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COMMISSION STAFF WORKING DOCUMENT

In-depth review for Slovakia

Prepared under Regulation 1176/2011 on the prevention and correction of macroeconomic imbalances

European Commission

Slovakia

In-Depth Review 2025

9033/25

ECOF

This in-depth review presents the main findings of the Commission's staff assessment of macroeconomic vulnerabilities for Slovakia for the purposes of Regulation (EU) No 1176/2011 on the prevention and correction of macroeconomic imbalances. It provides technical input to the Commission for the Communication "European Semester – 2025 Spring Package" that will set out the Commission's assessment as to the existence of imbalances or excessive imbalances in Slovakia. That Communication will be published in

This in-depth review (IDR) analyses the evolution of Slovakia's vulnerabilities related to cost competitiveness, external accounts, house prices and household debt. This year's IDR, which follows the 2025 Alert Mechanism Report (AMR) published in December 2024, assesses the persistence or unwinding of the vulnerabilities identified last year, potential emerging risks, and relevant policy progress and policy options that could be considered for the future [1].

The vulnerabilities in Slovakia are analysed in a macroeconomic context of moderate growth and slow recovery in exports. In 2024, Slovakia's GDP growth accelerated to 2.0% in 2024 compared to 1.6% in 2023 as inflationary pressures receded and supply chain bottlenecks eased. Real GDP growth is projected to be 2.3% in 2025 and 2.5% in 2026[2]. Growth will be mainly supported by strong domestic consumption and recovering exports. Headline inflation decreased significantly in 2024 to 3.2% but it is expected to accelerate again in 2025 to almost 4% due to tax increases and growing energy prices. The pass-through from energy and food prices to other goods and services continues, with core inflation reaching 4.1% in 2024; and is expected to remain at a very similar level in 2025 before edging to below 3% in 2026[3]. Given the tight labour market and past nominal wage growth below inflation, wage growth is expected to remain strong with nominal compensation per employee expected to grow by 4.9% in 2024. A weaker economic performance of Slovakia's major trading partners could adversely affect the current account and fiscal balances. There is also a risk that if inflation becomes entrenched at an elevated level, debt financing costs could also remain higher.

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(1) European Commission (2024), Alert Mechanism Report 2025, Communication from the Commission to the European Parliament, the Council and the European Economic and Social Committee, COM(2024) 702 final; and European Commission (2024), Alert Mechanism Report 2025, Staff Working Document, SWD(2024) 700 final.

(2) All forecast data used in the IDR come from the Commission Autumn 2024 Forecast (European Economy, Institutional Paper 296), unless stated otherwise, in order to ensure the coherence of the various figures and calculations. The cut-off date for the data for the preparation of this IDR was 24 March 2025. Actual outturn data that have become available after the Autumn Forecast, and before the cut-off date for the IDR, are mentioned.

(3) Input-output analysis indicates that over the period 2020-2024, foreign demand contributed -0.2 pps. to Slovakia's cumulated GDP growth of ca. 7.2%; conversely, due to its limited size, the Slovakian domestic demand had little impact on the EU growth. Over that same period, imported value-added inflation accounted for 2.7 pps. of the 34.7% cumulated inflation. See European Commission Institutional Paper 2025 (forthcoming) – "Economic spillovers and financial linkages in the EU".

In 2023 and 2024, Slovakia has been characterised by a large but improving current account deficit, high inflation and unit labour costs, elevated house prices and relatively high though declining household debt. Driven by recovering exports and lower energy prices, the current account deficit improved from 9.6% of GDP in 2022 to 1.8% of GDP in Q3 2024 and is forecast to increase slightly in 2025 and 2026. While inflation declined significantly from 10.5% in 2023 to 3.2% in 2024, a high inflation differential vis-à-vis the EU area is expected to persist, resulting mostly from the recently adopted tax increases. At the same time, unit labour costs are expected to continue growing faster compared to several trading partners, undermining further Slovakia's competitiveness. When it comes to the housing market, after a decrease in 2023, house prices have risen again in 2024, further straining households' housing affordability. Meanwhile, the decline in residential construction has exacerbated an already tight housing supply. After two decades of strong growth in household debt, higher interest rates dampened mortgage demand over the past two years. However, with the recent monetary policy easing, a rebound is expected.

2.1. EXTERNAL SECTOR

Assessment of gravity, evolution and prospects of vulnerabilities

The current account deficit fell significantly from 9.6% of GDP in 2022 to 1.8% of GDP in Q3 2024, closer to fundamentals, and it is forecast to increase slightly in 2025 and 2026. Over the period 2016-2020, Slovakia's current account deficit averaged 1.8 % of GDP, with a 1.1 % trade balance surplus and an average 2.9% deficit generated by the primary and secondary incomes, mainly income on the foreign direct investments. After a strong increase in 2022 due to temporary shocks from energy prices and supply bottlenecks, the current account deficit returned to 1.7% in 2023. A current account balance in line with economic fundamentals is estimated at around -0.1% of GDP. To attain the prudential level of the net international investment position (NIIP), a level around 1.9% would be required (Table 2.1). For 2025 and 2026, the current account balance is expected to stabilise somewhat below these benchmarks, at around -3.0% of GDP, slightly below the long-term average.

The trade balance of goods and services is forecast to remain positive in 2025 and 2026, but risks remain tilted to the downside. In the Commission's autumn forecast, the trade balance of goods and services is forecast to reach 0.4% of GDP in 2025 and 1.2% of GDP in 2026. Export volumes are forecast to grow by 3.8% in 2025 and 4.0% in 2026, driven by increasing exports of machinery and transport equipment. The services balance is expected to have an increasing positive contribution to the trade balance in the coming two years.

From a net borrowing/lending perspective by sector, the government was the main contributor to the economy's net borrowing in 2023 and 2024. The government deficit is expected to worsen from 5.2% of GDP in 2023 to 5.8% of GDP in 2024 and is set to continue to weigh on the economy's net external position (Graph 2.1.c). The persistent budget deficit also contributes to stimulating domestic demand and increasing imports. The elevated public deficit in 2023 was driven largely by untargeted energy support measures, whereas in 2024, public wage expenditure and social benefits were the key contributors. In the last years, Slovakia has had one of the highest sovereign bond yields in the euro area. The government deficit is projected to decrease to 4.7% of GDP in 2025 and further to 4.1% in 2026, primarily due to the fiscal consolidation package worth 1.9% of GDP in 2025. Nevertheless, it will continue to contribute to Slovakia's net borrowing going forward. Risks to fiscal sustainability are high overall in the short, medium and long term (see Box 2.1).

Corporations and households contributed positively to the net lending position in 2023. The net lending of corporations was positive in 2023 due to a strong increase in gross operating surplus significantly outweighing the increased private investments. The contribution is expected to remain positive in 2024. For households, their purchasing power was affected by high inflation in 2022 and 2023, but real disposable income started improving in 2024 on the back of real wage growth. While the households' lending position is expected to be positive in 2024, their position is expected to shrink going forward, as private consumption is forecast to outpace growth in disposable income.

Slovakia's net international investment position (NIIP) continues to strengthen, driven by strong GDP growth and an improving net position of the private sector. The Slovak NIIP increased from -60% of GDP in 2021, broadly the average of the past decade, to around -50% of GDP in 2024, primarily due to a strong growth in nominal GDP in the last three years (Graph 2.1.b). In terms of sectoral decomposition, the net position of the private sector improved significantly from -42% at the end of 2019 to -20.3% at the end of 2024, thanks to increases in corporate sector profitability. At the same time, the net position of the general government strengthened only moderately, from -26% at the end of 2019 to -21.4% at the end of 2024. Moreover, the share of public debt held by foreign investors rose to more than 50% at the end of September 2024, the highest value since 2021. The NIIP is markedly below the fundamental (-6%) but in line with prudential (-50%) thresholds. While new equity FDIs have declined between 2019 and 2023, with a small rebound in 2024, the stock of foreign direct investment (encompassing primarily equity and intercompany loans) still forms a significant portion of liabilities. The net position excluding non-defaultable instruments (NENDI) is therefore significantly lower than the NIIP at –10.9% in 2024. This significantly reduces the risk of sudden capital outflows.

Assessment of MIP relevant policies

Reducing the government deficit is an important step towards decreasing the pressure on the country's external balances. In its medium-term fiscal-structural plan, Slovakia commits to a net expenditure growth [4] that does not exceed 14.8% in cumulative terms by 2028. In particular, Slovakia commits to a net expenditure growth that does not exceed 3.8% in 2025, 0.9% in 2026, 1.6% in 2027 and 1.5% in 2028 [5]. According to the plan, general government debt would gradually increase from 58.5% of GDP in 2024 to 62.1% in 2027, before beginning to decline to 61.4% of GDP in 2028 (the end of the adjustment period). The fiscal strategy of the plan relies mainly on discretionary revenue measures, including an increase of the VAT base rate, adjustments in corporate income tax (CIT) rates, and the implementation of a financial transaction tax. The

(4) Net expenditure as defined in Article 2 of Regulation (EU) 2024/1263, namely government expenditure net of (i) interest expenditure, (ii) discretionary revenue measures, (iii) expenditure on Union programmes fully matched by revenue from Union funds, (iv) national expenditure on co-financing of programmes funded by the Union, (v) cyclical elements of unemployment benefit expenditure and (vi) one-offs and other temporary measures.

(5) These are also the growth rates that the Council recommended. The cumulative growth rates are calculated by reference to the base year of 2023. Council Recommendation of 21 January 2025 endorsing the national medium-term fiscal-structural plan of Slovakia, Official Journal of the European Union C/2025/645, 10 February 2025.

measures in the plan represent one third of the targeted consolidation amount, with the remaining two thirds to be specified in subsequent annual budgets.

Reducing Slovakia's high level of dependence on energy imports constitutes a major challenge. Reforms and investment in Slovakia's recovery and resilience plan (RRP) and REPowerEU contribute to reducing the energy intensity of the country's economy and to promoting renewable energy. These include investments in renewables, grid capacity and energy efficiency of buildings, as well as reforms reducing administrative hurdles and improving the regulatory framework for renewables. Once implemented, these policies are expected to reduce energy import dependence and help protect the economy against potential shocks to its current account balance.

Taking measures to improve the business environment and promote innovation would also indirectly support exports. Investments in innovative technologies can further boost the country's export potential in the long term. With IT representing 20% of the total services exports, digitalization of the economy is crucial for supporting this fast-growing export segment [6]. Slovakia has recently adopted several measures outlined in the Competitiveness section below (Section 2.2) to improve the business environment.

2.2. COMPETITIVENESS

Assessment of gravity, evolution and prospects of vulnerabilities

Slovakia's competitiveness is undermined by prolonged high inflation differentials and growing unit labour costs (ULC). HICP growth stood at 5.7% on average over the period 2019-2024, compared to 3.9% in the EU average. Unit labour costs increased by 5.3% on average over the period 2019-2023, compared to 3.3% in the EU, as salaries grew to keep up with inflation, while productivity growth remained low. With close to half of the exports going to the euro area countries, the effect of the appreciation of the nominal exchange rate has been limited. However, inflation had the largest effect on the appreciation of real effective exchange rate (REER) between 2022 and 2024, thus weakening the cost competitiveness position of Slovakia (Graph 2.2.a).

Inflation has been declining recently but is forecast to remain higher than in Slovakia's main trading partners in 2025 and 2026, posing a risk for price competitiveness. In 2024, HICP inflation dropped to 3.2%, still significantly above the 2.4% registered in the euro area (Graph 2.1.d). The 2024 core inflation in Slovakia also remained at a considerable level of 4.3%, compared to a more moderate rate of 2.8% in the euro area. Due to government agreements with main energy providers to limit the impact of energy price increases for households and businesses, energy prices drove HICP inflation less than in neighbouring countries in 2022-2023. In turn, the energy prices decline forecast for 2024-2026 will also have a weaker impact on Slovakia's inflation, compared to other EU countries while the prolongation of energy support measures into 2025 limits some of the inflationary pressures in the short term. However, due the inflationary effects of

[6] The implementation of European Digital Innovation Hubs aims to increase the digital intensity of enterprises and help SMEs integrate advanced digital solutions. Digital and innovation vouchers, which are measures financed by EU funds (like digital and innovation vouchers, Digitrans Slovakia) support the digitalization of businesses and SMEs.

the VAT increases included in the fiscal consolidation package and rising food prices, inflation in Slovakia is projected to remain the highest in the euro area, further widening the cumulated inflation differential.

ULC growth is projected to continue in the future, albeit at a slower pace, on the back of a tight labour market and still high inflation. ULC growth in Slovakia is expected to continue at 3.5% in 2025 and 2.8% in 2026 (slightly above the EU average of 2.6% and 1.8%, but below eastern European peers). The growth is driven by still consistent albeit declining increases in nominal wages, partly offset by gains in productivity. The nominal wage pressure is amplified by a tight labour market due to robust labour demand and demographic pressures. Additionally, due to the high inflation in past years, the real wage declined by 5.2% in 2022 and 0.4% in 2023, leaving a significant gap between the real and nominal wage. Thus, nominal wage growth is forecast above 5% in 2025 and 2026. Slovak productivity growth was above the EU average in the past 5 years and is set to grow by 2.2% in 2025 and 2.4% in 2026, compared to 0.9% and 1.3% in the EU, according to the Commission's Autumn 2024 Forecast. The slowdown in technological advancement, a structure of manufacturing that remains concentrated in low value-added activities and the shortages of skilled workers hold back productivity growth. This is compounded by R&D expenditures at 1.04% of GDP in 2023, being well below the 2.22% EU average.

The accumulated cost increases risk to negatively impact Slovak exports going forward. In 2021 and 2022, Slovak exporters registered a decline in market shares due to trade disruptions, followed by a slow recovery in 2023 and 2024. As the production and export activities are heavily focused on the automotive sector, with a high integration into global value-added chains, the structural changes driven by ongoing transitions and potential trade disruptions could have a profound impact on the economy's structural dynamics. Slovakia's increase in export prices of manufactured goods was lower compared to other EU countries [7], but given the labour-intensive exports, strong cumulated wage increases are posing a risk to the economy's already weakened cost competitiveness position.

Assessment of MIP relevant policies

Decreasing the labour tax wedge, increasing the labour supply and addressing skills mismatches would improve productivity and contain ULC growth. Slovakia's high labour taxes could dampen further increases in employment. Labour taxes as a share of total taxes stood at 53.9% in 2023, one of the highest in the EU. The tax wedge for lower income earners is relatively high in Slovakia, primarily due to the flat-rate social contributions, while the progressivity of personal income tax is limited. The newly adopted Adult Education Act is a step forward. Further measures such as those mentioned in the 2030 Digital Transformation Strategy, National Digital Skills Strategy and Action Plan 2023-2026 is being implemented. Stimulating labour mobility, both between sectors and geographically (including by addressing housing shortages), could help mitigate labour and skill shortages and alleviate excessive pressure on wages.

Measures to reduce the regulatory and administrative burden, improve access to finance and stimulate R&D investments should also help address competitiveness challenges. The

[7] *Inflation Differentials in Europe and Implications for Competitiveness: Thematic Note to Support In-depth Reviews*, European Economy: Institutional Paper 198. European Commission (2023).

government has taken steps to improve the business environment, many of them as part of the RRP. These include for example ex-ante evaluation of planned transposition of legislation to prevent unjustifiable gold plating, ex-post evaluation of the effectiveness and justification of already introduced regulation or the 'one-in two-out' rule that ensures that new legislation does not increase administrative costs for businesses. An update of the insolvency framework has also been put forward, considering that the index of new bankruptcies compared to 2015 was still high and above the EU average in 2018-2023. Access to capital markets for companies remains an issue, with the European Investment Fund (EIF) Access to Equity Finance index showing a value of just 0.07 in 2023 in Slovakia, compared to 0.21 in the EU on average, pointing to the importance of developing the capital markets and venture capital financing [8]. These measures would also facilitate addressing the low R&D especially among SMEs.

Recent consolidation measures increasing the tax burden for businesses pose risks to competitiveness. The fiscal consolidation package includes an increase in the rate of corporate income tax from 21% to 24% for companies with a yearly taxable income of above 5 million EUR. Furthermore, the new financial transaction tax (FTT) introduces a tax rate for businesses of 0.4% for every transaction (with a maximum tax value of 40 EUR) and 0.8% for cash withdrawals. The two measures together are to raise 1 billion EUR (0.7% of GDP) in 2025. These changes to the tax system increase cost pressures and create additional burdens for companies, adversely affecting competitiveness. It is important that the consolidation efforts preserve investment and are designed in a growth-friendly manner, helping Slovakia remain attractive to investors.

2.3. HOUSING MARKET

Assessment of gravity, evolution and prospects of vulnerabilities

After house prices declined in 2023, the housing market started to recover slowly in 2024. After a rapid increase in house prices up to 2022, the tightening of monetary policy that started in Q3 2022 led to a gradual decline in house prices, driven primarily by the higher cost of mortgages. However, as a result of higher economic growth and lower unemployment, nominal house prices have risen year-on-year again by 4% and 6.2%, respectively, in Q2 and Q3 2024. House prices have recovered also in real terms, rising by 2.2% in Q3 2024 after a decline of almost 12% in Q3 2023 year-on-year (Graph 2.2.b). The growth in prices is primarily driven by the Bratislava region, followed by the Žilina and Prešov regions. Following the significant increase in incomes in 2024, house prices were estimated to be overvalued by around 4% in 2024. However, house price growth is expected to increase going forward and possibly outpace income growth.

Housing affordability, despite some improvement in 2023, declined again in Q3 2024. After a recovery in 2023, housing affordability has started declining towards the end of 2024, particularly in the areas of Bratislava, Kosice and Banska Bystrica [9]. This is due to the increased price growth outweighing the effect of wage growth and reduced mortgage rate. According to the Deloitte

(8) EIF Working Paper 2023/92, The 2022 EIF SME Access to Finance Index August 2023 update.

(9) Housing affordability is measured through the price-to-income ratio. The price-to-income gap for Q3 2024 is below pre-pandemic levels, when housing affordability was lower due to the fast growth in house prices (Graph 2.2.c).

Property Index, Slovakia is among the countries in the EU with the worst housing affordability [10]. Low housing affordability weighs significantly on labour mobility and consequently on the competitiveness of the economy.

Housing supply in Slovakia remains weak and is not expected to increase in the near future. Slovakia continues to face a significant housing shortage, with the number of dwellings per thousand inhabitants among the lowest across the OECD countries [11]. Residential construction, accounting for 3.5% of GDP, below the EU average of 6%, has been declining since Q4 2023. Similarly, the number of building permits has been decreasing since Q4 2023, reaching a low of -26.3% in Q3 2024 on an annual basis, the biggest decline since Q4 2022. The main factors behind this are higher construction costs and labour shortages, which, going forward, might also translate into higher house prices and a further deterioration of housing affordability. Slovakia's inefficient permitting procedures, driven by high administrative fragmentation and inadequate resources at the municipal level, weigh on housing supply [12]. Additionally, a significant number of vacant dwellings, estimated at around 400 000 unoccupied flats and 250 000 unoccupied houses, further reduces the supply of dwelling available for purchase or rent.

Rents have been steadily increasing, and outpaced house price growth. In Q3 2024, the yearly growth of the nominal rent price index amounted to over 10% and was significantly higher than the growth in house prices over the same period. This is the result of a decline in the number of rental offers in 2024 because of the increased costs weighing on landlords, primarily linked to energy prices and maintenance. At the same time, demand for rented accommodations was in turn boosted by the inflow of Ukrainian refugees and foreign workers. Additionally, Slovakia's current legislative framework is not conducive to favouring rentals over homeownership, which remains the preferred alternative to most households in Slovakia [13]. The high rents and low availability of rented accommodations particularly affect young people who are unable to afford a mortgage and often continue living with their parents.

Social rental housing remains underdeveloped. In Slovakia, only 1.6% of the total housing stock is dedicated to social rental housing, against an EU average of 8% [14]. The demand for social housing exceeds supply, leading to long waiting lists, particularly in Bratislava. Despite financial support for construction or acquisition provided by the State Housing Development Fund, municipalities face numerous challenges for social housing projects, including limited land availability and complex bureaucracy. At the same time, housing allowances remain low and are primarily available to low-income homeowners or renters meeting strict eligibility criteria.

Assessment *of MIP relevant policies*

(10) Deloitte (2024): Property Index. Overview of European Residential Markets.

(11) De Pace, F. (2024), "Enhancing the efficiency, inclusiveness, and environmental sustainability of housing in the Slovak Republic", OECD Economics Department Working Papers, No. 1806, OECD Publishing, Paris, https://doi.org/10.1787/03157550-en.

(12) A shortage of skilled labour, insufficient qualifications, and irregular training contribute to delays, with building permits taking an average of 300 days, nearly double the 152-day average in OECD countries. Source: De Pace, F. (2024), "Enhancing the efficiency, inclusiveness, and environmental sustainability of housing in the Slovak Republic", OECD Economics Department Working Papers, No. 1806, OECD Publishing, Paris, https://doi.org/10.1787/03157550-en.

(13) In 2023, 93.5% of the population lived in owner-occupied dwellings, far above the EU average (69.2%).

(14) OECD (2024), OECD Affordable Housing Database - indicator PH4.2. Social rental housing stock, https://oe.cd/ahd.

Tackling the insufficient supply of housing is key to containing property price dynamics. Streamlining the process of obtaining building permits and reducing the administrative burden, through the Amendment to the Construction Act expected to be effective as of April 2025, would contribute to a faster creation of housing stock and thus stimulate new construction projects [15]. The amendment also features in Slovakia's medium-term fiscal-structural plan, as a measure strengthening social and economic resilience. The recent addition of approximately 100 rental units in Bratislava under the state-supported housing programme offers a modest contribution towards alleviating the substantial housing shortage. Around 35% of the units are reserved for public sector employees, particularly nurses, with rent subsidies of up to EUR 150 per month. While supported by a reduced 5% VAT rate, which applies generally to state-supported rental housing, the programme does not address social housing needs, as vulnerable groups remain excluded.

Slovakia's area-based property taxation system is widely regarded as inefficient and unequal. In Slovakia, property taxes are calculated based on the size of a property rather than its market value. This system, which Slovakia shares with regional peers like Poland and Czechia, fails to capture rising property values and disproportionately benefits owners of high-value properties. In contrast, a value-based property tax system, standard in most EU countries and recommended also by the IMF and OECD[16], is both more equitable and efficient. By linking taxes to market value, wealthier property owners would contribute proportionally more, boosting revenues while promoting fairness by equalising ownership and rental housing. Despite these advantages, the introduction of the relevant legislation would face considerable challenges, including the accurate valuation of properties and political resistance. Slovakia would benefit from developing analytical infrastructure to create property price maps, which could serve as a first step towards implementing value-based property taxation.

2.4. HOUSEHOLD DEBT

Assessment of gravity, evolution and prospects of vulnerabilities

After two decades of strong growth in household debt, Slovakia's household debt-to-GDP ratio declined in 2023 and 2024 due to slowing credit flows and elevated inflation. Household debt, which accounts for approximately half of private debt, steadily increased from 25% of GDP in 2010 to 47% in 2022. In 2023, it decreased to 44% and continued to decline to a moderate level of 42.3% in 2024, below the prudential threshold of 47.7% while remaining above the fundamentals-based benchmark of 29.9% [17]. The household debt level in Slovakia is higher than those of

(15) In January 2025, a large-scale cyber-attack on Slovakia's Office of Geodesy, Cartography, and Cadastre (UGKK) has paralysed the country's property management systems. The ransomware attack, suspected to have originated from outside Slovakia, has forced the UGKK to shut down all systems, significantly disrupting cadastral services, notary activities, property transactions, and other related public services such as parking permits in Bratislava. Despite the severity of the situation, the UGKK has assured that all land registry data is securely backed up.

(16) The transition to a value-based property tax system is recommended by the IMF (Slovak Republic: Staff Concluding Statement of the 2025 Article IV Mission, January 2025) and by OECD (*OECD Economic Surveys: Slovak Republic 2024*, *March 2024).*

(17) The fundamentals-based benchmark is derived from regressions capturing the main determinants of credit growth and taking into account a given initial stock of debt. The prudential threshold corresponds to the level of debt above which banking crises become more likely. It is derived from regressions minimising the probability of missed crises and that of false alerts. Methodologies are described in Bricongne et al. (2020) "Is Private Debt Excessive?", *Open Economies Review*, 31: 471-512.

regional peers, such as Czechia, Hungary and Poland, but still remains below the EU average, as the starting point for the increases was comparatively low. Commission calculations project that the debt ratio will rebound and increase by 15 ppt by 2034 under the baseline scenario, and by 25 ppt under a more pessimistic scenario of lower inflation and higher credit flows (Graph 2.2.d).

Low borrowing cost drove credit demand until 2022, but rising interest rates led to a sharp decline in household credit flows, followed by a gradual recovery in mortgage lending as conditions eased. The primary driver of credit demand has been cheap borrowing in a period of low interest rates until 2022, which drove demand for real estate. The cost of borrowing for new loans soared from around 1% in 2021 to more than 4% in the first half of 2024. It peaked in June 2024 but has come down only marginally since then. As a result, credit flows to households declined sharply from 4.1% of GDP in 2022 to 1.9% in 2023 and further to 0.9% in 2024, which is well below the benchmark value of 1.6%. The monetary easing started by the European Central Bank in June 2024 has fuelled a gradual recovery in both the number and average amount of mortgages for the first time since interest rates had begun to rise in 2022 [(18)]. Net lending bottomed in the first half of 2024 and is slowly moving back to its 2015-19 average levels. The rebound in mortgage lending can be related to positive developments in households' financial situation.

Households' financial situation has been improving due to declining inflation and positive labour market developments. The labour market shows low unemployment rate and rising real wages. In 2024, household consumption and real disposable income rebounded after a 2023 decline. The savings rate is expected to pick up in 2024 to 11.3%, exceeding its pre-pandemic levels, driven by strong real wage growth. Rising mortgage rates have had little impact on households' debt repayments. As of Q3 2024, 13% of mortgage holders benefited from a government subsidy, amounting to 89 euros on average, which supported Slovak households affected by an increase in interest payments. The volume-weighted average debt service-to-income (DSTI) ratio for newly issued mortgages declined from 47.5% to 45.4% between March 2023 and June 2024, though it remains above the 42.2% recorded at the end of 2021. The household non-performing loans (NPL) ratio remained relatively stable, declining from 4.6% in 2016 to a 2023 low before raising slightly to 1.9% in the first half of 2024, below the EU average [(19)]. Declining mortgage rates have resulted in shortening the rate fixation periods, which is now set mostly at 3 years or less instead of 5 years [(20)]. This shift reflects expectations of future rate cuts, allowing borrowers to renegotiate and reduce their overall debt burden.

Consumer credit has been growing steadily, partially driven by borrowers topping up their mortgage credit. The decline in consumer credit following the rate hikes in 2023 was less pronounced compared to the drop in mortgage origination. In Slovakia, unlike most other Member States, mortgage holders are allowed to top up their mortgage debt with consumer loans. This practice has been restricted through the introduction of borrower-based measures in 2018, whereby the maximum maturity of consumer loans has been capped at 8 years. This co-financing method is rather limited, with around 15% of households with the maximum loan-to-value (LTV)

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(18) Financial Stability Report, National Bank of Slovakia, November 2024.
(19) Financial Stability Report, National Bank of Slovakia, November 2024.
(20) Financial Stability Report, National Bank of Slovakia, November 2024

ratio set at 80% making use of it. In 2024, consumer credit grew by 5% of GDP, resulting from higher real incomes which have fuelled greater household consumption.

The banking sector remains sound and profitable, benefiting from an increased interest margin, rising mortgage demand, and high capital and liquidity buffers. Rising mortgage rates, which boosted net interest incomes, increased bank profitability with average returns on equity of 9.4% and 11.5% in 2022 and 2023. However, the introduction of the bank levy, set at 30% in 2024 and scheduled to decrease by 5 percentage points (pps.) annually until 2027, has significantly reduced the net-profits generated by banks. Meanwhile, declining mortgage rates have started fuelling households' growing demand for mortgages, driving banks' total interest income despite falling rates. At the same time, the slow recovery of the mortgage market, banks continue to benefit from relatively high interest rate margins. At the same time, banks' resilience remains high with elevated capital and liquidity ratios, and deposit growth outpacing lending growth.

Assessment *of MIP relevant policies*

The macroprudential policies adopted by Slovakia are adequate and ensure the stability of the banking sector. Following an adjustment which came into effect in 2023, the debt-to-income (DTI) limit is proportionally tightened for borrowers aged over 41 who will be repaying their loan after the age of 65. The DSTI ratio restricts loans if repayments exceed 60% of household's income. However, up to 5% of new loans may be approved with a DSTI ratio between 60% and 70% (21). Similarly, the LTV limit tightened in 2018 ensures that no loan can exceed 90% of the property value; while for only up to 20% of new loans, the LTV can reach 90%. Evidence shows that the average LTV ratio has increased in 2024 slightly compared to 2022, and the DSTI ratio has declined slightly.

The take up of the one-time public support for borrowers with high mortgage payments was much lower than expected in 2024. In 2024, mortgage holders could request a monthly contribution and tax allowance to cover the cost of the increased mortgage repayments. The contribution could amount to 75% of the difference between the increased and original monthly instalment, with a yearly cap at EUR 1 800 per mortgage holder. The National Bank of Slovakia deemed it unnecessary for addressing rising interest payments among Slovak households (22). In fact, the demand for this support turned out to be much lower than originally expected (the anticipated budgetary impact was less than 0.1% of GDP in 2024). Going forward, the support is assumed to be used even less.

Table A: **Main policies increasing or reducing risks of imbalances considered in this IDR**

Vulnerability	Policies	Implementation status
External sector	The consolidation package (largely revenue-driven, including adjustments in VAT, CIT and a new financial transaction tax), adopted as part of the 2025 budget law should help reducing the government deficit and, in turn, the pressure on the	Implemented in January 2025

(21) Financial Stability Report, National Bank of Slovakia, November 2024.

(22) Analytical Commentary, National Bank of Slovakia, March 2024

	country's external balance	
	Slovakia committed to take measures as part of its RRP to reduce its energy intensity and thus reduce energy imports. These include investment in renewables, grid capacity and energy efficiency of buildings, as well as reforms reducing administrative hurdles and improving the regulatory framework for renewables.	Ongoing as part of the RRP
Competitiveness	VAT adjustments, including a shift of the base rate from 20% to 23%.	Implemented in January 2025.
	CIT adjustments, including a rate increase from 21% to 24% for companies with a yearly taxable income of over 5 mil. EUR.	Implemented in January 2025.
	Financial transaction tax for businesses.	Adopted by the parliament, to be implemented as of April 2025.
	Measures to lower electricity and gas prices	In place since 2023
	The Adult Education Act, 2030 Digital Transformation Strategy and National Digital Skills Strategy and Action.	Ongoing implementation
	Measures to boost the digitalization of the economy and to improve the business environment. These include the implementation of the European Digital Innovation Hubs in Slovakia, or a "one-in, two-out" rule, ex ante and ex post evaluations for streamlining the regulatory environment. The measures should indirectly also help the exports (for example the IT services exports)	Ongoing as part of the RRP
Housing markets	The amendment to the Construction Act will streamline building procedures and is expected to reduce the administrative burden.	The amendment is expected to become effective in April 2025.
	The state-supported housing programme added approximately 100 rental units, with around 35% reserved for public sector employees (in particular nurses).	Implemented in March 2025.
Household debt and saving	Support for borrowers with high mortgage payments due to increases interest rates	Much lower impact already in 2024 than originally anticipated.

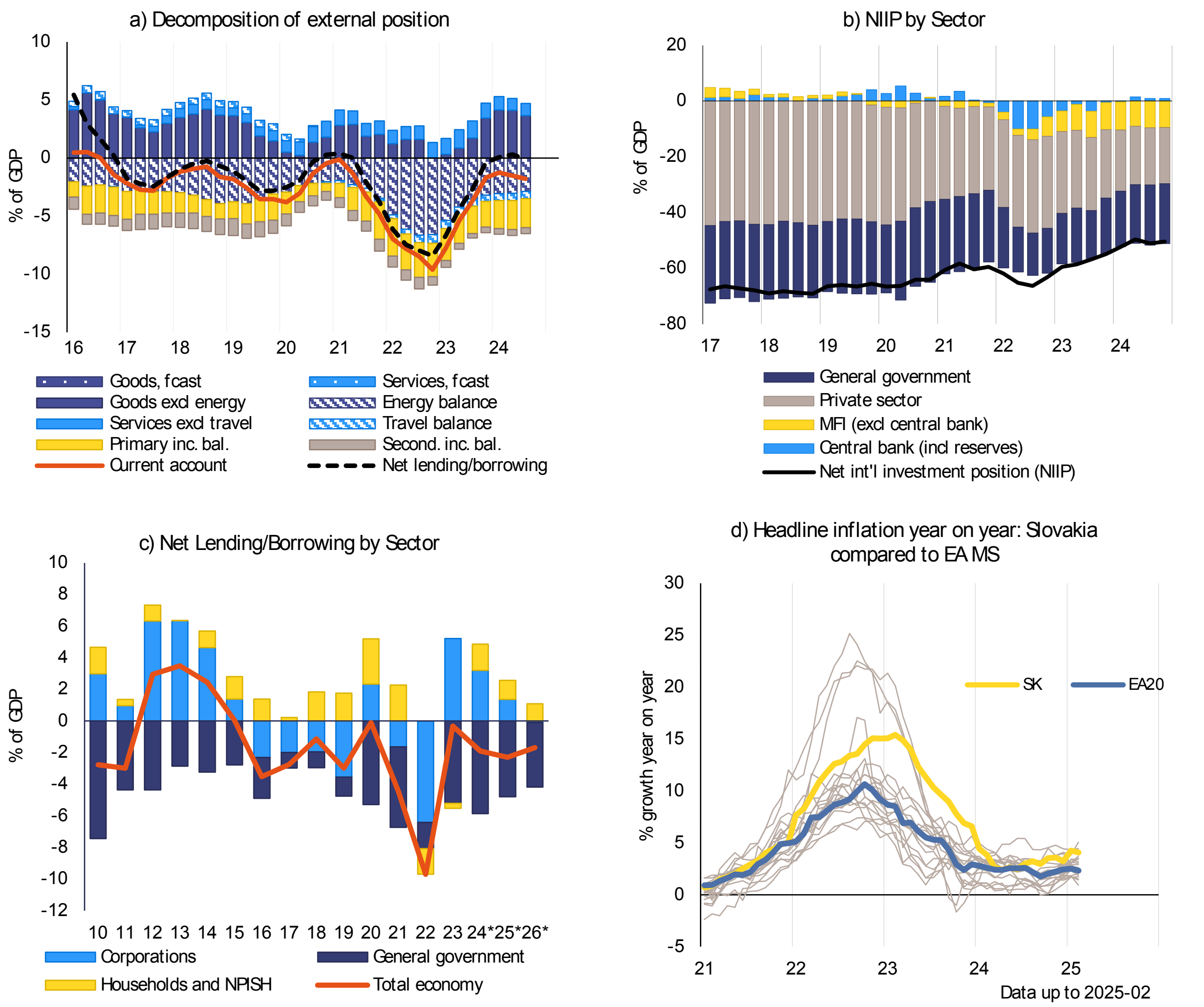
Note: This table lists the main measures that may increase or reduce the risks of macroeconomic imbalances. The measures are described more at length and reviewed in the text of this IDR.

Conclusions

Despite some recent improvements, Slovakia continues to face vulnerabilities related to competitiveness, external trade balance, housing sector, and household indebtedness. Slovakia's current account deficit declined, as recovering exports and lower energy prices led to improvements in the trade balance. However, the still high government deficit continues to pose a risk on the external sustainability as well as to fiscal sustainability, and the current account deficit is forecast to slightly increase again. Inflation decreased significantly but the inflation differential with the rest of the euro area and the EU is expected to persist due to recently introduced tax increases. Unit labour costs are expected to continue growing faster than in several trading partners, as the labour market remains tight, denting Slovak competitiveness. Additionally, house prices have slowly started to increase again, hampering housing affordability of households. At the same time, the decline of residential construction further exacerbates an already tight housing supply. After two decades of strong growth in household debt, higher interest rates muted the demand for mortgages in the past two years, which is expected to rebound as monetary policy has been easing.

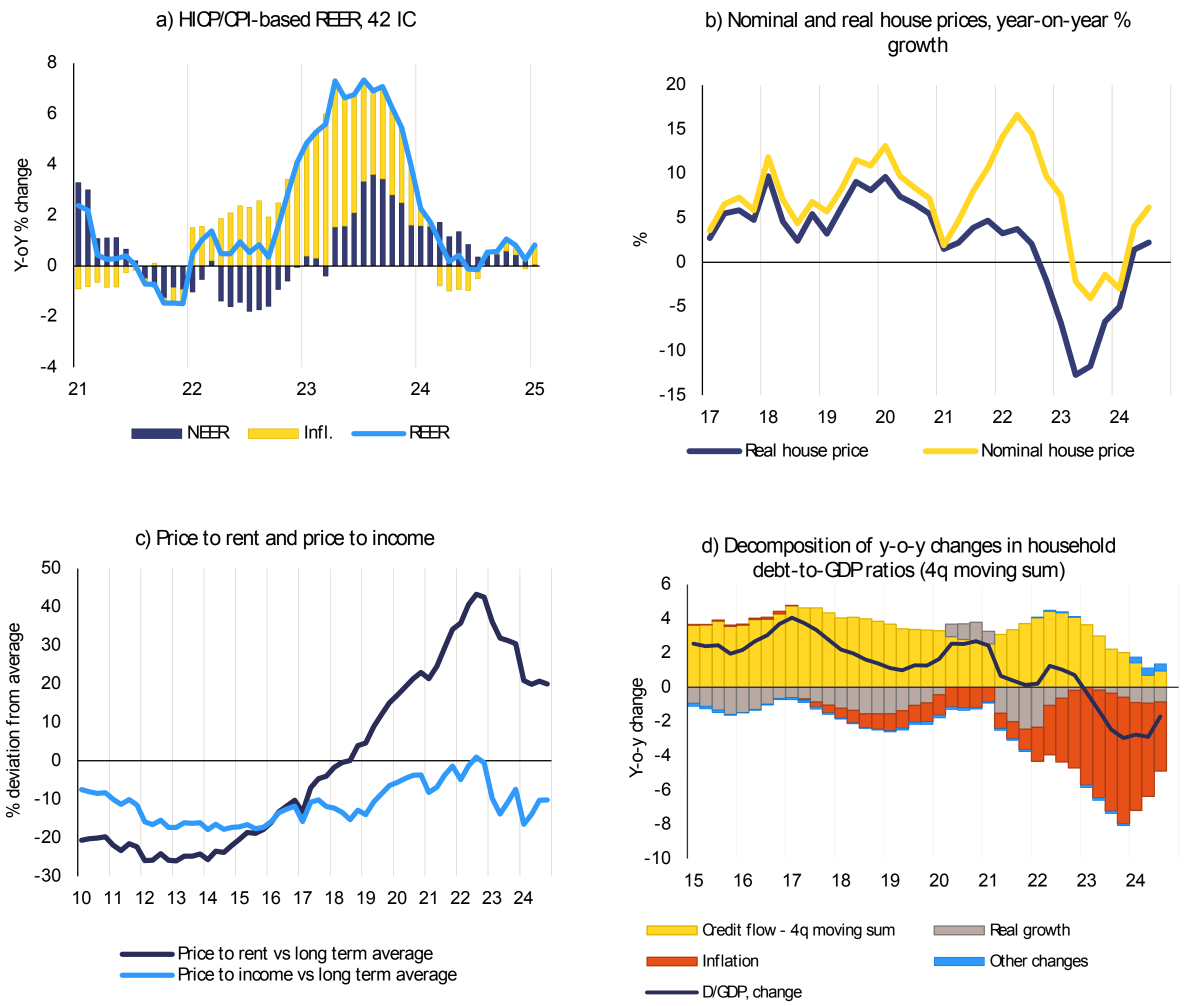
Policy progress has been limited. In order to limit inflation, energy support measures to limit price increases for household consumption of electricity and natural gas have been prolonged. However, this untargeted measure is one of the drivers of the sizeable government deficit as well as of the current account deficit. The medium-term fiscal-structural plan foresees a strong fiscal adjustment in 2025–2028. However, while supporting the reduction of the government deficit, recent tax increases weigh negatively on competitiveness. Measures to improve labour productivity and the business environment remain limited. When it comes to the housing market, Slovakia has recently adopted an amendment to the Construction Act, aimed at streamlining construction procedures, which will become effective as of April 2025. The borrower-based measures ensure the stability of the banking sector, while the take up of government support for households with high mortgage payments has been lower than originally expected.

Graph 2.1:**Selected graphs, Slovakia**



Source: ECB, Eurostat and European Commission forecasts and calculations.

Graph 2.2:**Selected graphs, Slovakia**



Source: ECB, Eurostat and European Commission calculations.

Box 2.1: **Medium-term external, private, and government debt projections**

This Box summarises external and internal debt to GDP projections for Slovakia over the next decade, based on scenario analysis. It covers scenarios to take into account different underlying assumptions for external, corporate and household debt stocks, as well as the outcomes of the latest government debt sustainability analysis (DSA) conducted by the Commission.

Slovakia's net international investment position (NIIP) is projected to strengthen further in the next ten years under the baseline scenario. In the baseline projections the NIIP strengthens, coming closer to the estimated prudential benchmark of around -50% of GDP at the end of the forecast period. According to the baseline scenario, with a trade balance surplus as key contributor, the NIIP will remain relatively flat. In an adverse scenario of a lower trade balance and if the annual inflation is assumed to be on average 1.6 pp below the baseline (assuming an annual average inflation rate of 0.9%), the NIIP ratio would deteriorate to around -63% of GDP. Risks to the country's external position are partly mitigated by the favourable NIIP structure, as non-defaultable instruments account for the bulk of net liabilities and are composed mostly of foreign direct investments. The NENDI (NIIP net of non-defaultable instruments) was around -15% of GDP in 2023.

The corporate debt-to-GDP ratio is projected to continue to decline over the next decade under the baseline scenario. The baseline scenario takes the 2024 nowcast as a starting point and foresees an average real GDP growth of 1.9% per year, average annual inflation rate of 2.7%, and annual corporate credit flows of 1% of GDP (below the debt-stabilising(1) NFC credit-to-GDP of 1.7%). In the baseline scenario, the NFC debt-to-GDP ratio is projected to decrease by about 6 pps to 33% by 2034 (Graph 2 b). Under an adverse scenario of high corporate credit flows over the entire projection horizon, this ratio would remain broadly stable over the projection horizon. If in addition to high credit flows, annual inflation is assumed to be on average 1.6 pp below the baseline (assuming an annual average inflation rate of 0.9%), the NFC debt-to-GDP ratio would increase to about 43%, still below its levels before and during the pandemic.

After a few years of deleveraging, the household debt-to-GDP ratio is projected to increase over the next decade under a broad range of scenarios. The baseline scenario takes the 2024 nowcast of 43% as a starting point and foresees an average real GDP growth rate of 1.9%, an average inflation rate of 2.7% and credit flows of 3.6% of GDP (solidly above the debt-stabilising credit-to-GDP ratio of 1.9%) for years 2025 until year 2034. As a result, the household debt-to-GDP ratio would increase by about 14 pps by 2034, to 57% (Graph 2 c). Under an adverse scenario of credit flows being higher for the entire period under consideration, the household debt-to-GDP ratio would decrease by 17 pps by 2034. If in addition to high credit flows, annual inflation is on average 1.6 pps below the baseline, the debt ratio would increase by 25 pps by 2034.

Short, medium and long-term risks to fiscal sustainability are overall high. The debt sustainability analysis carried out by the Commission indicates that, under the baseline scenario, the government debt-to-GDP ratio is projected to increase to around 72% in 2029 and to around 91% in 2034 (Graph 1 d) (2). This Commission's assessment of fiscal sustainability risks does not take into account Member States' commitments as outlined in the medium-term fiscal-structural plans. In line with standard practice, it only incorporates fiscal measures that have been legislated or agreed for 2025 and assumes unchanged policy afterwards.

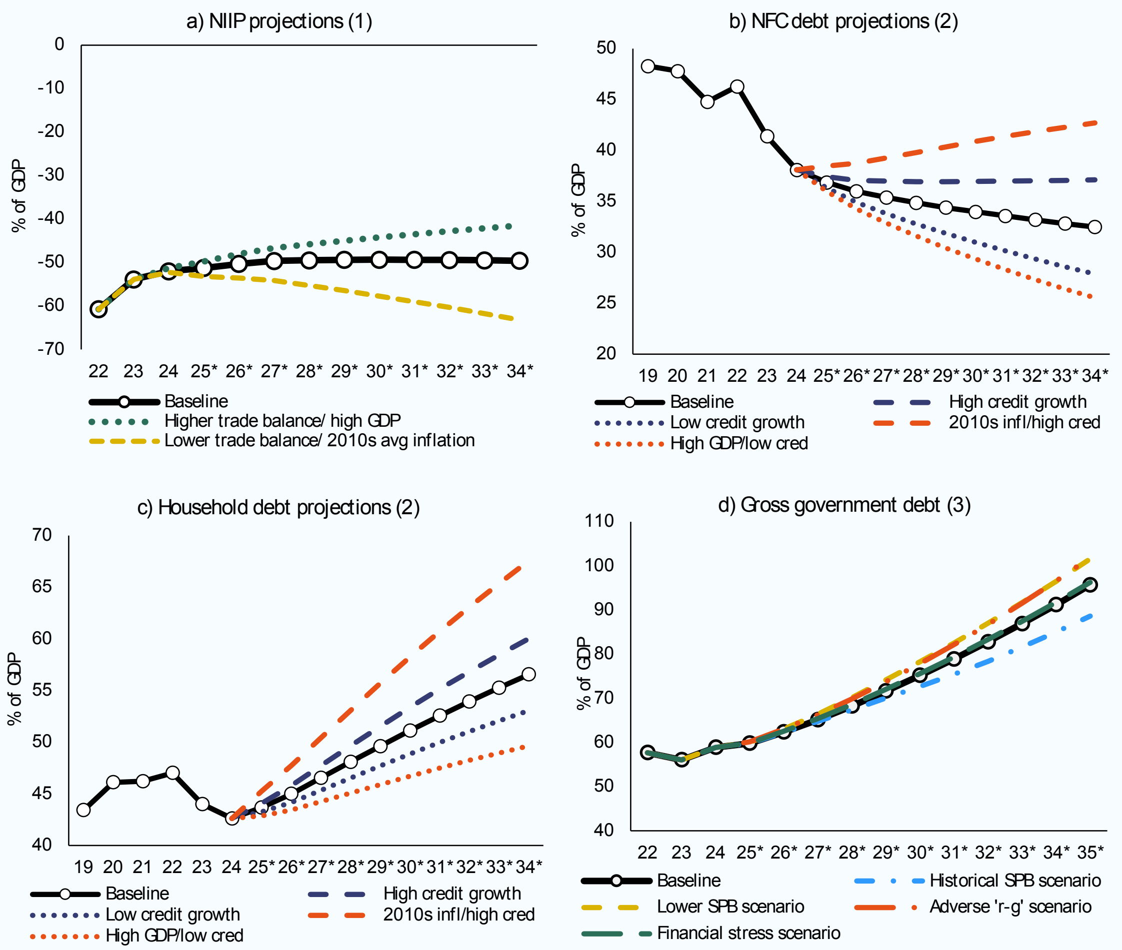
(1) The debt stabilising credit-to-GDP ratio refers to the credit ratio between 2025 and 2034 that would stabilise the debt to GDP ratio at its 2024 level.

(2) European Commission (2025), Debt Sustainability Monitor 2024, European Economy Institutional Paper 306.

(Continued on the next page)

Box (continued)

Graph 1: **External, private, and government debt projections, based on scenario analysis for Slovakia**



1) The baseline NIIP projections are based on the Commission's medium-term forecasts for GDP and interest rates. Additionally, assumptions are made about the drawdown of NGEU and MFF funds, and the median value of the last 3 years is used for non-investment income. The 'higher trade balance/ high GDP' scenario assumes higher trade balance in 2025 and beyond, with the difference to the baseline calculated as half the interquartile range of the annual 10-year-average trade balance to GDP ratios over 2013-2023 and additionally reflects a permanent 1 pp increase in GDP growth relative to the baseline scenario. The 'lower trade balance/ 2010s avg inflation' scenario assumes the same as the first scenario but with an opposite sign in the trade balance and also reflects an inflation rate that is set to the country-specific average inflation rate observed over the 2010s.
2) Both for the NFC and HH debt projections, the baseline refers to the country-specific median annual credit flow to GDP ratio over 2015-24. The high/low credit scenario assumes a higher/lower credit flow to GDP ratio, with the difference to the baseline calculated as half the intertercile range of the annual credit flow to GDP ratios over 2015-24. The high GDP growth scenario reflects a permanent 1 pp increase in GDP growth relative to the baseline scenario. The low inflation scenario reflects an inflation rate that is set to the country-specific average inflation rate observed over the 2010s.
3) The baseline projection for government debt is stress-tested against four alternative deterministic scenarios to assess the impact of changes in key assumptions: 'historical structural primary balance (SPB)' scenario, in which the SPB returns to its historical 15-year average of -2.1% of GDP; 'lower SPB' scenario: the improvement in the SPB forecast for 2025 is halved compared with the baseline; 'adverse interest-growth rate differential' scenario: the interest-growth rate differential is 1 pp. higher compared with the baseline; 'financial stress' scenario: interest rates temporarily increase by 1 pp. compared with the baseline.
Source: Eurostat, Debt Sustainability Monitor 2024, European Commission forecasts and calculations.

Table 2.1: **Key economic and financial indicators, Slovakia**

	average 2017-2019	average 2020-2022	2023	2024+	forecast 2025	2026
Output and Prices						
Real GDP (1 year % change)	3.1	1.1	1.4	2.0	2.3	2.5
Real GDP per capita (1 year % change)	2.9	1.1	1.4	2.0	2.6	2.7
GDP deflator (1 year % change)	1.9	4.0	10.1	3.6	3.8	2.8
Harmonised index of consumer prices (1 year % change)	2.2	5.5	11.0	3.2	5.1	3.0
Core inflation (HICP excluding energy, food, alcohol and tobacco) (1 year % change)	1.8	4.6	9.5	4.3	4.2	2.9
External position						
Current account balance, balance of payments (% GDP, 3y average)	**-1.9**	**-3.3**	**-5.4**	**-4.7**	**-2.6**	**-3.0**
Current account balance, balance of payments (% of GDP)	-2.3	-5.0	-1.7	-2.8	-3.5	-2.8
of which: trade balance (% GDP)	0.7	-1.9	1.0			
of which: income balance (% GDP)	-3.0	-3.1	-2.7			
Current account norm (% of GDP) (1)	-0.2	0.0	-0.2	0.1	0.2	0.2
Current account req. to reach fund. NIIP (% of GDP) (2)	0.3	0.8	1.6	1.9		
Net international investment position (% of GDP)	**-67.5**	**-62.3**	**-54.9**	**-48.1**	**-47.4**	**-46.5**
NENDI - NIIP excluding non-defaultable instruments (% of GDP)	-15.2	-15.8	-14.8			
Net lending-borrowing (% of GDP)	-1.7	-4.0	-0.4			
Competitiveness						
Nominal unit labour cost index per hour worked (3y % change)	**11.5**	**12.1**	**17.8**	**22.8**	**18.1**	**11.3**
Nominal unit labour cost index per hour worked (1 year % change)	4.7	4.0	9.2	4.5	3.5	2.8
Real effective exchange rate - 42 trad. part., HICP defl. (3y % ch.)	**1.1**	**4.1**	**7.5**	**8.3**	**6.4**	**3.6**
Real effective exchange rate - 42 trading partners, HICP deflator (1 year % change)	0.9	1.3	6.1	0.7	2.3	0.9
Export performance against advanced economies (3y % change)	**2.4**	**-0.4**	**-3.1**	**-5.9**	**2.8**	**2.6**
Export performance against advanced economies (1 year % change)	-0.2	-1.3	4.7	-3.0	3.2	2.5
Core inflation differential vis-à-vis the euro area (pps.)	0.8	2.6	4.5	1.4	1.8	0.9
Corporations						
Non-financial corporate (NFCs) debt, consolidated (% of GDP) (3)	**48.5**	**47.3**	**41.4**	**38.5**		
NFCs debt fundamental benchmark (% of GDP) (4)	44.9	46.7	45.1	45.2		
NFC (excl. FDI) credit flow, cons. (% debt stock t-1, excl. FDI)	4.8	5.7	2.5	1.1		
Households and housing market						
Household debt, consolidated (% of GDP) (3)	**42.1**	**46.4**	**44.0**	**43.0**		
Household debt fundamental benchmark (% of GDP) (4)	27.0	29.6	29.3	29.9		
Household debt, consolidated (% of Households' GDI)	60.7	63.3	61.1	57.6		
Household credit flow, consolidated (% debt stock t-1)	**10.1**	**8.1**	**4.8**	**2.3**		
Household gross saving rate (&)	9.1	9.7	7.2			
House price index, nominal (1 year % change)	**7.4**	**9.8**	**-0.2**	**0.8**		
House prices over/undervaluation gap (5)	-1.6	11.7	9.6	3.6		
Standardized price-to-income ratio	95.9	103.5	97.2			
Building permits (m2 per 1000 inh)	429.1	436.5	372.0			
Government						
General government gross debt (% of GDP)	**49.5**	**58.8**	**56.1**	**58.9**	**59.8**	**61.8**
General government balance (% of GDP)	-1.1	-4.0	-5.2	-5.9	-4.8	-4.1
Banking sector						
Return on equity of banks (%)	9.0	7.7	11.5			
Tier-1 capital ratio banking sector (% risk-weighted assets)	16.4	17.9	18.6			
Gross non-performing loans, domestic and foreign entities (% gross loans)	3.3	2.1	1.8	1.9		
Cost of borrowing for households for house purchase (%)	1.6	1.4	3.8	4.1		
Cost of borrowing for NFCs (%)	2.2	2.2	5.3	5.7		
Labour market						
Unemployment rate (% labour force Y15-74)	**6.8**	**6.5**	**5.8**	**5.3**	**5.1**	**4.9**
Labour force participation rate - % pop. aged 15-64 (3y change in pp)	**1.4**	**0.7**	**2.0**	**2.0**		

+ If actual data were unavailable at the cut-off date, forecast or nowcast data are presented instead; * Denotes values above prudential thresholds;

(1) Current accounts in line with fundamentals (current account norms): derived from reduced form regressions capturing the main determinant of the saving-investment balance, including fundamental determinants, policy factors and global financial conditions. See Coutinho, Turrini and Zeugner (2018), "Methodologies for the Assessment of Current Account Benchmarks", European Economy, Discussion Paper 86, DG ECFIN, European Commission.

(2) Current account required to reach the prudential level of the NIIP over 10 years: calculations make use of Commission's T+10 projections. See Coutinho, Turrini and Zeugner (2018), "Methodologies for the Assessment of Current Account Benchmarks", European Economy, Discussion Paper 86, DG ECFIN, European Commission.

(3) Prudential threshold for non-financial corporate and household debt-to-GDP ratio: corresponds to the level above which banking crises become more likely. It is derived from regressions minimising the probability of missed crises and that of false alerts. See Bricongne et al. (2020), "Is Private Debt Excessive?", Open Economies Review, 31:471-512.

(4) Fundamentals-based benchmarks for non-financial corporate and household debt-to-GDP ratios: assesses private debt from regressions capturing the main determinants of credit growth and taking into account a given initial stock of debt. See Bricongne et al. (2020), "Is Private Debt Excessive?", Open Economies Review, 31:471-512.

(5) House prices over/undervaluation gaps: is the simple average of the price-to-income, price-to-rent and model valuation gaps. The model valuation gap is estimated in a cointegration framework using a system of five fundamental variables: total population, real housing stock, real disposable income per capita, real long-term interest rate and price deflator of final consumption expenditure. Based on Philiponnet, N., Turrini, A. (2017), "Assessing House Price Developments in the EU", European Economy - Discussion Papers 2015 - 048, DG ECFIN, European Commission.

Source: Eurostat and ECB; European Commission for forecast figures (Autumn Forecast 2024).