SLOVENIA

Highlights

- **Economic recovery is accelerating.** After growing 2.3 per cent in 2015, the economy expanded by 3.1 per cent in 2016 on the back of rising exports and private consumption, and the pace of growth has picked up further in the first half of 2017.
- **Consolidation of public finances has advanced further.** This follows the exit of Slovenia in June 2016 from the European Commission's Excessive Deficit Procedure. The budget deficit dropped further to below 2 per cent of GDP in 2016, supported by over-performance of direct taxes and contributions, reflecting better-than-expected labour market developments.
- **Privatisations continue rather slowly.** Out of 33 state-owned enterprises (SOEs) reserved for privatisation in 2016, three have been successfully privatised, while a tender process is currently ongoing for 13 of them. The majority of the remaining companies are scheduled to be privatised this year. In June 2017 the government terminated the sale procedure for the country's largest bank, NLB.

Key priorities for 2018

- **Improving corporate governance and speeding up the privatisation of SOEs are key for future convergence.** High corporate indebtedness, complex ownership structures and the large footprint of underperforming SOEs in the economy weigh on investments, whose share in GDP has been falling almost constantly since 2008.
- **Remaining non-performing loans (NPLs) and corporate debt should be tackled.** Banks still hold significant bad portfolios in relation to small and medium-sized enterprises (SMEs) and, despite significant deleveraging in recent years, the long-term debt of over-indebted companies is still high.
- **Business environment reforms should focus on improving competitiveness and governance.** Measures that should be high on the agenda include: privatisation, improving SME access to finance, easing construction permits, improving contract enforcement, and enhancing SOE corporate governance standards.

Main macroeconomic indicators %

	2013	2014	2015	2016	2017 proj.
GDP growth	-1.1	3.0	2.3	3.1	4.0
Inflation (average)	1.8	0.2	-0.5	-0.1	1.6
Government balance/GDP	-14.7	-5.3	-2.9	-1.9	-0.9
Current account balance/GDP	4.4	5.8	4.4	5.2	5.7
Net FDI/GDP [neg. sign = inflows]	-0.1	-1.6	-3.3	-2.2	-1.0
External debt/GDP	114.9	125.5	120.1	110.9	n.a.
Gross reserves/GDP	1.9	2.0	2.0	1.7	n.a.
Credit to private sector/GDP	66.3	54.9	50.3	47.3	n.a.

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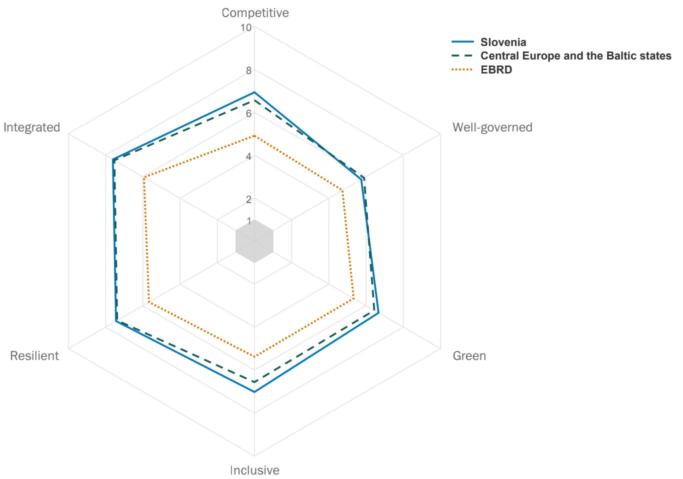
Macroeconomic performance

Economic growth has accelerated since 2016. Strong consumption growth of 4.3 per cent, backed by an improving labour market, helped economic growth accelerate from 2.3 per cent in 2015 to 3.1 per cent in 2016. Investments fell on the back of the termination of the previous EU funding cycle and imports caught up with exports on stronger consumption. Growth accelerated further to 4.8 per cent year-on-year in the first half of 2017, driven mainly by consumption and recovering investments. Inflation picked up from 0.5 per cent year-on-year at the end of 2016 to 1.5 per cent on average in the first nine months of 2017, mainly due to higher food and oil prices.

The general government deficit declined further from 2.9 per cent of GDP in 2015 to 1.9 per cent in 2016. Public debt is also down from 82.6 per cent of GDP in 2015 to 78.5 per cent in 2016, but remains high by regional standards. Achieving the medium-term objective of a balanced budget by 2020 requires further efforts. External debt is also elevated at 110.9 per cent of GDP but has been falling since 2015 due to large current account surpluses, including a surplus of 5.2 per cent of GDP in 2016.

Faster growth is likely in the short term. Slovenia's economy is expected to grow at a faster pace in 2017 (4.0 per cent) and slow down somewhat in 2018 (to 2.9 per cent). The growth will be driven by higher private and public investment as well as further recovery of household consumption. Although high corporate over-indebtedness as well as the slow pace of business environment reforms and privatisation could act as a drag on growth, overall risks to the projection are tilted to the upside.

Assessment of transition qualities (1-10)



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Major structural reform developments

Developments in the business environment have been mixed over the past year. The country ranked 37th among 190 countries in the World Bank's *Doing Business 2018* report (down seven places from the previous year), remaining slightly below the OECD high-income regional average. A noticeable improvement was recorded in getting credit, while the rankings in other areas have worsened or remained broadly unchanged. While Slovenia is doing well in trading across borders, protecting minority investors, getting electricity and resolving insolvency, in other areas, such as dealing with construction permits (100th) and enforcing contracts (122nd) as well as in getting credit (105th), it is well behind its peer countries. On the other hand, the country's competitiveness has improved according to the WEF's Global Competitiveness Index, ranking 48th out of 137 countries in 2017-18, up eight places from the previous year. The biggest improvement was reported in the macroeconomic environment, financial market development, technological readiness and business sophistication. However, the most problematic factors for doing business remain the same as previously – tax rates and regulations, government bureaucracy and (restrictive) labour regulations. Access to financing is now seen as an issue by 7.7 per cent of the polled managers (up from 5.4 per cent in the previous report).

Governance of SOEs has improved somewhat. A new comprehensive framework for the management of SOEs was implemented for the first time in 2016. In January 2017, the government approved a plan for 2017 quantifying performance indicators for each SOE and updating a list of assets for divestment prepared by the Slovenian Sovereign Holding (SSH). In June 2017, two new members of the SSH's supervisory board were appointed, which potentially enables a smoother privatisation process as all privatisation deals need the approval of the board.

Further actions have been taken in relation to the resolution of SME NPLs. Although the overall NPL ratio has fallen from 18 per cent in September 2013 to 5 per cent at the end of 2016, NPLs to SMEs remain elevated at 13.4 per cent as of the end of 2016. Many micro, small and medium-sized enterprises (MSMEs) are highly over-indebted and account for the majority of banks' NPLs, as the attention of banks and the regulator was until recently focused on large corporates. In March 2017, the *Handbook for Effective Management and Workout of MSME NPLs* was issued, with the cooperation of the World Bank and Bank of Slovenia. The manual is intended for practical application by the banks and provides for the operational implementation of previously adopted *Guidelines for the restructuring of micro, small and medium-size enterprises*, prepared by Bank of Slovenia and Banking Association of Slovenia.

Financial sector resilience has been improving further. In June 2017, the Slovenian "bad bank" (BAMC) announced that it had recovered over half of the value of the portfolio of assets transferred to it and that the €1 billion inflow generation threshold required for 2019 had already been achieved in May 2017. Consolidation of the banking sector continued with a merger of NKBM and KBS in January 2017. Early in 2017, the central bank launched an electronic credit register that covers both private individuals and businesses.

Progress on privatisation has been sluggish. Of 33 SOEs planned for privatisation in 2016, three have been successfully privatised, while the tender process has started for another 13 companies. The majority of the remaining enterprises are in the privatisation plan for 2017, which envisages the sale of 20 state-owned companies in total, including Slovenia's largest and third-largest banks (NLB and Abanka, respectively). In February 2017 the SSH announced the acceptance of a takeover bid for the tissue maker Paloma, while in May 2017 the sale of car parts maker Cimos was successfully completed. On the government's request, the European Commission approved the sale of 50 per cent of NLB by the end of 2017 and the remaining 25 per cent in 2018. The government announced plans to proceed with an initial public offering (IPO) of at least 50 per cent of its existing ordinary shares on the Ljubljana Stock Exchange but in June 2017 it terminated the sale procedure due to a pricing disagreement.

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The parliament appointed the members of the Fiscal Council in March 2017. This follows three failed attempts over a period of almost two years. The body is responsible for monitoring the implementation of the EU fiscal compact, which was also added to Slovenia's constitution.

A small-scale tax reform came into force. In September 2016, the Slovenian parliament adopted amendments to the Personal Income Tax Law, Corporate Income Tax (CIT) Law and Tax Procedure Law, including increasing the corporate income tax rate from 17 per cent to 19 per cent, abolishing the special zero tax rate for venture capital companies, and eliminating the recognition as an expense of the depreciation of goodwill. The reform package came into force in January 2017. The measures may have negative effects on investment and research and development activities. On the other hand, personal income tax has been reduced due to a flattening of the tax scale. Amendments to the Tax Procedure Act should facilitate tax payments, including through elimination of administrative barriers in paying social security contributions and provision of additional options for the settlement of tax debt.