SLOVENIA

Highlights

- **Strong growth in 2017 has continued into 2018.** GDP growth accelerated to 4.9 per cent in 2017, mainly on strong investments and exports. Despite decelerating in the first half of 2018, the growth rate remained strong at 4.2 per cent.
- **Slovenia has exited the European Union (EU)'s Macroeconomic Imbalances Procedure.** This reflects significant progress in fiscal consolidation (including a balanced budget in 2017), and important improvements in bank resolution and corporate deleveraging.
- **Privatisation continues to advance slowly.** The government has committed to privatise the country's largest bank, NLB, but progress with the sale of state-owned enterprises in the privatisation plan has been limited.

Key priorities for 2019

- **Further fiscal adjustments are needed to reduce public debt sustainably.** In light of still-high public debt levels, the authorities should keep expenditure growth under strict control to achieve their medium-term fiscal targets, while an ageing population highlights the need to reform the pension, health and long-term care systems.
- **Simplifying corporate ownership structures in the state sector and stepping up privatisation would enhance competitiveness.** Privatisations continue to lag behind schedule and need to be accelerated, while tackling cross-ownership among Slovenian companies would lead to better corporate governance.
- **Corporate over-indebtedness calls for more capital market financing (primarily equity) and governance improvements.** The country has one of the highest ratios of long-term debt of over-indebted companies to GDP among central and eastern European countries, preventing companies from operating more efficiently.

Main macroeconomic indicators %

	2014	2015	2016	2017	2018 proj.
GDP growth	3.0	2.3	3.1	4.9	4.2
Inflation (average)	0.2	-0.5	-0.1	1.4	1.9
Government balance/GDP	-5.5	-2.8	-1.9	0.1	0.6
Current account balance/GDP	5.8	4.5	5.5	7.2	7.5
Net FDI/GDP [neg. sign = inflows]	-1.6	-3.3	-2.1	-1.0	-1.2
External debt/GDP	125.6	120.0	111.0	101.9	n.a.
Gross reserves/GDP	2.2	2.0	1.7	1.7	n.a.
Credit to private sector/GDP	54.5	49.9	46.7	44.8	n.a.

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Macroeconomic performance

The economy grew strongly in 2017. Growth rose to 4.9 per cent in 2017 (from 3.1 per cent in 2016) on the back of increased investment and exports. Investments jumped by more than 10 per cent as public investments recovered with the start of the new EU funding cycle, while double-digit growth in exports was supported by strong demand from the eurozone. Consumption growth continued at around 2.0 per cent, reflecting favourable labour market trends and improved consumer confidence. At the same time, higher domestic demand and more intense export activity was accompanied by a significant increase in imports (above 10 per cent). Economic growth eased to 4.2 per cent year-on-year in the first half of 2018, mainly as a result of somewhat-weaker exports, but investment growth remained strong.

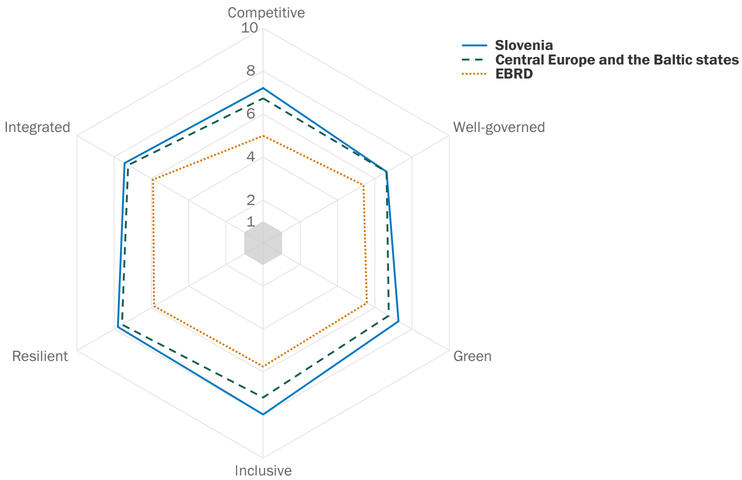
Labour shortages have become more prevalent. Economic recovery led to a fall in the unemployment rate to below 6.0 per cent in the first half of 2018 (from around 10.0 per cent in 2014), while employment growth averaged 2.8 per cent in 2017, the highest rate since 2007. As a result, the share of enterprises reporting a shortage of workers has risen to levels similar to those before the crisis in 2008-09. Slovenian employers face particular difficulties in recruiting highly skilled professionals, despite the increase in hiring of foreign workers.

Inflation has picked up but remains low. After a two-year period of deflation, inflation rose to 1.4 per cent in 2017 and 1.7 per cent in the first nine months of 2018, primarily on the back of higher oil prices.

The fiscal position has improved, but the long-term sustainability of public finances remains a major challenge. The general government budget was in a (slight) surplus (0.1 per cent of GDP) in 2017 for the first time since independence. The improvement in the fiscal position came as a result of expenditure restraint, the strong cyclical growth in revenues, and the reduction in the interest payment burden on outstanding debt. The budget balance improvement and strong nominal GDP growth led to a significant decline (around 4.5 percentage points) in the ratio of public debt to GDP in 2017. However, despite falling further, at 72.8 per cent of GDP in June 2018, the debt level is still high and there are calls for additional measures, especially in view of the ageing population and consequent future demand on social security programmes and health care.

Growth is likely to moderate in the medium term. Slovenia's economy is projected to grow more slowly in 2018 and 2019, at 4.2 and 3.3 per cent, respectively, as temporary effects of the new EU funding cycle subside and the economy reaches its potential. The downside risks come from possibly weaker demand from Slovenia's main trading partners, high corporate over-indebtedness as well as slow structural reforms and privatisation. However, a stronger than envisaged government investment cycle and growth in private consumption could push up short-run growth rates above projections.

Assessment of transition qualities (1-10)



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Major structural reform developments

The business environment remains problematic in some areas. According to the World Bank *Doing Business 2019* report, Slovenia ranks 40th out of 190 countries, three places down from the year before. The largest deterioration was reported in dealing with construction permits, where the country now occupies 120th position. The two other, similarly problematic areas are getting credit (112th) and enforcing contracts (110th), although in the latter the country has made some progress over the past year, by introducing a pre-trial conference as part of case management techniques used in court. According to the World Economic Forum *Global Competitiveness Report 2018*, the country's competitiveness remained unchanged. Slovenia ranks 35th out of 135 countries.[1] The biggest obstacles to improving competitiveness further are the financial system (with room for improvement in the areas of market capitalisation, soundness of banks and non-performing loans) and the insufficiently flexible labour market.

Slovenia has exited the EU's Macroeconomic Imbalances Procedure (MIP). The country had been under the MIP since April 2013 due to risks from corporate indebtedness, financial stability and slow progress in privatisation. According to the European Commission, Slovenia has made significant progress in fiscal consolidation, bank resolution and corporate deleveraging.

The processes of privatisation of NLB and Abanka have started. A decision in July 2018 by the interim government to sell 50 per cent of NLB, the country's largest state-owned bank, by the end of 2018 and another 25 per cent by the end of 2019 was well received by the European Commission, which set it as one of the key requirements when approving the bank's bailout in 2013. A controlling 25 per cent plus 1 share is to be kept by the state in the long term. In October 2018, the State Sovereign Holding (SSH) endorsed an initial public offering of NLB and also published an invitation to investors to express interest in Abanka, after which qualified investors will be able to submit their bids. Abanka has been state-owned since its bailout in December 2013 and, similar to NLB, the bank's sale (by mid-2019) was a key condition for the European Commission's approval of state aid. In addition, the SSH and NLB announced their intention to list NLB shares on the Ljubljana and London Stock Exchanges, while a total of 10 per cent of NLB shares should be offered to small investors in Slovenia.

The profitability of state-owned enterprises (SOEs) improved in 2017 but privatisation has progressed slowly and ownership structures remain complex. Slovenia still has a large state-owned sector, with assets of SOEs (including financial sector) exceeding 135 per cent of GDP in 2016. The SOEs' return on equity increased slightly in 2017 (to 6.1 per cent), but remained below the target (7.1 per cent) set in the State Assets Management Strategy. In 2017, only two significant privatisation deals were completed (Cimos and Paloma), both in the first half of the year, while out of 14 SOEs in the 2018 privatisation plan, a Sale and Purchase Agreement was concluded for only two companies in minority state ownership (Casino Bled and Central Securities Clearing Corporation KDD). Furthermore, corporate governance and ownership structures are complex (often with several state-owned companies cross-owning each other), which holds back their efficiency. In line with the Slovenian Compensation Fund Act, SSH transferred €200 million of capital assets to the Republic of Slovenia at the end of 2017, and further transfers are envisaged to take place in 2020.

[1] The rating for 2017 reflects the change in the methodology. According to the old methodology Slovenia was ranked 48th in 2017.