

**Republic of Slovenia: 2009 Article IV Consultation—Staff Report; Staff Statement; Public Information Notice on the Executive Board Discussion; and Statement by the Executive Director for 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 2009 Article IV consultation with the Republic of Slovenia, the following documents have been released and are included in this package:

- The staff report for the 2009 Article IV consultation, prepared by a staff team of the IMF, following discussions that ended on March 11, 2009, 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 28, 2009. The views expressed in the staff report are those of the staff team and do not necessarily reflect the views of the Executive Board of the IMF.
- A staff statement of May 13, 2009, updating information on recent developments.
- A Public Information Notice (PIN) summarizing the views of the Executive Board as expressed during its May 13, 2009, discussion of the staff report that concluded the Article IV consultation.
- A statement by the Executive Director for the Republic of Slovenia.

The document listed below will be separately released.

Selected Issues Paper

The policy of publication of staff reports and other documents allows for the deletion of market-sensitive information.

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INTERNATIONAL MONETARY FUND

REPUBLIC OF SLOVENIA

**Staff Report for the 2009 Article IV Consultation**

Prepared by the European Department

(In consultation with other departments)

Approved by Juha Kähkönen and Martin Mühleisen

April 28, 2009

**Executive Summary**

**Background:** Slovenia's economy is increasingly affected by the global crisis through decelerating investment and foreign demand. A recession started in fall 2008 and will continue until growth resumes in the main trading partners. Despite their dependency on foreign funding, banks have so far weathered the global crisis relatively well.

**Challenges:** The immediate goal should be to minimize the negative spillovers from the global crisis on the real economy and the financial system. In the medium term, Slovenia will face new challenges from more competitive neighboring countries and lower potential growth. In the long term, an aging population threatens fiscal sustainability under the current pension rules.

**Staff views:** The fiscal stimulus has been so far appropriate but fiscal policy should be tightened when aggregate demand rebounds. The contingency plan to help banks' funding is appropriate but the authorities need to step up the monitoring of credit risk. Slovenia needs reforms in the labor and product markets to bolster competitiveness. Pension system sustainability requires rising retirement age and moderating pension indexation.

**Authorities' views:** The authorities' goal is to attenuate the effects of the crisis through a fiscal stimulus package and measures to preserve credit flow. However, fiscal sustainability is a priority and the deficit will be kept under 4 percent of GDP in 2009. The authorities are considering options to reform the pension system.

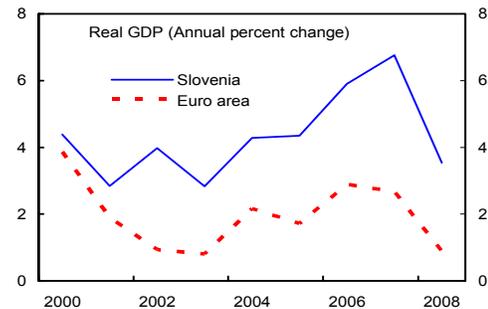
**Mission team:** Mr. Spilimbergo (Head, RES), Ms. Jaumotte, and Mr. Xiao (both EUR) visited Ljubljana March 2–11, 2009 and held discussions with the Minister of Finance, the Governor of the Bank of Slovenia, and other key economic ministers, government officials and representatives of parliament, financial sector, labor, business and media. Ms. Maver (Adviser to the Executive Director) attended also the meetings.

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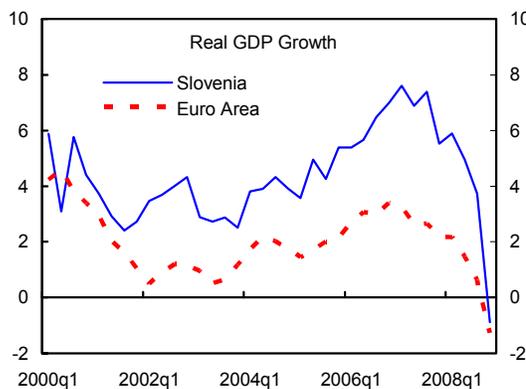
## I. CONTEXT

1. **The economy overheated following the adoption of the euro in 2007.** After a decade of solid economic growth, Slovenia's per capita income rose to 90.8 percent of the EU average in 2008. With the adoption of the euro, inflation rose to the highest level in the Euro area, wage growth eroded competitiveness, the real exchange rate appreciated, and the current account deficit widened significantly.

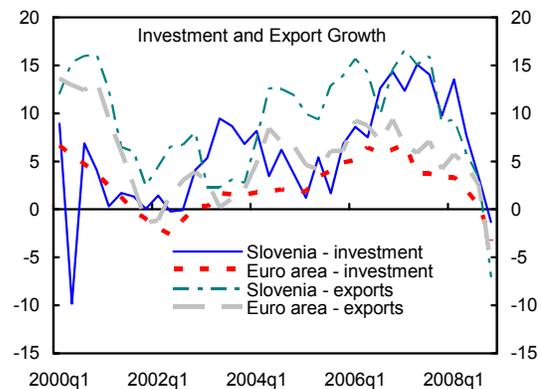


Source: Statistical Office.

2. **The global crisis hit Slovenia in the fall of 2008** (Table 1, Figures 1 and 2). Following 5.4 percent in the first half of 2008, growth slowed to 1.4 percent in the second half of the year, with a sharp decline in the last quarter. Manufacturing and trade, and later investment, decelerated sharply. Private consumption growth moderated from the high level in 2007.

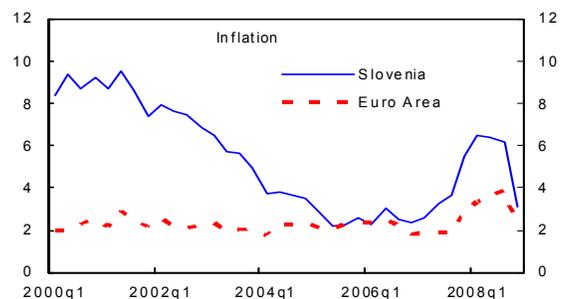


Sources: Statistical Office; Eurostat; and IMF staff projections.



3. **The labor market lost momentum at the end of 2008** (Figure 3). Until fall 2008, employment creation was strong, especially in construction and services, with full-time employment increasing 3 percent. Nominal wage growth also accelerated to 8.3 percent in 2008, as wage agreements were implemented. However, the labor market cooled in the fall, with unemployment increasing to 4.3 percent in the last quarter.

4. **Inflation has dropped sharply since the summer** (Figure 4). Reflecting a strong pass-through of fuel and food prices, inflation stood at 5.5 percent in 2008, 2.2 percentage points above Euro-area inflation. In addition, second-round effects led to a pickup in core inflation to 3.8 percent in 2008. After reaching a



Sources: Eurostat; and IMF staff projections.

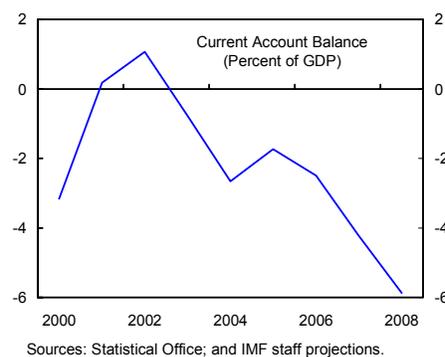
peak of 6.9 percent in July, inflation came down to 2.1 percent in February 2009, owing to the decline in fuel and food prices and the slowing economic activity.<sup>1</sup>

5. **The government's budget was broadly balanced in 2008, with a positive fiscal impulse** (Table 2, Figure 5). The fiscal deficit was 0.3 percent of GDP in 2008, slightly better than budgeted owing to strong revenues from direct taxes. The fiscal impulse was 0.7 percent of GDP, reflecting a deterioration in the structural balance. Public debt stayed broadly unchanged at 23 percent of GDP.

6. **Monetary conditions tightened in the fall 2008** (Figure 6). Until then, monetary conditions were loose as the decline in real interest rates more than offset the real exchange rate appreciation. However, monetary conditions tightened in the fall when the rapid decline in inflation led to an increase in real interest rates. Private credit growth also decelerated sharply.

7. **The financial sector is increasingly affected by the global crisis** (Figure 7). Banks weathered relatively well the first impact of the crisis, thanks to their limited exposure to the U.S. financial system, the low level of households' indebtedness, and the financial stability measures promptly put in place by the authorities. However, equity prices have fallen sharply, following international trends, and banks' funding costs have risen with a soaring sovereign risk spread. In response to tight international liquidity, banks have partly substituted foreign financing with other sources including ECB funds and government deposits. Loans to the nonfinancial private sector have decelerated sharply and banks' profits have fallen.

8. **The current account deficit continued to rise, reaching 5.9 percent of GDP in 2008** (Table 3, Figure 8). The main driver was a weakening of the goods balance by about 2.4 percentage points of GDP. Export growth declined starting in the fourth quarter of 2007 in line with the deceleration of activity in trading partners. Import volumes continued to grow faster than exports because of the overheating of the economy. The current account has been financed by banks' foreign borrowing and deposits from nonresidents. Consequently, Slovenia's net external debt rose to 25.4 percent of GDP by the end of 2008.



9. **Slovenia's competitive position has deteriorated in the past two years.** Fundamental determinants of saving and investment suggest that the equilibrium current

<sup>1</sup> The strong pass-through and the wage-setting mechanism suggest that inflation could increase again when the economy picks up. A Selected Issue Paper analyzes the lessons of the inflation surge in 2007–08.

account deficit for Slovenia is around 2–2.5 percent, the actual level observed in 2004–06.<sup>2</sup> While the significant deterioration in the current account since 2006 included some temporary components (the oil price hikes), the overheating of the economy led to second-round effects and a deterioration of competitiveness. Unit labor costs grew by 2.2 percent in 2007 and 7.6 percent in 2008. Hence, both the CPI-based and ULC-based real effective exchange rates have undergone an appreciation in the order of 5 percent. Using the three CGER methodologies, staff estimates that the competitiveness gap is 6 to 9 percent. The lagging competitiveness also reflects a lack of technological upgrading and the catch-up of regional competitors with resulting stagnating market shares over the past few years.<sup>3</sup>

## II. POLICY DISCUSSIONS

10. The policy discussion focused on the outlook, the policy responses to the crisis, the medium-term challenges of competitiveness and structural reforms, and the sustainability of the pension system. In the past, the authorities have broadly followed staff’s recommendations, although less so in the areas of fiscal policy and structural reforms (Box 1).

<b>Box 1: Effectiveness of Fund Surveillance</b>	
<b>Past Policy Advice</b>	<b>Policy Outcomes</b>
	<b><i>Fiscal Policy</i></b>
<ul style="list-style-type: none"> <li>• Fiscal stance in 2008-09 should be neutral to reduce overheating risk</li> <li>• Front-loaded consolidation with cuts in non-discretionary spending and pension reform when times are still good</li> <li>• Improve expenditure efficiency with performance budgeting</li> <li>• Undertake up-front substantive pension reform to increase retirement age and/or cut benefits</li> </ul>	<ul style="list-style-type: none"> <li>• Thanks to buoyant growth, the fiscal outcomes in 2007-08 over-performed the budget but fiscal stance was positive, contributing to the overheating.</li> <li>• Some consolidation happened but political support for reducing mandatory expenditures was limited.</li> <li>• The MoF is making some progress toward performance budgeting.</li> <li>• The authorities are considering options to improve retirement incentives without, however, changing the basic parameters.</li> <li>• The authorities regard more systemic reforms to be politically infeasible.</li> </ul>
	<b><i>Monetary Policy and Financial Sector</i></b>
<ul style="list-style-type: none"> <li>• Rapid implementation of the government’s plans for bank privatization and support the listing of large banks and insurance companies in the stock exchange</li> <li>• Reinforce risk assessments with stress tests and cooperation with foreign supervisors</li> </ul>	<ul style="list-style-type: none"> <li>• State control of the largest bank has been maintained as there were no good opportunities for privatization.</li> <li>• Partial privatization of the second largest bank.</li> <li>• Bank specific stress tests were implemented under the Capital Requirements Directives (CRD). The BoS signed Memoranda of Understanding with foreign banking supervisors.</li> </ul>
	<b><i>Labor and Product Markets</i></b>
<ul style="list-style-type: none"> <li>• Increase labor market flexibility by reducing high costs of hiring and firing</li> <li>• Improve the business climate by a “one-stop shop”</li> <li>• Continue to privatize state companies</li> </ul>	<ul style="list-style-type: none"> <li>• Unemployment benefits have been tied to active labor market policies.</li> <li>• Increased work incentives for high income earners by elimination of payroll tax.</li> <li>• “One-stop shop” has been implemented.</li> <li>• The privatization program has slowed down.</li> </ul>

<sup>2</sup> See “Exchange Rate Assessments: CGER Methodologies,” by Lee and others (2008) for more details on the methodology.

<sup>3</sup> See IMF Country Report No. 06/250.

## A. Outlook

11. **The authorities and staff concurred that the economy will experience a recession in 2009.** Staff projects that output will contract by 2.7 percent in 2009 following the sharp decline in the last quarter of 2008 (Table 6). The main factors driving the downturn are the deceleration of exports, as the Euro zone is in recession, and of investment, as credit conditions tighten and exports decelerate. Through production linkages, Slovenia's export industry is particularly sensitive to the cycle of the automotive industry. Private consumption should be more resilient because of the recent wage increases and the strong net asset position of the households (Box 2). Staff revised sharply downward the projections during the mission as the negative news on the last quarter of 2008 became known. In light of the new data, the authorities also revised their projections with the Bank of Slovenia (BoS) forecasting a contraction of 2 percent and the Ministry of Finance (MoF) expecting a more pessimistic contraction of 4 percent, on the account of lower employment, consumption, and investment.

### Box 2: Sectoral Balance Sheets

Sectoral balance sheet analysis suggests that Slovenian corporates have large net financial liabilities. Moreover, domestic banks' exposure to the rest of world is significant and increasing, exposing them to contagion in the international financial market. However, households are in a strong position with small liabilities vis-à-vis the other sectors of the economy.

Inter-Sector Financial Claims and Liabilities 1/  
(% of GDP, end of September 2008)

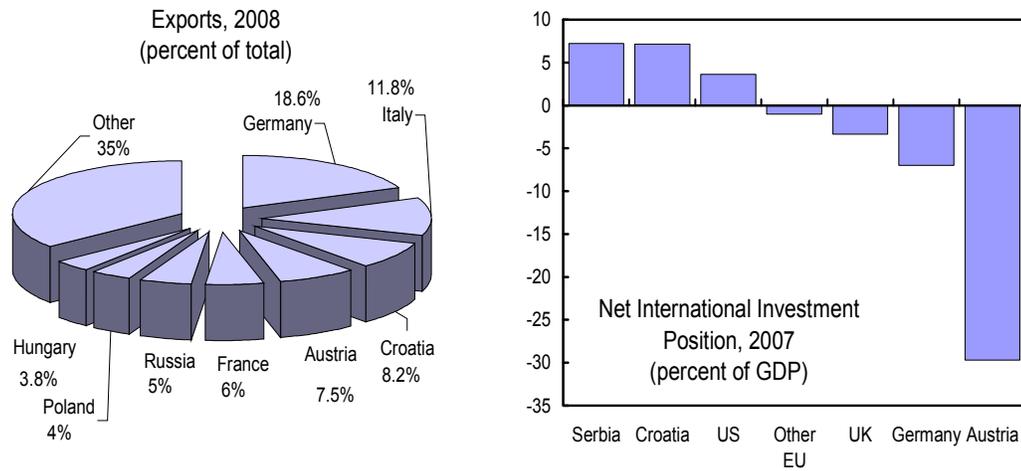
Liabilities	Claims					Rest of the world	Total Liabilities
	Domestic sectors				Total		
	Corporates	Financial sector	Government	Households			
Corporates	72.8	73.5	24.2	30.3	200.8	42.2	243.0
<i>Of which:</i>							
Loans	9.0	63.3	0.8	2.2	75.3	12.4	
Equity	39.0	7.8	18.9	23.5	89.1	16.1	
Financial sector	18.9	26.4	12.6	53.1	111.0	77.2	188.1
Government	6.0	10.8	14.1	2.0	32.9	11.5	44.4
Households	3.7	25.5	0.8	0.0	30.0	0.0	30.0
Total	101.5	136.3	51.9	85.4	375.0	130.9	505.9
Rest of the world	28.1	54.8	2.1	16.0	101.1		101.1
Total claims	129.6	191.1	54.0	101.4	476.1	130.9	606.9

Source: Bank of Slovenia.

1/ The columns refer to creditors.

12. **Inflation and the current account deficit are projected to moderate.** With the output gap projected to turn negative and world commodity prices declining, inflation is expected to slow to about 0.5 percent in 2009 and 1.5 in 2010. The current account will benefit from the decline in commodity prices and the slowdown in imports as aggregate demand decelerates. However, recent devaluation in neighboring countries will increase competition in the Slovenia's traditional export markets. Debt sustainability analysis suggests that Slovenia's external debt will continue to rise in the medium term. To prevent the current

account deficit from staying above 5 percent of GDP in the medium term, wage moderation and strong productivity gains are necessary.



Sources: Bank of Slovenia; and Direction of Trade Statistics.

13. **The authorities and staff agreed that risks to growth and the current account are on the downside, while risks to inflation are on the upside.** International spillovers will transmit through Slovenia's tight trade integration with Europe, as well as the banking system. The main downward risks to growth are lower-than-projected growth in Europe, and a credit crunch in the event that foreign financing dries up. Private consumption could prove to be less resilient than projected as a consequence of a weaker labor market. Finally, a failure to stem the fast wage growth observed in 2008 would lead to a persistent inflation differential with Euro-area countries, and a further deterioration in competitiveness and the current account.

## B. Financial Sector

14. **Slovenia's banks have so far withstood the global crisis relatively well.** The banks are well capitalized, the level of nonperforming loans is still low, and banks are well provisioned owing to prudent regulation (Figure 9, Table 4). Foreign ownership is relatively low. Acting together with other European countries, the authorities responded promptly to the turmoil with a set of financial measures (Box 3).

**Box 3: Financial Measures in Response to the Crisis**

- Unlimited guarantee for all deposits by individuals and small enterprises until end-2010;
- the provision of up to €12 billion in guarantees on new debt issuance by financial institutions until end-2010, which is estimated to cover all banks' foreign refinancing needs for the next two years;
- amendments to the Public Finance Act to empower the government to lend and provide guarantees to financial institutions, recapitalize banks, and purchase bank assets;
- the issuance of treasury bonds in the amount of €1 billion in January, which were temporarily deposited with the domestic banking system; and
- the announcement of €1.2 billion government guarantees for loans to nonfinancial companies.

15. **The international credit squeeze has considerably increased the banks' vulnerability on the liability side.** Foreign financing, at about one third of banks' total liabilities, of which almost one third is short term, is much higher than in other EU banks. However, the BoS and staff agreed that banks have maintained adequate liquid assets to cover their liabilities and could borrow more from the ECB. More pressing is a shortage of longer-term funding for the financing of loans. The authorities have put in place a contingency plan, including providing government guarantees for interbank loans, increasing government deposits in the banking system, and possibly repatriating part of BoS's foreign assets. The staff assessed these measures to be adequate to cover the banks' immediate funding needs but cautioned that additional public resources may be necessary if the international liquidity squeeze continues.

16. **On the asset side, rapid credit growth in the past few years and the severe economic downturn have also increased banks' credit risk.** Household debt, at around 30 percent of GDP, is much lower than the Euro-area average, and there is little sign of a housing price bubble (Figure 10).<sup>4</sup> However, the level of corporate debt (87.5 percent of GDP in 2008) has approached the Euro-area average. Loan concentration is high. Corporate vulnerability indicators do not compare well with peers (see table).

Indicators of Corporate Vulnerabilities, 2007

	Czech	Euro zone	Greece	Hungary	Portugal	Slovenia
Debt-to-assets ratio, in percent	14.0	24.4	27.7	17.0	41.2	29.6
Interest coverage ratio	65.0	19.0	21.9	35.4	3.7	6.6
Return on assets	5.9	5.0	6.6	8.5	5.2	8.0
Price to earning ratio	13.8	14.9	12.9	14.7	16.8	23.2

Source: Corporate Vulnerabilities Database.

So far, the debt service burden is low but nonperforming loans are likely to increase as the recession deepens. In addition:

<sup>4</sup> See Financial Stability Report (2008).

- **Some recent leveraged management buyouts could result in defaults as the value of the collateral has plummeted.** The largest group in trouble owes about €800 million (2.5 percent of total private sector loans). According to the BoS's stress tests, the banking system's capital adequacy is not at risk. As a precautionary measure, the BoS has raised the provision requirement for such exposures. However, a failure to restructure quickly the liabilities of this group could result in the largest bankruptcy in Slovenia in recent history. While no formal rule appears to have been violated, enhanced supervisory practices are called for.
- **Possible deterioration of credit made abroad, especially to the Balkans, is another source of vulnerability.** Loans abroad expanded rapidly in recent years but decelerated sharply in 2008, reaching close to 9 percent of total loans to the nonbanking sector by end-2008.

17. **The authorities and staff agreed on the need to strengthen the monitoring of credit risk.** In the staff's view, updated bank-by-bank stress tests are necessary to gauge the impact of potentially higher nonperforming loans on banks' capital needs, and the government should maintain a contingency plan for bank recapitalization. Banks should be encouraged to maintain precautionary capital buffers against worsening of the portfolio quality. The authorities should step up coordination with foreign supervisors to monitor potential regional spillovers. The BoS concurred with staff on the vulnerabilities and stressed that many of these measures are being taken, including the recommendation of retaining profits and raising provisions against risky exposures. The authorities also noted that their experience in recapitalizing banks and restructuring nonperforming assets during the transition is valuable in dealing with present challenges.

18. **The authorities are considering measures to increase lending to nonfinancial companies.** A second anti-crisis package, which includes auctioning partial state guarantees on new loans to nonfinancial enterprises of up to €1.2 billion, was announced in February. In addition, the publicly owned and recently recapitalized Slovene Export and Development Bank has expanded considerably its portfolio since September. The authorities stressed the need of ensuring credit to healthy companies. While staff appreciated the benefits of providing support to viable companies during difficult times, it stressed the need for the allocation of state guarantees to be transparent and to limit banks' moral hazard.

### C. Fiscal Policy

19. **The authorities and staff concurred that a fiscal stimulus is necessary.** The unprecedented crisis calls for a bold fiscal response to attenuate the drop in aggregate demand and to alleviate distress of the most vulnerable groups. Staff supported the size of the fiscal stimulus package (2.1 percent of GDP, Box 4) and projected the fiscal deficit to deteriorate to 4.2 percent of GDP in 2009, reflecting both automatic stabilizers and a fiscal stimulus package. The MoF indicated their intention to contain the fiscal deficit to 4 percent of GDP in

2009, possibly cutting public investment in case the deficit exceeds this threshold. Staff endorsed this prudent position in light of the necessity to keep fiscal sustainability and rising borrowing costs.

**Box 4: Fiscal Stimulus Package**

The government announced a €806 million fiscal stimulus package (equivalent to 2.1 percent of GDP, of which 1.8 percent will be spent in 2009, 0.2 percent in 2010, and 0.1 percent in 2011) in December 2008 and passed a supplementary budget in March 2009. The main components of the stimulus package are as follows:

- 0.6 percent of GDP in wage subsidies to companies for shorter labor hours;
- 0.5 percent of GDP in other subsidies to companies, including for R&D;
- 0.6 percent of GDP for the elimination of the payroll tax; and
- 0.5 percent of GDP in reduction of corporate taxation.

20. **Views differed on the wage subsidies to shorten working hours included in the package.** The authorities stressed that this measure was targeted at preserving jobs and could save the payment of unemployment benefits. According to staff, these measures might provide some relief to workers and medium and large-sized enterprises but were not sufficiently targeted to the most vulnerable groups; they might entail a risk of abuse and would be hard to reverse if the crisis continues, causing large fiscal costs. Staff recommended not to renew these measures and to use the funds for more targeted interventions in case the crisis continues.

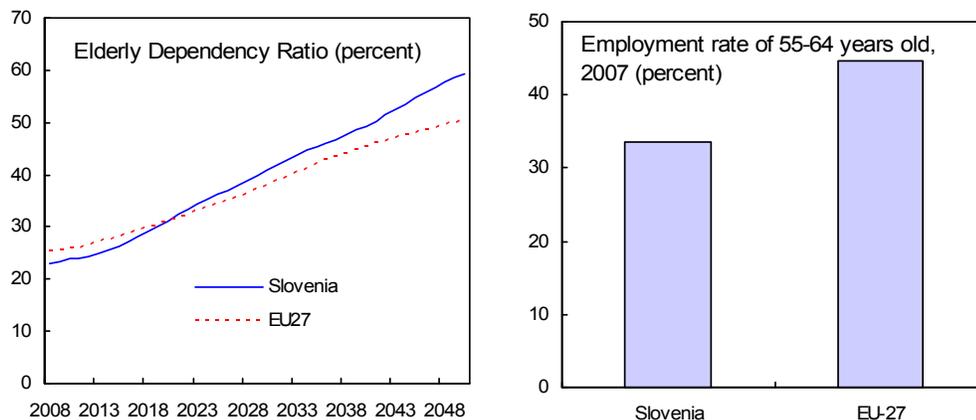
21. **Staff recommended increasing public investment.** Public investment could be leveraged with EU funding and has a direct effect on demand. Moreover, investment is key to upgrading infrastructure and to increasing potential growth and is, by nature, temporary. The authorities agreed but noted that institutional bottlenecks had limited absorptive capacity in the past.

22. **Looking forward, staff stressed that the fiscal position should be reverted to a more conservative stance as the crisis subsides.** Fiscal policy should be tightened as soon as possible considering the cost of public debt, the fiscal implication of the aging population, and the contingent liabilities deriving from the financial stability measures. The authorities aim to reduce the fiscal deficit to below 3 percent of GDP in 2010; however, no plan has been presented on how to achieve this objective.

23. **The authorities and staff concurred that fiscal adjustment should mainly come through the consolidation of expenditure.** The recent public sector wage agreement will raise the wage bill substantially over 2009 and 2010. Future increases need to be contained. Staff welcomed the authorities' goal of reducing by attrition public employment by 2 percent

a year over the next two years and suggested that the government should link the employment reduction measures to a comprehensive strategy to improve the efficiency of public expenditure, which would include the introduction of performance budgeting.

24. **The authorities agreed that a rapidly aging population and current policies pose a challenge for long-term fiscal sustainability, but there is no political consensus for systemic reforms.** The authorities also noted their goal of increasing minimum pension. With the lowest birth rate in Europe and an aging population, the elderly dependency ratio will increase to 60 percent in 2030, one of the highest in Europe. In the absence of reforms, age-related expenditures are projected to increase by 8 to 10 percentage points of GDP and reach almost 30 percent of GDP by 2050.<sup>5</sup> As a solution, the government is considering greater incentives for a longer working life and private pension savings and active aging policies aimed at increasing labor participation especially among older workers. In staff’s view, these measures go in the right direction but are insufficient to ensure long-term sustainability. Fiscal viability requires systemic reforms, including (partially) de-linking pensions from wages and increasing the retirement age. A prompt introduction of the pension reform would also anchor expectations for fiscal consolidation after the crisis.



#### D. Structural Issues

25. **Staff emphasized that successful competition in the Euro zone requires greater labor market flexibility.** As a consequence of large devaluations in neighboring countries, Slovenia will face tougher competition, especially in labor-intensive sectors. Labor markets need to be flexible to facilitate the reallocation of workers from sectors no longer competitive to new sectors and to contain the wage pressures that were observed after the euro adoption. To this end, further liberalization of employment protection legislation is necessary in the medium term and could be implemented in the context of a “flexicurity” approach. The

<sup>5</sup> See IMF Country Report No. 06/250.

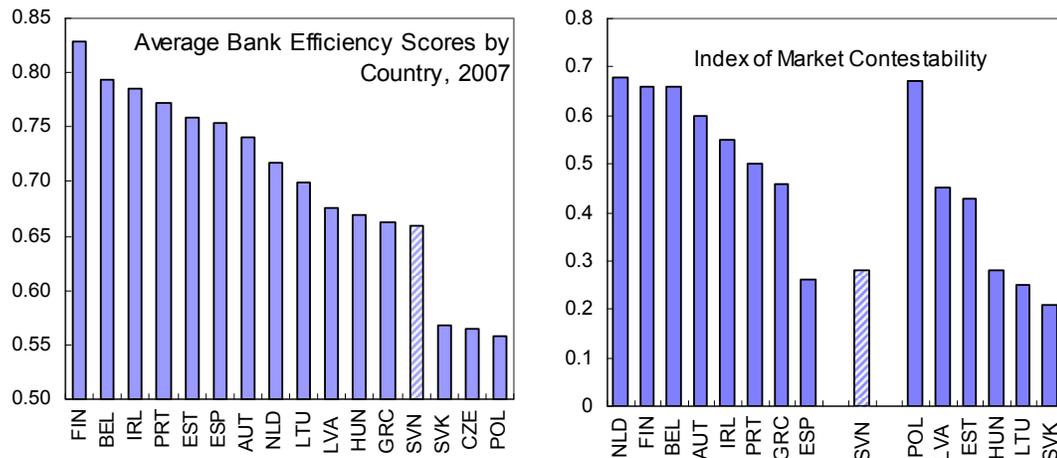
authorities stressed that the “flexicurity” model of labor market implies large fiscal costs and requires further analysis.

26. **Improvements in the product and financial markets are needed to enhance competitiveness** (Figure 11). Slovenian banks are among the least efficient in Europe (Box 5); Slovenia ranks low among European economies in the World Bank’s Ease of Doing Business indicators, and has attracted little FDI in the past few years. Among possible causes are the high government ownership and involvement in the economy, the extent of red tape and regulations, shortfalls in competition laws and their enforcement, and the lagging regulation of network industries. To ease business and property registration, the authorities have adopted several measures, including the introduction of the “one-stop shop” for companies’ registration. Staff endorsed the government’s program to simplify the regulatory burden and strengthen judicial enforcement. In staff’s view, further reforms should focus on enhancing competition in the product and financial markets, including by increasing the independence of the Competition Protection Office and continuing the privatization process once the crisis is over.

#### Box 5. Efficiency of Slovenian Banks

The financial sector remains dominated by domestic, largely state-controlled banks. How well are they prepared for increasing competition in the integrated European financial markets? A recent paper by IMF staff finds that Slovenian banks are among the least efficient in Europe, which may reflect the low contestability compared to EU peers.<sup>1</sup>

Slovenia tends to lag behind the New Member States (NMS) in cost efficiency, owing to high labor costs. Profitability is also lower than regional peers, driven by declining net interest margins. The analysis of scores for bank efficiency and indices for market contestability for Slovenia and its EU peers shows that Slovenian banks are, on average, less cost efficient than those in the EMU, and among the least contested in Europe. The Slovenian banking sector is characterized by higher-than-average market concentration and state ownership, which could have resulted in low efficiency and contestability, as suggested by larger cross-country studies.



<sup>1</sup> Rudolfs Bems and Piritta Sorsa, “Efficiency of the Slovenian Banking Sector in the EU Context,” *Slovene Banking Journal*, November 2008.

### III. STAFF APPRAISAL

27. **To date, the fiscal and financial policy responses have been broadly appropriate.** Going forward, it is essential that these measures be complemented by broad-ranging reforms aimed at raising the economy's growth potential and ensuring fiscal sustainability.

28. **Short-term actions are needed to counter the effects of the global crisis.** Policies should focus on attenuating the consequences of the crisis, taking into consideration that the slowdown may be protracted and the following recovery sluggish. Tight credit markets also limit the ability to finance fiscal deficits.

29. **In the medium term, the economy needs to emerge from the global crisis on a sustainable growth path.** As the crisis subsides, Slovenia will face new challenges from tighter international credit conditions, lower potential growth, and neighboring countries with competitive exchange rates. To address these challenges, reforms in labor, product, and financial markets are required.

30. **The main long-term challenge comes from the fiscal implications of a rapidly aging population.** The current pension system needs to be reformed to address the imbalance between the means available and commitments deriving from the current pension provisions and an aging population.

31. **Vulnerabilities in the banking system have increased and further preventive actions are in order.** Efforts should continue ensuring that the banks have enough funding in case of further international credit squeeze, especially at longer maturities. Bank-by-bank stress tests should be performed to gauge the liquidity and capital needs of the banks. The BoS should encourage vulnerable banks to raise their capital levels. If banks come under stress, the authorities should be ready to inject public capital into undercapitalized banks, accompanied by measures to restructure the nonperforming assets and the operation of the affected banks.

32. **The authorities' priority should be maintaining banks' stability rather than expanding further their portfolios given the protracted nature of the crisis.** Given the potential tightness in banks' capital, there is a trade-off between expanding further banks' portfolios during the crisis and keeping additional lending capacity for the future. The authorities announced measures to increase lending to nonfinancial enterprises, including auctioning partial state guarantees on new loans to nonfinancial enterprises. While staff appreciates the benefits of providing support to viable companies during difficult times, caution should be taken to maintain loan quality. The allocation of state guarantees needs to be transparent, to limit banks' moral hazard, and to avoid sector picking.

33. **The magnitude of the planned fiscal deficit is appropriate.** The severe economic downturn called for a bold fiscal response, which the authorities have implemented. Looking forward, the large spread on Slovenian sovereign bonds reminds of the necessity to keep a low

level of borrowing. Staff endorses the authorities' commitment to keep the fiscal deficit at or below 4 percent and to bring it down further as soon as the crisis subsides.

34. **The composition of the fiscal package could be improved by allocating relatively more resources to public investment.** Public investment increases directly aggregate demand and can be leveraged with EU funds; public investment is also key to upgrading infrastructure and increasing potential growth. The authorities should act swiftly to remove the legal and institutional bottlenecks, which previously hindered the use of EU funds. To this end, a task force to coordinate the use of EU funds among ministries should be considered.

35. **The fiscal position should be reverted back to a more conservative stance as soon as a recovery takes hold.** The short-term fiscal measures should be embedded into a long-term fiscal strategy, which highlights the future fiscal liabilities of the pension system and contingent liabilities owing to the extensive guarantees that the government may issue. Having a clear deficit reduction strategy coupled with an effective communication framework will also help in financing the budget.

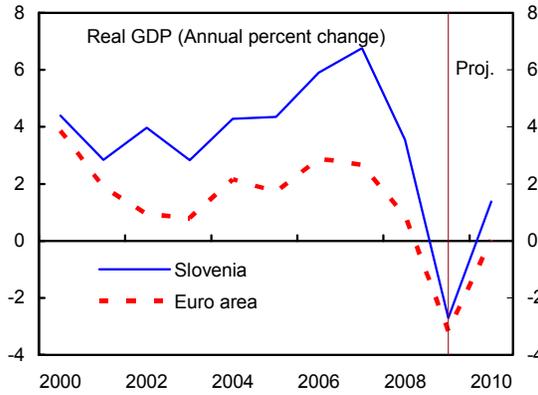
36. **Systemic changes to the pension system are necessary to ensure longer-term fiscal sustainability.** The measures the government is considering, including greater incentives for a longer working life and private pension savings, are insufficient to ensure long-term sustainability and to generate resources to increase minimum pensions. Fiscal sustainability requires a systemic reform that raises retirement age and/or moderates the indexation mechanism of the pension benefits. Pensions should not increase to reflect the one-off rise in wages following the recent public wage agreement.

37. **Structural reforms in the labor, product, and financial markets are imperative to improve competitiveness.** Greater labor participation and flexibility are essential to succeed in the Euro-area and to face competition from neighboring countries, which have recently devalued. Staff endorsed the government's program to simplify the regulatory burden and strengthen judicial enforcement. Improving the business climate, as well as reviving the privatization program once the crisis subdues, will boost productivity growth.

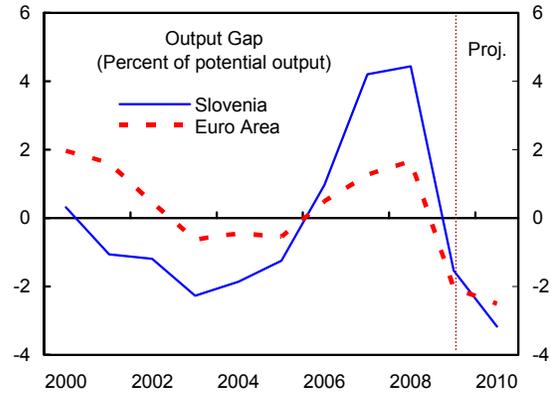
38. **It is recommended that Slovenia moves to a 24-month consultation cycle.** Slovenia, being a non-systemic country, with stable economic and financial conditions, and without outstanding Fund credit or pressing policy issues of broad interest to the Fund membership, meets the criteria for the 24-month consultation cycle. The authorities agreed to move the consultations to a 24-month cycle, with an interim staff visit.

Figure 1. Slovenia: Economic Indicators

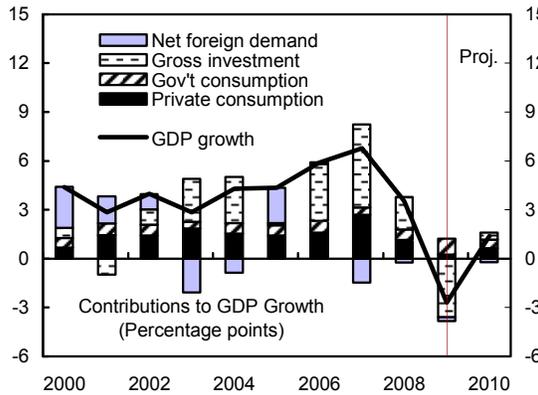
After overheating, the economy entered into recession due to the global downturn.



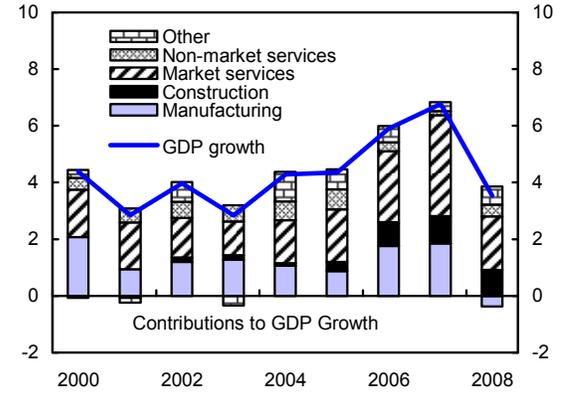
The output gap is expected to turn substantially negative over the next two years.



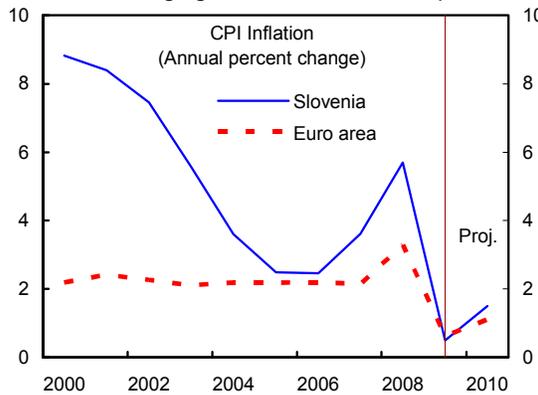
Slovenia is mainly affected through a contraction of investment and foreign demand.



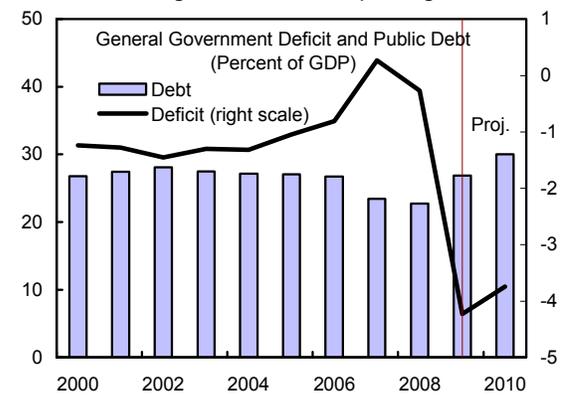
The manufacturing sector is being hit especially strongly.



The slowing economy and falling commodity prices are bringing inflation down from a peak.



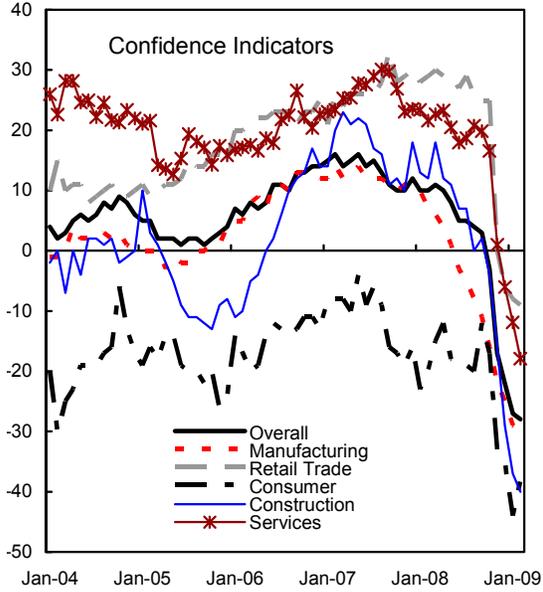
The deficit is set to widen substantially, in part due to a large fiscal stimulus package.



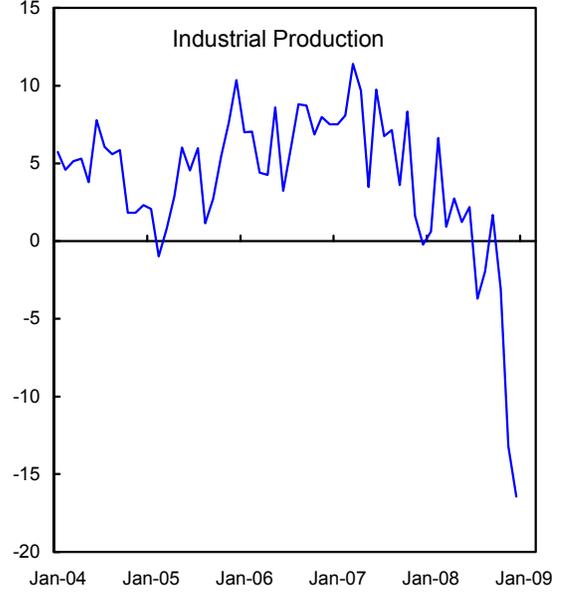
Sources: Bank of Slovenia; Ministry of Finance; Statistical Office; and IMF staff projections.

Figure 2. Slovenia: Short-term Indicators  
 (Year-on-year percent change, seasonally adjusted, unless otherwise indicated)

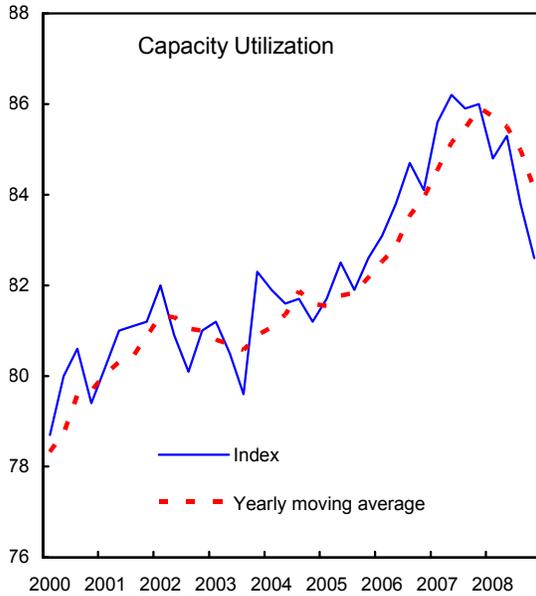
All confidence indicators plunged in November 2008.



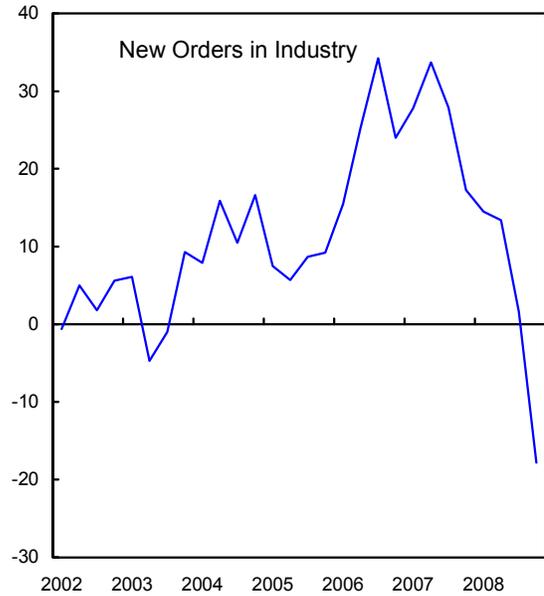
Similarly, industrial production contracted sharply in the last two months of 2008.



Capacity utilization has been falling strongly.



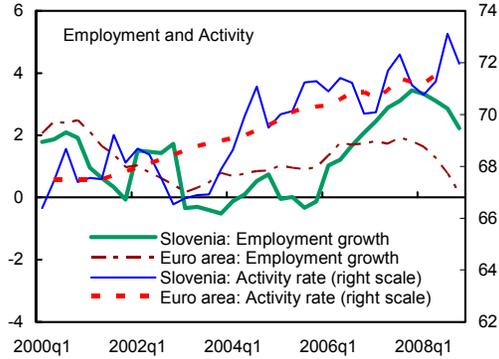
The lack of demand is one main limiting factor to economic activity.



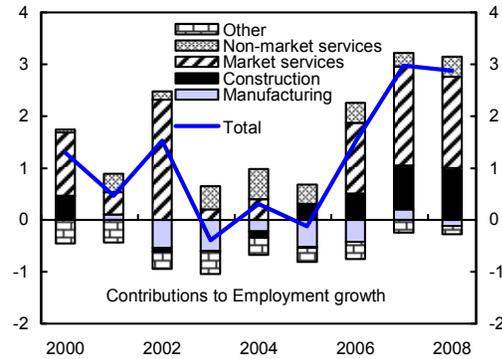
Sources: Statistical Office of the Republic of Slovenia; European Commission; and IMF staff estimates.

Figure 3. Slovenia: Labor Market Indicators

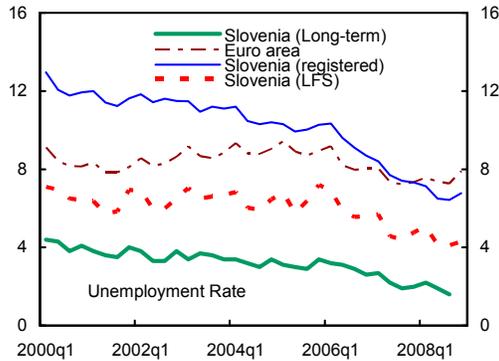
Employment growth started weakening from its high level in the fall of 2008.



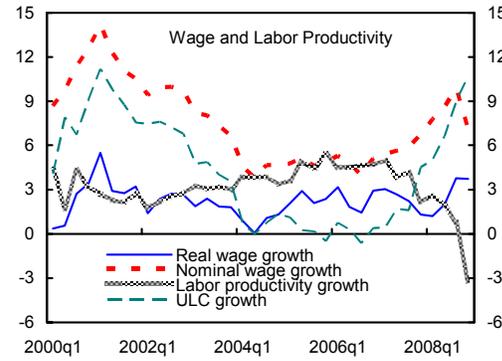
Employment in manufacturing is particularly affected.



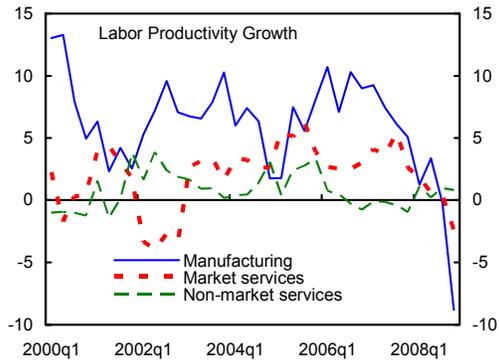
After declining steeply, the unemployment rate is starting to tip upwards.



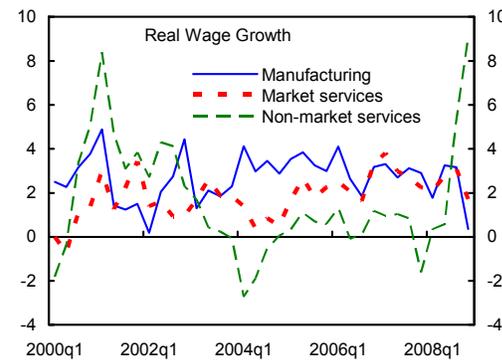
Nominal wages are still buoyant despite declining productivity growth, worsening competitiveness.



Labor productivity growth is falling in most sectors.



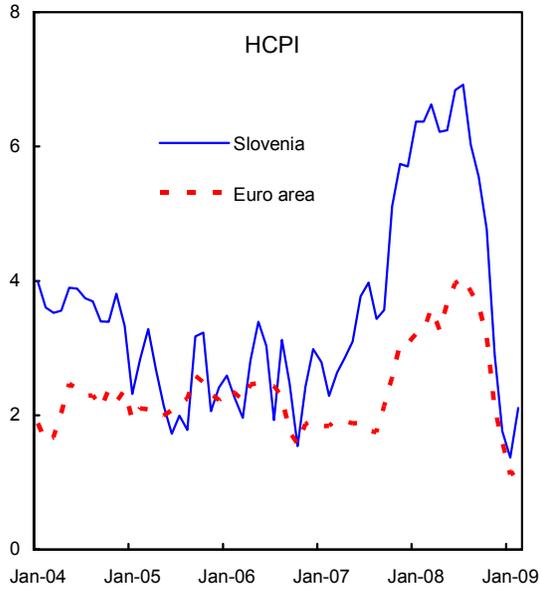
Real wage growth is still high, especially due to public sector wage agreements.



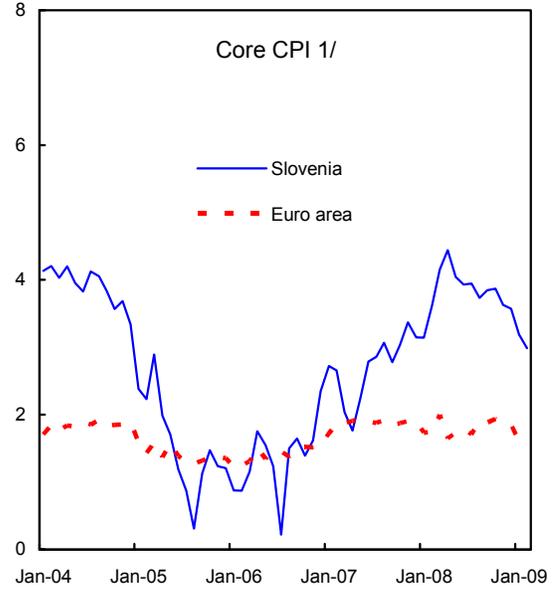
Sources: Statistical Office of the Republic of Slovenia; Eurostat; WEO; and IMF staff estimates.

Figure 4. Slovenia: CPI Inflation and Components  
(Year-on-year percent change)

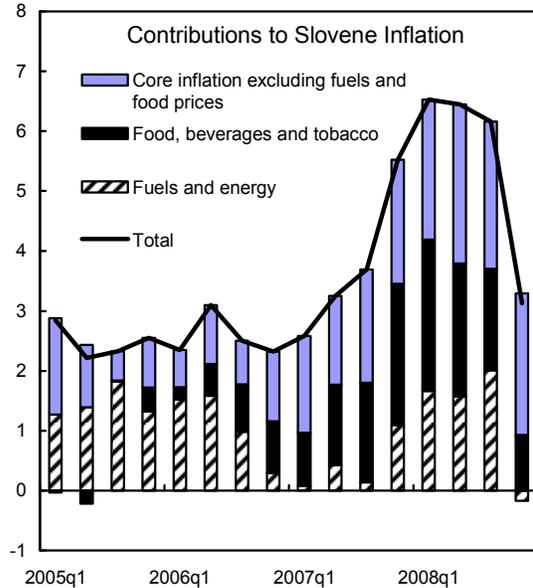
After peaking well above Euro area average, inflation came down sharply in the fall.



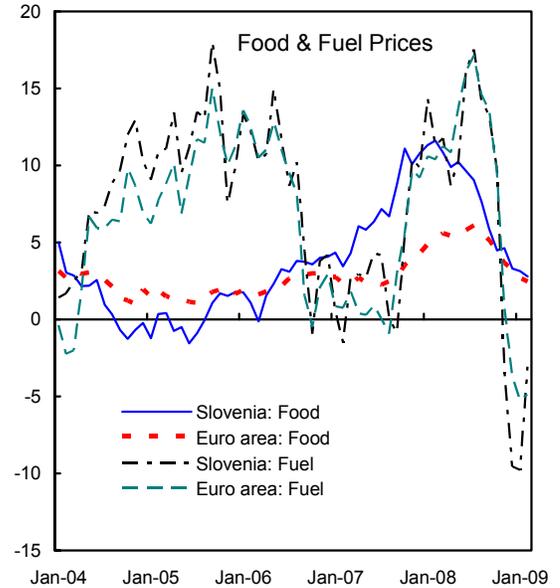
However, core inflation remains significantly higher than in the Euro area.



The falling commodity prices helped ease inflationary pressures in the fall of 2008.



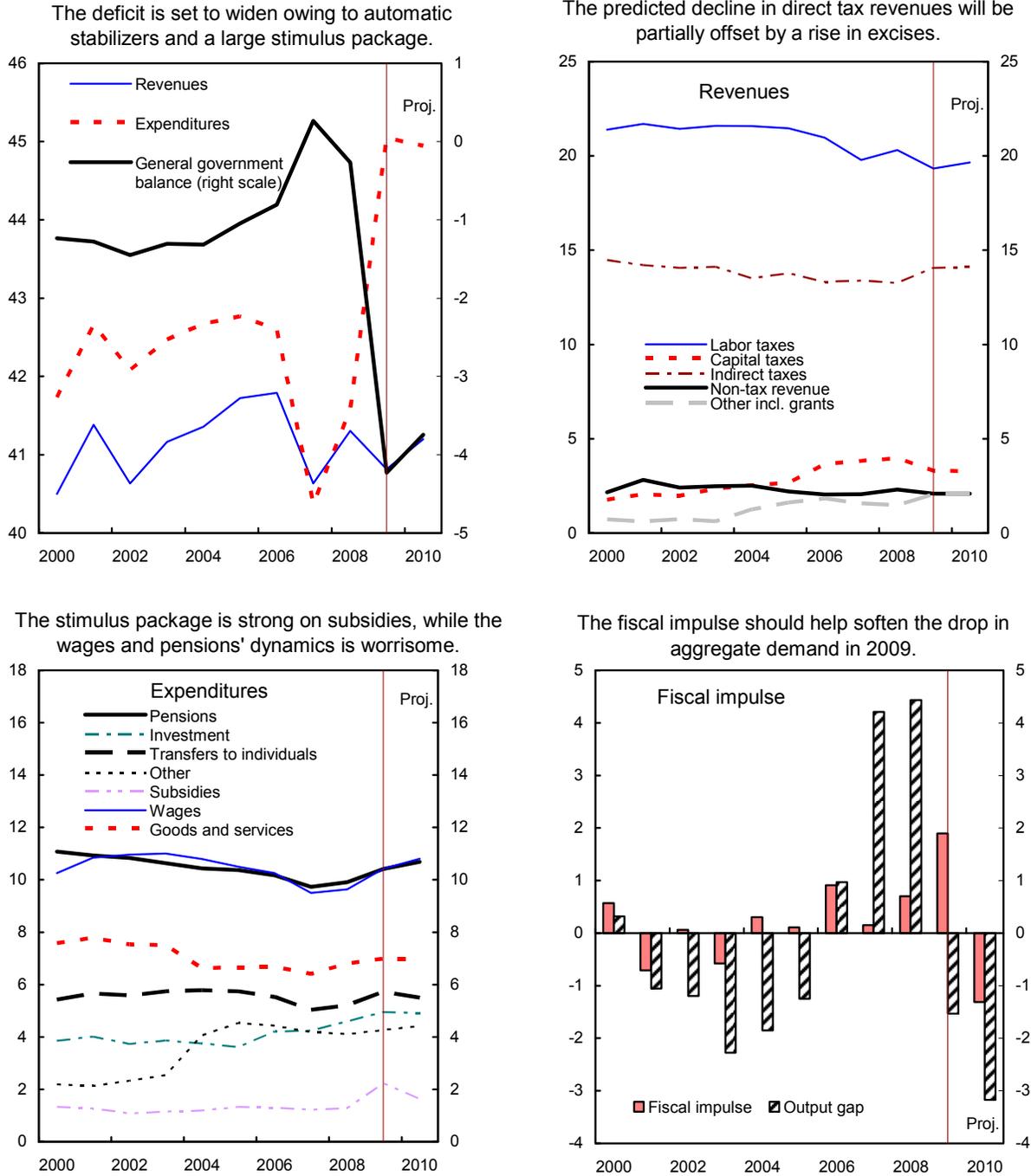
Slovenia's inflation is more sensitive to commodity price shocks than in the Euro area.



Sources: Eurostat; and IMF staff estimates.

1/ Core CPI is defined as total HCPI excluding energy, food, alcohol, and tobacco.

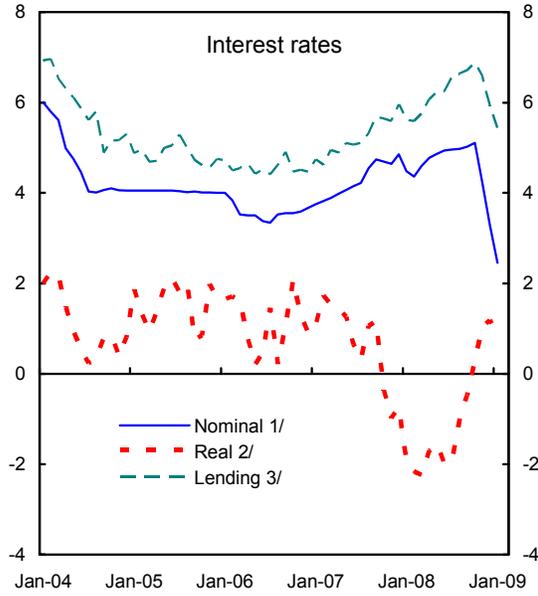
Figure 5. Slovenia: Fiscal Sector  
(Percent of GDP)



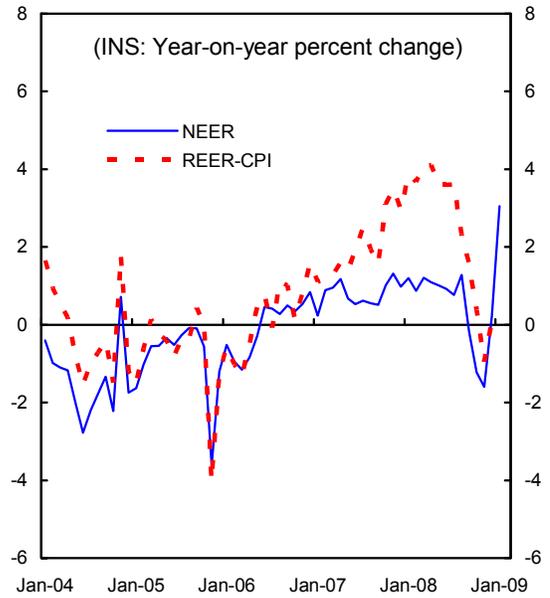
Sources: Ministry of Finance of the Republic of Slovenia; and IMF staff estimates.

Figure 6. Slovenia: Monetary Conditions  
(Percent, unless otherwise indicated)

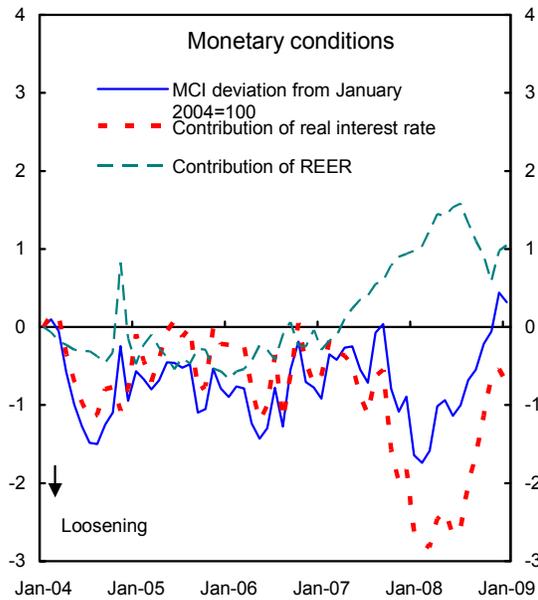
The sharp fall in inflation is driving real interest rates up despite declining nominal rates.



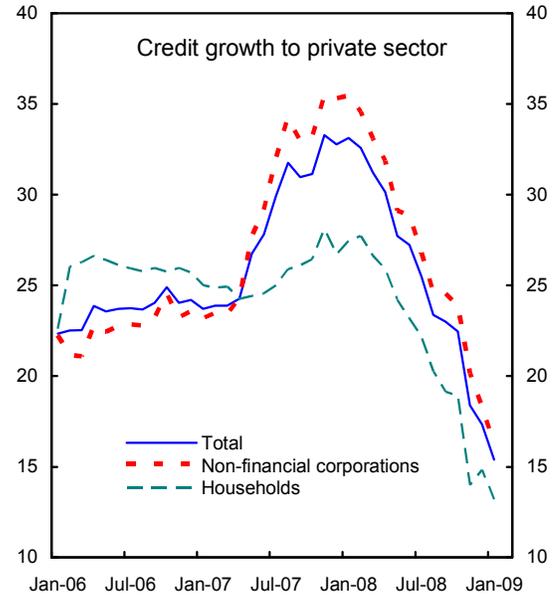
The rapidly falling inflation reversed part of the real exchange rate appreciation.



Overall, monetary conditions are tightening.



Credit growth to the private sector has slowed substantially.



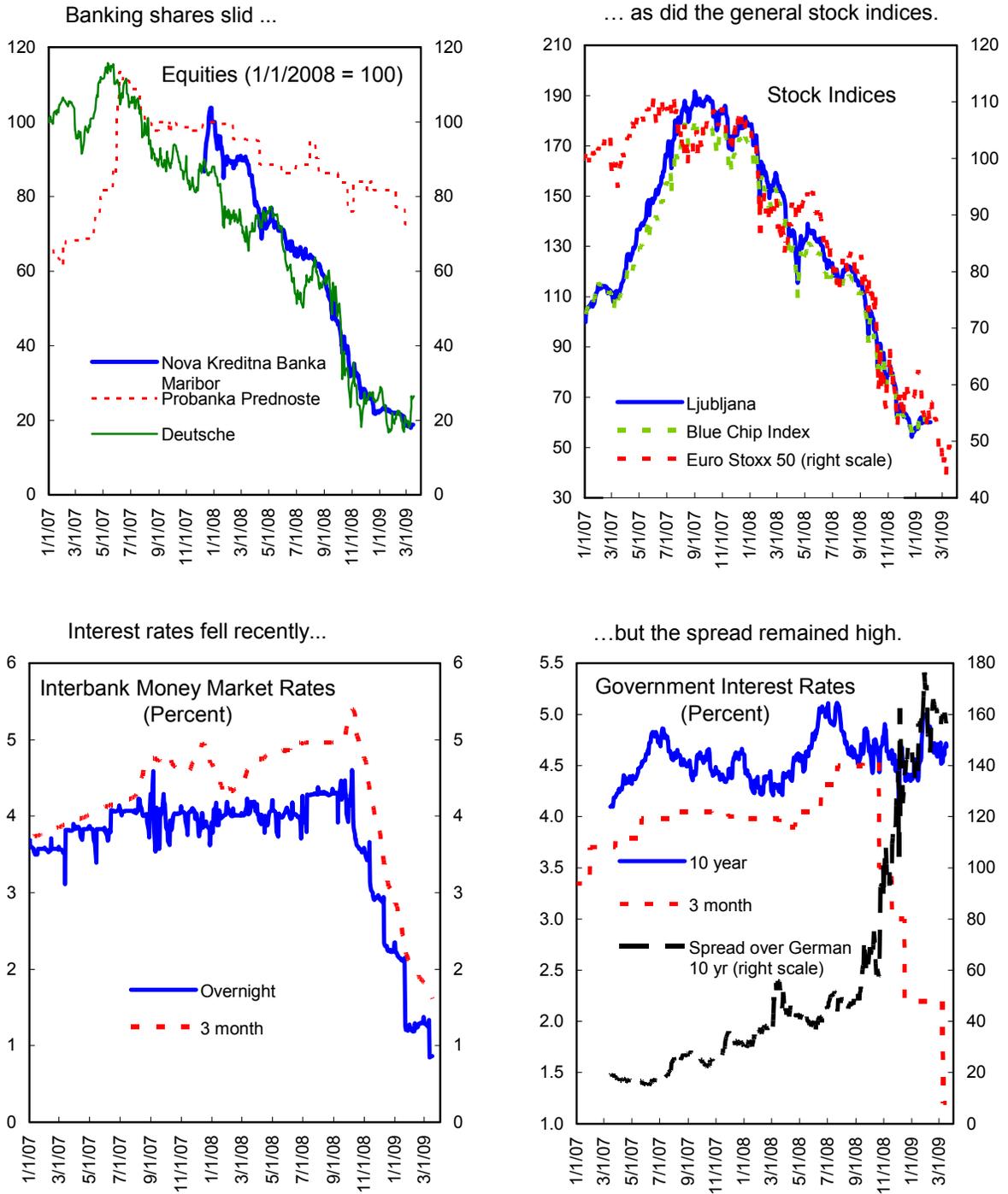
Sources: Bank of Slovenia; and IMF staff estimates.

1/ SITIBOR / EURIBOR three-month interest rate.

2/ Nominal three-month interest rate deflated by HCPI year-on-year percent change.

3/ Floating and up to one year initial rate fixation on loans over 1 million euro.

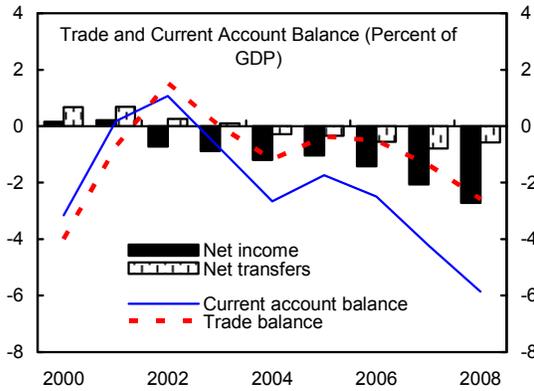
Figure 7. Slovenia: High-Frequency Financial Indicators 1/



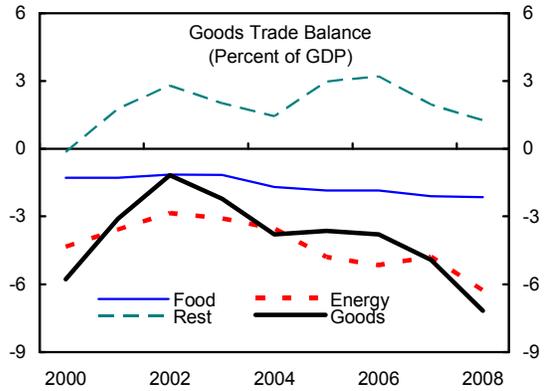
Sources: Thomson Financial/DataStream; and Bloomberg.  
 1/ The latest observation is as of March 18, 2009.

Figure 8. Slovenia: External Sector Developments

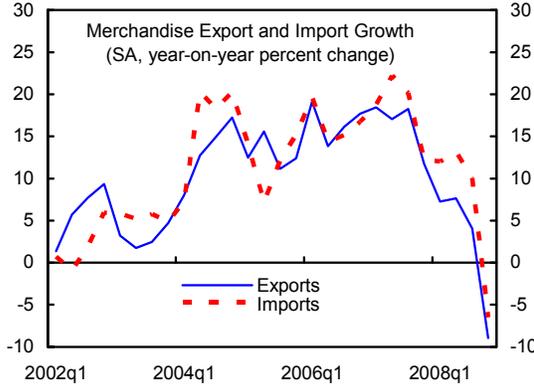
The trade and current account deficits have widened substantially.



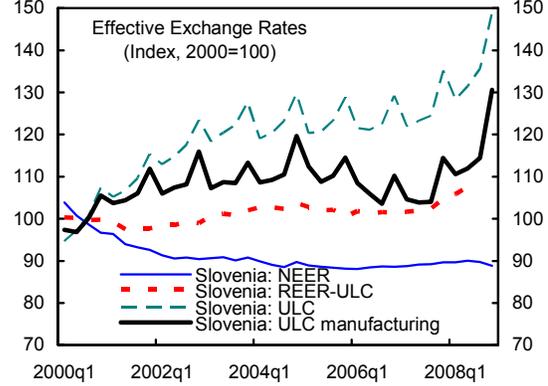
The goods trade balance deteriorated sharply, even excluding energy and food products.



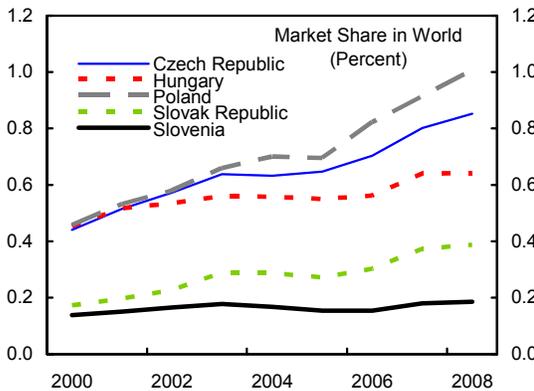
Despite a general decline, import growth remains stronger than export growth.



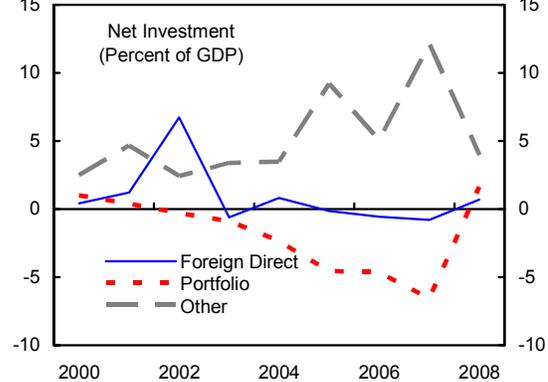
The real effective exchange rate has been trending up and competitiveness down.



Market shares are stagnating.

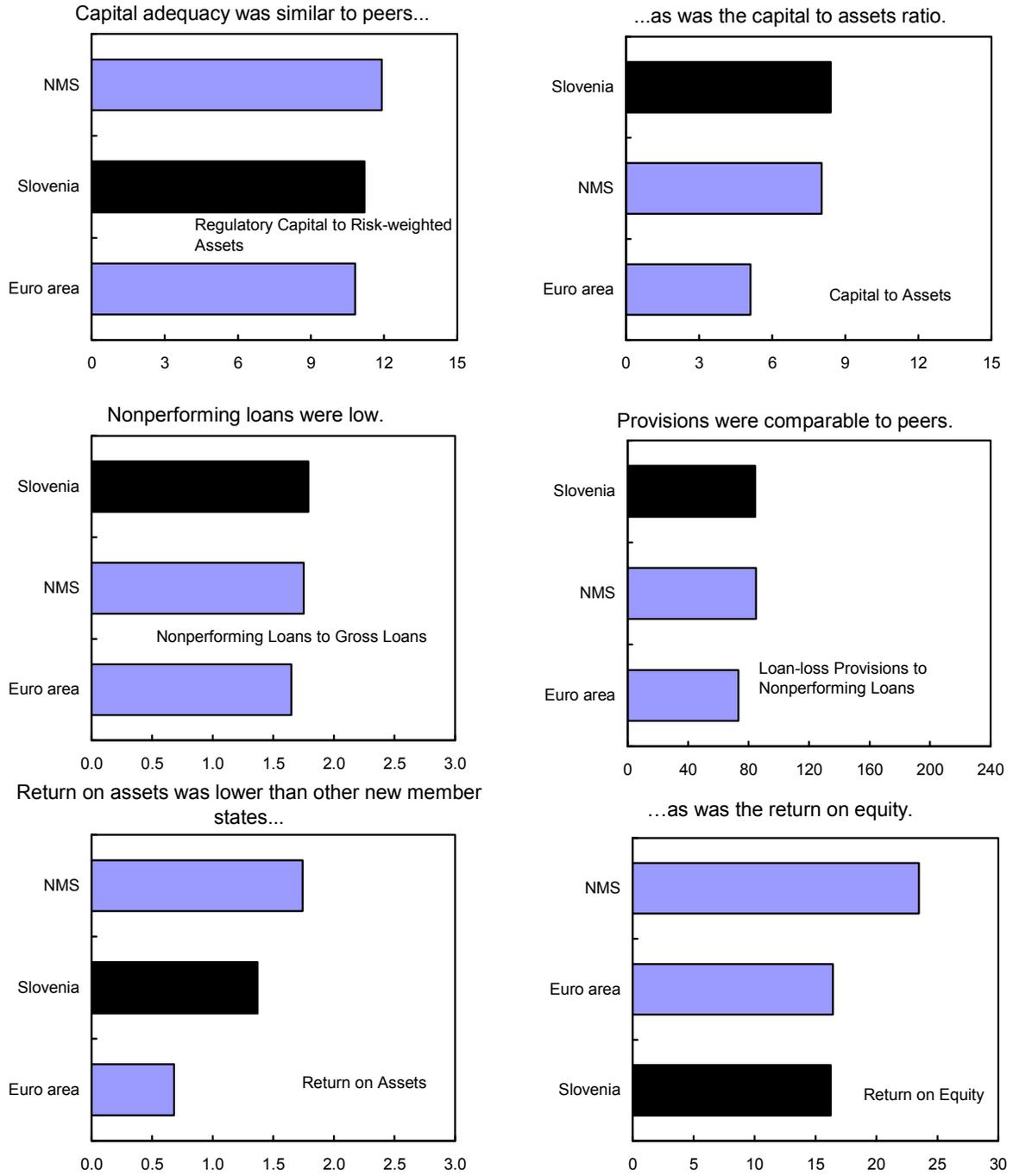


The large current account deficit is mostly financed by cross-border lending.



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

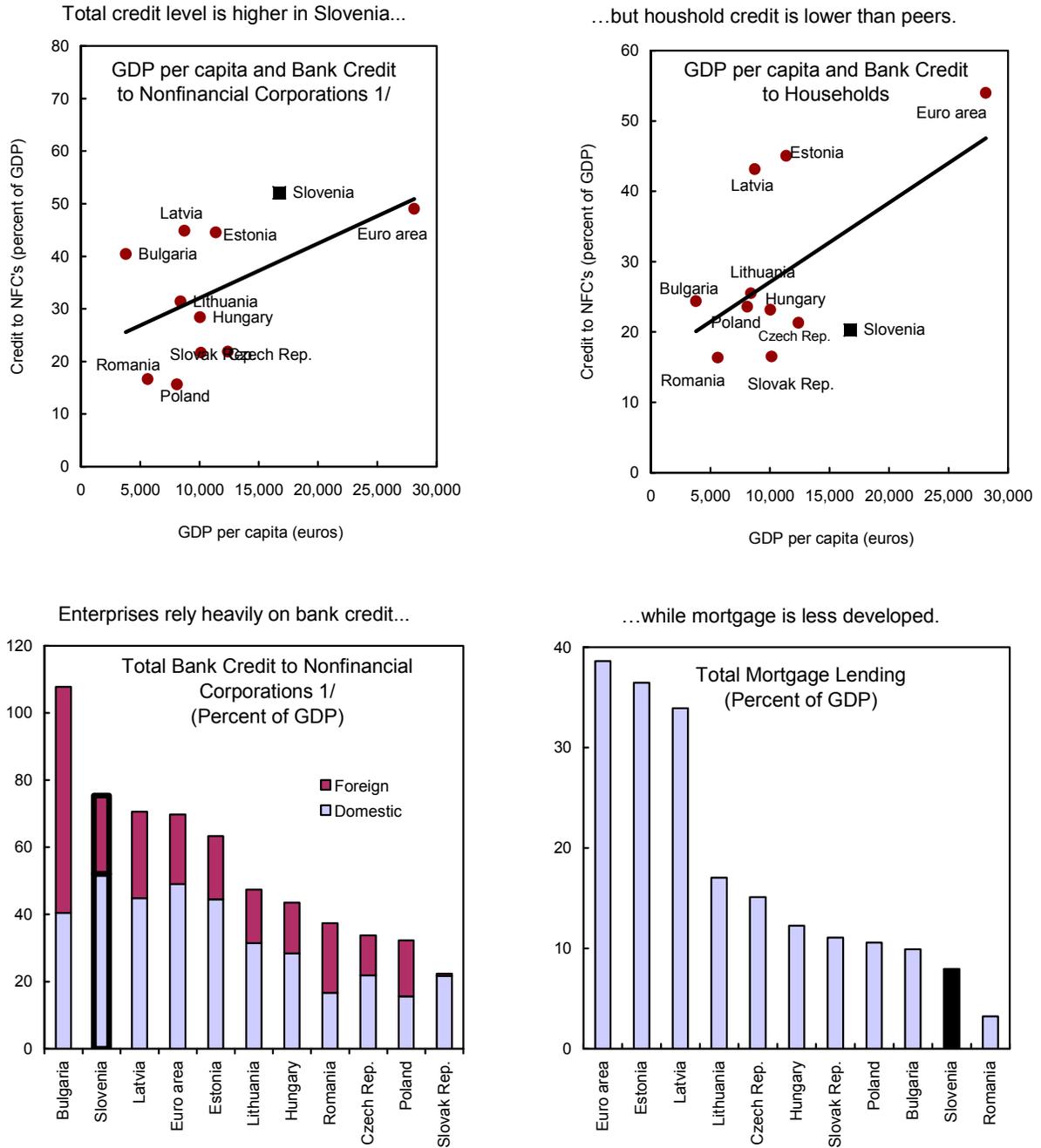
Figure 9. Slovenia: Financial Soundness Indicators, 2007 1/  
(Percent)



Sources: IMF, *Global Financial Stability Report*; and Bank of Slovenia.

1/ NMS includes: Czech Republic, Estonia, Hungary, Latvia, Lithuania, Poland, and Slovak Republic.

Figure 10. Bank Credit to Households and Nonfinancial Corporations in European Emerging Markets, 2007

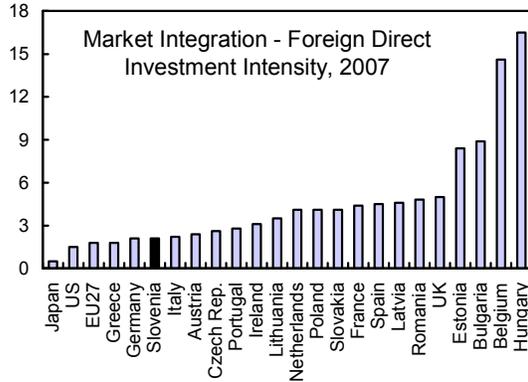


Sources: Eurostat; European Central Bank; and IMF staff estimates.

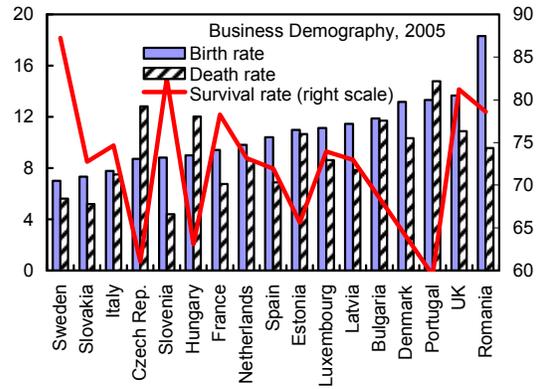
1/ Credit figures include domestic and foreign loans. For EMU, loans to enterprises include loans to domestic and (other) Euro area countries.

Figure 11. Structural Indicators of the Product Market

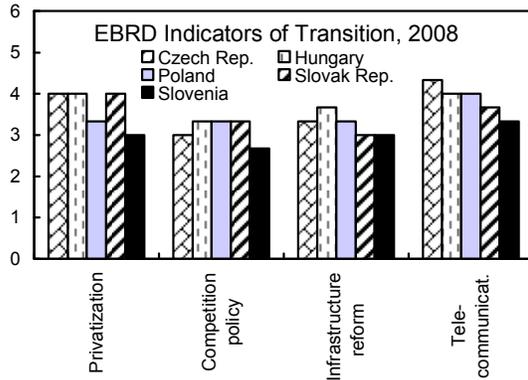
Foreign direct investment into Slovenia has been very limited.



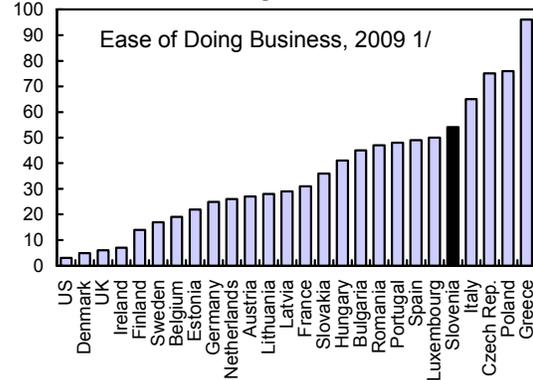
The dynamism of the business sector measured by firm entry and exit is also low.



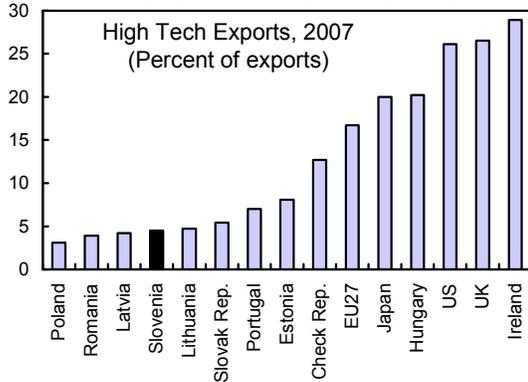
The State's prevalence in the economy remains high compared to other transition economies.



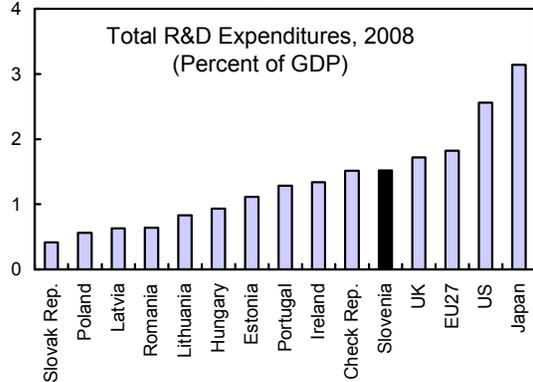
Slovenia also performs poorly on indicators of Ease of Doing Business.



Partly as a result of these factors, Slovenia has been lagging in technological upgrading.



Recent figures show an improvement in the spending on R&D.



Sources: World Bank, *Doing Business*; EBRD; European Commission, *European Innovation Scoreboard, 2008*.  
 1/ A lower value indicates a better performance.

Table 1. Slovenia: Selected Economic Indicators, 2005–10  
(Annual percentage change, unless noted otherwise)

	2005	2006	2007	2008	Projections	
					2009	2010
Real GDP	4.3	5.9	6.8	3.5	-2.7	1.4
Domestic demand	2.1	5.7	8.0	3.7	-2.0	1.6
Private consumption	2.6	2.9	5.0	2.2	0.5	1.2
Public consumption	3.3	4.1	2.5	3.7	5.7	2.8
Gross capital formation	0.4	12.5	17.2	6.1	-10.8	1.4
Net exports (contribution to growth)	2.2	0.1	-1.5	-0.2	-0.2	-0.2
Exports of goods and services	10.6	12.5	13.8	3.3	-4.3	1.5
Imports of goods and services	6.6	12.2	15.7	3.5	-3.9	1.8
Output gap (in percent of potential GDP)	-1.2	1.0	4.2	4.4	-1.5	-3.2
Prices						
GDP deflator	1.6	2.0	4.1	4.0	3.0	0.9
Consumer prices (national definition, period average)	2.5	2.5	3.6	5.7	0.5	1.5
HICP (period average)	2.5	2.5	3.8	5.5	0.3	1.3
Differential with euro area average	0.3	0.3	1.6	2.2	...	...
Core inflation (period average) 1/	1.5	1.3	2.7	3.8	...	...
Employment and wages						
Unemployment rate (in percent, ILO definition)	6.5	6.0	4.9	4.4	6.2	6.1
Employment (Full employment basis, National accounts)	-0.1	1.5	3.0	2.9	-2.5	0.0
Nominal wages (all sectors)	4.9	4.8	5.9	8.3	2.3	3.5
Real wages (all sectors)	2.3	2.3	2.2	2.5	1.8	2.0
Unit labor cost (all sectors)	0.4	0.4	2.2	7.6	2.6	2.1
Public finance (percent of GDP)						
General government balance	-1.0	-0.8	0.3	-0.3	-4.2	-3.7
Primary balance	0.1	0.3	1.2	0.5	-3.3	-2.7
Structural balance	-0.5	-1.2	-1.4	-2.1	-3.6	-2.4
General government debt	27.0	26.7	23.4	22.7	26.9	30.0
Monetary and financial indicators						
Credit to the private sector	23.7	26.5	34.1	18.0	...	...
Lending rates 2/	4.9	4.6	5.2	6.2	...	...
Deposit rates 3/	3.3	3.0	3.4	4.3	...	...
Government bond yield (3-year, average)	3.1	3.7	4.3	4.2	...	...
Balance of payments (percent of GDP)						
Trade balance (goods)	-3.6	-3.7	-4.8	-7.2	-5.6	-6.4
Current account balance	-1.7	-2.5	-4.2	-5.9	-4.0	-5.0
Gross official reserves (EUR billions)	6,894.5	5,418.5	723.8	702.8	...	...
Gross external debt (percent of GDP, end-period)	71.4	77.6	100.8	105.0	112.6	118.5
Nominal effective exchange rate (1995=100)	65.0	65.1	66.2	68.2	...	...
Real effective exchange rate (1995=100, CPI-based)	100.7	100.8	103.0	113.2	...	...
Real effective exchange rate (1995=100, ULC-based)	97.1	96.7	97.9	100.5	...	...

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

1/ HICP: Total excl Energy, Food, Alcohol, Tobacco (NSA, 2005=100), period average.

2/ Floating or up to one year fixed rate for new loans to enterprises over an amount of 1 million euro.

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

Table 2. Slovenia: Consolidated General Government Operations (cash basis), 2004–2010  
(Percent of GDP)

	2004	2005	2006	2007	2008	2009	2010
	Outturn	Outturn	Outturn	Outturn	Authorities Est.	IMF Proj.	IMF Proj.
Total revenues	41.4	41.7	41.8	40.6	41.3	40.8	41.2
Tax revenues	37.7	37.9	37.9	37.0	37.5	36.7	37.0
Personal income tax	5.9	5.7	5.8	5.2	5.9	5.5	5.7
Corporate income tax	1.9	2.1	3.0	3.2	3.4	2.7	2.7
Social security contributions	13.9	13.9	13.6	13.3	13.7	13.7	13.9
Taxes on payroll and workforce	1.8	1.8	1.5	1.2	0.7	0.1	0.0
Domestic taxes on goods and services	13.2	13.6	13.1	13.1	12.9	13.7	13.8
VAT	8.3	8.8	8.8	8.4	8.5	8.6	8.7
Excise taxes	3.4	3.3	3.1	3.4	3.3	4.0	4.0
Other	1.5	1.5	1.3	1.3	1.2	1.1	1.2
Taxes on international trade	0.3	0.1	0.2	0.3	0.3	0.3	0.3
Taxes on property	0.6	0.6	0.6	0.6	0.6	0.6	0.6
Other taxes	0.1	0.0	0.0	0.0	0.0	0.0	0.0
Nontax revenues	2.5	2.2	2.0	2.1	2.3	2.1	2.1
Capital revenues and grants	0.5	0.5	0.7	0.6	0.5	0.4	0.4
Receipts from the EU budget	0.7	1.1	1.1	1.0	1.0	1.6	1.7
Total expenditures	42.7	42.8	42.6	40.4	41.6	45.0	44.9
Current expenditures	38.9	39.2	38.4	36.1	37.0	40.1	40.0
Wages and social security contributions	10.8	10.5	10.3	9.5	9.6	10.4	10.8
Central and local government	3.7	3.7	3.6	3.4	3.6	3.8	3.9
Other public institutions	7.1	6.8	6.6	6.1	6.1	6.7	6.9
Expenditure on goods and services	6.6	6.7	6.7	6.4	6.8	7.0	7.0
Central and local government	3.1	3.0	3.2	3.1	3.2	3.3	3.3
Other public institutions	3.5	3.6	3.5	3.3	3.6	3.7	3.7
Interest payments	1.4	1.3	1.2	1.0	0.9	1.0	1.2
Transfers to individuals and households	5.8	5.8	5.5	5.0	5.2	5.7	5.5
Pensions	10.4	10.4	10.2	9.7	9.9	10.4	10.7
Subsidies	1.2	1.3	1.3	1.2	1.3	2.2	1.6
Other current transfers	2.0	2.2	2.3	2.1	2.1	2.0	2.0
Capital expenditures and transfers	3.8	3.6	4.2	4.2	4.6	5.0	4.9
Acquisition of capital assets	2.3	2.3	2.9	3.3	3.4	3.6	3.6
Capital transfers	1.4	1.3	1.3	1.0	1.2	1.4	1.3
Transfers to the EU budget	0.6	1.0	0.9	1.0	1.2	1.2	1.2
General government balance	-1.3	-1.0	-0.8	0.3	-0.3	-4.2	-3.7
Primary balance	-0.1	0.1	0.3	1.2	0.5	-3.3	-2.7
Memorandum items:							
General government balance (ESA 95)	-2.2	-1.4	-1.2	0.5	-0.7	-4.5	-4.0
Structural budget balance	-0.5	-0.5	-1.2	-1.4	-2.1	-3.6	-2.4
Structural primary balance	0.8	0.7	-0.1	-0.5	-1.3	-2.6	-1.3
General government debt	27.2	27.0	26.7	23.4	22.7	26.9	30.0
Nominal GDP (millions of euro)	27,073	28,704	31,008	34,471	37,126	37,203	38,045

Sources: Ministry of Finance; and IMF staff calculations.

Table 3. Slovenia: Balance of Payments, 2005–11  
(Millions of euros, unless otherwise noted)

	2005	2006	2007	2008	Projections		
					2009	2010	2011
Current account	-498	-771	-1,455	-2,180	-1,482	-1,890	-2,158
Trade balance, goods and services	-106	-158	-473	-959	-373	-687	-873
Goods	-1,026	-1,151	-1,666	-2,662	-2,072	-2,428	-2,760
Exports f.o.b.	14,599	17,028	19,799	20,278	19,359	19,984	21,413
Imports f.o.b.	-15,625	-18,179	-21,464	-22,940	-21,431	-22,411	-24,173
Services	920	993	1,193	1,703	1,700	1,741	1,887
Exports	3,214	3,572	4,291	5,064	5,256	5,383	5,811
Imports	-2,294	-2,580	-3,098	-3,362	-3,556	-3,642	-3,924
Income, net	-295	-440	-709	-1,008	-886	-975	-1,043
Current transfers, net	-97	-173	-274	-212	-223	-228	-242
Capital account	-114	-132	-52	-93	-33	-38	-29
Financial account, excl. reserves	1,273	-58	1,625	2,343	1,514	1,928	2,188
Direct investment, net	-43	-174	-269	257	235	252	323
In Slovenia	473	513	1,050	1,235	930	951	1,008
Abroad	-516	-687	-1,319	-978	-695	-699	-685
Portfolio investment, net	-1,313	-1,443	-2,265	606	372	571	564
Equity securities	-560	-590	-717	-55	30	69	65
Debt securities	-754	-853	-1,547	661	342	501	499
Financial derivatives	-10	-13	-21	6	0	0	0
Other investment, net	2,640	1,571	4,180	1,474	907	1,104	1,301
Government	-27	-115	-43	-28	-34	-39	-45
Bank of Slovenia	-2	-1	-45	-6	0	0	0
Commercial banks	2,847	1,960	5,554	1,406	1,256	1,354	1,464
Nonbank private sector	-179	-273	-413	-382	-579	-522	-492
Loans	188	479	346	599	407	486	576
Household currency and deposits	-263	-805	-802	-767	-781	-799	-847
Trade credits	66	36	109	-54	-37	-38	-40
Other	-170	17	-66	-161	-167	-171	-181
Net errors and omissions	-473	-321	-258	-92	0	0	0
Overall balance	189	-1,281	-140	-21	0	0	0
Change in official reserves (-: increase)	-189	1,281	140	21	0	0	0
Memorandum items:							
Current account balance (percent of GDP)	-1.7	-2.5	-4.2	-5.9	-4.0	-5.0	-5.4
Export of goods (percent change in value)	13.2	16.6	16.3	2.5	-4.6	3.2	7.2
Import of goods (percent change in value)	12.4	16.4	18.1	7.0	-6.8	4.6	7.9
Terms of trade (percent change)	-2.4	-0.4	0.2	-2.0	3.2	-1.1	0.1
Gross external debt	20,496	24,067	34,752	38,997	41,876	45,073	48,559
(percent of GDP)	71.4	77.6	100.8	105.0	112.6	118.5	120.5
Net external debt (liabilities - assets) 1/	922.0	3394.0	6198.0	9442.0	10690.8	12296.8	14096.6
(percent of GDP)	3.2	10.9	18.0	25.4	28.7	32.3	35.0

1/ A negative number indicates net creditor position.

Table 4. Slovenia: Banking Sector Soundness Indicators, 2004–08  
(Percent, end of period)

	2004	2005	2006	2007	2008
<b>Capital adequacy</b>					
Regulatory capital to risk-weighted assets	11.8	10.5	11.1	11.2	10.5 1/
Regulatory Tier 1 capital to risk-weighted assets	9.0	8.9	9.4	8.9	8.5 1/
Capital (net worth) to assets	8.1	8.5	8.4	8.4	8.4
<b>Asset quality</b>					
Nonperforming assets to classified claims	3.0	2.9	2.5	1.8	1.6 1/
Large exposures to capital	196.2	226.2	222.9	217.4	201.6 1/
<b>Earnings and profitability</b>					
Net interest margin to average interest bearing assets	2.9	2.6	2.4	2.3	2.2
Operating expenses to average assets	2.7	2.5	2.2	2.0	1.7
Return on average assets (before tax)	1.0	1.0	1.3	1.4	0.7
Return on average equity (before tax)	12.5	13.8	15.1	16.3	9.0
<b>Liquidity</b>					
Average liquid assets to average total assets	5.3	4.8	4.5	3.6	3.0
Average liquid assets to average short-term deposits	9.68	9.51	9.72	8.4	7.4
<b>Foreign exchange risk</b>					
Foreign currency-denominated loans to total loans	38.6	48.7	55.9	6.4	6.4
Foreign currency-denominated liabilities to total liabilities	44.5	49.4	53.3	5.9	6.1
<b>Market risk</b>					
Assets with maturity of more than 1 year (percent of total loans to non-bank sector)	34.1	32.3	33.4	35.1	37.0
Liabilities with maturity of less than 3 months (percent of total liabilities to non-bank sector)	64.5	66.9	68.2	66.3	57.1
<b>Memorandum item:</b>					
Ownership of banking sector (percent of equity capital)					
Nonresidents	32.3	34.9	37.7	37.7	38.1
Central government	19.1	18.2	17.4	15.1	17.7
Other domestic entities	48.6	46.9	44.6	47.2	44.2

Source: Bank of Slovenia.

1/ Figures refer to Q3.

Table 5. Slovenia: Vulnerability Indicators, 2003-08  
(Percent of GDP, unless otherwise indicated)

	2003	2004	2005	2006	2007	2008
<b>Financial Indicators (end of period)</b>						
General government debt	28.5	27.2	27.0	26.7	23.4	21.9
Domestic credit	52.5	59.8	68.1	76.6	87.8	92.0
Private sector credit (percent change) 1/ 2/	15.4	20.3	23.7	26.5	34.1	18.0
Foreign exchange deposits (in billions of euros) 2/	4.3	5.0	5.3	5.7	0.5	0.4
Banks' nonperforming loans (percent of total gross loans)	3.7	3.0	2.9	2.5	1.8	1.6
Capital adequacy ratio	11.5	11.8	10.5	11.1	11.2	10.5
<b>Financial Market Indicators (end of period)</b>						
Stock market index	3,932	4,904	4,630	6,383	11,370	3,696
Stock market capitalization	28.5	32.7	34.2	50.0	57.3	22.8
Foreign currency debt rating (S&P, long-term)	A+	AA-	AA-	AA	AA	AA
<b>External Indicators</b>						
Exports of goods and services (percent change, value in euros)	2.7	13.2	13.3	15.7	16.9	5.2
Imports of goods and services (percent change, value in euros)	5.5	15.5	11.7	15.9	18.3	7.1
Current account balance	-0.8	-2.7	-1.7	-2.5	-4.2	-5.9
Capital and financial account balance, excl. reserve assets	1.2	1.6	4.0	-0.6	4.6	6.1
Of which: Inward portfolio investment	-0.1	0.1	0.2	2.2	3.1	1.7
Inward foreign direct investment	1.1	2.5	1.6	1.7	3.0	3.3
Other investment net	3.4	3.5	9.2	5.1	12.1	4.0
Net foreign assets of commercial banks (in billions of euros) 2/	-1.6	-2.7	-5.1	-6.1	-6.5	-8.6
Short-term foreign assets of commercial banks (in billions of euros)	1.3	1.3	1.8	2.0	4.2	3.5
Short-term foreign liabilities of commercial banks (in billions of euros)	0.6	0.6	1.5	1.6	3.1	3.6
Foreign currency exposure of commercial banks (in billions of euros) 2/	-8.0	-9.9	-13.9	-16.8	-16.7	-18.3
Gross official reserves (in billions of euros)	6.9	6.5	6.9	5.4	0.7	0.7
Gross official reserves (in months of imports of goods and services)	5.9	4.9	4.6	3.1	0.4	0.3
Net international reserves (in billions of euros)	4.4	4.2	5.3	4.9	0.7	0.6
Total external debt	51.4	56.5	71.4	77.6	100.8	105.0
Of which: Public and publicly guaranteed	14.1	13.8	13.2	14.0	23.5	24.6
Total external debt (in percent of exports of goods and services)	95.3	97.6	115.1	116.8	144.3	153.9
Total external debt service payments (in percent of exports of goods and services)	14.6	12.7	14.4	17.4	...	...
External interest payment (in percent of exports of goods and services)	2.9	2.6	2.7	3.1	4.2	5.3
External amortization payments (in percent of exports of goods and services)	12.6	10.9	12.5	14.9	...	...
REER (CPI-based, period-average basis, an increase indicates appreciation)	3.6	0.1	-0.9	0.1	2.1	2.5

Sources: Data provided by the Slovene authorities; Bloomberg; and IMF staff calculations.

1/ Credit including loans and other claims.

2/ Series present a structural break in 2004.

Table 6. Slovenia: Macroeconomic Framework, 2006–14

	2006	2007	2008	Projections					
				2009	2010	2011	2012	2013	2014
Real GDP (percent change)	5.9	6.8	3.5	-2.7	1.4	3.7	3.7	3.7	3.5
Contribution									
Domestic demand	5.7	8.2	3.8	-2.4	1.6	4.1	4.0	4.0	3.9
Private consumption	1.6	2.7	1.1	0.2	0.6	1.6	1.7	1.7	1.6
Government consumption	0.7	0.5	0.6	1.0	0.5	0.7	0.5	0.5	0.4
Gross investment	3.5	5.1	2.0	-3.6	0.4	1.8	1.8	1.8	1.9
Net foreign demand	0.1	-1.5	-0.2	-0.2	-0.2	-0.4	-0.3	-0.3	-0.3
Exports of goods and services	8.2	9.6	2.5	-3.2	1.1	3.6	4.6	4.9	4.9
Imports of goods and services	-8.1	-11.1	-2.7	3.0	-1.3	-4.0	-4.9	-5.2	-5.2
Output gap (in percent of potential)	1.0	4.2	4.4	-1.5	-3.2	-2.5	-1.7	-0.9	-0.2
Growth rates									
Domestic demand	5.7	8.0	3.7	-2.0	1.6	4.0	3.9	3.8	3.7
Consumption	3.2	4.4	2.6	1.8	1.6	3.2	3.1	3.0	2.8
Government	4.1	2.5	3.7	5.7	2.8	3.9	2.4	2.4	2.4
Non-government	2.9	5.0	2.2	0.5	1.2	3.0	3.3	3.2	3.0
Gross capital formation	12.5	17.2	6.1	-10.8	1.4	5.8	5.8	5.7	5.8
Fixed investment	10.3	11.9	6.2	-12.2	1.6	6.7	6.6	6.5	6.5
Change in stocks (contribution to GDP growth)	0.8	1.8	0.2	0.0	0.0	0.0	0.0	0.0	0.0
Exports of goods and services	12.5	13.8	3.3	-4.3	1.5	4.9	6.2	6.5	6.3
Imports of goods and services	12.2	15.7	3.5	-3.9	1.8	5.2	6.3	6.6	6.4
Savings and investment (percent of GDP)									
National saving	26.2	27.2	26.4	24.9	24.1	24.3	25.0	25.7	26.3
Government	3.4	4.5	4.3	0.7	1.2	1.4	1.8	2.1	2.3
Non-government	22.8	22.7	22.0	24.2	22.9	23.0	23.1	23.5	24.1
Gross capital formation	28.7	31.4	32.2	28.9	29.1	29.7	30.3	30.9	31.5
Government 1/	2.9	3.3	3.4	3.6	3.6	3.6	3.5	3.5	3.4
Non-government	25.8	28.2	28.9	25.3	25.4	26.1	26.7	27.4	28.1
Foreign saving	-2.5	-4.2	-5.9	-4.0	-5.0	-5.4	-5.3	-5.2	-5.2
Prices									
Consumer price inflation	2.5	3.6	5.7	0.5	1.5	2.3	2.5	2.7	3.0
GDP deflator	2.0	4.1	4.0	3.0	0.9	2.1	2.4	2.7	3.0
Employment (percent change)	1.5	3.0	2.9	-2.5	0.0	1.0	0.9	0.7	0.5
Unemployment rate (ILO, percent)	6.0	4.9	4.4	6.2	6.1	5.9	5.7	5.6	5.5
Real wages (percent change)	2.3	2.2	2.5	1.8	2.0	2.9	2.7	2.8	2.8
Government budget (percent of GDP)									
Revenue	41.8	40.6	41.3	40.8	41.2	41.4	41.5	41.6	41.6
Expenditure	42.6	40.4	41.6	45.0	44.9	44.9	44.5	44.2	44.1
General government balance	-0.8	0.3	-0.3	-4.2	-3.7	-3.5	-3.0	-2.6	-2.4
Structural government balance	-1.2	-1.4	-2.1	-3.6	-2.4	-2.4	-2.2	-2.2	-2.4
Merchandise trade (percent change)									
Export volume	13.4	13.1	1.0	-5.3	1.7	4.7	5.8	6.1	5.8
Import volume	12.7	15.1	3.4	-4.6	1.9	5.3	6.4	6.7	6.5
Export value	16.6	16.3	2.5	-4.6	3.2	7.2	8.5	8.9	8.9
Import value	16.3	18.1	7.0	-6.8	4.6	7.9	9.1	9.4	9.6
External balances (in billions of euros)									
Trade balance	-1.2	-1.7	-2.7	-2.1	-2.4	-2.8	-3.1	-3.6	-4.1
In percent of GDP	-3.7	-4.8	-7.2	-5.6	-6.4	-6.8	-7.3	-7.8	-8.3
Exports of goods	17.0	19.8	20.3	19.4	20.0	21.4	23.2	25.3	27.6
Imports of goods	18.2	21.5	22.9	21.4	22.4	24.2	26.4	28.9	31.6
Current account	-0.8	-1.5	-2.2	-1.5	-1.9	-2.2	-2.3	-2.4	-2.5
In percent of GDP	-2.5	-4.2	-5.9	-4.0	-5.0	-5.4	-5.3	-5.2	-5.2

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

1/ Government capital transfers are not included in government investment.

Table 7. Slovenia: External Debt Sustainability Framework, 2004-2014  
(in percent of GDP, unless otherwise indicated)

	Actual					Projections					Debt-stabilizing non-interest current account 6/ -4.9	
	2004	2005	2006	2007	2008	2009	2010	2011	2012	2013		2014
<b>1 Baseline: Gross External debt</b>	56.5	71.4	77.6	100.8	105.0	112.6	118.5	120.5	121.3	121.9	122.3	
2 Change in external debt	5.1	14.9	6.2	23.2	4.2	7.5	5.9	2.0	0.9	0.6	0.4	
3 Identified external debt-creating flows (4+8+9)	0.0	0.8	-0.4	-0.7	-1.9	3.0	1.6	-2.3	-3.2	-3.5	-3.8	
4 Current account deficit, excluding interest payments	1.1	0.1	0.4	1.3	2.2	0.4	1.1	1.4	1.3	1.1	1.0	
5 Deficit in balance of goods and services	1.2	0.4	0.5	1.4	2.6	1.0	1.8	2.2	2.3	2.5	2.6	
6 Exports	57.9	62.1	66.4	69.9	68.3	66.2	66.7	67.5	69.2	71.1	73.1	
7 Imports	59.0	62.4	66.9	71.3	70.8	67.2	68.5	69.7	71.5	73.6	75.7	
8 Net non-debt creating capital inflows (negative)	0.0	2.1	2.5	2.9	-0.5	-0.7	-0.8	-1.0	-1.4	-1.4	-1.4	
9 Automatic debt dynamics 1/	-1.2	-1.4	-3.3	-4.9	-3.6	3.3	1.3	-2.7	-3.1	-3.2	-3.4	
10 Contribution from nominal interest rate	1.5	1.7	2.1	2.9	3.6	3.6	3.8	3.9	4.0	4.1	4.2	
11 Contribution from real GDP growth	-2.1	-2.3	-3.9	-4.7	-3.3	2.8	-1.5	-4.2	-4.2	-4.2	-4.1	
12 Contribution from price and exchange rate changes 2/	-0.6	-0.7	-1.4	-3.1	...	...	...	...	...	...	...	
13 Residual, incl. change in gross foreign assets (2-3) 3/	5.1	14.1	6.6	23.9	6.1	4.5	4.3	4.3	4.1	4.2	4.2	
External debt-to-exports ratio (in percent)	97.6	115.1	116.8	144.3	153.9	170.1	177.7	178.4	175.3	171.4	167.3	
<b>Gross external financing need (in billions of Euros) 4/</b>	4.9	5.4	8.4	10.3	17.5	18.3	15.9	17.2	18.3	19.5	20.8	
in percent of GDP	18.0	18.7	27.0	29.8	47.1	49.1	41.9	42.6	42.8	42.8	42.7	
<b>Scenario with key variables at their historical averages 5/</b>						112.6	113.7	114.8	115.7	116.6	117.5	-3.4
<b>Baseline: Net external debt</b>	-3.2	3.2	10.9	18.0	25.4	28.7	32.3	35.0	37.0	38.8	40.5	
<b>Key Macroeconomic Assumptions Underlying Baseline</b>												
Real GDP growth (in percent)	4.3	4.3	5.9	6.8	3.5	-2.7	1.4	3.7	3.7	3.7	3.5	
GDP deflator in Euros (change in percent)	1.1	1.3	2.0	4.1	4.0	3.0	0.9	2.1	2.4	2.7	3.0	
Nominal external interest rate (in percent)	3.1	3.1	3.1	4.2	3.9	3.4	3.5	3.5	3.6	3.6	3.6	
Growth of exports (Euro terms, in percent)	13.2	13.3	15.7	16.9	5.2	-2.9	3.1	7.3	8.9	9.4	9.5	
Growth of imports (Euro terms, in percent)	15.5	11.7	15.9	18.3	7.1	-5.0	4.3	7.8	9.1	9.5	9.7	
Current account balance, excluding interest payments	-1.1	-0.1	-0.4	-1.3	-2.2	-0.4	-1.1	-1.4	-1.3	-1.1	-1.0	
Net non-debt creating capital inflows	0.0	-2.1	-2.5	-2.9	0.5	0.7	0.8	1.0	1.4	1.4	1.4	

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

2/ The contribution from price and exchange rate changes is defined as  $[-(1+g) \frac{d}{dt}] / (1+r) \frac{d}{dt} + g \frac{d}{dt}$  times previous period debt stock.  $\frac{d}{dt}$  increases with an appreciating domestic currency ( $\frac{d}{dt} < 0$ ) and rising inflation (based on GDP deflator).

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; Euro 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, Euro deflator growth, and non-debt inflows in percent of GDP) remain at their levels of the last projection year.

Table 8. Slovenia: Public Sector Debt Sustainability Framework, 2004–2014  
(Percent of GDP, unless otherwise indicated)

	Actual					Projections					Debt-stabilizing primary balance 9/	
	2004	2005	2006	2007	2008	2009	2010	2011	2012	2013		2014
<b>Baseline: Public sector debt 1/</b> o/w foreign-currency denominated	27.2	27.0	26.7	23.4	22.7	26.9	30.0	31.7	32.7	33.2	33.5	-0.7
Change in public sector debt	0.2	0.1	-0.7	-3.1	-1.4	4.2	3.1	1.7	1.0	0.5	0.2	
Identified debt-creating flows (4+7+12)	-0.1	-0.3	-0.4	-1.3	-0.6	3.2	2.6	2.3	1.7	1.3	1.1	
Primary deficit	41.4	41.7	41.8	40.6	41.3	40.8	41.2	41.4	41.5	41.6	41.6	
Revenue and grants	41.3	41.5	41.4	39.3	40.7	44.0	43.8	43.7	43.2	42.9	42.7	
Primary (noninterest) expenditure	-0.3	-0.2	-0.8	-2.3	-0.8	1.0	0.6	-0.5	-0.6	-0.7	-0.7	
Automatic debt dynamics 2/	-0.6	-0.2	-0.8	-1.6	-0.8	1.0	0.6	-0.5	-0.6	-0.7	-0.7	
Contribution from interest rate/growth differential 3/	0.5	0.9	0.7	0.0	0.0	0.3	0.9	0.6	0.5	0.5	0.4	
Of which contribution from real interest rate	-1.1	-1.1	-1.5	-1.6	-0.8	0.6	-0.4	-1.1	-1.1	-1.1	-1.1	
Contribution from real GDP growth	0.3	0.0	0.0	-0.6	0.0	...	...	...	...	...	...	
Contribution from exchange rate depreciation 4/	0.6	0.6	0.5	0.4	0.0	0.0	0.0	0.0	0.0	0.0	0.0	
Other identified debt-creating flows	-0.1	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	
Privatization receipts (negative)	0.1	0.0	0.1	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	
Recognition of implicit or contingent liabilities	0.6	0.6	0.4	0.4	0.0	0.0	0.0	0.0	0.0	0.0	0.0	
Other (specify, e.g. bank recapitalization)	-0.5	-0.3	0.4	-0.2	0.7	0.0	0.0	-0.1	-0.1	-0.1	-0.1	
Residual, including asset changes (2-3) 5/	65.7	64.8	64.0	57.6	55.0	65.9	72.9	76.6	78.8	79.9	80.4	
Public sector debt-to-revenue ratio 1/	5.5	8.2	5.8	3.8	5.4	7.1	9.0	7.4	5.0	6.9	6.6	
Gross financing need 6/ in billions of U.S. dollars	1.9	2.9	2.2	1.8	3.0	3.5	4.5	3.9	2.8	4.2	4.3	
<b>Scenario with key variables at their historical averages 7/</b>						26.9	25.5	24.1	22.7	21.3	20.0	-0.7
<b>Scenario with no policy change (constant primary balance) in 2009-2014</b>						26.9	30.7	33.3	35.8	38.2	40.5	-0.9
<b>Key Macroeconomic and Fiscal Assumptions Underlying Baseline</b>												
Real GDP growth (in percent)	4.3	4.3	5.9	6.8	3.5	-2.7	1.4	3.7	3.7	3.7	3.5	
Average nominal interest rate on public debt (in percent) 8/	5.6	5.1	4.9	4.3	4.2	4.4	4.4	4.4	4.3	4.3	4.3	
Average real interest rate (nominal rate minus change in GDP deflator, in percent)	2.2	3.5	2.8	0.2	0.1	1.4	3.5	2.2	1.9	1.6	1.3	
Nominal appreciation (increase in US dollar value of local currency, in percent)	-2.2	-0.3	0.0	9.2	7.4	...	...	...	...	...	...	
Inflation rate (GDP deflator, in percent)	3.4	1.6	2.0	4.1	4.0	3.0	0.9	2.1	2.4	2.7	3.0	
Growth of real primary spending (deflated by GDP deflator, in percent)	5.1	4.9	5.7	1.5	7.1	5.4	0.8	3.5	2.6	3.0	3.1	
Primary deficit	-0.1	-0.3	-0.4	-1.3	-0.6	3.2	2.6	2.3	1.7	1.3	1.1	

1/ Gross debt of the general government.

2/ Derived as  $[(r - \delta)(1+g^s - g + \delta) + \pi]/(1+g+g^s)$ , times previous period debt ratio, with  $r$  = interest rate;  $\delta$  = growth rate of GDP deflator;  $g$  = real GDP growth rate;  $g^s$  = share of foreign-currency denominated debt; and  $\pi$  = nominal exchange rate depreciation (measured by increase in local currency value of Euro before 2007 and of U.S. dollar in 2007 and beyond).

3/ The real interest rate contribution is derived from the denominator in footnote 2/ as  $r - \pi(1+g)$  and the real growth contribution as  $-g$ .

4/ The exchange rate contribution is derived from the numerator in footnote 2/ as  $\delta \cdot (1+\pi)$ .

5/ For projections, this line includes exchange rate changes.

6/ Defined as public sector deficit, plus amortization of medium and long-term public sector debt, plus short-term debt at end of previous period.

7/ The key variables include real GDP growth; real interest rate; and primary balance in percent of GDP.

8/ Derived as nominal interest expenditure divided by previous period debt stock.

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.

INTERNATIONAL MONETARY

REPUBLIC OF SLOVENIA

**Staff Report for the 2009 Article IV Consultation—Informational Annex**

Prepared by the European Department

April 28, 2009

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**ANNEX I: SLOVENIA: FUND RELATIONS**

(As of March 27, 2009)

I. **Membership Status:** Joined: 12/14/1992; Article VIII status as from September 1, 1995.

II. <b>General Resources Account</b>	<b>SDR Million</b>	<b>Percent of Quota</b>
Quota	231.70	100.00
Fund holdings of currency	201.63	87.02
Reserve position	30.09	12.99

III. **SDR Department**

Net cumulative allocation	25.43	100.00
Holdings	7.66	30.12

IV. **Projected Payments to Fund<sup>1</sup>**

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

	Forthcoming			
	<b>2009</b>	<b>2010</b>	<b>2011</b>	<b>2012</b>
Charges/Interest	0.19	0.19	0.19	0.19
Total	0.19	0.19	0.19	0.19

V. **Exchange Rate Arrangement**

Slovenia adopted the euro on January 1, 2007, which floats freely and independently against other currencies. Slovenia has accepted the obligations of Article VIII and maintains an exchange system that is free of restrictions on the making of payments and transfers for current international transactions.

VI. **2009 Article IV Consultation**

Slovenia is on the standard 12-month Article IV consultation cycle. The 2009 mission visited Ljubljana during March 2–11, 2009 and held discussions with the Minister of Finance, Governor of the Bank of Slovenia, and other key economic ministers, government officials

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<sup>1</sup> When a member has overdue financial obligations outstanding for more than three months, the amount of such arrears will be shown in this section.

and representatives of the Parliament, financial sector, labor, business and media. Ms. Maver (Advisor to the Executive Director) attended some of the meetings.

The mission comprised Mr. A. Spilimbergo (Head, RES), Ms. F. Jaumotte and Mr. Y. Xiao (all EUR).

The mission held a press conference on the concluding statement. The authorities have agreed to the publication of the staff report.

## **VII. FSAP Participation and ROSCs**

An FSAP mission took place during November 6–20, 2000. A FSSA report was prepared on April 24, 2001 and published on September 18, 2001 (Country Report No. 01/161). An FSAP Update mission visited Ljubljana during November 10–21, 2003. An FSSA report (Country Report No. 04/137) was issued on April 26, 2004.

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

## **VIII. Technical Assistance**

<b>Date</b>	<b>Dept.</b>	<b>Subject/Identified Need</b>
August 2001	FAD	VAT
November 2001	FAD	Direct Tax Reform
November 2003	FAD	Public Expenditure Management
April-May 2004	FAD	Performance Information to Support Better Budgeting
November 2004	STA	Recording Transactions in International Trade in Services
April 2006	STA	Government Finance Statistics

## ANNEX II: SLOVENIA: 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 its metadata are posted 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 1995 (ESA95). 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 wish to adopt the *GFSM 2001* methodology, which could then be used as a building block for the compilation of the ESA 95-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. Pending the approval of the revision of the law on public finance, Slovenia plans the introduction of a new charts for all public entities based on GFSM 2001. Nevertheless, accrual principles will not yet be introduced for preparation, execution, and accounting of the central, local, and social security fund's budgets.

**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 the balance of payments statistics going 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.

**External Debt Statistics:** External debt statistics were revised and brought in line with the SDDS in August 2003. The main change comprised the inclusion of trade credits in the debt data.

**SLOVENIA: TABLE OF COMMON INDICATORS REQUIRED FOR SURVEILLANCE**  
AS OF MARCH 28, 2009

	Date of latest observation	Date received or posted	Frequency of Data <sup>6</sup>	Frequency of Reporting <sup>6</sup>	Frequency of publication <sup>6</sup>
Exchange Rates	3/28/09	3/28/09	D	D	D
International Reserve Assets and Reserve Liabilities of the Monetary Authorities <sup>1</sup>	2/09	3/09	M	M	M
Reserve/Base Money	2/09	3/09	M	M	M
Broad Money	2/09	3/09	M	M	M
Central Bank Balance Sheet	2/09	3/09	M	M	M
Consolidated Balance Sheet of the Banking System	2/09	3/09	M	M	M
Interest Rates <sup>2</sup>	2/09	3/09	M	M	M
Consumer Price Index	2/09	3/09	M	M	M
Revenue, Expenditure, Balance and Composition of Financing <sup>3</sup> – General Government <sup>4</sup>	12/08	2/09	M	M	M
Revenue, Expenditure, Balance and Composition of Financing <sup>3</sup> – Central Government	12/08	2/09	M	M	M
Stocks of Central Government and Central Government-Guaranteed Debt <sup>5</sup>	12/08	2/09	M	M	M
External Current Account Balance	12/08	2/09	M	M	M
Exports and Imports of Goods and Services	12/08	2/09	M	M	M
GDP/GNP	Q4/08	3/09	Q	Q	Q
Gross External Debt	12/08	2/09	M	M	M
International Investment Position	12/07	10/08	A	A	A

<sup>1</sup>Includes reserve assets pledged or otherwise encumbered as well as net derivative positions.

<sup>2</sup>Both market-based and officially-determined, including discount rates, money market rates, rates on treasury bills, notes and bonds.

<sup>3</sup>Foreign, domestic bank, and domestic nonbank financing.

<sup>4</sup>The general government consists of the central government (budgetary funds, extra budgetary funds, and social security funds) and state and local governments.

<sup>5</sup>Including currency and maturity composition.

<sup>6</sup>Daily (D), Weekly (W), Monthly (M), Quarterly (Q), Annually (A); Irregular (I); Not Available (NA).

**Statement by the IMF Staff Representative on Republic of Slovenia**  
**May 13, 2009**

1. This statement summarizes economic developments and policy action in Slovenia since issuance of the staff report. The additional information does not change the thrust of the staff appraisal.

2. **Recently released data confirm that economic activity continued contracting sharply in the first quarter of 2009.** High-frequency indicators worsened compared to the previous quarter. Industrial production plunged by 21.5 percent year-on-year in February, while new orders in industry declined by 49.8 percent year-on-year in the first quarter. Merchandise exports contracted by 25.1 percent year-on-year in February. Consumer and business confidence indicators dropped to new lows, and the unemployment rate rose to 5.1 percent in the first quarter.

3. **Having reduced their growth estimate to -4 percent in 2009, the authorities are projecting that the fiscal deficit could exceed 6 percent of GDP without corrective actions.** The government announced a number of budgetary measures to contain the deficit at 5.1 percent in 2009, below 4 percent of GDP in 2010, and below 3.5 percent of GDP in 2011. The main measures for 2009 include a cut in domestically funded public investment by 0.7 percent of GDP and lower expenditure on the purchase of goods and services by 0.5 percent of GDP. The measures for 2010 and 2011 include also a freeze in pensions, social transfers, and public sector's wages.

4. **Staff welcomes the authorities' commitment to maintain fiscal discipline but cautions against prematurely withdrawing fiscal stimulus in presence of an increasing output gap.** The announced measures could intensify the downturn in the short term, and proposed cuts in public investment could be detrimental to medium-term growth prospects. As discussed in the Staff Report, the proposed measures—which will be useful to rationalize expenditure—could be embedded in a medium-term plan and tied to the onset of the recovery.

5. **The financial sector remains under stress, but appears to be comparatively resilient.** Lending conditions remained tight and credit growth continued to decelerate. On a positive note, the sovereign spread vis-à-vis the German bond has fallen recently. Two large banks have applied for the government guarantees for debt issuance. The large conglomerate, which is heavily indebted due to a recent leveraged management buyout, is proceeding with negotiations with the banks to reach a debt restructuring plan to avoid bankruptcy.



INTERNATIONAL MONETARY FUND

*Public Information Notice*

EXTERNAL  
RELATIONS  
DEPARTMENT

Public Information Notice (PIN) No. 09/65  
FOR IMMEDIATE RELEASE  
May 22, 2009

International Monetary Fund  
700 19<sup>th</sup> Street, NW  
Washington, D. C. 20431 USA

## **IMF Executive Board Concludes 2009 Article IV Consultation with the Republic of Slovenia**

On May 13, 2009, the Executive Board of the International Monetary Fund (IMF) concluded the Article IV consultation with the Republic of Slovenia.<sup>1</sup>

### **Background**

After a period of overheating following the adoption of the euro in 2007, the global crisis hit Slovenia in the fall of 2008. Manufacturing and trade, and later investment, decelerated sharply, while private consumption growth moderated. While wage growth continued to accelerate as wage agreements were implemented, the labor market cooled in the fall with unemployment increasing to 5.1 percent in the first quarter of 2009. Reflecting a strong pass-through of fuel and food prices, inflation stood at 5.5 percent in 2008, which was significantly above euro-area inflation, but came down to 2.1 in February 2009. The current account continued to deteriorate owing to the overheating economy, reaching 5.5 percent of GDP in 2008, as did Slovenia's competitive position. Consequently, Slovenia's net external debt rose to 25.4 percent of GDP by the end of 2008.

Output is expected to contract by 2.7 percent in 2009. The main factors driving the downturn are the deceleration of exports as the Eurozone is in recession, and of investment as credit conditions tighten and exports decelerate. Private consumption

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<sup>1</sup> 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. 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.

should be more resilient because of the recent wage increases and the strong net asset position of the households. Inflation and the current account deficit are expected to moderate. The main downward risks to growth are lower-than-projected growth in Europe, and a credit crunch in the event that foreign financing of domestic banks dries up.

The government budget was broadly balanced in 2008 with a positive fiscal impulse. In reaction to the crisis, the authorities have adopted a fiscal stimulus package of 2.1 percent of GDP to attenuate the drop in aggregate demand and to alleviate distress of the most vulnerable groups. The fiscal deficit is expected to deteriorate to 4.2 percent of GDP in 2009, reflecting both automatic stabilizers and a fiscal stimulus package. The government indicated its intention to contain the fiscal deficit to 5 percent of GDP in 2009, possibly cutting public investment in case the deficit exceeds this threshold. Going forward, the authorities aim to reduce the fiscal deficit to below 4 percent of GDP in 2010. A rapidly aging population and current policies pose a challenge for long-term fiscal sustainability. As a solution, the government is considering greater incentives for a longer working life and private pension savings and active aging policies aimed at increasing labor participation especially among older workers.

Banks weathered relatively well the first impact of the crisis thanks to their limited exposure to the U.S. financial system, the low level of households' indebtedness, and the financial stability measures promptly put in place by the authorities. Nevertheless, the financial sector is increasingly affected by the global crisis. The international credit squeeze has considerably increased the banks' vulnerability on the liability side, given their high reliance on foreign financing. On the asset side, rapid credit growth in the past few years and the severe economic downturn have also increased banks' credit risk. The authorities have put in place a contingency plan which should help solve banks' short run funding needs, and recommended banks to retain profits and raise provisions against risky exposures.

In the medium term, the main challenge is that the economy needs to emerge from the global crisis on a sustainable growth path. As the crisis subsides, Slovenia will face new challenges from tighter international credit conditions, lower potential growth, and neighboring countries with competitive exchange rates. To address these challenges, comprehensive reforms in labor, product, and financial markets are required.

### **Executive Board Assessment**

The Executive Directors noted that, after a long period of strong economic performance that allowed a rapid catch-up to EU levels, Slovenia, as a small open economy, is now severely affected by the global economic crisis. They commended the authorities for their swift and decisive policy responses to slower growth and financial sector strains. Looking ahead, Directors stressed that it will be important to press ahead with broad-ranging reforms aimed at raising the economy's growth potential, bolstering

competitiveness, and ensuring fiscal sustainability, especially in light of the challenges posed by an aging population.

Directors recognized that the authorities need to strike the right balance between supporting domestic demand and preserving fiscal sustainability. They welcomed the authorities' intention to ensure that the fiscal stimulus measures are temporary, well-diversified, and targeted to protect the most vulnerable groups. Directors encouraged the authorities to maintain public investment in infrastructure, while avoiding generalized increases in public sector wages and wage subsidies to companies for shorter working hours. Directors suggested that, as recovery takes hold, the fiscal position should revert to a more prudent stance anchored by the Stability and Growth Pact. They also supported the authorities' intentions to tackle longer-term challenges, such as the fiscal liabilities of the pension system and contingent liabilities owing to the extensive government guarantees. They recommended systemic changes to the pension system, and encouraged the authorities to consider bolder reforms, including raising the retirement age and lowering the pension-to-wages ratio.

Executive Directors noted that the banking sector has so far been relatively resilient, and welcomed the authorities' swift measures to respond to the crisis. However, they cautioned that vulnerabilities have increased, and emphasized that efforts should continue to ensure that the banks have enough funding in case of a further international credit squeeze, especially at longer maturities. Updated stress tests should be performed including in a coordinated manner at the EU level, and the authorities should be ready to inject public capital into undercapitalized banks, accompanied by measures to restructure the nonperforming assets and the operation of the affected banks. Directors advised that the allocation of state guarantees on new loans to nonfinancial enterprises should be transparent, to limit banks' moral hazard and avoid unduly targeting specific sectors.

Directors stressed that structural reforms in the labor, product, and financial markets are imperative to improve external competitiveness and bolster potential growth. In this connection, they noted the staff's estimate of a modest external competitiveness gap, owing to rising unit labor costs and depreciations in the currencies of neighboring countries. Addressing this gap will require greater labor participation and flexibility, along with wage moderation as well as other reforms aimed at boosting productivity. Directors endorsed the government's program to simplify the regulatory burden, strengthen judicial enforcement, enhance the business climate, and revive the privatization program once the crisis subsides.

**Public Information Notices (PINs)** form part of the IMF's efforts to promote transparency of the IMF's views and analysis of economic developments and policies. With the consent of the country (or countries) concerned, PINs are issued after Executive Board discussions of Article IV consultations with member countries, of its surveillance of developments at the regional level, of post-program monitoring, and of ex post assessments of member countries with longer-term program engagements. PINs are also issued after Executive Board discussions of general policy matters, unless otherwise decided by the Executive Board in a particular case. The [staff report](#) (use the free [Adobe Acrobat Reader](#) to view this pdf file) for the 2009 Article IV Consultation with the Republic of Slovenia is also available.



**Statement by Johann Prader, Alternate Executive Director for Republic of  
Slovenia and Ksenija Maver, Advisor to Executive Director  
May 13, 2009**

The Slovene authorities thank the staff for the productive and stimulating Article IV discussions. They broadly concur with the staff's assessments of economic developments in Slovenia and the challenges that it faces.

**Global crisis imposing a heavy toll**

Slovenia was experiencing solid growth and a strong fiscal position, supported by buoyant investment and exports, before the global economy entered the current crisis. An annual inflation of 5.7 percent in 2008 and a widening current account deficit of 5.5 percent of GDP were a concern, although considered manageable over time in light of the monetary integration and rapid convergence processes. However, a sudden drop in external demand and foreign financing, associated with spillovers to domestic demand, were a strong shock to the economy with an export share in GDP of about 70 percent.

**Designing the response**

The authorities acted swiftly to deal with the adverse effects of the crisis with three sets of measures. First, provide liquidity to banks and enterprises. Second, safeguard production and jobs. Third, soften the impact of the crisis and restore medium-term fiscal sustainability. The fiscal stimulus package amounts to 2.1 percent of GDP, of which 1.8 percent would be spent in 2009. If necessary, the government will scale up the fiscal support in 2010, depending on the evolution of the national and regional situation. The first two sets of measures are already in effect, while the third is set for formal approval by mid-May.

The above measures were based on the following three principles. The measures should be (i) temporary, (ii) diversified, and (iii) tailored to Slovenia's fiscal space and anchored to a credible medium-term fiscal framework. Given the limited economic options for a small and open economy, the timing and pace of a sustained turnaround will depend mainly on actions to stabilize financial conditions and boost demand in Slovenia's main trading partners.

The global crisis has hit Slovenia's economy hard but it will leave the country better prepared for the future. The first two sets of measures are primarily aimed at counteracting the effects of the crisis. But the third set is more development-oriented. It includes proposals for medium- and long-term structural reforms, such as performance budgeting, expenditure rationalization in public institutions, modernization of the pension system, and changes in social expenditures. It also includes short-term measures in the field of employment, social protection and business environment, such as subsidies for workers made temporarily redundant and waiting for re-employment, training programs, active employment policies, a trade financing facility, "green tax reform", public procurement rationalization, etc. The authorities also introduced measures aimed at increasing the efficiency of using the EU cohesion funds for public investments.

### **Credit growth has declined**

The banking sector continues to be well capitalized and liquid, but credit growth has declined. Difficulties in borrowing abroad, lower demand for credit and reluctance of banks to lend in the uncertain economic environment have contributed to a slowdown in credit activity, to 13.3 percent y-o-y in March, down from an average annual growth of 20 percent recorded over the past few years, and a peak of 40 percent in 2007.

The banks' funding structure is changing. By making net repayments of foreign borrowing, banks are substituting foreign funding (which backs about one third of the banks' credit exposure) by government deposits (from the EUR 1 billion government bond issue) and Eurosystem liquidity. Nevertheless, foreign parent banks continue to provide funding to their banks in Slovenia. In the same vein, Slovenian banks are determined to keep the linkages with their subsidiaries in the region strong and provide additional capital to them if needed.

### **Possible rebound, but still contraction in 2009**

Recent preliminary data for Slovenia, as for Europe and other parts of the world, suggest that the pace of contraction may be slowing, and that a recovery is on the horizon. Notwithstanding this, the economy is expected to record a sharp decline in economic activity in 2009. The government projects a decline of 4 percent, the European Commission of 3.4 percent, the IMF of 2.7 percent, and the Bank of Slovenia of 2 percent. For 2010, projections show a slightly positive economic growth in the range of 0.7 to 1.9 percent, driven by stronger exports and increased investments in motorways and railway infrastructure.

Public finances are also deteriorating, reflecting the weakening economy, the cost of the fiscal stimulus package and the effects of changes in tax and expenditure legislation approved in 2007. The government is now preparing a second supplementary budget for 2009 that projects a widening of the general government deficit to 5.1 percent of GDP, or 1.4 percentage points more than envisaged in the first supplementary budget adopted in March. Cuts in investments, material expenditures and services are being planned in order to prevent the deficit from reaching 6 percent of GDP, a level the government considers unsustainable. The public debt to GDP ratio will increase from the current 23 percent to 36 percent by 2011. The general government deficit is expected to decline to 3.9 percent of GDP in 2010 and to 3.4 percent in 2011.

Other economic indicators also reflect the impact of the crisis. The current account deficit is expected to narrow this year by around 2 percentage points to 3.2 percent of GDP, due to lower imports and improved terms of trade. Inflation has moderated to 1.8 percent y-o-y in March. Unemployment is rising, especially in manufacturing, and is currently at 6 percent and trending towards 7 percent. As a result, the wage growth in the private sector has slowed. In the public sector, however, real wage growth in 2009 is currently projected at 6.2 percent, reflecting agreements with social partners, reached last August, on a gradual elimination of wage disparities.

## **Development policy priorities and challenges**

Key elements of Slovenia's development policy have been set by the 2008 Reform Program for Achieving Lisbon Strategy Goals, the government's anti-crisis measures and the Stability Program approved at the end of April. The priority is to pursue policies that will foster economic growth underpinned by sustainable public finances. Slovenia's growth prospects will depend very much on its ability to reduce the competitiveness gap, keep the external and internal accounts in check and contain public sector wage growth. It will also depend on how soon the banking sector will resume lending activities.

In the short run, further steps are planned in the following areas:

- Quality of public finance. Introduction of performance budgeting in the 2010–2011 budget cycle is aimed to improve prioritization, resource allocation and performance measurement. Rationalization of social transfers and other expenditures is also in the pipeline.
- Pension system. The plan is to finalize the proposals for modernizing the pension system by autumn, and to agree with the social partners on the main elements by the end of this year, including on solutions for the population to remain active longer, active aging, life-long learning, etc.
- Public sector wage policy. Negotiations with social partners on adjusting collective wage agreements for the public sector are also being planned.
- Business environment and labor market policy. Promoting investments in R&D, stimulating R&D cooperation between the research community and the economy, increasing labor market flexibility, and reducing administrative barriers also top the development agenda.

The task ahead is certainly not easy, in particular as it involves important trade-offs and social consensus. Slovenia's experience with transition, EU accession and Euro adoption proves that at the critical juncture the momentum does build up to move things forward.