Stability Programme of the Slovak Republic for 2018 to 2021

April 2018

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SUMMARY

The medium-term budgetary outlook of the Slovak Republic will be underpinned by the strongest growth of the economy since 2010 in this and the next year. Over the past year, the economy grew by 3.4%. The main source of growth was household consumption, which responded to positive developments in the labor market. Employment and unemployment have attributed new record-breaking levels. In this year, growth pace accelerates to 4.2%, especially when exports to the growing consumption of households are more pronounced. Ongoing positive developments in the labor market will cause further wage acceleration, resulting in an acceleration in inflation. In 2019, the economy is to accelerate slightly, thanks to the rise of new production in the automotive sector. In the coming years, the economy will begin to slow down towards its long-term potential. The risks to the macroeconomic forecast are balanced.

The general government deficit in 2017 reached 1.04% of GDP according to the Eurostat spring notification and significantly exceeded the budgetary target. In addition to the historically lowest general government deficit, this result also means the first primary surplus (the nominal balance net of interest expense). Compared to the target set at 1.29% of GDP, this is a better result by 0.25 p.p.. Compared to the budgetary assumption, a significantly better collection of tax was achieved, mainly due to positive developments in the labor market. Tax revenues, on the other hand, recorded a slight drop when the CIT was offset by the budget assumption, what was partly compensated by more effective collection of value added tax. The added benefit of improved VAT collection rates was 1.35% of GDP in 2017 compared to 2012. Cumulatively, the additional revenues represent 3.7 billion EUR (4.3% of GDP). Lower than the planned drawing of European funds has shown savings in co-financing. Netting out impacts from drawing of the European funds, there was a higher than budgeted increase in employees' compensation and capital expenditures. Increasing their growth over the budget was enabled by the reallocation of expenditure initially budgeted on other items, in addition to higher revenues.

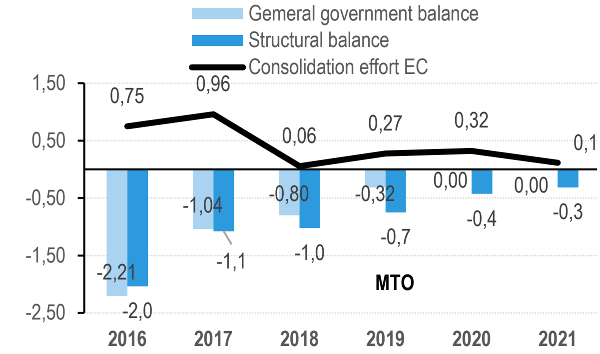
Gross general governemnt debt also exceeded the expectations of the budget. According to the spring notification, it reached 50.9% of GDP in 2017 and declined consecutively for the fourth year. The decline in debt in relation to GDP was mainly due to the nominal growth of the economy and the achievement of a better-than-budgeted primary general government surplus.

The budget target for 2018 at 0.83% of GDP is in line with the current estimate, with a modest reserve. The general government deficit is estimated at 0.80% of GDP. Update of the tax forecast compared to the budget has had a positive impact, in particular on the revenue side, thanks to the continued expansion in the labor market. The total general government expenditure is slightly above the approved budget. Their structure has altered in favor of higher capital expenditures and compensation of employees. On the other hand, lower current transfers, social benefits and intermediate consumption are expected.

In line with the government's manifesto, the medium term fiscal plan envisages achieving a balanced budget in 2020 and its subsequent maintenance in 2021. For the years 2019 to 2021, the the deficit target for 2019 is 0.32% of GDP and a balanced budget is planned since 2020. This target roughly[1] corresponds to the level of the medium-term budgetary objective of the SR (MTO). **Since the peak of the financial crisis in 2009, after one decade the structural deficit is expected to decrease by more than 6 p.p..** Since 2020 the mid-term fiscal outlook foresees a nominal balanced budget and full achievement of the MTO. The established trajectory respects the European fiscal rules of the Stability and Growth Pact. Fulfillment of the current budgetary targets up to 2021 will have a positive impact on the sustainability assessment. In terms of the mid-term horizon (S1 indicator), the fiscal space will increase to 3.1% of GDP, due to an additional recorded decline in GG debt compared to the reference value of 60% of GDP.

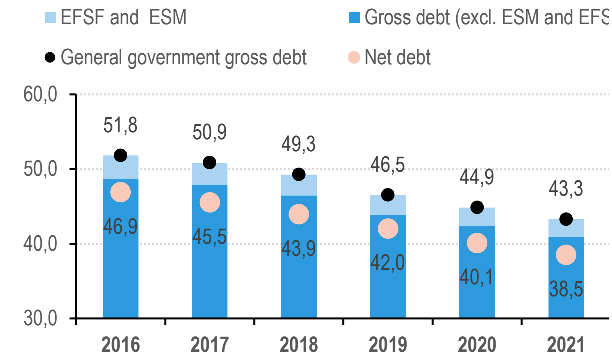
[1] The structural deficit with a deviation of up to 0.25% of GDP from the set targetted MTO is interpreted as meeting the MTO ex-post. The explanation is given in the interpretation of the European Commission's Stability and Growth Pact (Vade Mecum k SGP), page 36 (chapter 1.3.2.2).

FIGURE 1 - Consolidation effort (% GDP)



Source: MoF SR

FIGURE 2 - Gross general government debt (% GDP)



Source: MoF SR

The general governemnt gross debt will continue to decline and since 2021 will fall significantly below the bottom line of the constitutional act on the fiscal responsibility. Gross debt will decline over the entire forecast horizon. The decline in debt will accelerate more markedly from 2019 when its level will first fall below the lowest debt brake band. The expected primary government surpluses around 1% of GDP, acceleration of real economic growth above 4% and revival of growth in price levels above 2% will mainly contribute to the debt consolidation. The general governemnt interest rate will also fall to the lowest historic level in terms of GDP.

Fiscal policy will have a positive to neutral impact on economic growth. In 2018, the assumed fiscal impulse of 1% of GDP against the unchanged policy scenario is estimated to have a positive impact on GDP growth of 0.5 p.p. The fiscal framework assumes the use of space for government priorities, particularly in the field of capital investment, inter-consumption and compensation of general governemnt employees. The additional measures in 2020 and 2021 are low and have a neutral impact on the economy.

Strengthening of the institutional framework for the budget management will continue. In 2019, the Ministry of Finance will launch a test of the expenditure ceilings for the general government budget. Under the Value for Money project, the Ministry will develop a detailed methodology for reviewing expenditures and linking them to the budgetary process. Up to now, they have assessed the general government expenditure reviews estimated at about 15% of GDP, identified measures for almost 700 million EUR (0.77% of GDP). In the third round, the review will examine the expenditure on agriculture, the inclusion of groups at risk of poverty and social exclusion, and employment and remuneration in general government.

1. ECONOMIC OUTLOOK AND PROJECTIONS

The economy of Slovakia grew by 3.4% in the past year. The main source of growth was household consumption, which responded to positive developments in the labor market. Employment and unemployment have attributed new record-breaking levels. In this year, growth will accelerate to 4.2%, especially when exports will be more pronounced to the growing consumption of households. Continuing positive developments in the labor market will cause further wage acceleration, which will also result in an acceleration in inflation. In 2019, the economy is to accelerate slightly, thanks to the rise of new production in the automotive sector. In the coming years, the economy will begin to slow down towards its long-term potential. The risks to the macroeconomic forecast are balanced.

1.1 External environment

The size of the economic expansion in the euro area over the past year exceeded expectations, and a significant increase in activity has also taken place in world trade. The robust pace of growth in the euro area was broad. The euro area has traditionally benefited from domestic consumption and the external sector has also contributed slightly. In addition to the global activity, the cyclical recovery of the euro area has also boosted strong labor markets, economic optimism for consumers and businesses, and a relaxed monetary policy for the central bank. The cyclical momentum was not interfered with the turmoil on the European political scene associated with Brexit, the political negotiations on the composition of the new government in Germany, the uncertainty in Catalonia and other geopolitical risks[2]. As a result, the euro exchange rate strenghtened by almost 20% against the dollar for the whole of last year. The US economy dynamically grew and the negative shocks subsided on the major development markets in China, Russia and Brazil.

The development of leading indicators[3], together with forecasts of selected foreign institutions[4] indicate a sustained pace of growth of the main trading partners of the Slovak Republic in 2018. Several European leading indicators, as well as German business cycle surveys, reached historical highs in the past year[5]. However, the growth of Slovak business partners will be lower compared to the past year, reflecting the declining trajectory of economies towards the long-term equilibrium. The key risks to the forecast include the impact of hard Brexit, the political turbulences on the European political scene as well as the increased volatility of the euro exchange rate. From global risks, the outlook may be reduced by the introduction of additional protectionist measures in world trade.

The forecasts of the European Commission (EC) and the Ministry of Finance regarding the development of the external environment are very similar over the mid-term horizon (Table 1). The forecast of the Ministry of Finance[6] in line with the EC anticipates stabilization of the growth and moderate release of the rate of expansion of the euro area economies in the next years. GDP growth in Germany is expected to be slightly above 2% this year and then fall to a two-percent threshold on the horizon of the forecast. CEE countries outside the eurozone, which have largely exceeded the four-percent growth threshold last year, are expected to ease the pace of economic expansion this year.

TABLE 1 - External assumption for the current forecast (%)

	MoF SR			EC		
	2017	2018	2019	2017	2018	2019
Economic growth						
EU	-	-	-	2,4	2,3	2
Eurozone	2,4	2,1	1,9	2,4	2,3	2

[2] As a consequence of the direction of US domestic and foreign policy, the tension of diplomatic relations with North Korea, and so on.
[3] Until the deadline of the assumptions of the external environment on January 15, 2018.
[4] The European Commission (EC), the European Central Bank (ECB), the International Monetary Fund (IMF) and the Organization for Economic Cooperation and Development (OECD).
[5] For example, the German IFO index, but also the manufacturing component of the PMI of the euro area.
[6] The forecast of the Ministry of Finance is the forecast of the Committee for Macroeconomic Forecasts of 31 January 2018 according to its statute and in accordance with Art. 8 par. 2 of the Constitutional Fiscal Responsibility Act 493/2011 Coll.

Germany	2,5	2,2	1,9	2,2	2,3	2,1
Czech Rep.	4,4	3	2,7	4,5	3,2	2,9
Poland	4,4	3,5	3,2	4,6	4,2	3,6
Hungary	3,9	3,4	2,7	3,8	3,7	3,1
Long-term interest rates (10y)						
Germany	0,39	0,26	0,31	-	-	-
ECB main deposit rate	0,00	0,01	0,15	-	-	-
Exchange rate (USD/EUR)	1,13	1,20	1,24	-	1,23	1,23
Oil price (Brent, USD/bl)	54,8	66,5	62,9	54,8	68,3	64,2
Oil price (Brent, EUR/bl)	48,5	55,5	50,7	-	55,6	52,2
p.m. Economic growth of Slovakia	*3,3*	*3,3*	*4*	*3,4*	*4*	*4,2*

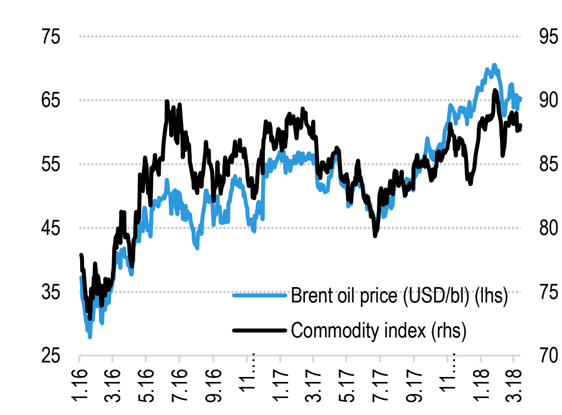
Source: MoF SR február 2018, EC zimná prognóza február 2018

The event of the year 2018 can be the rise of protectionism in world trade. Unilateral restrictive measures by the US administration, which has increased customs duty on steel (25%) and aluminum (10%) since March 2018, have intensified the uncertainty in international trade. Protectionist measures will have a negative impact on US consumers and US trading partners, especially China.

The commodity index stabilized over the past year, with oil prices rising in the second half of the year. Exceeding 70 USD a barrel is likely to have reached a ceiling and this year is expected to decline slightly, which will be linked to an increase in the US offer. The agreement on the limitation of oil production in OPEC countries, combined with satisfactory compliance by the member countries with this agreement, will continue to keep the price above 60 USD per barrel.

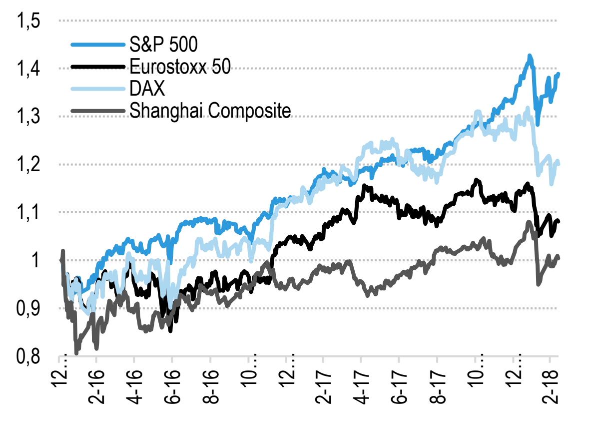
The US central bank raised interest rates in 2017 three times to 1.5% and the same scenario is expected this year[7]. The Yields of 10-year US government bonds fluctuated within a relatively narrow band during the year, and in the beginning of 2018 they climbed to the border of 3%. The stock indices reached strong pressure in February 2018, and European stocks in particular are only slowly recovering from this correction. The robust economic performance and the continued optimism of the business environment in the euro area increase the chances of strengthening the euro against major world currencies in 2018. The euro position against the British pound will be mainly influenced by the development of the Brexit negotiations.

FIGURE 3 - BRENT Oil price (USD/bl), commodity prices



Source: Bloomberg

FIGURE 4 - Stock market slump (basis=1.2016)



Source: Bloomberg

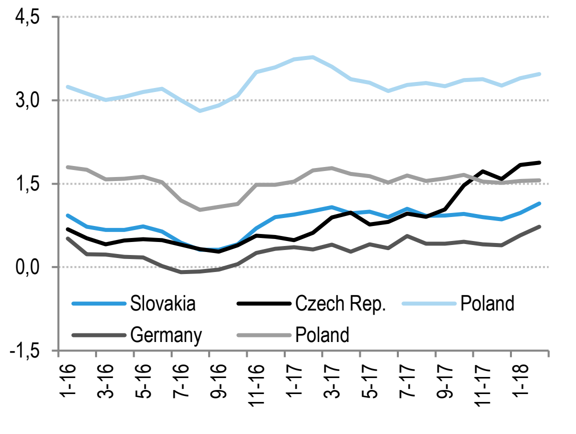
The European Central Bank (ECB) normalizes monetary policy only very cautiously. The monthly volume of purchases has been reduced again from 60 to 30 billion EUR in January 2018, but zero interest rates left the ECB unchanged. The Quantitative Release Program will be active by September of this year. Unpredictable

[7] In line with our expectations in March 2018, the FED increased the key rate to 1.75%.

developments in inflation indicate an increase in ECB key rates early in the first half of 2019. Yields of 10-year German bonds grew mainly at the turn of 2017 and 2018.

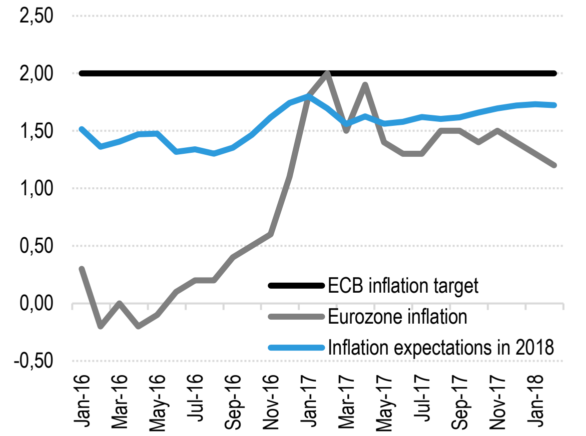
Completion of the quantitative release program from September 2018 will not have significant negative impacts on the Slovak economy. We assume that the growth in Slovak bond yields with longer maturities will be rather gradual thanks to the gradual increase in inflation expectations, which, combined with the relatively high duration of the debt portfolio (7.4 years at the end of 2017), means that the cost of servicing the National debt should not increase sharply. Equally, interests for businesses and households should not be increased considerably. The risk scenario of a step-up interest rate increase on the economy is evaluated in Chapter 3.

FIGURE 5 - 10y government bond yields (%)



Note.: Zero-coupon bonds are compared. Source: BBG

FIGURE 6 - Current inflation and expectations (%)

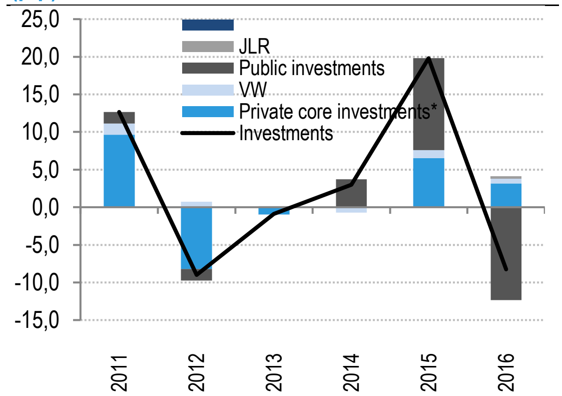


Source: ECB, Eurostat

1.2 Economic development in Slovakia in 2017

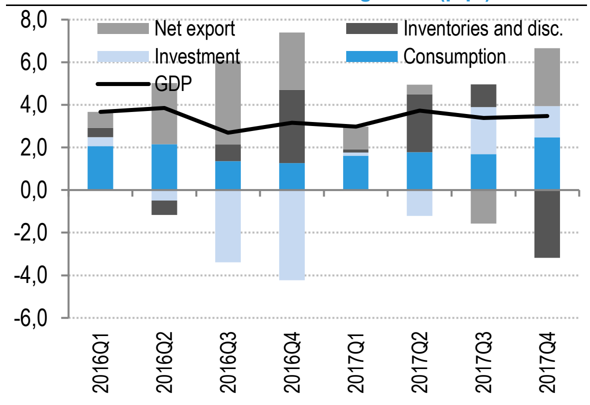
The Slovak economy credited an increase of 3.4% at the end of last year. The most significant growth was contributed by the consumption of households, which thanks to the excellent labor market condition achieved the highest after-crisis growth. That also outpaced the growth of disposable income, for the first time in four years. Export grew more slowly compared to foreign demand. This is the result of several temporary factors, the end of life cycle of some models of cars produced in Slovakia. Investments grew slowly under the influence of a strong base effect, especially in the first half of the year. This is related to the drawing out the euro funds in the same period of 2016. In the second half of the year, investments started to accelerate gradually and exports were also added. Government consumption dampened the economy and stagnated in real terms.

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



Source: ŠÚ SR, MoF SR

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

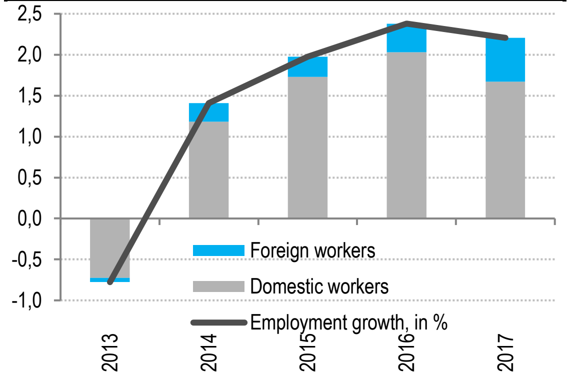


Source: ŠÚSR, MoF SR

The labor market again broke records last year. The number of workers (according to the ESA methodology) increased by 51,000 and employment climbed almost to 2.4 million. New jobs have arisen across all sectors of the economy, but the fastest in industry, where employment has grown most since 1995. The number of foreigners working in Slovakia (an increase of 12 thousand), which last year accounted for up to a quarter of newly created jobs, grew significantly.

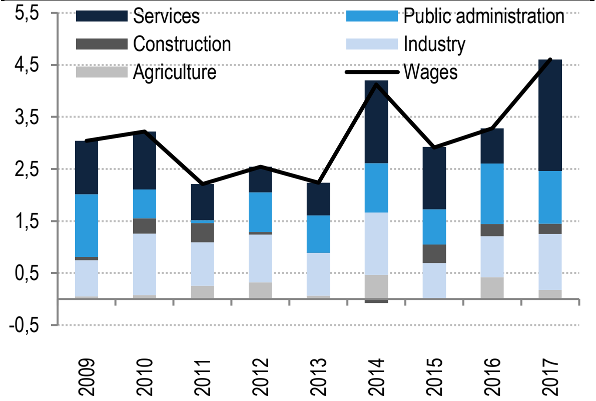
Strong employment growth, particularly in the domestic economy, has squeezed the unemployment rate to a new historical minimum at 8.1%. In February 2018, the number of vacancies (according to the COLSAaF[8]) reached a historic maximum of 78,000, which is also indicative of positive developments in the labor market also in the coming months. The robust development of demand for labor is also influenced by the migration balance of the Slovak Republic[9], which was positive for the second consecutive year. The number of foreigners in Slovakia is rising, as well as the returning Slovaks from abroad. We estimate that approximately 31,000 Slovaks returned to Slovakia in 2017.

FIGURE 9 - Contributions of foreign workers to employment growth (p.p)



Source: ŠÚ SR, UPSVaR, MoF SR

FIGURE 10 - Contributions to wages growth (p.p)



Source: ŠÚ SR, MoF SR

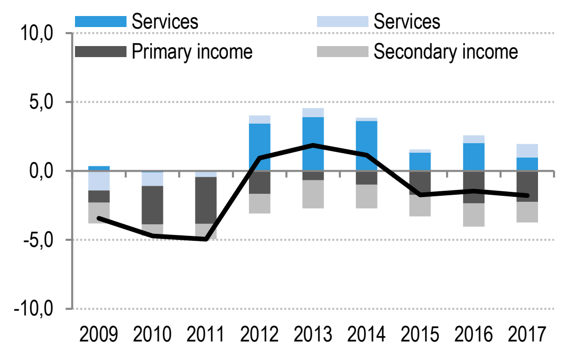
Wage growth accelerated to 4.6% last year, the most in the last nine years. Almost half of the growth was a rise in wages in services, especially in the low-skilled. This growth was also reflected in the rapid rise in the minimum wage. Industrial and general governemrnt wages have also seen a dynamic growth, thanks to a one-time bonus and valorisation of teacher salaries. Conversely, wages in construction stagnated below 3%. Accelerating inflation pushed real wage growth to 3.3%, the second fastest pace since the crisis.

The current account deficit in the balance of payments in 2017 reached 1.8% of GDP. The deepening of the deficit was due to a significant reduction in the goods surplus (1% of GDP). This was due to a significant increase in the import of goods, which may be related to the investment activity in the automotive industry, implying a significant impulse for exports in the forthcoming period. A lower surplus of goods balance did not offset either the highest positive balance of services in the post-crisis period (1% of GDP) and nor a slight improvement in the balance of primary and secondary revenues. Historical balance of payments data was reduced due to a review by the National Bank of Slovakia (NBS).

Price growth in 2017 resumed after three years of decline. The price level increased by 1.3% on average. Rising prices were mostly influenced by the rise in food prices, to a lesser extent, fuel prices, and increased regulated prices in response to rising energy commodity prices. The growth in services prices reflects robust labor market developments and the restoration of its bond to the service market. On the contrary, tradable goods grew slightly, reflecting the stronger exchange rate of the euro. At the end of the year, inflation started to close to 2% and in the beginning of 2018 even exceeded it.

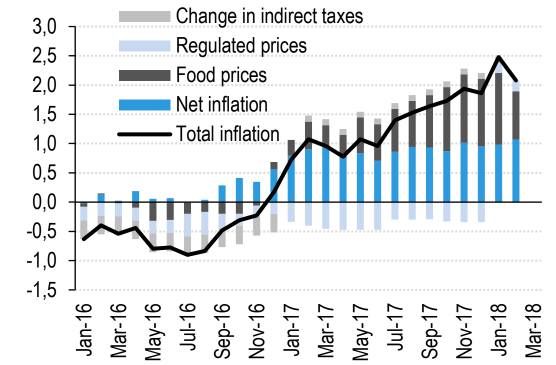
[8] Central Office of Labour, Social Affairs and Family.
[9] Based on public health insurance data.

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



Source: ŠÚ SR

FIGURE 12 - Structure of consumer inflation - contributions of components (y-o-y, p.p)



Source: ŠÚ SR

1.3 Economy development mid-term forecast

The current forecast[6] is expected to accelerate economic growth this year to 4.2%. Growth will be built on two pillars. The continued robust growth in household consumption will result in exports benefiting from positive growth prospects in Europe and the rise in Volkswagen's new production (VW). The investment accelerates over the previous year, as is the investment of Jaguar Land Rover (JLR - more detailed BOX 1).

In the coming year, the economic performance will reach 4.5%. The acceleration will be implemented by a more dynamic export driven by continuing positive developments abroad, notably due to the rise in production in the JLR automotive plant. Domestic consumption keeps a steady pace above 3 percent. Investments will slow down slightly due to the completion of larger car investments. The positive production gap should culminate in 2019, slightly above the 1% of GDP threshold.

In 2020 and 2021, economic growth will ease to 3.9%, respectively 3.4%. The effect of new car production is to gradually fall and foreign demand is to slow cyclically. In line with the long-term potential of the economy, household consumption and investment will also grow. We assume that at the end of the forecast horizon, the production gap will slowly begin to close.

TABLE 2 - Forecast of selected indicators of the Slovak economy for 2018 to 2021[10]

No.	Indicator		Actual			Forecast		
		unit	2016	2017	2018	2019	2020	2021
1	GDP, current prices*	bn. eur	81,2	85,0	90,2	96,1	102,0	107,9
2	GDP, constant prices	%	3,3	3,4	4,2	4,5	3,9	3,4
3	Final consumption of households and NPISH[1]	%	2,7	3,6	3,5	3,2	2,8	2,5
4	Final consumption of government	%	1,6	0,2	0,6	1,3	1,2	1,2
5	Gross fixed capital formation	%	-8,3	3,2	5,2	3,3	3,3	3,0
6	Export of goods and services	%	6,2	4,3	7,9	8,5	7,1	5,9
7	Import of goods and services	%	3,7	3,9	7,1	7,2	6,2	5,2
8	Output gap (share of pot. output)	%	-0,3	0,1	0,6	1,1	1,1	0,8
9	Average montly wage (nominal growth)	%	3,3	4,6	5,2	5,4	5,2	5,2
10	Average employment growth, LFS	%	2,8	1,5	1,2	0,8	0,7	0,4
11	Average employment growth, ESA	%	2,4	2,2	1,7	1,0	1,0	0,7
12	Unemployment rate, LFS	%	9,6	8,1	7,3	6,7	6,1	5,9
13	Unemployment rate, registered	%	9,5	7,1	6,1	5,6	5,1	4,9
14	HICP	%	-0,5	1,4	2,0	2,0	2,2	2,3
15	Current account balance (share of GDP)	%	-1,5	-1,8	-1,6	-0,7	-0,1	0,5

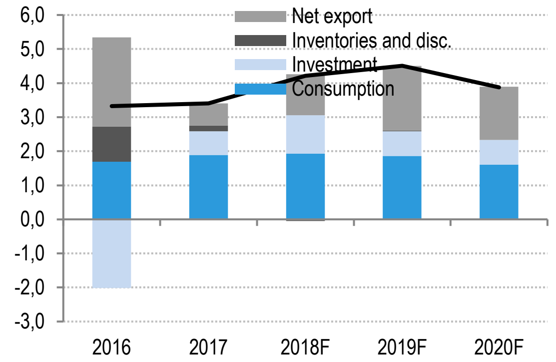
[10] The forecast for 2018-2021 was approved by the Macroeconomic Forecast Committee in January 2018 and officially published in February 2018.

** According to spring notification, 2017 GDP was revised slightly downwards by 47.6 mil. Using the nominal GDP growth of 2018 to 2021 from the official forecast (the Macroeconomic Forecasting Committee), a new series was compiled corresponding to the new level of the GDP. This time series has been used also in other parts of the document.* *Source: MoF SR*

The labor market will continue to have a positive development this year. Employment (according to the ESA methodology) will increase by 1.7%. **In the economy, there will be almost 40,000 new jobs**, more than half of which will arise in the market services sector. A slight increase in participation rates will continue also due to a shift in retirement age and increased employment of foreign workers in Slovakia. Higher participation will dampen a fall in unemployment (according to VZPS), which will reach 7.3%. In the coming years, we anticipate a gradual slowdown in employment dynamics, which is closer to its potential at the end of the forecast horizon.

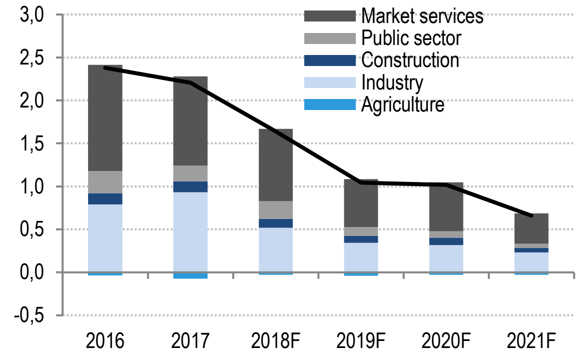
The average nominal wage exceeds the threshold of EUR 1,000 this year. Compared to 2017, it will grow by 5.2%, which is the highest since the crisis. Wage growth will accelerate across all sectors of the economy. Real wage growth is slightly above the 3% threshold. In the coming years, we expect the convergence of wage dynamics and labor productivity.

FIGURE 13 - Contributions to GDP growth (p.p)



Source: ŠÚ SR, MoF SR

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

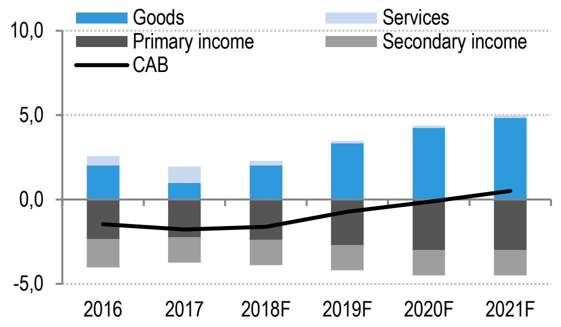


Source: ŠÚ SR, MoF SR

The balance of payments deficit after the deepening in 2017, will be gradually mitigated, when at the end of the forecast period will be tilted to a larger surplus. The decline in the deficit will be driven in particular by an increase in the surplus of the goods balance, which will be supported by the growth of exports in the automotive industry. Paying dividends and interest payments on foreign investment will, on the contrary, lead to a worsening of the primary income deficit.

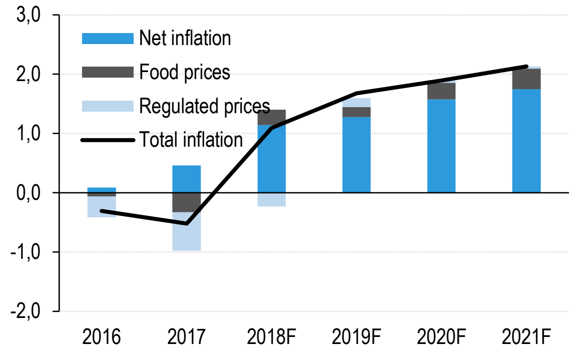
Inflation will accelerate in 2018 and prices should increase on average by 2%. Last year's sharp rise in food prices will gradually fade in 2018. The rise in oil prices will reflect in fuel prices and, consequently, in food and service prices. The rise in prices by the regulatory office in January 2018 has led to fact that regulated prices are positivelly contributing to overall price increases for the first time since 2014. Service prices will also accelerate in response to wage growth in the overheated labor market. Prices of tradable goods will grow more moderately thanks to the stronger euro. Overall inflation in the medium term horizon will slightly increase to 2.3%, in line with the assumption of convergence of the Slovak economy.

FIGURE 15 - External imbalances - CAB components (% of GDP)



Source: NBS, MoF SR

FIGURE 16 - Structure of consumer inflation - contributions of components (p.p)



Source: ŠÚ SR, MoF SR

Major risks of the forecast[11]

The risks to the macroeconomic forecast are balanced over the horizon. In an external environment, the political situation in Germany, Italy, or Spain can be negatively affected by the economic situation. Hard Brexit, protectionism in international trade, and increased volatility of the euro, which would not have support in the fundamentals and would dampen exports would pose other negative risks in the external environment. On the contrary, the secondary effects of the US fiscal stimulus and the smooth course of Brexit may influence positively the situation in the world. Two risks are identified in the home environment. The first is labor market developments where the amount of available labor force could reach its limit in the absence of an active migration policy, thus limiting the growth potential of the economy. The second risk is the slowdown in household consumption due to the saturation of the economy by credit. The positive risk in the domestic environment is a stronger acceleration of wages and domestic consumption as a result of increased surcharges for night and weekend work. The economy may also accelerate due to a faster drawing of the euro funds, which is still below the average in the long run. Higher flow of foreign workers or returning Slovaks can positively contribute to the development of the labor market.

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

The investment of Jaguar Land Rover (JLR) remains the largest investment in Slovakia in the post-crisis period. Since the announcement of the investment, the state has carried out investment activity related to the preparation of a strategic industrial park. New investments have also been announced by potential JLR suppliers. The update of the impact of JLR's investment on the economy is part of the baseline scenario of economic development presented in this chapter and is also part of the MoF SR forecast.

The JLR investment amount of 1.4 billion EUR remains unchanged. The investment phase of the project began at the end of 2016. In the past year, the construction of the plant was fully launced and the peak of the pre-invested funds is expected in 2018. In the context of the experience of the upcoming production of other SUV models in Slovakia and in light of the estimated development of the world economy, we have slightly modified the upward curve of the JLR production. We expect a gradual increase in production reflecting the growing position of JLR in the world. The conditions for import demand and created jobs remained unchanged. The actual number of JLR employees at the beginning of the current year indicates the correctness of the original assumptions.

TABLE 3 - Assumptions of the investment plan and production of JLR

	2016	2017	2018	2019	2020	2021
Investment (mil. eur)	50	500	630	203	23	0
Sales (mil. eur)			100	1 200	2 500	3 600
No. of manufactured cars			5 000	55 000	100 000	130 000
Model 1			5 000	50 000	75 000	80 000
Model 2				5 000	25 000	50 000
No. of jobs at JLR	164	405	1 168	2 025	2 456	2 456

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

No. of jobs at suppliers	410	1 094	3 388	6 076	7 614	7 614
Import intensity of investment [1]	48	59	74	79	79	79
Import intensity of export			67	67	67	67

[1] It is assumed that 30% of the construction work will be required. For imports of machinery and technology, 80% of the import demand is expected, 0% improvement of the plot and 100% import demand for know-how.

Source: Expert assumptions of IFP

The investment assumption regarding Volkswagen Bratislava (VW), which extends the production capacity of a new assembly hall for luxury SUVs production, remains unchanged at 800 million euros. The investment was completed in the past year. Additional investments in the next period related to regular production line replacement are considered as part of nuclear investments and are not explicitly modeled. The assumptions about the number of cars produced in the current and following years have remained unchanged and derived from historical experience with the rise of luxury cars production and the estimated evolution of the world economy. The production estimate for the past year was added, taking into account the earlier production launch in the fourth quarter.

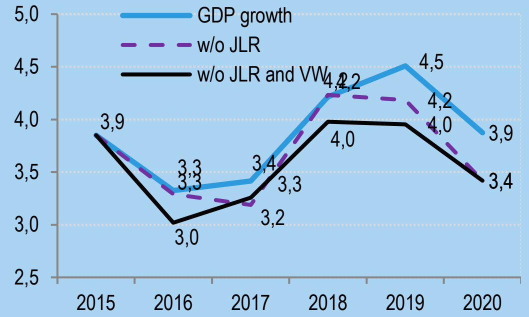
TABLE 4 - Assumptions of investment and new production of VW

	2016	2017	2018	2019	2020	2021
Investment (mil. eur)	400	400				
Sales (mil. eur)		100	1 000	1 600	1 600	1 600
No. of manufactured cars		5 000	50 000	80 000	80 000	80 000
Import intensity of investment[1]	48	70				

Source: MoF SR

The arrival of the fourth automobile manufacturer JLR will increase the growth of the Slovak economy by 2021 cumulatively by 1.4% of GDP. The impact on the horizon between 2016 and 2020 will increase employment cumulatively by 0.5%. Expansion of production capacities at VW Bratislava plant will help increase GDP growth cumulatively by 0.7 p.p. by 2021. Employment growth will cumulatively increase by 0.2 p.p..

FIGURE 17 - Impact of new production and investment of VW and JLR on Slovak economy



Source: MoF SR

TABLE 5 - Contributions of JLR and VW to growth

	2016	2017	2018	2019	2020	2021
JLR						
Investment	0,3	2,7	0,5	-2,4	-1,0	-0,1
Export			0,1	1,2	1,2	1,1
Employment	0,04	0,05	0,17	0,22	0,02	
GDP	0,0	0,2	0,0	0,3	0,5	0,4
VW						
Investment	2,2	-0,1	-2,4	0,0		
Export		0,1	1,1	0,5		
Employment	0,02	0,02	0,12	0,03		
GDP	0,3	-0,1	0,3	0,2		

Source: MoF SR

1.4 Cyclical development of the economy

According to the estimates of the Ministry of Finance, the growth potential of the economy in 2018 will markedly accelerate to 3.7%. The main impulse for potential growth is the increase in the overall productivity of the production factors brought by the JLR automotive plant. Increased investment activity will also lead to an increase in the capital contribution. In contrast, the potential employment contribution will moderate at the end of the forecast horizon as a result of demographic developments.

FIGURE 18 - Contribution of production factors to potential growth (p.p) – MoF SR approach

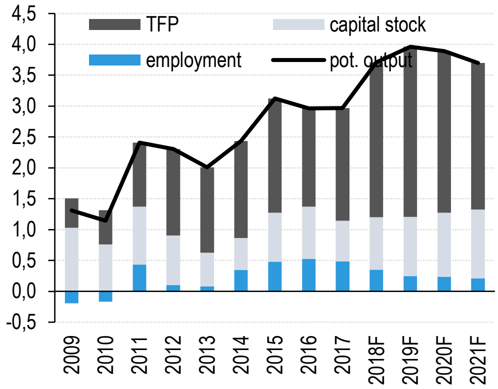


TABLE 6 - Contribution of production factors to potential growth (pp) – MoF SR approach

	Pot. GDP (growth, %)	TFP*	Capital stock	Labor
2013	2,0	**1,4**	**0,5**	**0,1**
2014	2,4	**1,6**	**0,5**	**0,3**
2015	3,1	**1,9**	**0,8**	**0,5**
2016	3,0	**1,6**	**0,8**	**0,5**
2017	3,0	**1,8**	**0,7**	**0,5**
2018F	3,7	**2,5**	**0,9**	**0,3**
2019F	4,0	**2,8**	**1,0**	**0,2**
2020F	3,9	**2,6**	**1,0**	**0,2**
2021F	3,7	**2,4**	**1,1**	**0,2**

** total factor productivity*

Source: MoF SR

After closing the production gap in the past year, the economy will start to overheat slightly from 2018 onwards. Even in the coming years, GDP growth will exceed potential product growth. The positive production gap will peak in the years 2019 and 2020 at the level of 1.1 % of potential GDP, despite the supply impulse of new car production. The overheating of the economy will begin to moderate gradually from 2020 onwards.

FIGURE 19 - Output gap (% of pot. output) – MoF SR approach

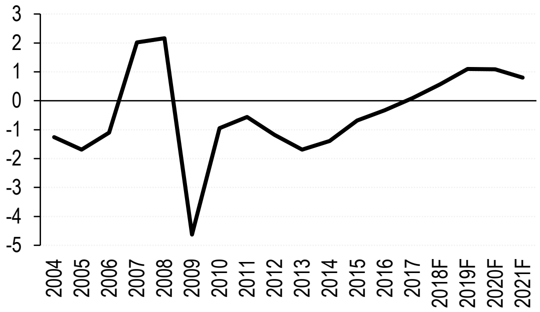


TABLE 7 - Output gap - MoF SR approach

	GDP (real. growth, %)	Pot. GDP (growth, %)	Output gap (% pot. GDP)
2013	1,5	2,0	**-1,7**
2014	2,8	2,4	**-1,4**
2015	3,9	3,1	**-0,7**
2016	3,3	3,0	**-0,3**
2017	3,4	3,0	**0,1**
2018F	4,2	3,7	**0,6**
2019F	4,5	4,0	**1,1**
2020F	3,9	3,9	**1,1**
2021F	3,4	3,7	**0,8**

Source: MoF SR

BOX 2 - Methodological differences in the calculation of the potential product by MoF SR and EC

As in the Draft Budget Plan for 2018, the estimate of the potential product and production gap is based exclusively on the Ministry of Finance's national methodology from the official forecast of the Macroeconomic Forecast Committee. The national methodology is in 2017 to 2018 closer to the European Commission's estimate with its results, than the EC methodology with the MoF SR forecast. At the same time, the results of the national methodology of the Ministry of Finance are closer to the actual, although unnoticed, production gap and are more consistent with other indicators of macroeconomic imbalances, such as net inflation or the current account balance. The national methodology is also used in this document to estimate the production gap in the calculation of the structural balance to set budgetary targets.

The difference between the production gaps estimates by individual methodologies was also reflected in the latest EC and MoF SR forecasts. While the estimates of the national methodology of the Ministry of Finance and the official Autumn forecast of the EC predict the closure of the production gap in 2017 and the gradual overheating of the Slovak economy, the production gap calculated by the EC methodology using the MoF macroeconomic forecast predicted the under-cooling of the economy in 2017 and a more pronounced overheating in 2019.

TABLE 8 - Output gap (% of GDP)

	2017	2018	2019
Commission Autumn 2017 Forecast	0,0	0,5	1,0
MF SR national methodology (February 2018)	0,1	0,6	1,1
Commission methodology with MF SR forecast (February 2018)	-0,2	0,6	1,5

Source: MoF SR, EC

The variety of estimates of the production gap between the EC and the Ministry of Finance (national methodology) generally results in a different horizon of forecasts and different overall factor productivity (TFP). While the EC methodology estimates the production gap for two years ahead, the MoF SR forecast estimates up to four years. The EC methodology is based on trends and filtering of variables, so prolonging the forecast horizon may result in different estimates of the production gap at a shorter horizon, although the input macroeconomic forecast for the particular years is unchanged. For a more accurate comparison, therefore, the horizon of input data into the MoF SR forecast with the EC methodology has been reduced for the next two years. The second difference lies mainly in historical data on total factor productivity (TFP). While both institutions calculate a potential product using the Cobb-Douglas production function, the Ministry of Finance increases the potential product through the TFP between 2019 and 2021 in a way to respond to the structural changes in the economy brought by the JLR investment and which the common EC method fails to capture.

The forecast of the Ministry of Finance, due to JLR's investment activity, increased the additional contribution of the TFP growth to the potential growth in 2019 to 2021 cumulatively by 0.44 p.p.. The increase in TFP growth contribution was based on an estimate of the contribution of exports to GDP growth from the demand side. These adjustments are consistent with adjustments for the period 2005 to 2008, when several major investments in the automotive and electrotechnical industries came to Slovakia. As a result of the new investment activity, not only the current growth of the economy but also its potential will increase. The production gap will therefore only grow to a limited extent. While the national methodology of the Ministry of Finance captures this phenomenon, the EC methodology will probably indicate a higher overheating of the economy, as it did in the years 2005 to 2008. This effect also indicates the above mentioned production gap estimate calculated by the EC methodology using the MoF SR macroeconomic forecast, which predicts higher overheating for 2019 compared to the national methodology.

1.5 Forecast comparison of the MoF SR and other institutions

The forecasts of other institutions, with the exception of the NBS, are slightly more conservative than the Ministry of Finance in terms of GDP growth. The main differences are in the estimation of the impact of the production start-up in JLR. With inflation, the MoF SR forecast is in the middle of the range of individual institutions. The current account deficit, according to domestic institutions, will decrease significantly only in 2019, mainly due to export production in JLR. The OECD and the IMF, on the other hand, expect a reduction in the deficit this year.

TABLE 9 - Comparisons of forecasts of MFSR and other institutions

	2017	2018	2019
		Real GDP growth (%)	
MFSR	**3,4**	**4,2**	**4,5**
MFC (median)	3,4	3,9	4,1
NBS	3,4	4,3	4,7
EC	3,4	4,0	4,2
OECD	3,3	4,1	4,3
IMF	3,4	4,0	4,2
		HICP (%)	
MFSR	**1,4**	**2,0**	**2,0**
MFC (median)	1,4	2,0	2,0
NBS	1,4	2,4	2,1
EC	1,4	2,2	2,0
OECD	1,3	1,9	2,2
IMF	1,3	1,9	1,9
		CAB (% GDP)	
MFSR	**-1,8**	**-1,6**	**-0,7**
MFC (median)	-1,8	-1,4	-0,3
NBS	-1,9	-2,4	-1,2
EC	-	-	-
OECD	-1,4	-0,1	0,8
IMF	-1,5	-0,3	0,5

Source: MoF SR (February 2018), Macroeconomic Forecasting Committee (february 2018), NBS (January 2018), EC (February 2018), OECD (November 2017) and IMF (April 2018)

2 PUBLIC FINANCE POSITION

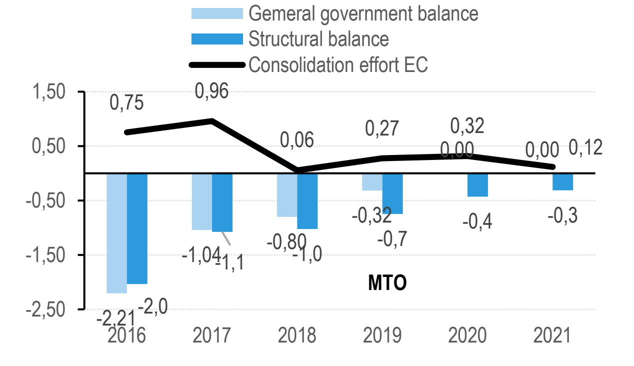
The general government deficit in 2017 exceeded budget assumptions and reached 1.04% of GDP. In addition to the historically lowest general government deficit, this result also means achieving the first primary surplus (the nominal balance net of interest costs). Structural consolidation efforts have significantly exceeded the required amount. The current estimate of the deficit for 2018 is 0.80% of GDP, approximately at the level of the budgetary target. The consolidation effort in 2018 is in line with the requirements for taking into account developments in 2017. Expectations of the budget also outweighed the gross debt of general government. According to spring notification, it reached 50.9% of GDP in 2017 and declined for the fourth consecutive year. Behind the better result there is the primary general government surplus achieved. This year the debt should further fall below 50% of GDP. The interest rate of the GG will also fall on the historically lowest level to the GDP ratio.

In line with the government's program statement, the fiscal framework is projected to achieve a balanced budget in 2020 and its sustainability in 2021. From 2019, Slovak public finances will be at the level of its medium-term budgetary objective (MTO) and will be fully achieved by 2020. From the time of the financial crisis peak in 2009 thus in one dacade the structural recovery of public finances will happen for more than 6 p.p.. Compliance with the budgetary targets will lower GG debt at the end of the forecast below 45% of GDP, significantly below the lowest sanctioning band of the Constitutional Fiscal Responsibility Act. From its peak in 2013, the share of gross debt to GDP will fall by more than 11 percentage points.

The general government deficit in 2017 reached 1.04% of GDP in the spring notification by Eurostat and significantly exceeded the budgetary target. Compared to the set target at 1.29% of GDP[12], this is a better result by 0.25% of GDP. Compared to the budgetary assumptions, a significantly better selection of the earnings revenue was achieved, mainly due to positive developments in the labor market. Tax revenues, on the other hand, recorded a slight drop when the corporate income tax was offset by the budget's assumptions, but this partly offset the more effective collection of value added tax. Less than the planned drawdown of EU funds has also shown savings in co-financing. After clearing the impact of EU spending on the expenditure side, there was a stronger than budgeted increase in compensation for employees and capital expenditure. The rise in compensation is also due to the reallocation of expenditure originally budgeted as current transfers and intermediate consumption.

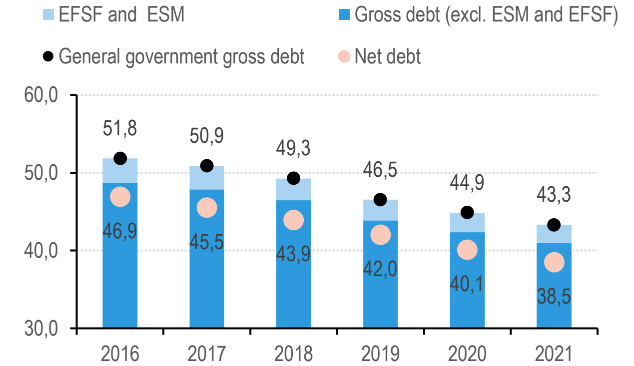
The budget target for 2018 at 0.83% of GDP is consistently fulfilled with a modest reserve. The current estimate of the general government deficit (GG) is at 0.80% of GDP. Updating the tax forecast[13] over the budget has had a positive impact on the revenue side, thanks to the continued expansion in the labor market. Silghtly over the approved budget is the total expenditures of the GG. They are also changing their structure by increasing capital expenditures and compensating GG employees. Savings compared to budget are, on the other hand, estimated on current transfers, social benefits and intermediate consumption.

FIGURE 20 - Consolidation effort (% GDP)



Source: MoF SR

FIGURE 21 - Gross general government debt (% GDP)



Source: MoF SR

[12] The GG budget for 2017 did not include revenues from the receipts of MH Invest II and JAVYS.
[13] Forecast of the Tax Forecast Committee from 08.02. 2018.

In the mid-term budgetary framework of the Slovak Republic for the years 2019 to 2021, the target of the deficit for the year 2019 is set to 0.32% of GDP and a balanced management is planned from 2020. Compared to the approved general government budget for 2018 to 2020, the fiscal framework will revise the targeted deficit for 2019 by 0.22 p.p. upwards. This target roughly[14] corresponds to the level of the medium-term budgetary objective of the SR (MTO). The medium-term framework foresees a nominal balanced budget to be achieved since 2020 and full achievement of the MTO.

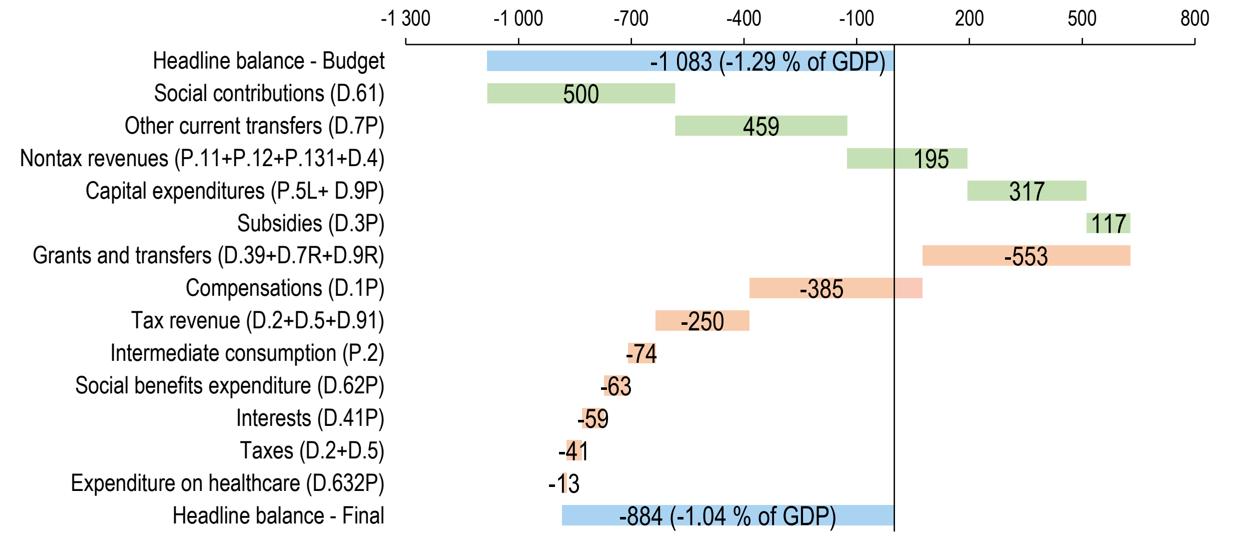
Fiscal policy will have a positive to neutral impact on economic growth. In 2018, a positive impact on GDP growth of 0.5 p.p. is estimated from the projected fiscal impulse of 1% of GDP against the unchanged policy scenario. The fiscal framework envisages the use of space for government priorities, particularly in the field of capital investment, inter-consumption and compensation of GG employees. The measures in 2020 and 2021 are low and have a neutral impact on the economy.

Government gross debt will continue to decline and will fall further below the bottom of the constitutional fiscal responsibility act by 2021. Gross debt will decrease over the entire forecast horizon. The decline in debt will accelerate more markedly from 2019 when its level first fells below the lowest debt brake sanction band[15]. To debt consolidation will mainly contribute the expected primary surpluses of the GG economy at around 1% of GDP, acceleration of the real growth of the economy above 4% and revival of the price level increase above the ECB's inflation target. At the lowest historical level in relation to GDP, GG interest expense is also to be lower.

2.1 General government balance in 2017

The general government deficit in 2017, according to Eurostat spring notification, decreased by more than 1 p.p. and reached 1.04% of GDP. The set target in the approved budget outgrew by 0.25 p.p. In terms of structural deficit reduction, this result implies a year-on-year consolidation of 1.0 p.p., well above the required effort of 0.5% of GDP under the Stability and Growth Pact. Slovak public finances in the past year are just only slightly over a half of percentage point away from the medium-term budgetary objective of the Slovak Republic (structural deficit of 0.5% of GDP).

FIGURE 22 - Analytical description of GG balance development in 2017 (ESA 2010), contributions in EUR mil.



(+) / (-) means a positive / negative impact on the balance *Source: MoF SR*

[14] The structural deficit with a deviation of up to 0.25% of GDP from the set target MTO is interpreted as meeting the MTO ex-post. The explanation is given in the interpretation of the Stability and Growth Pact by the European Commission (Vade Mecum to SGP) on page 36 (chapter 1.3.2.2)
[15] Sanction bands are falling according to the valid legislation of the Constitutional Act by 1 p.p. annually from 2018 to 2027.

Revenue side of the budget

Total tax - levy revenues[16] were compared to the approved budget higher by 250 mill. EUR (0.3% of GDP). The result is, in particular, more positive macroeconomic development, as well as improving the efficiency of VAT collection (BOX 3).

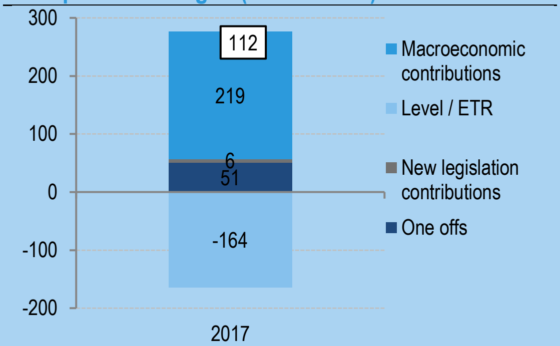
- **Higher social security contributions compared to the budget represent 500 million euros.** Better than expected development in employment and wages have led to overcoming of the budget in health and social contributions by 295 mill. euros. At the same time, the state's payment increased by 95 mill. euros, without affecting the overall balance of the GG (with respect to the expenditure counterpart item of the same amount). Above the budget there was a methodical change in the accounting for social security funding for armed forces, with a positive impact on this item of 95 million euros, although the impact on the balance is neutral. Overall, the levy revenue grew year-on-year by 8%, underlying the cancelation of the maximum health care base and its increase in social contributions. With these two measures, the already approved budget did not count with.
- **Tax revenues were lower by 250 million euros, compared to the approved budget**.[17] The main negative surprise was the loss of income from corporate tax[18] in the amount of 404 mill. euros[19]. Year-on-year, the accrual revenues from the corporate tax decreased by 5%. Legislation (with which the budget already considered) had a neutral effect when a corporate tax rate decreased by 1 p.p. to 21% was offset by changes in the rates in the regulated sectors. In addition, the corporate tax rate on the budget was partly offset by higher incomes from value added tax and corporate income tax. Value added tax revenues grew larger compared to the budget thanks to the continued improvement in the efficiency of its collection.

BOX 3 - Evaluation of tax revenue for the year 2017 (a forecast by the Tax Revenue Forecast Committee)

The Tax Forecasts Committee (VpDP), in accordance with its Statute, only assesses accrual tax and levy revenue that is considered taxed in accordance with the national economic classification. VpDP does not forecast the development of state-paid insurance, which has a neutral effect on the resulting balance of the GG. These non-forecast revenues accounted for approximately 4% of the total GG tax revenue for the years 2011 to 2014.

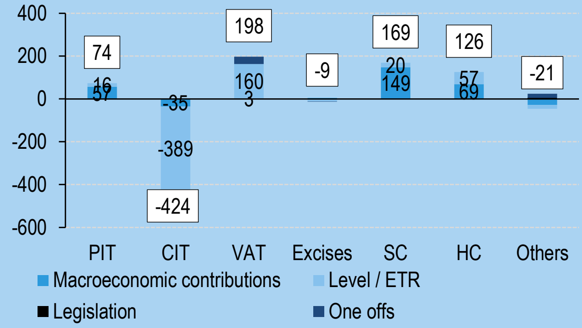
Tax revenues of the general government, which are forecast by the VpDP, were higher by 112 mill. euros compared to the budget. By the means of analytical analysis it is able to attribute differences in the development of individual taxes to individual factors (macroeconomic development, level influence, new legislation and one-off factors). Looking at the result for 2017, the positive factor in the labor market (personal income tax, social contributions) is a major factor in better development. To the higher than expected tax success rate and the one-off impact of higher control activity in the area of excess VAT deductions has contributed better VAT revenue. A significant corporate tax break was due to the fact that in time of creating the 2017 budget, 2016 was not yet known as for the reality. The tax adjustment for 2016 was lower than expected, thus reducing the level of corporation tax settlement in 2017. More detailed explanation on the development of corporate income tax can be found in the IFP commentary from June 2017.

FIGURE 23 - Change of 2017 GG revenue forecast compared to budget (EUR million)



Source: MoF SR

FIGURE 24 - Change of 2017 GG revenue forecast compared to budget (EUR million)



Source: MoF SR

[16] ESA 2010 items D.2+D.5+ D.61+ D.91
[17] Less than budgeted tax revenue is also related to the income statement of the Emergency Oil and Petroleum Products Agency in the non-tax revenue item in 2017. From 2017, the budget includes EOSA's revenue in tax revenue.
[18] Closer in IFP Commentary to tax forecast from June 2017.
[19] According to the ESA 2010 methodology

- **Non-tax revenue significantly exceeded budget assumptions (€ 319 million)**. Significant role is played by methodological factors, notably the recording of the revenues of the Emergency Oil and Petroleum Products Agency (EUR 92 million) [20], the interest income (EUR 110 million) [21] and the income of the newly transferred Nuclear and Disposal Company (EUR 71 million, hereinafter referred to as JAVYS) [22]. Furthermore, positive influence have non-budgeted revenue from the business activities of public higher education institutions (EUR 21 million). These positive impacts dampened the loss of income from dividends according to the ESA2010 methodology (-45 million euros).

- **Compared to the budget, on the contrary, revenues from grants and transfers decreased by 553 million euros.** After settlement by the estimated development of EU flows[23], the revenue from grants and transfers would be lower compared to the budget estimate of just 66 million euros.

Expenditure side of the budget

Total general government expenditure is lower than the budget by 183 million euros, this development is mainly due to the drops of EU flows. After abstraction of the EU's resources and the co-financing involved, total expenditure increases.

- **Savings on the co-financing of EU funded projects amount to € 297 million as estimated by the Ministry of Finance.** Budgeted co-financing from national sources has not been fully met, in particular, by subsidies (EUR 96 million) and capital expenditures (EUR 137 million).

- **Employee compensation exceeded the budget by 460 mill. euros**. Within the budgetary limits of the state budget, expenditures amounting to EUR 215 million were transferred mainly from the budgeted reserves on current transfers and intermediate consumption (EUR 148 million), which were already considered by the GG 2017 (RVS) [24] budget. Higher than budgeted revenues made it possible to increase compensation for local government workers (€ 94 million), contributory organizations (€ 35 million) and public higher education institutions (€ 31 million). At the same time, the budget did not yet consider the JAVYS expenditure (26 million euros). Wage growth (including EU flows) was 5%, in line with its long-term trend as well as wage developments in the private sector.

- **Intermediate consumption exceeded budget plans by 74 mill. euros**. Higher expenditure was due to higher draw of EU funds and expenditure non-budgeting of JAVYS (€ 47 million). Intermediate consumption (including EU flows) grew by 7% YoY, and developments are thus over the long-term average, despite the persisting slower growth in consumer prices.

- **The subsidies were lower by 117 mill. euros.** The main reason for this is the lower expenditure on co-financing of subsidies to agriculture from the state budget.

- **The expenditure of public health insurance (VZP) grew broadly in line with the approved budget (13 mill. euros)** despite the fact that VZP's revenue from the economically active population grew faster (EUR 126 million) and there was also an increase in the payment for state insurers (95 million euros). The weaker year-on-year growth is due to the one-off high public health expenditure in 2016, the ongoing implementation of the 2017 revision of expenditures and the implementation of the General Health Insurance Company (VšZP) recovery plan.

- **Total social benefits expenditure increased by € 63 million euros over the budget.** The state social benefits themselves recorded savings (56 million euros) compared to GG budget. At the same time, there was an increase in the payment for State insured persons (95 million euros for health insurance, which did not

[20] Income of the Agency for Emergency Oil and Petroleum Products was budgeted for the year 2017 on the tax revenue side. However, in the spring notification of Eurostat for 2017, it is recorded on non-tax revenue.
[21] The Debt and Liquidity Management Agency budgets the net impact of interest only on the expenditure side while the notified data are taken into account by Eurostat with both revenue and expenditure.
[22] At the time the budget was approved, the company was not included in the GG and therefore the company's revenues and expenditures were not included in the budget.
[23] Expenditure related to direct EU resource drawdown and co-financing from national sources.
[24] More detailed information in the Draft Budget Plan 2018 (page 16, BOX 3)

appear in the increased expenses of public health insurance.) There was also an increase in state payments and EUR 18 million in social insurance.

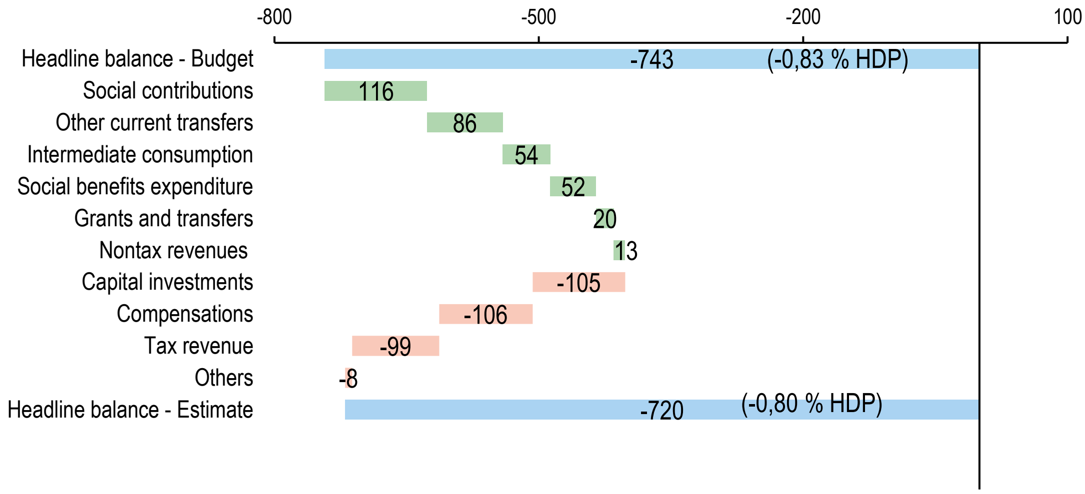
- **Other current transfers were lower by 459 mill. euros** which is mainly related to lower EU resource drawdown and co-financing. In addition to the impact of EU flows, savings from the movement of budgeted reserves to other items (EUR 98 million) are also recorded.

- **Capital expenditures were mostly affected by weak EU funds drawing, and total unspent budgeted resources amounted to 317 million euros.** However, after the settlement, the estimated EU flows the capital expenditures overcome the budget, especially for NDS and ŽSR. For comparison, the effect is also due to the fact that MH Invest II and JAVYS have not been included in the approved budget. Due to the weak drawdown of EU funds, total capital expenditure decreased by 7% Y-o-Y.

2.2 Current development in 2018

On the basis of the current estimate, the deficit will fall y-o-y by 0.24 p.p. to 0.80% of GDP, in line with the budgetary objective. The structural consolidation effort thus reaches 0.1% of GDP and, after taking into account recent developments, meets the requirements of the Stability and Growth Pact on a two-year horizon.

FIGURE 25 - Analytical description of GG balance development in 2018 (ESA 2010), contributions in EUR mil.



(+) / (-) means a positive / negative impact on the balance *Source: MoF SR*

Revenue side of the budget

According to the ongoing monitoring, the total revenues of the GG overcome the budget assumptions by 51 mill. euros.

- **Tax revenues compared to budget are lower by 99 mill. euros, while social security contributions show an increase compared to budget of 116 mill. euros.**
  - The actual update of the February 2018 macroeconomic and tax forecast increased the tax and levy revenue estimate by 150 million euros against the forecast based on the approved budget. Higher selection includes, in particular, the positive situation in the labor market, the growing consumption of households and improving the efficiency of VAT collection. The February forecast takes into account a number of new legislative measures[25] (-28 million euros).
  - Beyond the February tax forecast, there is also an update of several tax measures considered by the approved budget. By 2019, the efficiency of the forthcoming changes in gambling taxation (-65 million

[25] In particular, the introduction of the 13th and 14th salary (with effect from 1.5.2018), the abolition of the deductible item for health payments for employers and the introduction of a social deduction allowance with effect from 1.7.2018.

euros) and the increase in the fee for maintaining emergency stocks of oil and oil products (-32 million euros) will shift. In 2018, the current estimate is not related to the positive impact of the new premium tax (-16.2 million euros compared to the approved budget), but it is included in the fiscal framework for 2019-2021.

- **Non-tax revenues are estimated approximately at the budget level (+13 mill. euros).** We identify higher revenues from public higher education institutions, Železničná spoločnosť Slovensko (ŽSSK) and National Highway Company (NDS). These impacts are compensated by the outage of several non-tax revenues in corporate income, in particular by lower dividends from state-owned enterprises by 69 million euros according to the ESA2010 methodology.

- **Revenues from grants and transfers overcome the budget by 20 mill. euros.** Higher state budget revenue, the ŽSSK[26], and Eximbanka to somewhat extent counterbalance a drop in NDS revenue from the Connecting Europe Facility (CEF) tool.

Expenditure side of the budget

The total expenditures of the GG are above the budgetary projections by 28 mill. euros. There are slight structural changes, in particular by an increase in capital expenditure and employee compensation expenditure.

- **Compared to the budget assumption, we identify a slightly higher cost of employee compensation of 106 million euros.** Reason for this is mainly the reallocation of EU funds and co-financing from other current transfers of the state budget in the amount of 71 mill. euros. Year-on-year, compensation is increasing by 5%, in line with its long-term historical rate and wage growth in the private sector.

- **The negative impact of the higher compensation is partly balanced by savings on intermediate consumption amounting to 54 million euros.** Savings are primarily related to the binding of budgeted reserves[27] from the approved state budget. Total intermediate consumption expenditure increases by 1% year on year.

- **Social benefits expenditure are expected to be lower compared to the budget on the level of 52 million euros, in line with a better result in 2017.** Positive developments in the labor market help to dampen the rise in state social expenditure (-30mill. euros) as well as social insurance payments for state insurers (-20mill. euros).

- **Among the other current transfers we identify savings at the level of 86 million euros.** This is mainly due to the aforementioned reallocation of EU funds and co-financing within the state budget in the amount of 71 mill. euros to compensate employees.

- **Higher capital expenditure, on the other hand, exceed the budget by 105 million euros especially on the side of the local governments.** On the item of capital transfers, the expected negative impact of EU corrections is recorded at 19 million euros, with which the budget did not consider. Compared to the previous year, capital investments are estimated at 16% lower.

2.3 Medium-term budgetary outlook for 2019 to 2021

The proposed Stability Program[28] confirms the commitment to achieve a balanced budget by 2020. A year-on-year fall in the nominal deficit is expected to reach 0.32% of GDP in 2019. At the same time, this result corresponds to a structural deficit of 0.75% of GDP, the approximate level of the medium-term budgetary objective of the Slovak Republic[29], in the mild overheating of the economy. Achieving a nominally balanced budget and a

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[26] In the case of ŽSSK, it is the non-budgeted revenue.

[27] Savings on the reserve for the introduction of the 13th and 14th salaries amount to 30 mill. euros. Excessive commitment of expenditure (EUR 100.1 million) is from the reserve for worsening tax and non-tax revenues.

[28] In the context of the legislative requirements of the European Semester, the fiscal framework of the Stability Program thus defined is considered to be the national medium-term budgetary framework (hereinafter referred to as the "fiscal framework"). The requirement to disclose the national medium-term budgetary framework follows from Regulation of the Europen Parliament and the Council (EU) No 473/2013 of 21 May 2013, Art. 4

[29] The structural deficit with a deviation of up to 0.25% of GDP from the set target MTO is interpreted as meeting the MTO ex-post. The explanation is given in the interpretation of the Stability and Growth Pact according to the European Commission (Vade Mecum to SGP), on page 36 (chapter 1.3.2.2).

structural deficit of 0.4% of GDP in 2020 also means full achievement of the medium-term budgetary objective (MTO).

TABLE 10 - Change of fiscal targets (headline deficits) of public sector (% GDP)

	2016	2017	2018	2019	2020	2021
1. GG budget for 2016 to 2018	-1,93	-0,42	0	-	-	-
2. GG budget for 2017 to 2019	-1,93	-1,29	-0,44	0,16	-	-
3. GG budget for 2018 to 2020	-2,21	-1,29	-0,83	-0,10	0,00	-
4. Fiscal framework of the GG budget in the Stability Programme for 2019-2021	**-2,21**	**-1,04**	**-0,80**	**-0,32**	**0,00**	**0,00**
Change compared to the GG budget 2016 to 2018 (4-1)	-0,28	-0,62	-0,83	-	-	-
Change compared to the GG budget 2017 to 2019 (4-2)	-0,28	0,25	-0,39	-0,48	-	-
Change compared to the GG budget 2018 to 2020 (4-3)	**0,00**	**0,25**	**0,03**	**-0,22**	**0,00**	**-**

Source: MoF SR

2.4 Structural balance

Since 2014, the fiscal policy of the Slovak Republic has been subject to the rules of the preventive part of the Stability and Growth Pact (Pact) aimed at achieving the medium-term budgetary objective (MTO). This should correspond to a budget position (close to a structurally balanced budget) that is sustainable in the long term. In the short term, it should also provide sufficient space for fiscal policy stabilization function. For this reason, the progressive year-on-year improvement of the structural balance is required, based on the rules of the Pact (the so-called consolidation effort required, more specifically in Annex 3), until the MTO is reached.

Slovak economy since 2017 is in an expansionary phase of the cycle, but without significant overheating and without major risks to the sustainability in the medium term. According to the rules of the Pact, the y-o-y reduction of the structural deficit by 0.5 percentage points is required in this case until the MTO is reached. For the SR, the MTO is set at 0.5% of GDP and also reflects the stricter requirements of the intergovernmental fiscal compact agreement compared to the rules of the Stability and Growth Pact.

The structural deficit of the Slovak Republic reached 1.1% of GDP in 2017 and should stabilize at 1.0% of GDP this year. The year-on-year consolidation of 2017 in the amount of 1 p. p. significantly exceeded the required consolidation effort (0.5 p.p.). While maintaining the goal, however, the better-than-expected outcome in 2017 reduces the year-on-year consolidation effort in 2018. At the current estimate, reaches 0.1 p.p. and lags behind the Pact requirements by 0.4 p.p.. Taking into account the outcome of both years, consolidation achieved for both years is in accordance with the rules of the Pact.

TABLE 11 - Consolidation effort (ESA2010, % GDP)

	2016	2017	2018	2019	2020	2021
1. GG balance	**-2,21**	**-1,04**	**-0,80**	**-0,32**	**0,0**	**0,0**
2. Cyclical component	-0,1	0,0	0,2	0,4	0,4	0,3
3. One-off effects	0,0	0,0	0,0	0	0	0
4. Structural balance (1-2-3)	**-2,0**	**-1,1**	**-1,0**	**-0,75***	**-0,4**	**-0,3**
5. Consolidation effort according to the EC	0,75**	1,0	0,1	0,3	0,3	0,1
Deviation (1r)	**0,5****	**0,5**	**0,4**	**MTO***	**MTO**	**MTO**
Deviation (2r)	**0,1****	**0,3**	**0,0**	**MTO***	**MTO**	**MTO**
P.m. Required consolidation effort	*0,25*	*0,5*	*0,5*	*0,5 (MTO)*	*keep MTO*	*keep MTO*

Source: MoF SR

**The structural deficit of 0.75% of GDP would be interpreted as fulfilling the ex-post MTO - explanation in the Vade Mecum to SGP, p. 36 (in chapter 1.3.2.2).*
*** Structural balance deviation of 2016 based on frozen SF assessment of EC (2017)*

From 2019, the structural balance of the GG will already be around[30] the medium-term budgetary objective (MTO) level. The structural deficit should reach 0.75% of GDP. A deviation of up to 0.25% of GDP from a specified target MTO is interpreted as meeting the MTO ex-post. **Since the peak of the financial crisis in 2009, in one decade there will be the structural recovery of public finances by more than 6 p.p..**

The balance of the GG management will create an additional reserve in 2020 and 2021 compared to the MTO. In these years, the fiscal framework assumes an additional consolidation of 0.3 and 0.1 p.p. thus reducing the structural deficit to 0.3% of GDP. The stabilized consolidation rate should also ensure the maintenance of GG nominal balanced revenue and expenditure.

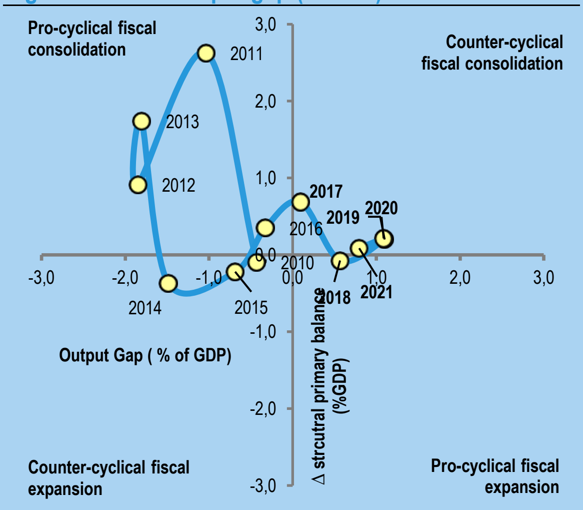
BOX 4 - Fiscal stance

In addition to achieving long-term sustainability of public finances, the objective of fiscal policy is also to stabilize the fluctuations in the economic cycle. In order to achieve an anti - cyclical fiscal policy, the structural difference between the GG revenue and the expenditure should increase during the recession. At the time of stronger overheating of the economy, on the other hand, budget deficits should be reduced more strongly.

The basic analytical method for assessing the anti - cyclicality of fiscal policy is to compare the change in the primary structural balance against the current level of production gap. The second approach uses the pace of its year-on-year change rather than tracking the production gap. The main difference is the lower sensitivity of this approach to revision of production gap, which is more often triggered than in the case of change. The pace of change at the same time indicates the trends of the economic cycle development. Both approaches are combined in determining the required consolidation effort within the Pact (Annex 3).

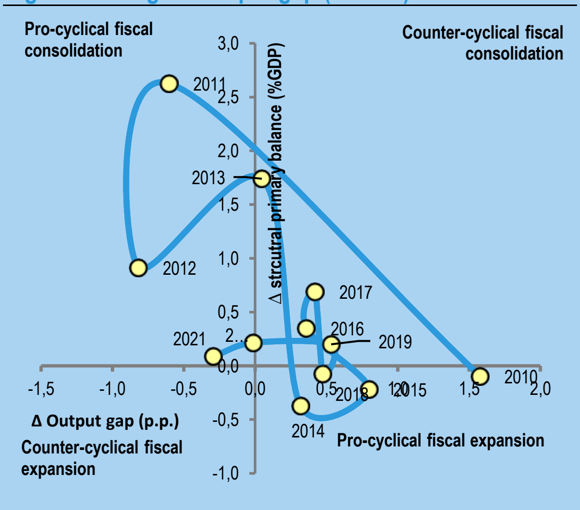
Starting in 2017, the Slovak economy is in a moderate phase of the expansion of the economic cycle, and the chosen consolidation pace is also responding appropriately. Fiscal policy has been more anti- cyclically responsive in 2017, while in 2018 fiscal policy is even more neutral in accelerating economic growth above its potential. A moderate dampening of the continuing expansion of the economy over its balance is again expected from 2019 until the MTO is fully attained. Even at the end of the horizon, the Slovak economy should not show any significant signs of overheating, which should also be addressed in a more fundamental way by fiscal policy.

FIGURE 26 - Structural primary balance change against level of output gap (% GDP)



Source: MoF SR

FIGURE 27 - Structural primary balance change against change of output gap (% GDP)



Source: MoF SR

TABLE 12 - Structural primary balance - EC methodology (% of GDP)

	2016	2017	2018	2019	2020	2021
Structural primary balance	-0,4	0,3	0,2	0,4	0,7	0,7
Output gap	-0,3	0,1	0,6	1,1	1,1	0,8

Source: MoF SR

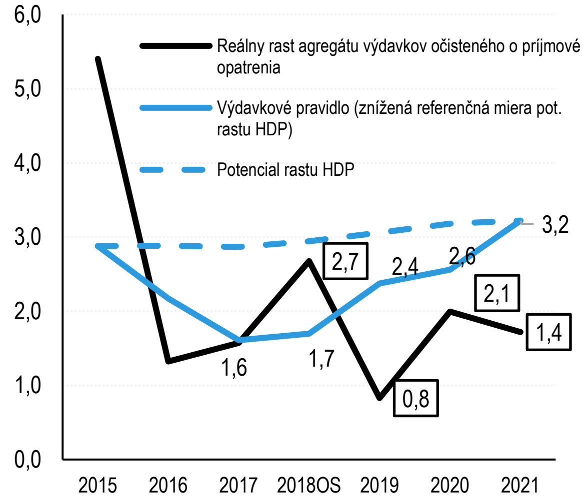
[30] The explanation is given in the interpretation of the Stability and Growth Pact according to the European Commission (Vade Mecum to SGP), on page 36 (chapter 1.3.2.2).

2.5 Expenditure benchmark

The second pillar of the preventive part of the Stability and Growth Pact is the expenditure benchmark. According to it, GG expenditures cleared of items outside the government control and new revenue measures[31] cannot grow faster than the medium-term potential growth of the economy[32]. Such a pace should ensure the stabilization of the GG balance. If the country has not yet reached its medium-term budgetary objective (currently the case of the SR as well), expenditure growth must also take into account the direction towards this target. In this case, the expenditure benchmark is adjusted by the so-called a convergence rate that relies on the desired consolidation effort (more in Annex 4).

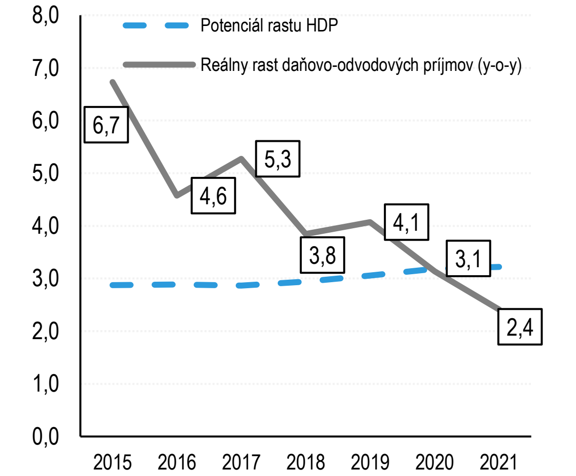
In recent years, the expenditure benchmark has gained of importance in assessing compliance with the rules of the Pact. The advantage of the expenditure benchmark over the structural balance is to use a longer-term and more stable estimate of potential growth, which is subject to less vigorous revisions than estimates of the production gap.

FIGURE 28 - Expenditure aggregate against expenditure benchmark (% y-o-y growth)



Note: expenditure growth under the expenditure rule increases at the end of the horizon as regards the fulfillment of the MTO level. Source: MoF SR

FIGURE 29 - Tax and social contribution[33] against potential growth of GDP (% y-o-y growth)



Note: The real growth of tax and social contrinution recalculated using GDP deflator Source: MoF SR

The shift of the Slovak economy to the positive phase of the cycle requires a dampening of expenditure growth since 2017, which is reflected in its permitted real growth rate between 1.6 and 1.7% per year until the MTO is reached[34]. This benchmark is based on the estimate of the real medium-term potential growth of the Slovak economy just below 3% and the required year-on-year structural consolidation of 0.5% of GDP.

According to Eurostat spring notification for 2017, the expenditure benchmark is being met on a continuous basis, while in 2018 we identify a slight deviation at both the one-year and the two-year horizons. In 2017, the expenditure in question grew by 1.6%[35] in real year-on-year terms, with a minimum reserve against the expenditure benchmark. Compliance with the expenditure benchmark in 2017 also allowed consolidation revenue measures of 0.2% of GDP (see Annex 4 in more detail). According to the current estimate, expenditure developments in 2018, on the other hand, slightly deviate. New revenue-mitigating measures also have a negative impact on the benchmark fulfillment. A deviation of 0.4% of GDP over one year, 0.2% of GDP over a

[31] So called discretionary revenue measures represent the additional year-on-year impacts of legislative tax measures (more in Annex 4).
[32] The potential of the economy is expressed as a reference growth rate of expenditure, calculated as the 10-year average of potential growth (in years t-4 to t + 5).
[33] Adjusted for the change in revenue due to discretionary revenue measures and the state paid insurance.
[34] The expenditure benchmark is influenced by the higher convergence rate due to the overheating of the economy, which requires higher consolidation effort of the structural balance. Furthermore, according to the expenditure benchmark, the expected continuing excess of revenue over the growth potential of the economy (Figure 29) should not be used for higher expenditure.
[35] According to the actual value of deflator, growth was at 1.5%. For conformity assessment, the "freeze" principle uses its value from the estimate from the EC Spring Forecast in year t-1.

two-year horizon, however, is within the permitted Pact definition.

The permitted expenditure growth rate is also respected by the submitted fiscal framework for the years 2019-2021. The reserve against the expenditure benchmark is around 0.6% of GDP in 2019 and respectively 0.2% and 0.6% of GDP in 2020 and 2021. The identified deviations of the expenditure benchmark are therefore fully in line with the Pact rules. The slightly stronger expenditure growth at the end of the horizon takes into account the fact that since 2021 there is no longer a need for additional consolidation, but only a stabilization of the reached level of the structural balance at the MTO level.

TABLE 13 - Expenditure benchmark (ESA 2010)

		2016	2017	2018	2019	2020	2021
Expenditures	mil. eur	33 685	34 351	35 203	36 502	38 707	40 033
Primary expenditure aggregate	mil. eur	**31 518**	**32 528**	**33 805**	**34 819**	**36 151**	**37 304**
Discretionary revenue measures	mil. eur	-174	144	-97	120	-122	-163
Nominal growth of expenditure aggregate net of DRM	%	2,5	2,8	4,2	2,6	4,2	3,6
Real growth of expenditure aggreagate net of DRM	**%**	**1,3**	**1,6**	**2,7**	**0,8**	**2,1**	**1,4**
Expenditure benchmark (low reference bound)	**%.**	**2,2**	**1,6**	**1,7**	**2,4**	**2,6**	**3,2**
Deviation from expenditure benchmark	p. p.	0,8	0,0	-1,0	1,6	0,5	1,8
Deviation from expenditure benchmark	% GDP	0,3*	**0,0**	**-0,4**	**0,6**	**0,2**	**0,6**
Two-year deviation from expenditure benchmark	% GDP	-0,1*	**0,2**	**-0,2**	**0,1**	**0,4**	**0,4**

Note: Expenditure growth allowed at the end of the medium-term horizon increases with respect to meeting the MTO.
** Consolidation effort and deviations of 2016 based on freezing as of the latest EC assessment (SF 2017).*

2.6 No-policy-change scenario

The no-policy-change scenario (NPC) illustrates the reference development of public finances, assuming unchanged legislation and updating macroeconomic development[36]. Its contribution is to quantify the approximate size of the measures needed (or fiscal space) to meet the medium-term objectives. The magnitude of such measures can be quantified by comparing the GG management balance in the NPC scenario against the agreed medium-term budgetary objectives. Taking into account the difference in budgeted revenues and expenditures compared to the structure in the NPC scenario, it is also possible to estimate the impact of government measures (consolidation or stimulus) on the economy.

The starting point for the no-policy-change scenario creation for 2019-2021 is the current estimate of the general government deficit in 2018 at 0.80% of GDP. This is settled for one-off impacts for the determination of the base (for more details BOX 6). Assuming that there were no changes in economic policies, the result of GG management would be in a gradually growing surplus from 2019 onwards. In 2019, the NPC scenario calculates a surplus of 0.64% of GDP, compared with a deficit target of 0.32% of GDP from the fiscal framework. In 2020 and 2021, the NPC scenario anticipates a surge in surplus to 0.88, respectively 1.07% of GDP, while the fiscal framework assumes a balanced revenue and expenditure balance in both years.

The identified difference in the balance between the fiscal framework and the NPC in 2019 is around 1% of GDP, based mainly on expenditure side measures. Intermediate consumption (0.2% of GDP) and capital investments (0.5% of GDP) are growing more rapidly in the fiscal framework compared to the development of their reference macroeconomic indicators (increase in consumer inflation or nominal GDP growth).

Differences between the fiscal framework and the NPC remain in the years to come. From 2020 onwards, the NPC scenario implies an additional stimulus that is more pronounced in terms of inter-consumption (0.4% of GDP) and government investment expenditure (0.4% to 0.6% of GDP). In 2021, the stimulus will also be backed by current transfers (0.3% of GDP), but will be moderately dampened by a slower growth rate of compensation (-0.2% of GDP) compared to the expected wage growth in the private sector.

[36] Officially published manual to NPC scenario.

TABLE 14 - Overall consolidation need to achieve the fiscal targets compared to NPC (ESA2010, % of GDP)

	2019	2020	2021
1. General government balance - Fiscal objectives	-0,32	0,00	0,00
2. General government balance - NPC scenario	0,64	0,88	1,07
3. Size of measures (1-3)	-0,96	-0,88	-1,07
- y-o-y change	**-0,96**	**0,08**	**-0,19**

Source: MoF SR

Development on the revenue side

The overall impact of revenue measures for the years 2019 to 2021 is approximately neutral compared to the NPC scenario. Legislative measures identified, in particular, in the area of tax and levy revenues, together with the development of non-tax revenues and current transfers, are offset against each other at the budgeted horizon.

- Since 2019, in particular, gambling changes (in the impact of € 70 million in 2019, which will fall to € 10 million from 2020) and the replacement of the original insurance premium on insurance excise premiums (the net impact from 2019 at EUR 36 million) **contribute to consolidation**. The increase in the fee for the maintenance of emergency stocks of oil and petroleum products should provide an additional 37 million euros.
- The introduction of the **13th and 14th salaries**[37] will compensate slightly the positive impacts. The overall impact of the measure will cause a total revenue shortfall of 82 million euros in the years 2019 and 2020, in the year to come it will increase to a total of 135 mill. euros. Gradually, it will negatively affect the yield from PIT, health payments, and from 2019 also social contributions. A slightly better yield is expected for CIT.
- Non-tax revenues will positively influence higher **revenue of health facilities compared to NPC scenario**. They stem from stronger healthcare expenditure growth compared to the NPC scenario. While this effect is slightly negative in 2019 (-17mill. euros), its positive impact will prevail from 2020 (34 or 114 million euros in 2020 and 2021 respectively).

The fiscal framework for the years 2019-2021 envisages an increase in social contributions of 50 mill. euros annually in the context of the forthcoming amendment to the Social Insurance Act.

TABLE 15 - List of measures in the fiscal framework for 2018 to 2020 (ESA 2010, compared to NPC, impact on the balance)

			2 019		2 020		2 021	
Measures	**Subsector**	**ESA2010**	mil. eur	% GDP	mil. eur	% GDP	mil. eur	% GDP
Total revenues(1+2+3+4)			**-5**	**-0,01**	**-22**	**-0,02**	**-1**	**0,00**
1. Tax measures	S13	D.2+D.5+D.91	111	0,1	51	0,0	51	0,0
2. Social contributions	S13	D.61	-47	0,0	-47	0,0	-100	-0,1
3. Non-tax revenues	S13	P.11+P.12	-17	0,0	34	0,0	114	0,1
4. Grants and transfers	S13	D.39+D.7R D.9R	-52	-0,1	-60	-0,1	-66	-0,1
Specific measures:								
- Changes in gambling		D.2	70	0,1	10	0,0	10	0,0
- Insurance premium tax		D.2	36	0,0	36	0,0	36	0,0
- 13. and 14. sallary		D.5+D61	-82	-0,1	-82	-0,1	-135	-0,1
- Service fee from EOSA		D.2	37	0,0	37	0,0	37	0,0
- Other			-66	-0,1	-23	0,0	51	0,0
Total expenditure (5+6+7+8+9+10)			**-915**	**-0,95**	**-874**	**-0,86**	**-1157**	**-1,07**
5.Compensations	**S.13**	D.1	-71	-0,1	-10	0,0	172	0,2
6.Intermediate consumption, of which:	**S.13**	P.2	-234	-0,2	-369	-0,4	-395	-0,4

[37] The measure is implemented by the amendment of the Labor Code, which envisages the introduction of the 13th and 14th salary (from 1.5.2018) in the form of a contribution for employees, which will not be subject to health insurance, income tax and social contributions.

- Higher expenses of healthcare facilities due to higher revenues			-50	-0,1	-114	-0,1	-191	-0,2
7.Subsidies	S.13	D.3p	-3	0,0	0	0,0	2	0,0
8.Social transfers, of which:	**S.13**	D.6P	-49	-0,1	-38	0,0	-53	0,0
- Social transfers in kind		D.632	-49	-0,1	-38	0,0	-53	0,0
9. Other current transfers	**S.13**	D.7P	-89	-0,1	-55	-0,1	-281	-0,3
10.Capital expenditure, of which	**S.13**	P.5+D.9P	-470	-0,5	-402	-0,4	-604	-0,6
- Higher expenses on defense	S.1311	P.51g	96	0,1	-408	-0,4	-540	-0,5
Total (consolidation/expansion against NPC scenario)	**-**	**-**	**-921**	**-0,96**	**-896**	**-0,88**	**-1158**	**-1,07**

Pozn. (+) increse of revenues or decrease of expenditure against NPC scenario. *Source: MoF SR*

BOX 5 - Additional tax changes

In addition to the tax measures described in the SR Stability Program 2018-2021 and the Draft Budget Plan 2018, a number of legislative measures[38] have been adopted in December 2017, with effects on revenue already in 2018. These measures were thus effectively adopted before the base year. Due to the NPC methodology we consider them as part of the current legislation.

TABLE 16 - Legislation changes not included in No-Policy-Scenario (% of GDP)

		2018	2019	2020	2021
1)	Abolition of tax HIC allowance for employers	22	85	75	66
2)	Increase in the MAB for social insurance contributions	0	-5	-28	-30
3)	SIC allowance for emloyee retirement agreements	-9	-19	-19	-19
4)	Reduction of the buildings depreciation period from 40 to 20 years	-3	-3	-3	-3
5)	Exemption of ad receipts taxation for non profit organizations	-1	-1	-1	-2
6)	Increased deduction of the cost of research and development	-9	-9	-9	-9
7)	Introduction of separate depreciation of technical upgrade	0	-1	-1	-1
8)	Introduction of tax allowance on spa care from 1 Jan 2018	-2	-2	-2	-2

Source: MoF SR

Development on the expenditure side

The fiscal framework expects higher expenditure compared to the NPC over the whole horizon of around 1% of GDP. Faster than NPCs, especially capital expenditures and intermediate consumption are growing. The one-off expenditures that are being basically settled in 2018 represent 479 million euros (BOX 6).

- The fiscal framework consideres an increase in **employee compensation** above the NPC level in 2019 and 2020. The budget takes into consideration wage increases for pedagogical and technical staff in education in line with the government's program statement.
- Above the NPC, the medium-term framework with higher **intermediate consumption** expenditure is considered over the whole horizon. Healthcare facilities are assuming higher expenditure due to higher health insurance revenue paid by the economically active population. At the end of the horizon, on this item will be also partly reflected the projected higher expenditure allocated to the modernization of defense as a result of international commitments.
- Higher expenditure on **natural social transfers** due to higher health care revenue is considered over the whole horizon and above the NPC framework.
- Behind the higher **current transfers** compared to the NPC, are funds allocated for co-financing from so far unallocated resources from EU funds.
- The fiscal framework assumes **capital expenditures** beyond the NPC. Public investments will increase to levels from 2016 to 2017. The additional expenditure assumes a fiscal framework, in particular, to modernize defense resulting from international commitments (increase in chapter expenditures of the Ministry of Defense of the Slovak Republic (MO SR) to 1.7% of GDP by 2021), measures to growth support, and government measures that are not yet specified.

[38] More detailed in TFC Chairman letter .

BOX 6 - One-off and temporary expenditure in 2018

To estimate the development of the deficit in the no-policy-change scenario, the base of the starting year 2018, which is indexed to the next years, would allocate one-off expenditures. In 2018, the total volume of one-off measures amounted to 479 million euros (0.53% of GDP), dominated by investment measures (0.32% of GDP).

TABLE 17 - The list of one-off measures in 2017 for the needs of NPC (ESA 2010, EUR mil.)

	ESA2010	2018	2018 (% of GDP)
One-off impact on wages	**D.1**	**2**	**0,00**
Intermediate consumption, of which:	**P.2**	**135**	**0,15**
Reserve for worsening tax and non-tax revenues		40	0,04
Reduced expenditures of ŽSR and ŽSSK		31	0,03
Other current transfers	**D.7p**	**29**	**0,03**
Subsidy for the Ministry of Education (Science and Research, APVV)	**D.3p**	**26**	**0,03**
Capital transfers, of which:	**D.9p**	**68**	**0,08**
Construction of the National Football Stadium		63	0,07
Capital investments, of which:	**P.51g**	**220**	**0,24**
Strategic park preparation		126	0,14
Projects of the Ministry of Transport		49	0,05
Reconstruction of the Slovak National Gallery		27	0,03
Total		**479**	**0,53**

Source: MoF SR

TABLE 18 - No-policy-change scenario and general government balance (ESA2010, % of GDP)

	E	NPC scenario			Medium-term targets			MTT-NPC		
	2018	2019	2020	2021	2019	2020	2021	2019	2020	2021
1.Revenue total	**38,2**	**37,7**	**38,0**	**37,1**	**37,7**	**37,9**	**37,1**	**-0,0**	**-0,0**	**0,0**
Tax revenue	17,9	17,7	17,5	17,2	17,8	17,5	17,2	0,1	0,0	0,0
Social contributions	14,7	14,4	14,2	13,9	14,3	14,1	13,9	0,0	0,0	-0,1
Non-tax revenue (P.11+P.12)	4,6	4,5	4,3	4,1	4,5	4,4	4,2	0,0	0,0	0,1
Grants and transfers (D.7R)	1,1	1,1	2,0	1,9	1,0	1,9	1,8	-0,1	-0,1	-0,1
2.Total expenditures	**39,0**	**37,0**	**37,1**	**36,0**	**38,0**	**37,9**	**37,1**	**0,1**	**0,9**	**1,1**
Current expenditure	36,3	34,6	34,2	33,3	35,1	34,7	33,9	0,5	0,5	0,6
Compensation of employees	9,1	8,7	8,9	8,8	8,8	8,9	8,6	0,1	0,0	-0,2
Intermediate Consumption	5,4	5,1	4,9	4,8	5,3	5,2	5,2	0,2	0,4	0,4
Subsidies	0,4	0,4	0,4	0,3	0,4	0,4	0,3	0,0	0,0	0,0
Interest	1,3	1,2	1,1	1,1	1,2	1,1	1,1	0,0	0,0	0,0
Total Social Transfers	18,1	17,2	16,6	16,1	17,3	16,7	16,2	0,1	0,0	0,0
- Social benefits other than in kind	13,2	12,5	12,1	11,7	12,5	12,1	11,7	0,0	0,0	0,0
- Social transfers in kind (healthcare facilities)	5,0	4,7	4,6	4,5	4,8	4,6	4,5	0,1	0,0	0,0
Other current transfers	1,9	1,9	2,3	2,2	2,0	2,3	2,4	0,1	0,1	0,3
Capital expenditures	3,0	2,4	2,9	2,7	2,9	3,3	3,3	0,5	0,4	0,6
Capital Investment	2,7	2,2	2,7	2,5	2,7	3,0	3,1	0,5	0,4	0,6
- Gross fixed capital formation	2,8	2,2	2,5	2,4	2,7	2,9	3,0	0,5	0,4	0,6
Capital transfers	0,3	0,2	0,2	0,2	0,2	0,2	0,2	0,0	0,0	0,0
3. Net lending/borrowing	**-0,8**	**0,6**	**0,9**	**1,1**	**-0,3**	**0,0**	**0,0**	**-1,0**	**-0,9**	**-1,1**

Note: subject of rounding

Source: MoF SR

2.7 The impact of fiscal policy on the economy in 2019 to 2021

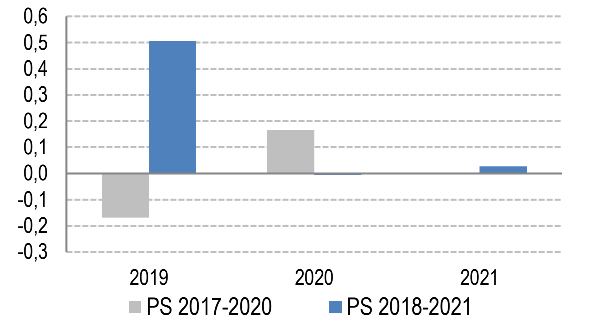
The starting point for quantifying[39] the magnitude of fiscal measures affecting the economy is the no-policy-change (NPC) scenario. The impact of fiscal policy on the economy between 2019 and 2021 is based on the measures needed to achieve the budgetary targets contained in the fiscal framework of the Stability program as compared to the NPC.

In the year 2019, a fiscal space of 1% of GDP is generated against the NPC scenario (Table 18) and the fiscal impulse is concentrated mainly on investments and inter-consumption. A moderate fiscal consolidation adjustment of 0.1% of GDP is achieved in 2020 to achieve a balanced budget. Once the balanced budget has been reached, the fiscal impulse is again partly released by 0.2% of GDP y-o-y.

All over the mid-term horizon, measures are almost exclusively on the expenditure side of the budget. Impact of fiscal policy on the economy has omitted measures that have no direct impact on GDP[40]. **In 2019, it is estimated to have a positive impact on GDP growth at 0.5 p.p.. The additional measures in 2020 and 2021 have an approximately neutral impact on the economy.**

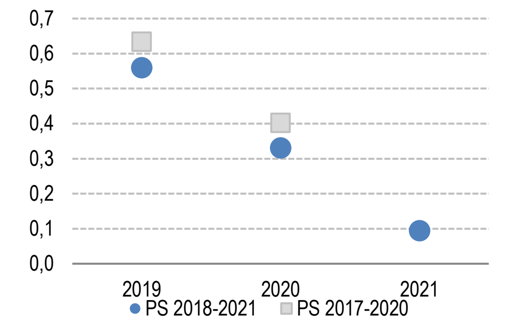
The implied fiscal multiplier in 2019 is estimated at 0.6. The height of the multiplier corresponds to the structure of the stimulus, which is concentrated mainly on the expenditure side of the budget, namely in investments, inter-consumption and compensations. **The estimated fiscal multiplier in 2020 is 0.3**. It is given by each compensating measures of both restrictive and expansive character. **In 2021, the implied fiscal multiplier achieves only 0.1**, which is again due to counter-measure influence. The decreasing multiplier of the entire package of measures is given in particular by a compensation-side restriction, which have individuallly the highest multiplying effect.

FIGURE 30 - Impacts of fiscal policy on GDP (% GDP) against Stability Programme (PS) 2017-2020*



** Stability Programme of SR for 2017- 2021* *Source: MoF SR*

FIGURE 31 - Implied fiscal multipliers against Stability Programme (PS) 2017-2020



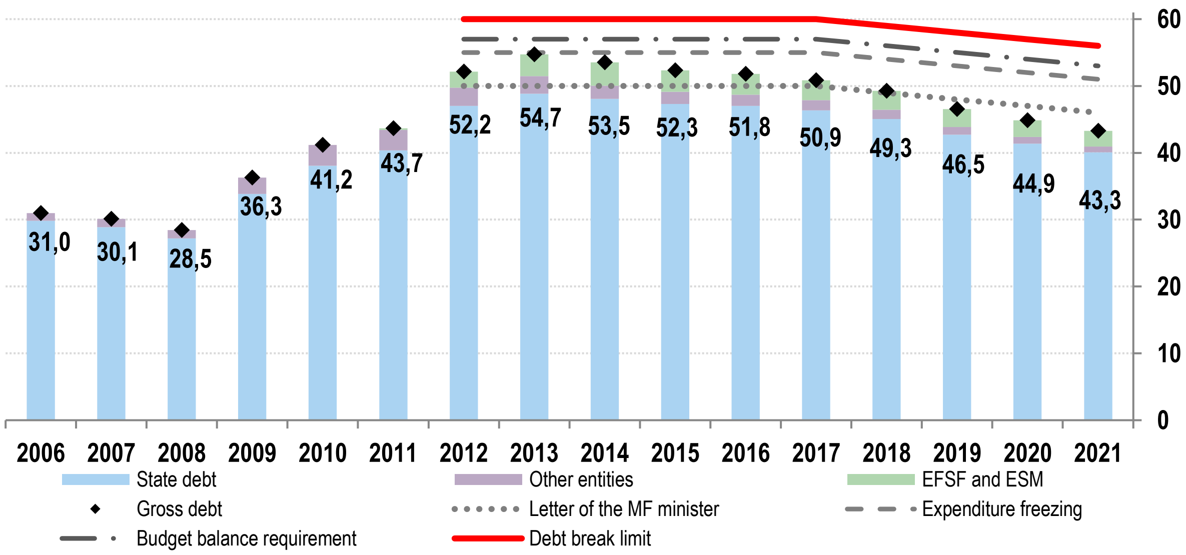
Source: MoF SR

2.8 General government debt

The share of gross general government debt to GDP in 2017, according to spring notification, fell by 1.0 p.p. and reached the level of 50.9% of GDP[41]. From the amount of gross debt, Slovakia's international commitments to the European Financial Stability Facility (EFSF) and the European Stability Mechanism (ESM) were 3% of GDP. The decline in debt in relation to GDP was mainly due to the nominal growth of the economy as well as to the primary surplus of public finances[42]. Gross debt was financed primarily by bond issues in 2017 and, to a lesser extent, Treasury bills and loans were used.

[39] More on the Impact of Fiscal Policy in 2019-2021 in Annex 2.
[40] On the revenue side, it is a category of grants and transfers, and higher gambling taxation.
[41] According to the preliminary Eurostat notification. All reported values are calculated in the methodology used to assess the fulfillment of the Maastricht criteria for the amount of general government gross debt - so called Maastricht's gross general government debt.
[42] The primary balance represents the nominal general government deficit, net of interest expense.

FIGURE 32 - General government gross debt (% of GDP)



Pozn: Relevant debt thresholds refer to Fiscal responsibility act. *Source: MoF SR*

By 2021, the GG debt should approach the 43% of GDP threshold and reach the level significantly below the lower sanctioning band of the Constitutional Fiscal Responsibility Act. Below 50% of GDP, debt will already be in 2018 (49.3% of GDP). From the following year, the nominal growth of the economy will accelerate significantly and the primary surpluses of the GG management will rise to 1% of GDP, which will also strengthen the dynamics of the GG debt decline. In 2019, the gross debt of the GG will get under the gradually tightening penalty debt brake limit.[43] At the end of the forecast horizon in 2021, GG gross debt will be at 43.3% of GDP. The GG debt will be more than 11 percentage points lower than its highest level in 2013. The forecast of the Ministry of Finance is roughly in line with the stochastic debt forecast. The exception is the end of the horizon where the stochastic estimate expects a slower decline by 2 p.p. by 2021 (detailed in BOX 7).

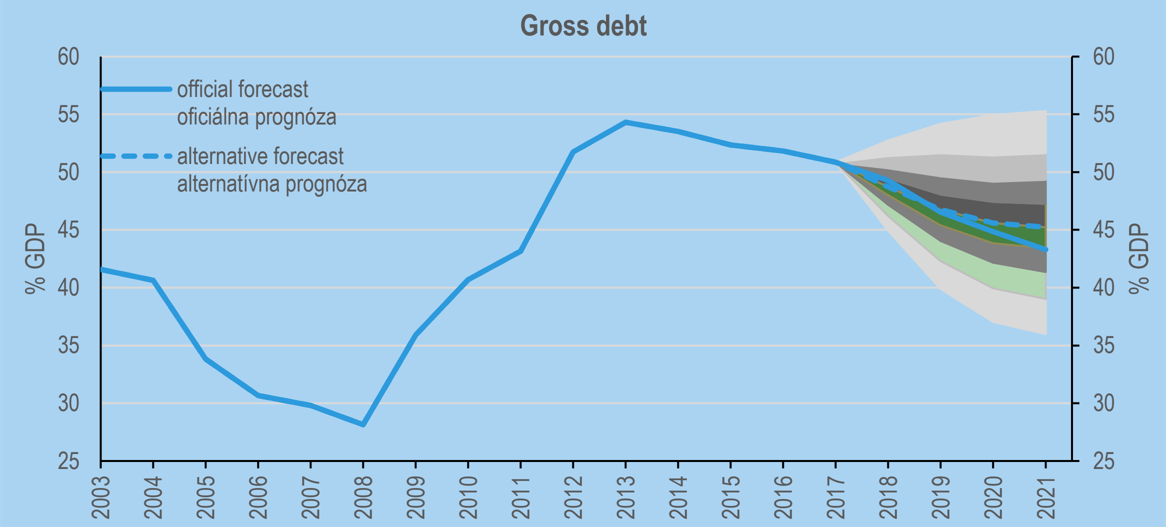
BOX 7 - Stochastic forecast of gross general government debt

The model forecast of the GG debt in 2018 and 2019 is almost identical to the official one. It is more conservative between 2020 and 2021. Both forecasts consistently expect the debt to fall below the sanctioning bands. At the end of the horizon, the model forecast predicts a debt level of 1.9 p.p. above the official forecast (45.2% of GDP). The lower contributions of the primary balance to the debt decline are the main difference between the two forecasts. The likelihood that the debt ratio will fall below the current value at the end of the horizon is roughly 75%. The official forecast appears to be slightly optimistic at the end of the horizon, with the probability that the debt level at the end of 2021 will be above the expected level (43.3% of GDP) and reaches the value up to 60%.

The advantage of such an approach is the modesty in entering prerequisites. It provides an independent source of debt estimation and quantification of forecasting risk. On the other hand, its weakness is taking into account only a limited amount of information and the assumption that the interrelationships among the different components of the model will be the same during the forecast period as it was in the past. The spread graph is a visual presentation of a large number[44] of random debt level simulations on the forecast horizon generated in the stochastic model. The estimation methodology is published in the Draft Budget Plan for 2016[45].

[43] The penalty bands are since 2018 annualy stricter by 1 p.p. (until 2027).
[44] 5000 random debt trajectories were simulated.
[45] Stochastic Debt Forecast Manual.

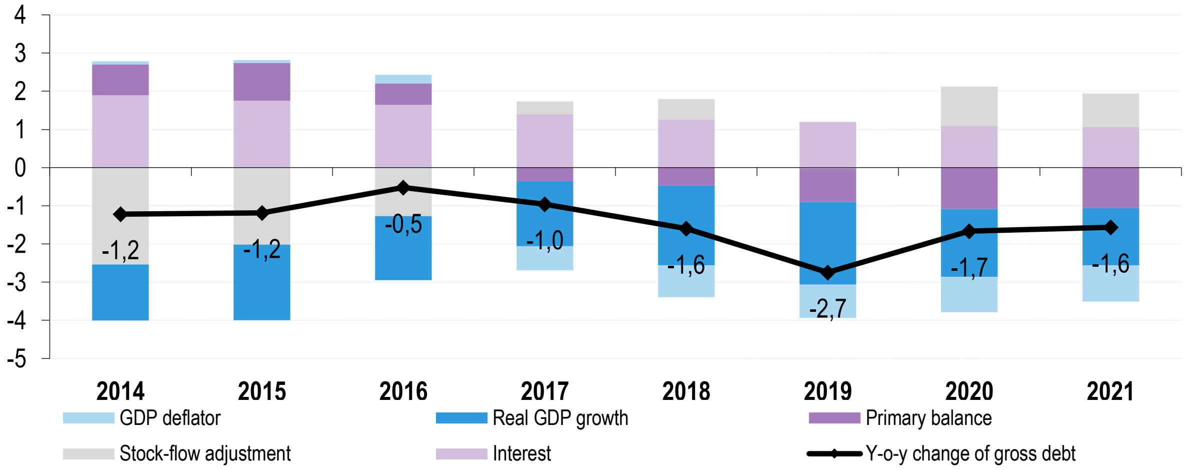
FIGURE 33 - Stochastic debt forecast (% of GDP)



Source: MoF SR

The most significant impact on the decline in GG debt stems from the real growth of the economy, supported by the recovery in the price level over the inflation target and the primary surpluses of the GG economy. Nominal GDP growth will be around 6% at the forecast horizon, with a moderate slowdown since 2020. The GG primary surplus of GDP will gradually converge to 1% of GDP. The decline in interest expense will also gradually contribute to the overall GG surplus of the budget deficit at the historically lowest level of 1.1% of GDP. Stabilizing the individual factors at these levels would mean an annual gross debt fall of 2 p.p.. However, the debt decreases slowlier at the end of the forecast horizon. Other GG entities (outside the state budget balance) do not expect the use of surpluses to reduce their debt in the same ratio in their budget plans. This leads to the accumulation of liquidity reserves that are taken into account in the net debt trajectory (in more detail, the stock-flow adjustment in BOX 8).

FIGURE 34 - Contributions of factors to the debt change (% of GDP)



Source: MoF SR

BOX 8 - Stock-flow adjustment

The stock-flow adjustment (SFA) is a discrepancy value between the actual (or expected) year-on-year change in GG gross debt and the achieved (or expected) deficit for the whole GG in accrual terms. The main reasons are different calculation methods. The general government balance is based on accrual data, whereas the amount of debt is primarily determined by the cash flows of the GG balance sheet. At the same time, the general government's balance is based on a net concept (revenue reduced by expenditure) while the debt is a gross concept, not reduced by assets. Its use or the acquisition affects the amount of the debt but not the balance of GG.

Unlike the period between 2014 and 2016, the SFA had a negative impact on the debt change in 2017. The main reason is the year-on-year increase in the total cash balance on the GG accounts. In particular, other GG entities (self-government, state funds, etc.) recapitulated cash liquidity that was not fully utilized to reduce their own existing liabilities.

Even between 2018 and 2021 (except in 2019), the SFA item will have a negative impact on the debt change. The main factors behind this development should be the positive difference between accruals and cash data balances of the GG (in particular in relation to the timing distinction of tax and interest items) together with the further accumulation of GG liquidity balances. Only in 2019 a one-off decrease in liquid assets is expected to cover cash deficit and debt overdraft costs in the financial markets.

TABLE 19 - Stock-flow adjustment (% of GDP)

	2014	2015	2016	2017	2018	2019	2020	2021
Stock-flow adjustment (1+2+3+4+5)	**-2,5**	**-2,0**	**-1,3**	**0,3**	**0,5**	**0,0**	**1,0**	**0,9**
1. Difference between accrual and cash data	**-0,4**	**-0,9**	**-0,9**	**-0,1**	**0,5**	**0,6**	**0,5**	**0,3**
2. Change of financial assets	**-1,9**	**-1,0**	**-0,3**	**0,5**	**0,3**	**-0,5**	**0,5**	**0,3**
Change of GG cash	-2,9	0,7	0,8	0,7	0,3	-0,5	0,5	0,3
Change of othe assets (receivables and payables)	0,7	-1,5	-1,1	-0,2	0,0	0,0	0,0	0,0
3. Bond issuance discount	**-0,4**	**-0,5**	**-0,4**	**0,1**	**0,1**	**0,1**	**0,2**	**0,4**
4. Bond discount at maturity	**0,0**	**0,0**	**0,0**	**-0,1**	**0,0**	**0,0**	**-0,1**	**0,0**
5. Other	**0,2**	**0,3**	**0,4**	**-0,1**	**-0,3**	**-0,2**	**-0,2**	**0,0**

Source: MoF SR

* A positive SFA means that debt is nominally rising at a faster rate than a deficit or, decreases slowly than assumed by the surplus achieved. A negative SFA means that the rise in gross debt is slower than the reported deficit. In the case of surplus, debt decreases faster in case of a negative SFA.

TABLE 20 - Contributions to gross debt (mil. eur)

	2016	2017	2018	2019	2020	2021
A. GG gross debt (as of 1.1.)	**41 295**	**42 053**	**43 226**	**44 421**	**44 706**	**45 760**
B. y-o-y gross debt change	**758**	**1 173**	**1 195**	**285**	**1 053**	**958**
- state budget deficit (cash accounting)	980	1 220	1 790	1 576	1 414	1 181
- State Treasury funds used to finance state needs	45	1	-614	-1 303	-448	-494
- SR commitment under EFSF and Contributions to ESM	0	0	0	0	0	0
- issuance discount	43	68	64	115	254	378
- discount at maturity	-61	-62	-6	0	-59	-4
- indebtedness of other GG entities	-93	-76	-38	-102	-106	-101
of which: Railways of the SR (ŽSR) and ŽSSK	32	41	46	17	18	18
of which: NDS	-40	-37	-17	-37	-37	-37
of which: municipal public transportation companies	-23	-3	-8	-13	-14	-11
of which: municipalities	-62	-74	-88	-86	-83	-81
- others	-156	22	-2	-2	0	-1
C. Gross debt of general government (as of 31 December) (A+B)	**42 053**	**43 226**	**44 421**	**44 706**	**45 760**	**46 718**
v % GDP	**51,8**	**50,9**	**49,3**	**46,5**	**44,9**	**43,3**

Note.: Positive items increase debt, negative items decrease debt. *Source: MoF SR*

Net debt

In order to assess debt developments, it is also appropriate to monitor the development of net debt. Net debt fell by 1.4 p.p. in 2017 to 45.5% of GDP. The ratio of net debt to GDP should decrease continuously throughout the monitored period. After 2020, the level of net debt will be below 40% of GDP. The Ministry of Finance presents a net debt[46] for the establishment of the Stability Program, as:

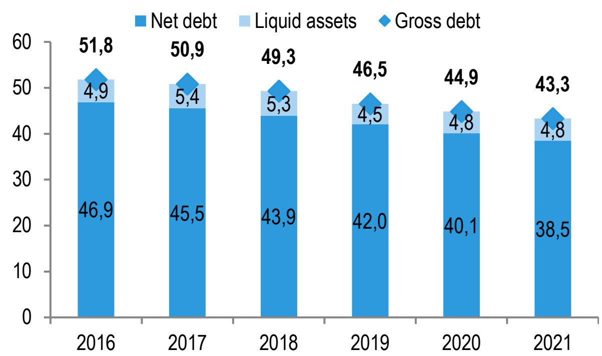
[46] At present, there is no standardized methodology that would clearly define the quantification of net debt. Under the Stability Program, the concept of gross debt settlement for liquid financial assets (LFAs) is used, especially for deposits on the accounts of individual GG entities.

Net financial debt = Maastricht (gross) debt – Liquid Financial Assets (LFA)[47]

In this way, the calculated net financial debt takes into account the cash on the accounts of all the general government entities. At present, the general government does not have any quoted shares in the accounts, neither gold nor SDR.

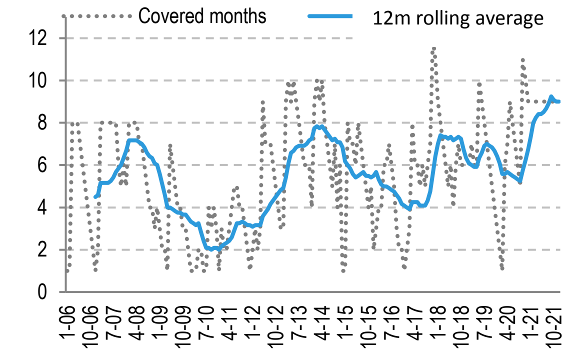
On the horizon of 2019 to 2021, the average LFA level is projected to be 4.7% of GDP. LFA decrease of 0.8 p.p. in 2019 results from the higher use of the accumulated funds to cover the State's expenditure. The difference between gross and net debt at the end of the forecast in 2021 is estimated at around 4.8 p.p..

FIGURE 35 - Net debt (% GDP)



Source: MoF SR

FIGURE 36 - Cash reserve (number of months of state expenditures covered by the reserve)



Source: MoF SR

Cash reserve

Cash reserve[48] is determined for liquid coverage of States´ liabilities. The volatile course of the reserve is explained by the character of application of the reserve. In relative terms, the reserve shows the number of months during which all government expenditures would be covered. The relative increase in the cash reserve between 2018 and 2021 reflects the assumption of a lower need to fund the cash deficit in the coming years.

[47] Under liquid financial assets in this case, we mean gold, SDR, cash (F.2), securities and quoted shares.

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

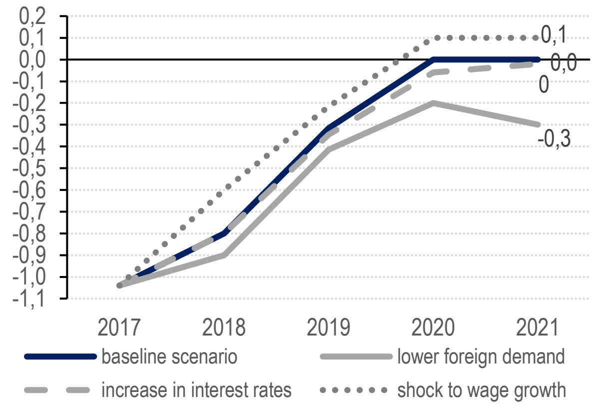
3 SENSITIVITY ANALYSES AND COMPARISON WITH THE PREVIOUS UPDATE

The stability program of the Slovak Republic is based on the basic scenario of economic development with exogenous assumptions about the development of the external environment as described in Chapter 1. This section presents selected risk scenarios based on model simulations anticipating a slower growth in foreign demand and a sharp increase in short- long-term interest rates and a one-off shock to wage dynamics. The biggest risk comes from the scenario of slowing foreign demand, which would hit the economy and public debt more significantly. Growth in interest rates has little negative impact on general government deficit and debt. Higher wage growth in the private sector, on the other hand, has a slightly positive effect on public finances.

3.1 Risk scenarios of development

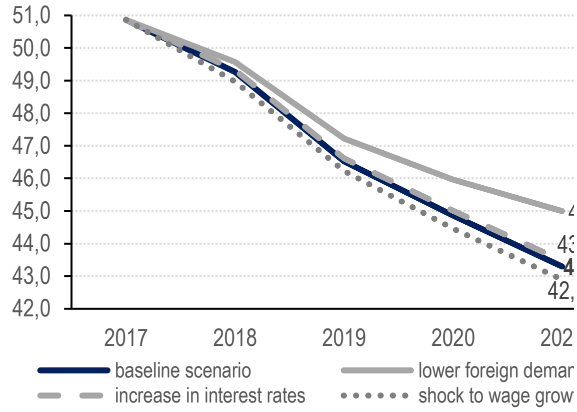
The simulation of selected risk scenarios does not indicate a more significant deviation of the gross debt forecast and GG deficit from its baseline scenario. The baseline scenario is based on both fiscal indicators from the current MoF SR forecast and the Government's current budgetary targets for the years 2019-2021. In the baseline scenario, the Ministry of Finance anticipates the achievement of a balanced budget by 2020 and the fall in the gross debt of the GG under the sanctioning band of the constitutional Fiscal Responsibility Act since 2019. Similar developments can be expected in the context of the risk scenarios tested. The scenario of a slowdown in foreign demand (in more detail below) could appear to be slightly negative, with a GG gross debt at 45% of GDP at the end of the horizon, and to achieve a balanced budget, 0.3p.p. would lack.

FIGURE 37 - Headline balance, baseline and risk scenarios



Source: MoF SR

FIGURE 38 - Gross debt, baseline and risk scenarios



Source: MoF SR

Scenario 1: Lower foreign demand

The first scenario simulates the impact of an annual decrease in the growth of real weighted foreign demand of Slovakia by 1 p.p. over the horizon 2018 to 2021. The latest forecast of the Ministry of Finance anticipates a gradual slowdown in the economic growth rate of the main export partners in the short and medium term. However, it also identifies the potential risk of the emergence of protectionism in world trade, which could lead to a faster deceleration of imports from our key trading partners. Slovakia, as a small open export-oriented economy, will feel a significant slowdown in world trade.

A drop in foreign demand would cause a cumulative fall in real GDP in Slovakia by 1.3 p.p. by 2021. The simulated shock will be reflected in the decrease in the output of export-oriented enterprises and an immediate slowdown in the growth of SR exports. As a result of lower profitability, companies will dampen investment activity over the baseline scenario. Lower utilization of the production capacities of enterprises also results in the redundancies of employees, which will negatively affect the unemployment rate and the consumption of households. The slowdown of aggregate domestic demand will reduce inflationary pressures in the economy. The impact on external imbalances is relatively low, as the slowdown in export growth is partly offset by a drop in imports from lower household consumption and imported investments. Decreasing economic activity, a slower rise in prices and wages as well as a higher rate of unemployment would lead to a deepening of the general government balance. **A significant fall in nominal GDP growth would lead to a deepening of the deficit in each year of the monitored horizon, in the range of 0.1 to 0.3% of GDP, due to lower tax revenues. This effect would also be reflected in the development of gross debt, which would increase by a cumulative 1.7% of GDP compared to the base forecast.**

TABLE 21 - Scenario 1: Slowdown of foreign demand growth by 1 p.p. in years 2018-2021

Cumulative change of variables compared to the baseline scenario in p.p

	Household consumption	Gross fixed investment	GDP	Unemployment rate	CPI	Current account balance (% GDP)	Headline balance (% GDP)	Gross debt (% GDP)
2018	-0,1	-0,4	-0,4	0,0	0,0	-0,2	-0,1	0,3
2019	-0,1	-0,8	-0,8	0,1	-0,2	-0,5	-0,1	0,7
2020	-0,1	-1,1	-1,1	0,2	-0,6	-0,8	-0,2	1,1
2021	0,0	-1,3	-1,3	0,3	-1,1	-1,1	-0,3	1,7

Source: MoF SR

Scenario 2: The increase in interest rates in the context of higher household debt

In the second scenario, we examine the impact of the growth of the short- and long-term interest rates by an additional 1 p.p. from 2018 onwards throughout the projected horizon. We also increase elasticity in household consumption to change interest rates by 50% (from 0.10 to 0.15). The current year is expected to end the ECB's quantitative easing program and normalize its monetary policy. Nevertheless, only a gradual increase in interest rates is expected. The impact of a possible sharp increase in interest rates may be stronger in countries that investors do not have to consider as the core of the eurozone. Slovakia, on the basis of the current financing of public debt and other economic fundamentals, can be considered as the semi-core country of the eurozone. Higher interest rates could be more pronounced in the elasticity of household consumption compared to the past. The share of household debt has almost doubled in the last 10 years and Slovakia has changed from the country with the lowest debt burden to households in the V4 region to the country with the highest debt burden in the region.

Increasing interest rates and elasticity would only result in a limited decline in household consumption and GDP. Rising rates will harden the access to loans for businesses and households, thus reducing household consumption as well as investment. The result will be a moderate slowdown in economic growth, which will only be reflected in a very slight decline in employment and real wages. The nominal quantities react stronger and with delays. The deceleration in inflation over the mid-term horison partially offsets the initial decline in real household consumption. Lower consumption and investments will also slow import growth, resulting in a slight improvement in the current account balance. Gross **general government debt would be cumulatively higher by 0.2% of GDP at the end of the period. The overall impact on the general government balance after calculating the interest payments of general government debt would be negligible throughout the horizon.** The negative impact of weaker macroeconomic developments and higher debt refinancing costs is partly offset by a higher rate of withholding tax, which is payable on interest from deposits.

TABLE 22 - Scenario 2: Increase in short-term and long-term interest rates by 1 p.p. in the entire forecast

Cumulative change of variables compared to the baseline scenario in p.p

	Household consumption	Gross fixed investment	GDP	Unemployment rate	CPI	Current account balance (% GDP)	Headline balance (% GDP)	Gross debt (% GDP)
2018	-0,2	-0,3	-0,1	0,0	0,1	0,00	0,00	0,06
2019	-0,1	-0,4	-0,1	-0,1	0,1	0,04	-0,03	0,09
2020	-0,1	-0,6	-0,1	-0,1	0,1	0,06	-0,06	0,15
2021	-0,1	-0,8	-0,1	-0,1	0,1	0,09	-0,02	0,18

Source: MoF SR

Scenario 3: Shock to wage growth

The third scenario assumes a one-off increase in wage dynamics by 1 p.p. regardless of the development of labor productivity. In the recent period, we have seen a sharp rise in wages linked not only to the overheating of the economy but also to government measures in the Central and Eastern European countries. Also in Slovakia, the minimum wage, statutory overtime allowances at night and at holidays are dynamically increasing, and the weekend surcharge is also introduced. The MoF SR forecast only calculates the slight impact of increased surcharges on average wages. However, in the context of a significant overheating of the labor market, employers may not have enough space to optimize, and they may be able to shift the administrative surcharge increase in the full extent to wages.

Simulated faster wage growth would bring mixed results for the economy. Higher wage growth will rapidly increase domestic consumption immediately, which will be reflected in higher investments. Despite a slight decrease in employment, this shock will shortly increase overall GDP growth. As a result of the economy's overheating, inflation will accelerate, which will erase the original GDP growth over the medium term. Although in nominal terms the economy will benefit, in real terms the economy will even decrease slightly. The impact on the current balance of payments account remains negligible. **The increase in the wage base, nominal consumption and nominal GDP growth would lead to an annual reduction of the GG deficit by approximately 0.1 to 0.2% of GDP by 2021 due to higher tax revenues. The positive effect would also be a reduction in the gross debt by 0.4 % of GDP over the baseline gross debt forecast by 2021.**

TABLE 23 - Scenario 3: Faster growth of wages by 1 p.p. in 2018

Cumulative change of variables compared to the baseline scenario in p.p

	Household consumption	Gross fixed investment	GDP	Unemployment rate	CPI	Current account balance (% GDP)	Headline balance (% GDP)	Gross debt (% GDP)
2018	0,5	0,2	0,2	0,1	0,0	-0,1	0,2	-0,3
2019	0,2	0,1	0,1	0,0	0,1	-0,1	0,1	-0,3
2020	0,0	-0,1	-0,1	0,0	0,2	0,0	0,1	-0,4
2021	0,0	-0,1	-0,1	0,0	0,2	0,0	0,1	-0,4

Source: MoF SR

3.2 Comparison with previous update

The Stability Program of the SR for the years 2017-2021 includes updated macroeconomic estimates and budgetary targets. **The goal of a balanced general government budget by 2020 remains unchanged.** The balance between revenue and expenditure of the GG is also planned for 2021.

Compared with the previous Stability Program in 2017, there is a slight deterioration for 2019 in the general government budgetary target by 0.32% of GDP. **The GG debt should decline faster compared to last year's assumption.** At the horizon of the entire forecast, the debt is lower by about 1 p.p., which stems mainly from the estimation of the faster growth of the economy.

TABLE 24 - Comparison of the previous and updated forecasts

	ESA code	2017	2018	2019	2020	2021
Real GDP growth (%)						
Previous update*		3,3	4,0	4,4	3,8	-
Outcome and current update		3,4	4,2	4,5	3,9	3,4
Difference		0,1	0,2	0,1	0,1	-
General government balance (% of GDP)	EDP B.9					
Previous update*		-1,24	-0,50	0,00	0,00	-
Outcome and current update		-1,04	-0,80	-0,32	0,00	0,00
Difference		0,20	-0,30	-0,32	0,00	-
General government gross debt (% of GDP)						
Previous update*		51,8	49,9	48,0	46,0	-
Outcome and current update		50,9	49,2	46,5	44,8	43,3
Difference		-0,9	-0,7	-1,5	-1,2	-

*Note: * Stability Programme of SR for 2017 - 2020* *Source: MoF SR*

4 PUBLIC FINANCE SUSTAINABILITY

The current assessment of the sustainability of public finances confirms the low risk in the medium term horizon. In the long run, Slovakia is rated at medium risk, and after meeting the objectives of the Stability Program, will be only 0.3% of GDP away from the low risk. The resolute reduction of the structural deficit of the GG in recent years together with the extensive reform of the pension system in 2012 significantly improved the sustainability of the Slovak public finances. The overall sustainability of the Slovak public finances has been improving continuously since the evaluation for 2009.

4.1 Assessment of the overall sustainability of public finance according to EC methodology

The sustainability of public finances assesses the expected impact of aging in the context of the current fiscal position. The current policy setting (fiscal position, pension and health system) should ensure long-term sustainability with the current level of debt and the general government balance so that the debt does not increase unchecked (also in view of potential macroeconomic shocks). In order to assess long-term sustainability, the European Commission (EC) uses S1 and S2 Sustainability Main Indicators.

- **Indicator S1**[49] (medium-term horizon) - presents the value by which the current primary structural balance needs to change to ensure that the general government debt **by 2032** (t_0+15) **does not exceed 60% of GDP** (after taking into account expected future expenditure on aging). The MoF SR is also pursuing a **stricter national scenario** which, in the long run, consideres the **debt limit to be at the level of 40% of GDP**, which will be the lowest sanctioning area after the transitional period under the constitutional Fiscal Responsibility Act. The assessment of the Ministry of Finance also reflects the impact of the second pillar on the revenue and expenditure side.[50]

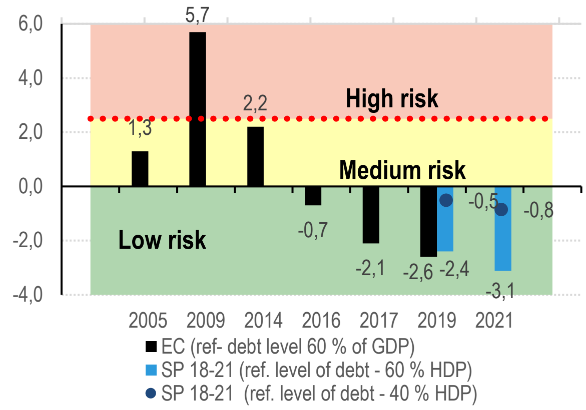
- **Indicator S2**[51] (long-term horizon) - presents the value by which the primary structural balance has to be permanently changed so that the present value of future primary deposits (after taking into account the expected future expenditure related to population aging) equals the current level of gross debt. Unlike S1, S2 indicator takes into account projections related to population aging **in the infinite horizon**, with the required balance change to ensure the **stabilization of the current debt level**.

The current assessment of the sustainability of public finances confirms the low risk in the medium term horizon and the medium-term risk in the long-term horizon. S1 is negative (-2.6% of GDP), indicating a fiscal margin while maintaining gross debt below 60% of GDP. The S2 long-term sustainability indicator is already more markedly affected by the growth of expenditure sensitive to population aging, reaching a value of 2.3% of GDP linked to a medium sustainability risk.

Compared to the EC assessment last year[52], there is a further improvement for the year 2019 over the medium term horizon and for maintaining the medium risk position over the long term. In the medium term (until 2032), the update of the projection will only minimize expenditure on aging. The strengthening of the low sustainability risk position (improvement of the S1 indicator by 0.5 p.p.) is mainly driven by the improvement in the initial fiscal position (the year-on-year decline in GG debt below the 60% of GDP reference level). An update of the cost of aging has an approximately neutral impact on the long-term sustainability assessment. A positive review of the rise in pension expenditure is offset in the long run by the increase in education expenditure (instead of the previously projected decline). Overall, the resulting S2 indicator and the medium risk assessment do not change.

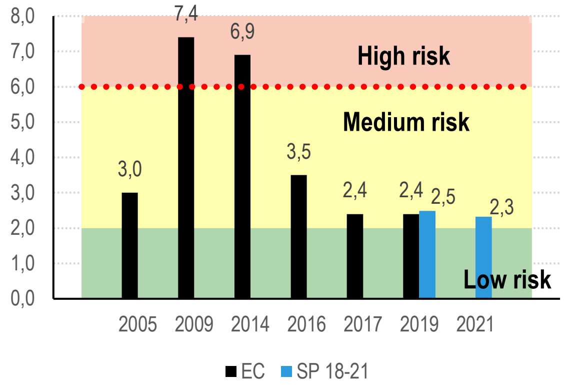
[49] Risk ranges for S1: low risk (<0), medium risk (0 to 2.5) and high risk (> 2.5). The negative value of the indicator shows that, while maintaining current policies, the 60% of GDP debt will not exceed the debt horizon by the target year.
[50] Total impact of revenues to the II. pillar for the sustainability rating is slightly negative by 2032, with a moderate positive trend over the long term. The Ministry of Finance considers this approach to be more economically correct, since in the case of capitalization systems its changes have an impact not only on the expenditure but also on the revenue of the pension system.
[51] Risk ranges for S2: low risk (<2), medium risk (2 to 6) and high risk (> 6).
[52] In January 2017, the EC published the Sustainability Report (with the baseline year of 2018 for debt and GG deficit).

FIGURE 39 - Medium-term sustainability S1 (EC, % of GDP)*



Source: EC, MoF SR

FIGURE 40 - Long-term sustainability S2 (EC, % of GDP)*



Source: EC, MoF SR

** Presented figures represent base year for sustainability assessment in the EC sustainability reports. The methodology and background data for assembling the development of S1 and S2 indicators are presented in Annex 6.*

The overall sustainability of the Slovak public finances has been improving continuously since the 2009 evaluation. In the medium to long term, the improvement of medium- and long-term sustainability is 8.3 p.p. or 5.2 p.p. between 2009 and 2019[53]. The main factors were the reduction of the primary structural balance (as reflected in the declining debt trajectory since 2014) as well as the 2012 pension reform, which reduced the growth rate of future pension expenditure by 2060 by 4 p.p..

Fulfillment of the current budgetary targets in 2021 will have a positive impact on the sustainability assessment. In terms of the medium-term horizon (S1), the fiscal area will increase to 3.1% of GDP, due to an additional drop in the GG debt (against a benchmark of 60% of GDP). A more rigorous national debt-brake scenario (40% of GDP)[54] corresponds to a lower fiscal space, at 0.8% of GDP. Sustainable long-term sustainability (S2) will also improve moderately, although a low level of risk (S2) will require surplus of GG management, at around 0.3% of GDP (instead of the planned balanced budget).

4.2 Update of the projection of expenditure sensitive to aging and impact on long-term sustainability

According to the most recent EC forecast[55] prepared in co-operation with the Ministry of Finance SR, expenditure on population aging between 2016 and 2060 will rise by 3.3% of GDP. In particular, pension costs (1.3% of GDP - in more detail BOX 9) and health care (1.4% of GDP) will be included. Compared to the previous round of projections three years ago, expenditure growth is revised downwards by 0.5% of GDP, thanks to a slower rise in pension and healthcare expenditure. On the contrary, expenditure on long-term care will grow faster and expenditure on education will grow slightly rather than a slight decline[56] (see Figure 41 and 42).

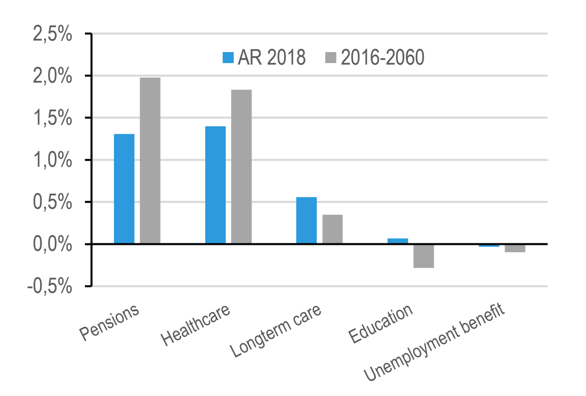
Projections were most affected by more favorable demographics and the labor market. Higher expected birth rate will increase the job offer in the future. Increasing the expected participation together with faster convergence in total factor productivity will cause us to grow by 0.5 - 1 p.p. faster than was predicted by the 2015 report.

The most recent EC projection also included measures adopted in 2017 with an impact on the long-term sustainability of the pension system. **For the years 2018 to 2021, a minimum valorisation hybrid rate of pension contribution was introduced[57].** Pensioners will be increased their pension entitlements by a percentage of year-

[53] Based on the EC's autumn forecast from 2017 for 2019.
[54] In contrast to the previous Stability Program, the Ministry of Finance has approached methodological changes. In the past, the debt threshold was observed at 47% of GDP (the second highest sanction band).
[55] The new projection was approved by the Economic Policy Committee (EPC) at the end of January 2018. Data from the new forecast was first used in the Country Reports released by the EC in March 2018.
[56] While in the last round, we expected a decrease in education expenditure between 2016 and 2060 by 0.3% of GDP, in the new round we expect an increase of almost 0.1% of GDP in this period (Figure 42).
[57] It also applies to accident rent.

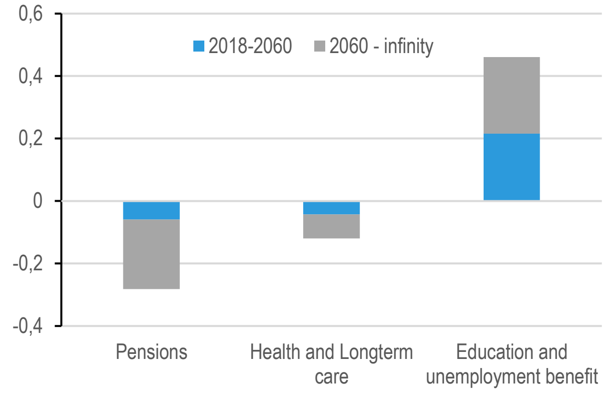
on-year growth in consumer prices for retirement households, by but at least a fixed amount of 2% of the average of the type of pension concerned. Thanks to this measure, under-average pensions will grow faster. Expenditure on this measure is estimated at over 80 million euros in 2018.

FIGURE 41 - Growth of the ageing related expenditure in 2016 - 2060, % of GDP



Source: EC, Ageing report 2015 and 2018

FIGURE 42 - Update of ageing projections and impact on longterm sustainability (S2), (% of GDP)



Note: (+) positive impact; (-) negative impact
Source: EC, Ageing report 2015 and 2018

In 2017, **an amendment to the Social Services Act** was adopted, which will increase long-term care expenditure in the long-term horizon. In particular, the method of determining the amount of the financial contribution for social service providers in care-dependent facilities is being changed[58]. There will also be an extension of entities eligible for a financial contribution to the provision of social services (except for municipalities and non-public providers as well as non-public providers within the scope of the selg-governing regions). The reform will increase expenditure in 2018 by 44.7 million euros.

BOX 9 - Updating the projection of pension expenditure by 2070

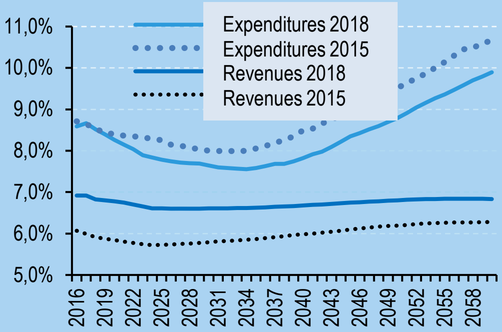
The updated projection predicts a 1.2% of GDP growth in pensions by 2070. By the next decade (by 2030), expenditure will decrease slightly compared to GDP, mainly due to the 2012 pension reform, robust GDP growth and demographic structure. Subsequent retirement of strong years, along with slower GDP growth and a higher average pension insurance, will result in a significant increase in pension expenditure. The deficit of the pension system should culminate above 3% of GDP just after 2060 (in 2016, the pension system deficit was 1.7% of GDP).

Compared to the previous Population Aging Report 2015, the projection of expenditure and revenue is improving. Compared to the previous projection, pension retirement expenditure should be lower by 0.8% of GDP in 2060. The improvement is mainly due to a more favorable Eurostat demographic forecast and a higher expected labor market participation rate that increases long-term real GDP growth. Expenditure is also significantly influenced by the updating of inputs to the model (especially the higher share of second-pillar savers[59] and lower retirement inflation[60]). Revenues are also due to legislative changes in levies higher already in 2016, by 0.8% of GDP. By 2070, revenue is mainly influenced by the II. pillar, in which based on IFP analysis we newly assume relatively more entrants (31% of the young population vs. 10% in the previous projection).

The retirement age will grow more slowly in the future. According to Eurostat's most recent demographic forecasts, retirement age over 65 will not be for around next 20 years. On average, it will increase annually by 52 days, i.e. significantly slower than 76 days in 2017. The Slovak retirement age is among the lowest in the EU.

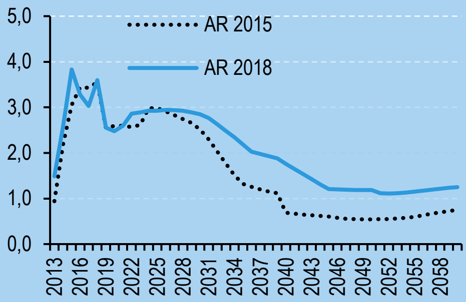
[58] The amount of the financial contribution is newly based on the structure of the social service recipients, depending on the degree of their dependence on the assistance of another person in the self-service and the form of the social service that determine the cost of the social service provided.
[59] Updated based on IFP commentary.
[60] Updated by taking into account historical data.

FIGURE 43 - Revenues and expenditures of pension system (% of GDP) as in Ageing report from 2015 and 2018



Source: MoF SR

FIGURE 44 - Real growth of GDP as in Ageing report from 2015 and 2018



Source: EC

The current projection by 2070 is already considering a number of pension measures taken since 2012. Among the most significant measures is the one-off increase in pension indexation to 2% in 2017, which increased expenditure by 113.6 million euros 20 per year and the introduction of minimum hybrid valorisation for the years 2018 to 2021. The additional measures together increase the pension expenditure by EUR 228 million in 2018 compared to the valid legislation in 2012. At the same time, the maximum benchmark for social contributions has been increased to 7 times of the average wage from 2017. In the medium term, the positive impact of the reform on long-term sustainability should be outweighed. By 2030, reforms of 12.3% of GDP will result in lower pension system expenditure and revenue measures bringing together 4.8% of GDP more. However, the measures adopted after the reform increase the expenditure, together by 4.1% of GDP by 2030, thus reducing the pension reform effect on the expenditure side by one third.

TABLE 25 - Pension related measures taken after the 2012 reform and impact on the GG (million euro)

	2013	2014	2015	2016	2017	2018
Measures to reduce expenditure growth						
Pension indexation by pension inflation	-	5,9	60,1	104,5	183,6	268,7
Linking retirement age to life expectancy	-	-	-	-	29,3	58,6
Total	-	5,9	60,1	104,5	212,9	327,3
Measures increasing the cost of pensions						
Christmas benefits	-	-9,2	-9,3	-9,5	-9,6	-9,7
Minimum pensions	-	-	-9,1	-22,4	-22,8	-23,3
Settlement of widows' pensions	-	-	-	-7,9	-8,7	-9,6
Settlement of widowers' pensions	-	-	-	-2,9	-3,2	-3,5
Higher valorisation in 2017	-	-	-	-	-113,6	-116,0
Min. valorisation for the years 2018-2021	-	-	-	-	-	-81,5
Recalculation of old - age pensions awarded prior to 2004	-	-	-	-	-	-50,2
Total	-	-9,2	-18,4	-42,7	-157,9	-293,8
Measures on the revenue side						
Increase of the maximum assessment base to 5 times the average wage	103,6	110,8	119,8	128,8	138,5	149,0
Increase the maximum cost basis to 7 times the average wage	-	-	-	-	67,2	70,5
Total	103,6	110,8	119,8	128,8	205,7	219,5
Overall balance of measures						
Total	103,6	107,5	161,5	190,6	260,7	253,0
Cumulative	103,6	211,1	372,6	563,2	824,0	1076,9

Source: MoF SR using MPSVaR data

Possible implementation of the retirement age ceiling would affect the long-term sustainability of the pension system. At the current regulation of the retirement age the 64 or 65 limit is expected to be reached in after 2030 or 2037.The fixing of the ceiling of the retirement age at these levels would therefore first be affected only by today's 40s. Determination of the ceiling at the level 64 or 65 years would increase expenditure in 2060 by 1.5%, event. 1% of GDP.

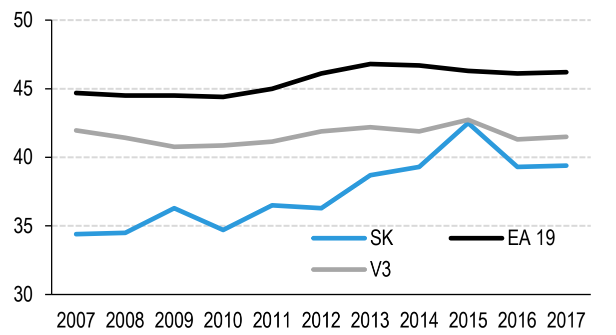
5 PUBLIC FINANCE QUALITY

Since 2012, the VAT collection gap has been reduced from 41% of the potential tax collection to 26.3% in 2017. The positive trend is also reflected in the development of the effective corporate tax rate. The continuing action plan to combat tax evasion and measures to strengthen voluntary tax compliance are a strategic prerequisite for ongoing positive developments in the success of tax collection. The ratio of total general government expenditure to GDP in the Slovak Republic is below the average of the eurozone and other V4 countries over the long term. The medium-term budgetary framework foresees a further decrease below 40% of GDP. The share of expenditure on GDP in education is increasing because of their prioritization by the government and the implementation of international commitments in the area of defense is being implmented. An assessment of the effectiveness of public expenditure continues. After two years, the revisions have assessed public expenditure of approximately 15% of GDP and identified measures for almost 700 million euros (0.77% of GDP). In the third round, the review will examine the expenditure on agriculture, the inclusion of groups at risk of poverty and social exclusion, and employment and remuneration in general government.

5.1 Revenue objectives of the general government budget

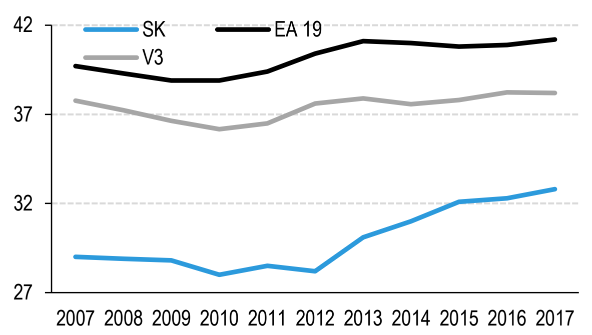
In spite of income growth, Slovakia continues to have the lowest ratio of tax and levy revenue (taxable)[61] **to GDP compared to the Eurozone average and the remaining V4 countries.** Thanks to the successful fight against tax evasion, a more efficient labor market and the adoption of measures, general government revenue has grown over the last few years. The ratio of total general government revenue to GDP in Slovakia was close to that of the Eurozone and the V3. 2015 is a specific exception, with a more pronounced revenue growth due to culmination of EU fund drawing in the end of the second programming period.

FIGURE 45 - Revenues of general government (% of GDP)



Source: Eurostat

FIGURE 46 - Total tax revenues of general government (% of GDP)



Source: Eurostat

The current fiscal forecast, on which the fiscal framework is based, predicts a slower increase in general government tax revenues than GDP. In 2018, the share of GG tax-levy revenue on GDP should reach 32.5% and further decrease to 31.1% of GDP within the fiscal framework of 2019-2021. The main explanatory factors for the development between 2018 and 2021 represent:

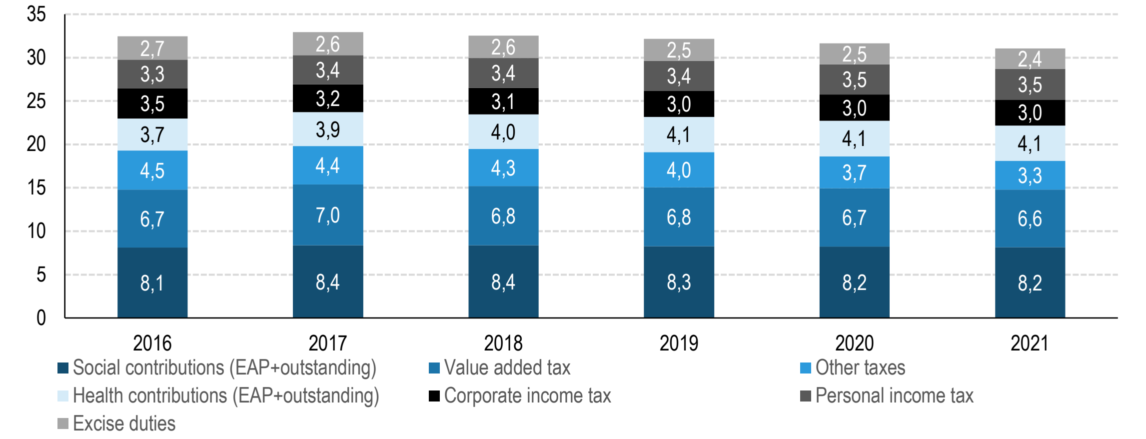
- the decrease of the share of value added tax on GDP (-0.2 p.p.) causes a slower growth of household consumption compared to the overall growth of the economy.
- the absence of automatic indexation of part of tax revenues (real estate taxes, excise duties, administrative fees and other income[62]) causes their erosion yield on GDP (-0.3 p.p.).
- the development of social contributions compared to the performance of the economy (-0.2 p.p.) affects the gradual increase of the rate of deduction to the 2 nd pension pillar from 2017[63], the existence of

[61] Furthermore in the text only tax revenue, corresponds to the sum of the ESA items (D.2REC + D.5REC + D61.REC).
[62] The current legislation foresees the termination of a special levy on fin. institutions in 2021
[63] It is not a tax revenue of the GG.

maximum ceilings and minimum contributions that do not allow for a full transformation of wage base growth into the levy yield.

- The stable share on GDP keep the Personal income tax despite fiscal drag[64] and corporate tax effects (including a special levy from regulated sectors where the rate is decreasing).

FIGURE 47 - Tax to GDP ratio (% of GDP)

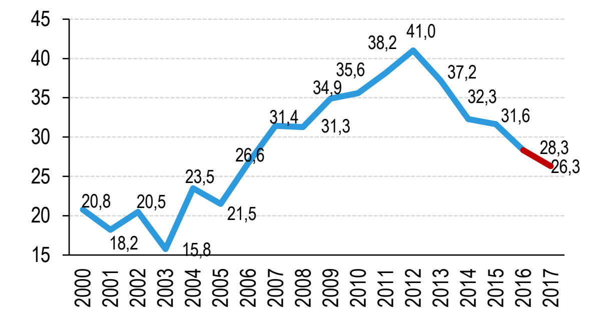


Source: MoF SR

5.1.1 Combating tax evasion

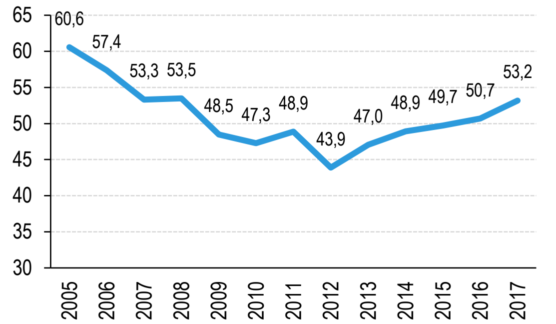
The combat against tax evasion remains a key priority of the Slovak government. Significant progress has been made in combating VAT evasion. The added benefit of improved VAT collection was 1.35% of GDP in 2017 compared to 2012. Cumulatively represent additional revenues 3.7 billion EUR (4.3% of GDP). The measures of the three-phase action plan adopted during 2012 to 2017 helped to reverse the long-term unfavorable development of the success of this tax collection (more specifically in Box 16 of the Stability Program 2017-2020). In the next period, further measures are planned to improve VAT collection.

FIGURE 48 - VAT GAP (% of theoretical liability)



Source: MoF SR

FIGURE 49 - Indicator of VAT collection efficiency (%)



Source: MoF SR / Eurostat

In line with the success of VAT collection, the improved tax collection (ETR) has grown in recent years. The preliminary results of the corporation tax gap estimate confirm the original assumption of the Ministry of Finance that measures aimed at combating VAT evasion have also been reflected in the development of ETR corporate tax[65]. Historically high ETR values, in addition to the procyclicality of this tax[66], can also be attributed to VAT measures, which are also positively reflected in the CIT[67] performance. The stabilization of ETR in 2016 is the result

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[64] The positive impact on the development of PIT has a faster wage growth compared to non-taxable parts of the tax. This effect is called the fiscal drag in the technical literature. Its level is estimated at about 70 mill. euros in 2017 (35% year-on-year growth).

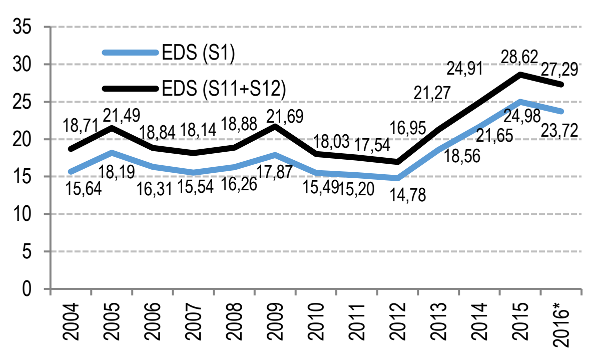
[65] Figure 53 in the Stability Program of Slovakia for the years 2017-2020.

[66] The development of CIT elasticity towards the macro base is pro-cyclical; in the period after the financial crisis, the tax collection rate also declined due to past losses.

[67] Measures aimed at reducing fraudulently applied VAT on entry in the form of duplicate or counterfeit invoices and eliminating unrecorded supplies to the customer will not only result in higher VAT tax but also in higher profitability and hence higher CIT tax liability. Conversely, measures aimed at fraud with excessive deductions are unlikely to affect CIT revenue, as taxpayers generally do not declare or pay taxes.

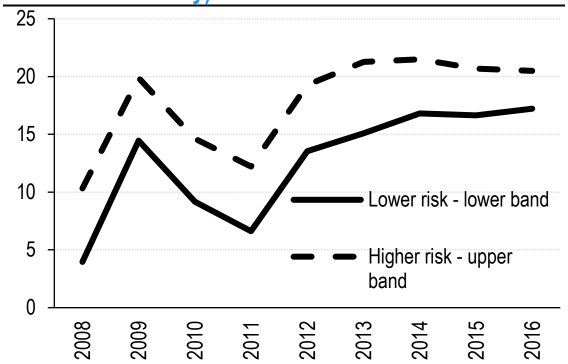
of a year-on-year increase in the volume of tax losses and the associated decline in profitability in the corporate sector.

FIGURE 50 - CIT effective tax rate (tax revenues divided by net operating surplus)



S1: the whole economy; S11 and S12: non-financial and financial corporations. The net operating surplus of the year 2016 may be subject to revisions.
** The net operating surplus data for 2016 may be subject to revisions.*
Source: MoF SR

FIGURE 51 - Excise duty on mineral oil gap (% of theoretical liability)



Source: MoF SR

The effort of the Financial Administration of the Slovak Republic (FS SR) is also focused on excise duties, which is **evidenced by the stabilization of the tax gap for mineral oil tax after the previous multiannual decline**. However, the gap is largely influenced by cross-border purchases of fuels, which has a significant impact on the exchange rate with neighboring countries[68].

BOX 10 - Methodology for calculation of tax gaps on VAT and CIT

The VAT tax gap is defined as the difference between the potential VAT that would be collected if all economic subjects behave in accordance with the law and its interpretation in the form in which it was adopted and the tax actually collected.

The tax gap in the context of VAT can be divided into **unidentified VAT and tax collection gap**. Unidentified VAT is part of the gap that taxpayers deliberately or unintentionally did not recognize and at the same time was not identified by the relevant tax administrator. Simply put, this is the difference between the potential and the prescribed tax. Prescribed tax includes voluntary VAT with VAT paid in tax returns and additional tax assessed in the context of the controlling activity of the Slovak Financial Administration (FS SR)[69]. The tax collection gap is the difference between the prescribed tax and the tax actually collected. Estimates of the tax gap include:

- Estimate of the theoretical VAT base based on the nominal GDP settlement method
- Estimate of theoretical VAT
- Quantification of accrual tax revenue
- The calculation of the tax gap

The CIT tax gap is defined as the difference between the potential CIT that would be collected if all economic subjects behaved in accordance with the law and its interpretation in the form in which it was adopted and the tax actually collected.

The tax gap in the CIT context can be divided into an **unidentified CIT, a legislative gap and a tax collection gap**. An unidentified CIT is part of the gap that taxpayers deliberately or unintentionally did not recognize and at the same time was not identified by the relevant tax administrator. Simply put, this is the difference between the potential and the prescribed tax. The legislative gap is part of the gap between the potential tax based on the current legislation compared to the normative legislation. The source of the legislative gap is all tax exemptions and tax expense. The prescribed tax includes the voluntary tax in the tax returns and the additional tax assessed in the control activity of the FS SR[70]. The tax collection gap is the difference between the prescribed tax and the tax actually collected.

Estimates of the tax gap include :

- Estimate of the theoretical CIT based on the gross operating surplus defined in the national accounts, which consists of :

[68] More on the methodology of calculation of the tax gap in the manual.
[69] Subtotal tax is understood as the self-imposed tax liability, but also the reduced value of the over-deduction applied
[70] Under the additionally imposed tax we understand additionaly imposed CIT

  - Adjustment of gross operating surplus to the result of the management according to accounting policies
  - Adjustment of result of management on potential tax base and potential tax
- Comparison of actual and potential tax

New measures to combat tax evasion (scheduled for 2018)

As part of the implementation of the reform plans, the Financial Administration of the Slovak Republic continues in its efforts to implement tax measures from the third **action plan in the combat against tax fraud for the years 2017-2018** (approved by the Government in April 2017).

The proposed measures relating to financial administration include the introduction of an **internal assessment of the reliability of tax subjects (the tax reliability index)**. This will be the assessment of the tax entity on the basis of its obligations to the financial administration and is of motivational as well as preventive character. The primary objective of this measure is to promote voluntary compliance with tax obligations and to increase legal certainty in commercial relations. The secondary effect of this measure should be to help taxpayers who fulfill their obligations to the state budget and the financial administration, improve their position and avoid possible and unintentional involvement in the fraudulent activities of other tax subjects.

In order to limit the immediate tax evasion associated with the sale of goods and the provision of services, the obligation to register revenue through an **electronic cash register** or through a **virtual cash register** with an online link to financial administration will be introduced.

In cooperation with other general government sectors, an **interdepartmental analytical center (JACK) dealing with financial crime and tax evasion** will be set up by the end of 2018. The aim is to improve cooperation between the financial administration and the police, including the collection of all available information. The aim is to eliminate the breach of tax obligations and to prevent further arrears, but also to eliminate duplicate checks by state authorities. At present, an analytical part is being developed for the area of customs fraud in order to automate the identification of individual customs risks. The solution will make it possible to target the control activity more targeted and thereby reduce the burden on economic subjects who properly discharge their customs duties at the time of the customs procedure, or after release of the goods into the proposed customs procedure.

Another intention of financial administration is to continue using the **soft warning** institute in the sense of "easy, gentle alert" of the FS client to fulfill its legal obligations, stating the legal consequences of non-fulfillment of these obligations. The aim of this measure is to achieve the cooperation of clients of FS SR in the fulfillment of their duties, which were not properly and timely fulfilled, thus increasing the voluntary fulfillment of the tax obligations of clients of FS SR by their self-government.

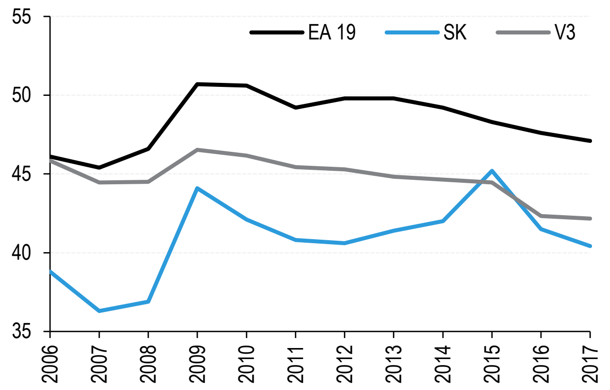
Information systems for the automatic exchange of information on financial accounts are being prepared. Information system modifications are being made, which will give the Financial Directorate information on the revenue of Slovak residents on financial accounts held abroad.

5.2 Expenditure objectives of general government budget

The ratio of GG total expenditure to GDP in Slovakia is in the long-term below the Eurozone average. By 2015, total GG expenditure has been converging to the Eurozone average and V3 (Figure 52). The high increase in 2015 affected the EU's uptake of funds from the second programming period. In 2016, expenditure went back to the 2013 level. The share of expenditure on GDP also declined in 2017 due to strong GDP growth. This trend is assumed throughout the medium-term horizon. Slovakia will continue to be among the Eurozone countries with the lowest (seventh lowest) ratio of general government expenditure to GDP.

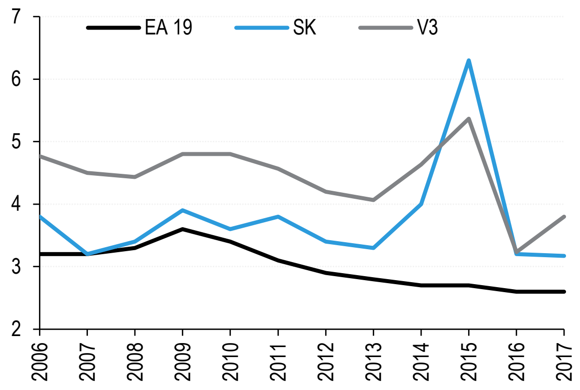
The ratio of capital expenditure to GDP is higher than the Eurozone average, but comparable to other V4 countries. Accelerating of the EU fund drawing in Slovakia as well as in other V4 countries also led to a significant increase in public investment in 2014 and 2015. In the years 2016 and 2017, the ratio of capital expenditures was normalized (Figure 53).

FIGURE 52 - Total expenditures of GG % of GDP)



** EA 19 (average)* *Source: MoF SR, Eurostat*

FIGURE 53 - Capital expenditures of GG (% of GDP)



** EA 19 (average)* *Source: MoF SR, Eurostat*

GG budget expenditure objectives according to its function[71]

An international comparison of the expenditure structure by function[72] compared to other V4 countries shows that Slovakia gives a lower share of expenditure on education, recreation, culture and religion and general public services. The share of expenditure on GDP is higher than in the other V4 countries average in the health sector and in social security. Compared to the Eurozone average, the difference in the share of social security expenditure is even higher. This is due to relatively lower expenditure on long-term care and other social services[73], as well as support and activation in unemployment. On the contrary, compared to the Eurozone average, Slovakia spends a higher share of expenditure on the economy, public order and security.

At the mid-term budget horizon, the share of total expenditure will fall below 40% of GDP. As part of their structure, priority will be given to expenditure rise on education in particular. Education expenditure will reach 4% of GDP but will still not reach the benchmark as the average of Eurozone and other V3 countries. The additional expenditure assumes a fiscal framework, in particular, to modernize the defense resulting from international commitments (increase in expenditures of MoD SR to 1.7% of GDP by 2021). According to COFOG classification defense expenditure exceeds the average level in other V4 countries as well as the Eurozone average. The share of the remaining items will decrease in proportion to GDP, mainly due to strong expected GDP growth.

TABLE 26 - General government expenditure under COFOG

Function	COFOG code	SK (2016)	MTT SK (2021)	V3 (2016)	EA 19 (2016)
		% GDP	% GDP	% GDP	% GDP
1. General public services	1	5,3	4,6	5,6	6,3
2. Defense	2	1,0	1,6	1,0	1,2
3. Public order and safety	3	2,3	1,8	2,1	1,7
4. Economic affairs	4	4,5	3,6	5,7	4,2
5. Environmental protection	5	0,7	0,6	0,5	0,8
6. Housing and community amenities	6	0,5	0,5	0,7	0,6
7. Health	7	7,4	6,7	5,6	7,1
8. Recreation, culture and religion	8	1,0	0,9	1,9	1,1
9. Education	9	3,8	4,0	4,8	4,6
10. Social protection	10	15,1	12,8	14,5	20
Total expenditures	**TE**	**41,5**	**37,1**	**42,4**	**47,6**

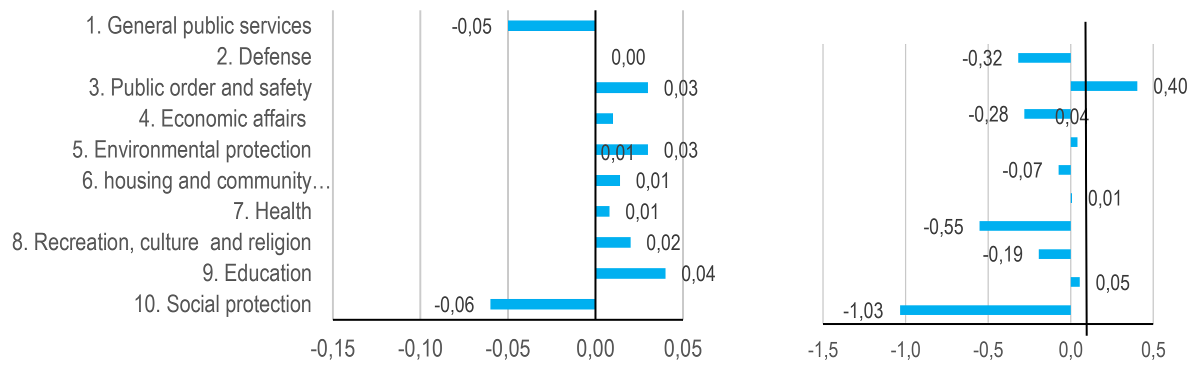
Source: MoF SR, Eurostat

[71] Note: The methodology for recording expenditure by functional classification may differ between countries. This may cause that within the same item data (e.g. taxed and non-taxed pensions) appear differently in different countries. The COFOG classification also does not take into account the expenditures realized through the tax system (e.g. child tax bonuses).
[72] The latest data available for the COFOG classification date back to 2016.
[73] For example, care for children, people in crisis.

According to the current estimate of the development of the GG balance for 2018, public expenditure is approximately at the same level as the approved budget. A slight increase over the budget is recorded in education, environmental protection and public order and security. Slightly lower expenditure for this year is estimated in the social security and general public services.

FIGURE 54 - Total general government expenditure under COFOG (differences in GDP percentage points)

Actual 2018 against budget 2018	SP 2019 against actual 2018



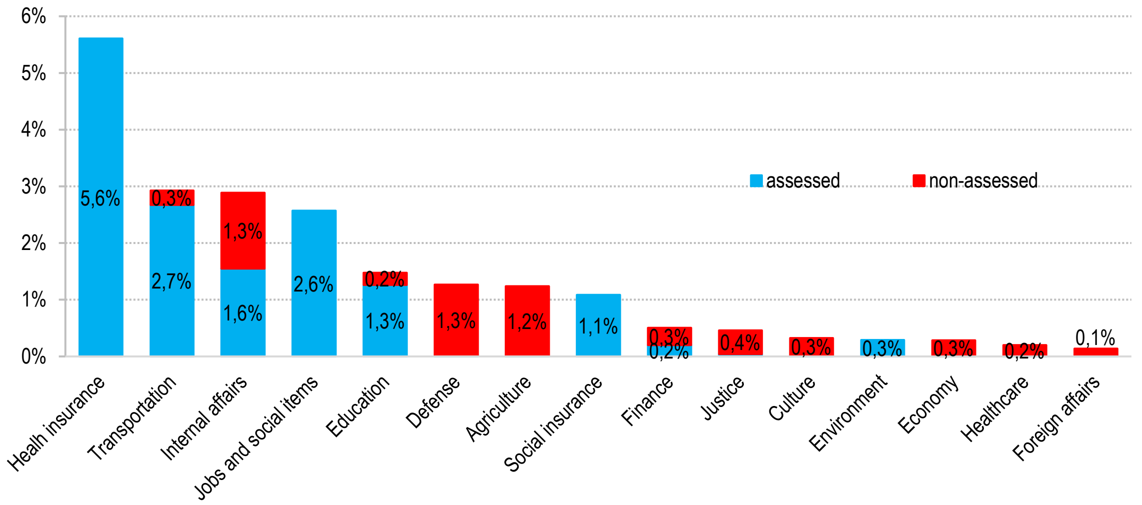
Source: Eurostat, MoF SR

The expenditure share on GDP in 2019 is decreasing compared to the current estimate of public expenditure for 2018. This is due to the faster expected GDP growth compared to the budgeted increase in nominal expenditures. In particular, expenditure on social security and education is growing year on year. Nominal expenditure on education is rising because of wage increases for pedagogical workers.

5.3 Spending review

One of government´s tool to increase the efficiency of public expenditure is the Value for Money project since 2016 onwards. In the years 2016 and 2017, the reviews focused on health, transport, informatisation, the labor market and the social system, education and the environment. The revisions assessed general governemnt expenditure of approximately 15.3% of GDP, thus identifying measures for almost 700 million euros (0.85% of GDP).

FIGURE 55 - Expenditure of central authorities assessed by the revision of expenditure (% of GDP)[74]



Source: MoF SR

[74] Volume of revised expenditure - revision 2016 and revision 2017 actual year, unrevised draft budget 2018.

Spending review results in 2017

The realized savings in 2017 amounted to 83 mill. EUR (0.09% of GDP). *The comprehensive implementation report* summarizing the deduction from the first round of health, transport and IT review measures is published as a separate annex.

The Ministry of Health and Transport, as well as the Deputy Prime Minister for Investments and Informatization of the Slovak Republic, met the measure of the Spending Review on average by 59% in 2017. Of the total of 98 measures[75] implemented, 22% of measures were implemented in 2017, only partial progress was recorded in 37% of the measures. Almost a third of the measures were not implemented and their implementation was shifted to 2018. Financial savings in health and transport reached 83 million euros.

In 2017, the Ministry of Health achieved a fiscal saving of 79.8 million euros which represents 45% of the set target. It implemented 42 measures, which it fulfilled and partially fulfilled 55%. The objective of the spending review on health is to improve the results achieved, strengthen fiscal sustainability and expenditure efficiency. The review identified cost-saving measures to reduce public health expenditure (hereinafter referred to as VZP) as well as hospitals, in 2017 by 174 million euros. The most significant was the saving in overconsumption of medicines (EUR 22.2 million), the reference of special medical supplies (EUR 13.2 million) and the procurement of hospital medical equipment (EUR 15.6 million). **For the year 2018, it is crucial to continue to meet defined fiscal savings, ensure the full functionality of DRG and the functioning of eHealth[76].**

Ministry of Transport SR has made progress in cooperation with the Ministry of Finance SR in evaluating investment projects and publishing data to the public. The aim of the review of transport expenditures is to prepare measures to streamline the current investment envelope and operating costs in the chapter of the Ministry of Transport and Construction (MDV SR). **MDV SR should implement 32 measures, fulfilled or partly fulfilled at 69%.** Financial savings of 3.2 mill. euros was achieved by a better purchase of electricity for the Slovak Railways. In the year 2017, several public procurements were announced without prior evaluation of investment projects[77], especially in rail transport. **In the near future, it is important to prepare and publish an analytically based investment plan of the MDV SR with the prioritization of individual sections.**

The review of IT spending aims to implement potential savings of between 5% and 7% of IT expenditures for 2017 and bring higher value to the upcoming investments. In the international comparison, the results of Slovak informatization showed slight improvement, but still lag behind the EU average. The most significant shift has been achieved in digital public services. **In the year 2017, the Office of the Deputy Prime Minister of the Slovak Republic for investment and informatization implemented 24 measures, fulfilled or partially implemented them at 54%.**

The budget assumed a large spending on IT in 2017, amounting to 393 million euros and the reality was by 9% higher. The benefits of informatization can be seen in postage-service expenditure, general government expenditure on postal services between 2016 and 2017 has fallen by more than 18 million EUR, thanks to the electronic communication of citizens with the public administration, expenditure decreased by 5 mill. euros. Citizens and businesses saved about 2.5 million euros. Only 38% of citizens with an electronic ID card have the security code needed to communicate electronically with the public administration.

According to the Implementation Unit, it is necessary for the strategic selection of new IT projects to unify the rules for the assessment of investment projects irrespective of the source of financing. **In 2018, it is crucial for the return on investment to increase the use of electronic services by citizens and to ensure optimization of the work of public servants by streamlining the work of the authorities through IT projects as well.**

Spending review in 2018

The third round of spending review focuses on agriculture, the inclusion of groups at risk of poverty and social exclusion, and employment and remuneration in general government. The Interim Report will be

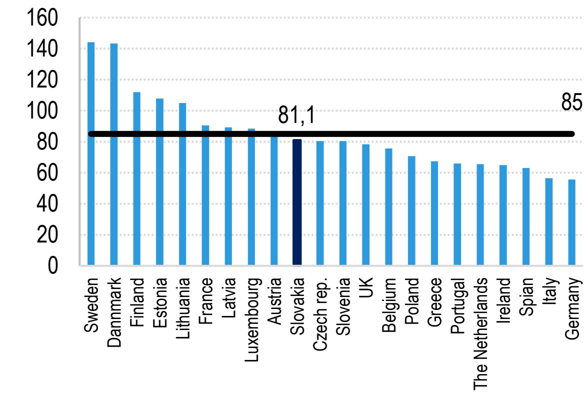
[75] The potential impact and degree of detail of the measures in the sectors is different, which does not allow a simple comparison of the performance between the different sectors. For this reason, in the next report, the value of the measure, will be expressed as composite index.
[76] Priority measures in health care for the next two years are presented in the National Reform Program.
[77] ZSSK project - Purchase of wagons for long distance transport (EUR 68 million), ŽSR - Communication Infrastructure of Telematics Services ŽSR (EUR 45.6 million)

published in October 2018, Final one with measures in March 2019. The results of the review will be incorporated into the general government budget for the years 2020 to 2022.

The positive labor market situation, declining unemployment and wage growth make it possible to optimize employment and remuneration in state and public administration with more sophisticated techniques than through redundancy (e..g by redeploying employees and increasing the efficiency of the activities being carried out). Activities are considered within the spending review of employment and remuneration in general government, the interim report of which will be published by October 2018.

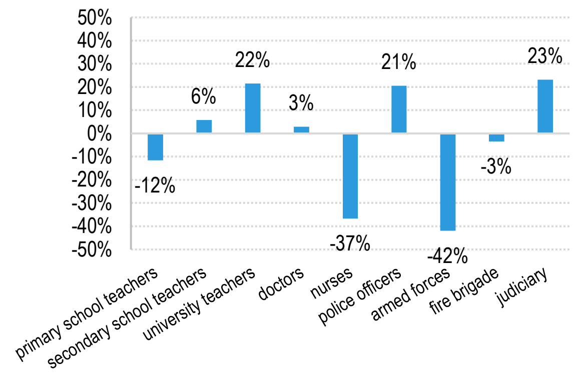
About 411,000 general government employees account for more than € 7.8 billion a year according to ESA2010 methodology[78]. In the GG sector[79] work, on average, less than 4 employees per thousand inhabitants when compared to the EU average. The wage expenditure in relation to GDP is lower by 1.5 p.p., while the total public expenditure is lower by 2.5 p.p..

FIGURE 56 - Eployees of theVS[80] per 1000 inhabitants (2016)



Source: MoF SR, Eurostat, ŠUSR

FIGURE 57 - Slovak Sectoral Employment Difference vs. Benchmark (%, 2015-2016)[81]

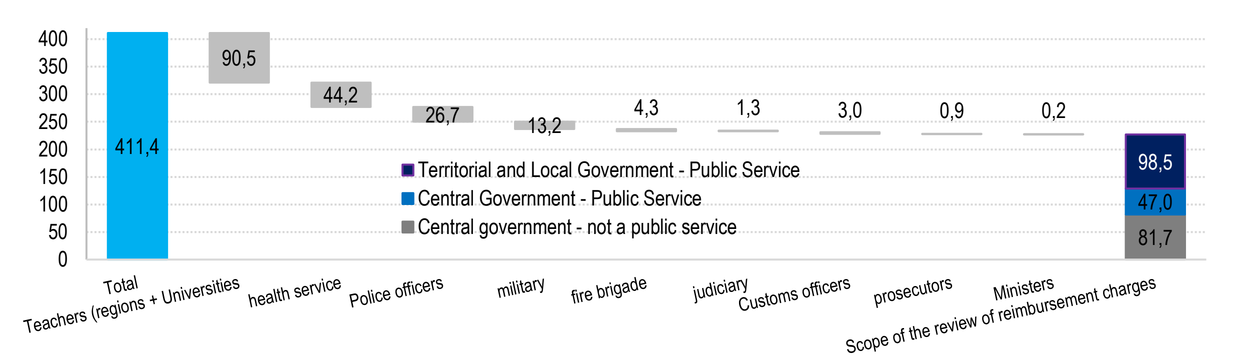


Sourcee: Eurostat, World bank, OECD

Slovakia has a comparable total number of GG employees compared to EU countries, but in a significantly different structure. On the basis of a simple comparison, Slovakia has more university teachers, police officers and judges, on the contrary, less nurses or soldiers. The review will look at the structure of employment in the GG sector in the light of the results it brings.

The revision of expenditure on employment and the GG remuneration deals with part of the GG sector employment. Of the total number of more than 411 thousand of employees is prioritized to 227,000 employees, especially in the central state administration bodies.

FIGURE 58 - GG employees by sector (2016, in thousands)



Source: MoF SR

[78] Data for 2017 including expenditure covered by EU funds and co-financing.
[79] General government sector according to methodology of ESA2010 National and Regional Accounts.
[80] Data unavailable for Bulgaria, Croatia, Malta, Cyprus, Hungary and Romania
[81] The comparisons are for 2015 except for the policemen for whom the comparison is for 2016; For teachers, there is a comparison via the number of pupils per teacher; for the other groups, the comparison is via the number per 1000 inhabitants; for health professionals and teachers, the benchmark is the OECD average, for others the average of EU countries

Another topic of the review is state-owned companies. More than 56,000 employees work in the ten largest state-owned companies, more than half of them work in two companies (Slovak Railways (Železnice SR) and Slovak Post (Slovenská pošta a.s.)). Examples of optimization projects are already made proposals to optimize the cost of state-owned companies in the Slovak water management company, or to modernize the traffic management in the Slovak Railways. State-owned institutions are will go through the performance audit. The optimization of the operational expenditures of selected ministries will be ensured through organizational-process audit and benchmarking of cross-sectional expenditure.

TABLE 27 - State-owned companies by number of employees (2016)

Company	No of employees	Personal costs (millions of euros)	Operating costs (EUR million)
Railways of Slovak Republic	14 009	233	374
Slovak Post, a.s.	13 446	167	278
Railway Company Cargo Slovakia, a.s.	6 028	91	248
Železničná spoločnosť Slovensko, a.s.	5 924	102	281
Social Insurance Agency (2015)	5 094	82	125
Forests of the Slovak Republic, state enterprise	3 528	71	205
Slovenský vodohospodársky podnik, š.p.	3 317	53	89
General Health Insurance Company, a.s. (2015)	2 075	46	86
National Motor Company, a.s.	1 487	36	197
Radio and Television of Slovakia	1 359	30	116

Source: MoF SR

The review for agriculture and rural development is estimated at 1.9% of GDP per year (EUR 1.8 billion). The review will examine spending on agricultural policy and support for rural development, including the expenditure of the affiliated organization of the sector and the largest enterprises in its managerial competence. The aim of the review is to evaluate the effectiveness of expenditure of the Ministry of Agriculture and Rural Development of the SR (MPRV SR) with an emphasis on achieving better results.

The review on the inclusion of groups at risk of poverty and social exclusion assesses spending with an impact on the social inclusion of groups at risk of poverty and social exclusion. It focuses on the effectiveness of current protection and inclusion policies, examines the current set of data collection, mentions examples of good practice and examines the possibilities of their systematic introduction.

The Stability Program formalizes a second review of health spending, which estimates expenditure in the volume of 5.5% of GDP per year (the mandate is published as Annex 8). It will focus on identifying health-enhancing measures that can be implemented to continue reducing inefficient spending. The review will introduce system funding based on total healthcare spending, improve tracking and data collection. Growth of health expenditure above the rate of inflation will be conditional to demonstrating a positive impact on results. Additionally, the major prerequisites for faster growth are the cessation of hospital indebtedness, the change of payrolls for health workers, prescriptive limits, and the full functionality of DRG and eHealth. The interim report with measures in the GG budget for the years 2019 to 2021 will be published by the end of September 2018, the final report by the end of September 2019.

5.4 Better investment management

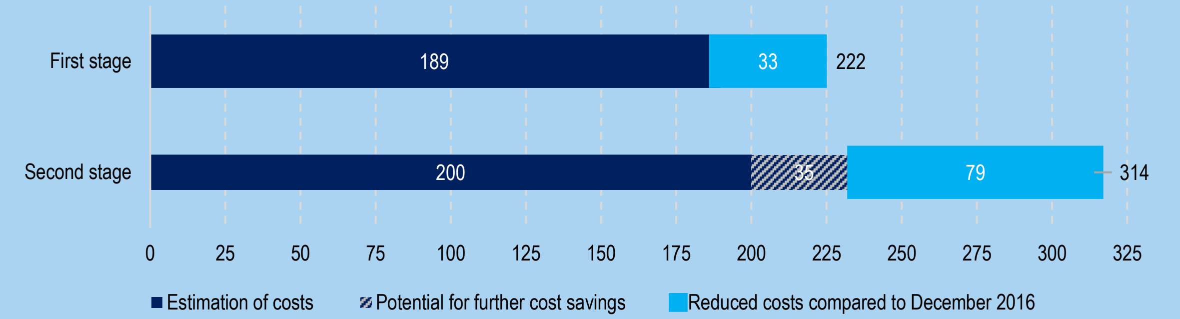
In 2017, the government reformed the process of evaluating significant investments. By adopting the *Framework for the evaluation of public investment projects*, the government has defined a methodological framework for the process and preparation of large investment projects and their evaluation according to the principles of value for money, the Ministry of Finance has issued an expanding investment instruction. Since 2017, the Ministry of Finance has been obliged to prepare and publish an evaluation of a publicly funded investment project with a cost of more than 40 million euros, in informatization more than 10 mill. euros. The Ministry of Finance published the evaluation of 3 sections of highways totaling 714 mill. euros. The estimated value of the contracts decreased by 149 million euros against the previous background at unit prices in order to achieve optimal benefits. There is a gradual assessment of the projects underway for the construction of motorways and highways (EUR 16.4 billion), Slovak Road Administration (Slovenská správa ciest) (EUR 3.2 billion) and Slovak Railways (EUR 1 billion). The Ministry of Finance published evaluations of 9 IT projects worth almost 194 million euros.

BOX 11 - Investment assessment - case study of the Northern Bypass of Prešov

From the beginning of 2017 the Ministry of Finance evaluates the project of the Northern Bypass of Prešov. The quality of the project improved, compared to the original plan it is by 112 mill. euros cheaper due to reconsidering the required capacity (half-profile in the second phase) and saving on unit costs (first stage). There is, however, insufficient consideration of alternatives.

Project for 424 mill. euros is socially beneficial, with a benefit / cost ratio of 1.25. The quality of the project improved over the course of 2017, it is cheaper and the benefits are estimated based on a standard transport model and methodology. However, it is not possible to say whether the bypass implementation brings the highest value for money, as the presented benefit and cost analysis compares only one alternative of the transport solution in Prešov.

FIGURE 59 - Decrease in the estimate of investment costs of the Prešova northern by-pass from December 2016 (mil.)



Rough line: full profile, narrow line: half profile. *Source: NDS, ÚHP, 2017*
A modified route of the second stage would mean a delay of construction by approx. 5 years.
Cursive - the original cost estimate of December 2016.

The Ministry of Finance has evaluated the construction project of R4 Prešov, a northern bypass with a total estimated cost of 424 mill. euros. In the evaluation process, the Ministry of Finance of the Slovak Republic worked with the NDS and the MDV SR to develop a transport model that meets the modeling standards used abroad. Based on the results of the transport model, the optimization of the technical solution was also made, the second round of the bypass being built in half the profile due to the lower expected traffic intensity. compared to the costs estimated in the review of transport costs, the cooperation of the Ministry of Finance and the NDS reduced the estimate of investment costs of the northern bypass by 112 mill. euros (21%). Costs of the first stage were reduced by 33 million euros by optimizing unit prices (15%). Costs for the construction of the second stage fell by 79 million euros in the half-profile construction decision (25% of EUR 314 million).

The investor of the project is the National Motorway Company (NDS), the MoF prepared a standpoint on the project in terms of value for money before the public procurement for the first stage of the bypass. Based on the assessment of project objectives, demand analysis, economic evaluation and project risks, the standpoint had advisory character, but at the same time, it critises the investor for the lack of assessment of other alternative transport solutions in the city of Prešov, and recommends that before completing the second phase work to compare the completion of the bypass with relevant alternatives (changing the bypass route, modifying roads and cross-roads in the city, or enhancing public transport in the city and region).

6 INSTITUTIONAL ASPECTS OF PUBLIC FINANCE

In 2018, the implementation of the amendment to the Budgetary Rules Act 2016 continues, with the main changes being the increase in the comparability of the budgeted data with the actual data reported. In 2019, the Ministry of Finance of the Slovak Republic will launch a test of spending ceilings for the GG budget. It will also continue to strengthen the institutional framework of the Value for Money project. Legislative anchoring of value for money in public spending and large investments and a unified methodology will increase the robustness of the process of reviewing and assessing investment. The Ministry will develop a detailed methodology for the revision of expenditure and its connection to the budgetary process.

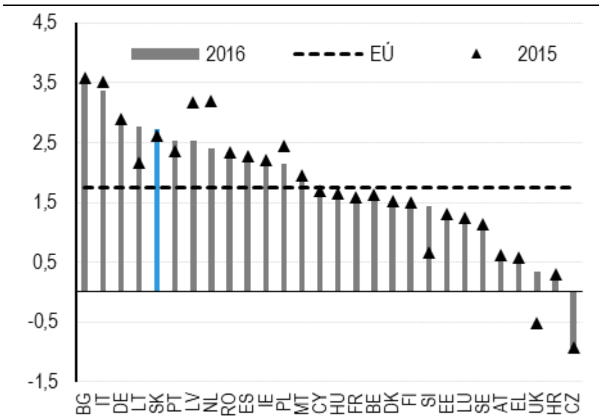
The goal of a good fiscal framework is to achieve a sustainable fiscal position, counter-cyclical fiscal policy influence, and increase of the efficiency of public expenditure. The National Framework for Fiscal Policy defines a set of rules, regulations and procedures that affect the implementation of national budgetary policies in the form of its planning, approval, monitoring and evaluation.

Evaluation of national fiscal frameworks - the relative position of the Slovak Republic compared to the EU for 2016

The current assessment of Slovakia's budgetary frameworks for 2016 has improved year-on-year. The European Commission assesses the quality of the institutional aspects of public finance each year. The results obtained are presented using specifically defined indices focusing on three basic areas.

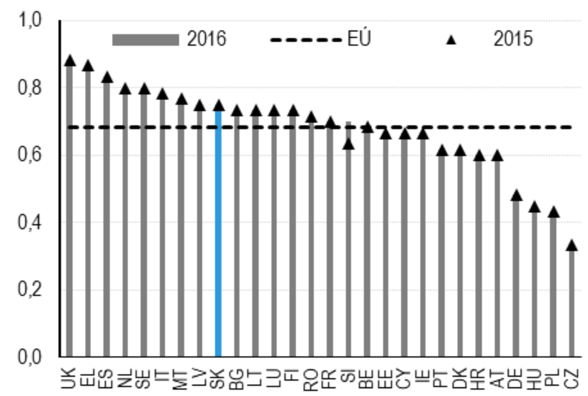
According to the EC index, **Slovakia's medium-term budgetary framework is assessed above average**. The mid-term budgetary framework index[82] reached 0.75 points from a maximum of 1 point and exceeded the EU average (0.68 points). The medium-term budgetary plan benefits in the long run from the good detail and extent of the information contained[83], the inclusion of the national parliament in the process of approving it and, in particular, from the fact that the preparation of the fiscal framework is based directly on independent macroeconomic and tax forecasts. The EC has repeatedly identified the improvement area in the strengthening of the medium-term commitment (with the exception of the first year the objectives are indicative), the introduction of binding spending ceilings and the need for an optimally defined correction mechanism.

FIGURE 60 - National fiscal rules (index)



Source: EC

FIGURE 61 - Medium-term bugetary framework (index)



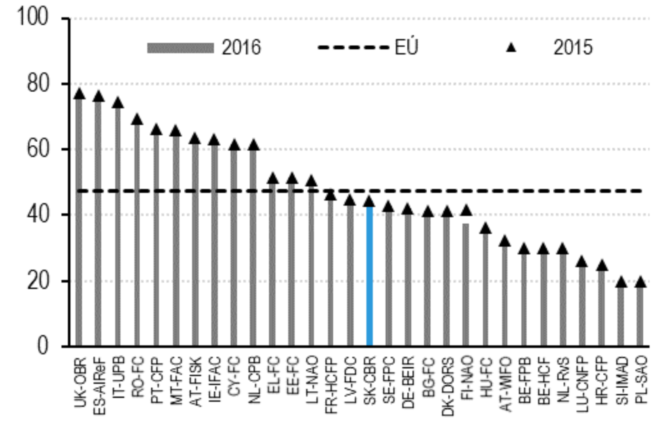
Source: EC

[82] The medium-term budgetary frameworks are described in the Stability Program for the years 2017 to 2020. The EC assessment compared to the previous year underwent significant methodological change, which improved the location of Slovakia in 2015 and 2016.
[83] The medium-term budgetary framework of the SR is directly projected in the SR Stability Program.

Slovakia has ranked in the assessment of the quality of the implemented fiscal rules among the 5 best countries in the EU. According to the European Commission's assessment, the National Fiscal Policy Index[84] for the year 2016 was slightly higher (2.7 points) than in 2015 (2.6 points).

In the framework of the evaluation of independent fiscal institutions, the Slovak Council for Budget Responsibility (RRZ) was just below the average. [85] Index evaluating the scope of independent fiscal institutions in the EU for 2016 assesses the role that independent fiscal authorities carry out within their job description. The RRZ, which in this assessment represents Slovakia, carries on its activity under the constitutional law on budgetary responsibility.

FIGURE 62 - Scope of independent fiscal institutions (index)



Source: EC

Changes in the area of the medium-term budgetary framework

Extending the scope of budgeted revenue and expenditure since 2018 will contribute to increasing the transparency of the budget. In 2016, the Ministry of Finance prepared an amendment to the Budgetary Rules Act, part of which entered into force on 1 January 2018. The most significant change resulting from this amendment, which affects the quality of the fiscal framework, is the introduction of the obligation to budget all revenues of the budgetary organizations[86].

At EU level, negotiations are currently taking place on the proposal for a Council Directive to strengthen fiscal responsibility and medium-term fiscal orientation in MS. The Directive affects potential adjustments in the Budgetary Rules Act in the Slovak Republic (paragraph 30a). The Slovak Republic already fulfills a substantial part of the presently submitted Directive. The main aspect is the anchoring of a balanced budget rule in national legislation. The new European Commission Directive proposes to reinforce the focus on the medium-term budgetary expenditure in expenditure budgeting and to strengthen the role of independent fiscal institutions.

Pilot simulations of expenditure ceilings in the general government budget

The Ministry of Finance starts work in 2018 on the testing of expenditure ceilings in the framework of the general government budget management (BOX 12). Obligatory expenditure ceilings are, according to international practice, one of the best operational tools for the planning and implementation of the general government budget. Its introduction is assumed by the constitutional Act on Fiscal Responsibility. In the initial phase, the Ministry of Finance will prepare simulations of expenditure ceilings on the basis of budgetary data. The evaluation of the individual simulations should consequently serve as a basis for deciding on the implementation of the expenditure ceilings in the future. The first genuine testing in setting and monitoring the implementation of the budget will take place in 2019.

[84] The National Fiscal Policy Index is described in the Stability Program for the years 2017 to 2020.

[85] In connection with this assessment, it should be noted that not all Member States have an independent fiscal authority to monitor the development of public finances. On the other hand, there are countries where several such institutions operate.

[86] De iure, there is the elimination of most extra-budgetary accounts

BOX 12 - Testing of expenditure ceilings in the general government budget

At the beginning of 2018, the Ministry of Finance publicly announced the testing of expenditure ceilings in general government. The initiative monitors the most up-to-date international practice in budget planning. Expenditure ceilings are appreciated by the wider academic community (e.g. Claeys et al, 2015; Bénassy-Quéré, et al, 2018, Carnot, 2014), as well as several international institutions (IMF, EC)

In the initial phase, the Ministry of Finance will focus on the testing of expenditure ceilings based on budget data. The result should be an assessment of the various technical and methodological aspects of the expenditure ceilings, their process setting and the definition of the necessary data base. Individual technical aspects of the expenditure ceilings are being discussed. The most important topics discussed are:

Formulation of goals

The expenditure ceilings monitor the achievement of the specified level of **fiscal targets**. These relate to the short-term horizon (nominal / structural balance or gross / net debt of the GG) or to a long-term perspective that also takes into account future implicit liabilities (e.g. the expected impact of population aging). This more comprehensive approach is the subject of long-term sustainability indicators (e.g. indicators S1, S2 from the European Commission or the sustainability gap, the so-called GAP indicator, quantified RRZ).

The second level is **the required pace of improvement of the selected goal within the chosen horizon**. It can be based on international commitments (e.g. the current economic cycle and the sustainability risks - approach from the Stability and Growth Pact) or from a national specific approach (e.g., more robust consolidation at the start of the electoral cycle)

Determination of the planning horizon

Expenditure ceilings follow a specific medium-term objective that should be predetermined. The horizon of this intention can be set either **fixed to 3 or 4 years** (e.g. according to the electoral cycle) or may be **updated annually** based on new facts (e.g. update of revenue forecast). While the first approach brings a stronger commitment to achieving the objectives, the second option is associated with greater flexibility in budget management.

Coverage of general government

The expenditure ceiling may be designed **for the entire general government** to reach the overall fiscal target. Under SR conditions, it may be more pragmatic to **exclude a group of entities that are not fully controlled by the central government** (i.e. self-governments in the context of decentralization of general government). In such case, these entities could be guided by other, precisely defined budget rules, such as the existing rules for local governments.

Level of detail

In the basic definition, the expenditure ceiling is set **only at the aggregate level**. In the extended version, it is possible to determine **individual ceilings for individual general government bodies**, or chapters of the state budget. Such an approach can also help prioritize the budget.

Exclusion of certain expenditure items

As with general government coverage, **a number of expenditure items are not under government control or are significantly influenced by a heavily predictable cycle** (e.g. interest costs, EU funds draw, or levy into the EU budget.) Therefore, when setting the expenditure ceilings for it is possible to consider the exclusion of such items.

Commitment

Successful implementation of expenditure ceilings will also depend on the **legislative definition of commitment**. The rigidity and flexibility ratio has several levels in the case of expenditure ceilings, depending on the nature of the situation, which the legislation should automatically respond to in a precisely defined way. It is, for example:

- reasons for adjusting the ceiling (legislative measures, statistical changes, macroeconomic developments)
- allowed deviation rate (flexibility degree)
- correction mechanism in case of significant deviation
- escape clauses in case of unexpected circumstances

Value for money

Strengthening of the institutions value-for-money project will continue by improving processes and methodologies. Legislative anchoring of value for money in public spending and large investments, as well as a uniform methodology, will increase the robustness of the process of reviewing and assessing investment. The Ministry of Finance will develop a detailed methodology for the review of expenditure and its connection to the budgetary process. The unified investment methodology ensures the comparability of the benefits of investment projects and the methodological instruction of the MoF SR will refine the process and task of the Ministry of Finance in the process of preparation and assessment of investments. These documents will be followed by more detailed investment methodologies in all sectors (following the transport methodology model).

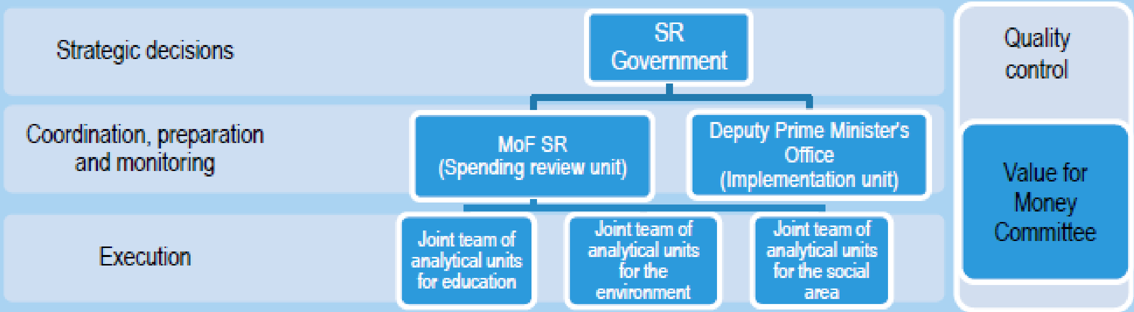
BOX 13 - Organization of Expenditure Review

Strategic decisions on the review of expenditure - review mandates and final reports are approved by the government or the ministers concerned. This is done in parallel with the preparation of strategic fiscal documents, i.e. the Stability Program, the Draft Budget Plan or the General Government Budget. The coordinator of the agenda is the MoF SR. It proposes the objectives, organization and technical parameters of the review and, in cooperation with the relevant ministries, performs individual reviews.

The identified measures from the completed review are implemented by the Ministry of Finance SR on the basis of a political agreement. Expenditure reviews are part of the general government budget. The timetable and course of implementation of the review measures is the content of the implementation plans. Their implementation is monitored by the Implementation Unit at the Office of the Deputy Prime Minister of the Slovak Republic for Investment and Informatization. Expenditure review measures are publicly evaluated quarterly. The Comprehensive Implementation Report is a separate annex to the Stability Program and will be prepared once a year.

Key decisions of strategic planning, quality control of outputs and transparency of outputs are evaluated by the Committee for Value for Money, made up of external public policy experts.

FIGURE 63 - Expenditure review organisation



Source: MoF SR

7 STRUCTURAL POLICIES

The Government has prepared a set of structural measures aimed at supporting economic growth and employment, responding to the major challenges of the Slovak economy - education, labor market and health. Education measures continue to focus on increasing the attractiveness of the teacher's profession, linking vocational education with practice and improving the quality of university education. Positive developments in the labor market will further support individualized employment services and active labor market measures aimed at disadvantaged groups. Alignment of family and work life will be promoted by building capacities of childcare facilities up to three years age. Several projects will support the integration of people from marginalized Romani communities. The implementation of healthcare review conclusions improves the cost effectiveness of selected parts of the healthcare system.

The structural measures planned in particular over the next two years are described in detail in the National Reform Program of the Slovak Republic 2018 (NPR). A comprehensive approach to prioritization that, in addition to GDP, takes other aspects of quality of life into account, has re-identified the labor market, healthcare and basic education as the persistent challenges of the Slovak economy.

In 2017, 51,000 new jobs were created and **the unemployment rate fell to the lowest level since the creation of the SR** (7.7% in the fourth quarter of 2017). Its further decline should bring about measures aimed in particular at reducing long-term unemployment, the implementation of which will continue in 2018. The retraining and training of employees and job-seekers will be supported on the basis of employers' needs in selected sectors. **Support will be given to the capacity building of childcare facilities up to three years age**, which will make it easier for mothers to return to the labor market. In the course of 2018, new project challenges will be announced to support the integration of people from marginalized Romani communities.

The Education resort will implement the measures from the expenditure review on education, which took place in 2017. **The attractiveness of the teaching profession** continues to increase, in particular by increasing the salaries of teachers in accordance with the Program Declaration of the Government of the SR. The amendment to the Vocational Education Act will motivate more schools and employers to engage in **dual education**. In the field of university education, the **accreditation commission** and the accreditation process are **reformed**, the internal management of public university education institutions is adjusted, professionally oriented university education programs will ensure better interconnection with the labor market. In 2018 and 2019, reconstruction of university dormitories will be supported.

The expenditure review on healthcare in 2016 identified a number of important system problems and their solutions. The gradual implementation of the review findings continually improves the cost-effectiveness of selected parts of the system. Since 2018, some **eHealth** features have been fully operational. During this year, emergency health service providers should also be gradually integrated into this system. The **Diagnostic Group Payment Scheme (DRG)** is gradually being introduced. In 2017, approximatelly 93% of the hospitals underwent at least partial reimbursement by DRG. At the beginning of 2018, a five-year process of convergence of individual rates for individual hospitals was launched into a single nationwide rate. In the field of drug policy, measures are being implemented to reduce prices and reduce their over-consumption. **Centralized procurement** should also be extended to the area of cost-noneffective medicines. In 2018, attention will be paid to the persistent problem of re-export of medicines, which has also emerged after approved Medicine and Medical Aids Act. Establishment of a fixed network of emergencies will go beyond the existing emergency ambulatory service network. Diagnosis will lead to the introduction of standard diagnostic and therapeutic procedures.

Better functioning of the general government should bring about a number of measures. In 2017, the so-called anti-mailbox law came into force, and should bring transparency into state and private sector businesses. Analytical capacity of the state will be strengthened in several ministries and other institutions.

To reduce the administrative burden of the business environment will help the support expansion of electronic and automated communication with the financial administration, the implementation of measures for better regulation, or further optimization services of the Commercial Register. MoE SR will prepare a new package of measures that will reduce the bureaucratic burden on entrepreneurs and simplify business in Slovakia.

Attention in the judiciary will be focused on **solving the problem of old execution proceedings** and the implementation of the conclusions and recommendations arising from the Report on the State of Justice, developed by the CEPEJ[87] organisation. A reform of trusteeship will be prepared to improve the status of people with disabilities, and to improve the protection of the elderly. In accordance with the Program Declaration of the Government of the Slovak Republic, the Law on Judicial Civil Service is being prepared.

By the end of 2018, legislation will be adopted **to introduce an annual social insurance settlement as an effective tool to prevent entity levy optimization**. This reduces the incentive to reoprt high renumerations in one month, which will make the levy load of the work more equitable and the state's revenue higher.

[87] The European Commission for the Efficiency of Justice

ANNEXES

Annex 1 – Compulsory tables

TABLE 28 (Table 1a) - Macroeconomic prospects (ESA2010, EUR bn.)

	ESA code	2017 Level	2017 Rate of change	2018 Rate of change	2019 Rate of change	2020 Rate of change	2021 Rate of change
1. Real GDP	B1*g	81,7	3,4	4,2	4,5	3,9	3,4
2. Nominal GDP	B1*g	85,0	4,7	6,1	6,6	6,2	5,8
Components of real GDP							
3. Private consumption expenditure	P.3	42,3	3,7	3,5	3,2	2,8	2,5
4. Government consumption expenditure	P.3	14,7	0,2	0,6	1,3	1,2	1,2
5. Gross fixed capital formation	P.51g	17,7	3,2	5,2	3,3	3,3	3,0
6. Changes in inventories and net acquisition of valuables (% of GDP)	P.52 + P.53	-	1,2	0,2	0,1	0,1	0,1
7. Export of goods and services	P.6	82,5	4,3	7,9	8,5	7,1	5,9
8. Imports of goods and services	P.7	76,4	3,9	7,1	7,2	6,2	5,2
Contribution to real GDP growth							
9. Final domestic demand (total)		-	2,6	3,1	2,6	2,3	2,1
10. Changes in inventories and net acquisition of valuables	P.52 + P.53	-	-0,1	0,0	0,0	0,0	0,0
11. External balance of goods and services	B.11	-	0,6	1,2	1,9	1,6	1,3

Source: MoF SR

** Forecast of final government consumption is based on the February macroeconomic forecast of MFSR. Macroeconomic forecast was passed by Committee for Macroeconomic Forecast before the release of actual numbers for 2017, which introduces the incosistency between nominal GDP level forecast for 2018 to 2021 as passed by the Committe and the GDP level calculated through approved nominal GDP growth rates for 2017-2020. For the budgetary purposes, the level of GDP approved by the Committee is valid.*

TABLE 29 (Table 1b) - Price development (ESA 2010)

	ESA code	2017 Level	2017 Rate of change	2018 Rate of change	2019 Rate of change	2020 Rate of change	2021 Rate of change
1. GDP deflator		1,0	1,3	1,8	2,0	2,2	2,3
2. Private consumption deflator		1,1	1,4	2,1	2,1	2,2	2,3
3. HICP		1,4	1,4	2,0	2,0	2,2	2,3
4. Public consumption deflator		1,1	3,2	3,2	2,7	2,9	2,9
5. Investment deflator		1,0	1,5	1,9	2,1	2,2	2,3
6. Export price deflator (goods and services)		1,0	2,2	1,6	1,9	1,9	1,9
7. Import price deflator (goods and services)		1,0	2,7	1,8	2,0	1,9	2,0

Source: MoF SR

TABLE 30 (Table 1c) - Labour market development (ESA 2010)

	ESA code	2017 Level	2017 Rate of change	2018 Rate of change	2019 Rate of change	2020 Rate of change	2021 Rate of change
1. Employment, persons (thousands) [1]		2 372	2,2	1,6	1,0	1,0	0,7
2. Employment, hours worked (thousands) [2]		4 066	0,7	1,6	1,0	1,0	0,7
3. Unemployment rate (%) [3]			8,1	7,3	6,7	6,1	5,9
4. Labour productivity per persons (EUR) [4]		34 450	1,2	2,5	3,4	2,8	2,7
5. Labour productivity per hours worked (EUR) [5]		20	2,7	2,5	3,4	2,8	2,7

6. Compensation of employees (EUR mill.)	D.1	34 070	6,8	7,1	6,4	6,3	5,9
7. Compensation per employee (EUR)		16 613	4,0	5,3	5,3	5,2	5,3

[1] Total occupied population, domestic concept – national accounts definition

Source: ŠÚ SR, MoF SR

[2] National accounts definition
[3] Harmonised definition according to Eurostat; levels
[4] Real GDP per person employed
[5] Real GDP per hour worked

TABLE 31 (Table 1d) - Sectoral balance (ESA 2010, % HDP)

	ESA code	2017	2018	2019	2020	2021
1. Net lending / borrowing vis-à-vis the rest of the world	B.9	-0,8	0,0	0,9	1,5	2,1
of which:						
- Balance on goods and services		2,0	2,3	3,5	4,4	5,0
- Balance of primary incomes and transfers		-3,7	-3,9	-4,2	-4,5	-4,5
- Capital account		0,9	1,6	1,6	1,6	1,6
2. Net lending / borrowing of the private sector	B.9	0,2	0,8	1,2	1,5	2,1
3. Net lending / borrowing of general government (budgetary target)*	B.9	-1,0	-0,8	-0,3	0,0	0,0
4. Statistical discrepancy		-	-	-	-	-

* Final 2017

Source: MoF SR

TABLE 32 (Table 2a) - General government budgetary prospects

	ESA code	2017 level	2017 % HDP	2018 % HDP	2019 % HDP	2020 % HDP	2021 % HDP
Net lending (EDP B.9) by subsector							
1. General government	S.13	-884	-1,04	-0,80	-0,32	0,00	0,00
2. Central government	S.1311	-1 111	-1,3	-1,4	-0,8	-0,5	-0,5
3. State government	S.1312	-	-	-	-	-	-
4. Local government	S.1313	-18	0,0	0,3	0,3	0,3	0,2
5. Social security funds	S.1314	245	0,3	0,2	0,2	0,3	0,3
General government (S13)							
6. Total revenue	TR	33 466	39,4	38,2	37,7	37,9	37,1
7. Total expenditure	TE [1]	34 351	40,4	39,0	38,0	37,9	37,1
8. Net lending/ borrowing	B.9	-884	-1,04	-0,80	-0,32	0,00	0,00
9. Interest expenditure	D.41	1 186	1,4	1,3	1,2	1,1	1,1
10. Primary balance	[2]	301,7	0,4	0,5	0,9	1,1	1,1
11. One-off and other temporary measures	[3]	0,0	0,0	0,0	0,0	0,0	0,0
Selected components of revenue							
12. Total taxes (12=12a+12b+12c)		15 344	18,1	17,9	17,8	17,5	17,2
12a. Taxes on production and imports	D.2	9 292	10,9	10,8	10,8	10,5	10,2
12b. Current taxes on income, wealth, etc	D.5	6 052	7,1	7,1	7,0	7,0	7,0
12c. Capital taxes	D.91	-	0,0	0,0	0,0	0,0	0,0
13. Social contributions	D.61	12 534	14,7	14,7	14,3	14,1	13,9
14. Property income	D.4	656	0,8	0,6	0,6	0,6	0,5
15. Other	[4]	4 932	5,8	5,1	4,9	5,7	5,5
16=6. Total revenue	TR	33 466	39,4	38,2	37,7	37,9	37,1
p.m.: Tax burden (D.2+D.5+D.61+D.91-D.995)	[5]	27 878	32,8	32,6	32,2	31,7	31,1
Selected components of expenditure							
17. Compensation of employees + intermediate consumption	D.1+P.2	12 593	14,8	14,5	14,1	14,1	13,8
17a. Compensation of employees	D.1	7 803	9,2	9,1	8,8	8,9	8,6

17b. Intermediate consumption	P.2	4 791	5,6	5,4	5,3	5,2	5,2
18. Social payments (18=18a+18b)	D6	15 715	18,5	18,1	17,3	16,7	16,2
of which Unemployment benefits	[6]	168	0,2	0,2	0,2	0,2	0,2
18a. Social transfers in kind - purchased market production	D.632	4 247	5,0	5,0	4,8	4,6	4,5
18b. Social transfers other than in kind	D.62	11 468	13,5	13,2	12,5	12,1	11,7
19.=9. Interest expenditure	D.41	1 186	1,4	1,3	1,2	1,1	1,1
20. Subsidies	D.3	363	0,4	0,4	0,4	0,4	0,3
21. Gross fixed capital formation	P.51g	2 696	3,2	2,5	2,7	2,9	3,0
22. Capital transfers	D.9	294	0,3	0,3	0,2	0,2	0,2
23. Other	[7]	1 503	1,8	2,0	2,1	2,5	2,6
24=7. Total expenditure	TE [1]	34 351	40,4	39,0	38,0	37,9	37,1
p.m.: Government consumption (nominal)	P.3	16 537	19,5	19,2	18,7	18,5	18,1

[1] Adjusted for the net flow of swap-related flows, so that TR-TE=EDP B.9 *Source: MoF SR*
[2] Primary balance is calculated as (EDP B.9, item 8) plus (EDP D.41, item 9)
[3] A plus sign means a deficit-reducing one-off measure
[4] P.11+P.12+P.131+D.39+D.7+D.9 (other than D.91)
[5] Including those collected by the EU and including an adjustment for uncollected taxes and social contributions (D.995), if appropriate.
[6] Includes cash benefit (D.621 and D.624) and in kind benefits (D.631) related to unemployment benefits
[7] D.29+D4 (other than D.41)+ D.5+D.7+P.52+P.53+K.2+D.8

TABLE 33 (Table 2b) - No-policy-change scenario

	2018	2018	2019	2020	2021
	mil. eur	% HDP	% HDP	% HDP	% HDP
1. Total revenue at unchanged policies	34 483	38,2	37,7	38,0	37,1
2. Total expenditure at unchanged policies	35 203	39,0	37,0	37,1	36,0

Note: The base for the NPC purposes for 2019 to 2021 is the actual estimate for 2018.. *Source: MoF SR*

TABLE 34 (Table 2c) - Amounts to be excluded from the expenditure benchmark

	2017	2017	2018	2019	2020	2021
	mil. eur	% HDP	% HDP	% HDP	% HDP	% HDP
1. Expenditure on EU programmes fully matched by EU funds revenue	632	0,7	0,4	0,3	1,2	1,2
1.a. of which investment fully matched by EU funds revenue	440	0,5	0,1	0,1	0,4	0,3
2. Cyclical unemployment benefit expenditure	0	0,0	0,0	0,0	0,0	0,0
3. Effect of discretionary revenue measures	144	0,2	-0,1	0,1	-0,1	-0,2
4. Revenue increases mandated by law	0	0,0	0,0	0,0	0,0	0,0

Source: MoF SR

TABLE 35 (Table 3) - General government expenditures by function (% of GDP)

	COFOG code	2016	2018 R	2021
1. General public services	1	5,3	5,1	4,6
2. Defence	2	1,0	1,1	1,6
3. Public order and safety	3	2,3	2,0	1,8
4. Economic affairs	4	4,5	3,6	3,6
5. Environmental protection	5	0,7	0,6	0,6
6. Housing and community amenities	6	0,5	0,5	0,5
7. Health	7	7,4	7,3	6,7
8. Recreation, culture and religion	8	1,0	1,0	0,9
9. Education	9	3,8	3,9	4,0
10. Social protection	10	15,1	13,9	12,8
11. Total expenditures	**TE**	**41,5**	**39,0**	**37,1**

R - Budget. *Source: Eurostat, MoF SR*

TABLE 36 (Table 4) - General governement debt development (% of GDP)

	ESA code	2016	2017	2018	2019	2020	2021
1. Gross debt		51,8	50,9	49,3	46,5	44,9	43,3
2. Change in gross debt ratio		-0,5	-1,0	-1,6	-2,7	-1,7	-1,6
Contributions to change in gross debt							
3. Primary balance*		-0,6	0,4	0,5	0,9	1,1	1,1
4. Interest expenditure		1,8	1,6	1,4	1,3	1,2	1,1
5. Stock-flow adjustment		-1,3	0,3	0,5	0,0	1,0	0,9
of which:							
- differences between cash and accruals		-0,9	-0,1	0,4	0,5	0,5	0,3
- net accumulation of financial assets		-0,3	0,5	0,3	-0,5	0,5	0,3
of which: revenues from privatisation		0,0	0,0	0,0	0,0	0,0	0,0
- valuation effects and others		0,0	-0,1	-0,1	0,0	0,0	0,3
p.m. implicit interest rate on debt		3,2	2,8	2,6	2,6	2,5	2,5
Other relevant variables							
6. Liquid financial assets		4,9	5,4	5,3	4,5	4,8	4,8
7. Net financial debt (7=1-6)		46,9	45,5	43,9	42,0	40,1	38,5
8. Debt repayment (existing debts) from previous year		-4,1	-5,9	-5,3	-3,6	-1,7	-2,9
9. Share of debt denominated in foreign currency**		3,7	3,7	3,0	2,5	2,0	1,8
10. Average maturity (years)***		7,0	7,9	8,4	-	-	-

* The 2018 primary balance is based on the 2018 estimate *Source: MoF SR*

** Loans included.

*** Maturity of state debt as of 31.12. For 2018 average maturity as of 17.4.2018

TABLE 37 (Table 5) - Cyclical developments

(% of GDP)	ESA code	2017	2018	2019	2020	2021
1. Real GDP growth (%)		3,4	4,2	4,5	3,9	3,4
2. Net lending of general government*	B.9	-1,0	-0,8	-0,3	0,0	0,0
3. Interest expenditure	D.41	1,4	1,3	1,2	1,1	1,1
4. One-off and other temporary measures	[1]	0,0	0,0	0,0	0,0	0,0
Of which:						
One-offs on the revenue side: general government		0,0	0,0	0,0	0,0	0,0
One-offs on the expenditure side: general government		0,0	0,0	0,0	0,0	0,0
5. Potential GDP growth (%)		2,9	3,7	4,0	3,9	3,7
contributions:						
- labour		0,5	0,3	0,2	0,2	0,2
- capital		0,7	0,9	1,0	1,0	1,1
- total factor productivity		1,8	2,5	2,8	2,6	2,4
6. Output gap		0,1	0,6	1,1	1,1	0,8
7. Cyclical budgetary component		0,0	0,2	0,4	0,4	0,3
8. Cyclically-adjusted balance (2 - 7)		-1,1	-1,0	-0,7	-0,4	-0,3
9. Cyclically-adjusted primary balance (8 + 3)		0,3	0,2	0,4	0,7	0,7
10. Structural balance (8 - 4)		-1,1	-1,0	-0,7	-0,4	-0,3

[1] A plus sign means deficit-reducing one-off measure *Source: MoF SR*
*Current estimate in case of 2018

TABLE 38 (Table 6) - Comparison between the previous forecast and the updated forecast

	ESA code	2016	2017	2018	2019	2020	2021
Real GDP growth (%)							
Previous update*		3,3	3,3	4,0	4,4	3,8	-
Current update		3,8	3,4	4,2	4,5	3,9	3,4
Difference		0,5	0,1	0,2	0,2	0,1	-
General government balance (% of GDP)	EDP B.9						
Previous update*		-1,68	-1,24	-0,50	0,00	0,00	-
Current update**		-2,21	-1,04	-0,80	-0,32	0,00	0,00
Difference		-0,53	0,20	-0,30	-0,32	0,00	-
General government gross debt (% of GDP)							
Previous update*		51,9	51,8	49,9	48,0	46,0	-
Current update		51,8	50,9	49,3	46,5	44,9	43,3
Difference		-0,1	-0,9	-0,7	-1,5	-1,1	-

*Note: * Stability Programme for 2017 - 2020* *Source: MoF SR*

**Current estimate in case of 2018

TABLE 39 (Table 7) - Long-term sustainability of public finances (% of GDP)*

	2020	2030	2040	2050	2060	2070
Total expenditure	37,9	38,7	39,2	39,8	40,4	40,3
Of which: Age-related expenditures	18,6	19,3	19,9	20,5	21,0	21,0
A. Pension expenditure	8,3	8,2	8,4	8,6	8,7	8,9
a) Old-age and early pensions	6,5	6,5	6,5	6,5	6,5	6,5
b) Other pensions (disability, survivors)	1,8	1,7	1,9	2,1	2,3	2,4
B. Health care	5,8	6,2	6,6	6,9	7,0	6,8
C. Long-term care	0,9	1,1	1,3	1,4	1,5	1,5
D. Education expenditure	3,5	3,6	3,5	3,6	3,8	3,7
E. Other age-related expenditures	0,1	0,1	0,1	0,1	0,1	0,1
Of which: Interest expenditure	1,1	0,9	1,2	2,1	3,8	6,1
Total revenue	37,9	37,9	37,9	37,8	37,8	37,8
Of which: Property income (D.4)	0,6	0,5	0,5	0,5	0,4	0,4
Of which: Pensions contributions	14,1	14,1	14,1	14,1	14,1	14,1
Pension reserve fund assets	-	-	-	-	-	-
Of which: Consolidated public pension fund assets	-	-	-	-	-	-
Systematic pension reforms						
Social contributions diverted to voluntary private scheme	0,7	0,9	0,8	0,7	0,7	0,7
Pension expenditure paid by voluntary private scheme	-	-	-	-	-	
Assumptions						
Labour productivity growth	3,0	3,1	2,3	1,8	1,7	1,5
Real GDP growth	2,5	2,8	1,8	1,2	1,2	1,5
Participation rate males (aged 15-64)	79,0	78,2	78,0	79,1	79,5	79,7
Participation rate females (aged 15-64)	67,5	68,6	68,5	69,7	70,3	70,4
Total participation rate (aged 15-64)	73,3	73,5	73,3	74,5	75,0	75,1
Unemployment rate (aged 15-64)	8,4	9,1	8,5	7,9	7,9	7,9
Population aged 65+ over total population	24,9	32,9	39,7	51,5	59,4	56,8

** Age-related expenditures as well as macroeconomic assumptions were updated after issuing Ageing report 2018* *Source: MoF SR*

TABLE 40 (Table 7a) - Contingent liabilities

	2015	2016	2017
	% HDP	% HDP	% HDP
Public guarantees	16,9	16,0	13,3
of which: linked to EFSF and ESM	9,3	9,0	8,9

** Estimate for 2017 is provisional.*

Source: MoF SR

TABLE 41 (Table 8) - Basic assumptions

	2016	2017	2018	2019	2020	2021
Short-term interest rate EONIA (annual average)	-0,32	-0,35	-0,30	-0,19	-0,02	0,14
Long-term interest rate 10Y-SLOVGB (annual average)	0,54	0,98	1,22	1,48	1,62	1,74
USD/€ exchange rate (annual average) (euro area and ERM II countries)	1,11	1,13	1,21	1,24	1,25	1,27
World excluding EU, GDP growth	-	-	-	-	-	-
EU GDP growth	2,14	1,80	1,72	1,74	-	-
Growth of relevant foreign markets	2,18	1,92	1,99	1,95	1,88	1,80
World import volumes, excluding EU	-	-	-	-	-	-
Oil prices (Brent, USD/barrel)	45,03	54,83	66,33	62,89	60,41	59,24

Source: Common external assumptions, MoF SR

Annex 2 - Impact of fiscal policy on the economy between 2019 and 2021

The size of fiscal measures is calculated against the no-policy change scenario based on the expected general government deficit figure for 2018. **In 2019, the budget target is set against the NPC scenario with a fiscal impulse of 1% of GDP, which is 921 million euros**. Fiscal impulse is also expected in the coming years, at 0.9% of GDP in 2020 and 1.1% of GDP in 2021. This is a cumulative impulse of measures against NPC, which means that **from the point of view of the year-on-year changes, in the year 2020 we see a very mild restraint. In 2021, the budget again counts with a fiscal impulse of 0.2% of GDP**.

TABLE 42 - Overall consolidation need to achieve the fiscal targets compared to NPC (ESA2010, % of GDP)

	2019	2020	2021
1. General government balance - Fiscal objectives	-0,32	0,00	0,00
2. General government balance - NPC scenario	0,64	0,88	1,07
3. Size of measures (1-3)	-0,96	-0,88	-1,07
- y-o-y change	**-0,96**	**0,08**	**-0,19**

Source: MoF SR

The volume of measures with a direct impact on GDP in 2019 is 870 million euros(0.9% of GDP). Fiscal expansion is projected primarily on the expenditure side, with government expenditure (€ 456 million total) and government consumption (€ 305 million) will increase. On the revenue side, exponential and restrictive measures are offset against each other.

In 2020, the impact of measures with a direct impact on GDP growth is negligible at -18 million EUR (0% of GDP). The structure of expenditure measures compensates for the additional increase in government consumption with a fall in investment and current transfers.

In 2021, the volume of measures with a direct impact on GDP growth reaches 314 million EUR (0.3% of GDP). The moderate fiscal expansion is based on an increase in the expenditure side, particularly investment and current transfers. The opposite direction acts a decrease in compensation.

TABLE 43 - Transmission macroeconomic channels (in mil. EUR)

	2019	2020	2021
Total	**921**	**-25**	**263**
(in % of GDP)	**0,96**	**-0,02**	**0,24**
Direct impact on GDP	**870**	**-18**	**314**
(in % of GDP)	**0,90**	**-0,02**	**0,29**
Government consumption	**305**	**74**	**-156**
Intermediate government consumption	234	135	26
Compensation of employees	71	-61	-182
Social transfers in kind (healthcare providers)	49	-11	14
Market production	-49	11	-14
Investments	**454**	**-56**	**210**
Government	456	-65	219
Other	-3	9	-9
Households	**190**	**-97**	**62**
Inflation	**-8**	**-1**	**16**

Source: MoF SR

The impact of fiscal policy on the main macroeconomic variables of the Slovak economy, including secondary effects, is quantified using the IFP macroeconomic model for medium-term forecasting. In the case of grants and transfers as well as additional gambling taxation, we consider a zero multiplier, therefore assumed direct impact on the economy is slightly adjusted.

In 2019, the impact of fiscal policy on GDP growth is positive at 0.5 p.p.. In 2020 and 2021, the impact of measures on the economy is neutral. The implied fiscal multiplier is 0.56 in 2019. Its height reflects a significant increase in investment, intermediate consumption, compensation and social transfers. However, it is dampened by a slight overheating of the economy, which is reflected in the outflow of government investment as well as in the higher GDP deflator. In the following years, the fiscal multiplier is relatively low, namely 0.3 or 0.1. It is given by mutual compensatory measures of both restrictive and expansive character. The decreasing multiplier of the entire package of measures is given in particular by a compensation-side restriction, which has the individual highest multiplier effect.

TABLE 44 - Impact of measures on GDP (in p.p.) according to the IFP macro model

	2019	2020	2021
measures with a direct impact on GDP	**0,90**	**-0,02**	**0,29**
contribution to a CPI change	0,03	0,00	0,00
GDP deflator	0,07	-0,01	0,00
employment	-0,04	0,04	-0,02
nominal wage	0,62	-0,24	0,15
gross disposable pension	0,39	0,00	2,94
household consumption	0,34	-0,12	0,08
government consumption	1,49	0,41	-0,53
investments	1,67	-0,28	0,82
import	0,29	-0,04	0,10
contribution to the YoY GDP change	**0,51**	**-0,01**	**0,03**

Source: MoF SR

Annex 3 – Structural balance

The structural balance represents the difference between general government revenue and expenditure excluding one-off and temporary effects, and assuming that the economy is at its potential level. Despite the use of several unobserved variables for its calculation, the structural balance more faithfully shows the country's medium-term fiscal position as compared to the nominal balance.

The Stability and Growth Pact is based on the premise that Member States should achieve a symmetrical approach to fiscal policy in line with the cyclical development of the economy. The main objective is to increase the focus on budgetary discipline in times of economic recovery, in order to avoid the pro-cyclical nature of fiscal policy and gradually achieve its medium-term budgetary objective. As a result of this behavior, budgeting should be created for periods with economic downturns and, at the appropriate pace, reduce public debt and positively affect the long-term sustainability of public finances.

The following matrix clarifies and specifies the requirements of the Stability and Growth Pact for fiscal consolidation within its preventive part. This matrix is symmetric and distinguishes between the greater consolidation efforts to be made at better times and lesser efforts, implemented at the time of the economy's downfall below its potential.

		Required annual fiscal adjustment (pp of GDP)	
	Condition	Debt ≤ 60% and low/medium sustainability risks	Debt > 60% or high sustainability risks
Exceptional ly bad times	Real growth < 0 or output gap < -4	No adjustment needed	
Very bad times	-4 ≤ output gap <-3	0	0,25
Bad times	--3 ≤ output gap <-1.5	0 if growth below potential, 0.25 if growth above potential	0.25 if growth below potential, 0.5 if growth above potential
Normal times	-1.5≤output gap	0,5	> 0,5
Good times	Output gap ≥1.5	>0.5 if growth below potential, ≥0.75 if growth above potential	≥0.75 if growth below potential, ≥1 if growth above potential

The assessment of compliance with structural balance is assessed on the basis of the one-year and two-year (based on average in both years) basis of the deviation indicated in% of GDP. One-off deviation with a limit of -0.5% of GDP and a two-year deviation, with a limit of -0.25% of GDP.

Calculation of the structural balance

In the first step, the nominal general government balance is settled by the cyclical component of the impact of economic fluctuations (estimated by the production gap, i.e. the difference between actual and potential GDP level). Estimation of the production gap is based on the current macroeconomic forecast of the Ministry of Finance of the SR from February 2018 (more BOX 2). Estimating the sensitivity of the GG balance to changes in the production gap based on the OECD[88] methodology will be taken over by the Ministry of Finance of the Slovak Republic in full from the EC.

In the next step, the adjusted balance is settled for the effect of the so called one-off and temporary measures whose fiscal impact is not repeated in the following years. For the needs of the draft budget plan,

[88] The original methodology was presented in Girouard, N., André, Ch. (2005): Measuring cyclically-adjusted budget balances for OECD countries. In 2014, the process of updating the methodology and the inclusion of new data for calculating elasticity took place. The methodology was adopted by the Member States in September 2014.

the Ministry of Finance of the Slovak Republic proceeds to their identification in accordance with the EC[89] methodology. The European Commission's (EC) [90] methodology is characterized by a one-off measure as a temporary measure, which is of a non-permanent nature and has been created independently from government decisions. The EC has established a one-off classification directive:

1. **Principle:** Only a temporary, unrepeatable impact on revenue or GG costs can be classified as a one-off impact.
2. **Principle:** The one-off of a measure can not be ordered by law or autonomous government decision.
3. **Principle:** Components of revenue or expenditure of high volatility should not be considered as one-off effects. In order to smooth the time series, the cyclic component is used in the SB calculation.
4. **Principle:** Government aware decisions that lead to an increase in the deficit can not be classified as one-off effects.
5. **Principle:** Only measures with a stronger impact on the budget of the GG (higher than 0.05% of GDP) should be considered as one-off.

All typical one-off measures are described in the 2015 Report of Public Finances in EMU[91], Chapter 3.3. In addition, the EC has identified specific exceptions and procedures for them, where a one-off measure can also be considered as an impact that violates the above principles, but these cases are also covered by that chapter.

In spite of a breach of the 5 th principle (the rule of impact influence above 0,05% of GDP) of the EC Directive, given the horizontal nature (applicable to all countries), it can be recognized as a one-off measure:

- Correction of the contribution to the EU budget

TABLE 45 - One-off and temporary measures (ESA 2010, v mil. eur)

	2015	2016	2017	2018	2019	2020
EU budget correction	-	-35	-	-	-	-
Total	**0**	**-35**	**0**	**0**	**0**	**0**

(+) positive impact, (-) negative impact *Source: MoF SR*

[89] Vade Mecum on the Stability and Growth Pact – 2017 Edition – Guiding principles pg.28. In the past, the Ministry of Finance has prepared a manual, in line with the existing EC methodology, which sets out detailed rules for the identification of one-off and temporary effects in national methodology.
[90] Vade Mecum on the Stability and Growth Pact – 2016 Edition – Guiding principles pg.28.
[91] Report on Public Finances in EMU, December 2015.

Annex 4 – Expenditure benchmark

The revised Stability and Growth Pact introduced a expenditure benchmark as an additional tool for assessing the adequacy of the trajectory towards the medium-term budgetary objective. It expresses a year-on-year growth of expenditure aggregate settled by revenue measures, which will allow fiscal progress to be assessed in relation to the permitted expenditure growth benchmark, as in the case of the structural balance.

According to the expenditure benchmark, general government expenditure in real terms should not grow faster than the average potential growth of the economy. These expenditures can grow at a higher rate only when additional revenue measures are implemented (we are talking about discretionary measures). For countries that have reached their MTO, the growth of the expenditure in question can accurately duplicate the potential of the economy. For those countries that have not yet reached the MTO, the pace of expenditure growth must also reflect the consolidation needed to achieve it. In this case, the potential growth rate of the economy is corrected for the required consolidation effort based on the structural balance approach.

Development of expenditure is to be settled by factors beyond the control of the government. These are interest expenditure, changes in expenditure on unemployment benefits resulting from the current economic cycle and expenditure financed by EU funds. Given the high volatility of government investment, their level is flattening to the average level for the current and the three previous years[92]. The nominal growth of such adjusted expenditures is converted to real growth via the GDP deflator to make it comparable to the expenditure benchmark.

The comparison of the year-on-year growth of the expenditure aggregate with the expenditure benchmark shows the expenditure growth overruns in 2015 (see Figure 16), which also contributed to the need to co-finance the substantial absorption of EU funds. In assessing the compliance of expenditures with the expenditure benchmark, account is taken to deviations in two horizons (graph 17), expressed in% of GDP. **The one-year deviation (the difference between the expenditure aggregate and the expenditure benchmark, calculated as% of GDP) is observed, with a limit of -0.5% of GDP and the two-year deviation (the average of the current and previous deviations) on which higher emphasis is put due to lower volatility and dependancy from the actual year, with a limit of -0.25% of GDP.** If the deviation is higher than the limit set, this is a significant discrepancy with the expenditure benchmark.

TABLE 46 - Expenditure benchmark (ESA 2010)

		2016	2017	2018	2019	2020	2021
1. Total expenditures	mil. eur	**33 685**	**34 351**	**35 203**	**36 502**	**38 707**	**40 033**
2. Interest payments	mil. eur	1 336	1 186	1 143	1 147	1 110	1 143
3. Expenditures covered by EU resources (capital)	mil. eur	507	440	51	108	397	334
3a. Total expenditures covered by EU resources	mil. eur	796	632	346	312	1 261	1 252
4. Capital expenditures covered by national resources	mil. eur	2 093	2 256	2 204	2 498	2 582	2 889
5. Smoothed capital expenditures (national resources 4-year floating average)	mil. eur	2 062	2 252	2 289	2 263	2 385	2 543
6. Cyclical unemployment benefit expenditure	mil. eur	4	0	-5	-11	-12	-12
7. Expenditures fully matched by automatic revenue increase	mil. eur	0	0	0	0	0	0
8. Primary expenditure aggregate (1-2-3a-4+5-6-7)	mil. eur	**31 518**	**32 528**	**33 805**	**34 819**	**36 151**	**37 304**
9. Year-on-year change of the primary expenditure aggregate (8t-8t-1)	mil. eur	674	1 011	1 277	1 015	1 331	1 153
10. Change in revenues due to discretionary revenue measures	mil. eur	-174	144	-97	120	-122	-163
11. One-off revenue measures	mil. eur	0	0	0	0	0	0
12. One-off expenditure measures	mil. eur	-35	0	0	0	0	0
13. Methodical adjustments	mil. eur	-34	0	0	0	0	0
14. Nominal increase in the expenditure aggregate adjusted for revenue measures ((9t-(10t-11t)+12t+13t)/8t-1)	%	2,5	2,8	4,2	2,6	4,2	3,6
15. Real increase in the expenditure aggregate adjusted for revenue measures	%	1,3	1,6	2,7	0,8	2,1	1,4

[92] Vade Mecum on Stability and Growth Pact, pg. 30.

16. Expenditure benchmark (reduced reference rate of pot. GDP growth)	%	2,2	1,6	1,7	2,4	2,6	3,2
17. Deviation from the expenditure benchmark (16-15)	p.p.	0,8	0,0	-1,0	1,6	0,5	1,8
18. Deviation from the expenditure benchmark	% GDP	**0,3***	**0,0**	**-0,4**	**0,6**	**0,2**	**0,6**
19. Two-year deviation from the expenditure benchmark	% GDP	**-0,1***	**0,2**	**-0,2**	**0,1**	**0,4**	**0,4**
p.m. convergence margin		*0,0*	*0,7*	*1,3*	*1,2*	*0,7*	*1,4*
p. m. Nominal GDP		81 154	84 985	90 161	96 092	102 010	107 905

* Consolidation efforts and deviations in 2016 are based on "freezing" values from the latest European Commission assessment

Source: MoF SR

Annex 5 - Discretionary revenue measures

The EC methodology defines discretionary revenue measures as legislative-character measures affecting the general government revenues. They are evaluated by means of so-called additional impacts (marginal changes) of these measures. Permanent or one-off measures are distinguished. A permanent measure is recorded with an impact in the first year (at the moment when it becomes applicable) and with no additional impact in the following years. In other words, changes in the impact of the measure in the following years due to macroeconomic development are not taken into account. If different effects occur due to a postponed application of a measure, only the marginal change is recorded[93]. For one-off revenue measures, the impact is recorded only in one year and in the following year a shortfall of the same amount, i.e. the overall impact of a measure in two subsequent years is zero (for example an extraordinary contribution in the banking sector).

TABLE 47 - Discretionary revenue measures (mil. eur, ESA2010)

Popis	2016	2017	2018	2019	2020	2021
Special bank levy reduction (unrealized)		-50				
II. piliera opening – common impact	13					
HIC - introduction	-109	15	53	13	11	9
Loosening conditions for payment of excess credit within 30 days	7					
Lower VAT rate (10%) on selected foodstuffs	-77					
Cash accounting scheme, Self-assessment in constructions industry- no impacts						
Increase in the number of cigarettes in a pack from 19 to 20	4	1				
Taxation of cigars and cigarillos depending on the weight		6				
Acts 595/2003 and 580/2004 - support of investments in capital market	-11					
Corporate income tax - rate reduction to 21%		-112				
Increase in the compensation for services (EOSA)				37		
Increase and prolongation of special levy on enterprises in regulated sector (decrease from 2019)		64		-28		-16
Increase in the excise duty on tobacco products		30		39		
Prolongation of special levy on selected financial institutions and abolition after 2020.		50				-50
Taxation of dividends - 7% WHT			44			
Interest on retained VAT excess credit, more efficient tax administration		3				
Exemption from the corporate income tax for the income of the Resolution Council		-5				
Lump-sum expenditures - 60% max. EUR 20 thousand		-13	-7	-4		
Abolition of the MAB for health insurance contributions		90	-14			
Increase in the MAB for social insurance contributions since		57				
Abolition of minimum CIT (tax license)			-115			
Increase in the real estate tax rate		6				
Non-life insurance - an 8% levy		16	-1	-15		
Fee for development		3				
Higher revenues from gambling		10				
Increase in the social insurance contribution to the second pillar (automatic from 2017)		-28	-32	-36	-40	-44
Increased deduction of the cost of research and development			-9			
Introduction of separate depreciation of technical upgrade			0	-1		
Introduction of tax allowance on spa care			-2			
Excise duty on mineral oils - change in rates			0			
Introduction of gambling licenses and other changes in gambling taxation				70	-60	
Extension and modification of initial levy to an excise duty on insurance premiums			14	42		
SIC allowance for emloyee retirement agreements			-9	-10		
Introduction of 13th and 14th salary			-37	-45		-53
Abolition of tax HIC allowance for employers			22	63	-10	-9
Exemption of income taxation from the sale of ownership interest				-5	-23	
Reduction of the buildings depreciation period from 40 to 20 year			-3			
Exemption of ad receipts taxation for non profit organizations			-1			
Total	**-174**	**144**	**-97**	**120**	**-122**	**-163**

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

Annex 6 - Prerequisites for the calculation of sustainability indicators

Beyond the EC's assessment, the Ministry of Finance works on the analysis of medium and long-term sustainability with the current macroeconomic assumptions approved by the Macroeconomic Forecast Committee and with the data from the fiscal framework for the Stability Program 2018 to 2021 (for the estimate of the balance of the GG and the GG debt in the base year). The methodic difference with the EC is also the inclusion of impact of the II. pillar not only on the expenditure side but also on the revenue side[94]. The calculation of indicators S1 and S2 takes into account the assumptions of the updated forecast of aging-sensitive expenditure under the most recent Aging Report of 2018.

Several scenarios have been analyzed for the purposes of the Stability Program. The assumptions for calculation and analytical analysis of contributions of individual factors to the resulting S1 and S2 values are presented in the tables below.

TABLE 48 - Assumptions of MoF SR behind S1 calculation

	Baseline year (t_0)	Primary structural balance	Debt (t_0)	Gradual consolidation*	End year (t_1)	Debt (t_1)	II. pension pillar included	Value of S1	Risk
Y 2019	2019	0,4	46,5	2020 až 2024	2032	60	**yes**	**-2,4**	**Low**
Y 2019 – Debt break	2019	0,4	46,5	2020 až 2024	2032	40	**yes**	**-0,5**	**Low**
Y 2021	2021	0,7	43,3	2020 až 2024	2032	60	**yes**	**-3,1**	**Low**
Y 2021 – Debt break	2021	0,7	43,3	2020 až 2024	2032	40	**yes**	**-0,8**	**Low**

Source: MoF SR

** In the case of a negative S1, use of the fiscal space in successive years.*

TABLE 49 - Breakdown of S1

	Y 2019	Y 2019 – debt break	Y 2021	Y 2021 – debt break
S1 indicator (% GDP)	**-2,4**	**-0,5**	**-3,1**	**-0,8**
Of which:				
Initiial budgetary position	-0,9	-0,9	-1,1	-1,1
Cost of delaying*	-0,3	-0,1	-0,5	-0,1
Required debt level	-1,1	0,5	-1,6	0,3
Longterm components (cost of ageing)	0,0	0,0	0,1	0,1
II. pension pillar	0,0	0,0	0,0	0,0

** In the case of a negative S1, use of the fiscal space in successive years.*

TABLE 50 - Assumptions of MoF SR behind S2 calculation

	Baseline year (t_0)	Primary structural balance	Debt (t_0)	II. pension pillar included	Value of S2	Risk
Y 2019	2019	0,4	46,5	**yes**	**2,5**	**Medium**
Y 2021	2021	0,7	43,3	**yes**	**2,3**	**Medium**

Source: MoF SR

TABLE 51 - Breakdown of S2

	Y 2019	Y 2021
S2 indicator (% GDP)	**2,5**	**2,3**
Of which:		
Initial budgetary position	0,2	-0,1
Pension expenditures	0,7	1,0
Health and longterm expenditures	1,4	1,3
Education and unemployment exp.	0,1	0,1
II. pension pillar	*0,1*	*0,0*

[94] Total impact of revenues to the II. pillar on the sustainability rating is slightly negative by 2032. In the long run, it is slightly positive. The Ministry of Finance considers this approach to be more correct because changes in capitalization systems affect not only the expenditure and revenue of the pension system.

Annex 7 - Macroeconomic and Tax Revenue Forecasts Committees

The Stability Programme is based on macroeconomic and tax forecasts up to 20201, disclosed in February 2018. The macroeconomic scenario as well as the forecast tax revenues are subject to continuous discussion, approval and expert scrutiny by committees composed of national experts from both the public and private sector. The dates for disclosing forecasts as well as the guiding principles of the committees are laid down in the Fiscal Responsibility Act.

After the January 2018[95] session of the Macroeconomic Forecasts Committee, most of its members assessed the medium-term macroeconomic forecast of the Ministry of Finance of the Slovak Republic as **realistic**, two members marked it as **optimistic**.

TABLE 52 - Assessment of the February forecast of the MoF SR by the Macroeconomic Forecasts Committee

Committee member	Forecast characteristics
NBS, ČSOB, Infostat, SAV, SLSP, UNICREDIT Bank	realistic
Tatrabanka, VÚB	optimistic

Source: Macroeconomic Forecasts Committee

TABLE 53 - Average forecast of Committee members

	2017	2018		2019		2020		2021	
in %, unless otherwise stated		Committee	MoF SR	Committee	MoF SR	Committee	MoF SR	Committee	MoF SR
Gross domestic product, real growth	3,3	3,9	4,2	4,1	4,5	3,7	3,9	3,2	3,4
Gross domestic product in current prices; EUR billion	85,0	89,9	90,2	95,1	96,1	100,6	102,1	106,6	108,0
Final consumption of households; real growth	3,7	3,5	3,5	3,2	3,2	2,9	2,8	2,8	2,5
Final consumption of households; nominal growth	5,1	5,6	5,7	5,4	5,3	5,2	5,1	5,1	4,9
Average monthly wage; real growth	3,3	2,8	3,2	3,0	3,3	2,9	2,9	2,9	2,8
Average monthly wage; nominal growth	4,6	4,9	5,2	5,0	5,4	5,1	5,2	5,1	5,2
Employment growth (statistical reporting)	2,2	1,6	1,7	1,1	1,1	1,0	1,0	0,6	0,7
Consumer price index; average growth; CPI	1,3	2,0	2,0	2,1	2,0	2,2	2,2	2,1	2,3
Current account balance; share of GDP	-1,8	-1,0	-1,6	-0,2	-0,7	0,3	-0,1	0,4	0,5

Source: Macroeconomic Forecasts Committee

Tax Revenue Forecasts Committee

At the meeting of the Tax Revenue Forecasts Committee in February 2018, the MoF SR presented an updated medium-term forecast of tax revenues for 2017–2021. The medium-term forecast of tax revenues and pensions contributions of the MoF SR was indicated by all of the members as **realistic**.

TABLE 54 - Assessment of the MoF SR forecast by the Tax Revenue Forecasts Committee

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

[95] The Macroeconomic Forecasts Committee met in January 2018, while the forecast itself was officially published in February 2018.

Annex 8 - Mandate for review of healthcare expenditure II.

Review of expenditures in the health sector II. in a volume of 5.5% of GDP per year, will seek to find the best options for improving patient health by increasing efficiency with available resources. Emphasis will be given to health-enhancing value measures that can be implemented to continue reducing inefficient expenditure. The review will introduce funding based on total healthcare expenditure, while improving tracking of results and data collection. The objective remains to reduce the number of avoidable deaths to the V3 average. Additional expenditure beyond inflation will be conditional on a positive impact on better health outcomes.

Review in healthcare I.

In 2016, the first round of the Health Expenditure Review was conducted. The result was the identification of potential savings worth 363 million euros and the plan to save 174 million euros in 2017. According to the Summary Implementation Report, savings of 80 mill. euros were implmented to the date of 31.12. 2017.

Resulting objectives

The main resulting objective for the health sector is to reduce mortality rate by the health care system to the level of the average of V4 countries by 2020 with health expenditure rising at the rate of inflation. In 2014, averted mortality in Slovakia amounted per 100,000 inhabitants, with 243 deaths; the average of Hungary, Poland and the Czech Republic (V3) represented 204 deaths (see Table 1). The review will include the setting of more detailed indicators of performance, which will be part of the budget and allow for better measurement of the added value of resources spent in the health sector.

TABLE 55 - Avoidable mortality

		2011	2012	2013	2014	2015
Mortality reversible by healthcare (standardized death rate per 100 thousand inhabitants)	SK	262	261	262	243	250
	V3	227	222	216	204	205
	EÚ28	138	135	131	126	127

Source: Eurostat

Fiscal objectives

Healthcare funding will be secured on the basis of planning the total necessary healthcare expenditure rather than funding for state insurers that is volatile and does not identify actual needs. Higher health expenditure above the level of inflation will be conditional on demonstrating a positive impact on health outcomes. In addition, the major prerequisites for faster growth are the cessation of hospital indebtedness, the change of salary of health care workers, prescription limits, the full functionality of DRG and eHealth.

TABLE 56 - Expenditure on public health insurance

	2016 S	2017 S	2018 OS	2019 N	2020 N	2021 N
Expenditure on public health insurance	4 539	4 576	4 714	4 808	4 914	5 027
Inflation (%)	-0,5	1,3	2,0	2,0	2,2	2,3

S - Reality, OS - expected, N - proposal *Source: MoF SR*

Improving the links between expenditures and results and their sustainability will be ensured by updating programs and indicators within the framework of program budgeting.

Areas of review

Despite the positive developments in recent years, there is space for improving patient health by increasing allocation efficiency beyond the ongoing investment in the construction and reconstruction of hospitals. The review of expenditure therefore identifies savings in areas where the funds are used inefficiently, on the one hand it identifies areas for the reallocation of savings.

Areas with potential for savings	Areas with potential for value growth

▪ Medicines, medical aids and special medical supplies ▪ Joint Investigational and Medicinal Components (SVHC, eg radiodiagnostic or laboratory examinations) ▪ management of the General Health Insurance Company ▪ hospital	▪ prevention ▪ long-term, home and after-care ▪ Day care ▪ shortening waiting times

Responsibilities and deadlines

The Ministry of Finance is responsible for drawing up the report, which is elaborated in co-operation with the Ministry of Health. For the needs of analyzes, the Ministry of Health of the Slovak Republic and the Ministry of Finance commit themselves to cooperation in providing complete and detailed data and information. The interim report with measures on the public finance budget for 2019-2021 will be published no later than the end of September 2018, the final report will be published by the end of September 2019.