SLOVENIA

Highlights

- **Robust economic growth is continuing.** Gross domestic product (GDP) grew by 4.1 per cent in 2018, following 4.8 per cent in 2017. Growth was broad-based, and among the highest in the European Union (EU).
- **Fiscal performance remains strong.** Following the balanced budget in 2017, the government reached an overall fiscal surplus in 2018, the first time since the country gained independence.
- **The restructuring of the banking sector has been completed.** The privatisation processes of NLB and Abanka have been completed, in accordance with the country's commitments to the European Commission (EC) following the government's bailout of, and state aid to, the banking sector in 2013.

Key priorities for 2020

- **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.
- **Privatisation of state-owned enterprises (SOEs) needs to be prioritised as it would enhance competitiveness and productivity.** SOEs remain dominant in a few sectors, therefore privatisation should be accelerated so that performance can be improved.
- **Despite significant improvements in recent years, corporate over-indebtedness highlights the need for more capital market financing (primarily equity) and governance improvements.** Notwithstanding the substantial deleveraging in recent years, the country still has one of the highest ratios of long-term debt of over-indebted companies to GDP among the peer central and eastern European countries.[1]

Main macroeconomic indicators %

	2015	2016	2017	2018	2019 proj.
GDP growth	2.2	3.1	4.8	4.1	3.0
Inflation (average)	-0.8	-0.2	1.6	1.9	1.8
Government balance/GDP	-2.8	-1.9	0.0	0.8	0.7
Current account balance/GDP	4.5	5.5	7.2	6.4	5.8
Net FDI/GDP [neg. sign = inflows]	-3.3	-2.1	-1.2	-2.0	-1.0
External debt/GDP	116.4	104.5	105.3	88.7	n.a.
Gross reserves/GDP	n.a.	n.a.	n.a.	n.a.	n.a.
Credit to private sector/GDP	48.7	45.7	44.0	42.2	n.a.

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[1] The long-term debt is concentrated in a small number of companies, including in the Slovenian highways company, reflecting major investments in this sector over the last 20 years.

Macroeconomic performance

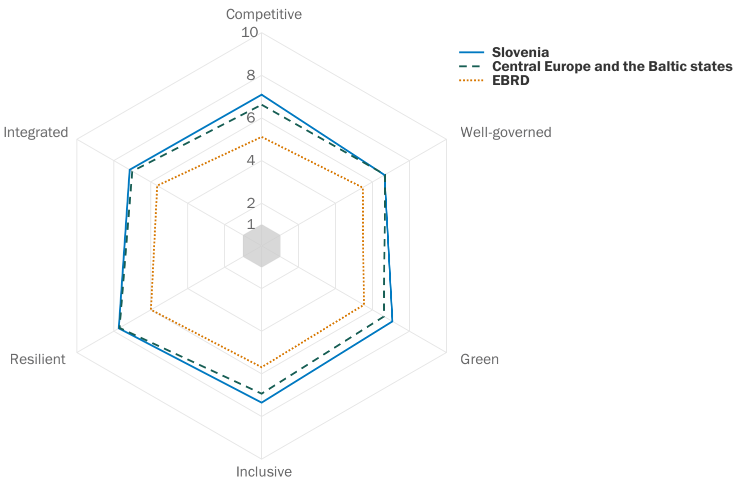
The economy continued to grow strongly in 2018. Real GDP growth was 4.1 per cent, among the fastest growth rates in the EU, following 4.8 per cent in 2017. Growth was broad-based, with investment being the largest contributor in both years, rising by more than 10.0 per cent each year. The strong labour market (unemployment being just 4.4 per cent as of the end of 2018), combined with a 3.0 to 4.0 per cent earnings growth in both 2017 and 2018, contributed to rising private consumption, of which growth remained robust at around 3.0 per cent. Exports continued their strong performance and grew by more than 6.0 per cent in 2018, helping net exports to contribute positively to growth despite a domestic demand expansion, which also pushed imports up. GDP increased 2.9 per cent year-on-year in the first half of 2019. Inflation has picked up but remained relatively low, averaging 1.9 per cent in 2018 (measured by the change in the Harmonised Index of Consumer Prices).

The fiscal position has improved significantly. The general government budget was balanced in 2017 for the first time since independence in 1991 and in surplus by 0.8 per cent of GDP in 2018. The improvement in the fiscal position came as a result of expenditure restraint (due to existing austerity measures in the field of social and family benefits and labour costs in the public sector), the strong cyclical growth in revenues, and the reduction in the interest payment burden on outstanding debt. The budget surplus and strong nominal GDP growth led to a significant decline in the ratio of public debt to GDP, from a peak of 83.0 per cent in 2015 to 70.0 per cent in 2018. The declining trend is expected to continue.

The sovereign credit rating has improved further. In June 2019 Standard & Poor's rating agency upgraded Slovenia's sovereign credit rating from A+ to AA-, with a stable outlook. In July 2019 Fitch upgraded Slovenia's rating from A- to A, also with a stable outlook. The upgrades reflect Slovenia's strong growth developments, fiscal surpluses and public debt improvements. This follows the country's exit from the EU's Macroeconomic Imbalances Procedure (MIP) in 2018 (having entered the procedure in 2013), following the EC's assessment that the country had made significant progress in fiscal consolidation, bank resolution and corporate deleveraging.

Growth is likely to moderate in the medium term. The economy is projected to grow at 3.0 and 2.8 per cent in 2019 and 2020, respectively, as the temporary effects of the new investment cycle wear off and the economy reaches its potential. Private consumption, supported by rising employment and wages, and favourable bank lending conditions, are expected to play a major role in maintaining solid growth rates over the forecasting period. The risks to the downside come from possibly weaker demand from main trading partners, as the country's economy, which is highly integrated into eurozone supply chains, significantly relies on exports. On the other hand, 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 is improving. Slovenia ranks 37th (out of 190 economies) in the World Bank's *Doing Business 2020* report, three positions higher than the year before. The country ranks 35th among 141 countries (the same position as in the previous year) in the World Economic Forum's Global Competitiveness Index 2019. Slovenia scores particularly well on macroeconomic stability (that is, inflation and debt dynamics), but significant obstacles are the small market size (82nd), and the depth and stability of the financial system (61st).

Slovenia's foreign direct investment has risen sharply in recent years due to takeovers. These include instances of privatisations in the banking sector, including that of the country's largest bank, NLB, through an initial public offering (IPO), but also includes China's Hisense takeover of the Slovenian household appliances maker Gorenje in 2018 and Generali Group's acquisition of insurer Adriatic Slovenica and fund manager KD Funds in 2019.

The privatisation processes of NLB and Abanka have been completed. With the sale of the remaining 10.0 per cent stake on the London Stock Exchange in June 2019, the Republic of Slovenia completed the privatisation process of NLB, the largest bank in the country. The first phase of the privatisation process was implemented in November 2018, when the Slovenian Sovereign Holding (SSH), in the government's name, carried out the IPO of a 65.0 per cent stake, listing the shares of NLB on the Ljubljana and London Stock Exchanges. A further 10.0 per cent was sold in June 2019; the Republic of Slovenia will remain the largest shareholder of NLB, with a 25.0 per cent stake plus one share. In June 2019 the SSH signed the sale and purchase agreement for Abanka, which is 100.0 per cent state-owned and the country's third-largest bank, with a market share of about 10.0 per cent, with the NKBM bank, the country's second-largest, which is owned by US investment fund Apollo and the EBRD. The closure of the transaction is subject to receiving all necessary approvals from the relevant authorities. Following the acquisition, the combined market share of the two banks will reach 22.0 per cent, almost equal to that of NLB. Also, in May 2019 Hungary's OTP Bank signed a deal to buy SKB Banka, the subsidiary of Société Générale, as part of a regional buy-out. SKB Banka has a market share of 9.0 per cent and is the fourth-largest bank in Slovenia.

The parliament has approved the Act on judicial and out-of court relief granted to holders of qualified bank credit (the so-called "bailout law"). The objective of the Act is to prescribe a process for judicial protection of former holders of qualified bank credit, compliant with the Constitutional Court decision on the topic. Any potential compensation will be paid by the Bank of Slovenia, subject to the rules on liability for damages in force at the time of the imposition of the extraordinary measures arising from the 2013 banking system overhaul. At the time, the sector was burdened with a large number of bad loans, and six banks – NLB, NKBM, Abanka, Banka Celje, Probanka and Factor banka – received capital from the government. In the meantime, Probanka and Factor banka were liquidated, while Banka Celje was merged with Abanka, which (as noted above) was recently bought by NKBM. At the same time, a total of around €600 million of subordinated bonds were scrapped. Many former subordinated bondholders and shareholders are now suing the banks and the central bank to get their money back.

Slovenia has adopted energy law amendments. In June 2018 the parliament adopted amendments to the Energy Law, which bring in a number of changes, including transposing EU directives' provisions on energy efficiency, following a warning on non-compliance from the EC. In addition, if it does not meet the targets for electricity generation from renewable energy sources, the amendments will allow the country to meet these obligations by making renewable energy payments to other EU countries. Energy consumption from renewable sources in Slovenia, at 22.0 per cent in 2018, is still below the 2020 target of 25.0 per cent.

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The government has passed pension and tax system reforms, aimed at better social protection and longer labour activity. In October 2019 the government adopted various measures, including increases in vesting percentage, disability benefits and minimum pensions, and more generous benefits for pensioners with more than 40 years in employment and for those on maternity or paternity leave. The changes also include raising the replacements rates and providing further incentives to remain in the insurance scheme and prolong active participation in the labour market. The government will also continue the dialogue with social partners to address other issues of the pension system, such as the retirement age. The ageing population of the country is one of the main challenges for Slovenia, making healthcare and long-term care among the high-level priorities of the Slovenian government. This issue is expected to put an increasing burden on public finances in the long run. At the same time, the government adopted measures to lower labour taxation to boost growth. After reduction in the taxation of the holiday allowance, implemented in spring 2019, the additional tax changes include reducing the tax rate for personal income within certain brackets, and increasing general tax allowances. The revenue implications of these measures will be offset by the restriction on the use of corporate tax reliefs up to a certain percentage of the tax base, by some changes in capital taxation for individuals and rental income, and by putting an extra effort into improving the efficiency of collecting fiscal duties.