SLOVENIA

Highlights

- **The economy is undergoing a serious downturn.** The Covid-19 pandemic has put the economy into recession and is particularly affecting private consumption, investments, goods exports and tourism.
- **A sizeable crisis-response support programme has been adopted.** The government has adopted, in four stages, a significant fiscal package, helping to preserve jobs and firms' liquidity; the fifth package is awaiting parliamentary approval.
- **Structural reforms have slowed, due partly to political changes as well as the pandemic.** A new government was appointed amid the Covid-19 crisis and has focused on addressing the health and economic impacts of the pandemic.

Key priorities for 2021

- **More effective absorption of EU funds is important for a quicker recovery.** Slovenia will receive more than €10 billion during the next European Union (EU) programming period, and the commitment of the authorities to improve the use of funds is a welcome signal.
- **Progressing with important structural reforms is important for further convergence with the richer EU countries.** Key priorities include further enhancing corporate governance of state-owned enterprises (SOEs), developing capital markets and removing unnecessary barriers to doing business.
- **Further fiscal adjustments will be needed to maintain sustainable public debt.** In light of increasing public debt levels amid the significant fiscal stimulus, the authorities should define a plan to stabilise medium-term fiscal targets, while in the medium to long term an ageing population highlights the need to begin reforming the pension, health and long-term care systems.

Main macroeconomic indicators %

	2016	2017	2018	2019	2020 proj.
GDP growth	3.2	4.8	4.4	3.2	-7.5
Inflation (average)	-0.2	1.6	1.9	1.7	0.2
Government balance/GDP	-1.9	-0.1	0.7	0.5	-7.2
Current account balance/GDP	4.8	6.2	5.9	5.7	4.5
Net FDI/GDP [neg. sign = inflows]	-2.1	-1.2	-2.0	-1.6	-2.4
External debt/GDP	104.5	105.3	88.7	87.6	n.a.
Gross reserves/GDP	n.a.	n.a.	n.a.	n.a.	n.a.
Credit to private sector/GDP	45.7	44.3	42.7	42.2	n.a.

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Covid-19: macroeconomic implications

Slovenia's economy has been hit hard by the coronavirus crisis. A slowdown in 2019 (to 2.4 per cent GDP growth) has been followed in 2020 by a severe recession, mainly due to the containment measures, which heavily affected private consumption, and the temporary collapse of international trade. In the first quarter of 2020 the economy was already contracting by 2.4 per cent year-on-year, one of the steepest falls in the region. In the second quarter, as the country felt the full effect of the crisis, the contraction reached almost 13 per cent year-on-year, as the lockdown measures, imposed in mid-March, resulted in a significant drop in domestic demand. The economy has also suffered disproportionately from the drop in international trade, due to its high integration in global value chains. Exports of goods, which account for more than 70 per cent of GDP, dropped by 12 per cent year-on-year in the first half of 2020. Another key channel for disruption was tourism, which normally accounts for about 7 per cent of GDP. The number of foreign tourists in the first half was down by about 80 per cent year-on-year, and the sector was relying more on local guests (whose spending was supported by government vouchers). This all resulted in a 7.7 per cent decline in economic activity in the first half of 2020. Unemployment, however, increased only marginally to 4.7 per cent in July 2020 (from 4.0 as of the end of 2019), mainly as a result of the government support schemes to preserve jobs.

The Covid-19 crisis has caused significant fiscal pressures. As a result of falling revenues and rising (crisis-response) spending, the fiscal deficit for 2020 is projected by the government at 9.3 per cent of GDP, with debt forecast to increase to 82 per cent of GDP by the end of the year, the same as at its peak level from 2015, following the banking sector bailouts. Nevertheless, access to funding remains satisfactory. By early September 2020, the government had raised €5.9 billion on the capital markets, covering almost 90 per cent of the estimated financing needs in 2020. Debt characteristics are favourable, as fixed interest debt, euro-denominated debt and long-term debt represents more than 95 per cent of government debt. In June 2020 credit ratings agency Standard & Poor's affirmed Slovenia's rating at AA- with a stable outlook, and in July 2020 Fitch kept Slovenia's rating at A, also with a stable outlook. These decisions reflect the economic resilience to the Covid-19 pandemic and the track record in recent years of fiscal prudence and reduced external and financial imbalances.

Growth is likely to return in 2021. In May, Slovenia was the first EU country to declare the end of the pandemic. While some precautions remained, the reopening of the economy paved the way for the recovery. Notwithstanding the severe immediate impact of the crisis, the recovery should limit the GDP reduction in 2020 to -7.5 per cent, and we expect GDP growth of 3.5 per cent in 2021, partly driven by a strong base effect. Nevertheless, the risks are on the downside. As a small, open economy, Slovenia is highly exposed to economic developments in its key trading partners, particularly the core eurozone economies. Support for the recovery is expected to come from public infrastructure projects, such as the second railway track to the port of Koper and the Karavanke tunnel.

Policy response to Covid-19

The government has supported the economy with several sizeable fiscal packages. A stimulus package of about 13 per cent of GDP is one of the most comprehensive responses in the EBRD regions. Preserving jobs, keeping businesses in operation and supporting those in vulnerable categories were at the core of the crisis response measures in Slovenia. The first economic package was adopted in early April 2020, worth €3 billion (6.7 per cent of GDP), and allowed payment of compensation and pension and healthcare contributions for businesspeople and farmers affected by the coronavirus, as well as to those who temporarily lost their jobs. The second economic package, worth €2 billion (4.5 per cent of GDP), was adopted in late April, and provided state guarantees to firms to take out bank loans to maintain their liquidity amid the crisis. In May 2020 the government adopted a third economic stimulus package, worth €1 billion (2.2 per cent of GDP), which featured subsidies for shortened working time, vouchers for citizens to spend in tourism facilities around the country, and favourable liquidity loans. Further precautionary measures were adopted in July and in September in preparation for a possible second wave of the pandemic. The latest measures include extension of the furlough scheme until year-end for all industries, reversing earlier plans to confine the measure to the

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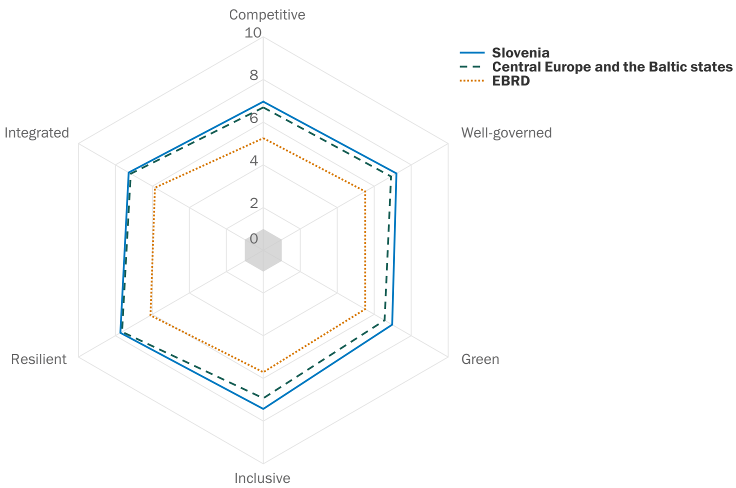
sectors worst hit, but with a stricter eligibility criterion, of at least a 30 per cent drop in turnover compared with last year. In addition, in April 2020 the Bank of Slovenia temporarily restricted banks regarding profits distribution, with the purpose of preserving capital so that the banking system could absorb potential losses and provide liquidity to the real economy. Likewise, the Slovenian Insurance Supervision Agency adopted the same measure.

Assessment of transition qualities (1-10)



Structural reform developments

The public procurement process has been strengthened. In November 2019 the new Act Amending the Legal Protection in Public Procurement Procedures was adopted. The amended act brought three major new features. First, a change in the organisation and formation of the National Review Commission (DKOM) to ensure greater independence and better operation of this authority, which has the status of a tribunal or an independent authority responsible for legal protection in public procurement procedures. Second, it allows administrative disputes against decisions of the DKOM. And third, it adopts measures to speed up legal protection procedures and enhance the effectiveness of legal protection in major projects.

Legislation was adopted to promote a more inclusive labour market. The new Labour Market Regulation Act was adopted in December 2019. The proposed amendments aim to provide better social security for the unemployed and increase the number of elderly persons in employment. They will also enable better integration of foreigners into the Slovenian labour market. Longer active participation in the labour market was also promoted through the pension and tax system reforms adopted in 2019.

Infrastructure development has continued, particularly in rail transport. Modernisation of the railway network includes: upgrading the lines between Zidani Most and Dobova (on the border with Croatia) and between Zidani Most and Celje; the planned upgrade of the line between Ljubljana and Divača (from where one route leads to Italy and the other to the port of Koper); and construction of a direct rail connection between the Primorska and Gorenjska lines (Tivoli curve); together with upgrading Ljubljana station.

Key infrastructure investments are being streamlined. According to new regulations which entered into force in May 2020, the projects benefiting from the new approach will be determined based on statutory criteria, which are that they: (i) implement objectives of national and strategic policies and EU cohesion policy; (ii) exceed €5 million investment; (iii) are ready to

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be implemented by the end of 2020; and (iv) have ensured financing by the end of 2020. They will receive priority treatment in administrative and court proceedings by being declared to be for public benefit. The benefits include obtaining construction permits quickly, allowing construction before a final building permit is issued, and overriding appeals related to environmental aspects. The participation of non-governmental organisations (NGOs) in the appeals process for these projects is being limited, prompting protests from environmental NGOs regarding the potentially harmful consequences of the regulation.

The share of renewables in energy production is increasing. In December 2019 Slovenia's state-owned power utility Dravske Elektrarne Maribor (DEM) began €65 million worth of investments in three wind farms – Ojstrica, Paski Kozjak and Rogatec – with a total installed capacity of 46 MW. Currently there are only two wind turbines in operation in the country, accounting for a negligible share of the country's energy mix, although Slovenia's wind potential is estimated at 415 MW. With this in mind, new wind park projects could help Slovenia meet renewable energy targets, which are set at a 27 per cent share of green energy in final energy consumption by 2030.