INTERNATIONAL MONETARY FUND

IMF Country Report No. 17/125

REPUBLIC OF SLOVENIA

May 2017

2017 ARTICLE IV CONSULTATION—PRESS RELEASE; STAFF REPORT; AND STATEMENT BY THE EXECUTIVE DIRECTOR FOR THE REPUBLIC OF SLOVENIA

Under Article IV of the IMF's Articles of Agreement, the IMF holds bilateral discussions with members, usually every year. In the context of the 2017 Article IV consultation with the Republic of Slovenia, the following documents have been released and are included in this package:

- A **Press Release** summarizing the views of the Executive Board as expressed during its May 10, 2017 consideration of the staff report that concluded the Article IV consultation with the Republic of Slovenia.
- The **Staff Report** prepared by a staff team of the IMF for the Executive Board's consideration on May 10, 2017, following discussions that ended on March 28, 2017, with the officials of the Republic of Slovenia on economic developments and policies. Based on information available at the time of these discussions, the staff report was completed on April 25, 2017.
- An **Informational Annex** prepared by the IMF staff.
- A **Staff Statement** updating information on recent developments.
- A **Statement by the Executive Director** for the Republic of Slovenia.

The documents listed below have been or will be separately released.

Selected Issues

The IMF's transparency policy allows for the deletion of market-sensitive information and premature disclosure of the authorities' policy intentions in published staff reports and other documents.

Copies of this report are available to the public from

International Monetary Fund • Publication Services
PO Box 92780 • Washington, D.C. 20090
Telephone: (202) 623-7430 • Fax: (202) 623-7201
E-mail: publications@imf.org Web: http://www.imf.org
Price: $18.00 per printed copy

International Monetary Fund
Washington, D.C.

© 2017 International Monetary Fund

Press Release No. 17/167
FOR IMMEDIATE RELEASE
May 15, 2017

International Monetary Fund
Washington, D.C. 20431 USA

IMF Executive Board Concludes Article IV Consultation with the Republic of Slovenia

On May 10, 2017, the Executive Board of the International Monetary Fund (IMF) concluded the Article IV consultation[1] with the Republic of Slovenia.

Slovenia has entered a fourth year of steady economic recovery following decisive measures by the authorities to address a looming banking crisis in 2013. Output and employment have risen considerably. The external position has strengthened, reflecting robust exports and strong tourism. The financial system has substantially improved in the past few years.

Rising domestic demand and continuing strong exports will support projected growth of about 3 percent in 2017. Inflation will hover around 2 percent, with core inflation gradually rising toward this level. The external current account surplus will start declining on the strength of domestic demand and higher international energy prices. Over the medium term, economic growth will converge to the estimated potential GDP growth rate of 1¾-2 percent. This low potential growth rate can be raised by policies to increase investment, reduce labor skills mismatches, and boost total-factor productivity growth.

The policy agenda should be geared toward rebuilding macroeconomic buffers and fostering broad-based and sustainable growth. On the fiscal front, the authorities aim to eliminate the structural budget deficit by 2020 and maintain that level afterwards. This will require substantial new fiscal reforms. Implementation of plans to complete the resolution of non-performing bank loans to small and medium enterprises (SMEs) and privatize major banks will support investment and growth, as will measures to improve the functioning of Slovenia's labor market and step up privatization.

Executive Board Assessment[2]

Executive Directors agreed with the thrust of the staff appraisal. They welcomed Slovenia's steady economic recovery fostered by decisive restructuring of ailing banks and prudent

[1] Under Article IV of the IMF's Articles of Agreement, the IMF holds bilateral discussions with members, usually every year. A staff team visits the country, collects economic and financial information, and discusses with officials the country's economic developments and policies. On return to headquarters, the staff prepares a report, which forms the basis for discussion by the Executive Board.

[2] At the conclusion of the discussion, the Managing Director, as Chairman of the Board, summarizes the views of Executive Directors, and this summary is transmitted to the country's authorities. An explanation of any qualifiers used in summings up can be found here: http://www.imf.org/external/np/sec/misc/qualifiers.htm.

macroeconomic policies after the 2013 crisis. At the same time, Directors emphasized the need to address outstanding fiscal and financial vulnerabilities by rebuilding fiscal buffers and completing the repair of bank and corporate balance sheets. Stepping up structural reforms, particularly to improve labor market functioning and accelerate privatization, would enhance efficiency and support medium-term growth.

To promote the long-term sustainability of public finances, Directors supported the authorities' fiscal consolidation plan aimed at eliminating the structural budget deficit by 2020. This would put public debt on a steady downward path and create fiscal space to respond to adverse shocks and address the looming aging-related rise in spending.

Directors encouraged the authorities to generate the needed budget savings with structural fiscal reforms. They noted that measures aimed at enhancing the sustainability of the pension and public wage systems, rationalizing health care and education spending, and reviewing the real estate tax system would alleviate pressures on public finances, achieve efficiency gains, and create room for raising public investment.

Directors welcomed the substantial progress in resolving banks' non-performing loans (NPLs) to large companies, and noted that the bank asset management company (BAMC) had been particularly instrumental in this effort. They urged continued reliance on the BAMC to complete the corporate restructuring process and emphasized the importance of safeguarding the BAMC's independence. Directors welcomed the authorities' efforts to accelerate reduction of NPLs to SMEs and called for a timely and effective implementation of banks' plans in this area.

Directors welcomed the authorities' intentions to proceed with the privatization of the two large state banks. They noted that attracting high-quality strategic investors would facilitate business model adjustments to reduce pressures on profitability in the current low interest rate environment. They cautioned, however, that the authorities' intention to maintain a controlling equity stake in the largest bank could reduce investor interest.

Directors urged deeper structural reforms to improve the business environment and increase labor market flexibility. While acknowledging the efforts embedded in the 2013 labor market reform, they called on the authorities to further increase the flexibility of employment contracts to boost long-term employment prospects for the young. They also urged the authorities to press ahead with retraining the unemployed and implementing an apprenticeship system to address skill mismatches. Expanding the range of SOEs eligible for privatization would improve governance and strengthen enterprise viability, raise productivity, and reduce public debt.

It is expected that the next Article IV consultation with the Republic of Slovenia will be held on the standard 12-month cycle.

Slovenia: Selected Economic Indicators, 2011–18

(Annual percentage change, unless noted otherwise)

Key Export Markets: Germany, Italy, Countries of Former Yugoslavia, France, Austria — Population (2015): 2.1 million

Quota (as of January 31, 2016): SDR 586.5 million — Literacy Rate (in percent): 99.5

Main products/exports: Automotive, Machinery-Appliances, Tourism, Transportation — At-risk poverty rate (pct., 2015): 14.3

	2011	2012	2013	2014	2015	2016	2017	2018
							Staff Proj.	
Nominal GDP (EUR millions)	36,896	36,003	35,917	37,332	38,570	39,769	41,247	43,116
GDP per Capita (EUR)	17,997	17,515	17,445	18,113	18,697	19,266	19,970	20,861
Real economy								
Real GDP	0.6	-2.7	-1.1	3.1	2.3	2.5	3.0	2.3
Domestic demand	-0.7	-5.7	-2.0	1.8	1.4	2.4	3.4	2.6
Private consumption	0.0	-2.5	-4.0	2.0	0.5	2.8	2.5	2.0
Public consumption	-0.7	-2.2	-2.1	-1.2	2.5	2.6	3.8	2.3
Gross capital formation	-2.2	-17.5	4.3	4.3	2.8	1.0	5.6	4.5
Net exports (contribution to growth)	1.3	2.8	0.8	1.4	1.1	0.3	-0.1	-0.1
Exports of goods and services	6.9	0.6	3.1	5.7	5.6	5.9	5.3	3.7
Imports of goods and services	5.0	-3.7	2.1	4.2	4.6	6.2	6.0	4.2
Output gap (in percent of potential GDP)	-1.0	-4.0	-5.5	-3.4	-2.3	-1.2	0.0	0.6
Prices								
Consumer prices (national definition, period average)	1.8	2.6	1.8	0.2	-0.4	-0.1	1.7	2.0
Employment and wages								
Unemployment rate (in percent, ILO definition)	8.2	8.9	10.1	9.7	9.0	7.9	7.0	6.4
Employment (domestic concept, period average)	-1.7	-0.9	-1.1	0.4	1.1	2.0	1.2	1.2
Nominal wages (all sectors)	2.0	0.1	-0.2	1.5	0.7	1.8	3.4	3.3
Real wages (all sectors)	0.2	-2.5	-1.9	1.3	1.2	1.9	1.7	1.3
Public finance (percent of GDP)								
General government balance 1/	-5.5	-3.1	-13.9	-5.8	-3.3	-1.8	-1.3	-1.3
General government balance excl. bank support 1/	-4.2	-3.1	-4.3	-3.5	-3.3	-1.8	-1.3	-1.3
Structural balance 2/	-4.3	-2.1	-1.7	-2.8	-1.9	-1.3	-1.1	-1.6
Structural primary balance 2/	-3.0	-0.4	0.5	0.1	0.9	1.4	1.1	0.6
General government debt 3/	46.4	53.9	71.0	80.9	83.1	79.7	78.0	77.0
Monetary and financial indicators								
Credit to the private sector 4/	-1.9	-5.5	-17.4	-13.3	-5.4	-2.6	3.0	3.0
Lending rates 5/	5.0	4.7	4.5	4.1	2.9	2.2	…	…
Deposit rates 6/	2.2	2.3	1.9	1.0	0.4	0.2	…	…
Government bond yield (10-year)	4.7	5.9	5.8	3.3	1.7	1.1	…	…
Balance of payments (percent of GDP)								
Trade balance (goods and services)	1.2	4.0	6.8	7.7	9.1	9.7	8.4	8.2
Current account balance	0.2	2.6	4.8	6.2	5.2	6.8	5.8	5.5
Gross external debt (percent of GDP, end-period)	112.9	119.1	116.6	126.8	116.6	108.8	103.0	99.7
Nominal effective exchange rate (2010=100)	100.4	99.3	100.7	101.7	100.3	101.3	…	…
Real effective exchange rate (2010=100, CPI-based)	99.4	98.2	99.6	99.7	97.1	97.3	…	…

Sources: Data provided by the Slovenian authorities; and IMF staff calculations and projections.

1/ Staff projections, cash basis. Includes 9.5 percent of GDP in 2013 and 2.3 percent of GDP in 2014 in capital injections into banks and support for deposit redemptions in banks being wound down.

2/ Excludes bank support and other one-offs. Adjusted for calendar year shifts between receipt and expenditure of earmarked EU funds.

3/ Includes EUR 1.1 bn in 2013 and EUR 0.7 bn in 2014 of debt issuance of the Bank Asset Management Company (BAMC).

4/ 2013 and 2014 data are adjusted to exclude the impact of transfers to the BAMC.

5/ Floating or up-to-one-year fixed rate for new loans to non-financial corporations over 1 million euros.

6/ For household time deposits with maturity up to one year.

INTERNATIONAL MONETARY FUND

REPUBLIC OF SLOVENIA

STAFF REPORT FOR THE 2017 ARTICLE IV CONSULTATION

April 25, 2017

KEY ISSUES

Context: Sustained efforts to restore financial stability and pursue prudent macroeconomic policies are paying off. Slovenia has enjoyed a robust three-year economic recovery, with output and employment rising steadily. Yet these indicators remain below their 2008 levels, highlighting the severity of the two crises in 2008–9 and 2012–13.

Outlook and risks: In 2017, rising domestic demand and continuing strong exports will support projected growth of about 3 percent. In the medium term, growth should slow toward its potential rate. Inflation is gradually normalizing. Risks stem mainly from possible external trade shocks and policy uncertainty.

Fiscal policy: After peaking at 83 percent of GDP in 2015, public debt declined last year for the first time since 2008. Yet the low-hanging consolidation fruit is gone, with discretionary spending cut to the bone. A reform-based consolidation strategy is needed to keep debt on a downward path, create room to counter any adverse growth shocks, and address future demographic challenges.

Financial sector: The financial system has substantially strengthened following the authorities' decisive resolution of the 2012–13 banking crisis. With the non-performing loan (NPL) ratio rapidly declining, Slovenia has largely addressed a significant legacy problem of the crisis. Completing the resolution of NPLs to small and medium enterprises (SMEs) and privatization of major banks will support investment and growth. Yet bank profitability will be challenged in the medium term, calling for further consolidation, deep cuts in operating costs, and new revenue sources.

Structural reforms: To raise economic growth, Slovenia should improve the functioning of its labor market and step up privatization. Further labor market reforms are needed to create more jobs, reduce skill mismatches, and address inactivity traps. The authorities should step up privatization, and significantly expand the list of state-owned enterprises (SOEs) in which majority ownership and control can be transferred to private investors.

Approved By
Philip Gerson and Zuzana Murgasova

The mission took place in Ljubljana during March 15–28, 2017. The team comprised Mr. Gueorguiev (head), Messrs. Halikias, Ralyea, and Dwight. Mr. Smith provided research and Ms. Calixto administrative support from headquarters. The mission held discussions with Ms. Vraničar-Erman (Minister of Finance), Mr. Jazbec (Governor of the Bank of Slovenia), other ministers, government and Bank of Slovenia officials, as well as representatives of parliament, financial sector, labor, and business. Mr. Repanšek (OED) attended most meetings.

CONTENTS

BACKGROUND 3
RECENT DEVELOPMENTS, OUTLOOK, AND RISKS 3
POLICY DISCUSSIONS 6
A. Fiscal Policy 6
B. Financial System Policies 10
C. Structural Reform Agenda 13

STAFF APPRAISAL 16

BOX
1. From Crisis to Recovery 4

FIGURES
1. Macroeconomic Developments 18
2. Labor Market 19
3. External Sector Developments 20
4. Financial Sector Developments 21

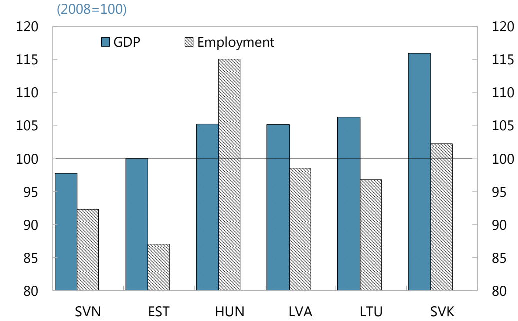
TABLES
1. Selected Economic Indicators, 2011–18 22
2. General Government Operations, 2011–22 23
3. Balance of Payments, 2011–22 24
4. Macroeconomic Framework, 2012–22 25
5. Financial Soundness Indicators (2008–16) 26

ANNEXES
I. External Assessment 27
II. Risk Assessment Matrix 33
III. Implementation of the 2016 Article IV Key Recommendations 35
IV. External Debt Sustainability Analysis 36
V. Public-Sector Debt Sustainability Analysis 39

BACKGROUND

1. Slovenia has completed three years of steady recovery from the crises in 2008–13. In 2014–16, GDP grew by 8.1 percent cumulatively, employment by 3.6 percent, and real wages by over 4 percent. The recovery partly reflected the prior deep recession, with a real GDP decline of 11¼ percent from peak to trough. Moreover, strong partner demand and closer integration in regional supply chains boosted Slovenia's exports.[1] Yet Slovenia's GDP and employment remain below their 2008 levels, as the recovery is weaker than in peers with similar pre-crisis credit booms.

GDP and Employment, 2016
(2008=100)



Sources: Haver Analytics; and IMF staff calculations.

2. Policies have aided the recovery (Box 1), but important challenges remain. Large bank recapitalizations and the two crises since 2008 quadrupled public debt by 2015. Steady fiscal consolidation since 2011 has relied on a mix of structural reforms and one-off measures, with some of the latter now being undone. While the pace of bank balance sheet repair has been fast by international standards, SME NPLs remain elevated, preventing indebted but sound SMEs from borrowing. Moreover, banks' business models are under pressure. Improving the functioning of the labor market and accelerating privatization remain important priorities.

3. Political developments. The three-party center-left coalition government has so far found common ground on economic policies despite occasional disagreements. Nevertheless, coalition politics sometimes slow the design and implementation of important reforms (see Annex III for the implementation of prior staff recommendations). Parliamentary elections are due in 2018.

RECENT DEVELOPMENTS, OUTLOOK, AND RISKS

4. The recovery continued and became more balanced in 2016 as domestic demand picked up. Real GDP grew by 2½ percent, with the output gap narrowing to about -1¼ percent (Table 1). Private consumption accelerated, supported by improved sentiment and sustained wage and employment gains. Although public investment nearly halved, reflecting lower absorption of EU funds at the start of the EU's new financial framework, strong private investment—mainly in export-oriented manufacturing—offset some of the decline. Amid robust trading partner demand and competitiveness gains, exports remained a major driver of growth. Unemployment declined further, while remaining higher than its long-term average at 7.9 percent. Higher commodity prices lifted consumer price inflation to 1.9 percent in March 2017.

[1] See *Selected Issues*, Chapter 2 for a discussion of the performance of Slovenia's exports in 2007–16.

Box 1. From Crisis to Recovery

Slovenia experienced a double-dip recession following the 2008 global financial crisis. Output contracted severely in 2009 as the external demand shock and sudden stop of capital inflows to banks caused by the global financial crisis triggered an adverse feedback loop between the over-leveraged corporate and banking sectors and the sovereign. Despite some recovery in 2010–11, the highly leveraged corporate sector was unable to service its debts, driving the mostly state-owned banking system towards insolvency. The crisis ultimately spilled over to the sovereign, which lost market access. These dynamics precipitated a new recession in 2012–13.

Cross-enterprise ownership structures and pervasive connected lending amplified the crises. The crisis revealed the enterprise sector's excessive leverage and much weaker than previously thought equity base, masked by a complicated web of cross-enterprise ownership with state-owned entities typically at the center. In the wake of the sudden stop in external financing, many enterprises turned out to be insolvent or close to insolvency. The cross-ownership structures transmitted the shock to an even wider range of companies and sectors. This led to widespread bankruptcies, an inability to service debt, and mounting NPLs that ate up bank capital.

Sound and timely macroeconomic policies stabilized the economy. Key turning points were the recapitalization of Slovenia's three largest banks by the state that restored confidence in the financial system and the authorities' success in securing budget funding through a private placement in late 2013. Importantly, the "bailing in" of private investors as part of the recapitalization helped limit the cost to taxpayers and the inevitable rise in public debt. Large NPL transfers to an independent bank asset management company (BAMC) further strengthened the banking system's stability, as did multi-creditor restructuring agreements of corporate debt assisted by the central bank. At the same time, steady fiscal consolidation brought the dynamics of public debt (swollen by the bank recapitalization) under control and alleviated fiscal sustainability concerns. Other policy actions such as revamping insolvency procedures, steps to improve the governance of state-owned enterprises, and the first sale of a recapitalized bank (NKBM) also helped. As a result, Slovenia has enjoyed three years of steady output, employment, and wage growth.[1]

[1]Slovenia's post-2013 economic performance follows the typical recovery pattern from financial crises after controlling for the worldwide nature of the global financial crisis. See *Selected Issues*, Chapter 1.

5. **Staff projects further robust growth in 2017, but the medium-term outlook is less favorable.** Growth in 2017 is projected at 3 percent, closing the output gap. Private consumption should remain strong, aided by continuing employment and wage growth. After years of weakness, private investment should continue its rebound, with capacity utilization near historic highs, strong profitability, and comfortable financing. Public investment should grow strongly as well if the absorption of EU structural and cohesion funds recovers as expected. Supported by rising demand in trading partners, exports should continue boosting growth. Robust economic activity and rising commodity prices will raise inflation toward 1¾–2 percent, dispelling deflation risks. Over the medium term, the growth picture is less favorable, with annual rates converging to the estimated potential growth rate of 1¾–2 percent.[2] This low potential growth rate is constrained by adverse demographic trends and still low private investment, both of which slow TFP growth.

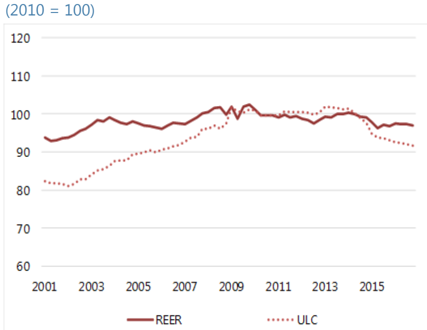
6. **Risks are tilted to the downside.** Externally, a rise in protectionism and economic isolationism would hit Slovenia hard given its high reliance on exports. Intensified political and policy uncertainty in Europe, or weaker than expected global growth would slow investment and

[2] Nevertheless, a positive output gap will open over the medium term, as growth will moderate only gradually.

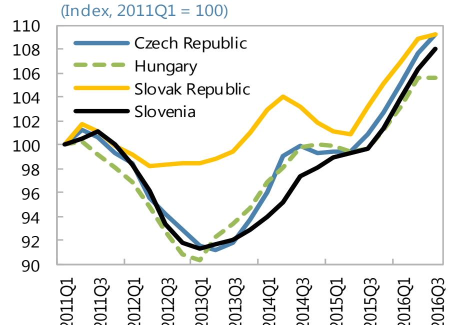
hiring. On the upside, stronger than expected demand in trading partners could support higher export, investment, and GDP growth. Domestically, continuing delays in EU funds absorption could depress investment and growth, while slow progress in restructuring SME NPLs could hinder credit extension and investment over the medium term. Lack of further reform-based fiscal consolidation would leave insufficient capacity to counter growth shocks and fewer resources for policies to raise potential growth.

7. **Slovenia's external position in 2016 is assessed as substantially stronger than suggested by fundamentals and desirable policy settings, but is expected to revert toward equilibrium in the medium term** (Annex I). The current account balance has risen from a deficit of 4 percent of GDP in 2007 to a surplus of 6.8 percent of GDP in 2016 as Slovenia's integration in regional supply chains expanded. Based on the Fund's methodology, staff assesses that a country with Slovenia's characteristics would have a current account surplus of about 1–3 percent of GDP in 2016, implying a gap of 4–6 percent of GDP. Fiscal policies in Slovenia and its trading partners (a shorter distance to the desirable fiscal deficit in Slovenia than in partners) and a below-average ratio of private sector credit to GDP explain about one percent of GDP of this gap. The remainder is not explained by the model, but could be caused by low energy prices and temporarily weak consumption and investment (a legacy of Slovenia's financial crises). Specifically, large uncertainty about economic prospects and burdened balance sheets in domestically-oriented firms (Box 1) have temporarily reduced investment and raised corporate and household savings. As these temporary factors fade with progress in reducing corporate debt and a rise in business and consumer sentiment (Figure 1), investment and savings should revert toward historical averages and the current account surplus should decline significantly over the medium term. Indeed, private investment and consumption have already started growing strongly in 2016 (Table 4). The current account gap translates into an 8-12 percent REER undervaluation at standard elasticities. However, the large change in the current account balance over the past 10 years despite a relatively stable REER suggests that the higher than expected surplus was caused by factors unrelated to the REER. Slovenia's NFA position was still negative (-35 percent of GDP) at end-2016. The main external vulnerability is the high gross external debt (109 percent of GDP at end-2016). While banks have significantly reduced external liabilities in recent years and corporations have started doing so, government external debt increased from 24 to 54 percent of GDP between end-2011 and end-2016.

Slovenia: REER & ULC
(2010 = 100)



Market Share in World Trade
(Index, 2011Q1 = 100)



Authorities' views

8. Encouraged by the recent positive economic momentum, the authorities had a more sanguine outlook than staff. They saw GDP growth accelerating to 3.6 percent in 2017 driven by a large turnaround in EU-financed public investment and continuing strong external demand, and then gradually moderating as employment and private consumption growth slow. Some agreed that medium-term growth could be limited by shortages of skilled labor and only moderate productivity growth; others thought that rising investment, policies to build skills, and immigration from within the EU would significantly raise potential growth. The authorities viewed the large current account surplus as temporary and expected a significant decline by 2019. They acknowledged the international policy uncertainties that could adversely affect external demand and investment in Slovenia, but also noted upside risks stemming from improving exports to Russia, a longstanding trade partner.

POLICY DISCUSSIONS

9. With Slovenia's cyclical recovery nearly complete, achieving faster, broad-based, and sustained growth is high on the policymakers' agenda. Discussions focused on policies to address remaining fiscal and financial vulnerabilities and raise potential growth:

- Adopting a credible reform-based fiscal strategy to reduce high debt, create adequate room for countering adverse shocks, and address the looming demography-related rise in spending;

- Completing the repair of bank and corporate balance sheets by resolving SME NPLs and encouraging viable bank business models to safeguard medium-term financial stability;

- Stepping up structural reforms: improving labor market functioning and accelerating privatization.

A. Fiscal Policy

10. Slovenia achieved substantial fiscal consolidation during and after the 2012–13 crisis with a mixture of tools, many of them of a one-off nature. The budget's structural primary balance improved by 4½ percentage points of GDP between 2011 and 2016 reaching a surplus of 1.4 percent of GDP (Table 2). Consolidation was achieved by a mix of structural measures (such as a VAT increase, pension reform, and debt management operations) and crisis-motivated fiscal restraint (one-off freezes on the wage bill, pension and other social transfer indexation, as well as a squeeze of non-EU-financed public investment).

11. Fiscal consolidation continued in 2016, as Slovenia exited the EC's Excessive Deficit Procedure (EDP). The cash budget deficit measured a below-target 1.8 percent of GDP. On the *revenue* side, strong over-performance of direct taxes and contributions (reflecting better than expected employment and wage growth) more than offset shortfalls in VAT revenue that came despite measures to strengthen tax administration. On the *expenditure* side, the wage bill and spending on goods and services ended up above budget, suggesting that ad-hoc compression of these budget lines in recent years has reached its limit. Expenditure offsets came from substantial cuts in public investment, in part related to the slow start of EU funds absorption from the new financial framework. Public debt declined significantly in 2016 as the Treasury reduced its high cash buffer by nearly 4 percent of GDP. Moreover, the Treasury replaced high-cost dollar-denominated bonds with euro-denominated bonds at much lower interest rates and longer maturities. This operation reduced interest costs and improved the debt amortization profile, significantly reducing medium-term gross financing needs (Annex V).

12. The authorities' medium-term consolidation target is appropriate in view of the need to reduce high public debt. The authorities' goal to eliminate the structural deficit by 2020 and maintain that level afterwards would steadily reduce debt below 60 percent of GDP by 2026. Rebuilding fiscal buffers would increase the space for a countercyclical response to growth shocks, keep borrowing costs low in the long term, and reduce vulnerability to external shocks (Annex II). The positive output gap that is projected to open in 2018–20 under the baseline allows for further consolidation at minimal output costs. Moreover, the boosting effect of fiscal consolidation on the current account surplus would be more than offset by the ongoing rebound of temporarily suppressed private investment and consumption (¶7).

13. However, achieving the authorities' target requires substantial new fiscal reforms. In staff's view, on current policies the budget outturns will fall short of the authorities' 2020 target (baseline), and additional structural adjustment of 1.8 percent of GDP by 2020 is needed to eliminate the structural deficit (staff recommendation, table). The authorities are aware of the challenge and are moving on several fronts. On pension reforms, they have published a White Paper with a set of reform options for public consultation. Some options would expand the pension contributions' base, gradually tighten retirement eligibility criteria, and—after a 20-year transition— index benefits to inflation only. In the health sector, draft legislation would expand the base for health insurance contributions, unify the basic contribution rates for all insured, and limit the duration and amount of relatively generous sick leave payments. While these proposals are steps in the right direction, staff recommended additional structural reforms to improve the budget permanently (table below):

Medium-term Budget Targets

(Percent of GDP)

	2016	2017	2018	2019	2020	2021	2022
Headline balance							
Staff projections (baseline)	-1.8	-1.3	-1.3	-1.5	-1.6	-1.7	-1.8
Staff recommendations	-1.8	-1.0	-0.2	-0.1	0.2	0.1	0.1
Structural balance							
Staff projections (baseline)	-1.3	-1.1	-1.6	-1.7	-1.9	-1.9	-1.9
Staff recommendations	-1.3	-0.8	-0.5	-0.3	0.0	0.0	0.0
Structural primary balance							
Staff projections (baseline)	1.4	1.1	0.6	0.7	0.6	0.7	0.6
Staff recommendations	1.4	1.4	1.7	2.0	2.3	2.4	2.3
Public debt							
Staff projections (baseline)	79.7	78.0	77.0	76.5	76.3	76.2	76.1
Staff recommendations	79.7	77.7	75.7	73.9	71.9	70.0	68.3

Sources: Authorities; staff calculations.

- design a sustainable public wage system that motivates employees, rewards good performance rather than providing automatic, seniority-based wage hikes, and reduces the wage bill relative to GDP toward the EU average. This will require a multi-annual remuneration framework, with separate limits for the number of employees and the wage bill increase by budget sectors;

Potential Fiscal Savings by 2020
(in percentage points of GDP)

	Cumulative
Revenue	
Real estate tax	0.8
Indexation of excises	0.2
Expenditure	
Health care 1/	0.3
Education 1/	0.2
Pensions	0.8
Transfers and subsidies	0.2
Total Savings	**2.5**

Source: Staff calculations.

1/ By closing part of the gap to the efficiency frontier of OECD countries; partly reflected in lower wage bill.

- implement further pension reforms in view of Slovenia's serious ageing problem (¶15). If adopted, the White Paper proposals to raise the retirement age to 67 and automatically adjust it to demographic trends, as well as to restrict early retirement further would be important steps. Additional reforms can include (i) moving quickly to index pensions to inflation only; (ii) abolishing the pension bonus, a relic from the 1980s, and (iii) eliminating pension income's preferential tax treatment. Low-income pensioners should be supported through the social assistance system. Reforms to raise labor market participation rates, thus broadening the pension contribution base, would also help.

- put in place further health and education reforms that reduce the distance to the efficiency frontier by maintaining the high quality of service but reducing costs, such as (i) expanding centralized procurement in the health care sector to benefit from stronger supplier competition and economies of scale and (ii) further optimizing the school network and means-testing financial support for tertiary students. The necessary savings in health and education spending can be achieved by slowing expenditure growth below GDP growth while still allowing for nominal increases;

- reform the real estate tax so that it yields revenue equal to the OECD average and adjust the specific excise tax rates as needed to prevent revenue erosion. Review the capital gains tax to enhance collections from high net-worth individuals.

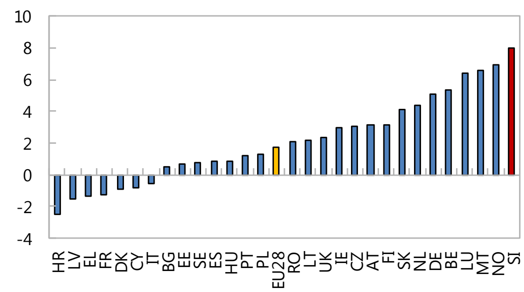
Implementation of these reforms will facilitate further sustainable consolidation and create room for growth-friendly fiscal policies, such as an expansion of public investment, active labor market policies, and cuts in the labor tax burden.

14. In this context, the 2017 budget leaves room for improvement despite the projected reduction in the headline deficit. Staff projects a 2017 cash deficit of 1.3 percent of GDP, implying a structural improvement of 0.2 percentage points of GDP (Table 2). This modest adjustment is, however, entirely due to sizable interest savings, while the structural primary balance would worsen by 0.3 percentage points of GDP. The budget includes a notable tax rebalancing, with a personal income tax cut of ¼ percent of GDP offset by a hike in the corporate income tax and expected gains from stepped up tax collection enforcement. Other measures include limits on non-pension social transfers. However, a wage agreement with the public sector unions restores (over a two-year period) a number of promotion and indexation components that had been frozen since the crisis, implying a rising wage bill in 2017 and beyond.

- While the projected 2017 headline deficit is below the 2016 outcome, the implied easing in the structural primary balance goes against the need for further consolidation and may harm the credibility of the authorities' medium term adjustment objective. That said, as the output gap is just closing in 2017, staff recommends a gradual consolidation path—maintaining the 2017 structural primary balance at its 2016 level and saving the interest windfall brought by the 2016 debt management operations and the ECB's continuing QE. This implies additional adjustment of 0.3 percentage point of GDP that can easily be achieved by, e.g., reducing budget subsidies to their 2015–16 level and accelerating improvements in tax collection with a focus on risk-based audits.

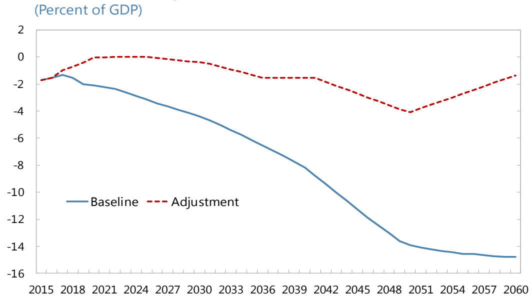
15. Substantial reforms of age-sensitive spending are essential to maintain fiscal sustainability in the long run. Pushed by the largest projected long-run increase in age-related spending in the EU (chart), debt will start growing rapidly after the mid-2020s under the baseline, or even earlier if risks to growth materialize (Annex V). To prevent this, staff's recommended scenario includes: (i) keeping the structural balance at zero until debt falls below 60 percent of GDP, as per the authorities' plans, but with the structural fiscal measures recommended by staff (¶13), which would reduce age-related spending early on; (ii) thereafter, keeping the primary balance excluding age-related components (pensions and health spending) constant relative to GDP and allowing the overall balance and debt to evolve with the dynamics of age-related spending and the (endogenous) interest bill. This approach keeps the deficit well contained and debt below 60 percent of GDP (charts). Staff's simulations are contingent on the implementation of staff's recommended pension and health reforms over the next few years; otherwise, a larger structural balance or deeper pension and health spending cuts would be needed over the medium and long term to cushion the demographic shock. Indeed, staff's analysis highlights a key trade-off: implementing pension and health reforms well ahead of the peak of the demographic shock allows for less overall adjustment than otherwise to maintain fiscal sustainability over the long term.

Age-related spending, change 2013-60
(Percentage points of GDP)



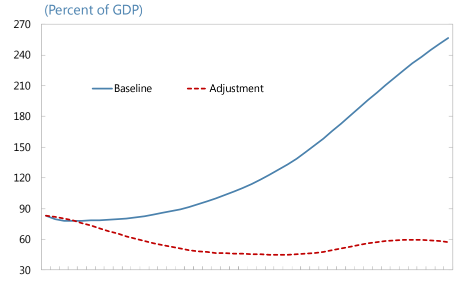
Sources: EU 2015 Ageing Report; and IMF staff calculations.

Structural Budget Balance
(Percent of GDP)



Sources: Authorities; IMF staff calculations.

Public Debt Ratio
(Percent of GDP)



Sources: Authorities; IMF staff calculations.

Authorities' views

16. The authorities were in broad agreement with staff's diagnostics and policy proposals. They emphasized their firm commitment to further reducing the structural budget deficit and public debt, to overcome the legacy of the 2009–13 crises. They concurred that the looming rise in age-related spending warrants a focus on further pension and health care reforms and pointed to their ongoing initiatives in this regard. At the same time, they noted that social protection of pensioners and other vulnerable groups, as well as high quality of services in health care and education, remained of paramount importance. They also agreed that the public wage system needs a thorough revamping. Regarding the 2017 budget, the authorities noted the ongoing efforts to improve tax administration, which should yield significant positive results.

B. Financial System Policies

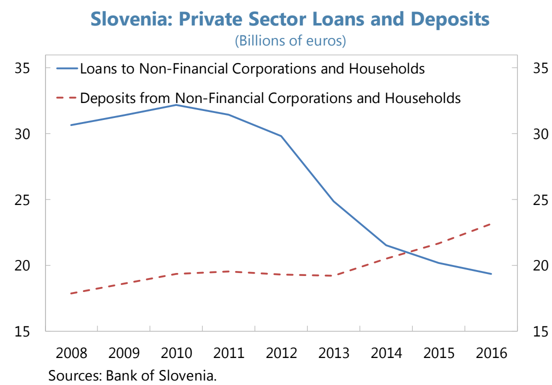
17. Banks are well capitalized and reasonably profitable. The system's CAR was 19.2 percent at end-2016. The major banks show ample capital, declining NPL ratios, and comfortable profitability that compares well with the SSM average. These developments came despite the sharp reductions in banks' net interest income, reflecting lower credit volumes and a QE-related narrowing of deposit-loan spreads. This squeeze has so far been more than offset by higher non-interest income, modest cost reduction, and, especially, the decline in provisioning for NPLs (asset revaluation costs) due to progress with NPL resolution (table).

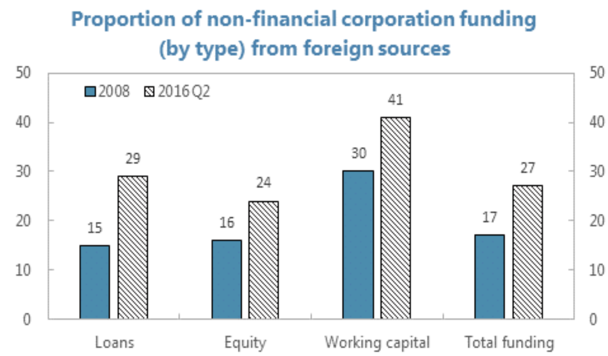
Banking system: Selected Profit and Loss Indicators 1/
(EUR millions unless otherwise noted)

	December 31,									16/15
	2008	2009	2010	2011	2012	2013	2014	2015	2016	Change (%)
Net interest income	945	932	1,038	1,018	886	708	832	746	670	-10.1
Non-interest income	416	493	437	429	679	383	399	412	457	11.0
Gross operating income	1,360	1,425	1,474	1,447	1,566	1,091	1,231	1,158	1,127	-2.6
Operating costs	776	765	766	777	743	721	687	686	667	-2.8
Net asset revaluation costs	278	500	810	1,207	1,599	3,809	650	313	96	-69.3
Pre-tax profit	306	161	-101	-537	-776	-3,439	-106	158	364	129.9
Net profit	248	122	-98	-442	-754	-3,586	-114	115	332	188.5
(Percentage points)										
Return on equity (ROE) 2/	7.1	2.0	-3.2	-11.8	-19.6	-98	-1.9	4.2	8.8	...
Return on assets (ROA) 2/	0.5	0.2	-0.2	-0.9	-1.5	-7.3	-0.2	0.5	1.1	...
NPL ratio 2/	4.2	5.8	8.2	11.8	15.2	13.3	11.7	10.0	5.1	...
NPL provisions/NPLs 3/	25	29	36	38	43	58	61	65	65	...

Source: Bank of Slovenia.
1/ For the years 2008 -10, the data includes information for banks and branches; from 2011 onwards for banks, saving banks and branches.
2/ IMF FSI definition.
3/ Bank of Slovenia definition. Coverage of non-performing claims by impairments and provisions.

18. Despite substantial balance sheet repair and low interest rates, credit to the economy has been very slow to recover. Since end-2010, the stock of credit to the non-financial private sector has contracted by 40 percent. While part of the decline stems from write-offs and transfers of NPLs outside the banking system, several factors suggest that domestic bank credit will remain structurally low. First, the export sector, deeply integrated into the European economy, has increasingly resorted to cheaper external (bank or parent company) financing, inter-company trade credit, and bond financing. Indeed, external borrowing accounted for 29 percent of total outstanding non-financial corporate loans at end-2016, nearly double the 2008 level. Second, recourse to self-financing from retained earnings by profitable corporations has increased. Third, on the supply side, banks have gradually relaxed credit standards, but are reluctant to lend to SMEs with NPLs; EC constraints on lending by the largest and the third-largest banks also appear to be binding.[3] Staff projects moderate credit growth in the coming years, led by credit to households. From a macrofinancial perspective, credit growth appears affected mainly by the shift of demand away from domestic banks, with supply restrictions moderate and limited to SMEs.





19. Banks' business models will need adjustments going forward, calling for active engagement of the supervisors. Specifically, net interest income is expected to fall further as (i) high-interest assets mature and are replaced by low-interest ones, and (ii) demand for domestic bank loans grows only modestly, while (iii) deposit interest rates are already near zero, limiting the scope to maintain interest margins. Raising non-interest income, while successful so far, has limits as the volume of new loans generating commissions and fees is low, and deposit fees risk pushing household money under the mattress. Finally, the decline in risk provisioning has a large one-off component that will fade as NPL resolution is completed. Banks' efforts to respond by changing the composition of assets and liabilities could provide short-term relief, but could entail vulnerabilities down the road. For instance, the recent shift to fixed-rate long-term loans could create interest rate mismatches as QE unwinds. All this calls for a reassessment of banks' business models—probably requiring further bank consolidation, deep cuts in operating costs, and new income sources. Staff recommended an active dialogue between the authorities and the banks on these issues and enhanced supervisory vigilance for signs of unsustainable operations.

20. NPLs of large companies have mainly been dealt with, but those of SMEs remain elevated despite recent progress. The banking system has significantly reduced NPLs from a peak of 18 percent in September 2013 to 5.1 percent at end-2016.[4] Large NPL transfers to the

[3] These banks were recapitalized with state aid in 2013, which triggered the EC constraints such as a minimum return on equity for new loans and a limit on the size of the balance sheet.

[4] IMF FSI definition.

BAMC (€5.5 billion) jump-started this process back in 2014. Subsequently, master restructuring agreements (MRAs) between banks and large debtors, encouraged by the Bank of Slovenia, have also addressed almost €1.9 billion of NPLs. Finally, commercial banks have sold NPL packages of about €700 million to outside investors. Banks have also written off a large amount of NPLs, a process facilitated by high provision coverage and ample good-quality collateral. As elsewhere, however, SME NPLs—13.4 percent of total SME loans as of end-2016—are proving more persistent than large company NPLs.

21. Resolving the remaining stock of NPLs, particularly of SMEs, would help raise economic growth. While adequately provisioned, unresolved NPLs continue to impair financial intermediation to indebted, but otherwise healthy enterprises. In this regard, staff welcomed the implementation of the guidelines for SME resolution prepared by the Bank of Slovenia and the Bank Association. The process involves evaluating bank NPL resolution strategies by the supervisors, including annual NPL reduction targets for 2017–19 and assisting banks to develop a tool kit for the restructuring. The success of this strategy hinges on close supervisory monitoring and safeguards to prevent "evergreening" of NPLs. In this regard, existing measures such as time-bound write-off requirements for uncollectible loans and nonaccrual of interest for loans past a set delinquency threshold should continue to be strictly enforced.

22. An independent BAMC is best placed to maximize the return on large legacy NPLs. BAMC restructuring has distinct advantages in maximizing asset recoveries and returning resources to economic circulation. These include capacity to overcome collective action problems, access to a wide range of debt restructuring instruments, and broad latitude over restructuring of the corporates it takes over. Accordingly, staff reiterated its view that the BAMC should continue to vigorously restructure and sell the remaining claims in its portfolio and argued against transfers of substantial claims from the BAMC to the Slovenian Sovereign Holding (SSH). Clearly, BAMC effectiveness hinges crucially on its independence, and this should be upheld by the Slovenian authorities by maintaining an appropriate governance framework and abstaining from frequent changes in senior management. In this regard, the late-2015 amendments to the BAMC law were steps in the right direction, clarifying that (i) the BAMC is operationally independent, as the Ministry of Finance (representing the state) may not issue instructions to the BAMC for action on individual cases; (ii) responsibility for management of the BAMC rests with its executive directors; and (iii) the BAMC has broad powers to restructure companies in its portfolio. Staff welcomed these clarifications and emphasized that the BAMC should be shielded from all kinds of outside interference and encouraged to take full advantage of the powers the amendments confer.

23. Slovenia has introduced several measures to enhance the stability and functioning of the financial system. In line with EU directives in the financial sector, a countercyclical capital buffer and an additional capital buffer for other systemically important institutions (OSIs) have been in place since 2015. Given the state of the financial cycle, both buffers are currently set at zero, with the OSI buffer scheduled to increase to 0.25–1.00 percent in 2019. In 2016, the central bank introduced non-binding guidelines on loan-to-value (80 percent) and debt service-to-income (50–67 percent) ratios for real estate loans, in preparation for possible acceleration of housing prices and loans. Early in 2017, the central bank launched an electronic credit register that covers both private individuals and businesses.

24. Bank privatization plans are encouraging, but some concerns remain. The privatization of the two remaining large state banks is of key importance to ensure that they continue to operate on commercial principles, expand into new activities, and reduce costs. This is especially important given the history of connected lending practices that prevailed in Slovenian state-owned banks prior to the 2012–13 crisis. After the sale of NKBM in 2016, the authorities are preparing to privatize the largest bank (NLB) via IPO in 2017. Staff supported the sale but expressed concern about the restriction that no private investor can have more than the state's 25 percent stake. Dropping the restriction would allow strategic investors to take a controlling stake and further improve the bank's performance. Moreover, staff encouraged the authorities to complete the sale of the last state owned commercial bank (Abanka) well before the mid-2019 deadline agreed with the EC. An early sale would allow dropping the constraints on the bank's activity imposed by the use of state aid and thus help its competitiveness and profitability.

Authorities' views

25. The authorities noted their substantial progress in NPL resolution and agreed that pressures on profitability were likely to re-emerge. The authorities took pride in the significant NPL reduction since late 2013 that was made possible by concerted efforts on various fronts: early and substantial bank recapitalization, early transfer of large amounts of NPLs to the BAMC, and constant supervisory dialogue with the banks to develop and implement strategies for NPL resolution. They are closely monitoring banks' implementation of the guidelines to restructure SME NPLs but expect this process to take time due to the granular nature of the claims. The authorities saw bank profitability pressures as calling for further consolidation and specialization, with a few universal banks picking up scale and smaller ones specializing in niches where they had competitive advantage. Both the authorities and commercial bankers saw room for further cost reduction and developing new consumer products to supplement interest income. The authorities assured staff in their intention to privatize NLB in 2017 and start preparations for the sale of Abanka in late 2017.

C. Structural Reform Agenda

26. Addressing labor market frictions and completing the clean-up of bank and company balance sheets will raise Slovenia's growth potential, a point reinforced by business climate surveys. While competitively ranked on a global basis for doing business, Slovenia's below-average ranking in the EU and OECD suggests

Slovenia Competitiveness Rankings

	2017	2016	Change 3/
World Bank 1/			
All (190 countries)	30	30	0
EU (28)	16	16	0
OECD (32)	21	21	0
WEF (138)	56	59	+3
IMD 2/ (61)	43	49	+6

Sources: The World Bank Group Doing Business 2017; World Economic Forum Global Competitiveness Report 2016-17; IMD World Competitiveness.

1/ Ranking for 2016 reflects the effects of data revisions and changes in methodology.

2/ Rankings are for 2016 and 2015, respectively.

3/ A positive change signals a relative improvement.

room for improvement. Respondents to the World Economic Forum survey identified restrictive labor regulations, high labor taxes, and poor access to credit as the biggest obstacles to hiring and investment. In the World Bank's Doing Business rankings, Slovenia showed most room for improvement in getting credit and enforcing contracts.[5] In the IMD survey, Slovenia's business environment ranking improved six places largely due to an improvement in government efficiency.

27. In this context, an assessment of the 2013 labor market reform is timely. The smooth functioning of the labor market is critical to facilitate adjustment to macroeconomic shocks and ensure sustained growth. Before the 2013 reform a preponderance of temporary contracts discouraged skill acquisition and exacerbated employment volatility. The reform aimed to enhance labor market flexibility and address segmentation by allowing more flexible workforce management under open-ended contracts and reducing the attractiveness of temporary contracts for employers.

28. The evidence suggests that the impact of the reform has been mixed.[6] Immediately after the reform there was a sharp shift in job creation from temporary to open-ended contracts. However, this effect tapered off after a year, and pre-reform patterns re-emerged (except for young workers, where the share of open-ended contracts increased from a low level). Staff discussions revealed that protection of open-ended contracts is still considered excessive by employers, mainly due to high layoff costs, even though Slovenia's employment protection indicators have moved close to the OECD average. Other evidence also provides a mixed picture of the reform's impact on labor market functioning. Specifically, growth has not become more employment-intensive post-reform, indicating continuing employer preference for substantial overtime over new hiring during expansions. Moreover, pre- and post-reform comparisons of mismatches between job vacancies and job seekers suggest emerging skill mismatches. Finally, OECD data point to exceptionally low gross flows from inactivity to employment, caused, among other things, by inactivity traps.

29. These findings suggest the need for substantial recalibration of labor market policies. First, the growing economy offers a good opportunity to further increase the flexibility of open-ended employment contracts. Second, more retraining courses for the unemployed designed with input from employers would alleviate skill mismatches. In the longer run, an apprenticeship system developed in cooperation between the education system and employers (similar to those in Germany and Austria) would help systematically develop the necessary skills and raise worker retention rate. Efforts should also be made to retain older experienced workers in the labor force by targeted training in new technologies and flexible working hours. Third,

---

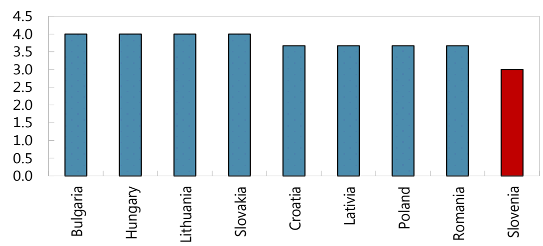
[5] The difficulties in getting credit mentioned in these two surveys likely pertain mainly to SMEs. Time lags between data collection and publication may have also played a role, as other sources (e.g., the EC 2017 Slovenia report) confirm staff's finding of a significant improvement in access to credit in the past year.

[6] See *Selected Issues*, Chapter 3.

taxation of low wages should ensure that the entry-level net wage is markedly higher than social assistance benefits.

30. Progress with privatization has been mixed. According to an EC analysis, Slovenia's SOEs have been less profitable and productive than their private-sector peers.[7] Slovenia has underperformed in large-scale privatization relative to other CESEE countries (chart). Out of 15 SOEs slated for privatization in 2013, 9 have been sold, but privatization of the largest, Telecom Slovenia, failed as the prospective investor withdrew from the negotiations. Staff argued that a strategic investor would inject capital and technological know-how that would benefit the broader economy, and discussed prospects for putting the company back on the market. An additional 25 SOEs were prepared for privatization in 2016, with a tender process currently ongoing for 13 of them. Staff recommended prompt sales without onerous conditions to strengthen the viability of the firms and maximize returns to the taxpayer.

EBRD Index of Large-Scale Privatization
(NMS-10)

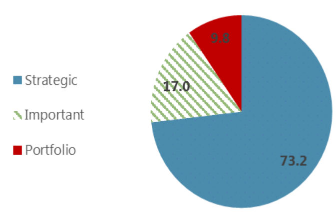


Y-axis scale is a transition indicator. Country-specific scores reflect the judgment of the EBRD about progress toward standards and performance (a score of 4+) typical in advanced industrial economies with more than 75 percent of enterprise assets privately held.

Source: EBRD (2015)

31. Staff supported a revision of the SSH strategy to facilitate the infusion of private capital in the economy, reduce public debt, and improve SOE performance. The current strategy classifies SOEs managed by the SSH into "strategic" (majority state ownership), "important" (the state retains a 25 percent stake that allows for control in important decisions), and "portfolio" (full control is ceded to the private owners). The classification is heavily tilted toward retaining state control, with "portfolio" companies comprising only a small fraction of the total SSH portfolio by value. Staff recommended significantly reducing the number of companies classified as "strategic" and "important", especially in sectors like manufacturing and tourism, which other countries have left mostly to the private sector.

SSH: Allocation of largest companies based on book value 1/



1/ Largest companies comprise 95 percent of book values at end-2015, exlcuding NKBM, which was sold in April 2016.

Authorities' views

32. The authorities concurred that labor market policies should aim to foster a culture of lifelong learning and flexible adjustment to changing employment circumstances. They informed staff that a draft law on vocational training envisaging the introduction of apprenticeships would be finalized in the coming months. The law would help build practical skills during the students' secondary education and thus alleviate emerging skills mismatches. In

[7] EC County Report Slovenia 2015.

consultation with social partners, the authorities are also preparing legal amendments to re-activate the unemployed with a focus on vulnerable groups (young, older, and low-skill workers). On privatization and SOE governance, the authorities pointed to improving SOE performance in 2016 but agreed that the SOE management strategy needed adjustments to make it more flexible and reduce the state's footprint on the economy. The authorities considered Slovenia globally competitive, citing the same business surveys as staff, and noted that their work to reduce labor costs and further expand SME access to finance as recommended in the surveys would lead to further improvements in competitiveness.

STAFF APPRAISAL

33. Slovenia is reaping the benefits of effective post-crisis macroeconomic policies. Swift and sustained action to repair the banking system and fiscal policies to contain the crisis fallout enabled a robust economic recovery. A competitive export sector integrated into the European supply chains also boosted growth, while corporations and banks aggressively deleveraged. Yet, an aging population and tepid investment dim medium-term growth prospects.

34. Further reforms are required to overcome remaining vulnerabilities and raise growth. Public debt remains high, SME NPLs slow investment, and the economy's potential growth rate is low. In addition, the banking system needs to adjust to the changing environment. To address these challenges, the authorities should: (i) adopt a credible reform-based fiscal strategy; (ii) support SME NPL resolution and encourage viable bank models; and (iii) improve labor market functioning and accelerate privatization.

35. The authorities' medium-term fiscal consolidation target is appropriate. The goal to eliminate the budget's structural deficit by 2020 and maintain this level afterwards will reduce debt to 60 percent of GDP by 2026. This rebuilding of fiscal buffers will increase the space for countercyclical policies, keep borrowing costs low in the long term, and reduce vulnerability to external shocks. It will also create fiscal space to partially accommodate the increases in spending due to population aging.

36. However, further substantial reforms are needed to achieve the medium-term target. Staff estimate that an additional structural adjustment of 1.8 percent of GDP by 2020 over the current baseline is called for. To achieve this, staff recommends a menu of revenue and expenditure reforms that tackle the unfinished fiscal structural agenda with a minimal toll on growth. Implementation of these reforms will also create room for growth-friendly fiscal policies, such as an expansion of public investment and support for the labor market.

37. In this context, the 2017 budget leaves room for improvement. The projected widening of the primary structural deficit, however moderate, runs counter to the need for consolidation and may hurt the credibility of the authorities' medium term plans. Staff recommends maintaining the 2017 structural primary balance at its 2016 level. The implied additional adjustment of ¼ percentage point of GDP could be achieved by reducing subsidies and improving tax collection.

38. Slovenia's external position in 2016 is assessed as substantially stronger than suggested by fundamentals and desirable policies, but should revert toward equilibrium over the medium-term. As temporary factors—low energy prices and subdued investment and consumption following crises in 2009-13—change direction, the current account surplus is expected to decline significantly. Steady reduction of public debt over the medium-term as recommended by staff, including by privatization and debt management operations, will address vulnerabilities arising from high external debt.

39. Advancing the privatization of the two large state-owned banks and resolving SME NPLs are important priorities. Staff welcomes the efforts to complete the privatization of NLB and to start the privatization process for Abanka this year. NLB's prospects would benefit from dropping the restriction that no private investor's ownership share can exceed the state's 25 percent. At the same time, unresolved NPLs still weigh on SME activity. Guidelines for SME resolution prepared by the Bank of Slovenia and the Bank Association provide a welcome way forward. Success will require a close dialogue between the banks and the supervisory authorities and safeguards to prevent "evergreening".

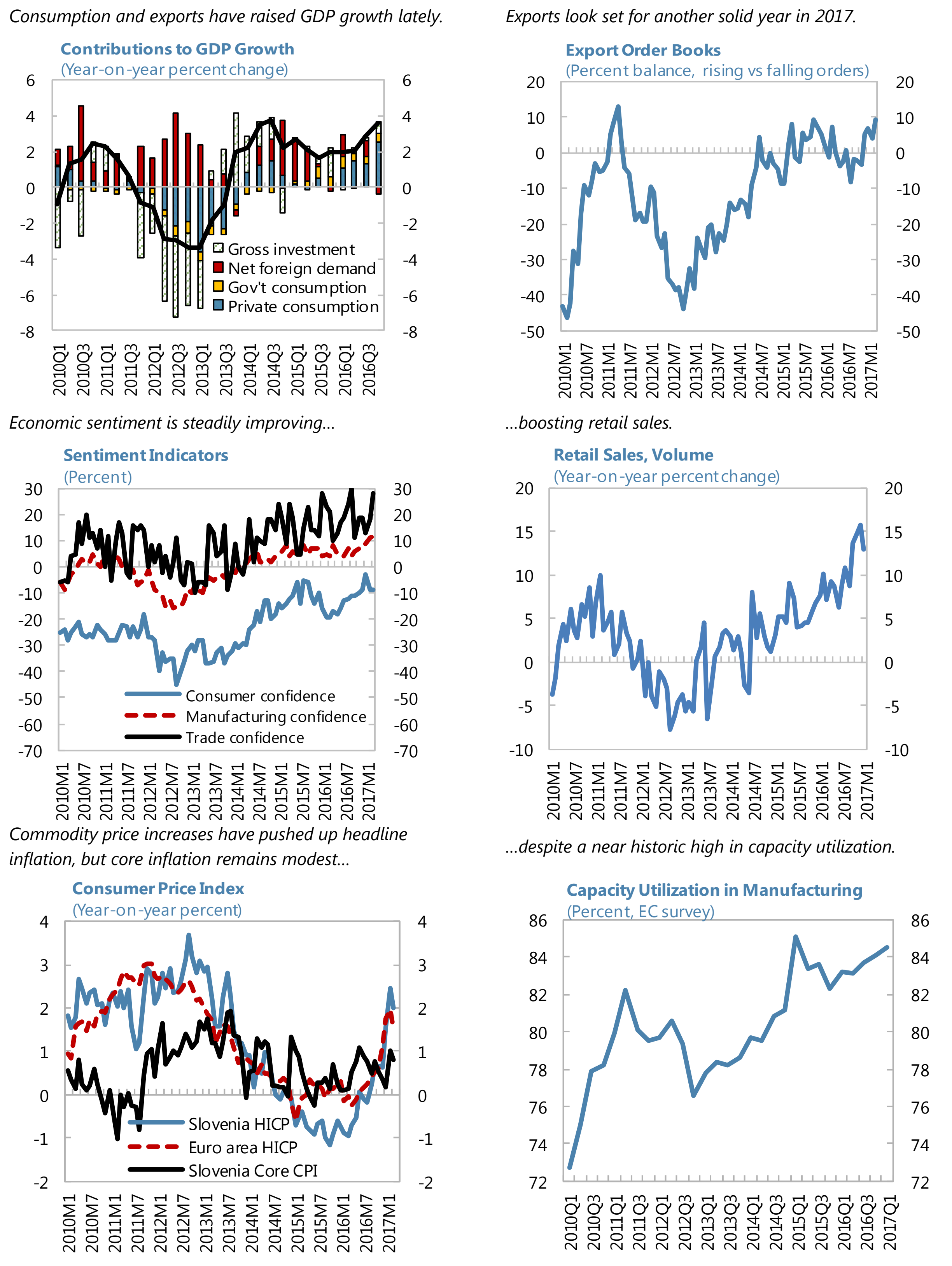
40. Only an independent BAMC can effectively fulfil its mandate. The BAMC's credibility depends crucially on its independence, and we welcome the amendments to the BAMC law that provide further safeguards in this regard. To be successful, the BAMC should be allowed to operate free of outside interference and encouraged to take full advantage of the powers the amendments confer.

41. Necessary adjustments in banks' business models call for active engagement of bank supervisors. Banks' interest income is under pressure and demand for domestic bank loans is modest. This calls for a reassessment of banks' business models, in active dialogue with the supervisor to ensure smooth adjustments and preserve financial stability.

42. To raise potential growth, the authorities should deepen labor market reforms and accelerate privatization. The 2013 labor reform was an important step in liberalizing the labor market. The authorities should build upon this reform by: (i) further increasing the flexibility of open-ended employment contracts; (ii) retraining the unemployed with input from employers; (iii) implementing an apprenticeship system to develop needed technical skills early on; and (iv) reviewing labor taxes to ensure that the entry-level net wage motivates work. To improve company performance, the SOE management strategy should allow full private control over more SOEs than at present and prompt sales without onerous conditions.

43. It is proposed that the next Article IV consultation be held on the 12-month cycle.

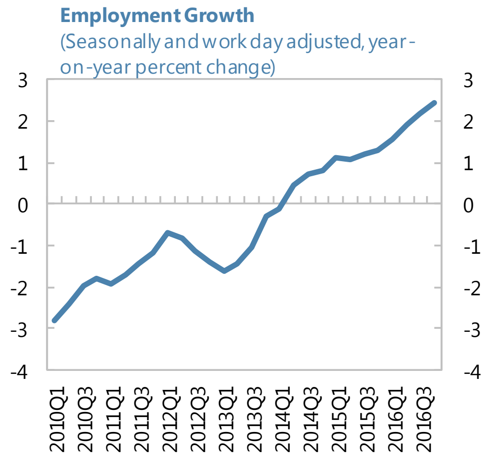
Figure 1. Slovenia: Macroeconomic Developments



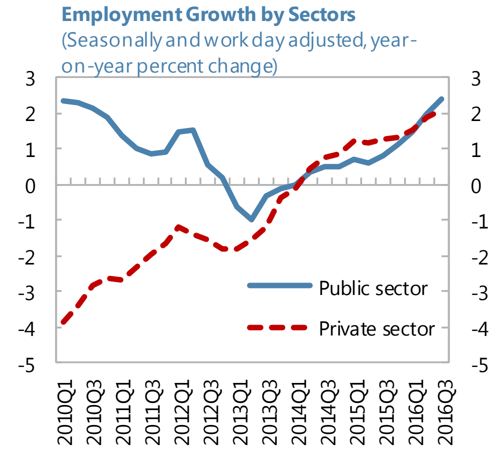
Sources: Bank of Slovenia; Eurostat; Ministry of Finance; Statistical Office of Slovenia; and IMF staff projections.

Figure 2. Slovenia: Labor Market

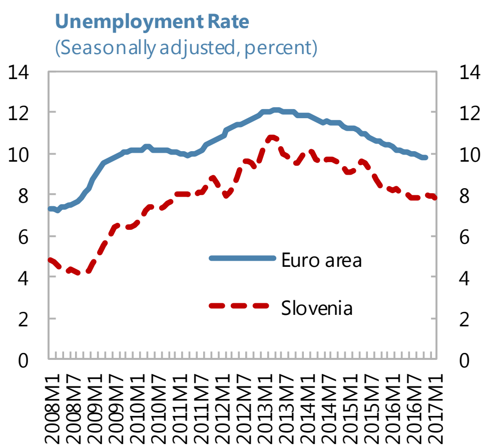
Steady employment growth continues…



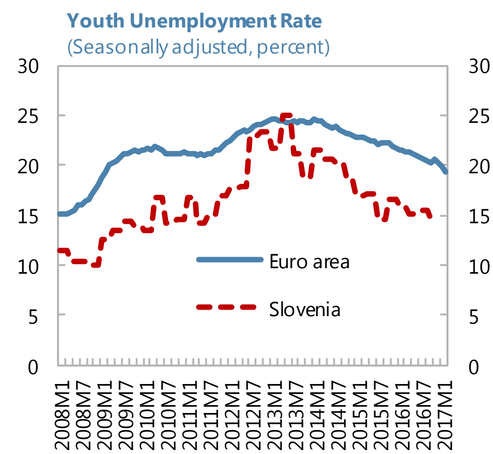
…in both the private and public sectors.



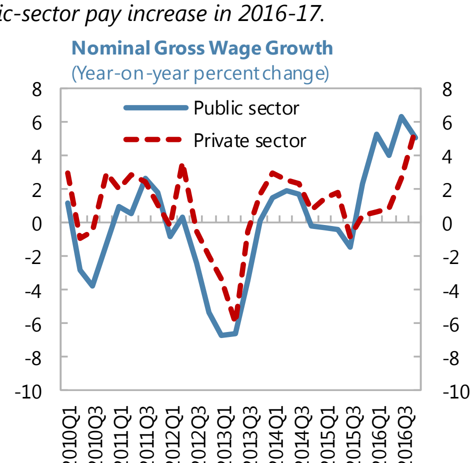
Overall unemployment continues to fall…



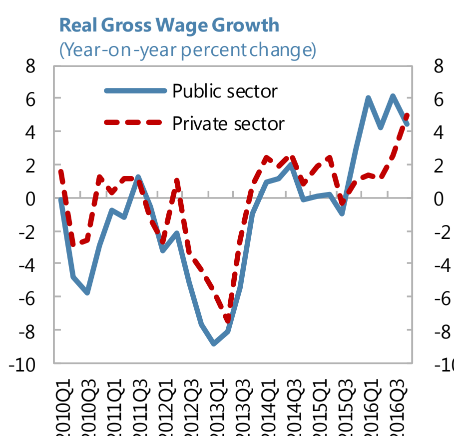
…including youth unemployment, but it remains elevated.



Private-wage growth is picking up on the heels of a public-sector pay increase in 2016-17.



With low inflation, real wages are moving up too.



Sources: Bank of Slovenia; Eurostat; and Haver Analytics.

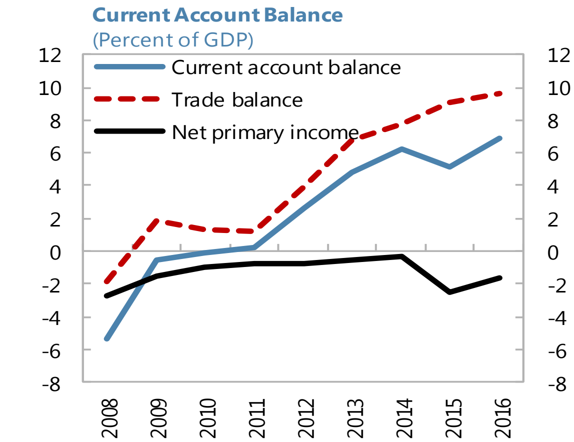
1/ Public administration and defense; compulsory social security; education; human health and social work activities; arts, entertainment and recreation; other service activities (NACE rev. 2).

2/ Industry, construction and services except activities of households as employers and extra-territorial organizations and bodies (NACE rev. 2).

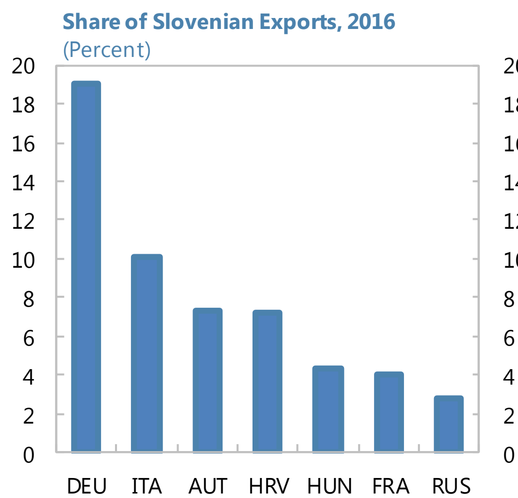
Figure 3. Slovenia: External Sector Developments

Strong external demand ...

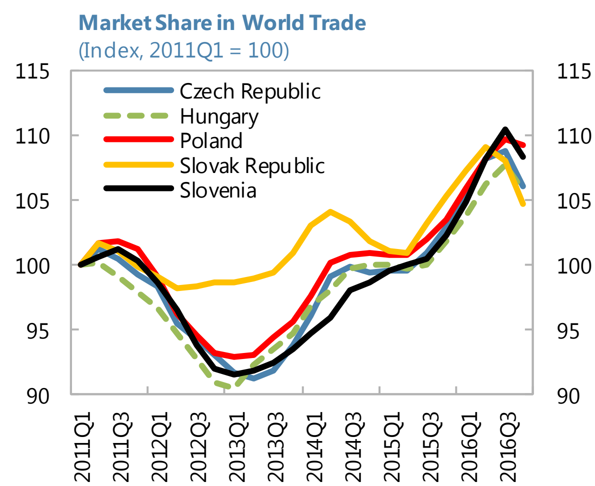
... led to a wider current account surplus in 2016.



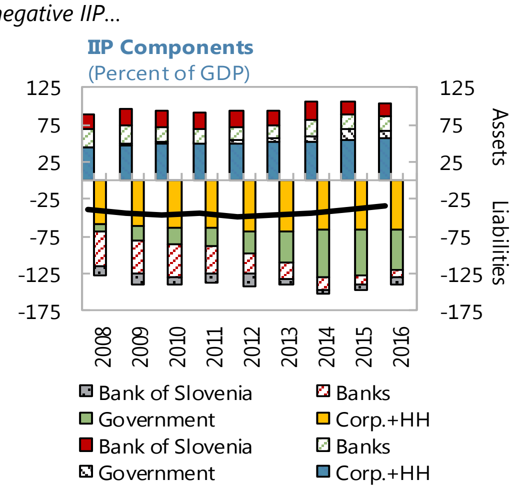
Slovenia's integration in regional supply chains directs exports mainly toward Germany and neighbors....



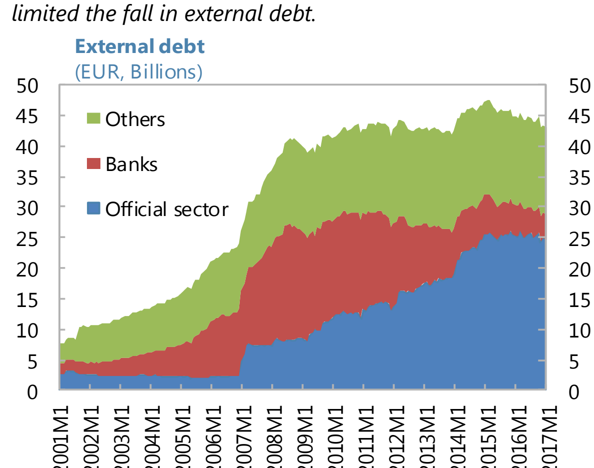
...contributing to strong growth in Slovenia's market share in world trade.



Current account surpluses are gradually closing the negative IIP...



...but public-sector borrowing, including pre-financing, has limited the fall in external debt.

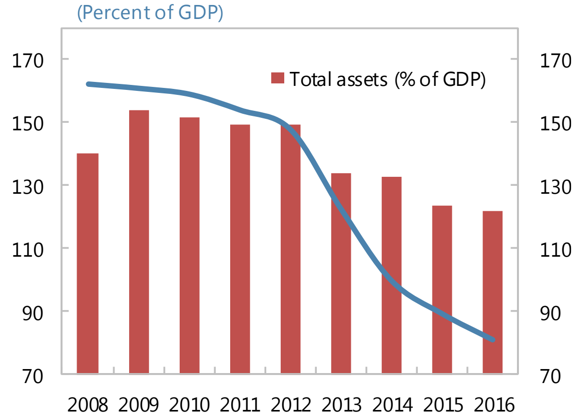


Sources: Bank of Slovenia; Direction of Trade Statistics; European Central Bank; Haver Analytics; Statistical Office of Slovenia; and IMF staff estimates.

Figure 4. Slovenia: Financial Sector Developments

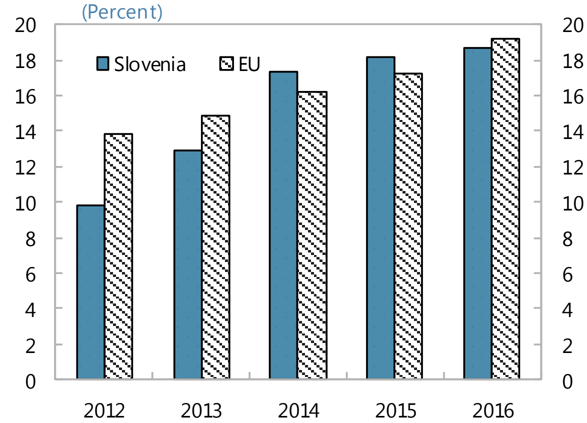
Bank balance sheets have contracted significantly as large companies found alternative financing sources…

Total Assets and Loan to Deposit Ratio
(Percent of GDP)



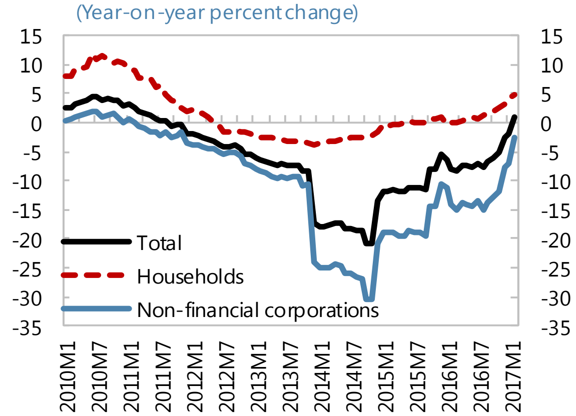
…allowing bank capital ratios to remain high after the 2013 recapitalization.

Tier 1 Capital Ratio
(Percent)



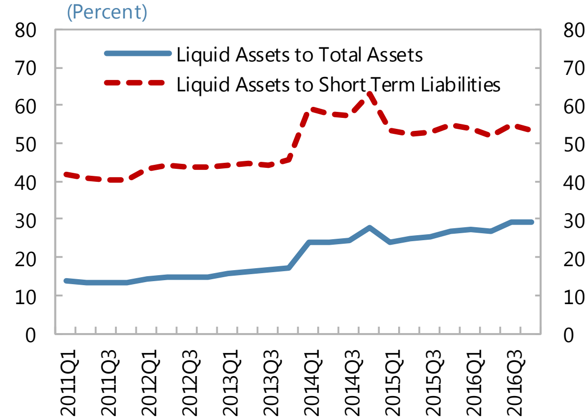
Overall credit growth turned positive in early 2017…

Credit Growth to Private Sector
(Year-on-year percent change)



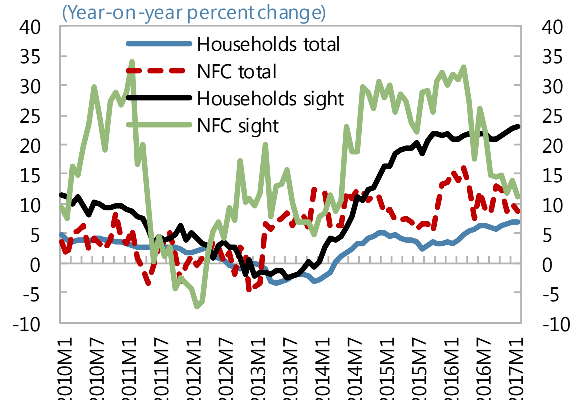
…and system-wide liquidity remains robust…

Liquid Assets
(Percent)



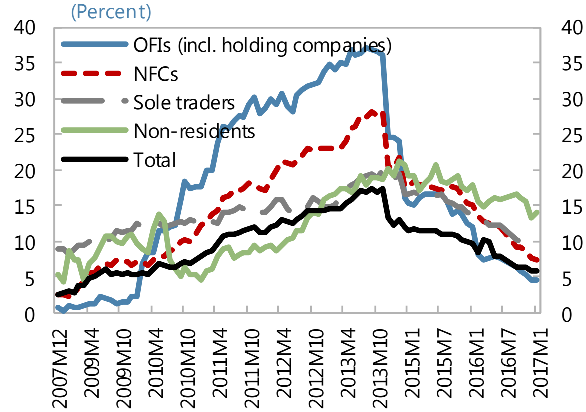
…as deposits continue to grow steadily.

Households and Nonfinancial Corporations Deposit Growth
(Year-on-year percent change)



NPLs keep marching steadily downwards.

NPL Ratios by Type of Borrowers
(Percent)



Sources: Financial Stability Report; Bank of Slovenia; Haver Analytics; IMF FSI; and IMF staff calculations.

Table 1. Slovenia: Selected Economic Indicators, 2011–18

(Annual percentage change, unless noted otherwise)

Key Export Markets: Germany, Italy, Countries of Former Yugoslavia, France, Austria — Population (2015): 2.1 million

Quota (as of January 31, 2016): SDR 586.5 million — Literacy Rate (in percent): 99.5

Main products/exports: Automotive, Machinery-Appliances, Tourism, Transportation — At-risk poverty rate (pct., 2015): 14.3

	2011	2012	2013	2014	2015	2016	2017	2018
							Staff Proj.	
Nominal GDP (EUR millions)	36,896	36,003	35,917	37,332	38,570	39,769	41,247	43,116
GDP per Capita (EUR)	17,997	17,515	17,445	18,113	18,697	19,266	19,970	20,861
Real economy								
Real GDP	0.6	-2.7	-1.1	3.1	2.3	2.5	3.0	2.3
Domestic demand	-0.7	-5.7	-2.0	1.8	1.4	2.4	3.4	2.6
Private consumption	0.0	-2.5	-4.0	2.0	0.5	2.8	2.5	2.0
Public consumption	-0.7	-2.2	-2.1	-1.2	2.5	2.6	3.8	2.3
Gross capital formation	-2.2	-17.5	4.3	4.3	2.8	1.0	5.6	4.5
Net exports (contribution to growth)	1.3	2.8	0.8	1.4	1.1	0.3	-0.1	-0.1
Exports of goods and services	6.9	0.6	3.1	5.7	5.6	5.9	5.3	3.7
Imports of goods and services	5.0	-3.7	2.1	4.2	4.6	6.2	6.0	4.2
Output gap (in percent of potential GDP)	-1.0	-4.0	-5.5	-3.4	-2.3	-1.2	0.0	0.6
Prices								
Consumer prices (national definition, period average)	1.8	2.6	1.8	0.2	-0.4	-0.1	1.7	2.0
Employment and wages								
Unemployment rate (in percent, ILO definition)	8.2	8.9	10.1	9.7	9.0	7.9	7.0	6.4
Employment (domestic concept, period average)	-1.7	-0.9	-1.1	0.4	1.1	2.0	1.2	1.2
Nominal wages (all sectors)	2.0	0.1	-0.2	1.5	0.7	1.8	3.4	3.3
Real wages (all sectors)	0.2	-2.5	-1.9	1.3	1.2	1.9	1.7	1.3
Public finance (percent of GDP)								
General government balance 1/	-5.5	-3.1	-13.9	-5.8	-3.3	-1.8	-1.3	-1.3
General government balance excl. bank support 1/	-4.2	-3.1	-4.3	-3.5	-3.3	-1.8	-1.3	-1.3
Structural balance 2/	-4.3	-2.1	-1.7	-2.8	-1.9	-1.3	-1.1	-1.6
Structural primary balance 2/	-3.0	-0.4	0.5	0.1	0.9	1.4	1.1	0.6
General government debt 3/	46.4	53.9	71.0	80.9	83.1	79.7	78.0	77.0
Monetary and financial indicators								
Credit to the private sector 4/	-1.9	-5.5	-17.4	-13.3	-5.4	-2.6	3.0	3.0
Lending rates 5/	5.0	4.7	4.5	4.1	2.9	2.2	…	…
Deposit rates 6/	2.2	2.3	1.9	1.0	0.4	0.2	…	…
Government bond yield (10-year)	4.7	5.9	5.8	3.3	1.7	1.1	…	…
Balance of payments (percent of GDP)								
Trade balance (goods and services)	1.2	4.0	6.8	7.7	9.1	9.7	8.4	8.2
Current account balance	0.2	2.6	4.8	6.2	5.2	6.8	5.8	5.5
Gross external debt (percent of GDP, end-period)	112.9	119.1	116.6	126.8	116.6	108.8	103.0	99.7
Nominal effective exchange rate (2010=100)	100.4	99.3	100.7	101.7	100.3	101.3	…	…
Real effective exchange rate (2010=100, CPI-based)	99.4	98.2	99.6	99.7	97.1	97.3	…	…

Sources: Data provided by the Slovenian authorities; and IMF staff calculations and projections.

1/ Staff projections, cash basis. Includes 9.5 percent of GDP in 2013 and 2.3 percent of GDP in 2014 in capital injections into banks and support for deposit redemptions in banks being wound down.

2/ Excludes bank support and other one-offs. Adjusted for calendar year shifts between receipt and expenditure of earmarked EU funds.

3/ Includes EUR 1.1 bn in 2013 and EUR 0.7 bn in 2014 of debt issuance of the Bank Asset Management Company (BAMC).

4/ 2013 and 2014 data are adjusted to exclude the impact of transfers to the BAMC.

5/ Floating or up-to-one-year fixed rate for new loans to non-financial corporations over 1 million euros.

6/ For household time deposits with maturity up to one year.

Table 2. Slovenia: General Government Operations, 2011–22

(In percent of GDP, unless indicated otherwise)

	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022
						Est.	Projections					
Revenue	40.3	41.3	40.6	41.3	40.4	39.4	39.7	39.6	39.7	39.6	39.8	39.7
Taxes	21.5	21.9	20.9	21.2	21.4	21.4	21.3	21.2	21.1	21.1	21.0	21.0
Taxes on income, profit, payroll	7.5	7.4	6.0	6.4	6.7	6.8	6.7	6.8	6.8	6.8	6.8	6.8
Taxes on goods and services	13.4	13.8	14.2	14.1	14.1	13.9	13.8	13.6	13.6	13.5	13.5	13.4
Other taxes	0.6	0.7	0.7	0.7	0.6	0.8	0.8	0.8	0.8	0.8	0.8	0.8
Social contributions	14.3	14.6	14.3	14.1	14.2	14.4	14.5	14.5	14.5	14.5	14.5	14.4
Other revenue	4.5	4.9	5.4	6.0	4.8	3.6	3.9	3.9	4.1	4.1	4.3	4.3
Expenditure	45.8	44.5	54.5	47.1	43.7	41.2	41.1	40.9	41.2	41.3	41.5	41.5
Expense	43.3	42.3	52.0	43.4	40.1	39.6	39.3	39.1	39.2	39.3	39.4	39.4
Compensation of employees	10.5	10.4	10.1	9.7	9.4	9.5	9.7	9.7	9.8	9.8	9.7	9.7
Purchases of goods and services	6.6	6.6	6.2	6.0	6.0	6.0	6.1	6.1	6.1	6.1	6.1	6.1
Interest	1.4	1.8	2.3	3.1	2.8	2.8	2.3	2.3	2.4	2.5	2.6	2.6
Transfers to individuals and households	17.7	17.7	17.7	17.0	16.5	16.3	16.1	16.1	16.1	16.1	16.2	16.2
of which: pensions	11.2	11.5	11.8	11.5	10.9	10.7	10.6	10.6	10.6	10.7	10.8	10.9
Subsidies	1.3	1.4	1.4	1.3	1.0	1.0	1.2	1.2	1.2	1.2	1.2	1.2
Other transfers	5.7	4.4	14.3	6.5	4.4	4.0	3.9	3.7	3.7	3.6	3.6	3.6
of which: capital transfers	2.3	0.9	10.4	1.9	0.8	0.4	0.5	0.5	0.5	0.5	0.5	0.5
transfers to the EU budget	1.1	1.1	1.2	1.1	1.1	1.1	1.0	1.0	1.0	1.0	1.0	1.0
Net acquisition of non-financial assets	2.4	2.2	2.4	3.7	3.6	1.6	1.8	1.8	1.9	1.9	2.1	2.1
Gross operating balance 1/	-3.1	-0.9	-11.4	-2.1	0.3	-0.2	0.4	0.5	0.4	0.3	0.4	0.3
Net lending / Net borrowing 1/	-5.5	-3.1	-13.9	-5.8	-3.3	-1.8	-1.3	-1.3	-1.5	-1.6	-1.7	-1.8
excluding bank related costs	-4.2	-3.1	-4.3	-3.5	-3.3	-1.8	-1.3	-1.3	-1.5	-1.6	-1.7	-1.8
Memorandum item:												
General government balance (ESA 2010)	-6.7	-4.1	-15.1	-5.4	-2.9	-1.8	...	...	...	...	...	...
Primary balance 1/	-4.2	-1.4	-11.6	-2.9	-0.6	1.0	0.9	0.9	0.8	0.8	0.8	0.7
Structural budget balance 2/	-4.3	-2.1	-1.7	-2.8	-1.9	-1.3	-1.1	-1.6	-1.7	-1.9	-1.9	-1.9
Structural primary balance 2/	-3.0	-0.4	0.5	0.1	0.9	1.4	1.1	0.6	0.7	0.6	0.7	0.6
General government debt 3/	46.4	53.9	71.0	80.9	83.1	79.7	78.0	77.0	76.5	76.3	76.2	76.1

Sources: Ministry of Finance; and IMF staff calculations.

1/ Includes 9.5 percent of GDP in 2013 and 2.3 percent of GDP in 2014 in capital injections into banks and support for deposit redemptions in banks being wound down.

2/ Excludes bank support and other one-offs. Adjusted for calendar year shifts between receipt and expenditure of earmarked EU funds.

3/ Includes EUR 1.1 bn in 2013 and EUR 0.7 bn in 2014 of debt issuance of the Bank Asset Management Company (BAMC).

Table 3. Slovenia: Balance of Payments, 2011–22

(Percent of GDP, unless otherwise noted)

						Est.	Projections					
	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022
Current account	0.2	2.6	4.8	6.2	5.2	6.8	5.8	5.5	5.1	4.6	4.1	3.6
Trade balance, goods and services	1.2	4.0	6.8	7.7	9.1	9.7	8.4	8.2	7.7	7.3	6.7	6.2
Goods	-2.6	-0.2	2.0	3.2	3.9	3.9	2.5	2.3	1.7	1.2	0.5	-0.1
Exports f.o.b.	57.0	59.0	60.4	61.5	62.3	62.6	64.0	64.3	64.7	65.4	66.3	67.3
Imports f.o.b.	59.7	59.3	58.4	58.3	58.4	58.8	61.5	62.0	63.0	64.3	65.7	67.3
Services	3.8	4.2	4.8	4.5	5.2	5.8	5.9	6.0	6.0	6.1	6.2	6.3
Exports	13.3	14.2	14.8	14.9	15.6	16.4	17.0	17.4	17.7	18.2	18.6	19.1
Imports	9.5	10.0	10.0	10.3	10.4	10.6	11.1	11.4	11.7	12.1	12.4	12.8
Primary income, net	-0.8	-0.8	-0.5	-0.3	-2.5	-1.6	-1.4	-1.5	-1.5	-1.4	-1.4	-1.4
Secondary income, net	-0.2	-0.6	-1.4	-1.1	-1.4	-1.2	-1.2	-1.2	-1.2	-1.2	-1.2	-1.2
Capital account	-0.2	0.1	0.5	0.4	1.0	-0.8	0.0	0.0	0.0	0.0	0.0	0.0
Financial account, excl. reserves	-1.8	-0.3	2.9	6.1	4.9	3.0	5.8	5.5	5.1	4.6	4.1	3.6
Direct investment, net	-1.7	-1.3	-0.1	-1.6	-3.2	-1.8	-1.2	-1.1	-0.6	-0.5	-0.1	-0.2
In Slovenia	1.7	0.1	0.2	2.0	3.9	2.4	2.6	2.5	1.9	1.8	1.5	1.5
Abroad	0.0	-1.2	0.1	0.4	0.7	0.6	1.4	1.4	1.3	1.4	1.5	1.3
Portfolio investment, net	-5.0	0.6	-11.6	-10.6	7.6	10.9	2.5	2.3	1.2	0.6	-0.5	-0.9
Equity	-0.8	-0.2	-0.1	0.1	0.2	-0.4	1.5	1.5	1.5	1.5	1.6	1.6
Debt	-4.2	0.8	-11.5	-10.7	7.4	11.3	1.0	0.8	-0.3	-0.9	-2.0	-2.5
Financial derivatives	0.4	0.2	0.1	0.0	0.1	0.1	0.0	0.0	0.0	0.0	0.0	0.0
Other investment, net	4.5	0.1	14.6	18.3	0.4	-6.3	4.5	4.3	4.4	4.5	4.6	4.7
Loans	3.6	3.6	0.8	2.5	-0.2	1.6	1.1	1.1	1.1	1.1	1.2	1.2
Currency and deposits	1.1	-2.7	13.2	15.7	-0.4	-8.0	2.0	1.9	2.0	2.0	2.0	2.1
Trade credits	-0.2	-0.9	0.6	0.3	0.3	0.1	1.1	1.1	1.1	1.1	1.1	1.1
Other	0.0	0.1	0.1	-0.3	0.8	-0.1	0.3	0.3	0.3	0.3	0.3	0.3
Net errors and omissions	-2.4	-3.1	-2.4	-0.3	-1.5	-3.3	0.0	0.0	0.0	0.0	0.0	0.0
Overall balance	-0.6	-0.1	0.0	0.2	-0.3	-0.2	0.0	0.0	0.0	0.0	0.0	0.0
Change in official reserves (+: increase)	-0.2	-0.1	0.0	0.2	-0.3	-0.2	0.0	0.0	0.0	0.0	0.0	0.0
Memorandum items:												
Export of goods (percent change in value)	12.9	1.0	2.1	5.9	4.7	3.6	6.0	5.0	4.9	5.1	5.2	5.5
Import of goods (percent change in value)	12.6	-2.4	0.9	2.2	3.1	3.7	8.5	5.3	5.9	6.0	6.3	6.4
Terms of trade (percent change)	-1.6	-1.3	0.8	1.1	1.3	0.8	-1.7	0.3	0.2	0.0	0.0	0.0
Gross external debt (billions of euros)	41.7	42.9	41.9	47.3	45.0	43.3	42.5	43.0	43.6	44.1	44.8	45.5
(percent of GDP)	112.9	119.1	116.6	126.8	116.6	108.8	103.0	99.7	96.9	94.5	92.3	90.2
Net int'l investment position (percent GDP)	-45.2	-49.9	-46.6	-44.2	-38.7	-34.5	-26.9	-20.1	-14.2	-9.0	-4.5	-0.7

Sources: Data provided by the Slovenian authorities; and IMF staff calculations and projections.

Table 4. Slovenia: Macroeconomic Framework, 2012–22

					Est.	Projections					
	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022
Real GDP (percent change)	-2.7	-1.1	3.1	2.3	2.5	3.0	2.3	2.0	1.9	1.8	1.8
Contributions to growth											
Domestic demand	-5.6	-1.9	1.7	1.3	2.2	3.1	2.4	2.5	2.2	2.3	2.3
Private consumption	-1.4	-2.3	1.1	0.2	1.5	1.3	1.0	1.0	1.0	1.0	1.0
Government consumption	-0.5	-0.4	-0.2	0.5	0.5	0.7	0.4	0.5	0.4	0.3	0.4
Gross capital formation	-3.8	0.8	0.8	0.6	0.2	1.1	0.9	0.9	0.8	1.0	0.9
Net exports	2.8	0.8	1.4	1.1	0.3	-0.1	-0.1	-0.5	-0.4	-0.5	-0.4
Exports of goods and services	0.4	2.2	4.2	4.2	4.6	4.2	3.0	3.2	3.4	3.5	3.6
Imports of goods and services	-2.4	1.3	2.8	3.1	4.3	4.3	3.1	3.7	3.7	4.0	4.0
Growth rates											
Domestic demand	-5.7	-2.0	1.8	1.4	2.4	3.4	2.6	2.7	2.4	2.5	2.4
Consumption	-2.4	-3.5	1.2	1.0	2.8	2.8	2.1	2.2	2.0	1.9	2.0
Private	-2.5	-4.0	2.0	0.5	2.8	2.5	2.0	2.0	2.0	2.0	2.0
Public	-2.2	-2.1	-1.2	2.5	2.6	3.8	2.3	2.8	1.9	1.7	1.9
Gross capital formation	-17.5	4.3	4.3	2.8	1.0	5.6	4.5	4.5	4.0	4.5	4.0
Fixed investment	-8.8	3.2	1.4	1.0	-3.1	6.0	4.8	4.8	4.3	4.8	4.2
Public	-4.4	7.3	20.3	-5.9	-33.9	9.0	5.8	5.8	2.6	6.1	2.6
Private	-10.0	2.0	-3.9	3.4	6.8	5.4	4.6	4.6	4.6	4.5	4.5
Change in stocks (contribution to GDP growth)	-2.0	0.2	0.6	0.4	0.8	0.0	0.0	0.0	0.0	0.0	0.0
Exports of goods and services	0.6	3.1	5.7	5.6	5.9	5.3	3.7	3.8	4.0	4.0	4.1
Imports of goods and services	-3.7	2.1	4.2	4.6	6.2	6.0	4.2	4.9	4.8	5.0	4.9
Output gap (in percent of potential)	-4.0	-5.5	-3.4	-2.3	-1.2	0.0	0.6	0.7	0.6	0.4	0.3
Potential growth	0.3	0.6	0.8	1.1	1.4	1.7	1.8	1.9	2.0	2.0	2.0
Savings and investment (percent of GDP)											
National saving	21.3	24.5	26.0	25.2	26.5	26.2	26.3	26.3	26.3	26.3	26.2
Government	0.3	-0.6	-0.1	1.4	0.6	1.3	1.4	1.3	1.2	1.2	1.2
Non-government	21.0	25.1	26.1	23.9	25.9	24.9	24.9	25.0	25.1	25.0	25.0
Gross capital formation	18.7	19.7	19.8	20.1	19.7	20.4	20.8	21.2	21.6	22.2	22.6
Public investment	4.1	4.4	5.1	4.7	3.0	3.2	3.3	3.4	3.4	3.6	3.6
Private investment	14.7	15.3	14.7	15.3	16.6	17.2	17.5	17.8	18.2	18.6	19.0
Foreign saving	-2.6	-4.8	-6.2	-5.2	-6.8	-5.8	-5.5	-5.1	-4.6	-4.1	-3.6
Private sector credit growth (year-over-year)	-5.5	-17.4	-13.3	-5.4	-2.6	3.0	3.0	3.0	3.0	3.0	3.0
Prices											
Consumer price inflation (national, period average)	2.6	1.8	0.2	-0.4	-0.1	1.7	2.0	2.0	2.0	2.0	2.0
GDP deflator	0.3	0.9	0.8	1.0	0.6	0.7	2.1	2.2	2.0	2.0	2.1
Employment (domestic concept, period average, pct. change)	-0.9	-1.1	0.4	1.1	2.0	1.2	1.2	1.0	0.7	0.6	0.5
Unemployment rate (ILO, percent)	8.9	10.1	9.7	9.0	7.9	7.0	6.4	6.3	6.4	6.5	6.7
Real wages (percent change)	-2.5	-1.9	1.3	1.2	1.9	1.7	1.3	1.0	1.2	1.0	1.0
Government budget (percent of GDP) 1/											
General government balance, cash basis 2/	-3.1	-13.9	-5.8	-3.3	-1.8	-1.3	-1.3	-1.5	-1.6	-1.7	-1.8
excl. bank support 2/	-3.1	-4.3	-3.5	-3.3	-1.8	-1.3	-1.3	-1.5	-1.6	-1.7	-1.8
General Government balance, ESA 2010	-4.1	-15.1	-5.4	-2.9	-1.8	…	…	…	…	…	…
Structural balance 3/	-2.1	-1.7	-2.8	-1.9	-1.3	-1.1	-1.6	-1.7	-1.9	-1.9	-1.9
Structural primary balance 3/	-0.4	0.5	0.1	0.9	1.4	1.1	0.6	0.7	0.6	0.7	0.6
General government debt 4/	53.9	71.0	80.9	83.1	79.7	78.0	77.0	76.5	76.3	76.2	76.1
Merchandise trade (percent change)											
Export volume	0.4	3.3	6.3	5.3	5.7	5.3	3.5	3.7	3.9	3.9	4.0
Import volume	-4.3	2.9	3.8	5.0	6.6	6.0	4.2	4.9	4.8	5.0	4.9
Export value	1.0	2.1	5.9	4.7	3.6	6.0	5.0	4.9	5.1	5.2	5.5
Import value	-2.4	0.9	2.2	3.1	3.7	8.5	5.3	5.9	6.0	6.3	6.4
External balances (percent of GDP)											
Trade balance (merchandise)	-0.2	2.0	3.2	3.9	3.9	2.5	2.3	1.7	1.2	0.5	-0.1
Current account	2.6	4.8	6.2	5.2	6.8	5.8	5.5	5.1	4.6	4.1	3.6
Memorandum: Nominal GDP (Billions of euros)	36.0	35.9	37.3	38.6	39.8	41.2	43.1	44.9	46.7	48.5	50.4

Sources: Data provided by the authorities; and IMF staff projections.
1/ Projections based on approved budget for 2016 and unchanged policies thereafter.
2/ Includes 9.5 percent of GDP in 2013 and 2.3 percent of GDP in 2014 in capital injections into banks and support for deposit redemptions in banks being wound down.
3/ Excludes bank support and other one-offs. Adjusted for calendar year shifts between receipt and expenditure of earmarked EU funds.
4/ Includes EUR 1.1 bn in 2013 and EUR 0.7 bn in 2014 of debt issuance of the Bank Asset Management Company (BAMC).

Table 5. Slovenia: Financial Soundness Indicators (2008–16)
(in percent unless indicated otherwise)

	2008	2009	2010	2011	2012	2013	2014	2015	2016
Capital									
Regulatory capital to risk-weighted assets	11.7	11.7	11.3	11.9	11.4	14.1	18.0	18.8	19.2
Regulatory Tier 1 capital to risk-weighted assets	9.0	9.3	8.6	9.3	9.8	13.3	17.3	18.1	18.7
Profitability									
Return on assets	0.5	0.2	-0.2	-0.9	-1.5	-7.1	-0.2	0.5	1.1
Return on equity	7.1	2.0	-3.2	-11.7	-19.6	-94.9	-1.9	4.2	8.8
Interest margin to gross income	152.3	163.1	63.6	65.4	58.0	53.9	55.4	57.4	54.4
Noninterest expenses to gross income	95.2	98.2	57.9	39.3	63.9	77.2	60.9	66.7	66.4
Liquidity									
Liquid assets to total assets	13.9	13.8	14.2	13.4	14.7	17.5	27.8	26.7	29.4
Liquid assets to short-term liabilities	34.8	36.2	42.9	40.3	43.5	45.6	62.9	54.8	53.5
Sensitivity to market risk									
Net open position in foreign exchange to capital	-2.2	-0.9	-1.2	-1.8	-2.7	-4.0	-1.1	0.9	0.6
Asset quality									
Nonperforming loans to total gross loans	4.2	5.8	8.2	11.8	15.2	13.3	11.7	10.0	5.1
Non-performing loans net of provisions to capital	30.2	41.7	50.5	70.9	85.8	55.6	36.7	25.0	10.8
Sectoral distribution of loans									
Central Bank	0.0	0.0	0.7	0.9	2.2	4.5	4.3	5.1	7.2
General Government	3.0	3.7	4.7	6.7	8.6	9.3	10.3	10.5	9.8
Financial corporations	11.1	12.5	13.5	13.0	12.1	9.7	8.2	6.8	6.0
Nonfinancial Corporations	51.5	49.0	48.5	47.0	44.8	40.1	35.3	34.4	32.8
Other Domestic Sectors	19.2	19.3	20.7	21.1	21.0	23.3	25.4	27.8	30.1
Nonresidents	15.2	15.4	11.9	11.3	11.2	13.0	16.5	15.4	14.1

Sources: Bank of Slovenia and IMF FSI.

Annex I. External Assessment

Overall Assessment

In 2016, staff assesses Slovenia's overall external position as substantially stronger than the level consistent with medium term fundamentals and desirable policies. This assessment is supported primarily by the large current account surplus, while other external sector indicators are in line with fundamentals. The current account gap (+4-6 percent of GDP) translates into an 8–12 percent REER undervaluation. However, the higher than expected surplus appears to have been caused by temporary factors not related to the REER, which has been stable over time. Current account surpluses should gradually decline over the medium-term as temporary factors unwind. Notwithstanding improvements in net assets and liabilities, gross external debt remains high and could make Slovenia vulnerable to changes of sentiment in the financial markets.

Potential Policy Responses

Slovenia's current account surplus is expected to decline as energy prices rise and investment and consumption shake up the legacy of Slovenia's crises in 2009-13. The Euro Area's accommodative monetary policies remain appropriate to support the recovery in Slovenia, as the output gap is just closing in 2017. The primary vulnerability stems from high government external liabilities. Reducing public debt, including by privatization and debt management operations, would address this vulnerability.

Foreign Assets and Liabilities

Background. Due to substantial current account surpluses beginning in 2012, Slovenia's net international investment position (NIIP) improved rapidly from -50 to -35 percent of GDP from end-2012 to end-2016. Most of the improvement was due to an increase in net assets of banks and other sectors (19 and 9 percent of GDP, respectively) which has brought the private sector's net asset position almost to balance. These improvements were partially offset by a decline in the net asset position of government (by 16 percent of GDP) to -43 percent of GDP at end-2016.

Gross external debt has fallen in recent years, but remains high (109 percent of GDP at end-2016). Since 2012, bank external debt liabilities declined by almost two-thirds to 10 percent of GDP, while external liabilities of other sectors declined by a fifth to 36 percent of GDP. Government external debt increased by 23 percent of GDP to 54 percent of GDP.

Assessment. The bank and corporate sectors have significantly reduced their external liabilities. By contrast, government liabilities have nearly doubled. With current account surpluses projected to continue, Slovenia's NIIP is projected to turn positive in 5-6 years. But the improvement in the net position masks high gross assets and liabilities, and gross external debt is expected to remain above 90 percent of GDP, sustained by high public debt. Reductions in public debt over the medium to long-run will help reduce this external vulnerability.

Current Account

Background. Slovenia's current account balance shifted significantly from -4.1 percent of GDP to an estimated 6.8 percent of GDP between 2007 and 2016. Both consumption and investment dropped substantially after the global financial crisis. While consumption has partially recovered, investment has remained low. Looking at trade, the improvement was driven by a broad-based surge in exports, mainly goods, relative to GDP. Vehicles and vehicle parts, pharmaceuticals, and electrical equipment contributed the most. Low prices of imported commodities over 2014–16 have also contributed to the surplus.

The IMF's current account methodology suggests a country like Slovenia would be expected to have a current account surplus of 1–3 percent of GDP. Since the actual surplus was 6.8 percent of GDP in 2016, this suggests a current account gap of +4–6 percent of GDP. About one percent of this gap is attributable to policies in Slovenia and its trading partners, particularly a fiscal deficit which is closer to its desired level than the average of trading partners, and fundamentals like credit to the private sector, which is below its historical average. The remainder (3–5 percent of GDP) is not explained by the model. This may be due to temporary factors including low energy prices in 2014–16 and weak consumption and investment, a legacy of financing disruptions caused by the global financial crisis and Slovenia's banking crisis in 2012–13. Specifically, large uncertainty about economic prospects and burdened balance sheets in domestically-oriented firms have temporarily reduced investment and raised corporate and household savings. As these temporary factors fade with progress in reducing corporate debt and a rise in business and consumer sentiment, investment and savings should revert toward historical averages and the current account surplus should decline significantly over the medium term. Indeed, private investment and consumption have already started growing strongly in 2016. Staff thus project a decline in the current account surplus from 6.8 percent of GDP in 2016 to 3.6 percent of GDP in 2022. This is based on an expected rebound in gross capital formation to 22.6 percent of GDP and a modest decline in gross national savings to 26.2 percent of GDP by 2022 (Table 4), numbers that only partially close the gap between the 2016 outcomes and the long-term historical averages. As a way of illustration, if gross capital formation and gross national savings revert to their 1995–2016 averages of 25.3 percent of GDP and 25.4 percent of GDP, respectively, the current account surplus would decline by some 6¾ percent of GDP from its 2016 level, eliminating the current account gap.

Assessment. Staff assesses the current account gap at 4–6 percent of GDP in 2016, caused by temporarily low energy prices, subdued investment, and elevated savings, a legacy of Slovenia's crises in 2009–13. As commodity prices, savings, and investment revert toward their long-term levels, staff expects the current account gap will gradually close over the medium-term.

Real Exchange Rate

Background. Taking account of different trading partners and economic characteristics, the IMF's real exchange rate methodology suggests Slovenia's REER is 5 percent stronger than predicted, within the models' margin of error. On the other hand, using standard elasticities, the current account methodology implies an undervaluation of 8–12 percent.

Assessment. Given the current account gap, staff assesses the REER to be undervalued by 8–12 percent. However, relatively little movement in the REER over the last 25 years (Annex Figure 3) suggests that other factors are primarily responsible for the large rise in the current account balance.

Capital and Financial Accounts

Background. Current account surpluses since 2011 have led the bank and corporate sectors to accumulate assets and substantial reduce portfolio debt and other investment liabilities. Inward FDI flows have rebounded from near zero in 2012 to about 2½ percent of GDP in 2016.

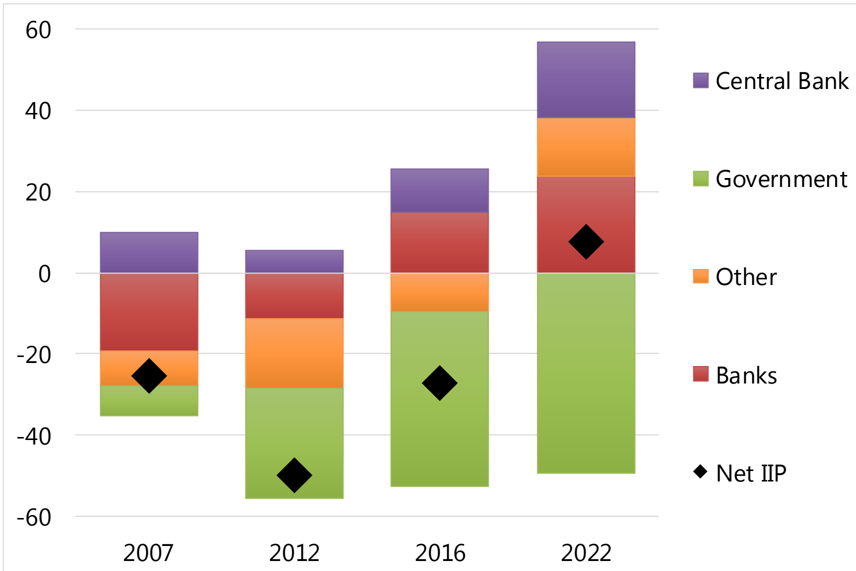
Assessment. Slovenia's private sector has significantly reduced external liabilities, although this has been somewhat offset by an accumulation of government external debt. As demand and imports pick up and Slovenia's current account surplus declines, net financial outflows should also decline.

Foreign Exchange Intervention and Reserves

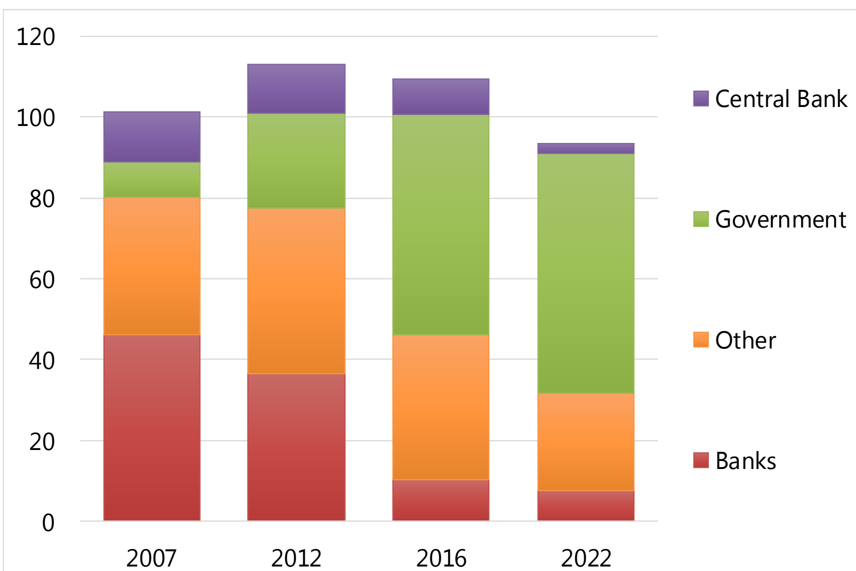
Background and Assessment. The euro is a global reserve currency. Reserves held by the euro area are typically low relative to standard metrics, but the currency is free floating.

Annex Figure 1. Historical and Projected External Assets & Liabilities
(Percent of GDP by Sector)

Net IIP



Gross External Debt

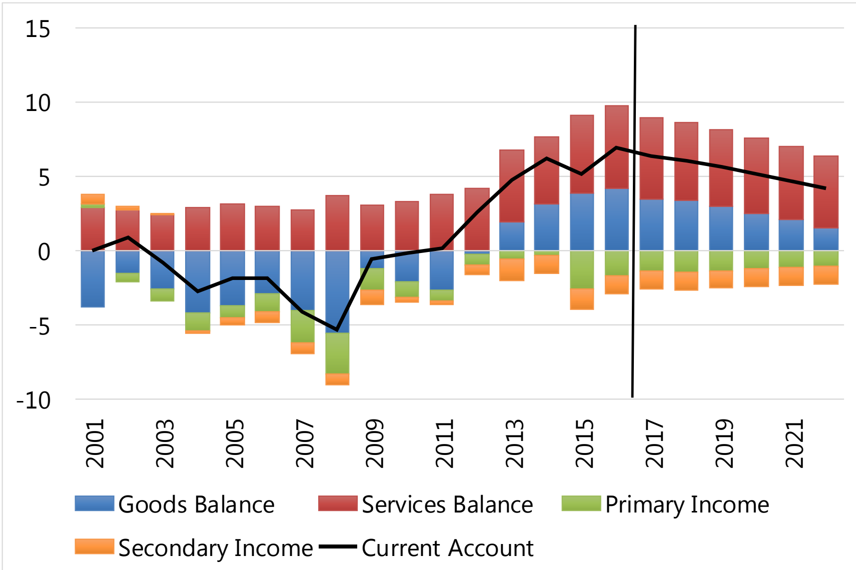


Sources: Bank of Slovenia and IMF staff calculations

Annex Figure 2. Trends in the Balance of Payments

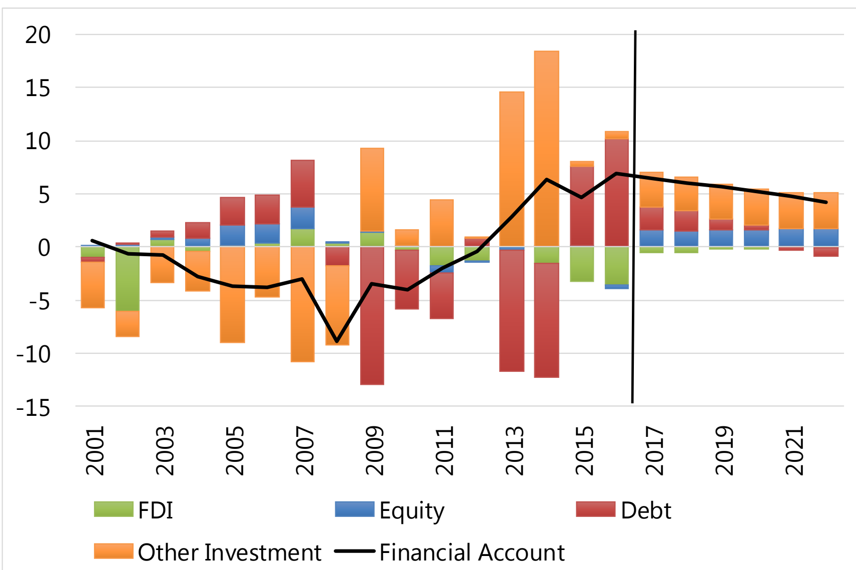
Current Account

(Percent of GDP)



Financial Account

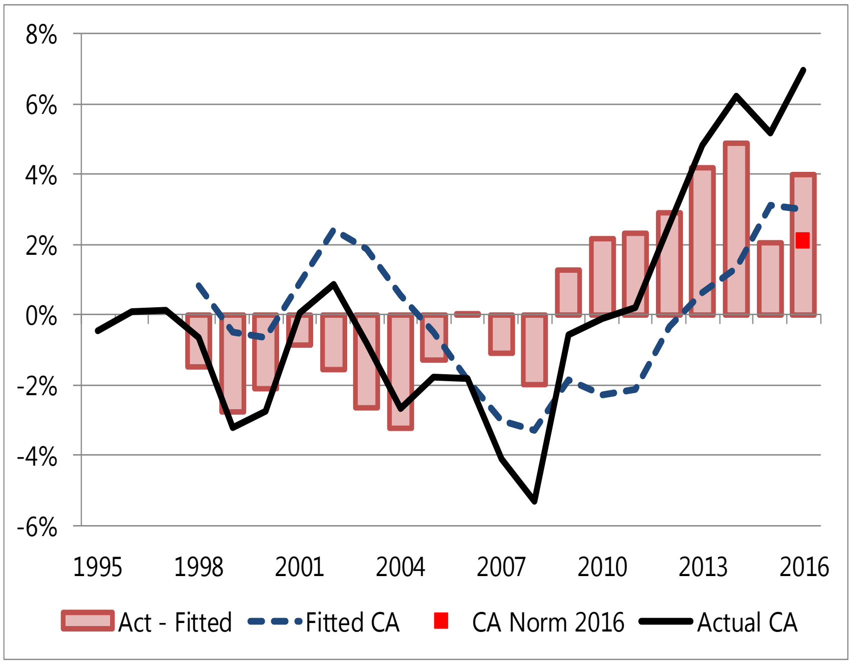
(Percent of GDP)



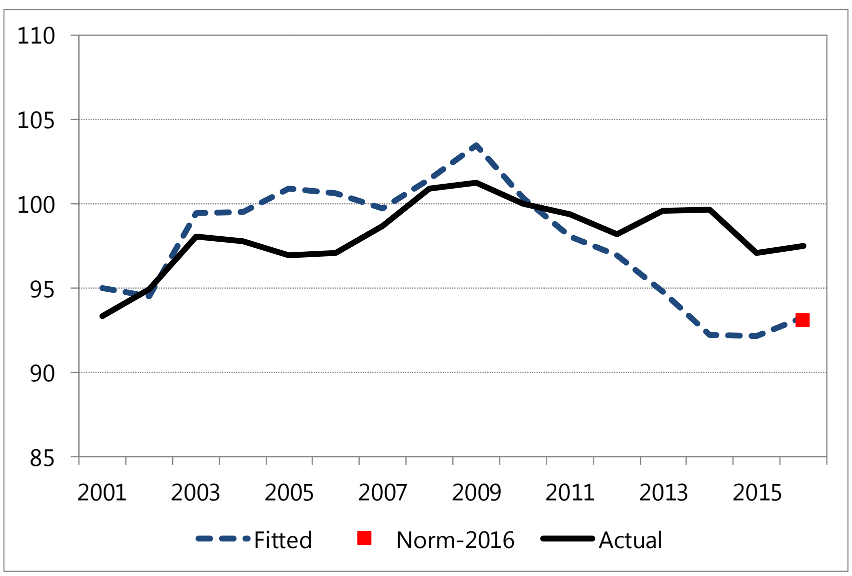
Sources: World Economic Outlook and IMF staff calculations

Annex Figure 3. EBA Current Account & Exchange Rate Estimates

Current Account
(Percent of GDP)



Real Effective Exchange Rate
(Index, 2010 = 100)



Sources: World Economic Outlook and IMF staff calculations

Note: Norms adjust the fitted values for differences between actual and desired policy settings.

Annex II. Risk Assessment Matrix[1]

Source of Risk	Likelihood of Risk	Time Horizon	Expected Impact	Policy Response
External risks				
Retreat from cross-border integration. A fraying consensus about the benefits of globalization could lead to protectionism and economic isolationism, leading to reduced global and regional policy collaboration with negative consequences for trade, capital and labor flows, sentiment, and growth.	**High**	**Short to Medium Term**	**High** Large impact on growth, given Slovenia's deepening integration in global supply chains and high exports. Mainly indirect as Slovenia's EU partners with higher global trade exposure are affected.	Accelerate the pace of structural reforms that strengthen demand and raise potential growth, including labor market reforms. Facilitate domestic financial intermediation. Accelerate privatization to cut public debt and raise productivity. Step up retraining and vocational education to reduce skills mismatches.
Policy and geopolitical uncertainties: - **Policy uncertainty and divergence.** Two-sided risks to U.S. growth with difficult-to-predict policies and global spillovers. In Europe, uncertainty associated with negotiating post-Brexit arrangements and with upcoming major elections. Policy divergence could lead to rising global imbalances and exacerbate exchange rate and capital flow volatility.	**High**	**Short to medium term**	**Medium** Adverse impact on exports due to increased volatility in partner demand and external financing conditions. Uncertainty about EU structural fund flows.	Strengthen domestic financial intermediation to make up for shocks to external financing and boost domestic investment if externally financed investment declines. Accelerate absorption of available EU funds.
- **Intensification of the risks of fragmentation/security dislocation in part of the Middle East, Africa, and Europe,** leading to a sharp rise in migrant flows, with negative global spillovers.	**High**	**Short to medium term**	**Low** Fiscal impact of migrant flows has so far been manageable.	Rebuild fiscal buffers to accommodate shock within broader consolidation envelope.
Weaker-than-expected global growth: - in China and other large emerging/frontier markets; - structurally weak growth in key advanced economies: Low productivity growth (U.S., the Euro Area, and Japan), a failure to fully address crisis legacies and undertake structural	**Low/ Medium** **High**	**Short/ Medium Term** **Medium Term**	**Medium** Indirect effects lead to lower exports and growth. Slower re-building of bank and company balance sheets through retained earnings. A higher budget deficit and public debt relative to GDP would exacerbate medium-	Accelerate the pace of structural reforms that strengthen demand and raise potential growth, including labor market reforms. Facilitate financial intermediation to support investment. Accelerate privatization to cut public debt and raise productivity. Step up efforts to reduce skills mismatches.

reforms, and persistently low inflation (the Euro Area, and Japan) undermine medium-term growth in advanced economies.			term fiscal vulnerabilities.	In the short term, allow automatic stabilizers to operate. In the medium term, design a fiscal consolidation plan with a minimal toll on output (e.g., reforms to the pension system, broad-based real estate tax).
Financial conditions: - **Significant further strengthening of the US dollar and/or higher rates.** As investors reassess policy fundamentals, as term premia decompress, or if there is a more rapid Fed normalization, leveraged firms and sovereigns with unhedged dollar exposures could come under stress. - **European bank distress:** Strained bank balance sheets amid a weak profitability outlook could lead to financial distress in one or more major banks with possible knock-on effects on the broader financial sector and for sovereign yields in vulnerable economies.	**High** **Medium**	**Short Term** **Short term**	**Medium/Low** The euro depreciation would boost Slovenia's non-EA exports and indirectly help EA exports, too. More expensive bank funding and credit (medium impact). Public debt servicing cost would rise, but impact mitigated by long debt maturities and low dollar debt (low impact) **Low** Tightening of export financing, but ample domestic bank liquidity would mitigate the impact.	Accelerate development of equity and bond financing. Accelerate bank and enterprise balance sheet repair. Strengthen monitoring of banks, including by stress tests tailored to the more adverse environment. Accelerate bank and enterprise balance sheet repair to strengthen domestic financial intermediation. Accelerate structural reforms to sustain and further encourage FDI.
Domestic risks				
Failure to design and implement credible reform-based consolidation strategy to rebuild fiscal buffers and address medium-term challenges.	**High**	**Medium Term**	**Medium** Insufficient capacity to counter growth shocks and invest to raise potential growth. Debt concerns could push up borrowing costs.	Announce and implement a reform-based consolidation strategy with measures that optimize spending in health care and education, further reform the pension system, and close revenue gaps.
Delays in completing the resolution of NPLs, especially of SMEs, and cleaning of bank and company balance sheets.	**Low**	**Short/ Medium term**	**Medium** Companies with burdened balance sheets will continue to be cut off bank financing.	Closely monitor implementation of guidelines for SME NPL resolution. Let the BAMC restructure companies under its control.

[1] The Risk Assessment Matrix (RAM) shows events that could materially alter the baseline path (the scenario most likely to materialize in the view of IMF staff). The relative likelihood is the staff's subjective assessment of the risks surrounding the baseline ("low" is meant to indicate a probability below 10 percent, "medium" a probability between 10 and 30 percent, and "high" a probability between 30 and 50 percent). The RAM reflects staff views on the source of risks and overall level of concern as of the time of discussions with the authorities. Non-mutually exclusive risks may interact and materialize jointly. "Short term" and "medium term" are meant to indicate that the risk could materialize within 1 year and 3 years, respectively.

Annex III. Implementation of the 2016 Article IV Key Recommendations

Key recommendations	Actions
Rebuild fiscal buffers	
Aim for a structural primary fiscal adjustment of 0.6 percent of GDP	Structural primary adjustment of 0.3 percent of GDP in 2016; 2017 projections imply a structural primary *loosening* of 0.3 percent of GDP.
Implement new property tax system, aiming to substantially increase revenue in the medium term	Plan to phase in a new system from 2019, in a way that gives rise to some revenue increase from an expanded number of commercial taxpayers.
Reform the pension system and spending on health and education to save money while maintaining the quality of service.	Published a White Paper on pension reform for public consultations; completed expenditure reviews on health care and drafted reform legislation
Rationalize public employment as part of a new multi-year collective agreement	Collective agreement for 2017-18 covers wages only.
Repair bank and corporate balance sheets	
Reduce non-performing loans, including through transferring to BAMC large bank exposures to debtors on whom BAMC already holds a claim; Set up SPV to bundle and sell non-performing SME loans	Reduced NPLs to 5 percent; SPV proposal did not gain political support, but instead, based on central bank guidelines, banks adopted annual 2017-19 targets for SME NPL restructuring; No further transfers to the BAMC, but transferred claims on large corporate group from the BAMC to the SSH
Privatize state-owned banks; for NLB, reconsider plans to prevent any investor from acquiring more than the state's designated share stake	Sale of the third-largest bank (NKBM) completed; government started the procedure to privatize the largest bank (NLB).
Put in place a centralized electronic credit register	Done in early 2017.
Pave the way for sustainable long-term growth	
Intensify privatization efforts. Restart privatization of Telecom Slovenia	Have sold 9 of the 15 firms identified in 2013 for privatization. The sale of the largest firm on this list (Telekom Slovenia) has been postponed indefinitely.
Increase number of "portfolio" SOEs in which private investors can acquire full control	SSH's proposal to increase the number of "portfolio" SOEs is being considered by the government and will have to be approved by parliament
Safeguard the independence of BAMC	After several senior management resignations, management of the BAMC has stabilized. Legal amendments confirm the BAMC's operational independence.

Annex IV. External Debt Sustainability Analysis

The gross external debt ratio is projected to fall gradually from 109 percent of GDP in 2016 to 90 percent of GDP in 2022. Between end-2015 and end-2016, external debt fell by 8 percentage points of GDP, mainly on account of falling public external debt and bank liabilities. Over the medium term, the private sector is expected to continue to reduce external debt significantly while public external debt is projected to rise by about 3 percentage points to 57 percent of GDP in 2022. Beyond 2022, continued improvement in the external debt-to-GDP ratio will require reductions in external debt of the government.

Slovenia's net international investment position remains negative (-35 percent of GDP at end-2016). However, the projected sizable, if declining, current account surpluses over the medium term will close this gap and lead to a balanced position by 2022 (see Annex I).

External debt dynamics show moderate vulnerability to standard shocks. With low interest rates over the last several years and most debt euro-denominated, an increase in nominal interest rates or a depreciation are not expected to materially affect the outlook for external debt. A shock to real GDP growth or a combination of smaller shocks to interest rates, growth, and the current account would push external debt up by about 10 percentage points to 103 percent of GDP in 2022, still below the current level of 109 percent of GDP. In a scenario with key variables at their historical averages, the external debt-to-GDP would rise above 120 percent in 2022. However, historical data was driven by debt accumulation by financial institutions ahead of the global financial crisis in 2007 and the government after the GFC and Slovenia's 2012–13 banking crisis. Since 2008, banks have reduced their external debt by 37 percentage points of GDP and were recapitalized so that a repeat of the historical scenario is unlikely.

Slovenia: External Debt Sustainability Framework, 2012–2022

(In percent of GDP, unless otherwise indicated)

	Actual							Projections						
	2012	2013	2014	2015	2016			2017	2018	2019	2020	2021	2022	Debt-stabilizing non-interest current account 6/
Baseline: External debt	119.1	116.6	126.8	116.6	109.0			**103.0**	**99.7**	**96.9**	**94.5**	**92.3**	**90.2**	**-1.5**
Of which: external public debt	30.8	43.6	63.1	60.1	54.3			53.3	53.7	54.4	55.2	56.1	56.9	
Change in external debt	6.1	-2.5	10.2	-10.2	-7.6			-5.9	-3.4	-2.7	-2.4	-2.2	-2.1	
Identified external debt-creating flows (4+8+9)	-1.3	-5.0	-12.6	-6.6	-12.6			-10.6	-9.3	-7.9	-7.2	-6.2	-5.8	
Current account deficit, excluding interest payments	-5.1	-7.4	-9.2	-8.0	-9.6			-8.2	-8.1	-7.6	-7.1	-6.5	-6.0	
Deficit in balance of goods and services	-4.0	-6.8	-7.7	-9.1	-9.7			-8.4	-8.2	-7.7	-7.3	-6.7	-6.2	
Exports	73.2	75.2	76.4	77.9	79.1			81.0	81.7	82.5	83.6	84.9	86.3	
Imports	69.3	68.4	68.7	68.8	69.4			72.6	73.4	74.8	76.3	78.2	80.1	
Net non-debt creating capital inflows (negative)	-1.5	-0.1	-2.0	-4.1	-2.3			-1.6	-1.5	-0.9	-0.8	-0.5	-0.5	
Automatic debt dynamics 1/	5.3	2.4	-1.5	5.4	-0.7			-0.7	0.2	0.6	0.7	0.8	0.8	
Contribution from nominal interest rate	2.7	2.5	3.0	3.4	2.8			2.6	2.6	2.5	2.5	2.4	2.4	
Contribution from real GDP growth	3.4	1.3	-3.5	-3.4	-2.8			-3.3	-2.3	-1.9	-1.7	-1.7	-1.6	
Contribution from price and exchange rate changes 2/	-0.8	-1.3	-0.9	5.5	-0.6			...	...	...	...	...	...	
Residual, incl. change in gross foreign assets (2-3) 3/	7.4	2.5	22.9	-3.6	5.0			4.6	5.9	5.2	4.8	4.0	3.6	
External debt-to-exports ratio (in percent)	162.6	155.0	166.0	149.5	137.8			127.2	122.0	117.5	113.1	108.8	104.5	
Gross external financing need (in billions of US dollars) 4/	12.1	14.1	10.3	9.7	10.3			11.0	7.5	7.5	6.7	7.4	6.8	
in percent of GDP	33.6	39.3	27.5	25.0	25.8	10-Year	10-Year	27.9	18.3	17.4	15.0	16.0	14.1	
Scenario with key variables at their historical averages 5/								**103.0**	**107.6**	**111.8**	**115.8**	**118.6**	**120.8**	**0.2**
Key Macroeconomic Assumptions Underlying Baseline						Historical Average	Standard Deviation							
Real GDP growth (in percent)	-2.7	-1.1	3.1	2.3	2.5	0.8	4.0	3.0	2.3	2.0	1.9	1.8	1.8	
GDP deflator in US dollars (change in percent)	-7.4	4.2	0.9	-15.7	0.3	0.6	9.0	-3.3	1.8	2.2	2.1	1.8	1.5	
Nominal external interest rate (in percent)	2.2	2.1	2.6	2.3	2.4	2.7	1.0	2.3	2.6	2.6	2.6	2.7	2.7	
Growth of exports (US dollar terms, in percent)	1.6	2.5	5.6	5.4	4.6	4.8	9.2	6.2	5.4	5.3	5.4	5.5	5.7	
Growth of imports (US dollar terms, in percent)	-2.3	-1.5	4.4	3.5	4.0	3.7	11.3	8.5	5.6	6.1	6.1	6.4	6.5	
Current account balance, excluding interest payments	5.1	7.4	9.2	8.0	9.6	4.4	4.0	8.2	8.1	7.6	7.1	6.5	6.0	
Net non-debt creating capital inflows	1.5	0.1	2.0	4.1	2.3	0.7	1.9	1.6	1.5	0.9	0.8	0.5	0.5	

1/ Derived as [r - g - r(1+g) + ea(1+r)]/(1+g+r+gr) times previous period debt stock, with r = nominal effective interest rate on external debt; r = change in domestic GDP deflator in US dollar terms, g = real GDP growth rate, e = nominal appreciation (increase in dollar value of domestic currency), and a = share of domestic-currency denominated debt in total external debt.

2/ The contribution from price and exchange rate changes is defined as [-r(1+g) + ea(1+r)]/(1+g+r+gr) times previous period debt stock. r increases with an appreciating domestic currency (e > 0) and rising inflation (based on GDP defla

3/ For projection, line includes the impact of price and exchange rate changes.

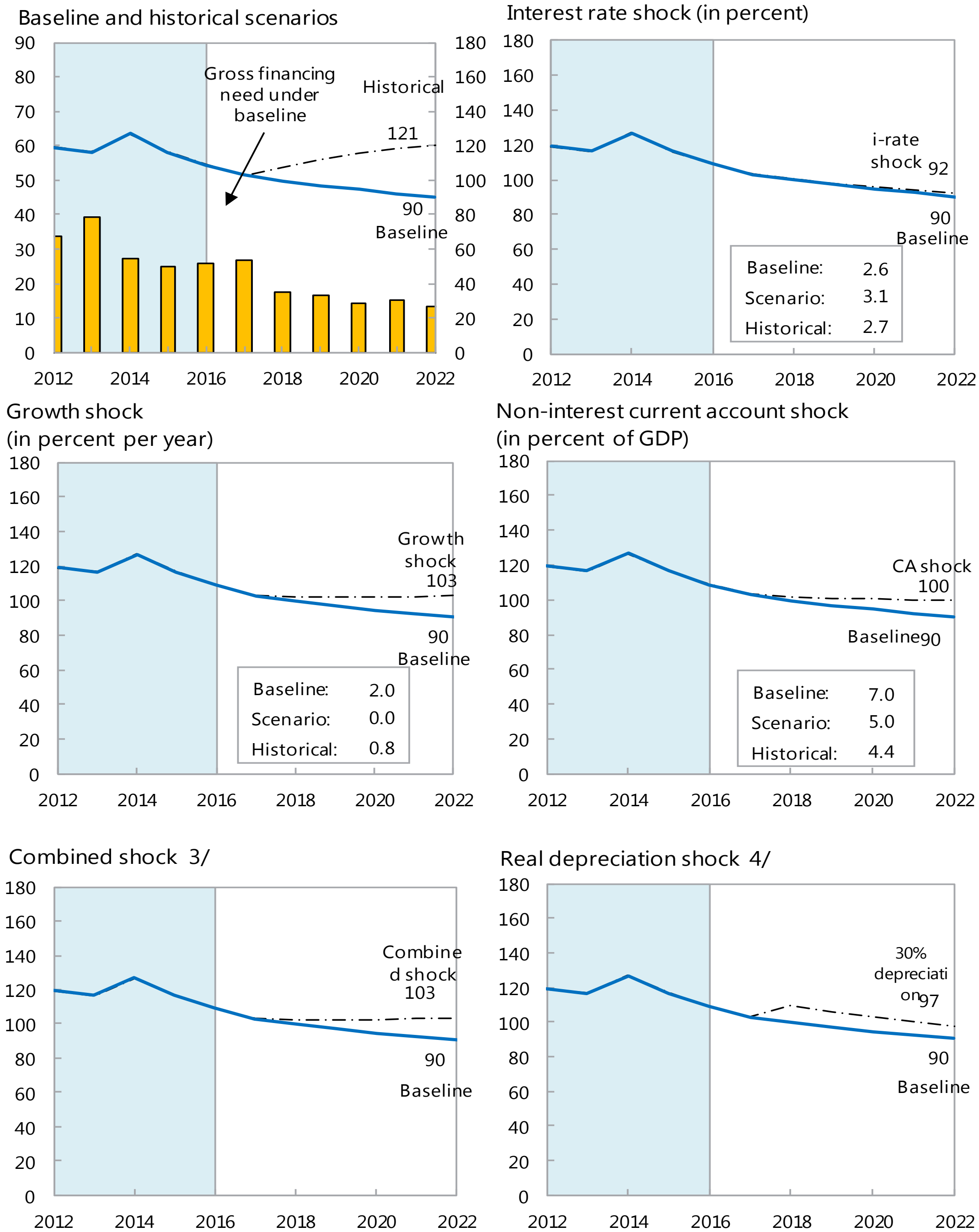
4/ Defined as current account deficit, plus amortization on medium- and long-term debt, plus short-term debt at end of previous period.

5/ The key variables include real GDP growth; nominal interest rate; dollar deflator growth; and both non-interest current account and non-debt inflows in percent of GDP.

6/ Long-run, constant balance that stabilizes the debt ratio assuming that key variables (real GDP growth, nominal interest rate, dollar deflator growth, and non-debt inflows in percent of GDP) remain at their levels of the last projection year.

Slovenia: External Debt Sustainability: Bound Tests 1/ 2/

(External debt in percent of GDP)



Sources: International Monetary Fund, Country desk data, and staff estimates.
1/ Shaded areas represent actual data. Individual shocks are permanent one-half standard deviation shocks. Figures in the boxes represent average projections for the respective variables in the baseline and scenario being presented. Ten-year historical average for the variable is also shown.
2/ For historical scenarios, the historical averages are calculated over the ten-year period, and the information is used to project debt dynamics five years ahead.
3/ Permanent 1/4 standard deviation shocks applied to real interest rate, growth rate, and current account balance.
4/ One-time real depreciation of 30 percent occurs in 2017.

Annex V. Public-Sector Debt Sustainability Analysis

Fiscal consolidation has improved Slovenia's medium-term public debt dynamics, but vulnerabilities remain in the absence of further adjustment. Under staff's baseline scenario, the structural primary balance is expected to deteriorate from 1.4 percent of GDP in 2016 to just over 1 percent of GDP in 2017, and continue to decline in the following years, ending up just above ½ percent of GDP by 2022. These trends notwithstanding, the budget overperformance in 2016 and the substantial savings in debt service costs stemming from the ECB's QE and debt management operations in 2016 allow for somewhat more benign public debt dynamics relative to the last Article IV projections. Thus, the debt ratio will: (i) register a further 1¾ percentage point decline in 2017, as the Treasury continues to draw down its cash buffer; (ii) continue declining at a slower pace in-2018–19, and (iii) virtually stabilize thereafter, settling at about 76 percent by 2022. Historical debt dynamics in 2013–14 were dominated by the impact of bank restructuring (which accounts for the large 2013 primary balance forecast error), and are thus unlikely to occur again given the banks' good health. The medium-term debt dynamics largely reflect the end of the fiscal adjustment that is projected to occur without additional measures, leaving a primary surplus at a level that roughly offsets the impact on debt dynamics of the growth-real interest rate differential and below-the-line government lending and equity injection operations.

Slovenia's relatively high public debt ratio remains a vulnerability, while debt service is projected to remain manageable, even under the stress scenarios. Under the baseline, the debt ratio remains below its high-risk threshold of 85 percent of GDP throughout the medium term. However, it is projected to exceed this threshold under some stress scenarios (particularly if growth disappoints or macro-fiscal shocks materialize). In terms of debt structure, the share of short-term debt is moderate, and while the share of debt held by non-residents exceeds the relevant threshold, the maturities of these holdings have been significantly lengthened, implying manageable annual rollover needs. Slovenia's spreads have fallen steadily to low levels. Under the baseline, debt gross financing needs remain below 8 percent of GDP throughout the medium term, mainly reflecting the recent debt operations that rolled over expensive dollar debt into low-yield, euro-denominated, long-maturity instruments, and the low interest rate environment in the context of ECB's QE. Gross financing needs are projected to remain well under the high-risk threshold of 20 percent of GDP under the standard robustness stress tests and scenarios.

Slovenia's debt dynamics are vulnerable to specific shocks:

- **Standardized macro shocks**: Sensitivity to **GDP growth shocks** is especially noteworthy—a negative one-standard deviation growth shock over two years would bring the debt ratio to well over 90 percent by 2022. This illustrates the importance of reforms to put Slovenia on a high and sustainable growth path.

- **Country-specific shocks**:

  - **Contingent fiscal liabilities** are a potential source of vulnerability, though to a smaller extent than in the recent past. Excluding guarantees extended to the EFSF and the BAMC (which are part of the general government debt), state guarantees extended to the nonfinancial sector amount to just over 10 percent of GDP, and the weak financial position of the borrowers concerned raises the probability that a sizeable portion of these guarantees may be called if economic and financial conditions were to deteriorate. To illustrate, calling of half of the guarantees outstanding, accompanied by a transitory negative confidence impact on Slovenia's spread, would bring the debt ratio to almost 85 percent by 2022. This highlights the importance of corporate restructuring and reducing the state's direct and indirect involvement in the economy.

- **A combined macro-fiscal shock** (with GDP growth at the level of the adverse growth scenario, inflation and fiscal revenue at the respective minima of the standardized scenarios, and fiscal expenditure, exchange rate, and interest rate spread at the respective maxima of the standardized scenarios) would also result in explosive debt dynamics, with debt close to 100 percent of GDP by the end of the projection period, highlighting the importance of a credible medium-term fiscal policy.

An active scenario of fiscal adjustment along the lines of staff's recommendations can put debt dynamics on a firmly downward path. Adoption of additional structural fiscal measures amounting to some 1¾ percent of GDP over the next few years would bring the debt ratio below 70 percent by 2022 and 60 percent by 2026, even as medium-term growth may be somewhat lower as a result of the fiscal headwinds. Implementing measures yielding more than this minimum and using the extra savings for growth-friendly fiscal policies, as well as strengthening private investment, labor market functioning, and productivity, as described in the staff report, could more than overcome these headwinds.

Slovenia: Public Sector Debt Sustainability Analysis (DSA) – Baseline Scenario

(in percent of GDP unless otherwise indicated)

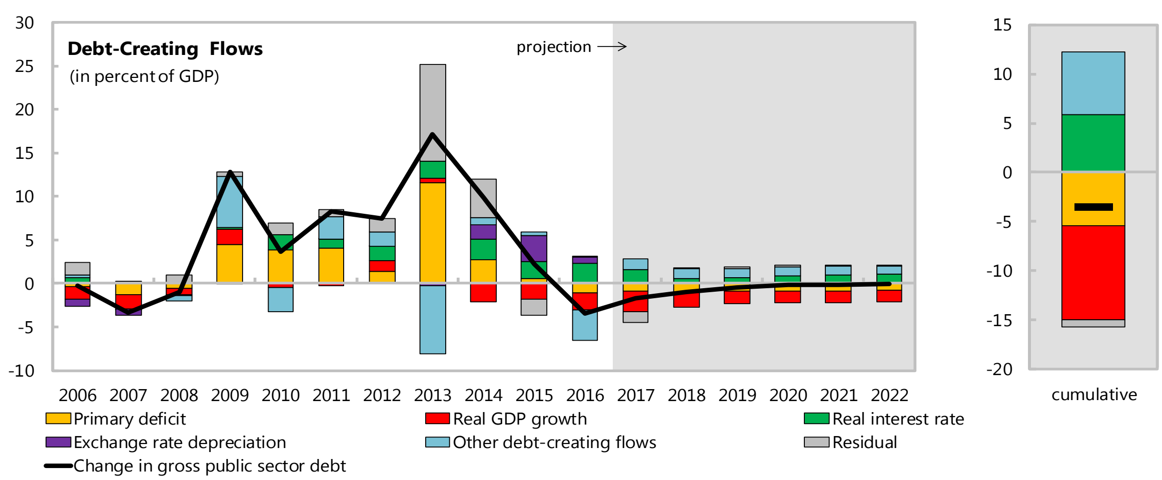
Debt, Economic and Market Indicators [1/]

	Actual			Projections					
	2006-2014 [2/]	2015	2016	2017	2018	2019	2020	2021	2022
Nominal gross public debt	43.9	83.1	79.7	78.0	77.0	76.5	76.3	76.2	76.1
Public gross financing needs	8.5	6.0	10.6	8.0	6.3	6.8	4.7	7.8	6.9
Real GDP growth (in percent)	1.0	2.3	2.5	3.0	2.3	2.0	1.9	1.8	1.8
Inflation (GDP deflator, in percent)	1.8	1.0	0.6	0.7	2.1	2.2	2.0	2.0	2.1
Nominal GDP growth (in percent)	2.9	3.3	3.1	3.7	4.5	4.2	3.9	3.9	3.9
Effective interest rate (in percent) [4/]	4.2	3.6	3.5	2.9	3.0	3.1	3.3	3.4	3.6

As of March 31, 2017		
Sovereign Spreads		
EMBIG (bp) 3/		38
5Y CDS (bp)		77
Ratings	Foreign	Local
Moody's	Baa3	Baa3
S&Ps	A	A
Fitch	A-	A-

Contribution to Changes in Public Debt

	Actual			Projections							
	2006-2014	2015	2016	2017	2018	2019	2020	2021	2022	cumulative	debt-stabilizing primary balance [9/]
Change in gross public sector debt	6.1	2.3	-3.5	-1.7	-0.9	-0.5	-0.2	-0.1	-0.1	-3.5	
Identified debt-creating flows	3.6	4.1	-3.5	-0.4	-1.0	-0.6	-0.3	-0.3	-0.1	-2.8	
Primary deficit	2.9	0.5	-1.0	-0.9	-1.0	-0.9	-0.9	-0.9	-0.8	-5.4	0.7
Primary (noninterest) revenue and gra	40.8	40.7	39.8	40.1	40.0	40.0	40.0	40.2	40.1	240.4	
Primary (noninterest) expenditure	43.6	41.3	38.8	39.2	39.0	39.1	39.1	39.3	39.3	235.0	
Automatic debt dynamics [5/]	0.7	3.2	1.0	-0.6	-1.2	-0.8	-0.5	-0.4	-0.3	-3.7	
Interest rate/growth differential [6/]	0.7	0.2	0.3	-0.6	-1.2	-0.8	-0.5	-0.4	-0.3	-3.7	
Of which: real interest rate	1.0	2.0	2.3	1.6	0.6	0.6	0.9	1.0	1.1	5.9	
Of which: real GDP growth	-0.3	-1.8	-2.0	-2.3	-1.7	-1.5	-1.4	-1.3	-1.4	-9.6	
Exchange rate depreciation [7/]	0.0	3.0	0.7	…	…	…	…	…	…	…	
Other identified debt-creating flows	0.0	0.4	-3.5	1.2	1.1	1.1	1.0	1.0	1.0	6.3	
FIS: Other (specify, e.g. bank recapital	-2.1	0.5	0.0	1.4	0.0	0.0	0.0	0.0	0.0	1.2	
Contingent liabilities	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	
FIS: Other financing sources	2.1	-0.1	-3.5	-0.2	1.2	1.1	1.1	1.0	1.0	5.2	
Residual, including asset changes [8/]	2.5	-1.8	0.0	-1.3	0.1	0.2	0.1	0.1	0.0	-0.8	



Source: IMF staff.

1/ Public sector is defined as general government.

2/ Based on available data.

3/ Long-term bond spread over German bonds.

4/ Defined as interest payments divided by debt stock (excluding guarantees) at the end of previous year.

5/ Derived as [(r - π(1+g) - g + ae(1+r)]/(1+g+π+gπ)) times previous period debt ratio, with r = interest rate; π = growth rate of GDP deflator; g = real GDP growth rate; a = share of foreign-currency denominated debt; and e = nominal exchange rate depreciation (measured by increase in local currency value of U.S. dollar).

6/ The real interest rate contribution is derived from the numerator in footnote 5 as r - π (1+g) and the real growth contribution as -g.

7/ The exchange rate contribution is derived from the numerator in footnote 5 as ae(1+r).

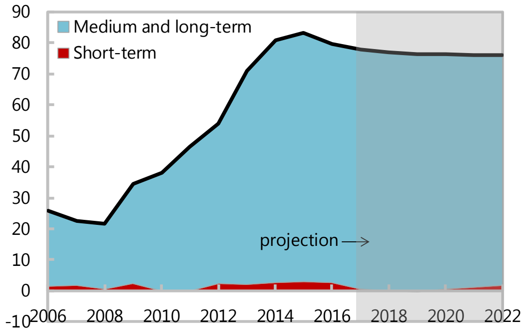
8/ Includes asset changes and interest revenues (if any). For projections, includes exchange rate changes during the projection period.

9/ Assumes that key variables (real GDP growth, real interest rate, and other identified debt-creating flows) remain at the level of the last projection year.

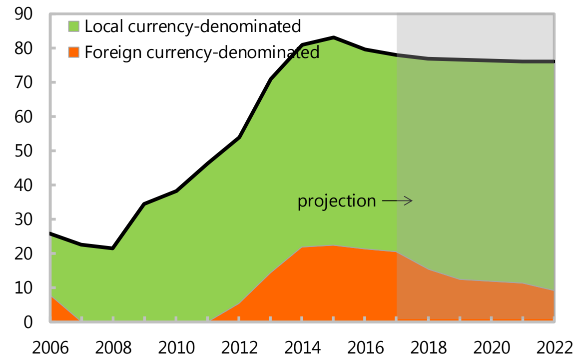
Slovenia: Public DSA Composition of Public Debt and Alternative Scenarios

Composition of Public Debt

By Maturity
(in percent of GDP)



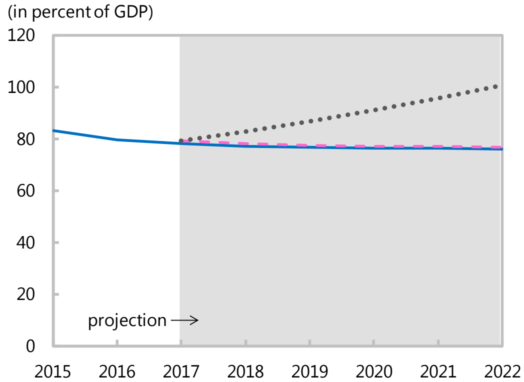
By Currency
(in percent of GDP)



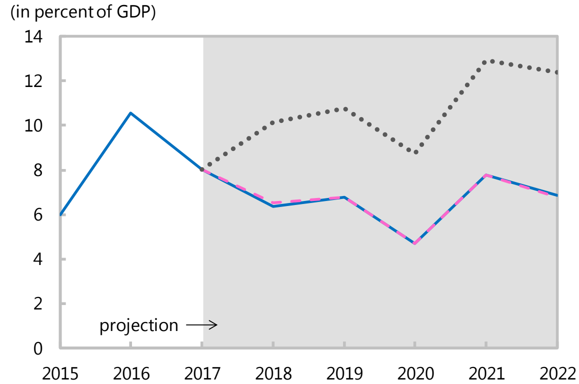
Alternative Scenarios

Baseline   Historical   Constant Primary Balance

Gross Nominal Public Debt
(in percent of GDP)



Public Gross Financing Needs
(in percent of GDP)



Underlying Assumptions
(in percent)

Baseline Scenario	2017	2018	2019	2020	2021	2022
Real GDP growth	3.0	2.3	2.0	1.9	1.8	1.8
Inflation	0.7	2.1	2.2	2.0	2.0	2.1
Primary Balance	0.9	1.0	0.9	0.9	0.9	0.8
Effective interest rate	2.9	3.0	3.1	3.3	3.4	3.6
Constant Primary Balance Scenario						
Real GDP growth	3.0	2.3	2.0	1.9	1.8	1.8
Inflation	0.7	2.1	2.2	2.0	2.0	2.1
Primary Balance	0.9	0.9	0.9	0.9	0.9	0.9
Effective interest rate	2.9	3.0	3.1	3.3	3.4	3.6

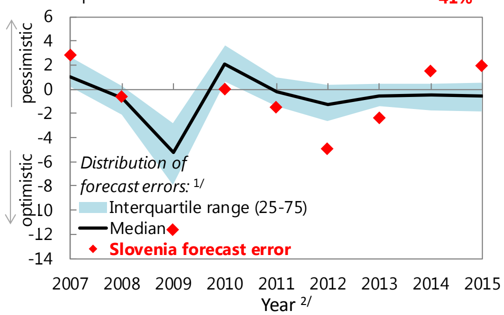
Historical Scenario	2017	2018	2019	2020	2021	2022
Real GDP growth	3.0	0.8	0.8	0.8	0.8	0.8
Inflation	0.7	2.1	2.2	2.0	2.0	2.1
Primary Balance	0.9	-2.6	-2.6	-2.6	-2.6	-2.6
Effective interest rate	2.9	3.0	3.3	3.7	3.9	4.3

Source: IMF staff.

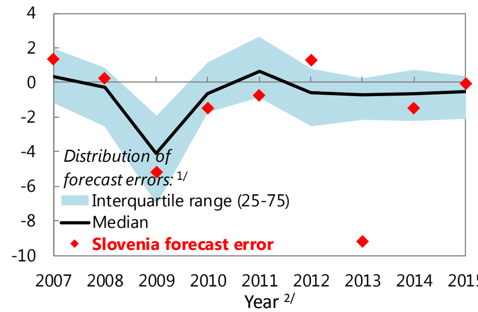
Slovenia Public DSA - Realism of Baseline Assumptions

Forecast Track Record, versus all countries

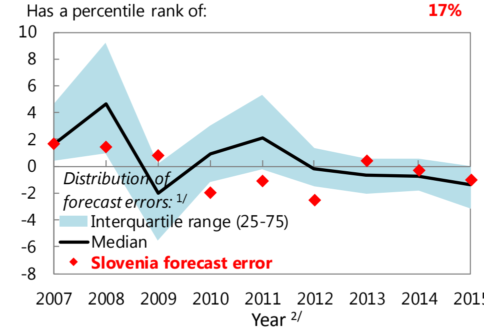
Real GDP Growth
(in percent, actual-projection)
Slovenia median forecast error, 2007-2015: **-0.49**
Has a percentile rank of: **41%**



Primary Balance
(in percent of GDP, actual-projection)
Slovenia median forecast error, 2007-2015: **-0.74**
Has a percentile rank of: **39%**

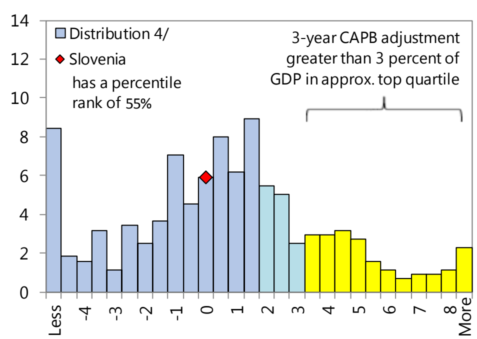


Inflation (Deflator)
(in percent, actual-projection)
Slovenia median forecast error, 2007-2015: **-0.71**
Has a percentile rank of: **17%**

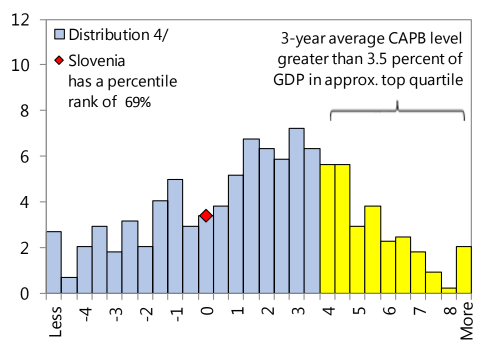


Assessing the Realism of Projected Fiscal Adjustment

3-Year Adjustment in Cyclically-Adjusted Primary Balance (CAPB)
(Percent of GDP)

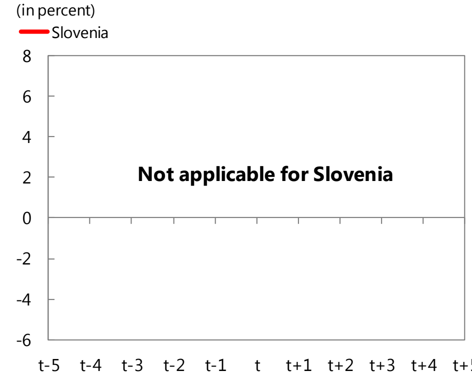


3-Year Average Level of Cyclically-Adjusted Primary Balance (CAPB)
(Percent of GDP)



Boom-Bust Analysis 3/

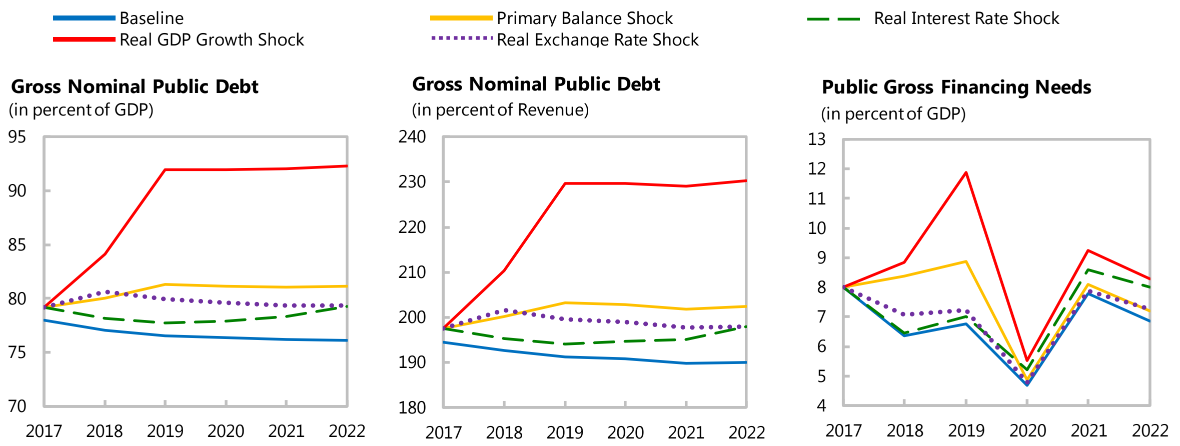
Real GDP growth
(in percent)



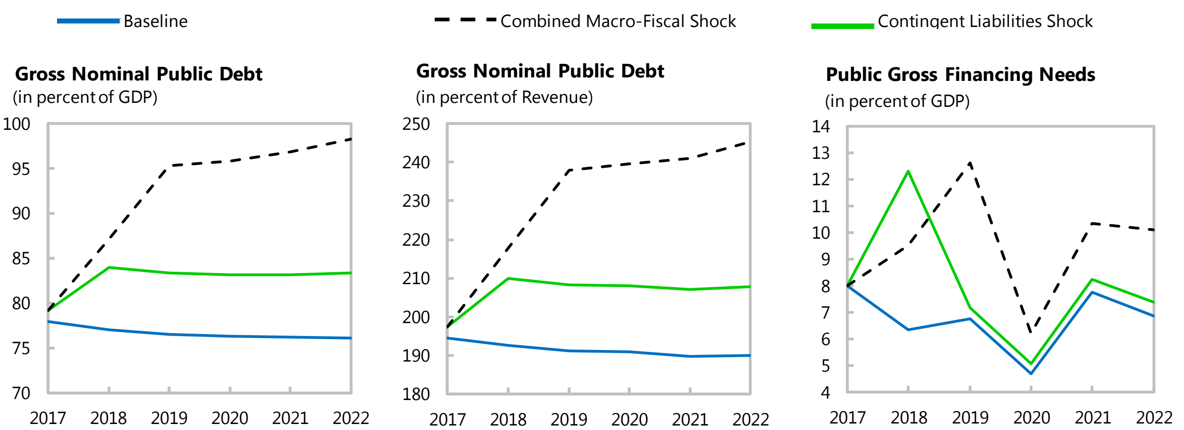
Source : IMF Staff.
1/ Plotted distribution includes all countries, percentile rank refers to all countries.
2/ Projections made in the spring WEO vintage of the preceding year.
3/ Not applicable for Slovenia, as it meets neither the positive output gap criterion nor the private credit growth criterion.
4/ Data cover annual obervations from 1990 to 2011 for advanced and emerging economies with debt greater than 60 percent of GDP. Percent of sample on vertical axis.

Slovenia Public DSA – Stress Tests

Macro-Fiscal Stress Tests



Additional Stress Tests



Underlying Assumptions

(in percent)

Primary Balance Shock	2017	2018	2019	2020	2021	2022
Real GDP growth	3.0	2.3	2.0	1.9	1.8	1.8
Inflation	0.7	2.1	2.2	2.0	2.0	2.1
Primary balance	0.9	-0.9	-1.0	0.9	0.9	0.8
Effective interest rate	2.9	3.0	3.2	3.5	3.6	3.8
Real Interest Rate Shock						
Real GDP growth	3.0	2.3	2.0	1.9	1.8	1.8
Inflation	0.7	2.1	2.2	2.0	2.0	2.1
Primary balance	0.9	1.0	0.9	0.9	0.9	0.8
Effective interest rate	2.9	3.0	3.4	4.0	4.4	4.9
Combined Shock						
Real GDP growth	3.0	-1.7	-2.0	1.9	1.8	1.8
Inflation	0.7	1.1	1.2	2.0	2.0	2.1
Primary balance	0.9	-1.0	-3.2	0.9	0.9	0.8
Effective interest rate	2.9	3.1	3.5	4.3	4.7	5.2

Real GDP Growth Shock	2017	2018	2019	2020	2021	2022
Real GDP growth	3.0	-1.7	-2.0	1.9	1.8	1.8
Inflation	0.7	1.1	1.2	2.0	2.0	2.1
Primary balance	0.9	-1.0	-3.2	0.9	0.9	0.8
Effective interest rate	2.9	3.0	3.2	3.6	3.7	3.9
Real Exchange Rate Shock						
Real GDP growth	3.0	2.3	2.0	1.9	1.8	1.8
Inflation	0.7	2.6	2.2	2.0	2.0	2.1
Primary balance	0.9	1.0	0.9	0.9	0.9	0.8
Effective interest rate	2.9	3.1	3.1	3.3	3.4	3.6

Source: IMF staff.

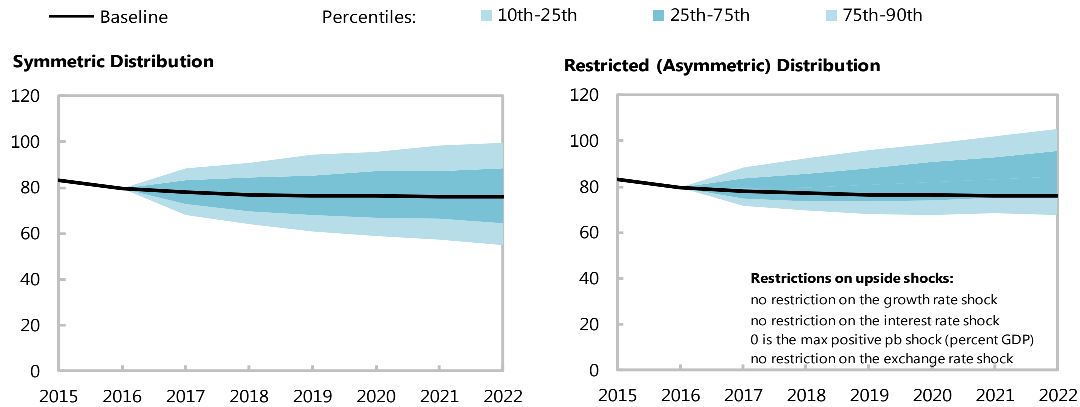
Slovenia: Public DSA Risk Assessment

Heat Map

Debt level 1/	Real GDP Growth Shock	Primary Balance Shock	Real Interest Rate Shock	Exchange Rate Shock	Contingent Liability shock
Gross financing needs 2/	Real GDP Growth Shock	Primary Balance Shock	Real Interest Rate Shock	Exchange Rate Shock	Contingent Liability Shock
Debt profile 3/	Market Perception	External Financing Requirements	Change in the Share of Short-Term Debt	Public Debt Held by Non-Residents	Foreign Currency Debt

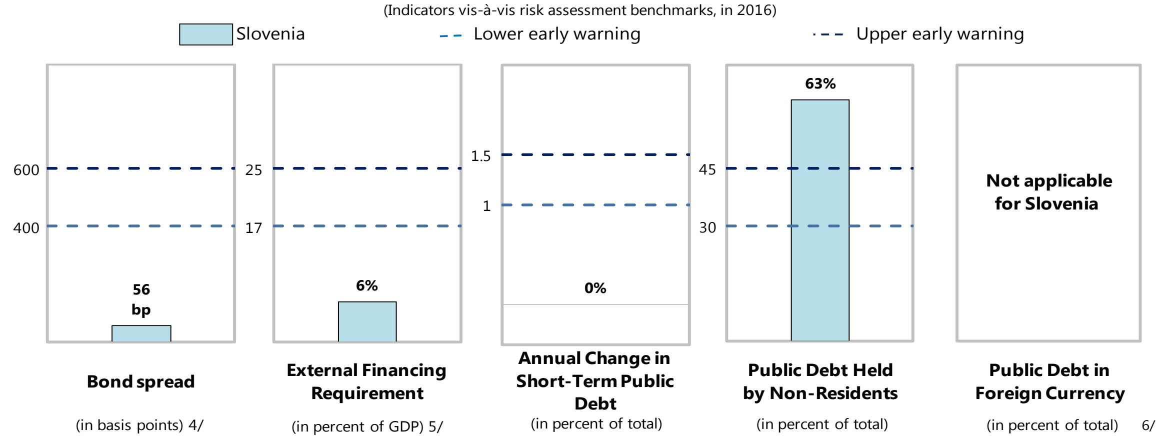
Evolution of Predictive Densities of Gross Nominal Public Debt

(in percent of GDP)



Debt Profile Vulnerabilities

(Indicators vis-à-vis risk assessment benchmarks, in 2016)



Source: IMF staff.

1/ The cell is highlighted in green if debt burden benchmark of 85% is not exceeded under the specific shock or baseline, yellow if exceeded under specific shock but not baseline, red if benchmark is exceeded under baseline, white if stress test is not relevant.

2/ The cell is highlighted in green if gross financing needs benchmark of 20% is not exceeded under the specific shock or baseline, yellow if exceeded under specific shock but not baseline, red if benchmark is exceeded under baseline, white if stress test is not relevant.

3/ The cell is highlighted in green if country value is less than the lower risk-assessment benchmark, red if country value exceeds the upper risk-assessment benchmark, yellow if country value is between the lower and upper risk-assessment benchmarks. If data are unavailable or indicator is not relevant, cell is white.
Lower and upper risk-assessment benchmarks are:

400 and 600 basis points for bond spreads; 17 and 25 percent of GDP for external financing requirement; 1 and 1.5 percent for change in the share of short-term debt; 30 and 45 percent for the public debt held by non-residents.

4/ Long-term bond spread over German bonds, an average over the last 3 months, 31-Dec-16 through 31-Mar-17.

5/ External financing requirement is defined as the sum of current account deficit, amortization of medium and long-term total external debt, and short-term total external debt at the end of previous period.

6/ Non-euro (mainly US dollar) debt is fully hedged.

INTERNATIONAL MONETARY FUND

REPUBLIC OF SLOVENIA

STAFF REPORT FOR THE 2017 ARTICLE IV CONSULTATION—INFORMATIONAL ANNEX

April 25, 2017

Prepared By	European Department

CONTENTS

FUND RELATIONS ____ 2

STATISTICAL ISSUES ____ 5

FUND RELATIONS

(As of March 31, 2017)

Membership Status: Joined 12/14/1992; Article VIII

General Resources Account:

	SDR Million	Percent of Quota
Quota	586.5	100
Fund holdings of currency	483.15	82.38
Reserve position	103.37	17.62
Lending to the Fund		
Borrowing Agreement		

SDR Department:

	SDR Million	Percent of Allocation
Net cumulative allocation	215.88	100
Holdings	162.57	75.30

Outstanding Purchases and Loans: None

Financial Arrangements: None

Projected Payments to Fund:
(SDR Million; based on existing use of resources and present holdings of SDRs):

	Forthcoming				
	2017	2018	2019	2020	2021
Principal					
Charges/Interest	0.16	0.23	0.23	0.23	0.23
Total	0.16	0.23	0.23	0.23	0.23

Exchange Rate Arrangement:

Slovenia adopted the euro on January 1, 2007. Slovenia has accepted the obligations of Article VIII. Slovenia maintains an exchange system that is free of multiple currency practices and restrictions on the making of payments and transfers for current international transactions, with the exception of exchange restrictions maintained for security reasons, which have been notified to the Fund pursuant to Decision No. 144-(52/51).

Article IV Consultation:

Slovenia is on the 12-month Article IV consultation cycle. The 2017 mission visited Ljubljana March 15–28, 2017, and held discussions with Ms. Vranicar Erman (Minister of Finance), Mr. Jazbec (Governor of the Bank of Slovenia), other ministers, government and Bank of Slovenia officials, as well as representatives of parliament, financial sector, labor, and business. Mr. Repanšek (OED) attended most meetings.

The mission comprised Mr. Gueorguiev (Head), Mr. Halikias, Mr. Ralyea (all EUR), and Mr. Dwight (SPR). The mission held a press conference on March 28, 2017.

FSAP Participation and Reports on Standards and Codes (ROSCs):

An FSAP mission took place November 6–20, 2000, and an FSSA report (SM/01/129) was issued on April 24, 2001, and published on September 18, 2001 (Country Report No. 01/161).

The fiscal transparency module of the fiscal ROSC was published in June 2002.

An FSAP Update mission visited Ljubljana November 10–21, 2003. An FSSA report (SM/04/152) was issued on April 26, 2004, accompanied by ROSCs on Banking Supervision and Insurance Supervision (May, 2004).

An FSAP mission took place April 4-16, 2012. An FSSA report (Country Report No. 12/325) was published on December 6, 2012, accompanied by the Detailed Assessment of Observance of Basel Core Principles for Effective Banking Supervision (Country report No. 12/324).

Technical Assistance: See attached table.

Resident Representative Post: None.

Table 1. Republic of Slovenia: Technical Assistance, 2001–16

Department	Timing	Purpose
MCM	December 2009	Financial Supervisory Architecture
	October 2012	Bank Resolution
	December 2012	Bank Asset Management Company
	November 2013	Stress testing Workshop
	December 2013	Peripatetic expert, Financial Stability
	May 2014	Bank supervision
	December 2014	Bank resolution framework
LEG	October 2013	Insolvency Law
FAD	August 2001	VAT
	November 2001	Direct Tax Reform
	November 2003	Expenditure Rationalization
	May 2004	Options for Short-Term Public Expenditure Rationalization
	October 2004	Performance Information to Support Better Budgeting
	April 2014	Strengthening the Public Financial Management Framework
	May 2015	Establishing a Spending Review Process
	October 2015	The 2013 Property Tax Act: Evaluation of its Design and the Employed Mass Valuation System
STA	November 2004	Recording Transactions in International Trade in Services
	April 2006	Government Finance Statistics

STATISTICAL ISSUES

Data provision is adequate for surveillance purposes.

Special Data Dissemination Standard: Slovenia has subscribed to the Special Data Dissemination Standard (SDDS), meets SDDS specifications, and posts its metadata on the Fund's Dissemination Standards Bulletin Board on the Internet.
http://dsbb.imf.org/Applications/web/sddscountrycategorylist/?strcode=SVN

Real Sector Statistics: The Statistical Office of the Republic of Slovenia (SORS) follows the European System of Accounts 2010 (ESA10). Quarterly GDP estimates by industry and expenditure categories are compiled in both current and constant prices, and are published within 80 days after the reference quarter. In September 2005, the SORS changed the base year for compiling constant prices GDP from 2000 to the previous year's prices and started using the chain–link index methodology.

The SORS compiles the Harmonized Index of Consumer Prices (HICP) for monitoring compliance with the Maastricht inflation criterion. However, price collection is restricted to four cities and their surrounding rural areas. The weights are based on the three-year average of expenditure data for consumer goods from continuous Household Budget Surveys for 2002, 2003, and 2004. It also compiles a retail price index (RPI), which differs from the consumer price index in weights only.

Government Finance Statistics: Slovenian fiscal statistics are timely and of a high quality. The ministry of finance publishes a comprehensive monthly *Bulletin of Government Finance*, which presents monthly data on the operations of the "state budget" (Budgetary Central Government), local governments, social security (Pension and Health funds), and the consolidated general government. The coverage of general government excludes the operations of extra-budgetary funds and own revenues of general government agencies *(zavods)*. However, these operations are small in size. Monthly fiscal indicators are reported for publication in *IFS* on a timely basis and annual statistics covering general government operations, including the operations of the extra-budgetary funds are reported for publication in the *Government Finance Statistic Yearbook* (*GFS Yearbook*).

The data published in the *Bulletin of Government Finance* are on a cash basis and broadly use the analytical framework and classification system of the IMF's 1986 government finance statistics methodology. The data reported for publication in the *GFS Yearbook* are also on a cash basis but are recast in the analytical framework and classifications of the *Manual on Government Finance Statistics 2001*(*GFSM 2001*).

The Slovenian authorities adopted the *GFSM 2001* methodology, which is used as a building block for the compilation of the ESA 2010–based data jointly by the Ministry of Finance and the SORS for reporting to the European Commission. To assist the Ministry of Finance resolve several classification issues and develop a migration path, a STA technical assistance mission visited Ljubljana in April 2006. The introduction in 2008 of a new chart of accounts for all public entities based on accrual principles greatly facilitated the adoption of the new methodology.

Money and Banking Statistics: Monetary statistics are timely and of good quality.

Balance of Payments Statistics: Balance of payments data are comprehensive and of high quality. The data have been published in the *Balance of Payments Statistics Yearbook* since 1993 (with estimates of the international investment position published since 1994). In 2002, the Bank of Slovenia revised balance of payments statistics back to 1994; the most significant revisions were related to the income component of the current account and to the other investment component of the financial account. In June 2014, the Bank of Slovenia began reporting balance of payments and international investment position data according to the methodology of the sixth edition of the Balance of Payments Manual (BPM6). In September 2014, the Bank of Slovenia started reporting financial accounts according to the European System of National and Regional Accounts 2010 (ESA2010).

External Debt Statistics: External debt statistics were revised and brought in line with the SDDS in August 2003.

Republic of Slovenia: Table of Common Indicators Required for Surveillance
(As of April 12, 2017)

	Date of Latest Observation	Date Received or Posted	Frequency of Data[6]	Frequency of Reporting[6]	Frequency of Publication[6]
Exchange Rates	4/17	4/17	D	D	D
International Reserve Assets and Reserve Liabilities of the Monetary Authorities[1]	2/17	3/17	M	M	M
Reserve/Base Money	2/17	3/17	M	M	M
Broad Money	2/17	3/17	M	M	M
Central Bank Balance Sheet	2/17	3/17	M	M	M
Consolidated Balance Sheet of the Banking System	2/17	3/17	M	M	M
Interest Rates[2]	4/17	4/17	D	D	D
Consumer Price Index	3/17	3/17	M	M	M
Revenue, Expenditure, Balance and Composition of Financing[3] – General Government[4]	1/17	3/17	M	M	M
Revenue, Expenditure, Balance and Composition of Financing[3]– Central Government	2/17	3/17	M	M	M
Stocks of Central Government and Central Government-Guaranteed Debt[5]	2/17	3/17	M	M	M
External Current Account Balance	1/16	3/16	M	M	M
Merchandise Trade	2/16	4/16	M	M	M
GDP/GNP	Q4/16	2/17	Q	Q	Q
Gross External Debt	1/17	3/17	M	M	M
International Investment Position	Q4/16	3/17	Q	Q	Q

[1]Includes reserve assets pledged or otherwise encumbered as well as net derivative positions.

[2] Both market-based and officially-determined, including discount rates, money market rates, rates on treasury bills, notes and bonds.

[3] Foreign, domestic bank, and domestic nonbank financing.

[4] The general government consists of the central government (budgetary funds, extra budgetary funds, and social security funds) and state and local governments.

[5] Including currency and maturity composition. The first date corresponds to the stock of central government debt while the second to the stock of central government guaranteed debt.

[6] Daily (D), Weekly (W), Monthly (M), Quarterly (Q), Annually (A); Irregular (I); Not Available (NA).

Statement by the IMF Staff Representative
May 10, 2017

This statement provides information that has become available since the Staff Report (SM/17/94) was circulated to the Executive Board on April 26, 2017. The information does not alter the thrust of the staff appraisal.

The authorities reaffirmed their fiscal objectives in their 2017 Stability Program. The Stability Program confirms the authorities' plan to eliminate the structural budget deficit by 2020 through continuing expenditure reduction, mainly on wages, goods and services, and subsidies. Staff supports the intention to eliminate the structural deficit and continues to recommend reform-based expenditure consolidation in these and other areas as described in the staff report.

The external trade surplus declined in early 2017. Data for January-February show that the trade balance of goods and services declined by 0.3 percent of GDP on an annualized basis relative to the same period last year. The overall decline masks a big drop in the trade surplus of goods (-1½ percent of GDP, annualized) driven by rising imports of consumer and investment goods as well as higher international energy prices. The trade balance in services has notably increased, driven by exports of business services, transport, and travel.

The authorities requested modifications to their commitments regarding Nova Ljubljanska Banka (NLB) from the EC. Specifically, rather than selling 75 percent of the bank's shares in an IPO by end-2017 as planned, they now propose to sell at least 50 percent of the bank's shares by end-2017 and the rest by end-2018. The authorities stated this would ensure the best possible conditions for the sale and potentially raise the share price while still transferring the majority ownership to private hands by end-2017. The prohibition on any individual private investor acquiring more than 25 percent of the bank's shares, which staff opposes, remains in place. The EC's response is expected shortly.

The authorities are making further progress in fostering resolution of NPLs of SMEs. To this end, a handbook for management of nonperforming loans of micro, small, and medium sized companies was issued recently. It was prepared in cooperation between the Bank of Slovenia, the World Bank, and the banking industry in Slovenia within a project financed by the European Commission. The handbook spells out the recommended procedures and best practices in NPL resolution.

Statement by Michaela Erbenova, Executive Director for the Republic of Slovenia
Borut Repansek, Advisor to the Executive Director
May 10, 2017

The Slovenian authorities thank staff for the useful discussions during the Article IV mission and the compilation of their findings in the insightful set of papers.

The authorities' policy measures in response to the 2009-13 credit bubble burst and double dip recession have been showing their positive effect for the past three years, as reflected in sustained economic growth, significant fiscal consolidation and a well-capitalized banking sector with a decreasing NPL ratio now in the single digits. The corporate debt-to-equity ratio decreased and is now comparable to the euro area median at around 110 percent. The current account surplus is notable, FDI inflow, which was negligible in 2012, rose to 2.5 percent of GDP in 2016, and the proportion of nonfinancial corporations' equity held by non-residents increased to almost a quarter.

Solid economic growth in Slovenia is not only critical per se, but also for further pursuing structural reforms. Staff recently revised upwards their 2017 growth projection from 2.5 to 3 percent. The government's projection is 3.6 percent for 2017 and 3.2 percent for 2018. Export growth will be supported by demand in major trading partners, while domestic demand will underpin growth acceleration, in particular growth in households' consumption, and strong private investment, including corporate investment in equipment and machinery. Economic sentiment in Slovenia is high. The use of European Union funds will also contribute to strong economic performance, once government investment rebounds following the transition to the new financial perspective.

The authorities however, are aware that ensuring sustained, broad-based medium-term growth requires continued policy efforts. In that regard, they appreciate staff's comprehensive analyses including their assessment that in 2016 Slovenia's output gap stood at about 1.25 percent of GDP and could only be closed this year. The authorities acknowledge that Slovenia's economy has not moved into positive output gap territory.

Fiscal developments

Abrogation of the European Commission's Excessive Deficit Procedure for Slovenia in 2016 was a milestone in the fiscal consolidation process. Since then, progress has been made with reducing the deficit to 1.8 percent in 2016 (0.4 percentage points lower than envisaged) and expected to decline further to 0.8 percent in 2017. Importantly, public debt declined for the first time in nominal terms and as a percent of GDP in 2016. The banking sector bail-out, structural reforms, enhancement of the fiscal framework and post crisis fiscal restraint have proven to be efficient. A neutral tax reform and improvement in tax procedures would contribute to improving the business environment and economic performance.

The fiscal framework has been substantially upgraded. Following the introduction of the fiscal rule in 2015 and expenditure ceilings in 2016, the Fiscal Council has been fully operational since March 2017.

In late April, the government adopted the 2017-2018 National Reform Program and adjustments to the 2017 Stability Program. It is envisaged that in 2017, the general government deficit will fall to 0.8 percent of GDP and turn into surplus in 2019.

Recent monetary developments

Staff expects that robust economic activity and rising commodity prices will raise inflation this and next year to around 1.75 - 2.0 percent. Confirming this projection, the very recent Statistical Office information shows that inflation in April 2017 stood at 1.8 percent. Price developments have primarily been influenced by oil-based products price movements while growth in domestic demand and the increase in unit labor have not had a significant impact so far.

Credit market

The credit market is highly competitive, and faces a decline in corporate sector demand for loans due to the increased use of internal resources and non-bank resources. The line between domestic and foreign credit supply is waning, particularly in the context of the EU single market for financial services.

The most recent data of Banka Slovenije for February 2017 show that the nonfinancial corporate sector credit growth in the first quarter of 2017 turned positive after 6 years of continuous decline. Households' credit lately grows at somewhat below 6 percent on y-o-y basis. Risks to the household sector remain subdued given that Slovenian households' debt is among the lowest in Europe and that over 60 percent of the population live in an owner-occupied home for which there is no outstanding loan or mortgage.

The creditworthy enterprises, including small and medium-sized enterprises (SMEs), are mostly able to access credit smoothly. According to the European Commission's February 2017 Country Report on Slovenia, access to finance for SMEs has improved and is in line with the EU average. In 2016, some 9 percent of SMEs had their loan applications rejected, down from 24 percent in 2014. Both the willingness of banks to lend money and access to public financial support that include guarantees have improved, and access to finance is no longer seen to be among the main obstacles for the operation of Slovenian micro, small and medium-sized businesses.[1]

Smooth credit market functioning in Slovenia is not yet reflected in the World Bank Doing Business ranking in the category of "getting credit" mainly because of the past credit register deficiencies. These deficiencies were however addressed in January 2017 when Banka Slovenije replaced the old system with a full-fledged credit register.

Banking sector

The process of bailing out banks in Slovenia has been a clear game changer in terms of confidence both externally (government yields) and internally (confidence indicators) affecting

[1] Country Report Slovenia 2017; Brussels, 22.2.2017; page 31. (https://ec.europa.eu/info/files/2017-european-semester-country-report-slovenia_en)

positively economic growth. Banks in Slovenia are now adequately capitalized and better shielded against risks. Between 2012 and 2016 the banking sector's regulatory capital to risk-weighted assets (CAR) increased from 11.4 percent to 19.2 percent due to various measures in addition to the capital increase and cleaning of NPLs, such as restructuring and continuing deleveraging of corporates. Coverage of nonperforming claims by impairments is high and the banking system's capital is five times the stock of claims more than 90 days overdue not covered by impairments.

Banks' recapitalization and revamped insolvency regulation helped reduce the high share of NPLs[2] in total gross claims. In 2016, the process was accelerated resulting in a decline from 10 percent to 5.1 percent. Regarding the remaining NPLs, largely with SMEs, policy measures have already been taken. Banka Slovenije and the Banking Association issued NPLs guidelines for SME resolution supporting the process of evaluating bank NPL resolution strategies by the supervisor, including annual NPL reduction targets for 2017–19 and assisting banks to develop a tool kit for restructuring. In March 2017, the Handbook for management of nonperforming loans of micro, small and medium-sized companies was issued. It has been the result of the cooperation of the World Bank and Banka Slovenije in a project financed by European Commission.

The Bank Assets Management Company (BAMC) has been an important part of the NPL reduction process in 2013 and 2014 and operates well. Its management stabilized and measures were taken in late 2015 to shield the BAMC's independence: (i) the BAMC is operationally independent, as the Ministry of Finance may not issue instructions to the BAMC for action on individual cases; (ii) management of the BAMC rests with its executive directors; and (iii) the BAMC has broad powers to restructure companies in its portfolio. According to the BAMC's end-April 2017 information, cash generated from asset management in 2016 corresponded to 18.3 percent of the transfer value of the assets. This is substantially exceeding the legal requirement of annual liquidation of at least 10 percent of the estimated value of the assets.

In 2016, return on equity of the Slovenian banking sector doubled to more than 8 percent. Going forward however, bank profitability pressures will require adjustments in the industry. The market-driven consolidation process in the Slovenian banking system may likely continue. The three systemic banks in Slovenia are supervised by the Single Supervisory Mechanism. The banking system's supervision has undergone improvements, including with the support of 6 rounds of much appreciated Fund TA provided between 2012 and 2014. Future adjustments of banking business models are largely expected to be made within the wider European banking industry, while supervisors will in parallel concentrate on banking regulation compliance and containing risks to the financial system. Lastly, the authorities remain committed to privatize two of the remaining banks which received state aid after having privatized the third one in 2016.

The Financial Stability Board in Slovenia is a fully operational macro-prudential authority and macroprudential policy is proactively pursued. Given the increasing property prices, in August, 2016, Banka Slovenije issued non-binding guidelines on loan-to-value and debt–to-income

[2] Measured as classified claims in arrears over 90 days.

guidelines. The 2015 strategic framework for macroprudential policy for the banking sector and the related guidelines were updated in January 2017.

External developments

The elevated surplus in Slovenia's balance of payments' current transactions reflects export competitiveness gains in the tradable sector, corporate sector deleveraging and the low level of domestic consumption in previous years. The authorities expect that this and next year the current account surplus will decline to around 4.5 percent of GDP. In 2017 price factors, mainly deteriorating terms of merchandise trade, would drive the decline. The lower current account balance, the expected balancing of the international investment position by 2022 and the gradual public debt reduction will further improve macroeconomic stability of Slovenia's highly open economy.

Structural reforms

The 2017-2018 National Reform Program aims at supporting economic growth and public finance stability and sustainability through a comprehensive set of structural measures. In March 2016, the Parliament adopted a strategic plan for developing the health care system and in December 2016 the new Pharmacies Act was adopted. The Health Care and Health Insurance Act, the central piece of the health care reform, is in public consultation phase and envisaged for adoption by the Government in July. In addition, the prioritized introduction of the long-term care system aims at sending the needed new regulation for public consultation by the end of July this year. The 2012 pension reform's notable positive effects are still supporting the pension system's sustainability. To strengthen it over a longer horizon amid significant aging population pressures, the April 2016 White Paper provides the basis for the next round of adjustments to the pension system. The related consultation period is ending and the necessary regulation should allow new measures to start kicking in in 2020. Lastly, revisions to the Public Finance Act are in the pipeline. Following the introduction of a fiscal rule, they refocus budgeting to medium term and strengthen the budget discipline.

The medium- and short-term measures concentrate on improvements in debt management, local communities financing, public sector wage and employment regulation and budget transfers. The third set of envisaged measures is growth-supporting and spreads across 15 areas. Among them are administrative barriers reduction and investment support measures, improvements in tax collection, public procurement, judicial system, construction and spatial planning regulation and labor market functioning.

Slovenia's unemployment rate is below EU average. However, in 2016, there were 8.1 percent fewer persons employed in Slovenia than in 2008. Also, compared to EU average, Slovenia has a below average employment rate among the youth and the elderly. The 2013 labor market reform to further improve the labor market, contributed to better labor outcome and the authorities are now moving on in the areas where weaknesses remained. In early 2016 tax relief and exemption from paying social security contributions for employers hiring workers above the age of 55 has been introduced. The forthcoming introduction of vocational training should address youth unemployment and skills mismatch. More broadly, in 2016 a policy paper and an action plan were adopted to reduce the problem of elderly unemployment, complementing the White Paper on pensions. Two additional programs are being prepared to support employment of longer unemployed and elderly, and the drafted amendments of three labor market acts, aimed at improving its functioning, are in process.

The authorities remain committed to further pursuing policies of macroeconomic stabilization and on implementing their multipronged structural measures program.