that would contribute to savings in general government expenditures and increase the efficiency of the functioning of general government.

1. Reorganisation of central government

Several ministries will be abolished or merged with other ministries in order to streamline the central government structure and reduce its operating expenditures. This measure will be accompanied by staff reductions, resulting in additional savings on account of wages and salaries.

2. Co-location of ministries (GovCity)

In order to reduce the size of operating expenditures connected with the operation of ministries, the government will endorse a plan to bring all ministries 'under one roof'. Apart from making the administration of ministries more efficient, this measure will also improve their mutual communication. Any assets made redundant by the GovCity project will be sold.

3. Centralised and transparent public procurement of central government

A new public procurement system will be put in place to purchase selected goods and services for the whole of central government, reducing the procurement-related costs as well as the spending of ministries and other central government agencies due to the economies of scale derived from the centralised procurement approach. The process of procurement will be computerized wherever possible, making it more transparent from the initial stages of applicants' registration.

4. State Property Management Agency

A centralised management of state property will be more efficient in terms of reducing public expenditure thanks to the improved quality of management in the area of procurement, rental and other uses of state property.

5. Information technologies in public administration

A more robust deployment of information technologies for the provision of government services will eliminate a number of activities which currently require considerable public spending. Interconnected electronic registers and e-Government services will also reduce the costs incurred by the business sector in communicating with public administration.

II. ECONOMIC OUTLOOK AND PROJECTIONS

The impacts of the global financial and economic crisis on the Slovak economy were particularly significant in 2009. The crisis has stifled foreign demand, causing considerable reduction in exports and domestic investments and, in particular, labour market deterioration. There is a degree of uncertainty as to the extent and duration of the financial crisis effects on the real economy due to enfeebled economic activity of Slovakia's major trading partners abroad. However, unlike other countries in the central European region, the economy of Slovakia operates in a stable monetary environment thanks to the country's entry into the euro area as of 1 January 2009.

II.1. External environment

In spite of certain signs of stabilisation in the second and third quarters of 2009, the global economy remains in deep crisis. Projected recovery will be slow and the financial system remains weakened. After increase by 3.1% in 2008, the global output is expected to contract by 1.2% in 2009[2]. It is the slowest global economic growth for the past 60 years. The global economy is expected to pick up in 2010, with output growth projected at 3.1%.

The consequences of the financial crisis, which hit the global economy in the second half of 2008, are gradually beginning to ebb. Confidence on the financial markets is on the rebound and, after months of plummeting indices, many stocks have booked above-average gains. Global industrial output and global exports have stabilised at low levels in recent months and are unlikely to slump any further. Market expectations have improved and so have the indices of various economic sentiment indicators (IFO, ZEW, EU economic sentiment). The OECD, IMF, European Commission and other international institutions have, after quite some time, released slightly more optimistic forecasts for 2010. Nevertheless, the world economy is not out of recession yet, and the expected recovery will be slow.

U.S. economy is expected to shrink by 2.5% in 2009 (compared with 0.4-percent growth in 2008), particularly due to the contraction of economic activity in the first half of the year. Unemployment reached its all-time high since the beginning of 1980. Gradual recovery is expected to unfold in the second half of 2009, also thanks to the unprecedented measures taken on the fiscal and monetary fronts. In 2010, U.S. should economy grow 2.2%.

The contraction of foreign demand and the withering sources of external financing have taken their toll in the emerging markets, too. In spite of that, the economic development of these countries improved already in the first half of 2009, mainly thanks to domestic consumption. The emerging economies' real GDP is projected to rise by 5% in 2010, against less than 2% in 2009. The growth on the emerging market is propelled mainly by China and India. Also thanks to the extensive stimulus package designed to support domestic consumption, China is expected to post a growth of 8.7% in 2009 (9.7% in 2008). In 2010, the Chinese economic growth is projected to reach 9.6%. International Monetary Fund expects that the developed economies will shrink by 3.4%, while the emerging economies will grow 1.7% of GDP in 2009.

Similarly as the U.S., also the EMU countries have felt the full impact of the financial crisis. However, the latest economic development data indicate that the euro area has begun to stabilise. GDP in the euro area increased in the third quarter, compared to the first- and second-quarter contractions. Germany and France no longer fulfil the technical definition of recession when their economies grew in the third quarter of 2009 by 0.7% and 0.3% quarter-on-quarter, respectively. The euro area economy is expected to contract by 4.0% in 2009 (4.1% for the EU), in contrast to the 2008 increase by 0.6% (0.8% for the EU). Against the backdrop of the 2009 economic downturn, the credit crunch continues to have an adverse impact on the economic activity and foreign demand, as well as on the expected corrections in the real estate market. The 2010 real GDP growth in both the euro area and the EU as a whole is forecasted at 0.7 %.

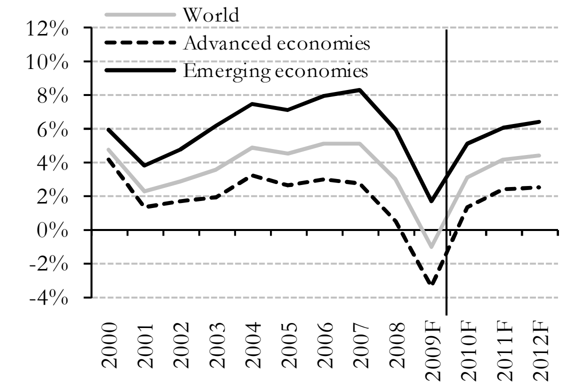
[2] In its forecasts, the Ministry of Finance (MFSR) takes the external environment assumptions from the Commission forecasts. When preparing the macroeconomic forecasts, the MFSR based itself on the available assumption by the Commission published in Interim Forecast of August 2009. The external assumptions fed into the MFSR forecasts are almost identical with the Autumn Economic Forecast published by the Commission on November 2009. The description of current developments in the external environment is based on the latest Autumn Economic Forecast, as well as the IMF Global Economic Outlook MMF published in October 2009.

TAB 3 - Basic economic indicators

	2009	2010	2011
Economic growth			
EU	-4.1	0.7	1.6
USA	-2.5	2.2	2.0
China	8.7	9.6	9.5
Long term interest rates			
Euro area	3.2	3.5	3.8
USA	3.2	3.7	4.0
Exchange rate (USD/Euro)	1.39	1.48	1.48
Oil prices (Brent, USD/barrel)	61.3	76.5	80.5

Source: EC, Autumn Forecast, November 2009

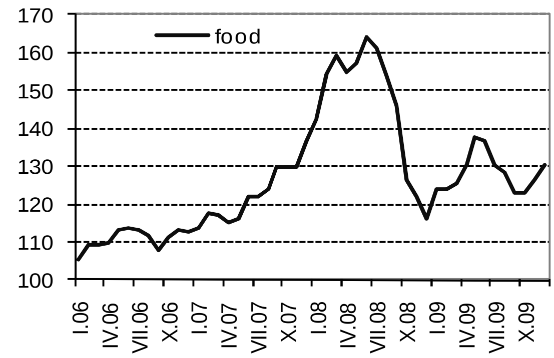
GRAPH 1 - Economic growth (% of GDP)



Source: IMF, Global Economic Outlook, October 2009

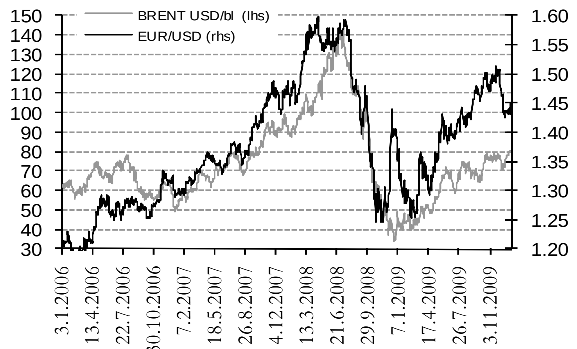
In 2009, global commodity prices picked up, rising from the lowest levels in several years to which they had tumbled at the end of 2008. Although the price gains (notably for oil and metals) are high in percentage terms, often around 100%, commodity prices remain well below their all-time highs from the summer of 2008. Their increase is driven by the signs of economic recovery and positive sentiment on the financial markets where the global economy appears to have passed the worst of times.

GRAPH 2 - IMF food commodities index (SDR, 2005=100)



Source: IMF

GRAPH 3 - BRENT oil (USD/bl) and EUR/USD exchange rate development



Source: Reuters

As for most other commodities, the price of oil in 2009 rose from its record-lows from December 2008 when it nosedived to 34.1 USD per barrel. At the end of November 2009, one barrel sold at 77 USD, which is more than 100% higher than the December 2008 minimum. Yet, the price of oil is still about 50% below its last year's high of 150 USD per barrel. The reasons behind the increase are the same as for other commodities, i.e. anticipation of economic recovery and the related positive sentiment on the financial markets. The hike in oil prices was also supported by the repeated and coordinated crude oil output reductions by OPEC members in early 2009. The impact of the rising oil prices on the Slovak economy and prices in Slovakia has been largely offset by the relatively significant appreciation of the euro against US dollar.

In 2009, central banks pursued strongly expansive monetary policies. The U.S. Federal Reserve System (FED) repeatedly lowered its interest rate in an effort to keep recession at bay. The Fed Funds Target Rate (FFTR) thus dipped from 4.25% in early 2008 to 0.25% in December 2008 and remained flat at 0.25% throughout 2009. The ECB reduced its main refinancing operations rate to 2.5% at the end of 2008 and, gradually over the first five months of 2009, brought it down to 1% in an effort to avert global recession. Apart from the traditional monetary policy instruments, several central banks (U.S., U.K.) deployed a broad spade of instruments to support liquidity in the banking sector.

II.2. Economic development in Slovakia during 2009

In the first three quarters of 2009, the real GDP in Slovakia declined by 5.3% in quite a stark contrast to the 2008 developments when, during the first three quarters, the economy expanded by 7.8%. In terms of structure, reduced demand for investments and inventory contributed towards the economic downturn most of all. Moreover, final household consumption in the first three quarters of 2009 shrank by 0.2%, which was quite a decline compared to the year before (up by 6.7%). Along with falling employment and a curbed growth in wages, household consumption was also deterred by a decline in consumer confidence, mainly in the first quarter. Improved performance in the second quarter of 2009 (increase by 0.5%) was largely influenced by the car scrapping scheme. Investments shrank considerably (-11.6%), mainly due to their second-quarter downswing by 17.7% at constant prices. Government consumption remained the only GDP component which continued to grow (up 2.5%) despite the overall GDP contraction. The contribution of net foreign demand to GDP growth in the first quarter was considerably negative (-2.9 pts). However, as a consequence of a steeper decline in imports compared to exports, its contribution in the next two quarters turned positive (0.9 pts)

The Slovak labour market began to feel the impacts of deteriorating economic developments and falling foreign demand with some time delay. While the previous positive pattern of rising employment and falling unemployment turned flat in the fourth quarter of 2008, yet without slumping, the figures for the first quarter of 2009 indicated a sharp deterioration. In the first quarter alone, the economy lost the same number of jobs as the number of jobs created in the previous four quarters. According to the Labour Force Survey (LFS), employment declined by 1.9% year-on-year during the first three quarters of 2009. The crisis thus upset the positive labour-market trend from previous years (employment in 2008 increased by 3.2%). The overall decline in employment was particularly influenced by job reductions in the private sector where the number of entrepreneurs without employees increased. According to the LFS methodology, the number of the unemployed in the first three quarters increased on average by 42,000 compared to the same period last year. The unemployment rate (LFS) in the third quarter of 2009 increased to 12.5%, from 8.7% in the last quarter of 2008. The latest figures released by the Centre of Labour, Social Affairs and Family from November indicate that the adverse trend on the labour market continues, with the rate of registered unemployment rising by 4.6 pts year-on-year to 12.4% in November. In the third quarter, the average nominal monthly wage in the national economy increased 2.5% year-on-year, while the real wage rose by 1.3%. The average nominal monthly wage in the third quarter reached EUR 723.

After the first 10 months of 2009, foreign trade reached a surplus of EUR 1 133.4 million, which was caused by a faster decline in imports compared to imports. The trade balance improved due to lower imports of industrial supplies and transport accessories. Nominal exports and imports for the first 10 months of 2009 fell by 11.7% and 18.1% year-on year, respectively. The improved foreign trade balance reduced the current account deficit for the first three quarters of 2009 to EUR 1 266.2 million, which represents 2.7% of GDP (the deficit for the first half of 2008 reached 6.5% of GDP). Also the balance of income and current transfer items improved considerably. The balance of income was particularly influenced by lower dividend payouts to foreign investors.

Inflation in Slovakia declined continuously throughout 2009 under the influence of slack global demand caused by the economic downturn. The trend of declining inflation was further supported by falling prices of oil and foodstuffs. Inflation in Europe hit its bottom in July 2009 when it dropped to –0.7% in the euro area. In November, the HICP inflation rate in Slovakia reached 0.0% year-on-year. Under the deflationary influence of the economic crisis, the concerns over the rise in prices on account of the euro changeover did not materialise. The Ministry of Finance estimates that the euro changeover impact on inflation spanned from 0.12 – 0.19 pts.

Banking is one of the areas hit hardest by the current crisis on a global scale. The banking sector in Slovakia has been almost unaffected by the financial crisis, but is in no way immune from the growing risks of economic downturn. None of the banks in Slovakia needed government intervention, and all the measures adopted by the Slovak government to stabilise the sector were of a preventive nature in order to underpin confidence in banks.

BOX 1 - Banking sector in Slovakia during the financial and economic crisis

Banking sector vs. the financial crisis

The impact of the crisis on the Slovak banking sector has been marginal only, as confirmed by a number of 2008 indicators: the profits of the sector remain relatively high, the volume of loans continues to grow fast, the interest rates on new loans and the interbank rates remain stable, and the NBS maintains a high sterilisation position. The causes behind the good shape of the sector include robust economic growth, consistently prudent lending policy, and a low degree of the sector's international integration which, taken together, resulted in a limited exposure of Slovak banks to toxic assets.

The net profit of the banking sector in 2008 exceeded EUR 0.5 billion, which was four times higher than the level of profit in 2000. The fact that the 2008 profit of the Slovak banking sector was at about the same as in 2007, without having been diluted by massive losses sustained in 2008 by many banks in the United States and the EMU countries, was particularly significant within the context of the financial crisis.

The banks confirmed their good condition also during the crisis, which is obvious from the relatively high increase of loans to businesses and households, as well as high capital adequacy ratios. These increases continued also in the second half of 2008, at a pace of about 20%, although the lending activity of banks began to slacken on a month-on-month basis.

The relatively stable interest rates on new loans, spanning consistently from 6.5% to 8.5%, reflected the stable situation in the Slovak banking sector. Even in 2008, the situation was not characterised by rising interest rates; they dropped at year-end when the central bank reduced its prime rate (down by 1.75 pts in 2008 from 4.25% to 2.50%).

In addition to profits, also the liquidity of banks remained relatively positive. The short-term interbank interest rate (3-month Bribor) remained steady until September 2009, oscillating around the NBS prime rate. Its subsequent decline followed the cuts in the NBS prime rate.

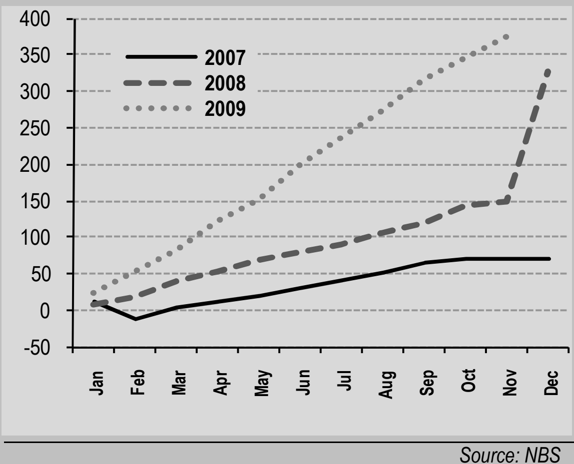
The high liquidity in the Slovak banking sector was reflected by the high sterilisation position of the NBS which, during the financial crisis, hovered around EUR12 billion. No liquidity drain in connection with the crisis has been reported.

Banking sector vs. the economic crisis

The adverse situation on the financial markets spilled over to the real economy through the aggregate demand channel, mainly due to the credit crunch. The worsened economic performance, causing higher insolvency among debtors, has adversely affected several indicators of the banking statistics. With the volume of non-performing loans on the rise, the banks must create higher provisions which, in turn, reduces their profits or restricts lending.

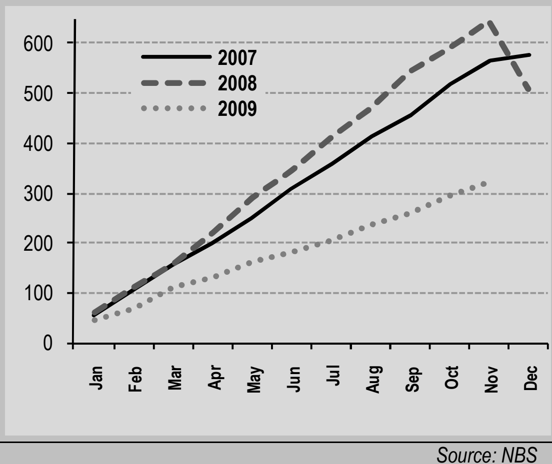
The write-downs in the first 11 months of 2009 reached EUR 376 million, which is considerably more than EUR 149 million for the same period of 2008 or EUR 71 million in 2007. This means that the banking sector is now directly affected by the economic downturn through the impaired ability of businesses and households to repay their loans. Increased write-downs are the main reason behind the considerable decline in bankers' profits. The net profit of the banking sector for January-November 2009 reached EUR 322 million, which is over 50% less than in the same period of 2008.

Net write-downs (cumulated from 1st January of the relevant year, EUR mill.)



Source: NBS

Net profit of the banking sector (cumulated from 1st January of the relevant year, EUR mill.)



Source: NBS

The impact of the economic crisis is also obvious from the growing volume of non-performing loans. Their share in total loans over the past years remained relatively consistently below 2.5%. However, non-performing loans started to rise in

2009 and their share in total loans in November 2009 exceeded 4.8%.

As a consequence of increased caution and uncertainty about future developments, lending activity has cooled down and the volume of provided loans is stagnating. Annual increases in the volume of loans in the economy consistently exceeded 20% in the past years. However, since the end of 2008, the increase in loans slowed down considerably (1.7% year-on-year in November 2009) and has begun to stagnate on a month-on-month basis. In other words, the amount of new loans provided in a given month tallies with the amount of instalments collected in that month.

It is obvious that the economic crisis (unlike financial crisis) is having an impact on the Slovak banking sector. However, given the magnitude of the current crisis, the situation in the banking sector remains relatively good and the banks are handling the higher incidence of defaults in a standard manner, without putting their operation at any risk. In contrast to many banks in developed economies, the banks in Slovakia need no rescue packages or government bailouts and they are still able to generate profits and maintain their liquidity and solvency.

II.3. Medium-term forecast of economic development

The latest official forecasts by the Ministry of Finance from 10 September 2009 reflect the economic slowdown caused by the global financial and economic crisis. In 2009, GDP at constant prices is expected to contract by 5.7%[3] (against 6.2-%increase in 2008). It should then gradually pick up in the years to come and consolidate at higher levels at the end of the forecast period.

TAB 4 - Forecast of the selected economic indicators

No.	Indicator	unit	Actual 2008	Forecast 2009	2010	2011	2012
1	GDP; current prices	EUR bn.	67.2	63.6	67.4	72.4	78.9
2	GDP; constant prices	%	6.2	-5.7	1.9	4.1	5.4
3	Final consumption of households and NPISH[4]	%	6.0	-0.4	1.5	3.4	4.9
4	Final consumption of government	%	5.3	2.3	2.4	3.0	2.4
5	Gross fixed capital formation	%	1.8	-10.3	2.9	4.1	5.1
6	Export of goods and services	%	3.2	-15.2	2.9	7.1	10.0
7	Import of goods and services	%	3.1	-14.7	3.2	5.6	8.4
8	Output gap (share of potential output)	%	3.9	-3.9	-4.3	-2.9	-1.2
9	Growth of average monthly wages (real)	%	3.3	0.8	0.2	2.3	3.2
10	Average employment growth (LFS)	%	3.2	-2.2	0.2	1.0	1.8
11	Average employment growth (ESA95)	%	2.8	-1.9	-0.1	0.9	1.6
12	Average unemployment rate (LFS)	%	9.6	11.7	12.1	11.6	11.0
13	Harmonised index of consumer prices (HICP) growth	%	3.9	1.2	2.6	3.7	4.1
14	Current account balance (share of HDP)	%	-7.0	-5.8	-5.2	-4.8	-4.0

** forecast*

Source: Ministry of Finance

The 2009 economic development was primarily influenced by a slump in external demand which depressed industrial production and depleted stocks of inventory. Due to the lower utilisation of manufacturing capacities and the financial market situation, the inflow of foreign investments into Slovakia fell short of expectations. The estimated decline in exports (-15.2%) and imports (-14.7%) in 2009 reflect a considerable slowdown in foreign trade, mainly under the influence of ebbing demand among Slovakia's major trading partners. Economic growth in Slovakia is expected to gradually recuperate in the course of 2010 as the global economic recovery gains ground, with GDP growth accelerating again and reaching fairly high levels (4.1% in 2011 and 5.4% in 2012).

Labour Market

Labour market forecasts take due account of the still lasting impacts of the global crisis. Unfavourable developments from the first half of the year affected the employment growth forecasts for the whole of 2009 which, according to Labour Force Survey (LFS), will decline by 2.2% year-on-year. The main factors include a fall in demand for Slovak exports and the ensuing downswing in demand for labour in the manufacturing sector and associated industries. According to the LFS, the layoffs of Slovak nationals abroad and their return to Slovakia have also contributed towards the overall decline in employment. Future employment projections should reflect the recovery of the external environment. Hence, employment is expected to grow by 0.2% in 2010 and, rising progressively overtime, the rate of growth should reach 1.8% in 2012. The effect of the higher retirement age for women as well as the demographic development should contribute to the increase in the labour force in 2010, which should result in a slight increase in the employment and the unemployment at the same time. The slowdown in the creation of new jobs, coupled with increased layoffs, will push the rate of unemployment to its

[3] Based on the developments in the third quarter of 2009 and the most recent monthly indicators, the decline will be probably more moderate.

[4] Household consumption stands for the household consumption and the consumption of the non-profit institution serving households (NPISH) in the following text.

culmination point at 12.1% in 2010. In the medium term, however, unemployment is expected to decrease in line with employment increases.

The worsening of situation on the labour market and the downward pressure on payroll costs will deflate the 2009-2010 wage increases to record lows, with the average monthly nominal wage rising by 2.6% in 2009 and 3.4% in 2010. Despite the pressure on further payroll reductions, relatively low flexibility of wages and a slump in labour productivity, real wages are not expected to decrease during the forecast period. The reasons include partial indexation of wages through collective bargaining for the last year's high inflation (CPI) of 3.9% and the fact that the layoffs primarily affect under-qualified employees on low average monthly wages. Real wages should thus increase by 0.8% in 2009 and by 0.2% in 2010. In the years after, the growth in real wages should reflect higher GDP growth rates (up 2.3% in 2011 and 3.2% in 2012).

External Balance

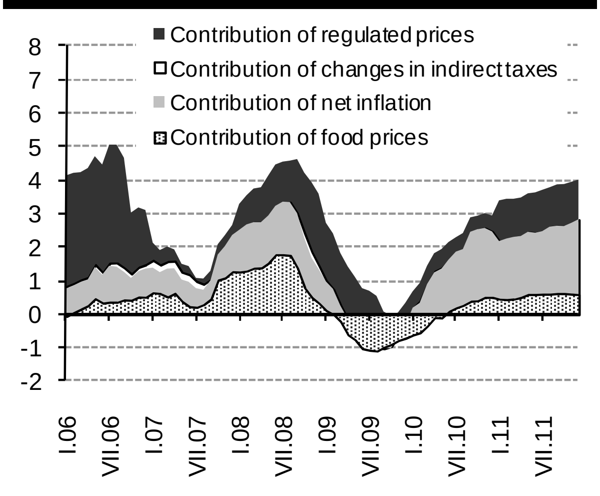
The most adverse impacts of the global economic crisis are expected occur in the area of foreign trade. The recent slump in foreign demand is likely to have negative ramifications on trade balance. Exports are expected to decline in real terms by 15.2% in 2009, increase by 2.9% in 2010, and accelerate further in 2011 and 2012 when foreign demand picks up and new investment projects will have reached the stage of production. Due to the high import intensity of the Slovak economy, imports will develop along similar lines as exports. Yet, the decline will be less steep thanks to major investment projects. Imports should thus contract by 14.7% in 2009 and increase moderately in 2010 to 3.2%. Foreign trade deficit will reach 1.0% in 2009 and 1.8% in 2010. From 2011 onwards, foreign trade deficit is expected to diminish.

Inflation

In terms of price development, inflation in Slovakia in the last months of 2009 hovered at its historically lowest levels, close to zero, and is expected rise moderately in the nearest future. The average rate of inflation in 2009 is expected to reach only 1.2%. Such a low inflation rate will endure until the spring of 2010, when the base effect of the falling prices of raw materials and food on the commodity markets sets in, accompanied by the one-off effects of increased excise duty on spirits and the discontinued dual display of prices.

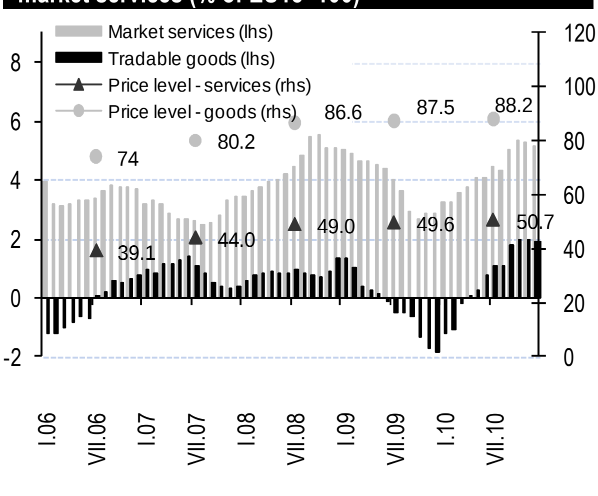
In the years to come, inflation is expected to accelerate, particularly as global recovery gains ground and the domestic and international demand for goods and services rekindles. Oil prices may also rise more significantly. Inflation is expected to increase gradually to an average of 2.6% in 2010. After the adoption of the common currency and monetary policy, the entire nominal convergence boils down to price-level convergence through the inflation channel. The average increase in the prices of market services will reach around 6% from 2012.

GRAPH 4 - Structure of inflation (HICP)



Source: Statistical Office, Ministry of Finance

GRAPH 5 - Price development of tradable goods and market services (% of EU15=100)



Source: Statistical Office, Eurostat, Ministry of Finance

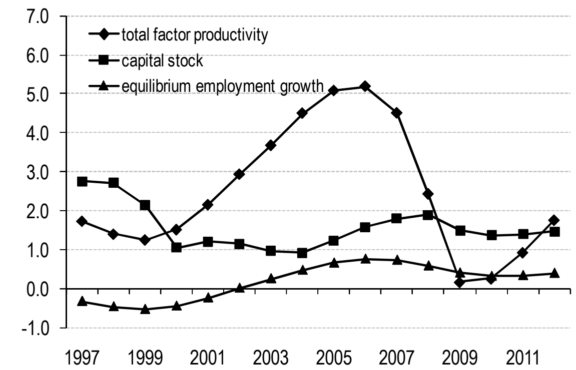
II.4. Cyclical developments of the economy

This chapter provides an overview of the cyclical developments of the Slovak economy in the context of the current economic crisis. The first part contains a forecast of potential output, contributions of individual factors towards its growth and towards output gap in the medium term. The second part deals with the impact of the economic crisis on potential growth in the medium term and the likely development of potential output in the long term. The final part of the chapter compares various output gap forecasts presented by important domestic (MF SR, NBS) and international institutions (Commission, IMF).

Potential output and output gap

Apart from depressing demand, the effects of the current economic crisis in the economy should, in the short and medium term, also slacken the growth of potential output. In crisis times, the contributions of all factors diminish – capital accumulation due to investment slump, growth of equilibrium employment, as well as productivity growth. The growth of potential output should continue to slacken until 2010, however, without skidding into negative values. Afterwards, as the real economy gradually recovers, potential growth should also begin to accelerate.

GRAPH 6 - Contributions of main factors to the potential GDP growth (p.p.)



TAB 5 - Contributions of main factors to the potential GDP growth (p.p.)

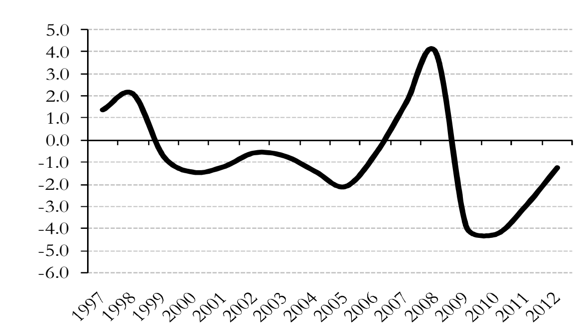
	Pot. GDP (growth, %)	TFP*	Capital stock	Equilibrium employment growth
2004	5.9	**4.5**	**0.9**	**0.5**
2005	7.0	**5.1**	**1.2**	**0.7**
2006	7.5	**5.2**	**1.6**	**0.8**
2007	7.0	**4.5**	**1.8**	**0.7**
2008	4.9	**2.4**	**1.9**	**0.6**
2009F	2.1	**0.2**	**1.5**	**0.4**
2010F	1.9	**0.3**	**1.4**	**0.3**
2011F	2.7	**0.9**	**1.4**	**0.3**
2012F	3.6	**1.8**	**1.5**	**0.4**

* total factor productivity

Source: Ministry of Finance

Albeit real GDP plummeted in 2009, potential output continued to grow at a moderate pace, turning the positive output gap from 2008 (3.9%) into a negative one in 2009 at -3.9% of potential output. The slower growth of both the real economy and the potential output will widen the output gap further also in 2010. As the economic recovery unfolds in the years come, output gap will progressively narrow. However, the gap will remain considerably negative throughout the entire forecast period.

GRAPH 7 - Output gap (% of potential GDP)



TAB 6 - Output gap (% of potential GDP)

	GDP**) (real growth, %)	Potential GDP (growth, %)	Output gap (% pot. GDP)
2004	5.2	5.9	**-1.4**
2005	6.2	7.0	**-2.1**
2006	9.1	7.5	**-0.6**
2007	9.5	7.0	**1.7**
2008	7.3	4.9	**3.9**
2009F	-5.7	2.1	**-3.9**
2010F	1.6	1.9	**-4.3**
2011F	4.1	2.7	**-2.9**
2012F	5.4	3.6	**-1.2**

**) F - forecast*

***) GDP growth adjusted for cigarettes stockpiling*

Source: Ministry of Finance

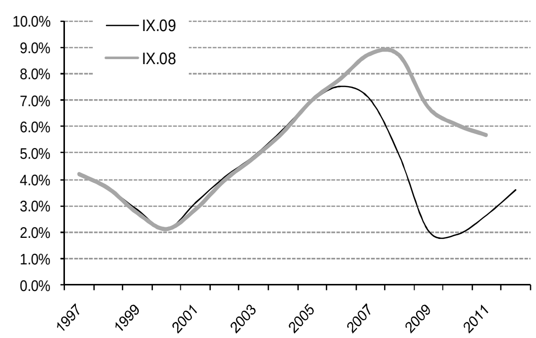
Impact on the economic crisis on potential output in Slovakia

The current economic crisis is having a major impact on the revision of the potential output and output gap estimates. The Ministry of Finance estimates that the recession – apart from having caused the GDP slump – will influence potential output in Slovakia in the short and medium term through the contributions of all three production factors:

- A considerable drop in the productivity factor represents the main impact of the crisis. Productivity growth in Slovakia has been mostly driven by the know-how brought in by foreign investments. High TFP increase as a consequence of FDI inflows is the main factor behind the hitherto high rates of potential output growth.
- The current financial and economic crisis has largely stifled new investments and, thereby, retarded capital accumulation. The financial market situation impairs borrowers' access to credits, while the depletion of foreign demand is causing considerable surpluses of redundant production capacities which, in combination with reduced profitability of companies, undermines motivation to invest.
- Although the contribution of labour supply to the potential growth will temporarily recede, the crisis should not affect the rate of employment growth in the long run.

The main risk to potential output lies in the potential hysteresis effects on the labour market, which may permanently increase the rate of structural unemployment. This would further contract the contribution of employment to the growth of potential output in the medium term.

GRAPH 8 - Comparison of the potential output forecast in September 2008 and in present



TAB 7 - Difference of the forecast of individual indicators between September 2008 and present (p.p.)

	GDP*) (real growth)	Potential GDP (growth)	Output gap (% pot. GDP)
2005	0.0	0.0	**-0.7**
2006	0.0	-0.3	**-0.5**
2007	0.1	-1.7	**1.2**
2008	-1.3	-3.8	**3.5**
2009F	-12.2	-4.6	**-4.1**
2010F	-4.3	-4.2	**-4.3**
2011F	-1.7	-3.0	**-3.0**

**) GDP growth adjusted for cigarettes stockpiling*

Source: Ministry of Finance

The total cumulative loss in potential output against the pre-crisis scenario of September 2009 should represent 14.8%, i.e. EUR 9.0 billion, in 2011.

The long-term development of potential output in the aftermath of the crisis is more open. In its document on the impacts of the crisis on potential output[5], the Commission presents as plausible the central scenario of 'permanent level loss' with return to its pre-crisis growth. Moreover, it is becoming obvious that the growth rates in the last years before the crisis resulted from the overheating of global economy.

On the other hand, the Slovak economy has a number of specificities. In addition to some, mentioned above, such as productivity increase based on FDI inflows, which the standard method of TFP calculation cannot capture, Slovakia has a relatively sound banking sector which has not been affected by the financial crisis as severely as in other countries. There is still a room for credits to businesses to grow. The increase in investments will, according to the Ministry of Finance, regain a relatively high level, although not as high as in the pre-crisis period, which was characterised by the overheating of the economy. The same principle applies to R&D investments which represent an important determinant of productivity growth. Accession to the euro area on 1

[5] Impact of the current economic and financial crisis on potential output, Occasional Papers 49, DG ECFIN.

January 2009 and lower labour costs will continue to support FDI inflows and the related productivity growth in Slovakia. Although the Ministry of Finance expects a one-off increase in structural unemployment, employment growth should soon regain balance.

Comparison of the output gap estimates

The differences in the methods of calculation produce different output gap estimates from institution to institution. The Commission uses a 'production function method', common for all EU Member States. The Ministry of Finance also bases its calculations on the production method, however, applying certain expert methods that reflect the specificities of the Slovak economy. The NBS applies multi-dimensional filer with non-measurable state variables using the Kalman recursive algorithm. The IMF, which applies country-specific methods for the calculation of output gap, uses the production function method and the Kalman filter for TFP calculation.

TAB 8 - Comparison of the output gap forecast of various institutions (% of pot. output)

	2005	2006	2007	2008	2009	2010
MF SR (September 2009)	-2.1	-0.6	1.7	3.9	-3.9	-4.3
NBS (September 2009)	-	-	-	0.5	-8.4	-7.6
EC (November 2009)	-0.4	2.4	7.5	9.2	-0.8	-2.1
IMF (October 2009)	0.4	1.1	0.9	-0.3	-3.8	-3.0

Source: Ministry of Finance, NBS, EC, IMF

As shown in the table, compared with other institutions, the Commission estimates show a significantly more positive output gap in 2008 and only a moderately negative output gap in 2009. In the opinion of the Ministry of Finance, the Commission estimates are not realistic because they do not correspond with other imbalance indicators (inflation, ratio between growth in wages and productivity, current account deficit).

III. GENERAL GOVERNMENT BALANCE AND DEBT

After Slovakia's entry to the euro area, fiscal policy became the key instrument for influencing the development of the real economy in the face of internal or external shocks. The importance of fiscal policy has been confirmed in the current global economic crisis, the consequences of which required a flexible and targeted response. Complying with Council recommendations, the government allowed a free play of automatic stabilisers in 2009, while taking complementary targeted and time-limited measures to promote economic growth. The government is aware of the fact that an expansionary fiscal policy is unsustainable in the long run and that it could have adverse effects on macroeconomic development in the medium term. For this reason, the government intends to resume fiscal consolidation from 2010 onwards with a view to achieving balanced budget. The ongoing improvement in fiscal position is the Slovak government's basic strategy to prepare its public finances for the consequences of demographic development over next decades.

III.1. Policy strategy and objectives

The strategy of fiscal policy is built around the primary objective, which is to safeguard the long-term sustainability of public finance, especially in the context of population ageing. The government has committed itself to consolidate the public finance from 2010 onwards until the attainment of a balanced budget. In the medium term, the Slovak government has two basic fiscal objectives. **Assuming that the economy will develop in line with the basic economic scenario presented in this programme, the first objective is to reduce the general government deficit to 3 % of GDP by 2012** and thus to comply with the requirements of the excessive deficit procedure**.** Should macroeconomic developments exceed expectations, the government commits itself to consolidate the public finance at a faster pace. **The second objective is to continue pursuing the ambitious consolidation also beyond the year 2012 in order to achieve a balanced budget by 2015 at the latest,** as an essential prerequisite for the creation of conditions for the long-term sustainability of public finances**.**

TAB 9 - General government balance between 2008 and 2012 (ESA95, % of GDP)

	2008E	2009E	2010B	2011B	2012B
1. Net lending / net borrowing	**-2.3**	**-6.3**	**-5.5**	**-4.2**	**-3.0**
2. Cyclical component	1.1	-1.1	-1.2	-0.8	-0.4
3. One-off measures	-0.7	0.0	0.0	0.0	0.0
4. Cyclically adjusted GG balance net of one-offs (MTO) (1-2-3)	**-2.8**	**-5.2**	**-4.3**	**-3.4**	**-2.6**
5. Impact of the implementation of the 2nd pillar of pension scheme	-1.3	-1.2	-1.1	-1.1	-1.2
6. Interest expenditure	-1.2	-1.8	-1.9	-1.9	-1.9
7. Adjusted primary balance (4-5-6)	**-0.3**	**-2.2**	**-1.2**	**-0.3**	**0.4**
8. Consolidation effort (y-o-y change in adjusted primary balance)*	**-0.1**	**-1.9**	**1.0**	**0.9**	**0.7**

**(+) restriction, (-) expansion; E - estimate, B – budget* *Source: Ministry of Finance*

The starting point for the adjustment of fiscal objectives is the general government deficit in 2009 which, compared to the target set at 3.0% of GDP in the previous stability programme, increased to an estimated 6.3% of GDP. The rise in the 2009 deficit can be fully ascribed to three factors. Firstly, the shortfall in revenues and increase of expenditures brought about by the growth of unemployment. This means that automatic stabilisers were given free play. Secondly, anti-crisis fiscal measures amounting to 0.4% of GDP according to ESA 95 methodology, which the government decided to take in order to boost economic growth, but with the condition that they will not increase the deficit any further. The anti-crisis fiscal package is thus partly offset by savings on the expenditure side of the budget. The third factor is a permanent loss of part of the potential output due to the crisis, which automatically deteriorated the structural general government deficit. According to Ministry of Finance estimates, it led to an increase in the 2009 structural deficit by 2.5% of GDP and its impact is expected to rise in 2011 to 4.3 % of GDP in comparison with the pre-crisis scenario (Box 2). These figures point at the necessity of additional consolidation for restoring the structural position to the initially planned level.

The Ministry of Finance considers that, in the light of current economic conditions, the markedly expansionary overall impact of fiscal policy on aggregate demand in 2009 at the level of as much as 2.5% of GDP represents a sufficient fiscal impulse for the economy. The fiscal impulse already counts with the impact of the gradual roll-out of PPP projects for road infrastructure development, expected to contribute to the fiscal impulse in 2009 at the level of 0.3% of GDP.

BOX 2 – Estimated impact of the loss of potential output on structural general government balance

The first step in the estimation consisted in the quantification of the percentage of the loss of potential output due to the crisis. In this step, the September 2008 forecasts of the Ministry of Finance, which did not yet reflect the impact of the crisis, were compared with the current forecast. The next step consisted in the quantification of impact on the general government balance, using the coefficient of sensitivity of general government balance to changes in the output gap, taken over from European Commission´s estimates based on OECD methodology. The reason for using this coefficient was that the changes in the estimated potential output are transposed into the general government balance through changes in the structural levels of employment and unemployment, i.e. analogically to changes in the output gap.

The impact of potential output loss (ESA 95, EUR mill.)

	2009	2010	2011
Potential output - non-crisis scenario (Sept. 2008)	54 454	57 752	61 029
- latest forecast (Sept. 2009)	49 693	50 655	52 005
- difference	-4 760	-7 097	-9 023
- percentage change (in %)	**-8.7**	**-12.3**	**-14.8**
Budgetary sensitivity on changes in potential output	0.29	0.29	0.29
Impact of potential output loss on GG balance (% of GDP)	**-2.5**	**-3.6**	**-4.3**

Source: Ministry of Finance

The consequence of the loss of potential output will be the deterioration of the structural general government balance by 2.5% of GDP in 2009. The loss will continue to deepen also in the subsequent years compared to the pre-crisis scenario, and will reach the level of 4.3% of GDP in 2011.

The attainment of ambitious consolidation objectives is built on the assumption that anti-crisis measures will be eventually withdrawn, since their duration was predominantly limited until the end of 2010 already at the time they were adopted, and their overall impact in the years 2009-2010 was set at 1.0% of GDP (in 2009 they reached 0.4% of GDP and in 2010 will reach the level of 0.6% of GDP). Some of the anti-crisis measures (e.g. incentives for research and development activities carried out by the business sector) have a permanent nature with a total impact of 0.2% of GDP in 2011. Additional measures consist mainly in savings in general government expenditures, especially through cuts in government consumption and capital expenditures. The savings will amount to 1.2%, 1.0 % and 0.7% of GDP in 2010, 2011 and 2012, respectively. These savings are a necessary prerequisite for setting out ambitious consolidation objectives, and the resulting pressure towards efficiency improvements will play a major role in the attainment of permanent savings also beyond the 2012 horizon. The consolidation will be significantly fostered by the prospects of economic growth that will accelerate from its 1.9% level in 2010 up to 5.4% in 2012. An important source of consolidation is the indexation of expenditures at a rate that is slower than the nominal GDP growth rate. In line with its priorities, the Slovak government maintains an adequate growth of expenditures in three basic priority areas: social security, healthcare and education, and refrains from formulating new expenditure policies that could adversely impact general government balance in the future.

In spite of fiscal consolidation in 2010, fiscal policy will have an overall counter-cyclical expansionary effect at the level of 2.5% of GDP similarly to the year 2009. Significant influences on the fiscal impulse include, besides year-on-year changes in structural deficits, higher drawdown on EU funds and the launching of PPP motorway construction projects. Another major investment project (completion of the Mochovce nuclear power plant) is expected to be launched in 2010 but, since the project is still at the preparatory stage, it has not been included in the programme. A greater impact of fiscal consolidation will prevail from 2011 onwards, and the overall position will be moderately procyclically restrictive.

The Stability Programme is based on the macroeconomic and tax forecasts from September 2009. The macroeconomic scenario, as well as projected tax revenues, are subject to scrutiny by the professional public through committees comprised of the national public and private sector experts.

III.2. Fiscal development in 2009 and impact on the 2010 budget

The basic prerequisite for setting adequate and realistic fiscal objectives for the general government budget is the assessment of the current state of public finances. Similarly to the April 2009 stability programme, this chapter includes, in addition to basic information concerning the estimate of the general government deficit in 2009, including contributions to changes in the balance, also updated information on the launch of PPP projects.

The key fiscal objective of the government in 2009 was defined in the general government budget for the years 2009-2011 as a general government deficit of 2.1% of GDP. The current estimate of the general government deficit is 6.3% of GDP.

The general government balance reflects the negative impact of the state budget at the level of EUR 1 459.1 million, worse fiscal performance of state financial assets and extra-budgetary accounts at the level of EUR 430.9 million, and a worse fiscal performance of other general government entities at the level of EUR 610.5 million.

TAB 10 - Current estimate of the general government balance in 2009 (ESA 95, EUR mill.)

General government deficit after approval of individual budgets in EUR mill.	**1 527.0**
General government deficit after approval of individual budgets in % of GDP	**2.1**
A. State budget	1 459.1
- estimate of the general government tax revenues in ESA95	1 477.7
- estimate of the state budget non-tax revenues (excl. EU funds)	43.9
- estimate of the state budget expenditures (excl. EU funds)	-62.5
B. State financial assets and extra-budgetary accounts	430.9
C. Other general government entities	610.5
- Social Insurance Agency	448.2
- Health insurance companies	-10.2
- State funds	68.0
- Public universities	-9.6
- Higher territorial units (local government)	71.3
- Municipalities	33.2
- Slovak Television and Slovak Radio	8.2
- other	1.4
Current estimation of general government deficit in EUR mill.	4 027.5
Current estimation of general government deficit in % of GDP	**6.3**
of which: deterioration of deficit by means of the GDP estimation update (in % of GDP)	-0.8

(+) indicates increase and (-) indicates decrease of the GG deficit in the ESA 95 methodology *Source: Ministry of Finance*

Particularly negative consequences for the state budget stemmed from the update of general government tax revenues, with the largest shortfalls reported in comparison with the general government budget for income tax, value-added tax and excise taxes standing at EUR 1 038.2 million, EUR 479.6 million, and EUR 209.2 million, respectively. The downward revision of tax revenue estimates resulted mainly from the update of the macroeconomic environment, which displayed a fall in all macroeconomic indicators compared to the general government budget assumptions. Another adverse impact on the state budget consists in the reduction of estimates of the other than tax revenues by EUR 43.9 million. On the other hand, the general government deficit was positively influenced by savings in state budget expenditures in the amount of EUR 62 million.

As regards other general government entities, the balance was negatively influenced by deterioration in the fiscal performance of the Social Insurance Agency by EUR 448.2 million and of municipalities and higher territorial units by EUR 104.5 million. On the other hand, economic performance of public universities and health insurance companies had a positive influence on the balance at EUR 9.6 million and EUR 10.2 million, respectively.

The next part of this chapter describes the contributions to the changes in general government balance in 2009, and the construction of motorways and expressways through public-private partnerships (PPP).

BOX 3 - Contributions to changes in general government balance in 2009

The draft general government budget for 2009, approved by the Slovak government on 15 October 2008, assumed the general government deficit at 1.7% of GDP, based on the Ministry of Finance projections from September 2008, which did not envisage a more substantial impact of the crisis on the Slovak economy.[6] *Based on the updated estimate for 2009, the general government deficit is expected to reach 6.3% of GDP. The deterioration of the balance by 4.6% of GDP can be attributed to several factors that are summarised in the following table.*

Contributions to the change in general government balance in 2009 (ESA 95, % of GDP)

1. General government budget for 2009 - government proposal	**-1.7**
2. Estimate of the general government balance in 2009	**-6.3**
3. Change (2-1)	**-4.6**
Contributions to the change in GG balance:	**-4.6**
Cyclical component	-1.2
One-off effects	-0.1
Implementation of the 2nd pillar of pension scheme	-0.2
Interest expenditures	-0.5
Structural primary balance:	-2.6
- impact of potential output loss	-2.5
- anti-crisis measures	-0.4
- cut of state budget expenditures	0.5
- changes in tax legislation	0.0
- other changes	-0.1

Note: (+) indicates improvement, (-) deterioration of GG balance *Source: Ministry of Finance*

An important part in the above change was played by the cyclical component which, as a result of a major shift in the output gap in 2009 (from 0.2% of potential output envisaged in the budget down to -3.9 % of potential output according to the current forecast), will contribute to the deterioration of the balance by 1.2% of GDP.

Moreover, the increase in the general government deficit heightens the need of its refinancing, especially by issuing government bonds. This will be reflected in higher interest payments associated with the general government debt. The negative impact of this factor will amount to 0.5% of GDP.

The most important item is the structural primary balance that will be by 2.6% of GDP worse than budgeted. This situation reflects a combined impact of changes in the estimate of potential output, government's discretionary measures, and other factors as follows:

- *The change in the estimate of potential output influences the structural balance, especially through the level of structural unemployment which affects the amount of tax revenues and unemployment-related expenditures. The loss of potential output caused by the crisis was estimated by comparing the current forecast of potential output with a no-crisis scenario (Ministry of Finance forecast of September 2008); its negative impact on the*

[6] On 28 November 2008, the National Council of the Slovak Republic approved the general government budget with a deficit at the level of 2.1 % of GDP. The level of the deficit was revised as a result of the update of macroeconomic and tax forecasts of the Ministry of Finance and its upward revision above the government's budget proposal can be ascribed in its entirety to the impact of the crisis on the economy of Slovakia. Stability Programme of the Slovak Republic for the years 2008-2012 of April 2009 set the target value of the general government deficit for 2009 at the level of 3.0 % of GDP. The revision of the target compared to the approved budget was mainly due to the impact of the update of macroeconomic and tax forecasts of February 2009, the adoption of measures under anti-crisis packages, and the securing of their funding.

general government balance in the order of 2.5% of GDP was quantified using standard budgetary sensitivity used also for calculation of the cyclical component.

- *Furthermore, the table shows the impact of selected discretionary measures taken by the government, namely specific anti-crisis measures funded through re-allocation of state budget expenditures, and of the legislative changes in the tax system adopted beyond the framework of the anti-crisis measures. Their combined contribution to change of the balance was positive, amounting to 0.1% of GDP.*

- *Other changes included additional discretionary measures involving non-tax revenues and expenditures; the key measures were listed under the previous bullet point. Moreover, since this is a residual item, it also includes factors not covered under other items. They can be exemplified by short-term fluctuations of budgetary elasticities. The cyclical component of the general government balance is quantified by means of estimated budgetary elasticity that should correspond to the long-term elasticity. Changes in the GDP structure over time also influence the tax and social contribution revenues, because individual GDP components have a different tax intensity (for instance export is VAT-exempt) with the resulting variations in budgetary elasticities. Consequently, the effect of the deviation of short-term elasticities from their long-term level is also part of this item. Other changes contributed to the deterioration of the deficit compared to the budget at a level of 0.1% of GDP.*

The impact of the crisis on the general government balance can be estimated mainly on the basis of changes in the cyclical component, interest payments, changes in the estimate of potential output, and government response in the form of discretionary measures. It may thus be concluded that the most important factor behind the deterioration of the deficit in 2009 (4.2 % of GDP out of the overall worsening by 4.6 % of GDP) was the impact of the crisis on the Slovak economy.

BOX 4 - PPP projects in the field of motorway and expressway construction

On 5 September 2007, the Slovak government approved a timetable for the construction of motorways and expressways through PPP projects. Individual motorway and road sections were divided into three packages. In two of these packages, concession agreements were already concluded with private partners – on 23 March 2009 (for the second package) and on 15 April 2009 (for the first package). The proposal for concluding the concession agreement related to third package was approved by the Slovak government on 21 January 2010. Total construction costs (in prices exclusive of VAT) for the three packages are estimated at around EUR 5.3 billion (8.3% of GDP).

Given the impact of the financial crisis on the available sources of funding, the project financing arrangements will be finalised only at the stage of the financial close. The construction itself can be launched once the financial close has been finalised. The financial close for the second package was reached on 28 August 2009, giving green light to the construction phase. The date of the financial close for the first package has been set at 15 February 2010. Because the funding requirements for the first package significantly exceed those for the second package and given the impaired availability of credit sources, the funding will require a state guarantee for a loan from the European Investment Bank up to a maximum amount of EUR 800 million.

Since the construction under the second package is already in progress and the first sections of the expressway will be handed over in 2011, the first availability payments by the state are to be made in that year. For this reason, payments for availability of expressway sections under the second package have been incorporated into the general government budget for the period 2010-2012. State payments envisaged for 2011 amount to EUR 25.3 million, and the payment to be made in 2012 is expected at the level of EUR 99.8 million. Payments for the first package have not been incorporated into the general government budget because the conditions for its implementation have not yet been finalised.

Planned PPP projects - construction of motorways and express ways

	road	length (km)	estimated construction costs (EUR bn.)	planned finalisation
1st package	D 1	75.0	2.4	2013-2014
2nd package	R 1	51.6	0.9	2012
3rd package	D 1	30.1	2.0	-
Total**		**156.7**	**5.3**	

Note: D 1 - motorway between Bratislava and Košice
R 1 - express way connecting Bratislava and Banská Bystrica

III.3. Structural balance, fiscal position, fiscal impulse

The consolidation of public finances should create room for sustainable economic growth with low inflation, low interest rates, and positive expectations of stakeholders concerning future economic policy, exerting a positive influence on the supply side of the economy, and thus more than compensate for the lower contribution to aggregate demand.

The importance of public finance consolidation is even more pronounced in the context of global financial and economic crisis that leads governments to adopt expansionary fiscal policies with a view to mitigating its impact on individual economies. It is therefore necessary to alleviate the considerable deterioration in fiscal positions and their impact on the long-term sustainability of public finances by intensifying consolidation efforts over a medium-term horizon.

The consolidation effort describes the path the government plans to take in order to meet its medium-term objectives. The consolidation effort as presented in this document takes into account, in addition to the cyclical component of the budget and the one-off effects, the costs associated with the launch of the second pillar of the pension system that represents an important structural reform fostering the long-term sustainability of public finances, as well as the impact of interest payments.

TAB 11 - Consolidation effort between 2008 and 2012 (ESA95, % of GDP)

	2008E	2009E	2010B	2011B	2012B
1. Net lending / net borrowing	**-2.3**	**-6.3**	**-5.5**	**-4.2**	**-3.0**
2. Cyclical component	1.1	-1.1	-1.2	-0.8	-0.4
3. One-off measures	-0.7	0.0	0.0	0.0	0.0
- remission of receivables towards non-financial corporations	-0.4	-	-	-	-
- assumption of loans with state guarantees	-0.2	-	-	-	-
- exit from the 2nd pillar of pension scheme	0.2	0.2	-	-	-
- stockpiling - excise taxes	-0.3	-0.2	-	-	-
4. Implementation of the 2nd pillar of pension scheme	-1.3	-1.2	-1.1	-1.1	-1.2
5. Interest payments	-1.2	-1.8	-1.9	-1.9	-1.9
6. Cyclically adjusted prim. balance net of one-offs and 2nd pillar (1-2-3-4-5)	**-0.3**	**-2.2**	**-1.2**	**-0.3**	**0.4**
Consolidation effort	**-0.1**	**-1.9**	**1.0**	**0.9**	**0.7**

Source: Ministry of Finance

In order to quantify the government's consolidation effort it is first of all necessary to divide the actual (officially reported) general government balance into its cyclical and structural components. The structural component reflects the state of general government budgets, assuming that the economy functions at its potential level of output. The structural balance of general government thus corresponds to the current general government balance net of changes in the cyclical component which expresses the response of general government revenues and expenditures to changes in the output gap. The magnitude of the cyclical component depends on the size of the output gap and elasticities of selected revenue and expenditure categories that respond to swings in economic activity. The Ministry of Finance's estimate of the degree of sensitivity of the general government balance to changes in the output gap has been taken in full from the European Commission's estimates based on OECD methodology.

The second item comprises one-off and temporary measures of the government. The last two of four one-off effects identified in 2008 also apply to the year 2009:

- Firstly, the remission of receivables towards non-financial entities totalling 0.4% of GDP. The receivables consist of loans extended by the former National Labour Office under the active labour market policy and claims of former state funds arising from credits granted to agricultural enterprises and transferred to the Ministry of Agriculture after the closure of funds.
- Secondly, the debt assumed from risk liabilities of the National Property Fund (NPF) of the Slovak Republic. These included the guarantees provided by the NPF during the privatisation of state-owned companies to cover their liabilities vis-à-vis third parties. Due to the high probability of their non-

performance, the liabilities amounting to 0.2% of GDP were assessed as risk liabilities, which had a negative impact on the general government balance in 2008.

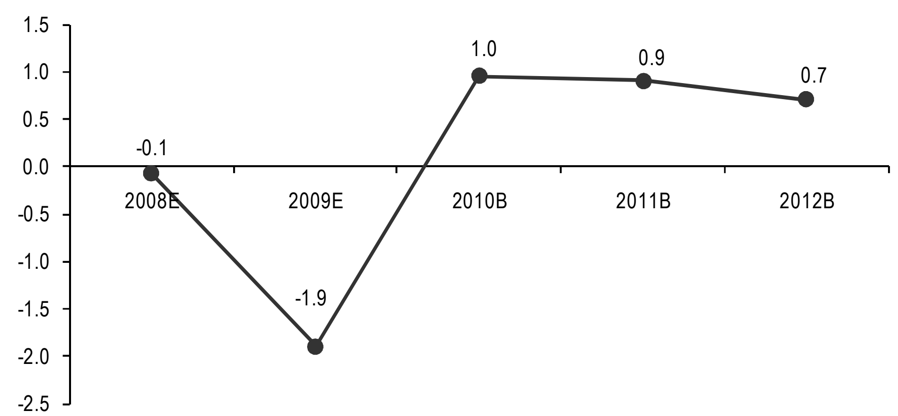
- The third factor relates to the option of entering or leaving the fully- funded (second pillar) of the pension system that was made available in the first half of 2008, and subsequently from 15 November 2008 to 30 June 2009. This means that when a participant decided to leave the second pillar, his/her funds from the old-age pension saving system were subsequently transferred to the pay-as-you-go system. The transfer applied to all assets accrued since the person's entry to the second pillar, a portion of which, attributable to previous years, represents a one-off component. On that account, general government revenues recorded a one-off increase of 0.2% of GDP in both 2008 and 2009.
- The last factor is the stockpiling associated with the increase in excise taxes on cigarettes, which occurred in January 2008 and February 2009. The effect of stockpiling means that during the last few months preceding the effective date of new tax rates, a large quantity of tobacco products subject to original tax rates are released into circulation and continue to be sold in the period following the effective date for new tax rates. This also results in one-off fluctuations in tax revenues which are not matched by variations in the final consumption of these products.

The third item taken into account in the quantification of government's consolidation effort are the costs related to the implementation of the second pillar of the pension system. In 2008, the costs of the pension system reform reached 1.3% of GDP, and in 2009 they are expected to stand at 1.2% of GDP. The figures for 2008 and 2009 also include transfers (connected with exits from the second pillar) of pension savers' funds accrued during the current year. They do not, however, incorporate the transfer of pension savers' funds accrued over the previous years. Since this is a one-off transfer, it is reported among one-off effects. In both 2010 and 2011, the costs are estimated at 1.1% of GDP mainly because of the decline in the number of savers, and are expected to rise to 1.2% of GDP in 2012.

The last, fourth item covers interest payments. The amount of interest payments depends mainly on the level of general government debt gradually accumulated in the previous period and on external factors, such as exchange rate and interest rate developments. This item should not have an impact on the government´s consolidation efforts. For this reason, the general government balance was also given net of interest payments.

It is evident from the following graph that after the easing of fiscal policy in 2009, related mainly to the adverse impact of the loss of potential output due to the crisis and to the attempt to mitigate the consequences of the crisis for the Slovak economy, the consolidation of public finance will resume in 2010. In medium term, the consolidation efforts will comply with Council recommendation on the average consolidation effort.

GRAPH 9 - Consolidation effort between 2008 and 2012 (% of GDP)



Source: Ministry of Finance

The second part of this chapter discusses the fiscal impulse which measures the contribution of the general government budget to the year-on-year change in aggregate demand. It indicates whether the government pursues an expansionary or a restrictive fiscal policy. In conjunction with the output gap it characterises the fiscal policy in terms of having a stabilising effect or, on the contrary, a procyclical impact on the economy.

For the purpose of calculating the fiscal impulse, the primary balance used for quantifying the consolidation effort was adjusted by taking account of the additional items that further specify the effects of fiscal policy on aggregate demand. These additional items are represented by financial links to EU budget and the impact of PPP projects in motorway and expressway construction.

Financial links to EU budget have been included because Slovakia's contributions to EU budget reduce aggregate demand while, on the other hand, revenues from the EU have an expansionary effect on the economy, however, without deteriorating the deficit (appearing on both the revenue and the expenditure sides).

An important expansionary impulse stems from PPP projects in the area of construction of motorways and expressways. These projects have been included in the calculation of the fiscal impulse because, although they will have an impact on the economy already at the time of construction, they will be reflected in the general government balance as regular payments only after the handover of individual road sections, i.e. with a considerable delay. This means that they will have an adverse effect on the general government balance when the regular availability payments fall due, but they will have no impact on aggregate demand. This is why the net effect of PPP projects is considered for calculation purposes, covering both the construction phase and the payment phase.[7]

TAB 12 - Fiscal impulse (ESA 95, % of GDP)

	2008E	2009E	2010B	2011B	2012B
1. Net lending / net borrowing	**-2.3**	**-6.3**	**-5.5**	**-4.2**	**-3.0**
2. Cyclical component	1.1	-1.1	-1.2	-0.8	-0.4
3. One-off measures	-0.7	0.0	0.0	0.0	0.0
4. Impact of the implementation of the 2nd pillar of pension scheme	-1.3	-1.2	-1.1	-1.1	-1.2
5. Interest expenditure	-1.2	-1.8	-1.9	-1.9	-1.9
6. Cyclically adj. prim. balance net of one-off effects and 2nd pillar (1-2-3-4-5)	**-0.3**	**-2.2**	**-1.2**	**-0.3**	**0.4**
7. Financial links to the EU budget	0.6	1.0	3.2	3.3	2.3
8. PPP projects - motorway and express way infrastructure	-	0.3	1.6	1.2	1.0
- construction costs	-	0.3	1.6	1.3	1.1
- state budget payments for availability	-	-	-	0.0	-0.1
9. Aggregate balance including the EU effect and PPP projects (6-7-8)	**-0.9**	**-3.4**	**-5.9**	**-4.8**	**-2.9**
10. Fiscal impulse	**-0.1**	**-2.5**	**-2.5**	**1.1**	**1.9**
p.m. Output gap	*3.9*	*-3.9*	*-4.3*	*-2.9*	*-1.2*

(+ restriction, - expansion) *Source: Ministry of Finance*

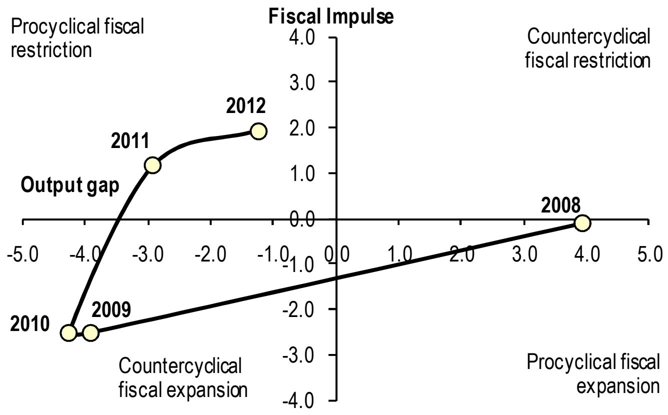
The table indicates that the nature of fiscal policy in the near future will be influenced mainly by an important increase in the amount of resources from EU funds and the launch of motorway and expressway construction through PPP projects. **As a result, fiscal policy in the years 2009 and 2010 will have a clearly expansionary counter-cyclical character with identical contributions of 2.5% of GDP in both years**. Taking into account the expansionary nature of monetary policy and anticipated impacts of the global financial crisis, such fiscal policy will provide sufficient demand stimuli for the Slovak economy. In the years 2011 and 2012, the fiscal impulse will be affected mainly by the impact of the restrictive nature of the consolidation effort.

However, an inevitable precondition for the implementation of this scenario is the successful drawdown of EU funds as budgeted, and the launch of the construction of motorways and expressways through PPP projects as planned. The drawing of EU funds also raises the question of their effective use in order to enhance the potential

[7] Availability payments include, moreover, reimbursements of costs incurred during the construction and costs connected with the maintenance of roads in the relevant period. This means that a certain portion of availability payments exerts an influence on aggregate demand. Since, however, maintenance costs only account for a relatively small portion of overall availability payments, calculations do not take this impact into consideration.

growth of the economy. The possibility to increase the drawing of EU funds will bring out the role the government plays in the allocation of resources to priority areas with the aim of improving the quality of public finance.

GRAPH 10 - Fiscal impulse (ESA 95, % of GDP)



Source: Ministry of Finance

III.4. General government debt

The development of general government deficits in the years 2009 to 2012 is expected to be reflected in an increase in the gross debt. **The gross general government debt will increase from the level of 27.7% of GDP in 2008 to 42.2% of GDP at end-2012**. During this entire period, the general government debt will be significantly below the level of the reference value of the Maastricht criterion. **Net general government debt at the end of the forecast period will reach 38.9% of GDP.**

TAB 13 - General government debt development between 2008 and 2012

		2008E	2009F	2010F	2011F	2012F
Gross debt (EUR mill.)		**18 613**	**23 588**	**27 490**	**30 772**	**33 311**
Net debt (% of GDP)	(2-1)	**24.0**	**33.0**	**36.9**	**38.8**	**38.9**
Liquid financial assets (% of GDP)	(1)	3.7	4.1	3.9	3.7	3.3
Gross debt (% of GDP)	(2)	**27.7**	**37.1**	**40.8**	**42.5**	**42.2**
Change in gross debt (p.p.)		-1.7	9.4	3.7	1.7	-0.3
growth in nominal GDP		-2.5	1.6	-2.1	-2.8	-3.5
primary balance		1.1	4.5	3.6	2.3	1.1
interest payments		1.2	1.8	1.9	1.9	1.9
stock-flow adjustment		-1.5	1.5	0.3	0.3	0.2
p.m. Implicit interest rate (%)		*4.6*	*6.2*	*5.5*	*5.0*	*4.8*

Source: Ministry of Finance

The gross general government debt-to-GDP ratio was continuously falling since 2000 when it peaked at 50.3% of GDP. By 2008, the debt was reduced by 22.6% of GDP to the level of 27.7% of GDP. The key factors behind this dramatic fall in the general government debt included, in particular, the pursuance of consolidation objectives, the creation of conditions for a robust and healthy economic growth, improved efficiency of the debt and state financial assets management, and use of privatisation revenues mainly for debt reduction purposes. From 2009 onwards, the debt is expected to grow mainly as a consequence of the counter-cyclical fiscal policy aimed at mitigating the effects of the crisis, and to stabilise in the medium term just above the level of 40% of GDP.

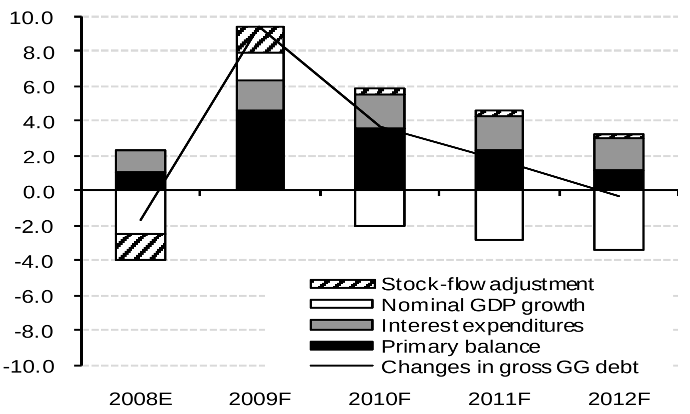
In nominal terms, the gross general government debt increased by EUR 560 million in 2008. The sum of the negative factors increasing the government's liabilities reached EUR 597 million, the largest contributor being the state debt with its year-on-year growth of EUR 349 million. As regards other general government entities, the debt of the National Property Fund rose by EUR 152 million, and the debt of the higher territorial units by EUR 95 million. However, these negative effects were partly offset by a drop in the debt of municipalities by EUR 36 million.

In the following years, the debt will be influenced mainly by a cash deficit of the state budget and by changes in the level of borrowings from the refinancing system of the State Treasury. As regards other general government entities, the largest contribution to increasing the debt will be made by credit facilities taken by municipalities and higher territorial units to implement their investment plans.

As for changes in the amount of borrowings from the State Treasury, the forecast of the general government debt incorporates both the realized and planned transactions that influence the level of funds used to cover the state debt. Besides the planned drawdown of funds designed to cover transformation costs of the pension reform, also the provision of returnable financial assistance and increases in the registered capital of state-owned companies significantly reduced the level of borrowings in 2009. These sources of state debt financing must be replaced by the issuance of new bonds. It is expected that the funds earmarked for the pension reform will be exhausted in 2010 (the financing of the pension reform costs is partly reflected in the state budget deficit for 2010, and fully incorporated into the budget deficits of 2011 and 2012); in the subsequent years, the amount of borrowings will slightly increase as a result of anticipated repayments of the returnable financial assistance provided in the past.

As regards relative contributions of individual factors to debt changes, the most important factor increasing the debt in the forecast period will be the planned general government deficits. In addition to interest payments, a relatively high primary deficit is also expected, although it will gradually decline due to the implementation of the planned fiscal consolidation. The contribution of the stock-flow adjustment to the gross debt increase will also be positive and will reach 1.5% of GDP in 2009. On the other hand, the growth of nominal GDP from 2010 onwards will contribute to the reduction of the debt-to-GDP ratio and, in 2012, will fully offset other negative factors mentioned above. As a result, the forecast assumes a moderate decline in the debt-to-GDP ratio already in 2012.

GRAPH 11 - Contributions of factors to the change in gross general government debt (p.p.)



Source: Ministry of Finance

According to the debt forecast, the value of the stock-flow adjustment in 2009 will be equivalent to 1.5% of GDP, which means that this factor will contribute to the debt increase. The difference between the cash-based and accrual flows, and the net acquisition of financial assets, will contribute to this development fairly evenly. The difference between the cash-based and accrual data reflects mainly the impact of the legislative amendment that shortened the period for refunding VAT excessive deductions from 60 to 30 days and that will result in a one-off shortfall in cash tax revenues, while having no impact on tax revenues under the accrual methodology. The net acquisition of financial assets is mainly due to the provision of returnable financial assistance and increase in the registered capital of state-owned companies that resulted in the decline of disposable financial assets used for debt financing within the refinancing system of the State Treasury and the subsequent need to replace these resources by the issuance of state bonds.

In the years 2010 to 2012, the value of the stock-flow adjustment will be influenced by the differences between the cash-based and accrual methodology, mainly as regards tax revenues and interest payments. An additional factor is the net acquisition of financial assets, especially in the form of increased indebtedness of municipalities and higher territorial units. Since more than 99 % of the gross general government debt is denominated in euro, the forecast does not account for the impact of exchange rate fluctuation.

TAB 14 - Stock-flow adjustment (% of GDP)

	2008E	2009F	2010F	2011F	2012F
Stock-flow adjustment	**-1.5**	**1.5**	**0.3**	**0.3**	**0.2**
Differences between cash and accruals	0.1	0.8	-0.1	0.0	0.0
Net accumulation of financial assets	-0.9	0.7	0.4	0.3	0.2
Appreciation (+) /depreciation (-) of foreign currency debt	-0.7	0.0	0.0	0.0	0.0
Other	0.0	0.0	0.0	0.0	0.0

Source: Ministry of Finance

BOX 5 - The issue of Eurobond SR 2009

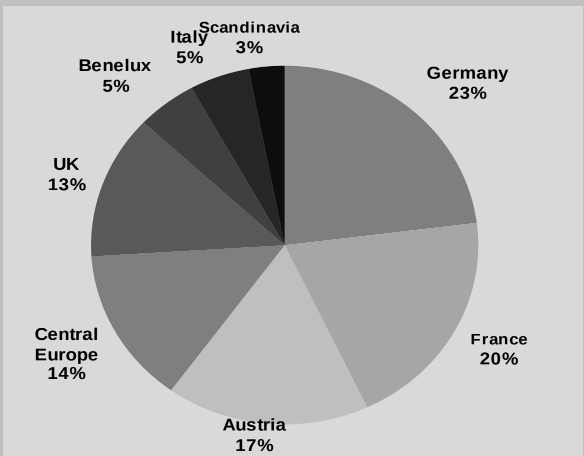
After intermission in 2008 caused especially by the financial market crisis, a Slovak Eurobond was issued on 21 May 2009 in line with the "Debt Management Strategy". The launching of the benchmark issue on the European market took a relatively short time. The rapid placement of the issue was influenced by the constantly changing conditions on financial markets. The successful Eurobond issue was preceded by a presentation roadshow in major European financial centres.

The bond underwritten on the European market will mature in January 2015; the total volume of the issue is EUR 2 billion. Compared to the reference bonds of Germany, the margin stands at 1.9 % p. a., and the annual interest rate of the coupon has been set at 4.375 % p.a. Compared to the European reference rate, the margin stands at 1.7% p.a. which is, all expenses considered, one-quarter of a percent better than the margin on the Eurobond issued by the Czech Republic in the same period. The overall yield for the investor reached the level of approximately 4.5 % p.a.

An important characteristics of the bond lies in its adequately diversified geographical and investor allocation. The greatest interest in the bond was traditionally shown by the German speaking countries (Germany, Austria) which underwrote a total of 40% of the issue, and by France and the United Kingdom with 20% and 13%, respectively. The bond issue was attractive especially to banks (43%) and investment funds (40%).

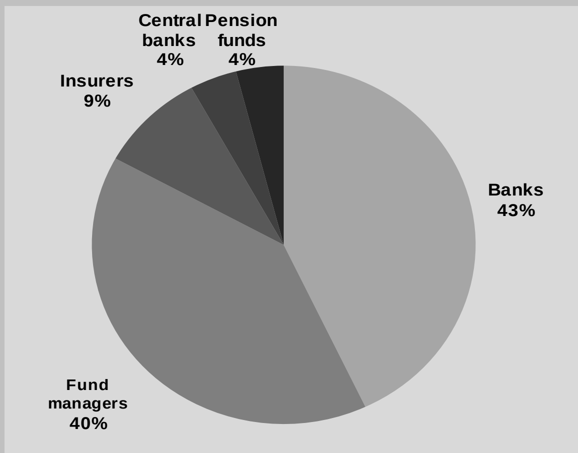
The transaction became the largest Slovak financial operation on the European bond market in history and, except for the privatisation of assets of the Slovak Republic, its biggest financial operation ever. It was the first Slovakia's benchmark issue after accession to the euro area. The success of the issue was significantly underpinned by the positive rating of the Slovak Republic.

Eurobond distribution by region



Source: MF SR

Eurobond distribution by investor type



Source: MF SR

IV. SENSITIVITY ANALYSIS AND COMPARISON WITH THE PREVIOUS UPDATE

The Stability Programme stems from a baseline scenario of economic development. This section presents alternative scenarios based on model simulations that envisage a faster recovery of the external economy, higher oil prices, and increased interest rates.

IV.1. Alternative scenarios and risks

Scenario no. 1: Faster recovery of the external economy

This scenario simulates the positive risk of a faster recovery in the economies of Slovakia's major trading partners which would stimulate Slovak exports. The simulation envisages an increase in the real foreign demand of Slovakia's trading partners in 2010 by 1 percentage point compared to the baseline scenario.

Higher exports compared to the baseline scenario will reduce the current account deficit. Improved profitability of export-oriented companies will accelerate the growth of investment (driven by the generally higher foreign demand and the resulting need to build new production capacities) and employment growth. This, in turn, will stimulate consumption. Higher domestic demand, in combination with lower unemployment, will unleash inflationary pressures, but their impact, including on interest rates, will be very limited. Accelerated consumption and investment growth will be reflected in the growth of imports, which will tone down a bit the improvements in the trade balance deficit.

TAB 15 - Scenario 1 – Faster recovery of the foreign demand by 1.5 p. b. in 2010
Cumulative change in values of the variables in comparison to the basic scenario is in p.p.

	Consumer expenditure	Gross fixed investment	GDP	Unemployment rate	CPI	Short-term interest rate	Current account (% of GDP)	GG balance (% of GDP)
2010	0.1	0.2	0.2	0.0	0.0	0.0	0.0	0.0
2011	0.2	0.1	0.2	0.0	0.0	0.0	0.1	0.1
2012	0.3	0.1	0.3	-0.1	0.0	-0.1	0.1	0.1

Source: Ministry of Finance

Scenario no. 2: Higher oil prices

The following scenario envisages a negative risk of further increases in oil prices, which oscillated around USD 77 per barrel at end-October 2009, more than a 100-% increase over their minimum from December 2008. Specifically, the simulation assumes a rise in oil prices over the baseline scenario by USD 10 per barrel for each year of the forecast, with the exchange rate remaining unchanged compared to the baseline scenario. The baseline scenario stems from the forecasts of oil prices and USD/EUR exchange rates as projected in the European Commission's *Common External Assumptions*.

The immediate result of the rise in oil prices would be an increase in prices for fuel and gas and, subsequently, in household heating bills. The impact of such shock on inflation would be most visible at the beginning of the reference period. Since the price of oil has an impact on the global economy, these simulation results reflect the general context of Slovakia's economic development within the global economy (using a multi-country model).

The growth of inflation driven by increased prices of oil and oil products would push the short-term interest rate up. Higher inflation would cause a fall in real income and, in combination with higher interest rates, would thus contribute to lowering household consumption. At the same time, higher interest rates would slow down investment growth. The overall slowdown of the real economy would lead to higher unemployment. Economic downturn resulting from the price shock and from a lower demand from our trading partners would have a negative effect also on the deficit of current account and on the general government balance.

TAB 16 - Scenario 2 - Increase in oil price by 10$ (in each year of forecast) Cumulative change in values of the variables in comparison to the basic scenario is in p.p.								
	Consumer expenditure	Gross fixed investment	GDP	Unemployment rate	CPI	Short-term interest rate	Current account (% of GDP)	GG balance (% of GDP)
2010	-0.5	-0.2	-0.2	0.0	1.1	0.0	-0.9	0.0
2011	-1.1	-1.4	-0.5	0.3	1.6	1.7	-0.9	-0.1
2012	-1.6	-1.8	-0.7	0.3	1.8	1.3	-1.0	-0.2

Source: Ministry of Finance

Scenario no. 3: Increased interest rates

The risk scenario was specified as a simulation entailing the rise in interest rates by 1 percentage point above the baseline scenario level in 2010.

Higher interest rates will impair the access of businesses and households to loans, thus slowing down household consumption and investments. This would lead to a general contraction of economic growth translated into a slower employment growth and, consequently, slower rate of increase in household consumption. While the contraction of aggregate demand will reduce the pressure on price growth, slower employment growth will relax the wage growth pressures. Lower consumption and investment rates will slow down the growth of imports, thus improving the current account balance. The overall adverse impact on the general government balance, including direct interest payments for general government debt, is quantified at 0.1% - 0.2% of GDP.

TAB 17 - Scenario 3 - Increase of interest rates of 1 p.p. Cumulative change in values of the variables in comparison to the basic scenario is in p.p.								
	Consumer expenditure	Gross fixed investment	GDP	Unemployment rate	CPI	Short-term interest rate	Current account (% of GDP)	GG balance (% of GDP)
2010	-0.2	-0.8	-0.2	-0.3	1.0	0.3	0.1	-0.1
2011	-0.2	-0.1	-0.1	-0.1	-0.5	0.1	0.1	-0.2
2012	0.0	0.2	-0.1	-0.3	-0.1	-0.1	0.1	-0.2

Source: Ministry of Finance

IV.2. Comparison with the previous update

The Stability Programme reflects the impact of the global financial crisis on the Slovak economy. The revision of the development of macroeconomic and fiscal parameters presented in the last year's update to the Stability Programme of the Slovak Republic resulted in adjustments in a negative direction.

TAB 18 - Comparison between the previous forecast and the updated forecast	ESA code	Year 2008	Year 2009	Year 2010	Year 2011	Year 2012
Real GDP growth (%)						
Previous update*		6.4	2.4	3.6	4.5	5.1
Current update		6.2	-5.7	1.9	4.1	5.4
Difference		-0.2	-8.1	-1.7	-0.4	0.3
General government net lending (% of GDP)	EDP B.9					
Previous update*		-2.2	-3.0	-2.9	-2.2	-
Current update		-2.3	-6.3	-5.5	-4.2	-3.0
Difference		-0.1	-3.3	-2.6	-2.0	-
General government gross debt (% of GDP)						
Previous update*		27.6	31.4	32.7	32.7	-
Current update		27.7	37.1	40.8	42.5	42.2
Difference		0.0	5.7	8.1	9.8	-

*Note: * Stability Programme of the Slovak Republic for 2008-2012*

Source: Ministry of Finance

V. QUALITY OF PUBLIC FINANCE

An important aspect of the quality of public finance is the existence of adequate links between fiscal objectives and the Lisbon Strategy goals. As far as budgetary issues are concerned, it is necessary that structural policies and reforms respect the government's fiscal objectives which determine a financial framework for such policies. At the level of government's policy objectives and commitments this involves the coordination and integration of the Stability Programme with the National Reform Programme for 2008–2010.

V.1. Policy strategy

As stated in Chapter III, the financial and economic crisis deteriorated the fiscal position of Slovakia quite considerably. Once the effects of the crisis have subsided, the fiscal consolidation agenda will regain prominence in the medium term. The key challenge for setting the consolidation objectives is to identify particular resources in a manner ensuring that they contribute to sustainable improvements in the fiscal position without jeopardising the fulfilment of the basic fiscal policy objectives, i.e. the creation of conditions for accelerating improvements in the living standard of the population and catching up with the advanced Member States of the EU. In other words, the consequences of the crisis also accentuate a need to improve the qualitative side of public finances.

According to the general government budget for 2010-2012, fiscal consolidation will be pursued in a situation of the falling share of general government revenues in the GDP (excluding revenues from EU funds); this means that specific measures focus exclusively the expenditure side. Consolidation will be supported by the anticipated acceleration of economic growth, because the setup of the expenditure policies assumes that the indexation of key expenditure items will be slower than the GDP growth rate. The Slovak government, in line with its priorities, maintains an adequate rate of increase in expenditures for three priority areas, namely social security, healthcare and education, without adopting new expenditure policies that might have a negative future impact on the general government balance.

This chapter outlines the main trends of medium-term development of general government revenues and expenditures. Because of the short time series of the available data, COFOG classification data served as a supplementary source of information.

V.2. Developments on the revenue side

The Slovak government continues to address its goals, including through modifications in the area of taxes and contributions. Several measures were introduced in the taxation system in 2009 with the aim of mitigating the impacts of the financial crisis on the Slovak economy. These measures and their influence on tax revenues were described in the Stability Programme of the Slovak Republic for 2008-2012.

Other legislative changes introduced in the course of 2009 include increasing excise taxes on alcohol and a change in the VAT registration threshold. The rate of excise tax on alcohol will be increased by 15% from its current level of 939.38 EUR/hl to 1 080 EUR/hl effective from 1 March 2010. The VAT registration threshold was raised from EUR 35 000 to EUR 49 790 with effect from 1 July 2009. Since the impact of these measures on tax revenues does not exceed 0.03% of GDP, their contribution as a source of revenue for the general government budget is negligible.

TAB 19 - Impact of legislative changes on tax revenues (ESA95, EUR ths.)

	2009	2010	2011	2012
Increase of excise taxes on alcohol	0	13 170	20 040	20 710
Change in the annual turnover threshold for VAT registration	13 643	-5 709	-6 174	-667
Total	**13 643**	**7 461**	**13 866**	**20 043**
Total (% of GDP)	**0.02**	**0.01**	**0.02**	**0.03**

Source: Ministry of Finance

When assessing the pace of consolidation, it should be borne in mind that throughout the period 2009-2012 the revenues from taxation and social contributions, expressed in terms of their share in GDP, will fall approximately by 0.9% of GDP. A decline is also expected in non-tax revenues, mainly due to lower revenues from dividends of companies where the state is a shareholder. An important role in the general government sector will be played by EU funds averaging close to 4% of GDP in the years 2010-2012. However, these revenues do not create room for reducing the deficit since their absorption is conditioned by co-financing from the general government budget. Hence, the planned consolidation of public finances in the above period will take place alongside a falling share of general government revenues in GDP (excluding resources from EU funds).

V.3. Developments on the expenditure side

The general government budget for the years 2010 to 2012 is built on the assumption that ambitious consolidation objectives will be attained by means of changes on the side of general government expenditures.

The most substantial savings are to be achieved by streamlining government consumption expenditures and capital expenditures in individual chapters of the state budget. At the level of central government, cuts are envisaged compared to the 2009 budget in expenditures on goods and services, capital expenditures and current transfers, amounting in total to EUR 787 million (1.2% of GDP) in 2010, EUR 738 million (1.0% of GDP) in 2011 and EUR 570 million (0.7% of GDP) in 2012.

Consolidation will be also supported by reducing the share of expenditures on the wages of civil servants in the medium term. This development will be supported especially by a prudent wage policy approach involving a moderate indexation of civil servant wages (except for regional school system employees) throughout the entire budgeted period, with a 1% increase in 2010. To a certain extent, this expected development offsets the relatively steep growth of wages in public sector during 2009. The 2010 level of salaries of ministers, members of parliament and other political office holders will be maintained at the 2009 level. Concerning employment in the general government sector, cuts will be made in the level of staffing. The number of employees in central government is expected to fall compared to 2009 (by approximately 2%), especially in connection with the reorganisation of the armed forces and a decrease in the number of regional school system employees.

One of the Slovak government's priorities is to build a knowledge-based society as evidenced by the re-allocation of expenditures to education and science. In the regional school system, teacher wages are planned to remain above the level of average wage in the economy. A considerable increase in the funding is also expected for universities and science, and these are the areas which represent a priority even in terms of drawdown from the EU structural funds. As a result, public expenditures on universities will increase in 2010 by 12% above their 2009 level, and the financing of science will rise by 10% year-on-year.

Another key priority for the government is the construction and modernisation of Slovakia's transport infrastructure with a view to its interconnection with the trans-European transport network and improved access to all regions of the country, thus contributing to the creation of preconditions for improving the standard of living across different regions and reducing regional disparities. The overall budgetary resources allocated for transport in 2010 are 29% higher than in 2006, also as a result of the increased availability of EU funds. The emphasis is laid especially on the construction of motorways and expressways and on railway modernisation. The general government budget for 2010-2012 is built on the assumption that the construction of motorways and expressways will be financed primarily from the state budget, EU funds and with participation of private funding through PPP projects. Since the construction under the second package (R1 expressway) started already in 2009 and the first completed sections are to be handed over as early as 2011, the budget also includes the expected availability payments by the state for this infrastructure (Box 4). In the area of railway infrastructure, the funds for the development and modernisation of railways increase significantly in 2010, with expected year-on-year growth by 39 %.

Despite realized cut-backs in capital expenditures, the share of these expenditures in GDP will rise from 4.2% of GDP in 2009 to 4.9% of GDP in 2010. The main reason behind such development is the anticipated acceleration in the drawdown of structural funds and Cohesion Fund of the EU, a considerable portion of which should be channelled into regional development projects, particularly in the areas of infrastructure, education and the environment. In the next years, a drop in funds available from the EU budget will lead to a decline of capital expenditures to 3.5% of GDP in 2012. However, the actual development of capital expenditures is conditional on the ability and the speed of spending the EU funds.

TAB 20 - General government revenue and expenditure in years 2002 and 2012 (modified ESA95*, % of GDP)

	2002	2008E	2009B	2009E	2010B	2011B	2012B	2012B-2009E
TOTAL REVENUES	**37.5**	**35.1**	**34.3**	**34.4**	**35.6**	**35.1**	**34.1**	**-0.3**
Tax revenues	**18.1**	**16.7**	**16.6**	**16.4**	**16.0**	**16.1**	**16.0**	**-0.4**
Personal income tax	3.3	2.7	2.8	2.6	2.4	2.7	2.8	0.2
from dependent activity	2.8	2.4	2.5	2.3	2.1	2.4	2.4	0.1
from self-employment	0.4	0.3	0.3	0.3	0.3	0.3	0.4	0.1
Corporate income tax	2.5	3.1	3.3	2.8	2.6	2.6	2.7	-0.2
Withholding income tax	0.8	0.3	0.3	0.2	0.2	0.2	0.2	0.0
Property taxes	0.5	0.4	0.3	0.4	0.4	0.4	0.4	0.0
Value added tax	7.0	6.9	6.7	7.0	6.8	6.7	6.7	-0.3
Excise taxes	2.9	2.7	2.7	2.7	3.0	2.8	2.7	0.0
Road tax	0.2	0.2	0.2	0.2	0.2	0.2	0.2	0.0
Taxes from international trade and transactions	0.4	0.1	0.1	0.0	0.0	0.0	0.0	0.0
Taxes on specific services (municipalities)	0.3	0.2	0.2	0.3	0.3	0.2	0.2	0.0
Television and radio licence fees	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.0
Other taxes	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Social contributions	**14.3**	**12.0**	**11.9**	**12.4**	**12.0**	**11.9**	**11.9**	**-0.5**
Social Insurance Agency	8.4	7.2	7.0	7.1	6.7	6.7	6.7	-0.5
Health insurance companies	5.0	4.8	4.9	5.3	5.3	5.2	5.2	-0.1
National labour office	0.9	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Non-tax revenues	**4.8**	**4.8**	**3.3**	**3.5**	**3.2**	**2.8**	**2.9**	**-0.6**
of which: Dividends	0.1	0.8	0.7	1.1	0.6	0.5	0.5	-0.6
Interest	0.7	0.2	0.2	0.1	0.2	0.2	0.2	0.1
Grants and transfers	**0.2**	**1.6**	**2.6**	**2.0**	**4.4**	**4.2**	**3.2**	**1.2**
of which from the European Union	0.0	1.4	2.6	2.0	4.4	4.2	3.2	1.2
TOTAL EXPENDITURES	**45.7**	**37.4**	**36.4**	**40.7**	**41.1**	**39.3**	**37.1**	**-3.7**
Current expenditure	**38.1**	**33.0**	**32.2**	**36.6**	**36.2**	**34.9**	**33.6**	**-3.2**
Compensation of employees	**7.6**	**6.4**	**6.2**	**7.0**	**6.7**	**6.3**	**6.0**	**-1.1**
- Wages and salaries	5.6	4.9	4.6	5.2	5.0	4.7	4.4	-0.8
- Employers´ social contributions	1.9	1.6	1.6	1.8	1.7	1.6	1.5	-0.3
Goods and other services	**10.0**	**10.4**	**9.5**	**10.4**	**10.2**	**10.2**	**9.7**	**-0.7**
- Health insurance companies	4.9	4.7	4.7	5.0	5.1	5.0	5.0	0.0
- Other	5.1	5.7	4.8	5.4	5.1	5.2	4.7	-0.7
Subsidies and transfers	**17.1**	**14.9**	**15.2**	**17.3**	**17.4**	**16.5**	**16.0**	**-1.5**
- Agricultural subsidies	0.7	0.9	0.9	1.0	0.9	0.8	0.7	-0.3
- Transport subsidies	0.4	0.9	0.6	0.7	0.6	0.6	0.7	0.0
- Housing subsidies	0.3	0.1	0.1	0.1	0.1	0.1	0.1	0.0
- Active labour market policy	0.3	0.2	0.2	0.2	0.3	0.2	0.2	0.0
- Sickness benefits	0.8	0.4	0.4	0.5	0.5	0.5	0.5	0.0
- Old-age and disability pensions	7.2	6.7	6.8	7.9	7.9	7.8	7.6	-0.3
- Unemployment benefits	0.4	0.1	0.1	0.3	0.3	0.3	0.2	-0.1
- State benefits and social assistance	3.0	1.6	1.8	1.8	1.9	1.8	1.6	-0.2
- Social contributions on behalf of certain groups	2.2	1.8	1.9	2.2	2.3	2.2	2.2	0.0
- Transfers to the EU budget	0.0	0.8	0.9	1.0	1.2	0.9	0.9	-0.1
- Transfer of 2% of income tax to the third sector	0.0	0.1	0.1	0.1	0.1	0.1	0.1	0.0
- Other subsidies and transfers	1.8	1.4	1.5	1.4	1.3	1.1	1.2	-0.4
Interest	**3.6**	**1.2**	**1.3**	**1.8**	**1.9**	**1.9**	**1.9**	**0.1**
Capital expenditures	**7.6**	**4.4**	**4.2**	**4.2**	**4.9**	**4.3**	**3.5**	**-0.5**
Capital assets	3.2	2.3	1.9	2.2	2.0	1.9	1.8	-0.2
Capital transfers	4.4	2.1	2.2	1.9	2.9	2.4	1.7	-0.3
General Government balance	**-8.2**	**-2.3**	**-2.1**	**-6.3**	**-5.5**	**-4.2**	**-3.0**	**3.3**
Impact of the 2nd pillar	*0.0*	*-1.3*	*-1.1*	*-1.2*	*-1.1*	*-1.1*	*-1.2*	*0.0*
GG balance excluding the impact of 2nd pillar	**-8.2**	**-1.1**	**-1.0**	**-5.2**	**-4.4**	**-3.1**	**-1.8**	**3.3**

Note: * in comparison with table 2 in the annex, table 20 presents the general government balance with two key differences without any impact on the GG deficit: first, the revenues and expenditures from EU funds are recorded in full amount (irrespective of the sector where the final recipient of these funds is classified); second, capital revenues are classified in non-tax revenues instead of decreasing the amount of capital expenditures by their level

Source: Ministry of Finance

V.4. The linkage with the National Reform Programme of the Slovak Republic

In connection with the launching of a new three-year cycle of the Lisbon Strategy, in October 2008 the Slovak government approved and submitted to the European Commission the National Reform Programme for 2008-2010 which includes measures in five priority areas – 1) research, development and innovation, 2) education, 3) employment, 4) business environment, and 5) climate change and energy.

The linkage between the Stability Programme of the Slovak Republic for 2008–2012 and the National Reform Programme of the Slovak Republic for 2008 – 2010 is ensured by incorporating the public funding of the measures planned in the National Reform Programme into the general government budget, which in turn is in line with the medium-term fiscal consolidation objectives. Since the parameters of some of the measures financed from EU structural funds and from the Cohesion Fund need to be specified in greater detail, the estimate of their budgetary impact is only indicative.

The funding of the anti-crisis measures approved by the Slovak government in the three packages is also fully provided for in the general government budget. The aim of these measures is to improve energy efficiency in the economy, reduce administrative burden for companies, decrease the tax and contribution burden of employees, support small and medium enterprises, promote research and development, create jobs, safeguard employment, and increase labour market flexibility.

VI. SUSTAINABILITY OF PUBLIC FINANCE

Sustainability of Slovak public finances was set out for the first time in the Convergence Programme of May 2004. Since that time, the aspect of long-term sustainability is present also in other key government documents, in particular the general government budget. The issue of sustainability of public finances and underlying measures is thus not only a topic for expert discussions, but it also and more importantly constitutes the framework guiding the political decision-making.

VI.1. Policy strategy

The long-term sustainability of public finance has an economic and a moral dimension. From the economic point of view, sound public finance is an essential precondition for high and sustainable economic growth. The moral dimension lies in ensuring intergenerational justice. This is because general government budgets do not just reallocate resources between different groups of the population (solidarity), but also between generations. Carrying out a policy of high deficits and debts automatically means requiring future generations to pay the costs – usually through higher taxes.

From this perspective Slovakia belongs among responsible countries that demonstrated their ability to significantly reduce the general government deficit while addressing important issues for the long-term sustainability of public finances. The current worsening of the fiscal position in 2009 due to the adverse impact of the economic crisis therefore suggests the need for additional consolidation effort. The positive initial fiscal position constitutes the essential prerequisite for the ability of the public finance to absorb future negative influences of demographic developments. The reduction of the general government deficit is therefore the central medium-term goal of fiscal policy.

Starting from 2010, the approved general government budget for 2010 – 2012 assumes a gradual reduction of the general government deficit with the aim to reach a 3% of GDP deficit in 2012. The key objective in the field of long-term sustainability of public finances is to gradually achieve a balanced general government budget in 2015. This target reflects the provisions of the Stability and Growth Pact and takes into account implicit liabilities related to population ageing,

Notwithstanding additional consolidation, the adverse effects of population ageing must be toned down through structural reforms. Higher employment, productivity gains and economic growth are not just the only sustainable sources of improvement in the population's living standards: they can also make a significant contribution to the sustainability of the pension system, and to the overall consolidation of public finances. The prerequisites for employment and productivity growth include the relatively low and effective tax burden, flexible labour market, and flexible markets for goods and services.

VI.2. Long-term budgetary prospects in the context of population ageing

Population ageing as a global phenomenon currently affects mainly developed economies, Slovakia being no exception. In recent years, this issue has been given particular attention in the EU framework. It is addressed by the Ageing Working Group (AWG) established to analyse, in cooperation with the European Commission, the expenditures that are sensitive to demographic trends, and to identify their implications for overall development of public finance. Its objective is to obtain comparable and the most complete information possible concerning the risks associated with the expected demographic changes. In 2009, the AWG and the European Commission jointly presented updated projections for the extended period up to 2060.[8]

In line with the requirements of the Code of Conduct, the Member States are obliged to incorporate the projections made by the AWG into their stability programmes. Slovakia endorsed the updated projections of 2009

[8] European Commission (DG ECFIN) and the Economic Policy Committee (AWG) (2009) 'The 2009 Ageing Report: economic and budgetary projections for the EU-27 Member States (2008-2060)', European Economy, No 2, April 2009.

at expert level within the AWG, and the Ministry of Finance therefore fully accepts them and uses them for its own analyses. The European Commission subsequently uses these projections for assessing the long-term sustainability of the fiscal position and fiscal objectives.

It needs to be mentioned with respect to the topicality of these projections that, since they were made during 2008 on the basis of the legislation effective from July 2008, they do not reflect the implications of re-opening the second pillar between 15 November 2008 and 30 June 2009.

This subchapter has two parts. The first part describes the magnitude of the problem that will have to be tackled in the field of public finance in Slovakia in the future. The second part presents sustainability indicators. They represent quantified measures in the area of fiscal policy that will have to be adopted as of now to address the problem of sustainability of public finances. Both parts present the most recent calculations of the European Commission, i.e. the results of the projections of implications of population ageing on public finance in 2009 (Ageing Report 2009), as well as assessment of sustainability for the same year (Sustainability Report 2009).

Long-term projections of revenues and expenditures sensitive to population ageing

The AWG identified those general government expenditures that may be favourably or adversely influenced by demographic changes. These include expenditures on pensions, health care, long-term care, education and unemployment benefits. In the future, the first three types of expenditures will grow while expenditures on education and unemployed persons will go down (fewer children, lower unemployment, and fewer labour market participants).

Moreover, the revenue side reflects changes in property income and for certain countries, including Slovakia, changes resulting from pension system adjustments. In case of Slovakia, this is related to the shortfall in general government revenues resulting from the introduction of the fully-funded pillar of the pension system.

TAB 21 - Changes in GG revenues and expenditures induced by demographic changes (% of GDP)

	2007	2010	2020	2030	2040	2050	2060	Change 2007-2060
A. Revenue shortfall (loss due to 2nd pillar)	**-1.0**	**-1.2**	**-1.4**	**-1.6**	**-1.7**	**-1.7**	**-1.8**	**-0.7**
B. Expenditures sensitive to population ageing	**15.2**	**14.9**	**14.5**	**16.1**	**17.5**	**19.2**	**20.4**	**5.2**
- pension benefits	6.8	6.6	6.3	7.3	8.3	9.4	10.2	**3.4**
- health care	5.0	5.2	5.7	6.2	6.7	7.1	7.2	**2.3**
- long-term care	0.2	0.2	0.2	0.3	0.4	0.5	0.6	**0.4**
- education	3.1	2.8	2.2	2.2	2.1	2.1	2.3	**-0.8**
- unemployment benefits	0.1	0.1	0.1	0.1	0.1	0.1	0.1	**-0.1**
C. Property income	**1.5**	**1.4**	**1.2**	**1.1**	**1.1**	**1.1**	**1.0**	**-0.5**
Impact on general government balance								**-6.4**

* *Current legislation status* : retirement age 62 years, indexation 50:50 (wages, inflation), 2nd pillar implemented

Source: Ageing report 2009

Commission and AWG projections suggest that, unless remedial action is taken, adverse demographic developments and falling general government revenues will lead to an increase in the general government deficit at a level of 6.4 percentage points by 2060. These results take account of all the key measures: introduction of the fully-funded pillar, increase in retirement age to 62 years, indexation of pensions in line with wages and inflation, etc. This means that the calculations are up-to-date, except for the impact of the opening of the second pillar in 2009.

Assessment of long-term sustainability

The purpose of assessing the long-term sustainability is to examine the current situation in public finances in the light of the future growth of age-related public finance expenditures presented in the preceding section, i.e. to judge whether the current policy mix (fiscal discipline, pension system, healthcare system) is sustainable in the long run (capable of preventing an uncontrolled growth of debt and maintaining its stable level) with the current level of government debt. To this end, the European Commission uses so-called sustainability indicators[9]: *S1 indicator, S2 indicator, RPB – Required Primary Balance, Costs of Delay. These indicators* quantify the volume of immediate fiscal measures needed to ensure sustainability. A brief description of individual indicators was provided in the previous Convergence Programmes.

In carrying out its sustainability assessment the European Commission, besides quantifying the size of fiscal measures needed to ensure sustainability, classifies Member States into three categories depending on the degree of risk (low, medium and high). In the 2009 Sustainability Report, Slovakia was classified for the first time (along with several other countries) among high-risk countries in terms of long-term sustainability of public finance.

In classifying the countries into the above-mentioned categories, the Commission used the S2 indicator and the year 2009 as the baseline for quantification (The 2009 Scenario) while, for some countries, it also took account of other, "qualitative", factors such as the existence of the time frame for carrying out the necessary reforms (if the sustainability problem is mainly related to ageing and the country has sufficient time to implement the necessary reforms), current debt level, forecast of the development of primary structural balance, level of implicit liabilities, evolution of the replacement rate in the pension system, and the tax-GDP ratio. However, in case of Slovakia no consideration was given to such "qualitative" factors.

The Slovak Ministry of Finance does not agree with the reclassification of Slovakia among the high-risk countries in terms of sustainability of public finances. Box 6 gives the justification for this disagreement.

BOX 6 - The Ministry of Finance position on Slovakia's assessment in terms of sustainability of public finance

Sustainability indicators offer, subject to their correct and prudent interpretation, valuable information for the economists and economic policy makers. However, the Ministry of Finance cannot agree, as a matter of principle, with the reclassification of Slovakia among the high-risk countries on the grounds invoked by the European Commission, for the following objective reasons:

- ***The calculation of S2 indicator used as the basis for assessment is based exclusively on the year 2009 (The 2009 Scenario) without taking account of consolidation objectives that must be pursued by the government within the EDP procedure.*** *Under "The 2009 Scenario", a country's economic performance in the long term is the same as in the base year (2009), population-ageing effects being "added-on" in the future. In simplified terms, in case of Slovakia this would mean that the country would in the long term run the same deficit as recorded in 2009. The Ministry of Finance* ***believes that since the deficits run deeper in crisis times, this is an extreme assumption and, in the light of the rules of the Stability and Growth Pact, an absolutely unrealistic one (especially for a small and open economy)****. In our opinion, such assumption cannot be used as a basis for classifying any country as being at high risk in terms of its long-term sustainability.*

  Unlike in the case of other three countries, no account was taken in Slovakia's case of "qualitative" factors which, in the opinion of the Ministry of Finance, markedly improve the country's position in the assessment of its long-term sustainability, namely:
  1. ***the lowest tax/contribution-to-GDP ratio in the EU which, in contrast to other countries, gives Slovakia a manoeuvring room for addressing fiscal problems***
  2. ***a comparatively very low initial level of general government debt***
  3. ***tradition of the fulfilment of consolidation objectives in compliance with the plan (track record)***
  4. ***tradition of consolidation by means of cuts in expenditures rather than by raising taxes (sustainability of consolidation)***
  5. ***the government-approved budget for 2010-2012 with ambitious consolidation objectives starting in 2010***

[9] European Commission – DG ECFIN (2009) ´Sustainability Report 2009´, European Economy, no. 9, 2009

- ***The high degree of uncertainty concerning the size of the cyclical component**. The S2 calculation is built on the data on structural balance, which raises the issue of the calculation of potential output. This is an area where the positions of the Ministry of Finance and of the European Commission have been at odds for quite some time. As a rule, the Commission uses a single common method and common assumptions for calculating potential output for all countries. While recognising the merits of a common methodology, the Ministry of Finance is of the opinion that in case of Slovakia this methodology leads to economically unjustifiable results. For this reason, the methodology should be applied with caution and its results should be interpreted with due regard to the context.*

Long-term sustainability is a particularly sensitive subject for Slovakia which has already proven its ability to substantially reduce the general government deficit while, at the same time, addressing important problems relevant for long-term sustainability of public finance. Moreover, it is absolutely inappropriate to attach labels to small and open economies (rating, investment) at the time of crisis (and, in particular, to change their label) on the basis of a mechanical calculation that, even though it is derived from relevant data (initial structural deficit, debt, pension forecasts), cannot grasp the quintessence of sustainability in each and every case because it does not take account of other relevant factors, and also because the benchmarks for the classification of countries into sustainability categories and the weights of individual parameters in the S2 indicator equation are set in an arbitrary manner.

The S2 calculation is based on the 2009 data published in the EC 2009 Spring Forecasts. Important parameters of the calculation include current deficit level, current debt, and the level of future public expenditure sensitive to demographic changes, which are assumed to develop in accordance with the previously-mentioned AWG projection. An important assumption is that the European Commission takes into account only the current legislation (year 2008) that influences future growth of these expenditures. Consequently, the planned changes and reforms are not reflected in the calculations. The ratio of demography-unrelated revenues and expenditures (except for income from property) to GDP remains constant throughout the entire period. In other words, only those revenues and expenditures that are influenced by the ageing of the population have an impact on the deficit level.

TAB 22 - Quantitative indicators of long-term sustainability of public finance (2009 scenario)

	Value	Initial fiscal position	Requirement for debt in 2060 (60% of GDP)	Change of the primary balance within a long-term horizon
S1 indicator	**5.7** (2.3)	**4.3** (0.9)	**-0.3** (-0.3)	**1.6** (1.7)
S2 indicator	**7.4** (4.0)	**4.5** (1.1)	**-**	**2.9** (2.9)

** values from the 2008-2012 Stability Programme of the Slovak Republic assessment in July 2009 (2008 scenario) are displayed in parentheses*

Source: Sustainability report 2009; SLOVAKIA: MACRO FISCAL ASSESSMENT - AN ANALYSIS OF THE APRIL 2008 UPDATE OF THE STABILITY PROGRAMME (July 2009)

The interpretation of the S1 indicator from the table is as follows: If Slovakia's target is to reach the general government debt of 60% of GDP in 2060, as from now (2009), the government should increase the tax burden or reduce expenditures by 5.7% of GDP (in structural terms). The required fiscal consolidation at the level of 5.7% of GDP can be divided into three components. Because of the present high deficit, there is a need for consolidation at the level of 4.3% of GDP. Conversely, because the level of the current general government debt of Slovakia is relatively low (less than 60% of GDP), it would be possible to ease the fiscal policy on this account (reduce taxes or increase expenditures) by an equivalent of 0.3% of GDP. The third factor is related to demographic trends described in the previous section that necessitate consolidation already now at a level of 1.6% of GDP.

The interpretation of S2 indicator is similar. In contrast to S1, the objective is not to attain a particular debt level in a given year, but overall sustainability of the debt. Given the fact that Slovakia's general government debt is significantly below 60% of GDP, it comes as no surprise that the need for consolidation is considerably higher compared to S1, and it was quantified at 7.4% of GDP in 2009. In other words, if Slovakia's fiscal performance from now on were exactly the same as assumed for 2009 (EC 2009 Spring Forecasts), the general government debt will be sustainable and will not have a tendency to "explode" solely on account of a positive correction to primary structural balance by 7.4% of GDP. A look at the structure of the S2 indicator confirms that an increase in its level to 7.4% of GDP and the ensuing reclassification of Slovakia into the category of high-risk countries was clearly influenced by the initial budgetary position (IBP), since future negative impacts of population ageing (LTC) did not substantially change as compared to the preceding evaluation.

ANNEXES

Annex 1 - Required tables

Table 1a. Macroeconomic prospects (ESA95, EUR bn.)

	ESA code	2008 Actual	2008 Rate of change	2009 Rate of change	2010 Rate of change	2011 Rate of change	2012 Rate of change
1. Real GDP	B1*g	50.4	6.4	-5.7	1.9	4.1	5.4
2. Nominal GDP	B1*g	67.2	9.5	-5.5	5.9	7.5	8.9
Components of real GDP							
3. Private consumption expenditure	P.3	26.6	6.1	-0.4	1.5	3.4	4.9
4. Government consumption expenditure	P.3	8.3	4.3	2.3	2.4	3.0	2.4
5. Gross fixed capital formation	P.51	13.2	6.8	-10.3	2.9	4.1	5.1
6. Exports of goods and services	P.6	48.3	3.2	-15.2	2.9	7.1	10.0
7. Imports of goods and services	P.7	46.7	3.3	-14.7	3.2	5.6	8.4
Contributions to real GDP growth							
8. Final domestic demand		-	5.9	-2.4	1.4	2.7	3.9
9. Changes in inventories and net acquisition of valuables	P.52 + P.53	-	0.5	-2.5	0.6	0.3	0.0
10. External balance of goods and services	B.11	-	0.0	-0.8	-0.1	1.1	1.5

Source: Statistical Office, Ministry of Finance

Table 1b. Price developments (ESA95)

	ESA code	2008 Level	2008 Rate of change	2009 Rate of change	2010 Rate of change	2011 Rate of change	2012 Rate of change
1. GDP deflator		1.3	3.0	0.2	3.8	3.2	3.4
2. Private consumption deflator		1.4	4.5	2.0	3.0	3.8	4.0
3. HICP		-	3.9	1.2	2.6	3.7	4.1
4. Public consumption deflator		1.4	4.4	3.1	3.0	3.8	4.0
5. Investment deflator		1.3	2.0	-1.1	2.8	2.4	2.3
6. Export price deflator (goods and services)		1.2	1.4	-5.0	0.8	0.5	0.6
7. Import price deflator (goods and services)		1.2	3.0	-5.0	1.2	1.1	0.7

Source: Ministry of Finance

Table 1c. Labour market developments (ESA95)

	ESA code	2008 Level	2008 Rate of change	2009 Rate of change	2010 Rate of change	2011 Rate of change	2012 Rate of change
1. Employment, persons (thousands) [1]		2 237.1	2.8	-1.9	-0.1	0.9	1.6
2. Employment, hours worked (thousands)[2]		3 958.3	2.4	-6.6	2.9	2.6	1.8
3. Unemployment rate (%) [3]		9.6	1.4	2.1	0.4	-0.5	-0.6
4. Labour productivity per persons (EUR) [4]		22 566	4.3	-3.7	2.0	3.2	3.7
5. Labour productivity per hours worked (EUR) [5]		12 753	3.9	1.0	-1.0	1.4	3.6
6. Compensation of employees (EUR mill.)	D.1	24 129	8.1	2.6	3.4	6.5	7.5
7. Compensation per employee (EUR)		10 786	5.1	2.4	-	-	-

[1] Occupied population, domestic concept national accounts definition.
[2] National accounts definition.
[3] Harmonised definition, Eurostat; levels.
[4 Real GDP per person employed.
[5] Real GDP per hour worked.

Source: Statistical Office, Ministry of Finance

Table 1d. Sectoral balances (ESA95, % of GDP)

	ESA code	2008	2009	2010	2011	2012
1. Net lending/borrowing vis-à-vis the rest of the world	B.9	-5.3	-4.2	-3.2	-2.7	-1.9
of which:						
- Balance on goods and services		-1.8	-2.5	-2.9	-2.3	-1.4
- Balance of primary incomes and transfers		-4.7	-3.3	-2.3	-2.5	-2.6
- Capital account		1.2	1.6	2.0	2.1	2.1
2. Net lending/borrowing of the private sector	B.9	-3.0	2.1	2.3	1.5	1.1
3. Net lending/borrowing of general government	EDP B.9	-2.3	-6.3	-5.5	-4.2	-3.0
4. Statistical discrepancy						

Source: Ministry of Finance

Table 2. General government budgetary prospects

	ESA code	2008 EUR mill	2008 % GDP	2009 % GDP	2010 % GDP	2011 % GDP	2012 % GDP
Net lending (EDP B.9) by sub-sector							
1. General government	S.13	-1 549	-2.3	-6.3	-5.5	-4.2	-3.0
2. Central government	S.1311	-1 801	-2.7	-5.6	-5.5	-4.3	-3.0
3. State government	S.1312	-	-	-	-	-	-
4. Local government	S.1313	-48	-0.1	-0.2	0.0	0.0	0.0
5. Social security funds	S.1314	300	0.4	-0.6	0.0	0.2	0.1
General government (S.13)							
6. Total revenue	TR	21 844	32.5	32.8	32.5	32.3	31.7
7. Total expenditure	TE [1]	23 393	34.8	39.1	38.0	36.5	34.7
8. Net lending/borrowing	EDP B.9	-1 549	-2.3	-6.3	-5.5	-4.2	-3.0
9. Interest expenditure	EDP D.41	833	1.2	1.8	1.9	1.9	1.9
10. Primary balance	[2]	-715	-1.1	-4.5	-3.6	-2.3	-1.1
11. One-off and other temporary measures	[3]	-452	-0.7	0.0	0.0	0.0	0.0
Selected components of revenue							
12. Total taxes (12=12a+12b+12c)		11 318	16.8	16.7	16.4	16.5	16.4
12a. Taxes on production and imports	D.2	6 995	10.4	10.8	10.9	10.6	10.4
12b. Current taxes on income, wealth, etc.	D.5	4 322	6.4	5.9	5.6	5.9	6.0
12c. Capital taxes	D.91	0	0.0	0.0	0.0	0.0	0.0
13. Social contributions	D.61	8 137	12.1	12.4	12.0	11.9	11.9
14. Property income	D.4	816	1.2	1.4	0.9	0.8	0.7
15. Other	[4]	1 573	2.3	2.3	3.2	3.1	2.7
16=6. Total revenue	TR	21 844	32.5	32.8	32.5	32.3	31.7
p.m.: Tax burden (D.2+D.5+D.61+D.91-D.995)	[5]	19 455	28.9	29.1	28.4	28.5	28.3
Selected components of expenditure							
17. Compensation of employees + Intermediate consumption	D.1+P.2	7 781	11.6	12.3	11.2	10.8	10.0
17a. Compensation of employees	D.1	4 417	6.6	7.4	7.0	6.7	6.3
17b. Intermediate consumption	P.2	3 364	5.0	4.8	4.2	4.1	3.7
18. Social payments		10 515	15.6	18.4	18.5	18.2	17.7
18a. Social transfers in kind supplied via market producers	D.6311, D.63121, D.63131	2 924	4.3	5.0	5.1	5.0	5.0
18b. Social transfers other than in kind	D.62	7 591	11.3	13.4	13.4	13.2	12.7
19. = 9. Interest expenditure	EDP D.41	833	1.2	1.8	1.9	1.9	1.8
20. Subsidies	D.3	1 116	1.7	1.8	1.7	1.6	1.6
21. Gross fixed capital formation	P.51	1 314	2.0	1.9	1.6	1.6	1.2
22. Other	[6]	1 833	2.7	3.0	3.0	2.5	2.3
23=7. Total expenditure	TE [1]	23 393	34.8	39.1	38.0	36.5	34.7
p.m.: Government consumption (nominal)	P.3	11 691	17.4	19.0	18.0	17.5	16.7

[1] Adjusted for the net flow of swap-related flows, so that TR-TE=EDP B.9.

Source: Ministry of Finance

[2] The primary balance is calculated as (EDP B.9, item 8) plus (EDP D.41, item 9).

[3] A plus sign means deficit-reducing one-off measures.

[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] D.29+D4 (other than D.41) +D.5+D.7+D.9+P.52+P.53+K.2+D.8.

Table 3. General government expenditure by function (% of GDP)

	COFOG code	2008	2012
1. General public services	1	3.7	4.7
2. Defence	2	1.4	1.0
3. Public order and safety	3	2.3	1.5
4. Economic affairs	4	5.4	4.4
5. Environmental protection	5	0.6	1.0
6. Housing and community amenities	6	0.6	0.8
7. Health	7	6.7	7.3
8. Recreation, culture and religion	8	0.9	0.9
9. Education	9	3.3	4.1
10. Social protection	10	9.8	11.5
11. Total expenditure	**TE**	**34.7**	**37.1**

Source: Eurostat, Ministry of Finance

Table 4. General government debt developments (% of GDP)

	ESA code	2008	2009	2010	2011	2012
1. Gross debt		27.7	37.1	40.8	42.5	42.2
2. Change in gross debt ratio		-1.7	9.4	3.7	1.7	-0.3
Contributions to change in gross debt						
3. Primary balance		1.1	4.5	3.6	2.3	1.1
4. Interest expenditure	EDP D.41	1.2	1.8	1.9	1.9	1.9
5. Stock-flow adjustment		-1.5	1.5	0.3	0.3	0.2
Of which:						
- Differences between cash and accruals		0.1	0.8	-0.1	0.0	0.0
- Net accumulation of financial assets		-0.9	0.7	0.4	0.3	0.2
- Valuation effects and others		-0.7	0.0	0.0	0.0	0.0
p.m. Implicit interest rate on debt		4.6	6.2	5.5	5.0	4.8
Other relevant variables						
6. Liquid financial assets		3.7	4.1	3.9	3.7	3.3
7. Net financial debt (7=1-6)		24.0	33.0	36.9	38.8	38.9

Source: Ministry of Finance

Table 5. Cyclical developments (% of GDP)

	ESA code	2008	2009	2010	2011	2012
1. Real GDP growth net of the impact of stockpiling (%)		6.2	-5.7	1.9	4.1	5.4
2. Net lending of general government	EDP B.9	-2.3	-6.3	-5.5	-4.2	-3.0
3. Interest expenditure	EDP D.41	1.2	1.8	1.9	1.9	1.9
4. One-off and other temporary measures	[1]	-0.7	0.0	0.0	0.0	0.0
5. Potential GDP growth (%)		4.9	2.1	1.9	2.7	3.6
contributions:						
- labour		0.6	0.4	0.3	0.3	0.4
- capital		1.9	1.5	1.4	1.4	1.5
- total factor productivity		2.4	0.2	0.3	0.9	1.8
6. Output gap		3.9	-3.9	-4.3	-2.9	-1.2
7. Cyclical budgetary component		1.1	-1.1	-1.2	-0.8	-0.4
8. Cyclically-adjusted balance (2 - 7)		-3.4	-5.2	-4.3	-3.4	-2.6
9. Cyclically-adjusted primary balance (8 + 3)		-2.2	-3.4	-2.3	-1.5	-0.8
10. Structural balance (8 - 4)		-2.8	-5.2	-4.3	-3.4	-2.6

[1] A plus sign means deficit-reducing one-off measure

Source: Ministry of Finance

Table 6. Divergence from previous update

	ESA code	2008	2009	2010	2011	2012
Real GDP growth (%)						
Previous update*		6.4	2.4	3.6	4.5	5.1
Current update		6.2	-5.7	1.9	4.1	5.4
Difference		-0.2	-8.1	-1.7	-0.4	0.3
General government net lending (% of GDP)	EDP B.9					
Previous update*		-2.2	-3.0	-2.9	-2.2	-
Current update		-2.3	-6.3	-5.5	-4.2	-3.0
Difference		-0.1	-3.3	-2.6	-2.0	-
General government gross debt (% of GDP)						
Previous update*		27.6	31.4	32.7	32.7	-
Current update		27.7	37.1	40.8	42.5	42.2
Difference		0.0	5.7	8.1	9.8	-

*Note: * Stability Programme of the Slovak Republic for 2008-2012* *Source: Ministry of Finance*

Table 7. Long-term sustainability of public finances - AWG scenario (% of GDP)

	2007	2010	2020	2030	2040	2050	2060
Total expenditure	**34.4**	**38.0**	**39.1**	**43.0**	**48.8**	**57.5**	**68.8**
Of which: age-related expenditure	**15.2**	**14.9**	**14.5**	**16.1**	**17.5**	**19.2**	**20.4**
A. Pension expenditure	6.8	6.6	6.3	7.3	8.3	9.4	10.2
1. Social security pension	6.8	6.6	6.3	7.3	8.3	9.4	10.2
a) Old-age and early pensions	4.3	4.0	3.6	4.1	4.8	5.6	6.2
b) Other pensions (disability, survivors)	2.5	2.6	2.7	3.2	3.5	3.8	4.1
2. Occupational pensions (if in general government)	-	-	-	-	-	-	-
B. Health care	5.0	5.2	5.7	6.2	6.7	7.1	7.2
C. Long-term care	0.2	0.2	0.2	0.3	0.4	0.5	0.6
D. Education expenditure	3.1	2.8	2.2	2.2	2.1	2.1	2.3
E. Other age-related expenditures	0.1	0.1	0.1	0.1	0.1	0.1	0.1
Interest expenditure	1.4	1.6	3.1	5.5	9.8	16.9	26.9
Total revenue	**32.5**	**32.5**	**32.2**	**32.1**	**32.0**	**31.9**	**31.9**
Of which: property income (D.4)	1.5	1.4	1.2	1.1	1.1	1.1	1.0
Of which: from pensions contributions	11.8	12.0	11.7	11.6	11.5	11.4	11.4
Pension reserve fund assets	2.5	5.5	16.5	28.4	41.7	53.4	61.2
Of which: consolidated public pension fund assets	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Assumptions							
Labour productivity growth	5.3	4.7	3.1	2.7	1.7	1.7	1.7
Real GDP growth	6.4	6.2	3.4	2.0	0.5	0.2	0.5
Participation rate males (aged 15-64)	76.6	77.7	79.1	78.2	75.7	75.5	76.2
Participation rate females (aged 15-64)	61.2	62.9	66.7	67.5	65.3	65.2	66.1
Total participation rates (aged 15-64)	68.8	70.3	72.9	72.8	70.5	70.4	71.2
Unemployment rate	11.1	11.0	6.2	6.2	6.2	6.2	6.2
Population aged 65+ over total population (in %)	11.9	12.3	16.4	21.3	25.3	31.6	36.1

Table 8. Basic assumptions

	2008	2009	2010	2011	2012
Short-term interest rate (annual average)	4.6	1.3	1.5	2.1	2.8
Long-term interest rate (annual average)	4.0	3.2	3.5	4.1	4.1
USD/€ exchange rate (annual average) (euro area and ERM II countries)	1.47	1.48	1.48	1.49	1.50
World excluding EU, GDP growth	3.9	-0.4	3.8	4.1	4.1
EU GDP growth	1.0	-4.1	0.7	1.6	1.6
Growth of relevant foreign markets	1.5	-4.1	0.9	1.9	2.2
World import volumes, excluding EU	4.1	-12.6	4.6	5.0	5.0
Oil prices (Brent, USD/barrel)	98.5	61.3	76.5	80.5	85.5

Source: Common external assumptions, Ministry of Finance

Annex 2 - Additional tables and graphs

Annex 2a - Forecast of the Ministry of Finance - key macroeconomic and fiscal indicators

Estimate up to 2012						
	unit	**2008**	**2009F**	**2010F**	**2011F**	**2012F**
GDP; current prices	EUR bn.	67.184	63.608	67.378	72.418	78.891
GDP; constant prices	%	6.2	-5.7	1.9	4.1	5.4
Final consumption of households	%	6.0	-0.4	1.5	3.4	4.9
Final consumption of government	%	5.3	2.3	2.4	3.0	2.4
Gross fixed capital formation	%	1.8	-10.3	2.9	4.1	5.1
Export of goods and services	%	3.2	-15.2	2.9	7.1	10.0
Import of goods and services	%	3.1	-14.7	3.2	5.6	8.4
GDP deflator	%	3.0	0.2	4.0	3.2	3.4
Output gap	% pot. output	3.9	-3.8	-4.2	-2.9	-1.2
Potential output	%	5.0	2.1	2.0	2.7	3.6
Total employment LFS	%	3.2	-2.2	0.2	1.0	1.8
Unemployment rate LFS	%	9.6	11.7	12.1	11.6	11.0
Real wages per employee	%	3.3	0.8	0.2	2.3	3.2
Trade balance	EUR bn.	-0.76	-0.65	-1.24	-1.03	-0.60
Current account balance	% GDP	-7.0	-5.8	-5.2	-4.8	-4.0
Index of consumer prices (CPI) growth	%	4.6	1.8	3.2	4.1	4.2
Harmonised index of consumer prices (HICP) growth	%	3.9	1.2	2.6	3.7	4.1
Index of producer prices (PPI - domestic)	%	6.1	-2.2	2.2	2.6	2.3
Net inflation	%	2.2	0.3	3.1	3.3	3.9
GG revenues (ESA 95)	% GDP	32.5	32.8	32.5	32.3	31.7
GG expenditures (ESA 95)	% GDP	34.8	39.1	38.0	36.5	34.7
GG balance (ESA 95)	% GDP	-2.3	-6.3	-5.5	-4.2	-3.0
Primary GG balance (ESA 95)	% GDP	-1.1	-4.5	-3.6	-2.3	-1.1
Gross GG debt (Maastricht definition)	% GDP	27.7	37.1	40.8	42.5	42.2

Source: Ministry of Finance

Annex 2b - Committees for macroeconomic and tax revenue forecasts

In the interest of greater transparency and objectiveness of macroeconomic forecasts, the Ministry of Finance addresses the members of the Macroeconomic Forecasts Committee on a regular basis. Following its regular sessions in February and June 2009, the Committee held another session on 10 September 2009. By and large, members of the Committee perceived the medium-term macroeconomic forecast by the Ministry as realistic.

Following the session of the Macroeconomic Forecasts Committee, the Tax Revenue Forecasts Committee held its session on 21 September 2009, at which the Ministry of Finance presented its updated medium-term tax revenue forecast for 2009–2012. The medium-term forecast of tax revenues and social contributions prepared by the Ministry of Finance was described as realistic by all Committee members.

Assessment of Ministry of Finance´s forecast by members of committees

Member	Macroeconomic forecasts	Tax revenue forecasts
NBS	realistic	realistic
Infostat	optimistic	realistic
VÚB*	realistic	-
ING Bank	optimistic	realistic
Tatrabanka	realistic	realistic
SLSP	realistic	realistic
UNICREDIT Bank	realistic	realistic
ČSOB	realistic	realistic
SAV*	realistic	-

*Note: * institutions are not members of Tax Revenue Forecasts Committee*

Source: Macroeconomic Forecasts Committee, Tax Revenue Forecasts Committee

Average forecasts of the selected indicators of the Slovakia's economic development by the members of the Macroeconomic Forecasts Committee (excluding MoF) and MoF forecasts

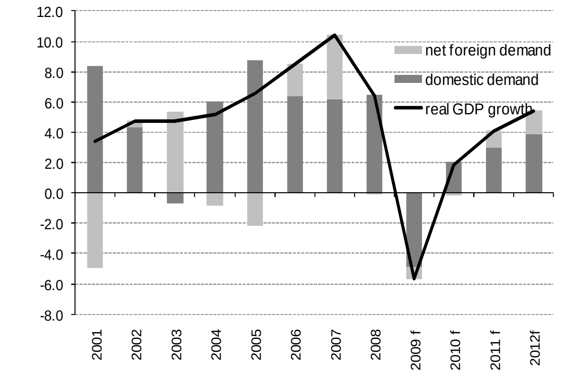
in % if not indicated otherwise	2008	2009		2010		2011		2012	
		MFC	MoF	MFC	MoF	MFC	MoF	MFC	MoF
GDP; real growth	6.2	-4.8	-5.7	1.8	1.9	3.6	4.1	4.1	5.4
GDP; current prices; bn. EUR	67.2	64.3	63.6	66.7	67.4	71.1	72.4	76.2	78.9
Final consumption of households; real growth	6.0	-0.5	-0.4	0.8	1.5	2.5	3.4	3.5	4.9
Final consumption of households; nominal growth	10.8	1.6	1.8	2.7	4.5	5.6	7.3	7.0	9.7
Average monthly wages (real growth)	3.3	0.0	0.8	1.1	0.2	1.8	2.3	2.3	3.2
Average monthly wages (nominal growth)	8.1	2.4	2.6	3.6	3.4	5.3	6.5	6.2	7.5
Average employment growth, LFS	3.2	-2.7	-2.2	-0.9	0.2	0.7	1.0	1.1	1.8
Consumer price index, (average growth)	4.6	2.3	1.8	2.6	3.2	3.4	4.1	3.8	4.2
Current account balance (share of GDP)	-6.5	-5.5	-5.8	-5.5	-5.2	-5.1	-4.8	-4.4	-4.0

Note: MFC - Macroeconomic Forecasts Committee

Source: Committee for Macroeconomic Forecasts

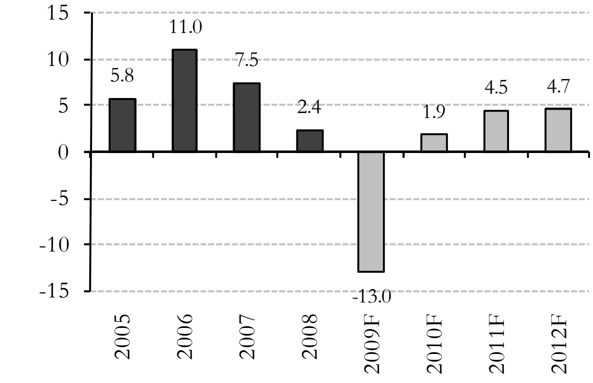
Annex 2c - Graphs

Contributions to GDP growth (p.p.)



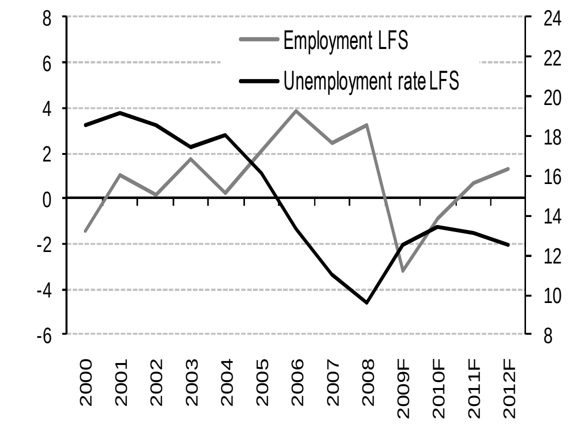
Source: Statistical Office, Ministry of Finance

Weighted GDP growth of Slovakia's trade partners (%)[10]



Source: European Commission, Ministry of Finance

Economic activity, LFS (%)

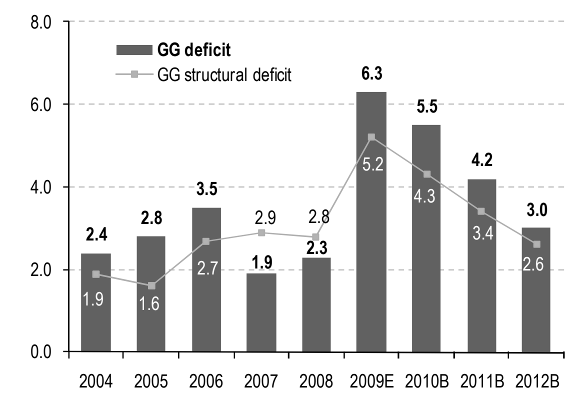


Source: Statistical Office, Ministry of Finance

Real wages and labour productivity growth (%)

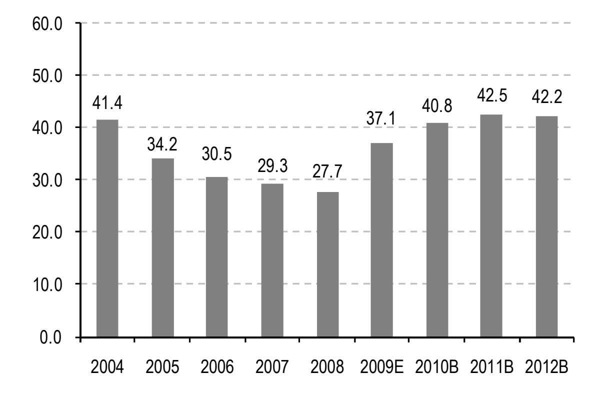
Source: Statistical Office, Ministry of Finance

General government deficit (% of GDP)



Source: Statistical Office, Ministry of Finance

Gross general government debt (% of GDP)



Source: Statistical Office, Ministry of Finance

[10] The weighted average of the 10 most important trading partners was calculated based on the countries' share on the Slovakia's exports (Germany, Czech Republic, Italy, Austria, Hungary, Poland, Spain, the US, France, Great Britain, 75% of the total exports).