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2014 ARTICLE IV CONSULTATION—STAFF REPORT; PRESS RELEASE; AND STATEMENT BY THE EXECUTIVE DIRECTOR FOR THE REPUBLIC OF SLOVENIA

Under Article IV of the IMF's Articles of Agreement, the IMF holds bilateral discussions with members, usually every year. In the context of the 2014 Article IV consultation with the Republic of Slovenia, the following documents have been released and are included in this package:

- The **Staff Report** prepared by a staff team of the IMF for the Executive Board's consideration on February 13, 2015, following discussions that ended on December 12, 2014, 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 January 29, 2015.
- An **Informational Annex** prepared by the IMF.
- A **Staff Supplement** updating information on recent developments.
- A **Press Release** summarizing the views of the Executive Board as expressed during its February 13, 2015 consideration of the staff report that concluded the Article IV consultation with the Republic of Slovenia.
- A **Statement by the Executive Director** for the Republic of Slovenia.

The document listed below has been or 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 2014 ARTICLE IV CONSULTATION

January 29, 2015

KEY ISSUES

Context: Slovenia is recovering from a profound recession, which culminated in a banking crisis in 2013. Following the recapitalization by the state of the major banks, growth has returned, supported by strong exports and EU funded public investment. Nevertheless, output is below pre-crisis levels, and unemployment remains high. Large deleveraging needs of the private and public sectors weigh on medium-term growth.

Challenges: The balance sheets of banks, corporations, and the state remain vulnerable and are deeply interlinked. Without continued reforms to address these, more losses could materialize, risking renewed financial stress.

Policy priorities: Slovenia needs to reignite the reform momentum to reduce vulnerabilities and boost potential growth. Priorities include the following:

- Address the still high non-performing loans, including through more transfers to the bank asset management company (BAMC), strengthen bank governance, and fully privatize all state-owned banks;
- Restructure the corporate sector by making full use of existing tools, such as the BAMC, whose independence should be safeguarded, and the new debt-restructuring legal framework; further reduce the role of the state in the economy;
- Consolidate the public finances through structural measures and reforms, including of the pension system, to put public debt on a sustained downward path; and
- Implement structural reforms to support corporate restructuring and youth employment and facilitate domestic and foreign investment.

Approved By
Phil Gerson and
Ranil Salgado

The mission took place in Ljubljana from December 2 through 12, 2014. The team comprised Ms. Velculescu (head), Messrs. Dalgıç, Halikias, Lombardo, Jaramillo-Vallejo, Craig, and Garrido, and was assisted at headquarters by Misses. Moraes Rego and Chen. The mission held discussions with Mr. Mramor (Minister of Finance), Mr. Jazbec (Governor of the Bank of Slovenia), other ministers, government officials and representatives of parliament, financial sector, labor, business, academy, and media. Mr. Repanšek (Advisor to the Executive Director) attended most meetings. Mr. Çanakçı (Executive Director) attended the concluding meeting.

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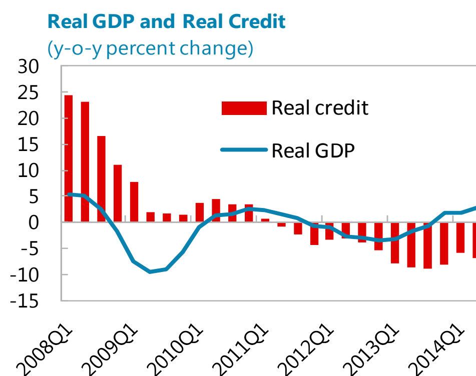
CONTEXT AND RECENT DEVELOPMENTS

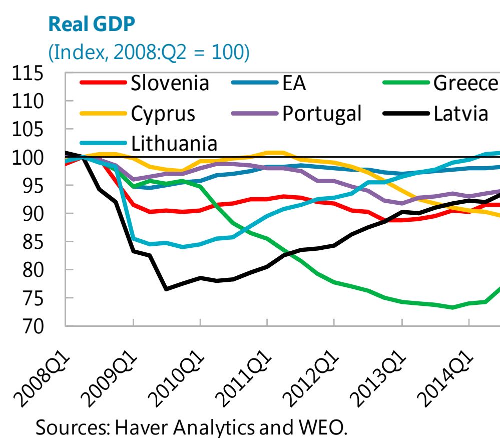
Slovenia is slowly emerging from a deep crisis....

1. **Slovenia experienced a deep crisis, which culminated in a bank bailout in late 2013**. After being hit hard by the global crisis in 2009 through external trade and financing channels, the economy experienced a modest recovery in 2010–11, only to fall back into recession in 2012. Domestic imbalances were largely at play in the relapse, with mounting losses in the highly-leveraged corporate sector leading to rising non-performing loans (NPLs) and a sharp contraction in credit, further fuelling the renewed recession. This raised concerns about the magnitude of bank losses and the sovereign's ability to address them. The state managed to maintain market access after providing substantial support to the banks in 2013 following a bank asset-quality review and transferring part of their NPLs to the state-owned asset-management company (BAMC).



Source: Haver Analytics.

2. **While growth has resumed, output remains below pre-crisis levels.** Economic activity expanded by 2.6 percent (year-on-year) in the first three quarters of 2014, and high-frequency indicators point to continued improvement in the fourth quarter (Figure 1). The recovery has been driven largely by exports and EU-funded public investment. Private consumption is also showing signs of revival, as household balance sheets are relatively strong and confidence, employment, and real wages are gradually rebounding (Figure 2). Private investment, however, remains weak, given that many firms are burdened with high debt (Figure 3). In all, output remains some 8 percent below its pre-crisis peak—among the largest crisis-related losses in the region—and unemployment is still high, at 9½ percent (with youth unemployment at 16½ percent). Inflation fell sharply in 2014, driven by food and energy prices, averaging 0.2 percent.



Sources: Haver Analytics and WEO.

3. **The current account remains in surplus (Figure 4).** The positive balance reached 5.6 percent of GDP in the first three quarters of 2014, slightly below its level over the same period in 2013. This reflects export growth of 6 percent over this period, on the back of improving cost competitiveness. Imports continued to increase, but at a slower pace than exports, leading to a widening of the trade surplus to 8.4 percent of GDP. The income balance, however, registered a deficit, due to higher interest payments on external public debt. In the financial account, large inflows associated with external government-bond issuances were more than offset by repayments of

external liabilities by the banking sector. The net international position was negative 38 percent of GDP at end-June 2014, with external liabilities largely dominated by government and corporate debt.

4. **The cumulative general-government cash deficit reached 5.3 percent of GDP at end-September (Figure 5).** Net of bank-related costs and extra-budgetary funds, the deficit was 3.7 percent of GDP, significantly lower than a year ago (4.9 percent), but still above the 2014 budget target (2.9 percent). The underperformance was due to both higher-than-planned spending on subsidies to some public enterprises and increased absorption of EU funds supporting public investment and to lower tax revenues—mainly as a result of the rejection by the Constitutional Court of the new real-estate tax—which were only partially compensated by one-off non–tax revenues (cell-phone license sales, exceptional SOE dividends, and central bank profit transfers) and tighter spending on goods and services. Relative to 2013, revenues were 6 percent higher, but spending (net of bank costs) was also 4.6 percent higher. Taking advantage of falling yields (Figure 6), the government pre-financed part of 2015 fiscal needs. Public debt was 78.3 percent of GPD at end-June.

5. **The situation in the banking sector has improved over the last year (Figure 7).** Its core tier 1 (CT1) capital ratio stands at 15.3 percent after the recapitalization of four banks in 2013—two of which are being wound down—a fifth partly in 2013 and partly in 2014, and a sixth in 2014 (at a total cost of about 10 percent of GDP for the state). The ECB's recent comprehensive assessment (CA) identified only small additional capital needs for the two largest banks (€65.3 million), which will be covered by profits realized in 2014. After falling by about 6 percent in 2013, deposits increased by 10.8 percent in the first eleven months of 2014 (excluding intra-bank deposits), of which 4.2 and 11.4 percent for household and corporate deposits, respectively. Banks used liquidity, including from recapitalization and sales of assets to the BAMC, to repay debt on the wholesale markets and LTRO liabilities to the ECB and were able to maintain comfortable liquidity buffers through 2014.

6. **Nevertheless, non-performing loans (NPLs) remain high, hampering credit.** System-wide NPLs stood at 13.2 percent of total loans at end-October (and reportedly at 17.5 percent if restructured loans are included), even after gross transfers to the BAMC (of about €5 billion). Corporate NPLs reached close to 20 percent, while household NPLs remained low, at 5.5 percent. Provisioning of NPLs stands at about 60 percent. Credit growth declined by close to 7 percent during December 2013-November 2014 (net of transfers to the BAMC). Corporate loans fell by around 10 percent, reflecting the sector's focus on reducing existing debt, the ability of creditworthy firms to borrow from abroad, but also banks' reluctance to lend, given still tight credit standards. Household loans fell by 1½ percent, although housing loans have recorded small positive growth.

7. **A new government took office in September**. The last three years have been marred by high political instability, with two early elections called and four governments sworn in. The previous government fell in April 2014 due to internal turmoil, but early elections took place only in September, contributing to delays in policy implementation. The current center-left governing coalition, comprised of the recently established party of Prime Minister Miro Cerar, the Social Democrats, and the Pensioners' Party, has broadly endorsed the previous government's reform agenda. It holds a narrow majority in Parliament, and its public support has been eroding recently.

OUTLOOK AND RISKS

… and the growth outlook remains subdued and vulnerable to risks.

8. The recovery is projected to be gradual. It faces headwinds from necessary fiscal consolidation and the corporate sector's need to restructure and reduce its debt. Growth is thus expected to moderate to just under 2 percent in 2015 after reaching an estimated 2½ percent in 2014. Lower oil and commodity prices and a weaker euro this year are expected to support exports and private consumption, while public investment should continue to expand. Private investment is projected to stay subdued, as financing conditions will take time to normalize. Inflation is projected to decline to slightly below zero in 2015, given lower expected energy and commodity prices. Unemployment is set to fall gradually over the medium term.

Selected Macroeconomic Indicators, 2014-2020

	2014	2015	2016	2017	2018	2019	2020
	est.	projections					
Real GDP (percent change)	2.6	1.9	1.7	1.8	1.8	1.8	1.7
Unemployment rate (ILO, percent)	9.7	9.0	8.4	7.8	7.0	6.5	6.0
Consumer price inflation	0.2	-0.2	0.8	1.5	1.5	1.5	1.5
Current account balance	5.5	6.2	5.7	5.3	4.8	4.1	3.5

Sources: Slovenian authorities; and IMF staff calculations and projections.

9. Potential growth remains weak. Staff estimates the output gap to have declined to 2.3 percent for 2014 and expects it to close by 2017. These estimates, however, are subject to high uncertainty, especially given the structural break experienced during the crisis. Potential growth is estimated to reach about 1¾ over the medium term, significantly lower than the pre-crisis average of 3¾ percent. This reflects low capital accumulation, as deleveraging continues and some of the stock was rendered obsolete by the crisis, high structural unemployment eroding human capital, and continued weak TFP trends. By 2020, investment as a share of GDP is projected to remain some 8 percent below its pre-crisis peak, and living standards would only just have returned to pre-crisis levels.

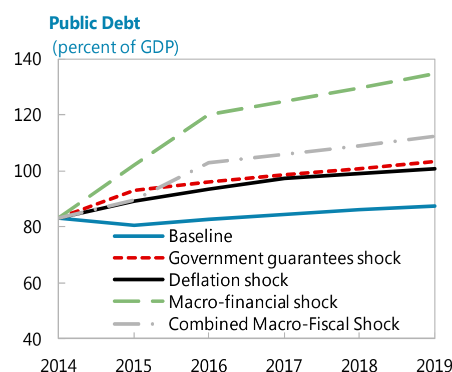
10. The general government deficit (in cash terms, and excluding extra-budgetary entities) is estimated at 6 percent of GDP in 2014. On the basis of end-October 2014 fiscal data, the deficit net of bank-support costs (two bank recapitalizations and repayment of ELA for the banks being wound down) is estimated at 3.7 percent of GDP in 2014. The authorities only implemented about a fifth of the original measures envisaged, relied on one-off measures, and increased public investment spending substantially. As a result, the structural primary balance is estimated to have deteriorated by ½ percent of GDP in 2014.

2014 Fiscal Consolidation Package

	Proposed Measures (Stability Program)	2014 Budget Measures	Implemented Measures
Income tax increase	1.0	0	0
Real estate tax	0.7	0.7	0
VAT increase	0.4	0.4	0.3
Wage cuts	0.2	0.2	0.2
Public investment cut:	0.2	0.2	-0.7
Other one off	0	0	0.6
Total	**2.5**	**1.5**	**0.4**

Sources: Slovenian authorities and IMF staff estimates.

11. Public debt sustainability remains highly vulnerable to shocks (Annex I). On the basis of current policies, the gross debt-to-GDP ratio is projected to continue to gradually increase to just under 90 percent by the end of the decade, raising sustainability concerns. Moreover, public debt dynamics are highly vulnerable to shocks. In particular, the materialization of half of outstanding government guarantees or a prolonged deflation shock could bring debt above 100 percent of GDP by 2019, while a combined growth-primary fiscal balance shock could increase it even further, to close to 115 percent of GDP. A macro-financial shock combining both a deep recession and a renewal of corporate and bank stress (with a fiscal cost similar to that of the recent crisis) would result in an explosive debt path, highlighting the importance of resolute policies to address remaining bank and corporate vulnerabilities.



12. Slovenia's external position is assessed as sustainable. With the current account expected to stay in surplus over the medium term, external debt is projected to decline to just under 95 percent of GDP by 2020, as private sector deleveraging more than offsets the increase in public sector debt. As a result, the international investment position is expected to reach balance from a deficit of about 38 percent of GDP in 2014. Still, external debt dynamics remain vulnerable to shocks, such as a sharp slowdown in growth or a deterioration in the current account (Annex II). Staff's assessment does not point to competitiveness problems, suggesting that the current account and the real exchange rate are broadly consistent with medium-term fundamentals and desirable policies (Annex III).

13. Risks remain tilted to the downside (Annex IV). While immediate domestic risks have been mitigated by the recent bank recapitalization and the government's pre-financing of 2015 external-amortization needs, this could reduce the perceived urgency of reforms, increasing risks of a re-emergence of financial stress in the medium term. Moreover, failure to credibly consolidate the public finances could lead to higher borrowing costs—which could also be affected by renewed stress elsewhere in the euro-area—jeopardizing debt sustainability. The real debt burdens of both the public and private sectors could be exacerbated if deflation persists. The ECB's recent quantitative easing measures are welcome, although they are expected to have only a limited effect on credit growth, given weak demand; while exports could benefit from a weak euro and financing conditions for the government could ease, this may also diminish incentives for reform. On the external front, a more pronounced slowdown in the euro-area or an intensification of geopolitical tensions around Ukraine, could weigh on exports.

14. The authorities shared staff's views on the outlook, but saw lower risks. The official growth forecast has been revised upward for 2014–16 on account of the stronger-than-anticipated momentum. In its December forecast update, the Institute for Macroeconomic Analysis and Development (IMAD) foresees growth at 2 percent in 2015 and 1.7 in 2016. The authorities estimated a somewhat lower fiscal deficit outturn for 2014 and the medium term, which was seen to enable stabilization of the debt level at a lower level than that projected by staff. They shared staff's

assessment of external stability. While they agreed that external risks to the outlook remain elevated, they considered that domestic risks are on the upside as a result of reform implementation.

POLICY DISCUSSIONS

Policies need to focus on reducing vulnerabilities and boosting potential growth.

15. The authorities took steps to address the crisis in 2013, but policy implementation slowed in 2014. The bank recapitalization (largely undertaken in 2013) and transfer of some NPLs to the BAMC during 2014 reduced uncertainty in the financial sector, but NPLs are still high. The reform of the insolvency regime in 2013 put in place conditions to facilitate corporate-debt restructuring; however, restructurings have just begun, and the sustainability of some restructured loans appears questionable. The authorities took measures to consolidate the public finances during 2013–14, including through steps to reform the pension system, but the quality of fiscal adjustment weakened considerably in 2014. Finally, although the authorities have announced plans for a substantial privatization effort, only three small privatizations have been completed to date. The slow pace of reform implementation reflects, partly, the high political uncertainty during 2014.

Policy Actions since the 2013 Article IV Consultation

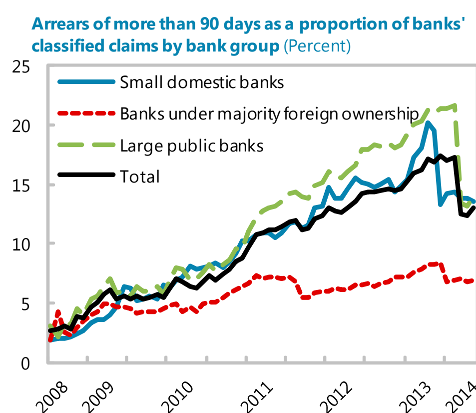
Article IV Recommendations	Policy Actions
Banking Sector	
• NPLs: Deal with banks' impaired assets, including through additional transfers to BAMC. • Governance: Improve governance and risk management. • Consolidation and privatization: Merge entities and divest state-owned banks.	• NPLs: The asset transfers to the BAMC envisaged in late 2013 have now been completed. No additional transfers were made. • Governance: N/A. • Consolidation and privatization: A merger of two banks is in process; no banks have been privatized.
Corporate Sector	
• Facilitate debt restructuring and equity injections. • Reduce state involvement and improve governance.	• Restructuring have started, but they remain few, and largely focused on extension of maturities. • The new Slovenia Sovereign Holding Company was established to manage all state assets.
Fiscal Policy	
• 2014: Take additional structural measures of 1 percent of GDP relative to those in the approved 2014 Budget. • 2015: Improve the structural primary balance by ¾ percent of GDP in 2015. • Medium-term: Take measures of ¾ percent of GDP in 2016 to achieve a primary fiscal surplus of 3 ½ percent of GDP and reform the pension system.	• 2014: Budget measures were further diluted, and replaced with one offs. No additional permanent measures were taken. • 2015: The revised budget (yet to be approved) includes structural measures estimated at 0.7 percent of GDP. • Medium-term: No measures contemplated; a new fiscal rule law—specifying the path toward the MTO —is yet to be implemented.
Structural Reforms	
• Labor marked: Further reduce employment protection in permanent contracts. • Business environment: Privatize and reduce red tape.	• Labor marked: N/A. • Business environment: Three companies were privatized.

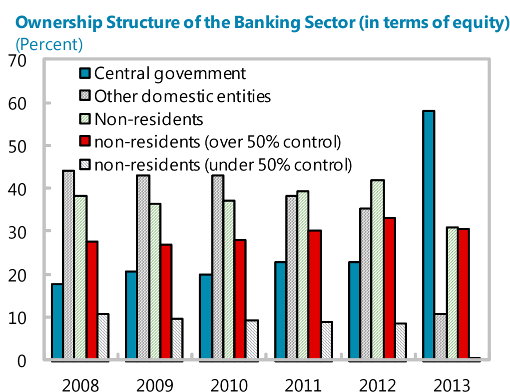
16. Reigniting the reform momentum is essential to mitigate still high risks and support sustainable growth. Despite the policy actions taken so far, the balance sheets of banks, corporations, and the state remain vulnerable and deeply interlinked. Without continued reforms to restructure the banks and the corporate sector, strengthen their governance, and significantly reduce the role of the state in the economy, more losses could materialize, risking renewed financial stress. These reforms and associated confidence effects could also help facilitate the transmission of monetary policy and alleviate deflation risks. In addition, maintaining fiscal sustainability requires a credible fiscal consolidation strategy underpinned by structural reforms, including of the pension system. Finally, further structural reforms of labor markets and the business environment are needed to support corporate-sector restructuring, and diversify the sources of growth to strengthen the economy's resilience against external shocks.

A. Financial Sector

Better asset quality and governance are keys to strengthening the health of the banking sector

17. Banks' weak asset quality and governance impede their ability to support the economy. The high level of NPLs—three to four times as high as pre-crisis levels system-wise, and even more at state-owned banks—is a drag on banks' cash flow and profitability, limiting their capacity to generate credit. Indeed, close to half of new lending reportedly financed NPL restructurings, most of which represented an extension of maturities of large and connected clients, with a third of restructured loans already under renegotiation (Box 1). In addition, as the state now owns more than 60 percent of the banking sector, the risk of political interference in lending decisions remains substantial. Although the authorities have committed to privatize the state-owned banks, the process could be prolonged, given strong vested interests. Moreover, another bank is still in need of capital, while the merger of two banks and resolution another two are yet to be finalized.





Source: 2014 Financial Stability Report, Bank of Slovenia.

18. Banks need to address their NPLs decisively. A two-pronged strategy can help maximize effectiveness:

- ***For large corporate NPLs***—which are highly concentrated, with 50 corporates accounting for a third of total NPLs[1]—transferring all large exposures to the BAMC would help offload NPLs from banks' balance sheets. In line with current restructuring plans, only about half of corporate NPLs were transferred to the BAMC, suggesting further room to do so. While more transfers will likely result in a higher public debt in the short run, BAMC's centralization of the workout process and its longer time horizon can help maximize returns for the taxpayer and lead to a reduction in debt in the long run, while allowing banks to focus on new lending to the economy rather than on caretaking of existing exposures. Using the recent bank asset-quality reviews as a valuation basis for the transfers can help ensure banks' capital neutrality, although approvals from the European Commission would still be required and may take time. If large corporate NPLs are maintained on banks' books, all available legal tools should be used to achieve efficient and sustainable loan restructuring agreements with viable companies, including through debt-to-equity swaps. The Central Bank of Slovenia (BoS) should closely monitor banks' operational capacity and progress toward reducing corporate NPLs against set targets, including through a framework assessing the sustainability of restructurings.
- ***SME NPLs***—which represent about 40 percent of corporate NPLs—need to be dealt with through the banks' internal restructuring units, given the large number of clients involved. However, only a few SME restructurings have reportedly taken place to date. With SMEs playing a key role in the economy (representing 63 percent of value added and 73 percent of employment in the business sector),[2] addressing the indebtedness of a critical mass of SMEs can help lay the foundation of a more robust and sustained recovery.[3] To do so, the BoS will need to enhance its supervisory tools, such as by developing a framework for voluntary negotiations including simplified debt-restructuring options (differentiated based on a few criteria, such as size, indebtedness and ability to generate cash-flow), which could be used by banks readily, while remaining within provisioning margins. Care needs to be taken to minimize incentives for strategic default and to ensure that both creditors and debtors have adequate incentives to negotiate and to take advantage of potentially mutually beneficial outcomes, including by strengthening the implementation of the insolvency regime (see below). BoS should set ambitious SME restructuring targets and monitor progress against them.

19. Bank governance should be strengthened, and the state's role in credit intermediation curtailed. Lax governance and pervasive connected lending were at the root of the recent banking crisis and resulted in large fiscal costs. To avoid further taxpayer costs, state-owned banks should be

[1] Bank of Slovenia, 2014 Financial Stability Review, Box 6.4.

[2] According to the European Commission's "2014 SBA Fact Sheet."

[3] Evidence suggests that countries with a higher prevalence of SMEs tended to recover more slowly from the global crisis (see IMF WP/14/98).

insulated from political pressures and/or interference. All state-owned banks should thus be privatized as soon as possible. In particular, the authorities need to make good on their commitment to privatize the second largest bank (NKBM) in 2015, and sell in full (rather than only in part) the largest bank (NLB); given that a partial privatization of the latter had already been tried in the past and proved inadequate to ensure either proper governance or capitalization, this should be avoided. The authorities need to add the other state-owned banks (after completing planned mergers) to the privatization list. In the meantime, a governance relationship framework between the banks and the relevant state agency (as the shareholder) should be put in place ensuring these banks' independent management, including appropriate operational performance targets and transparent and strong accountability.[4] Even after privatization, maintaining adequate bank governance is essential to safeguarding financial stability.

20. The bank recapitalization and restructuring process needs to be finalized. The authorities have granted a new extension (to mid-2015) to one of the banks identified as undercapitalized in late 2013, following remedial measures taken in the interim to minimize the identified shortfall. To safeguard financial stability, they will need to closely monitor the bank's efforts to raise capital and stand ready to address any remaining shortfalls in a transparent manner, while minimizing fiscal costs. Moreover, the wind-down procedures for the two banks intervened in September 2013 need to be completed as soon as possible. Mergers of smaller nationalized banks can help attract strategic investors, but care should be taken to prevent concentration and enhance competition. Finally, banks should be encouraged to focus on core lending activities, including by continuing to divest non-core operations and selling corporate-equity stakes in due course.

21. The authorities need to continue to improve the monitoring and management of macro-financial risks. With the Single-Supervisory Mechanism (SSM) now in effect, supervision is expected to be strengthened as standards are brought in line with international best practice. In particular, resolution mechanisms need to be aligned with the new pan-European framework and the BoS's operational capacity strengthened to enable it to intervene and resolve banks promptly. In addition, the authorities should speed up implementation of a centralized-credit registry, especially given the widespread practice of firms to borrow from multiple banks. The BoS should also develop a comprehensive system to monitor connected lending, which has been pervasive in the past. Finally, the authorities should review the various administrative and macro-prudential tools introduced during the crisis,[5] whose usefulness appears limited. In particular, there seems to be scope to eliminate the deposit-rate cap and to simplify the complex loan-to-deposit growth instrument, as well as to consider introducing a cap on loan-to-value ratios on all assets, including those purchased through leveraged buy-outs, to prevent overleveraging in the future.

22. The authorities agreed that addressing NPLs and strengthening governance are key priorities. They saw that results from restructuring efforts are starting to materialize and expected

[4] An example is Ireland's Relationship Framework between state-owned banks and the Ministry of Finance.

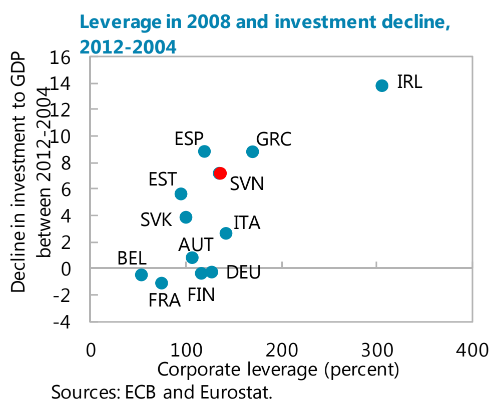
[5] See Box 6.1 of the 2014 Financial Stability Review by the Bank of Slovenia.

NPLs to gradually decline as a result. They concurred with the need to monitor progress in this regard, and noted that proposed innovations in the supervisory toolkit may need to be discussed and agreed with the SSM. The authorities considered that additional transfers to BAMC are not needed, as BAMC was seen to hold a critical mass of exposures, and any other transfers could add to the short-run debt level and take substantial time due to the need to secure approvals from the European Commission. While they agreed that bank governance should be strengthened and reiterated their commitment to sell NKBM bank in 2015, they intend to maintain a blocking minority stake in NLB. The authorities aimed to complete remaining bank recapitalization and restructuring processes this year. They expressed a slight preference for maintaining existing administrative and macro-prudential tools.

B. Corporate Sector

Corporate restructuring and improved governance are needed to boost investment and growth

23. High corporate sector indebtedness and weak governance weigh on growth. Although the corporate debt-to-equity ratio has fallen in recent years, it remains higher than its pre-crisis average and the level of peers. Deleveraging will continue to hamper investment and employment, unless corporate restructuring effectively lowers debt and/or equity increases.[6] But restructurings have been limited so far, and the sustainability of some bank-led multilateral restructuring agreements is questionable, reflecting strong vested interests and bottlenecks in the implementation of the new insolvency legal framework (Box 1). Moreover, prospects for increasing firm equity are dim, given a shallow equity market, limited domestic liquidity, and Slovenia's poor record in attracting FDI. Weak corporate governance compounds the sector's problems, with prevalent direct and indirect state control and complex corporate structures distorting decision-making and hampering efficiency.



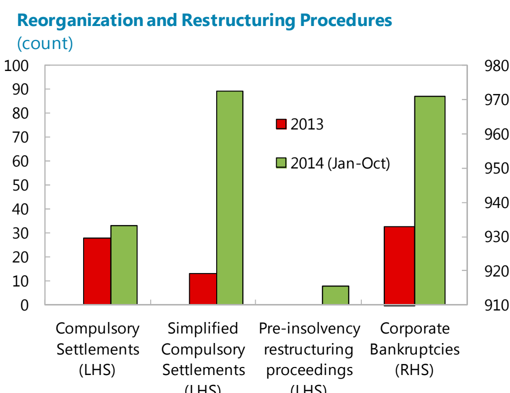
Sources: ECB and Eurostat.

Sources: OECD.
1/ Index of state ownership in large companies, 6 highest, 0 lowest.

[6] See Zakharova, Dalgic, and Lombardo, 2014, "Reviving Credit Growth for Strong and Sustainable Recovery," The Journal of Money and Banking of Slovenia Banking Association, vol. 63, No. 11, November 2014.

Box 1. Corporate Debt Restructuring

Corporate restructuring has begun, but is proceeding only slowly. Following the 2013 reform of the insolvency framework, creditors and debtors have more options to address corporate indebtedness. As a result, during 2013–14, about 30 compulsory settlements were completed per year. Simplified compulsory settlements also increased from 10 in 2013 to 90 in 2014. And in 2014, some 8 pre-insolvency restructuring proceedings were concluded for the first time in Slovenia. By comparison, corporate bankruptcy procedures remain widespread, amounting to close to 1000 per year in 2013–14, double their level in 2012.



Source: Ministry of Justice.

For large corporates, restructurings are occurring through two main channels:

- **BAMC**: As of end-September 2014, it received 616 corporate NPLs, with a gross value of €3.5 billion, for which BAMC paid €1.5 billion in bonds (reflected in public debt). Of these, a sixth was assessed as potentially viable and is being restructured, while the rest is in recovery proceedings. Of the restructuring cases, fifteen cases (about €1 billion gross value) are reportedly completed or at an advanced stage. A third of these are being dealt with through compulsory settlement and a few through preventive restructuring. In other cases, orderly bankruptcy proceedings were required to separate viable from non-viable operations, with the viable part successfully leased to investors. The BAMC has also been working with the banks on voluntary MRAs (see below). It recovered €94 million from sales of non-viable NPLs received so far, most of which had already been in bankruptcy proceedings.

- **Bank-led Multilateral Restructuring Agreements (MRAs):** These are based on agreed restructuring guidelines on the basis of key principles, including: (i) keeping the restructuring voluntary; (ii) applying to debtors with more than one financial creditor; (iii) assigning a lead bank to coordinate all creditors; and (iv) a commitment by creditors to allow for a standstill pending the restructuring negotiations. So far, 36 MRAs have been initiated, of which 30 were concluded. The 36 MRAs represent gross exposures of €2 billion, or about a fifth of excessive leverage in the economy.[1] Of the total cases, 6 involve compulsory settlements and 4 are preventive restructurings under the new legal framework. Negotiations are often complex, involving multiple creditors (9 banks, on average, although in some cases, 15 or more banks were involved). The BAMC has been involved in 16 of the MRAs, of which 4 have included debt-to-equity swaps (representing 10 percent of all MRAs).

The sustainability of some corporate restructurings under MRAs is questionable. The vast majority (90 percent) of bank-led restructurings under MRAs involve a re-profiling of debt, rather than representing a reduction of corporates' debt burden relative to their capacity to generate income. In fact, in a third of the signed agreements, additional financing or guarantees were provided by the banks. And a third of concluded agreements are being renegotiated.

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[1]Excessive leverage is debt in excess of debt-to-EBITDA ratios of 5. See Jože P. Damijan, "Corporate financial soundness and its impact on firm performance: Implications for corporate debt restructuring in Slovenia."

24. The BAMC should play a leading role in corporate restructuring. International evidence suggests that asset-management companies (AMCs) can effectively centralize and coordinate the workout of distressed debt, as they can achieve economies of scale, unify workout practices, break corporate-bank links, and concentrate the ownership of collateral, thus enhancing leverage over debtors. Successful cases highlight the vital role of a strong legal framework, independence from political interference, and professional and highly skilled management and staff.[7] Maintaining these conditions in place, in particular safeguarding BAMC's independence from political interference, is essential to achieve sustainable debt-restructuring solutions and maximize taxpayer returns. Indeed, BAMC has started to show results (Box 1) and its efforts will need to accelerate.

25. The operational effectiveness of the insolvency framework should be increased. The recent reform of the framework has brought it closer in line with international best practice. Although some legal weaknesses remain, given frequent changes to the law in recent years, further modifications would be unwelcome at this point, as maintaining a stable and predictable framework is key to fostering debt-restructuring agreements The authorities should focus on strengthening the implementation of existing tools, which are hampered by capacity constraints and other operational bottlenecks (see Selected Issues Paper *"Legal and Institutional Challenges in Corporate Insolvency"*). The capacity of the judiciary and the professionalism of bankruptcy administrators should be enhanced, including through adequate appointment and remuneration systems and proper supervision and accountability. The corporate-insolvency framework should also be supported by a more efficient mortgage-enforcement regime, which would facilitate credit and help underpin debt-restructuring efforts. Finally, the authorities could consider tax measures to incentivize debt restructuring and, over the medium term, could consider simplifying and further strengthening the legal framework.

26. Corporate governance needs to be strengthened. To facilitate corporate restructuring and attract much needed equity, corporate governance standards should be brought in line with best practice by enhancing the accountability of directors, the protection of investor rights, and auditing and reporting standards and practices. The authorities should also ensure that the recently-established Slovenia Sovereign Holding Company (SSH) remains professional and independent and maintains an appropriate governance framework ensuring management of state assets on commercial criteria, with clear objectives and accountability.

27. The authorities should step up privatization efforts. Slovenia has been slow to privatize compared to its peers, which has contributed to governance problems and led to inefficiencies. Well-designed and implemented privatization can bring in fresh capital, including FDI, and related technological and managerial know-how, fostering competition and leading to better quality at lower prices. It can also help reduce public debt. The authorities should thus intensify efforts to divest the remaining twelve companies slated for sale, while avoiding fire sales. A few early and successful sales

[7] Such cases include the Finnish and Swedish AMCs established in the early 1990s. See Klingebiel , Daniela. *The use of asset management companies in the resolution of banking crises: cross-country experience*. No. 2284. World Bank, Financial Sector Strategy and Policy Group, 2000.

(such as of the telecom company and NKBM, expected this year) can send a strong signal to the markets about Slovenia's commitment to privatization and openness to FDI. The strategy for remaining state assets should be finalized, with the aim to divest all non-strategic ones.

28. The authorities concurred that reducing corporate debt overhang is a priority. They agreed that the BAMC can play a key role, but noted that its independence also comes with obligations to maintain transparency and accountability. In this regard, they suggested that remuneration may need to be lowered and governance changed to achieve balance in its board (now majority foreign). The authorities saw positively the reformed insolvency framework, which is facilitating MRAs, but agreed that capacity bottlenecks need to be addressed. They reiterated their commitment to privatize companies slated for sale, formulate a strategy for other state-owned assets, and ensure an independent professional board of the SSH.

C. Fiscal Policy

Fiscal consolidation underpinned by structural reforms is key to ensuring debt sustainability

29. The authorities are planning additional measures this year. The authorities' revised budget, to be adopted in February, includes additional measures aiming at reducing the overall deficit (ESA2010 terms) below the EDP target of 3 percent of GDP while protecting public investment. Staff has a somewhat more conservative estimate of potential savings from the measures, as some have been diluted since being proposed, while others do not appear well specified. On this basis, but also given the expiry of one-offs from 2014, staff projects a general government deficit (cash terms, not including broader public sector entities) of 4 percent of GDP in 2015. Depending on cash-accrual adjustments and developments in the broader public sector, there is a risk that the authorities' EDP target (ESA2010 terms) may not be achieved, which could jeopardize policy credibility.

2015 Fiscal Measures (in percent of GDP)

	Yield (authorities)	Yield (staff)
Revenue measures	**0.4**	**0.2**
Tax student work	0.2	0.2
Tax fin. serv.	0.1	0.1
Environmental tax	0.1	0.0
Increased collection efficiency	0.1	0.0
Spending measures	**1.4**	**1.0**
Public sector wage cuts	0.6	0.4
Cuts goods&serv spending	0.5	0.2
Pension bonus and insurance	0.1	0.1
Cuts in subsidies	0.1	0.1
Cuts in capital spending	0.1	0.1
Total measures	**1.9**	**1.2**
o/w permanent		0.7

Sources: MoF and staff estimates.

30. Without further structural fiscal adjustment, both the medium-term objective of a balanced budget and debt sustainability would be jeopardized. On the basis of current policies, staff projects about 3¾ percent of GDP in further measures will be required to reach a balanced budget in the medium term, as committed to under the Stability and Growth Pact (SGP). Moreover, without further adjustment, debt is projected to increase to close to 90 percent of GDP by 2020, raising sustainability concerns. Vulnerabilities also arise from large maturities (some 12 percent of GDP) coming due in 2016 and sizeable government guarantees (18 percent of GDP), which are concentrated in a few public entities. Finally, population aging will boost pension costs beyond 2020; left unaddressed, they would lead to an explosive debt path.

Fiscal indicators
(percent of GDP)

	2013	2014	2015	2016	2017	2018	2019	2020
				Baseline				
General government balance	-13.8	-6.0	-4.0	-3.5	-3.5	-3.6	-3.6	-3.7
Net of bank restructuring	-4.3	-3.7	-4.0	-3.5	-3.5	-3.6	-3.6	-3.7
Overall structural balance	-2.2	-3.5	-2.9	-3.4	-3.5	-3.6	-3.7	-3.7
Primary balance	-11.5	-2.9	-1.0	-0.3	-0.1	0.1	0.1	0.1
Structural primary balance	0.1	-0.4	0.1	-0.2	-0.2	-0.1	0.0	0.0
Public debt	70.0	83.2	80.5	82.9	84.4	86.0	87.6	89.3
				Staff-recommended scenario				
General government balance	-13.8	-6.0	-4.0	-2.6	-1.8	-1.0	0.0	0.0
Net of bank restructuring	-4.3	-3.7	-4.0	-2.6	-1.8	-1.0	0.0	0.0
Overall structural balance	-2.2	-3.5	-2.3	-2.0	-1.4	-0.6	0.0	0.0
Primary balance	-11.5	-2.9	-1.0	0.7	1.6	2.5	3.6	3.6
Structural primary balance	0.1	-0.4	0.7	1.1	1.9	2.8	3.6	3.6
Public debt	70.0	83.2	80.5	82.2	82.0	80.9	79.0	76.7

Sources: Slovenian authorities, and IMF staff estimates.

31. To enhance the durability of the adjustment, the authorities could target a somewhat more ambitious structural improvement in 2015. Structural measures of around 1.2 percent of GDP—corresponding to an improvement in the structural balance of about 1 percent of GDP—can help strike a balance between short-run cyclical and long-run sustainability concerns. This would imply replacing some ½ percent of GDP of proposed temporary measures with permanent ones. Measures could include better targeting of social transfers and subsidies to ensure that those most vulnerable are protected, while reducing abuse in the system. Indeed, the crisis has led to an increase in the risk of social exclusion relative to the pre-crisis period.[8] The authorities could also consider reducing the tax preferential treatment for pensions and the pensioner-specific social benefits (while ensuring that low-income pensioners are adequately covered by the safety net), which would also help mitigate long-run population aging costs. Plans to protect public investment through absorption of EU funds should be maintained, as they are supportive of growth.

32. The deficit reduction needed to put debt on a sustained downward path should be undertaken gradually to help minimize risks to the recovery while ensuring policy credibility. An adjustment of ¾ percent of GDP per year over 2016–19 would be required to reach structural balance (and an overall primary surplus of around 3.3 percent of GDP) by 2019. This would bring debt down to around 77 percent of GDP by 2020, close to the 2013 level, but still more than three times its pre-crisis level.

- ***On the revenue side***: Redesigning and adopting a real-estate tax next year in line with the constitution would not only help boost revenues, but would also promote social and inter-generational equity by ensuring an adequate sharing of the tax burden based on wealth. Broader tax reforms could help to address the erosion in the tax base by revisiting income tax exemptions as the economy recovers and remove tax distortions favoring debt over equity financing.
- ***On the spending side***: The authorities should pursue further pension reforms, including the measures noted in ¶19, as well as moving to indexation of benefits to prices and reducing

[8] See IMAD "Slovenian Economic Mirror," October 2014, No. 10, Vol XX.

remaining incentives for early retirement (see Selected Issues Paper "*Social Spending Reform and Fiscal Savings in Slovenia*"). Early adoption can help to minimize costs. Furthermore, the planned health expenditure review is an opportunity to modernize the sector and achieve efficiency savings. More broadly, a public administration review and reform could help reduce inefficiencies and costs while maintaining the quality of public services. Putting in place a system of monitoring government guarantees that is integrated into the overall debt-management strategy can help reduce fiscal risks.

33. Fiscal credibility would also be enhanced by implementing a fiscal rule. The authorities have drafted legislation implementing the new EU fiscal framework by introducing expenditure ceilings consistent with the EU's minimum recommended structural adjustment of ½ percent per year, while providing flexibility in exceptional circumstances, and setting up an independent Fiscal Council. As noted above, they should aim for a more ambitious medium-term structural adjustment to reach the medium-term objective in a well-specified and realistic timeframe. This is a key to enhancing predictability and safeguarding the credibility of fiscal policy and debt sustainability. Specification of automatic corrective mechanisms to deal with unforeseen deviations and with large shocks impacting the fiscal accounts would also help.

34. The authorities had a more sanguine view of short and medium-term fiscal prospects. They were confident that the new fiscal measures (which they estimate to have a higher yield than staff expects), together with large and positive cash-accrual adjustments and substantially improved financial outturns of extra-budgetary entities would be sufficient to attain the 2015 EDP target. Moreover, they considered that a pace of fiscal adjustment of ½ percent of GDP per year would be appropriate from a cyclical perspective, while being sufficient to meet their SGP targets in the medium term. They agreed that further adjustment should be supported by structural reforms, but did not see an urgency to implement the real-estate tax and pension reforms.

D. Structural Reforms

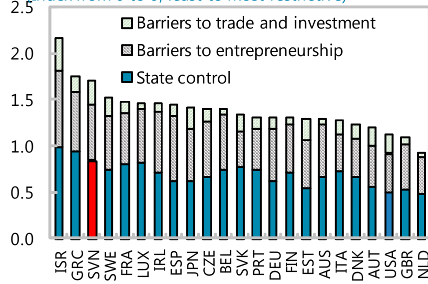
Structural reforms can help support corporate restructuring, jobs, and growth

35. Structural bottlenecks hinder investment and growth (Figure 8). In the labor market, the 2013 reform reducing severance payments and notice periods has led to an increase in the share of new contracts that are open-ended.[9] Yet, the number of temporary contracts remains large and is among the highest in the EU, discouraging job-specific investment in human capital, which is especially problematic for the youth. In addition, following a 23 percent minimum-wage increase in 2010, the wage structure is highly compressed, which also affects employment negatively and limits productivity. Entry barriers in restricted professions further constrain employment

[9] See "Labor market performance and challenges during the crisis", in IMAD *Economic Issues 2014*, June 2014.

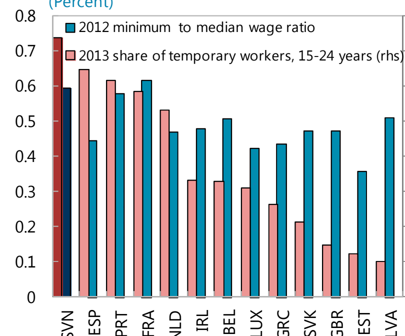
opportunities, despite some recent liberalization.[10] Finally, restrictive product market regulations and red tape hinder competition, investment, and FDI.

Economy-Wide Product Market Regulations, 2013 1/
(Index from 0 to 6; least to most restrictive)



Source: OECD.
1/ 2013 data is missing for USA. 2008 vaules are used instead.

Minimum Wages and Temporary Work
(Percent)



Sources: Eurostat and OECD.

36. Further labor and service-market reforms can help boost long-term youth employment. Such reforms are also key to facilitating the reallocation of labor across firms and sectors, supporting corporate restructuring and boosting long-run productivity. Building on the 2013 reform, the authorities should take further steps to reduce the protection of open-ended contracts, in particular on collective dismissals, where Slovenia still lags the OECD average.[11] Active labor market policies can also be better focused on providing the skills required by changing economic conditions. Additionally, reducing wage compression, for example through slower indexation of minimum wages, can help boost employment and reward (and retain) strong performers. And closed professions should be further liberalized.

37. Other institutional reforms can help spur domestic and foreign investment. Streamlining procedures and regulations (e.g., easing rules for registering or selling property, simplifying requirements for foreign trade, cutting barriers to business development, and eliminating red tape related to the granting of construction permits) can help attract fresh capital in the economy, including from abroad. To boost long-run growth and innovation, education curricula can be better aligned to the needs of the economy, and cooperation between universities and industry strengthened. Bringing the institutional environment in line with best practice could have a significant impact on growth (with the upside estimated at up to 2-2¾ percentage points), and carefully prioritizing reforms can maximize their impact (see Selected Issues Paper "*Prioritizing Structural Reforms to Support the Recovery*").

38. The authorities concurred with the need to strengthen institutions to boost jobs and growth. However, they considered that the 2013 labor market reform, together with recent measures to increase payroll taxes on student work, are sufficient to reduce discrepancies between temporary

[10] According to the European Commission's *Member States' Competitiveness Report 2014*, there are still 262 regulated professions.

[11] Reforms reducing the gap between the protection of permanent and temporary contracts have been found to support youth employment. See Banerji et al., (2014) "Youth unemployment in Europe: Searching for Solutions."

and permanent contracts. The authorities agreed that there is further scope to improve the business environment and noted that they have recently integrated plans from various ministries into a single reform strategy aiming, inter alia, at reducing the administrative burden by 25 percent.[12]

STAFF APPRAISAL

39. Slovenia is recovering from a profound recession. The economy was hit hard by global developments, which, combined with domestic imbalances, culminated in a banking crisis in 2013. The authorities responded by providing significant state support to the banks and implementing measures to facilitate corporate-debt restructuring and bolster the public finances. As confidence returned and external conditions improved, activity rebounded last year, supported by strong exports and EU-funded public investment.

40. But the legacies of the crisis weigh on the outlook. Output remains well below pre-crisis levels, and unemployment is still very high. Bank NPLs remain excessive, also reflecting the over-indebtedness of the corporate sector, hampering investment and job creation. And the public finances are strained, as the large bank recapitalization costs boosted the deficit and debt, placing a heavy burden on future generations of taxpayers. As a result, the growth outlook remains subdued and the economy is still vulnerable to shocks.

41. Resolute policy action therefore remains of the essence to reduce vulnerabilities and boost growth. With the balance sheets of banks, corporations, and the state still weak and deeply interlinked, continued comprehensive reforms are needed to strengthen the economy's resilience to shocks, improve the monetary transmission mechanism, and pave the way for sustainable long-term growth. Policy complacency, on the other hand, could lead to more losses down the road, risking renewed financial stress.

42. A key policy priority is to address NPLs decisively and strengthen bank governance. The authorities should take steps to ensure more active use of transfers to the BAMC, as these are a critical element of any strategy to reduce large corporate NPLs. For SMEs, guidelines for voluntary negotiations including simplified debt-restructuring options could help promote work-outs for viable firms. The supervisory authorities should monitor banks' operational capacity to deal with NPLs, set ambitious targets, and monitor progress toward these. Bank governance should be strengthened and state-owned banks (including the largest bank) should be fully privatized as soon as possible, in order to reduce the risk of political interference in credit allocation.

43. Bank restructuring should be completed, and macro-financial risk management strengthened. To safeguard financial stability, any remaining capital shortfalls should be addressed in a timely and transparent manner, while minimizing taxpayer costs. Ongoing wind-down procedures need to be completed. With the SSM now in effect, supervision is expected to be strengthened. Still,

[12] http://www.stopbirokraciji.si/fileadmin/user_upload/mju/English/Publication/Enotni_dokument-22102013_en_final1.pdf.

there is scope to enhance the monitoring of risks, including by implementing a centralized credit registry and a monitoring system for connected lending.

44. Corporate-sector restructuring should accelerate. The BAMC should play a leading role in the restructuring process, to achieve economies of scale and sever corporate-bank links. Safeguarding the BAMC's independence from political interference is essential to maximizing taxpayer returns. The authorities should encourage the use of existing legal tools to restructure the debt of viable companies, including through debt-to-equity swaps. Increasing the operational effectiveness of the insolvency framework can help facilitate this process.

45. Corporate governance should be strengthened, including by speeding up privatizations. Weak governance and pervasive state control in the economy were at the root of the crisis. To address this, facilitate corporate restructuring, and attract much needed equity capital in the economy, the authorities need to intensify privatization efforts, while avoiding fire sales. Strategic state-owned assets should be managed independently, without undue political interference.

46. Another policy priority is to put public finances on a sustainable footing. After the 2014 fiscal targets were missed due to slippages and setbacks, the 2015 budget includes additional consolidation measures to bring the deficit in check. In light of still rising and vulnerable public debt, the authorities could target a somewhat more ambitious structural improvement this year, aiming for an adjustment of about 1 percent of GDP. Additional structural measures of about ¾ percent of GDP per year over the subsequent four years would be needed to reach structural balance and place debt on a sustained downward path by 2020.

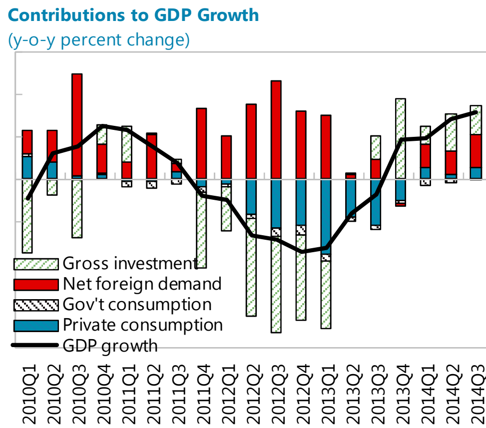
47. Structural fiscal reforms need to underpin the adjustment. Implementation of a new property-tax system in line with the constitution can help boost revenues and enhance inter-generational equity. Comprehensive pension reform is critical to address the large costs of population aging. Further tax reform can help simplify the system, reduce compliance costs, and eliminate biases in favor of debt. And reforms of the health sector and public administration can help reduce fiscal costs and boost efficiency.

48. Other institutional reforms can help support employment and long-term growth. Addressing labor market segmentation by taking further steps to reduce the protection of open-ended contracts can help facilitate labor relocation as the corporate sector restructures, while boosting long-term prospects for youth employment. Improving the business environment, including by cutting red tape, is key to spurring investment, including from abroad. Careful prioritization of structural reforms can maximize their impact on growth.

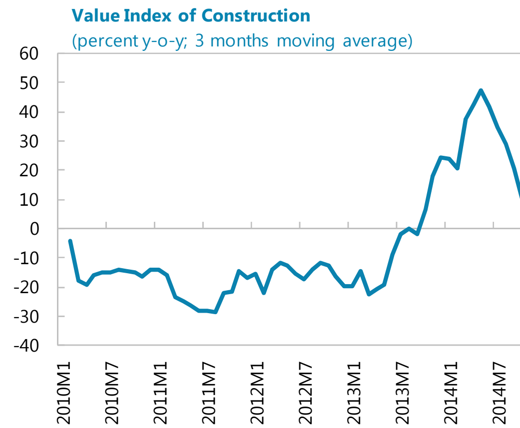
49. It is proposed that the next Article IV consultation be held on the 12-month cycle.

Figure 1. Slovenia: Macroeconomic Developments

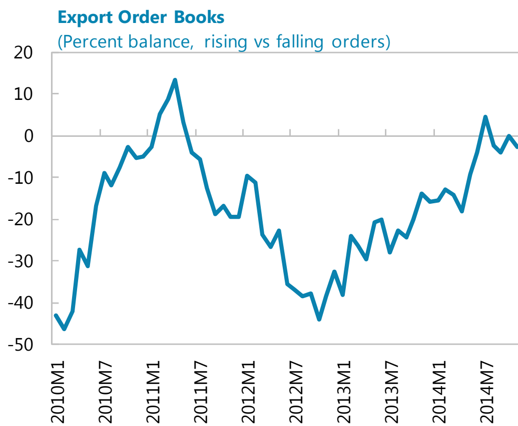
Economic growth resumed since late 2013, on the back of exports and EU-funded public investment…



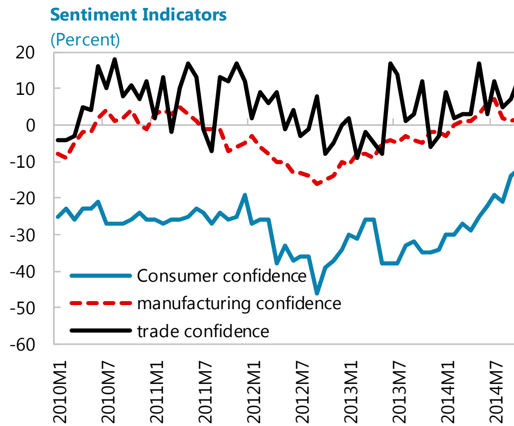
…with construction activity rebounding in 2014.



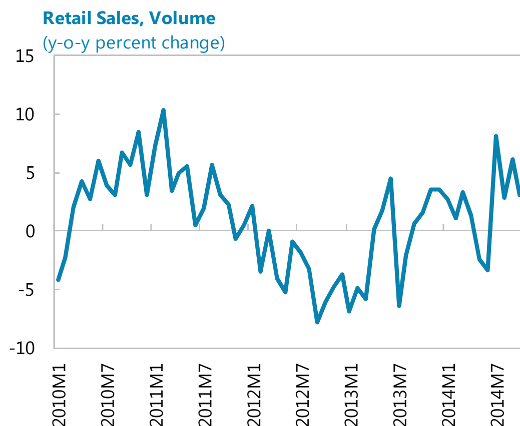
Export orders are so far resilient…



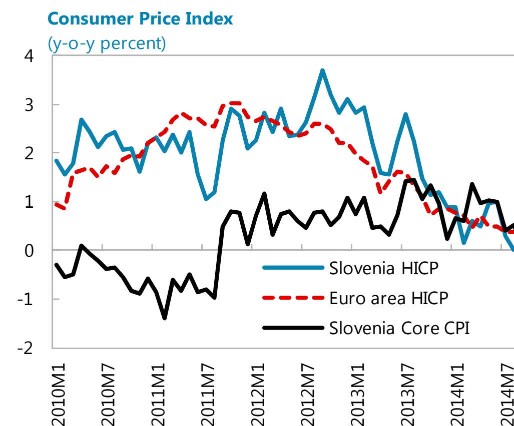
…and confidence has been rising…



…helping boost retail sales.



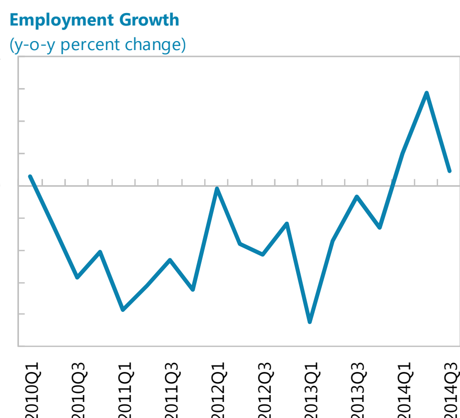
However, inflation has slowed sharply, in line with global commodity prices and euro are trends.



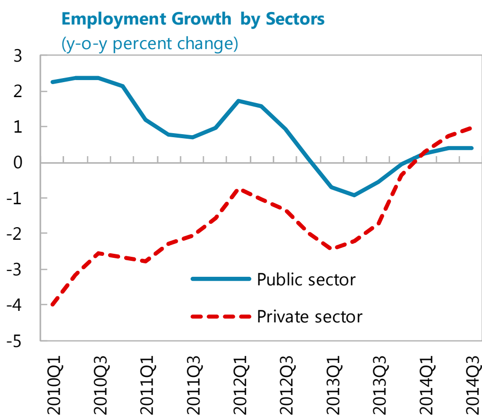
Sources: Bank of Slovenia; Eurostat; Ministry of Finance; Statistical Office of Slovenia; and IMF staff projections.

Figure 2. Slovenia: Labor Market

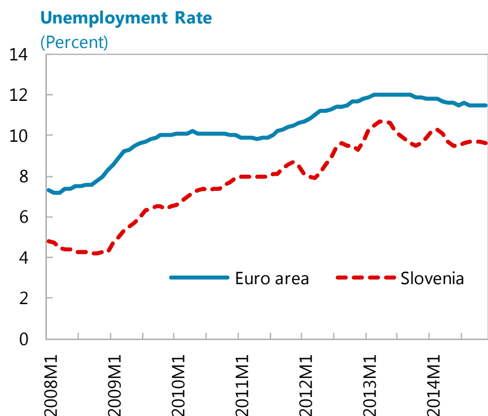
Employment growth returned in 2014...



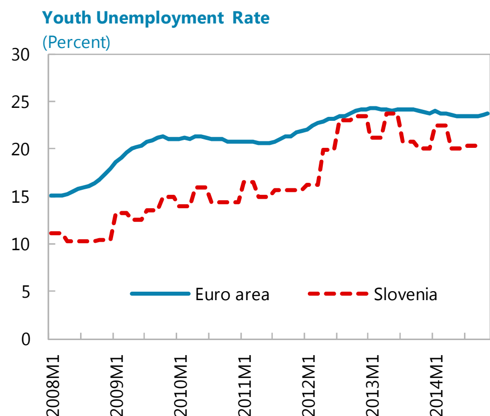
...with modest growth in both the public and the private sectors.



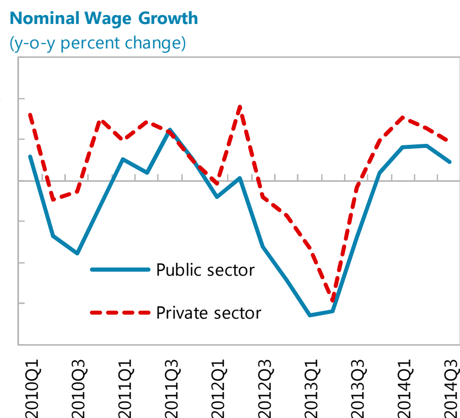
While unemployment has fallen, it remains high by historical standards...



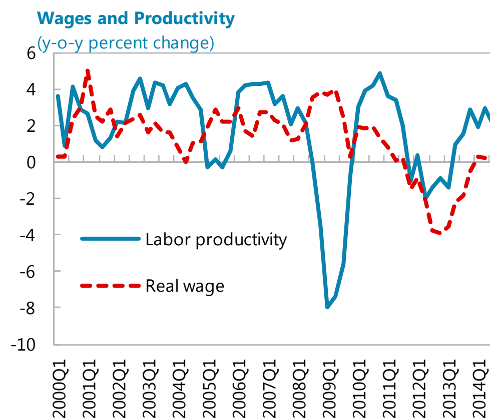
...especially for youth.



Wage growth is positive but subdued..



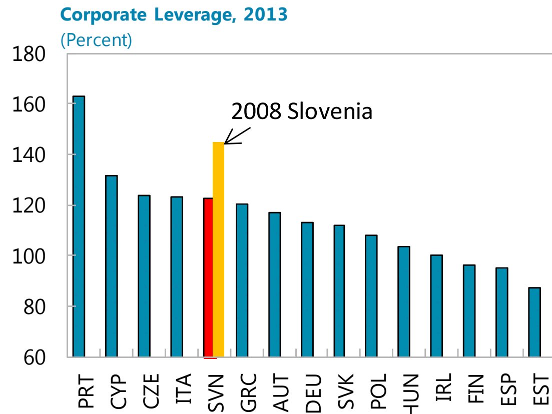
...and remains broadly in line with that of productivity.



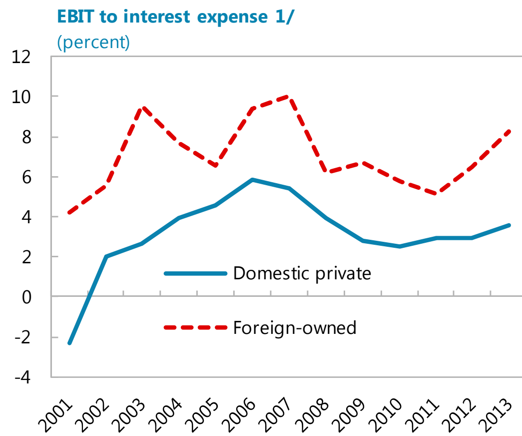
Sources: Bank of Slovenia; Eurostat; Haver Analytics.

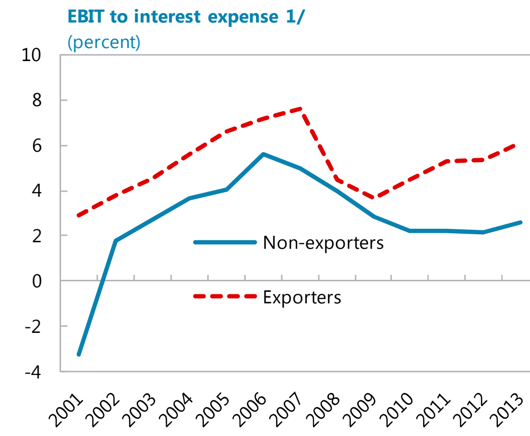
Figure 3. Slovenia: Corporate Sector Developments

While corporate leverage remains high, it is gradually decreasing from its 2008 peak.

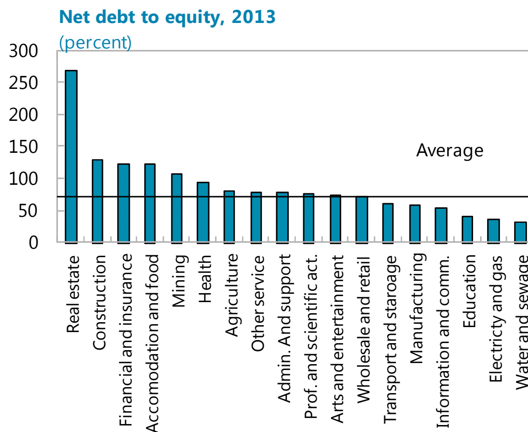


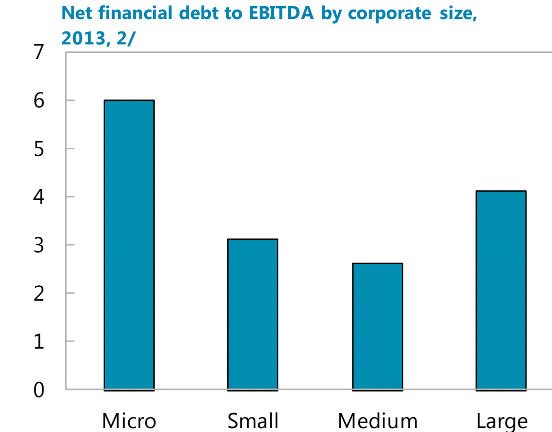
Domestically-owned and oriented firms have low earnings relative to their interest burden.





...with leverage particularly high in real estate-related sectors, and in both large and micro-sized firms.

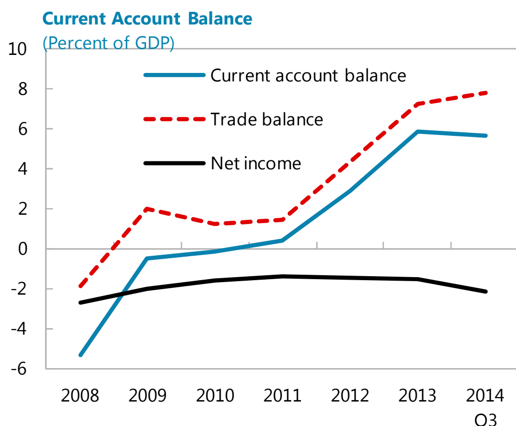




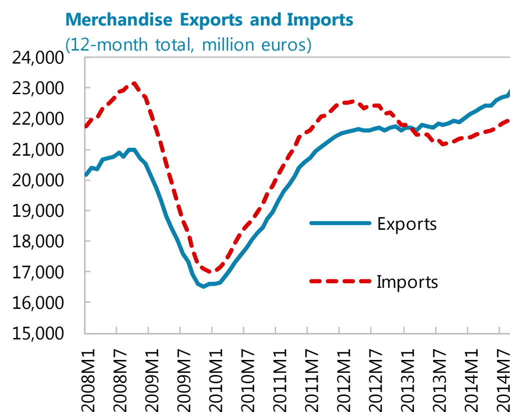
Sources: AJPES, and IMF and BoS staff calculations.
1/ EBIT stands for earnings before interest and taxes.
2/ EBITDA stands for earnings before interest, taxes, depreciation, and amortization.

Figure 4. Slovenia: External Sector Developments

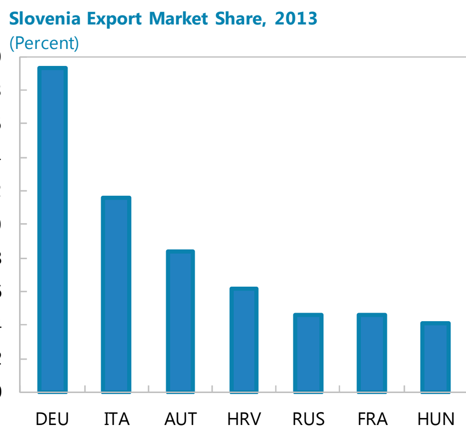
The current account continued to improve, underpinned by a rising trade surplus…



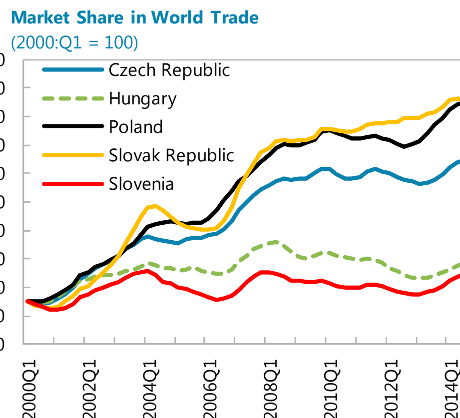
…as imports were overtaken by rising exports.



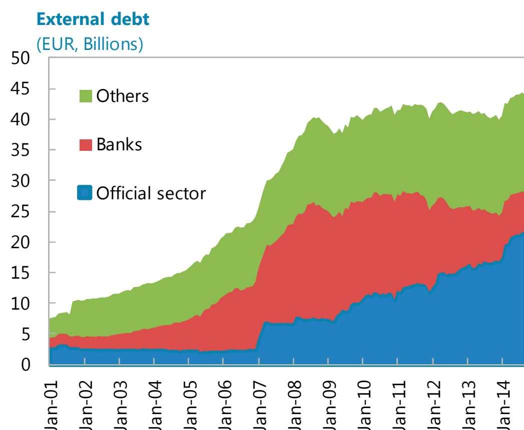
Trade ties to Germany and Austria helped export growth.



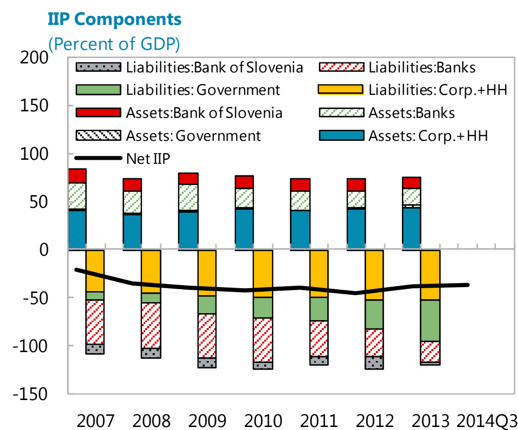
Slovenia has broadly maintained market share relative to competitors.



External debt remained broadly stable with bank repayments offset by sovereign borrowing.



against the background of a stable net international investment position.

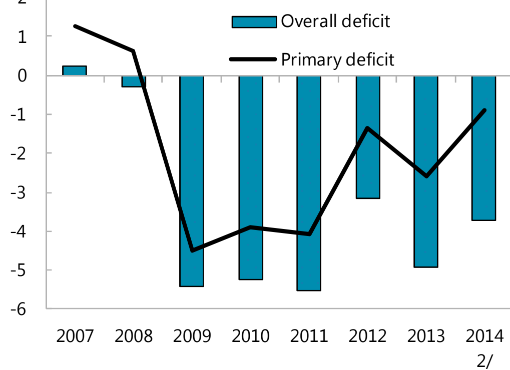


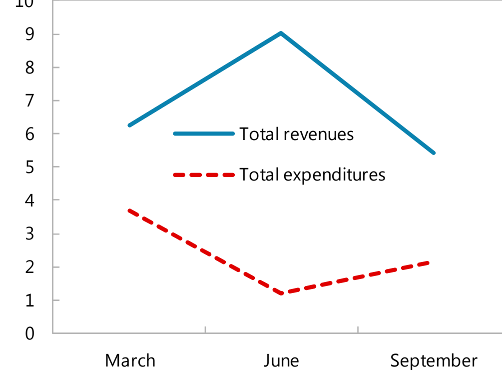
Sources: Bank of Slovenia; Direction of Trade Statistics; European Central Bank; Haver Analytics; Statistical Office of Slovenia; and IMF staff estimates.

Figure 5. Slovenia: Fiscal Developments

The deficit has declined relative to 2013…

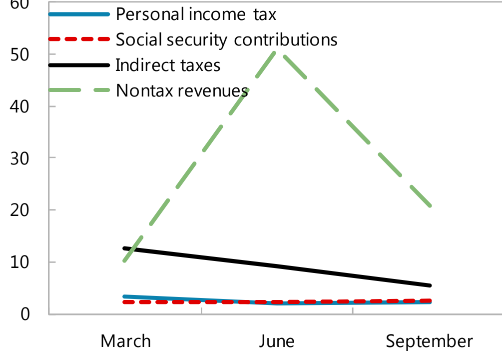
…as revenue growth outpaced spending growth during 2014.

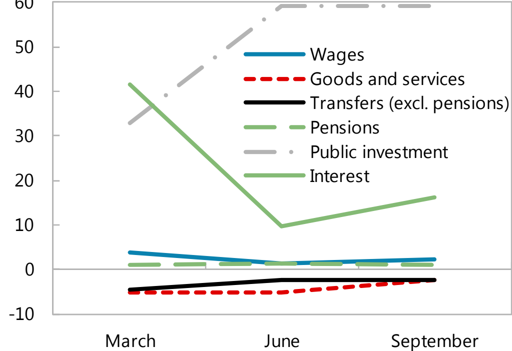


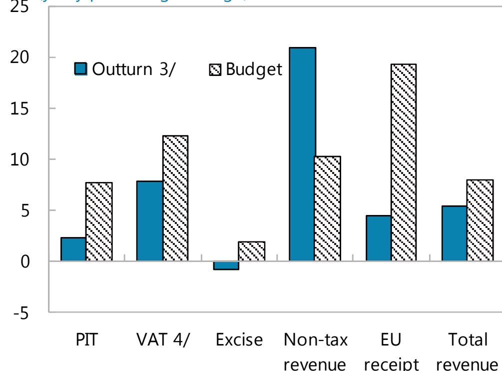


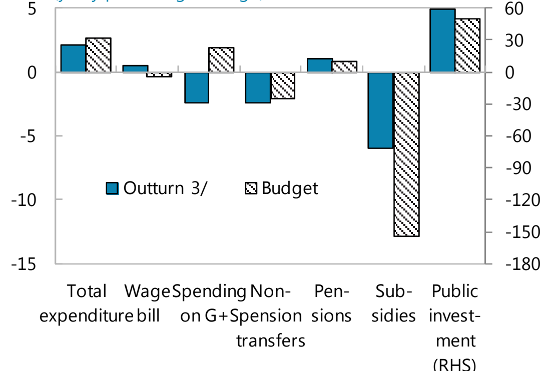
Revenue growth was in large part due to one-off nontax revenue measures taken in mid-year.

Current primary spending has been contained, but public investment and interest payments have been growing rapidly.







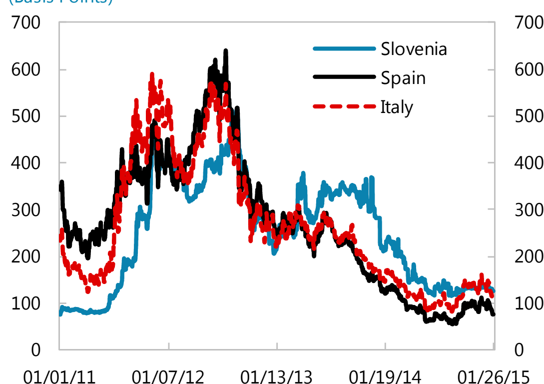


Sources: Haver Analytics; Ministry of Finance; and IMF staff calculations.
1/ Excludes bank recapitalization.
2/ 2014 number is the sum of Q1 to Q3.
3/ Jan-Sept., y-o-y percentage change.
4/ VAT budget is adjusted for timing of rate increase.

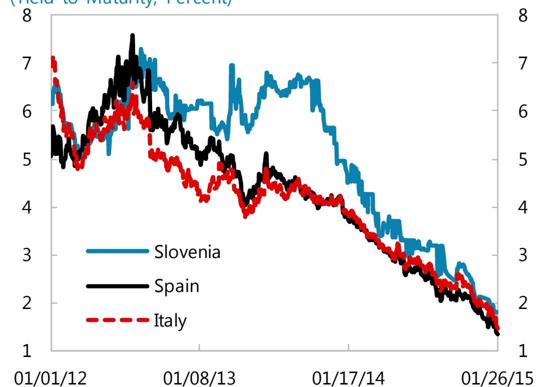
Figure 6. Slovenia: Asset Prices

Slovenian spreads have narrowed considerably...

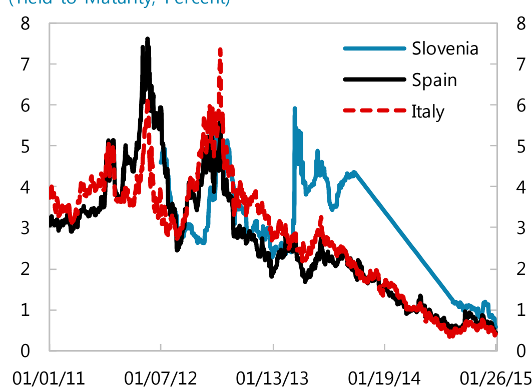
...as have CDS spreads, in line with those on Spain and Italy.



Overall yields also declined, helped by the bank recapitalization and regional trends...



...also for shorter maturities.



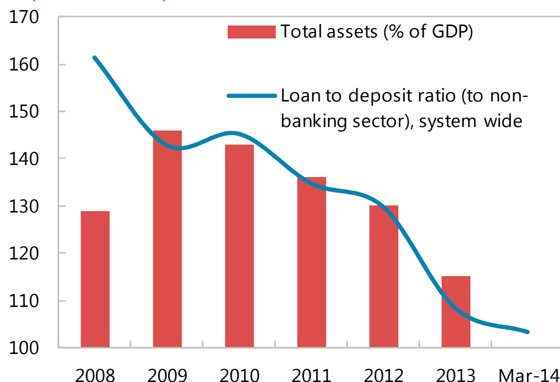
Equity prices rose in 2014...

...while house prices are still declining.

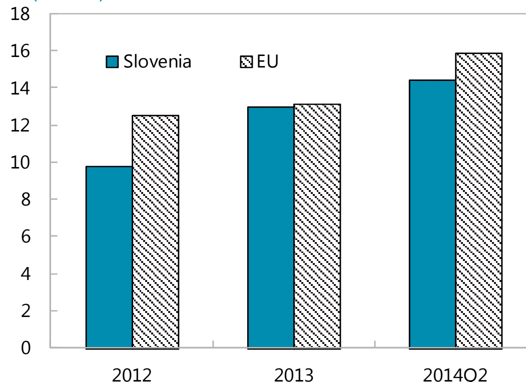
Source: Bloomberg; Statistical Office of Slovenia; and IMF staff calculations.
1/ SLOREP 4.625 09/09/24 used for Slovenia.
2/ Bloomberg 3-year generic bond yields.

Figure 7. Slovenia: Financial Sector Developments

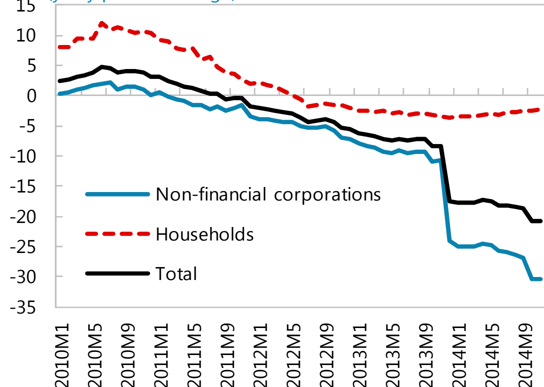
Banks have reduced their assets to bring them closer in line with their deposit base.



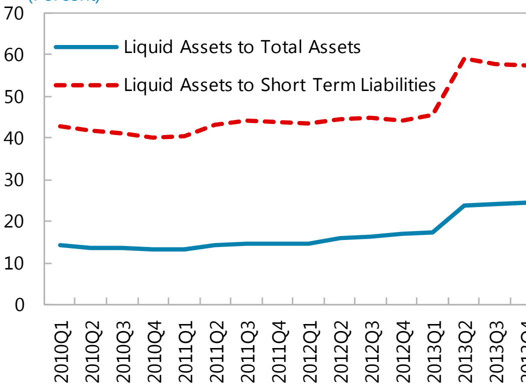
Recent recapitalizations have helped improve the capital position...



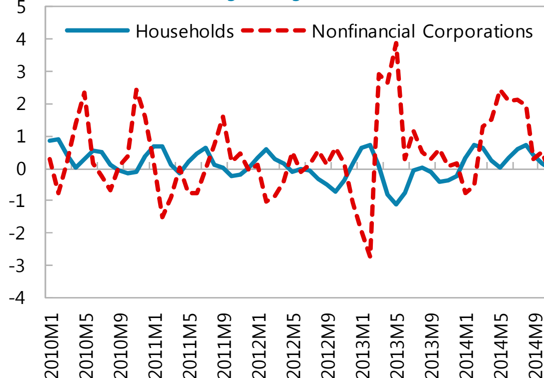
...but underlying credit growth remains negative, with transfers to the BAMC also playing a role.



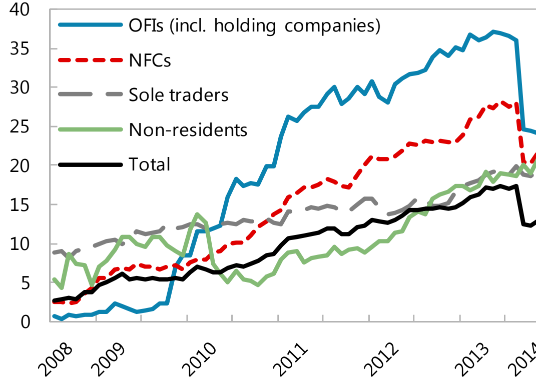
Banks have improved their liquidity ratios...



and deposits are growing at a brisk pace, especially for corporates.

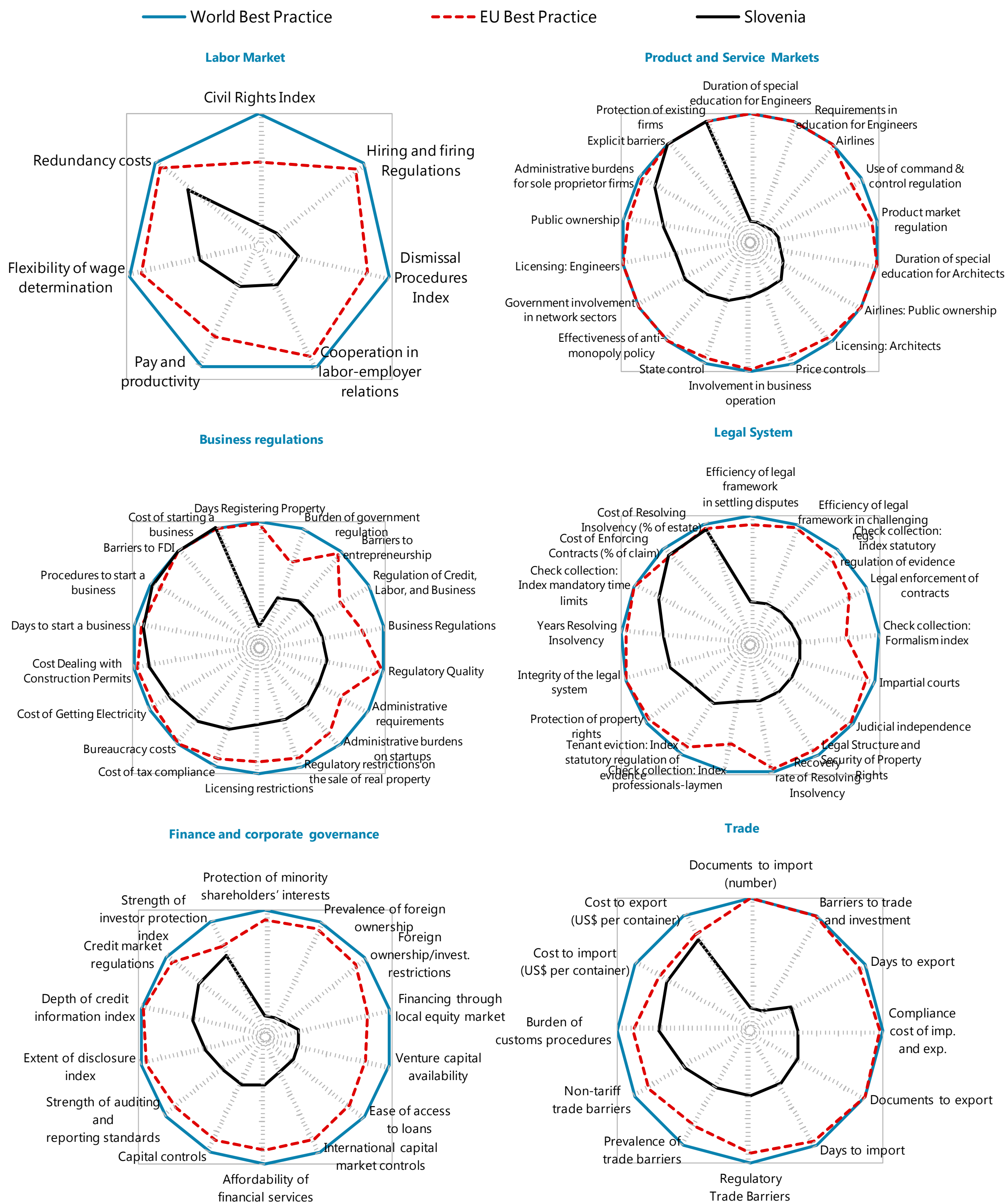


However NPLs remain high, and concentrated among corporates and holding companies.



Source: 2014 Financial Stability Report, Bank of Slovenia; Haver Analytics, IMF FSI.

Figure 8. Slovenia: Structural Indicators



Notes: For each indicator, "World Best Practice" is defined as the average of the five best performers and is set equal to 100, while the worst performer in the EU27 is set equal to zero. For a description of the indicators and their sources, see Cheptea and Velculescu (2014), "A Disaggregated Approach to Prioritizing Structural Reforms for Growth and Employment", in *Jobs and Growth: Supporting the European Recovery,* IMF.

Table 1. Slovenia: Selected Economic Indicators, 2010–16

(Annual percentage change, unless noted otherwise)

Key Export Markets: Germany, Italy, Countries of Former Yugoslavia, France, Austria
Quota (as of June 30, 2014): SDR 275 million
Main products/exports: Automotive, Machinery-Appliances, Tourism, Transportation

				Est.		Projections	
	2010	2011	2012	2013	2014	2015	2016
Nominal GDP (EUR millions)	36,220	36,868	36,006	36,144	37,079	37,768	38,681
GDP per Capita (EUR)	17,694	17,983	17,517	17,556	17,981	18,285	18,697
Real economy							
Real GDP	1.2	0.6	-2.6	-1.0	2.6	1.9	1.7
Domestic demand	-0.9	-0.8	-5.6	-2.1	0.9	1.0	1.8
Private consumption	1.0	-0.1	-3.0	-3.9	0.4	0.8	1.6
Public consumption	0.1	-1.3	-1.5	-1.1	-0.6	-0.6	0.7
Gross capital formation	-6.3	-1.8	-16.5	2.2	5.6	3.1	3.2
Net exports (contribution to growth)	2.3	1.5	3.1	1.1	1.4	0.8	0.1
Exports of goods and services	10.1	7.0	0.3	2.6	5.8	4.1	3.8
Imports of goods and services	6.6	5.0	-3.9	1.4	4.5	3.7	4.2
Output gap (in percent of potential GDP)	-1.6	-1.3	-3.8	-4.5	-2.3	-0.9	-0.2
Prices							
Consumer prices (national definition, period average)	1.8	1.8	2.6	1.8	0.2	-0.2	0.8
Core inflation (period average)	-0.4	-0.4	0.7	0.9	0.3	...	...
Employment and wages							
Unemployment rate (in percent, ILO definition)	7.3	8.2	8.9	10.1	9.7	9.0	8.4
Employment (Full time basis, national accounts)	-2.2	-1.6	-0.8	-1.5	0.6	0.7	0.7
Nominal wages (all sectors)	3.9	2.0	0.1	-0.1	1.1	0.4	1.1
Real wages (all sectors)	2.0	0.2	-2.5	-1.9	1.1	0.6	0.3
Public finance (percent of GDP)							
General government balance 1/	-5.2	-5.5	-3.1	-13.8	-6.0	-4.0	-3.5
General government balance excl. bank support 1/	-5.2	-4.2	-3.1	-4.3	-3.7	-4.0	-3.5
Structural balance 2/	-4.6	-4.1	-2.2	-2.2	-3.5	-2.9	-3.4
Structural primary balance 2/	-3.4	-2.8	-0.5	0.1	-0.4	0.1	-0.2
General government debt 3/	37.9	46.2	53.3	70.0	83.2	80.5	82.9
Monetary and financial indicators							
Credit to the private sector 4/	2.9	-1.9	-5.4	-6.9	-6.8	-4.6	-2.8
Lending rates 5/	4.9	5.0	4.7	4.5	4.2	...	...
Deposit rates 6/	1.8	2.2	2.3	1.9	1.0	...	...
Government bond yield (10-year)	3.8	5.0	5.8	5.8	3.3	...	...
Balance of payments (percent of GDP)							
Trade balance (goods and services)	-2.3	-2.6	-0.5	1.8	3.2	4.1	4.1
Current account balance	-0.1	0.4	2.8	5.8	5.5	6.2	5.7
Gross external debt (percent of GDP, end-period)	112.4	108.8	114.6	110.5	119.0	115.3	110.7
Nominal effective exchange rate (2010=100)	100.0	100.4	99.3	100.7	...	...	...
Real effective exchange rate (2010=100, CPI-based)	100.0	99.4	98.2	99.7	...	...	...

Sources: Data provided by the Slovenian authorities; and IMF staff calculations and projections.
1/ Includes 9.5 percent of GDP in 2013 and 2.3 percent of GDP in 2014 in capital injections into banks and support for deposit redemptions in banks being wound
2/ Excludes bank support and other one-offs. Adjusted for calendar year shifts between receipt and expenditure of earmarked EU funds.
3/ Includes EUR 1.1 bn in 2013 and EUR 0.7 bn in 2014 of debt issuance of the Bank Asset Management Company (BAMC).
4/ 2013 and 2014 data are adjusted to exclude the impact of transfers to the BAMC. 2014 data reflects November 2014.
5/ Floating or up-to-one-year fixed rate for new loans to non-financial corporations over 1 million euros. 2014 entry is the January-November average.
6/ For household time deposits with maturity up to one year. 2014 entry is the January-November average.

Table 2. Slovenia: Balance of Payments, 2010–20

(Percent of GDP, unless otherwise noted)

					Est.	Projections					
	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020
Current account	-0.1	0.4	2.8	5.8	5.5	6.2	5.7	5.3	4.8	4.1	3.5
Trade balance, goods and services	1.2	1.4	4.3	7.2	8.1	9.1	9.0	8.5	8.0	7.4	6.8
Goods	-2.3	-2.6	-0.5	1.8	3.2	4.1	4.1	3.8	3.6	3.3	2.9
Exports f.o.b.	52.4	58.2	60.1	60.9	63.0	64.4	65.8	67.2	68.6	70.1	71.6
Imports f.o.b.	-54.7	-60.8	-60.6	-59.2	-59.8	-60.2	-61.7	-63.3	-65.0	-66.9	-68.7
Services	3.5	4.0	4.8	5.4	4.9	5.0	4.9	4.7	4.5	4.2	3.9
Exports	12.7	13.1	14.1	14.8	14.9	15.0	15.1	15.3	15.4	15.5	15.7
Imports	-9.1	-9.1	-9.3	-9.4	-10.0	-10.0	-10.2	-10.6	-10.9	-11.4	-11.8
Income, net	-1.6	-1.4	-1.5	-1.6	-2.8	-3.1	-3.5	-3.4	-3.4	-3.5	-3.5
Current transfers, net	0.2	0.4	0.0	0.2	0.2	0.2	0.2	0.2	0.2	0.2	0.2
Capital account	0.1	-0.2	0.1	0.3	0.3	0.3	0.3	0.3	0.3	0.3	0.2
Financial account, excl. reserves	1.3	-1.2	-3.0	-8.1	-7.3	-6.5	-6.0	-5.5	-5.1	-4.4	-3.7
Direct investment, net	1.2	1.7	0.5	-1.7	1.2	1.5	1.5	1.0	1.0	1.0	1.0
In Slovenia	0.8	1.9	-0.2	-2.2	1.7	2.0	2.0	2.0	2.0	2.0	2.0
Abroad	0.4	-0.2	0.6	0.5	-0.5	-0.5	-0.5	-1.0	-1.0	-1.0	-1.0
Portfolio investment, net	5.4	5.0	-0.6	11.0	9.6	-2.3	-1.9	-2.3	-2.5	-2.4	-2.5
Financial derivatives	-0.3	-0.4	-0.3	0.2	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Other investment, net	-5.0	-7.5	-2.6	-17.4	-18.0	-5.7	-5.6	-4.2	-3.6	-3.0	-2.2
Government	0.0	0.2	1.7	1.2	-0.1	-0.1	-0.1	-0.1	-0.1	-0.1	0.0
Bank of Slovenia	0.3	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Commercial banks	-2.5	-4.2	0.1	-15.4	-4.8	-4.3	-4.2	-3.4	-3.1	-2.6	-1.8
Nonbank private sector	2.5	-3.9	-3.1	-4.9	-11.3	0.3	0.6	0.9	1.0	0.6	0.3
Loans	0.1	-0.4	0.3	0.7	-0.1	-0.1	-0.1	-0.1	-0.1	-0.1	0.0
Currency and deposits	-2.5	-2.8	-3.6	-1.2	-11.2	-0.2	0.1	0.5	0.6	0.2	-0.2
Trade credits	0.5	0.2	0.9	-0.5	0.5	0.5	0.5	0.5	0.5	0.5	0.5
Other	4.3	-0.8	-0.7	-3.9	-0.5	0.0	0.0	0.0	0.0	0.0	0.0
Net errors and omissions	-1.3	0.5	-0.1	2.0	1.5	0.0	0.0	0.0	0.0	0.0	0.0
Overall balance	-0.1	-0.6	-0.1	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Change in official reserves (-: increase)	0.1	0.2	0.1	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Memorandum items:											
Export of goods (percent change in value)	14.4	13.0	1.0	2.1	6.2	4.1	4.8	5.5	5.5	5.5	5.5
Import of goods (percent change in value)	15.3	12.6	-2.5	0.4	3.8	3.0	4.5	6.1	6.0	6.1	6.2
Terms of trade (percent change)	-4.8	-1.6	-1.2	1.0	0.1	0.5	0.5	0.1	0.1	0.0	0.0
Gross external debt (billion euros)	40.7	40.1	41.3	39.9	44.1	43.6	42.8	42.1	41.4	41.1	41.3
(percent of GDP)	112.4	108.8	114.6	110.5	119.0	115.3	110.7	105.2	100.2	96.5	94.0
International investment position (net, percent GDP)	-42.3	-40.0	-44.9	-37.8	-29.8	-22.8	-16.3	-10.2	-4.8	-0.3	3.4

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

Table 3. Slovenia: General Government Operations, 2010–20

(In percent of GDP, unless indicated otherwise)

	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020
					Est.			Projections			
Revenue	40.0	40.3	41.3	40.3	41.9	41.0	41.1	41.1	41.2	41.2	41.2
Taxes	21.0	21.5	21.9	20.8	21.4	21.4	21.3	21.4	21.4	21.5	21.6
Taxes on income, profit, payroll	6.9	7.5	7.4	6.0	6.5	6.5	6.4	6.5	6.5	6.5	6.5
Taxes on goods and services	13.4	13.4	13.8	14.1	14.3	14.2	14.2	14.2	14.2	14.3	14.3
Other taxes	0.6	0.6	0.7	0.7	0.7	0.7	0.7	0.7	0.7	0.7	0.7
Social contributions	14.5	14.3	14.6	14.2	14.2	14.2	14.1	14.2	14.1	14.1	14.0
Other revenue	4.5	4.5	4.9	5.3	6.2	5.4	5.7	5.6	5.6	5.6	5.6
Expenditure	45.3	45.8	44.5	54.1	47.9	45.1	44.6	44.6	44.7	44.8	44.9
Expense	42.5	43.4	42.3	51.7	44.0	41.1	41.2	41.2	41.4	41.5	41.6
Compensation of employees	10.8	10.5	10.4	10.0	9.8	9.6	9.4	9.3	9.3	9.2	9.1
Purchases of goods and services	6.9	6.6	6.6	6.2	6.0	6.4	6.5	6.5	6.5	6.5	6.5
Interest	1.3	1.4	1.8	2.3	3.1	3.0	3.2	3.4	3.6	3.7	3.8
Transfers to individuals and households	17.3	17.7	17.7	17.5	17.1	16.8	16.8	16.9	17.0	17.1	17.2
of which: pensions	11.1	11.2	11.5	11.8	11.6	11.4	11.6	11.7	11.9	12.1	12.2
Subsidies	1.6	1.3	1.4	1.4	1.3	0.9	0.9	0.9	0.9	0.8	0.8
Other transfers	4.4	5.7	4.4	14.2	6.7	4.4	4.3	4.2	4.1	4.1	4.1
of which: capital transfers	1.1	2.3	0.9	10.4	2.0	1.0	1.0	1.0	1.0	1.0	1.0
transfers to the EU budget	1.1	1.1	1.1	1.2	1.1	1.1	1.1	1.1	1.1	1.1	1.1
Net acquisition of non-financial assets	2.8	2.4	2.2	2.4	3.9	3.9	3.5	3.3	3.3	3.3	3.3
Gross operating balance 1/	-2.4	-3.1	-0.9	-11.4	-2.1	-0.1	-0.1	-0.1	-0.2	-0.3	-0.4
Net lending / Net borrowing 1/	-5.2	-5.5	-3.1	-13.8	-6.0	-4.0	-3.5	-3.5	-3.6	-3.6	-3.7
excluding bank related costs	-5.2	-4.2	-3.1	-4.3	-3.7	-4.0	-3.5	-3.5	-3.6	-3.6	-3.7
Net acquisition of financial assets	-2.8	2.6	...	...	...	...	...	...	...	...	...
Net incurrence of liabilities	2.4	8.1	...	...	...	...	...	...	...	...	...
Memorandum item:											
Primary balance 1/	-4.0	-4.2	-1.4	-11.6	-3.0	-1.1	-0.4	-0.2	0.0	0.0	0.0
Structural budget balance 2/	-4.6	-4.1	-2.2	-2.2	-3.5	-2.9	-3.4	-3.5	-3.6	-3.7	-3.7
Structural primary balance 2/	-3.4	-2.8	-0.5	0.1	-0.4	0.1	-0.2	-0.2	-0.1	0.0	0.0
General government debt 3/	37.9	46.2	53.3	70.0	83.2	80.5	82.9	84.4	86.0	87.6	89.3

Sources: Ministry of Finance; and IMF staff calculations.

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

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

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

Table 4. Slovenia: Macroeconomic Framework, 2010–20

	2010	2011	2012	2013	Est. 2014	Projections 2015	2016	2017	2018	2019	2020
Real GDP (percent change)	1.2	0.6	-2.6	-1.0	2.6	1.9	1.7	1.8	1.8	1.8	1.7
Contributions to growth											
Domestic demand	-0.9	-0.7	-5.4	-1.9	0.6	0.9	1.6	2.1	2.0	2.2	2.2
Private consumption	0.5	-0.1	-1.6	-2.1	0.2	0.4	0.8	1.1	1.1	1.2	1.2
Government consumption	0.0	-0.2	-0.3	-0.2	-0.1	-0.1	0.1	0.1	0.1	0.1	0.1
Gross capital formation	-1.6	-0.4	-3.7	0.4	1.1	0.6	0.7	0.9	0.9	0.9	0.9
Net exports	2.3	1.5	3.1	1.1	1.4	0.8	0.1	-0.2	-0.3	-0.4	-0.5
Exports of goods and services	6.7	5.0	0.2	2.1	4.7	3.5	3.3	3.3	3.4	3.5	3.5
Imports of goods and services	4.3	3.5	-2.8	1.0	3.3	2.7	3.2	3.6	3.7	3.9	4.0
Growth rates											
Domestic demand	-0.9	-0.8	-5.6	-2.1	0.9	1.0	1.8	2.3	2.3	2.4	2.4
Consumption	0.7	-0.5	-2.6	-3.1	0.1	0.4	1.3	1.8	1.7	1.8	1.9
Private	1.0	-0.1	-3.0	-3.9	0.4	0.8	1.6	2.1	2.1	2.2	2.2
Public	0.1	-1.3	-1.5	-1.1	-0.6	-0.6	0.7	0.7	0.5	0.6	0.7
Gross capital formation	-6.3	-1.8	-16.5	2.2	5.6	3.1	3.2	4.0	4.0	4.0	4.0
Fixed investment	-13.7	-4.6	-8.9	1.9	5.7	3.1	3.2	4.0	4.0	4.0	4.0
Change in stocks (contribution to GDP growth)	2.0	0.6	-1.8	0.1	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Exports of goods and services	10.1	7.0	0.3	2.6	5.8	4.1	3.8	3.8	3.8	3.8	3.8
Imports of goods and services	6.6	5.0	-3.9	1.4	4.5	3.7	4.2	4.6	4.6	4.7	4.7
Output gap (in percent of potential)	-1.6	-1.3	-3.8	-4.5	-2.3	-0.9	-0.2	0.1	0.2	0.1	0.0
Potential growth	0.4	0.3	-0.2	-0.2	0.2	0.5	1.0	1.5	1.7	1.8	1.8
Savings and investment (percent of GDP)											
National saving	22.0	22.1	21.8	25.3	25.7	26.6	26.4	26.4	26.4	26.2	26.1
Government	-0.5	-0.5	0.3	-0.6	0.1	0.1	0.4	0.5	0.7	0.9	0.0
Non-government	22.5	22.6	21.5	25.9	25.6	26.5	26.0	25.9	25.7	25.4	26.1
Gross capital formation	22.2	21.7	19.0	19.5	20.2	20.4	20.7	21.1	21.6	22.1	22.6
Foreign saving	0.1	-0.4	-2.8	-5.8	-5.5	-6.2	-5.7	-5.3	-4.8	-4.1	-3.5
Private sector credit growth (year-over-year)	2.9	-1.9	-5.4	-6.9	-6.8	-4.6	-2.8	-1.2	0.4	0.9	2.5
Prices											
Consumer price inflation	1.8	1.8	2.6	1.8	0.2	-0.2	0.8	1.5	1.5	1.5	1.5
GDP deflator	-1.1	1.2	0.3	1.4	0.0	0.0	0.7	1.5	1.4	1.5	1.5
Employment (percent change)	-2.2	-1.6	-0.8	-1.5	0.6	0.7	0.7	0.7	0.6	0.4	0.4
Unemployment rate (ILO, percent)	7.3	8.2	8.9	10.1	9.7	9.0	8.4	7.8	7.0	6.5	6.0
Real wages (percent change)	2.0	0.2	-2.5	-1.9	1.1	0.6	0.3	0.6	0.5	0.5	0.5
Government budget (percent of GDP)											
General government balance 1/	-5.2	-5.5	-3.1	-13.8	-6.0	-4.0	-3.5	-3.5	-3.6	-3.6	-3.7
General government balance excl. bank support1/	-5.2	-4.2	-3.1	-4.3	-3.7	-4.0	-3.5	-3.5	-3.6	-3.6	-3.7
Structural government balance 2/	-4.6	-4.1	-2.2	-2.2	-3.5	-2.9	-3.4	-3.5	-3.6	-3.7	-3.7
Structural primary balance 2/	-3.4	-2.8	-0.5	0.1	-0.4	0.1	-0.2	-0.2	-0.1	0.0	0.0
General government debt 3/	37.9	46.2	53.3	70.0	83.2	80.5	82.9	84.4	86.0	87.6	89.3
Merchandise trade (percent change)											
Export volume	11.9	8.2	0.0	2.8	6.3	4.4	4.0	4.0	4.0	4.0	4.0
Import volume	7.4	6.0	-4.6	2.2	4.0	3.8	4.3	4.6	4.6	4.7	4.7
Export value	14.4	13.0	1.0	2.1	6.2	4.1	4.8	5.5	5.5	5.5	5.5
Import value	15.3	12.6	-2.5	0.4	3.8	3.0	4.5	6.1	6.0	6.1	6.2
External balances (in billions of euros)											
Trade balance (merchandise)	-0.8	-1.0	-0.2	0.6	1.2	1.6	1.6	1.5	1.5	1.4	1.3
in percent of GDP	-2.3	-2.6	-0.5	1.8	3.2	4.1	4.1	3.8	3.6	3.3	2.9
Exports of goods	19.0	21.4	21.6	22.0	23.4	24.3	25.5	26.9	28.3	29.9	31.5
Imports of goods	19.8	22.4	21.8	21.4	22.2	22.7	23.9	25.3	26.8	28.5	30.2
Current account	0.0	0.1	1.0	2.1	2.0	2.3	2.2	2.1	2.0	1.8	1.5
in percent of GDP	-0.1	0.4	2.8	5.8	5.5	6.2	5.7	5.3	4.8	4.1	3.5

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

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

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

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

Table 5. Slovenia: Financial Soundness Indicators, 2008–14

(in percent unless indicated otherwise)

	2008	2009	2010	2011	2012	2013	Sep-14
Capital							
Regulatory capital to risk-weighted assets	11.7	11.7	11.3	11.9	11.4	13.7	15.8
Regulatory Tier 1 capital to risk-weighted assets	9.0	9.3	8.6	9.3	9.8	12.9	15.1
Profitability							
Return on assets	0.5	0.2	-0.2	-0.9	-1.5	-7.3	0.4
Return on equity	7.1	2.0	-3.2	-11.8	-19.6	-97.6	3.8
Interest margin to gross income	65.7	61.3	63.6	65.3	58.0	53.7	55.1
Noninterest expenses to gross income	62.5	60.2	57.9	63.0	63.9	77.3	60.2
Liquidity							
Liquid assets to total assets	13.9	13.8	14.2	13.4	14.7	17.5	24.5
Liquid assets to short-term liabilities	34.8	36.2	42.9	40.3	43.5	45.6	57.3
Sensitivity to market risk							
Net open position in foreign exchange to capital	-2.2	-0.9	-1.2	-1.8	-2.7	-4.1	-1.7
Asset quality							
Nonperforming loans to total gross loans 1/	4.2	5.8	8.2	11.8	15.2	13.3	13.2
Non-performing loans net of provisions to capital	30.2	41.7	50.5	71.0	85.8	55.3	60.8
Sectoral distribution of loans							
Central Bank	0.0	0.0	0.7	0.9	2.2	4.5	2.8
General Government	3.0	3.7	4.7	6.7	8.6	9.2	9.5
Financial corporations	11.1	12.5	13.5	13.0	12.1	9.7	9.0
Nonfinancial Corporations	51.5	49.0	48.5	47.0	44.8	40.2	39.3
Other Domestic Sectors	19.2	19.3	20.7	21.1	21.0	23.3	24.1
Nonresidents	15.2	15.4	11.9	11.3	11.2	13.0	15.2

Source: Financial Soundness Indicators; Financial Stability Review.

1/ The 2014 figure refers to end-October and is from the 2014 Stability of the Slovenian Banking System Report.

Annex I. Public Debt Sustainability Analysis

On the basis of current policies, Slovenia's public debt is projected to continue to slowly increase toward 90 percent of GDP by the end of the decade, raising sustainability concerns. Moreover, public debt dynamics are highly vulnerable to shocks. In particular, the materialization of part of outstanding government guarantees or a prolonged deflation shock could bring debt above 100 percent of GDP by 2019, while a combined growth-primary fiscal balance shock could increase it even further, to close to 115 percent of GDP; if the latter shock is also combined with fiscal losses from the financial sector, debt would rise to 135 percent of GDP. This analysis highlights the importance of resolute policy action to ensure debt sustainability. In particular, a durable and credible fiscal consolidation can help put debt on a sustained downward path. Restructuring of the bank and corporate sectors, improved governance, and a reduction of the role of the state in the economy can strengthen the resilience of the economy to shocks. And structural reforms can boost potential growth.

Slovenia's public debt is projected to gradually increase over the medium term under the baseline scenario. Without additional fiscal consolidation beyond the 2015 proposed measures, the debt ratio would be rising by around 1¾ percentage points of GDP per year on average, approaching 90 percent by the end of the decade. While debt dynamics in 2013–14 were dominated by the impact of bank restructuring, the medium-term increase in the debt ratio largely reflects the limited adjustment, with the primary surplus too low to offset the impact on debt dynamics of the unfavorable growth-real interest rate differential and of "below-the-line" liabilities, including called guarantees (assumed at ½ percent of GDP annually, in line with the 2013–14 average).[1]

While staff's forecasting performance to date has been mixed, the current macroeconomic baseline remains conservative. Staff's real sector forecast has tended to underestimate growth in the period preceding the crisis, and overestimate it since then. The depth of the global downturn in 2009 was difficult to forecast, as was the second dip in the recession. Staff has also tended to over-predict inflation, which in the more recent period reflected the unanticipated depth and duration of the recession, and also the consistent undershooting of the ECB's inflation target. In this context, staff's current macroeconomic baseline—based on slow reforms and fiscal consolidation in 2015 alone—is more conservative than indicated by quarterly growth trends, and the inflation forecast has been brought down.

The baseline fiscal adjustment is broadly realistic, although staff's recommended adjustment is ambitious by international standards. Staff's past fiscal forecasts have been close to the actual outturn, with the forecasting error remaining within the 25–75 inter-quartile range. The projected fiscal adjustment under the baseline falls below the top quartile, and the primary balance is slightly below the median of the distribution. However, the baseline adjustment is insufficient to place the debt ratio on a downward path. Staff recommendations would put Slovenia well into the top quartile in terms of size of required adjustment, and the primary balance at the low end of the top quartile. While these targets may be viewed as ambitious, Slovenia has achieved an adjustment in the primary structural balance of a similar size during 2011–13 (half of the time span currently envisaged), while the economy was in recession.

[1] The projections assume a gradual reduction in the cash buffer from over 10 percent of GDP in 2014 to under 5 percent over the medium term.

the primary structural balance of a similar size during 2011–13 (half of the time span currently envisaged), while the economy was in recession.

Slovenia's high level of public debt and debt service are the main areas of vulnerability, in particular under the stress scenarios. The debt ratio remains below 90 percent of GDP throughout the medium term under the baseline, but is projected to exceed this threshold under stress scenarios, in some cases substantially. In terms of debt structure, the shares of non-resident holders and of short-term debt in total debt are moderate, and Slovenia's spreads have fallen steadily to low levels. Debt service is projected to remain marginally below 20 percent of GDP during most of the medium term, but it exceeds this threshold in 2019, when two large maturities come due. However, debt service is projected to cross the threshold much earlier under standardized stress scenarios, and to approach 30 percent of GDP under the most adverse ones.

Slovenia's debt dynamics are highly vulnerable to specific shocks:

- **Standardized macro shocks**: Sensitivity to **GDP growth shocks** is especially noteworthy: a negative 1-standard deviation growth shock over 2 years would bring the debt ratio to almost 110 percent by 2020.
- **Country-specific shocks**:
  - **Contingent liabilities from government guarantees** are a potential source of vulnerability. Guarantees amount to 18 percent of GDP, and the weak financial position of borrowers raises the probability that guarantees may be called. To illustrate, calling of some 10 percent of GDP of guarantees outstanding would bring the debt ratio to over 100 percent by 2020, highlighting the importance of reducing the state's involvement in the economy.
  - **A deflation shock** would have an adverse impact on debt dynamics. A negative 1-standard deviation shock over 2 years would bring the debt ratio close to 105 percent by 2020.
  - **A combined macro-fiscal shock** (with GDP growth at the level of the adverse growth scenario, inflation and fiscal revenue at the respective minima of the standardized scenarios, and fiscal expenditure, exchange rate, and interest rate spread at the respective maxima of the standardized scenarios) would bring debt above 115 percent of GDP by the end of the projection period, highlighting the importance of a credible medium-term fiscal policy.
  - **A macro-financial shock** could have dramatic effects on debt dynamics. A scenario combining the macro-fiscal shock presented above with further losses from the corporate and banking sector (10 percent of GDP) would bring the debt-to-GDP ratio to around 135 percent by 2020. This highlights the importance of policies to strengthen the banking and corporate sectors and reducing the state's direct and indirect involvement in the economy.
  - **An active scenario of fiscal adjustment along the lines of staff's recommendations can put debt dynamics on a firmly downward path.** Adoption of structural fiscal measures of ¾ percent of GDP in 2015–19, implying a cumulative improvement in the structural primary balance of 3¾ percentage points of GDP over that period, would bring debt down to close to 75 percent by 2020, even as medium-term growth would be somewhat lower, as a result of the fiscal headwinds. Structural reforms, including privatization, could further reduce the debt-to GDP ratio.

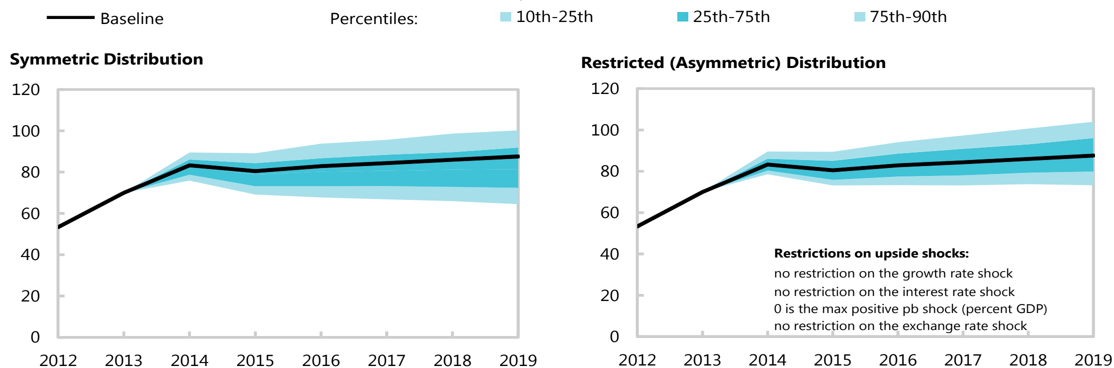
Slovenia: Public Debt Sustainability Analysis – Risk Assessment

Heat Map

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

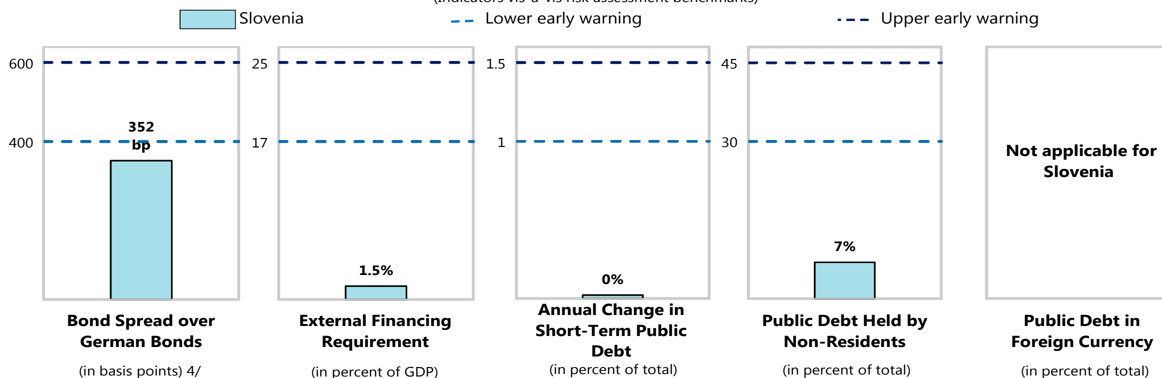
Evolution of Predictive Densities of Gross Nominal Public Debt

(in percent of GDP)



Debt Profile Vulnerabilities

(Indicators vis-à-vis risk assessment benchmarks)



Source: IMF staff. This is an update of the assessment presented in the 2013 Art IV staff report, to reflected intervened reductions in sovereign spreads, the fact that the bank recapitalization has taken place (partly in the form of a bond) in late 2013 rather than in early 2014, and the 2013Q4 headline GDP figures

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

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

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

Lower and upper risk-assessment benchmarks are:

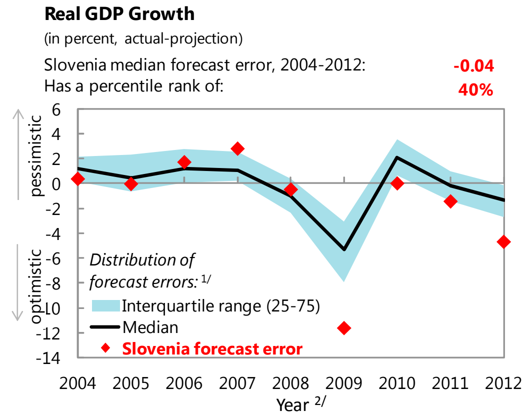
400 and 600 basis points for bond spreads; 17 and 25 percent of GDP for external financing requirement; 1 and 1.5 percent for change in the share of short-term debt; 30 and 45 percent for the public debt held by non-residents.

4/ An average over 01-Nov-13 through 30-Jan-14.

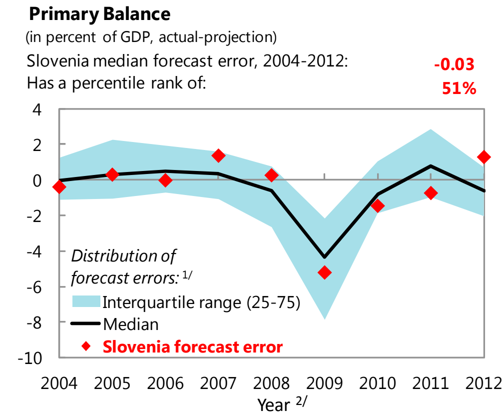
Slovenia: Public Debt Sustainability Analysis – Realism of Baseline Assumptions

Forecast Track Record, versus all countries

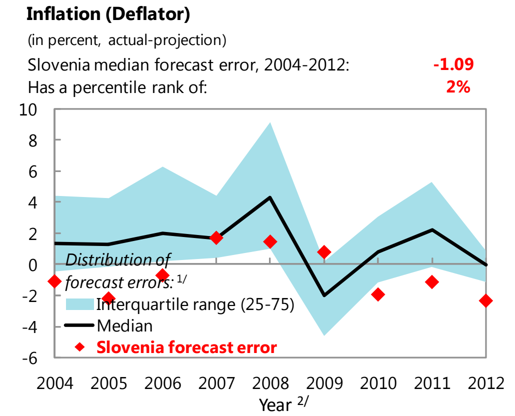
Real GDP Growth
(in percent, actual-projection)
Slovenia median forecast error, 2004-2012: **-0.04**
Has a percentile rank of: **40%**



Primary Balance
(in percent of GDP, actual-projection)
Slovenia median forecast error, 2004-2012: **-0.03**
Has a percentile rank of: **51%**

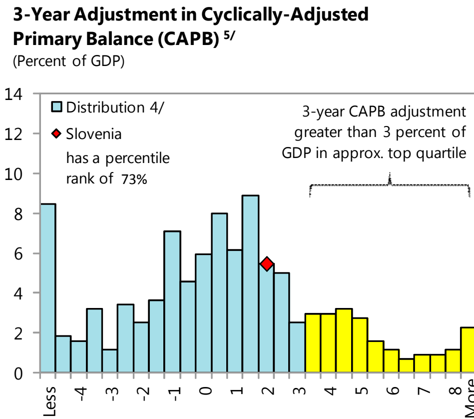


Inflation (Deflator)
(in percent, actual-projection)
Slovenia median forecast error, 2004-2012: **-1.09**
Has a percentile rank of: **2%**

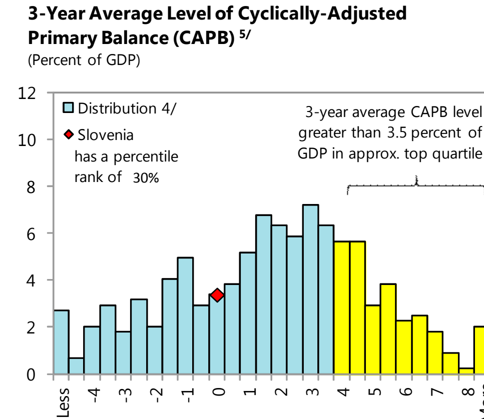


Assessing the Realism of Projected Fiscal Adjustment

3-Year Adjustment in Cyclically-Adjusted Primary Balance (CAPB) 5/
(Percent of GDP)

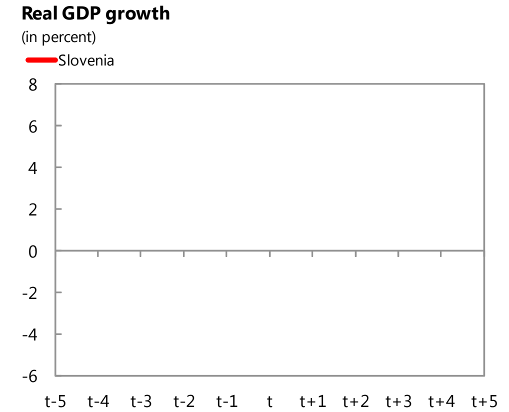


3-Year Average Level of Cyclically-Adjusted Primary Balance (CAPB) 5/
(Percent of GDP)



Boom-Bust Analysis 3/

Real GDP growth
(in percent)



Source : IMF Staff.
1/ Plotted distribution includes all countries, percentile rank refers to all countries.
2/ Projections made in the spring WEO vintage of the preceding year.
3/ Not applicable for Slovenia.
4/ Data cover annual obervations from 1990 to 2011 for advanced and emerging economies with debt greater than 60 percent of GDP. Percent of sample on vertical axis.
5/ For Slovenia, the CAPB is excluding bank support outlays.

Slovenia: Public Sector Debt Sustainability Analysis – Baseline Scenario

(in percent of GDP unless otherwise indicated)

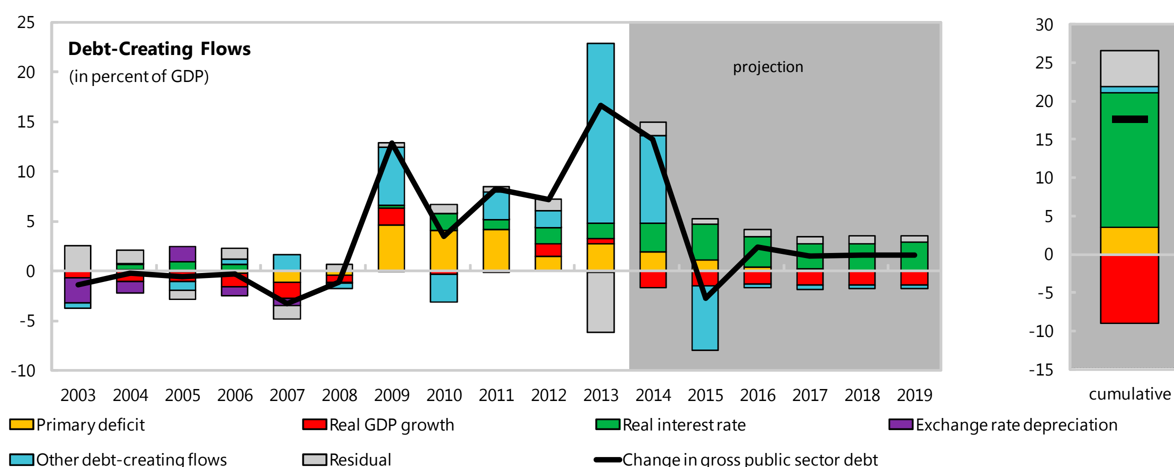
Debt, Economic and Market Indicators [1/]

	Actual			Est.	Projections				
	2003-2011 [2/]	2012	2013	2014	2015	2016	2017	2018	2019
Nominal gross public debt	29.9	53.3	70.0	83.2	80.5	82.9	84.4	86.0	87.6
Public gross financing needs	5.8	6.6	10.7	24.2	19.1	17.3	19.4	20.4	25.4
Real GDP growth (in percent)	2.3	-2.6	-1.0	2.6	1.9	1.7	1.8	1.8	1.8
Inflation (GDP deflator, in percent)	2.8	0.3	1.4	0.0	0.0	0.7	1.5	1.4	1.5
Nominal GDP growth (in percent)	5.2	-2.3	0.4	2.6	1.9	2.4	3.3	3.2	3.2
Effective interest rate (in percent) [4/]	4.6	3.8	4.4	4.2	4.3	4.6	4.7	4.8	4.9

As of January 26, 2015		
Sovereign Spreads		
Spread (bp) 3/	135	
CDS (bp)	126	
Ratings	Foreign	Local
Moody's	Baa3	Baa3
S&Ps	A-	A-
Fitch	BBB+	BBB+

Contribution to Changes in Public Debt

	Actual			Est.	Projections						
	2003-2011	2012	2013	2014	2015	2016	2017	2018	2019	cumulative	debt-stabilizing primary balance [10/]
Change in gross public sector debt	2.0	7.18	16.68	13.2	-2.8	2.4	1.5	1.6	1.6	17.6	
Identified debt-creating flows	1.4	6.03	22.68	11.9	-3.4	1.7	0.8	0.9	1.0	12.9	
Primary deficit	1.2	1.4	2.7	1.9	1.1	0.4	0.2	0.0	0.0	3.5	0.8
Primary (noninterest) revenue and grants	40.4	41.6	40.7	42.0	41.2	41.3	41.3	41.3	41.3	248.3	
Primary (noninterest) expenditure	41.6	43.0	43.3	43.9	42.3	41.6	41.4	41.3	41.3	251.8	
Automatic debt dynamics [5/]	-0.5	2.9	1.9	1.1	2.0	1.7	1.1	1.2	1.4	8.6	
Interest rate/growth differential [6/]	-0.1	2.9	2.1	1.1	2.0	1.7	1.1	1.2	1.4	8.6	
Of which: real interest rate	0.5	1.7	1.6	2.9	3.5	3.1	2.6	2.7	2.8	17.6	
Of which: real GDP growth	-0.6	1.2	0.5	-1.8	-1.5	-1.3	-1.5	-1.4	-1.5	-9.0	
Exchange rate depreciation [7/]	-0.4	0.0	-0.2	…	…	…	…	…	…	…	
Other identified debt-creating flows [8/]	0.7	1.7	18.1	8.9	-6.5	-0.4	-0.4	-0.4	-0.4	0.8	
FIS: Privatization receipts (negative)	0.2	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	
Contingent liabilities	0.0	0.1	0.2	0.0	0.0	0.0	0.0	0.0	0.0	0.0	
FIS: Other (specify, e.g. bank recapitalization)	0.4	1.6	17.9	8.9	-6.5	-0.4	-0.4	-0.4	-0.4	0.8	
Residual, including asset changes [9/]	0.6	1.2	-6.0	1.3	0.6	0.7	0.7	0.8	0.7	4.7	



Source: IMF staff.

1/ Public sector is defined as general government.

2/ Based on available data.

3/ Bond Spread over German Bonds.

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

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

6/ The real interest rate contribution is derived from the denominator in footnote 4 as r - π (1+g) and the real growth contribution as -g.

7/ The exchange rate contribution is derived from the numerator in footnote 2/ as ae(1+r).

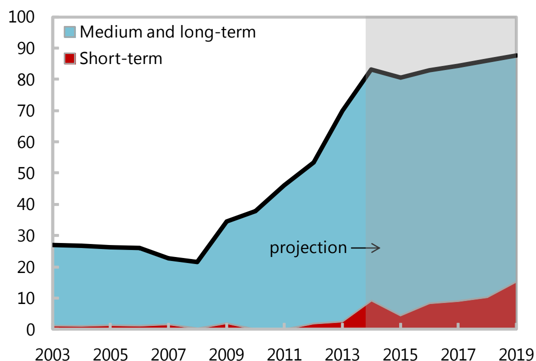
8/ Assumes issuance of EUR 1.7bn of bonds by the Bad Assets Management Company (BAMCO), and recap of EUR 3 bn at end 2013 (of which, EUR 2 bn in cash), and--conservatively--government recap of EUR 0.6 bn in 2014 of two currently privately-owned small banks.

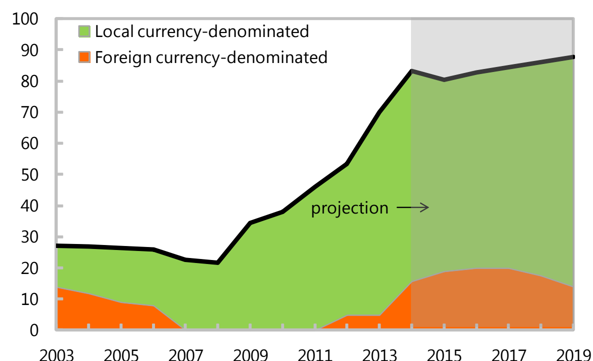
9/ For projections, this line includes exchange rate changes during the projection period. The figures in 2013 and 2014 reflect accumulation and subsequent use of cash balances around the bank recapitalization

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

Slovenia: Public Debt Sustainability Analysis – Composition of Public Debt and Alternative Scenarios

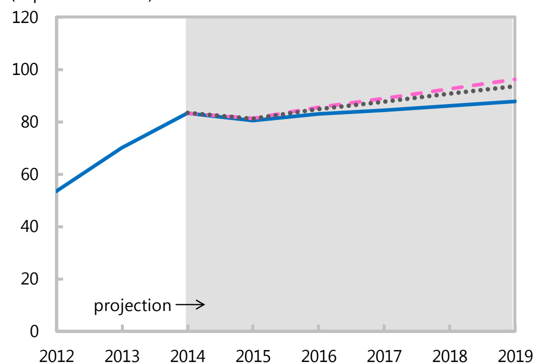
Composition of Public Debt

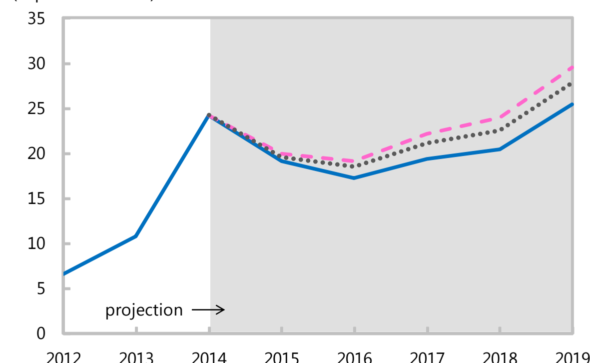




Alternative Scenarios

Baseline Historical Constant Primary Balance





Underlying Assumptions

(in percent)

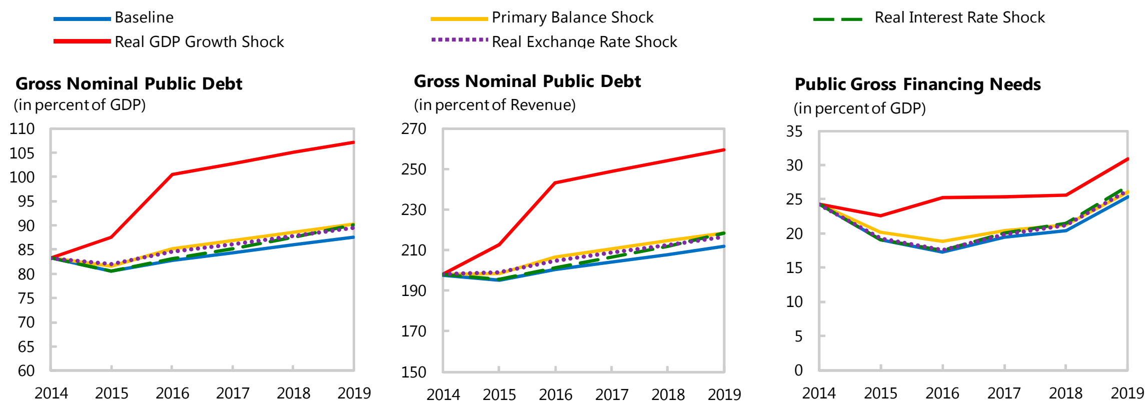
Baseline Scenario	2014	2015	2016	2017	2018	2019
Real GDP growth	2.6	1.9	1.7	1.8	1.8	1.8
Inflation	0.0	0.0	0.7	1.5	1.4	1.5
Primary Balance	-1.9	-1.1	-0.4	-0.2	0.0	0.0
Effective interest rate	4.2	4.3	4.6	4.7	4.8	4.9
Constant Primary Balance Scenario						
Real GDP growth	2.6	1.9	1.7	1.8	1.8	1.8
Inflation	0.0	0.0	0.7	1.5	1.4	1.5
Primary Balance	-1.9	-1.9	-1.9	-1.9	-1.9	-1.9
Effective interest rate	4.2	4.3	4.6	4.7	4.8	4.8

Historical Scenario	2014	2015	2016	2017	2018	2019
Real GDP growth	2.6	1.5	1.5	1.5	1.5	1.5
Inflation	0.0	0.0	0.7	1.5	1.4	1.5
Primary Balance	-1.9	-1.5	-1.5	-1.5	-1.5	-1.5
Effective interest rate	4.2	4.3	4.4	4.2	4.1	4.0

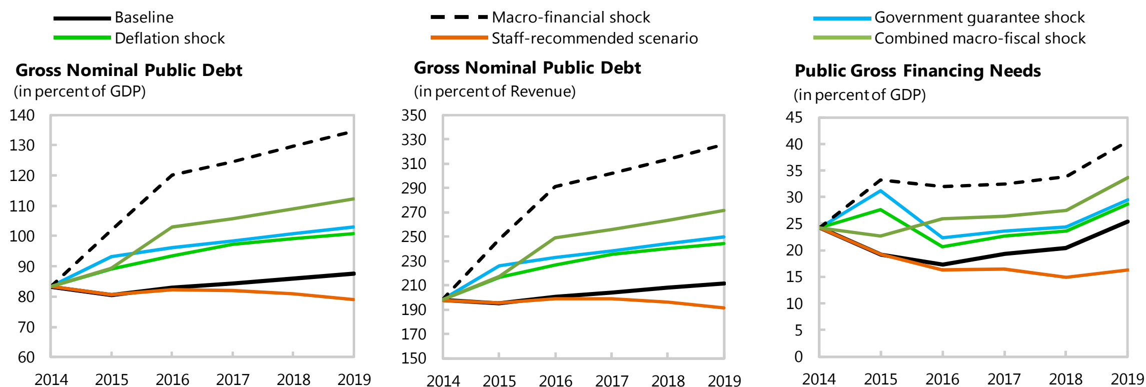
Source: IMF staff.

Slovenia: Public Debt Sustainability Analysis – Stress Tests

Macro-Fiscal Stress Tests



Additional Stress Tests



Underlying Assumptions
(in percent)

Primary Balance Shock	2014	2015	2016	2017	2018	2019
Real GDP growth	2.6	1.9	1.7	1.8	1.8	1.8
Inflation	0.0	0.0	0.7	1.5	1.4	1.5
Primary balance	-1.9	-2.2	-1.5	-0.2	0.0	0.0
Effective interest rate	4.2	4.3	4.7	4.8	4.8	4.9
Real Interest Rate Shock						
Real GDP growth	2.6	1.9	1.7	1.8	1.8	1.8
Inflation	0.0	0.0	0.7	1.5	1.4	1.5
Primary balance	-1.9	-1.1	-0.4	-0.2	0.0	0.0
Effective interest rate	4.2	4.3	4.9	5.3	5.6	5.9
Macro-financial Shock						
Real GDP growth	2.6	-4.8	-5.0	1.8	1.8	1.8
Inflation	0.0	-1.1	-0.4	1.5	1.4	1.5
Primary balance	-1.9	-13.5	-5.2	-0.2	0.0	0.0
Effective interest rate	4.2	4.5	5.7	6.5	6.7	6.7
Deflation Shock						
Real GDP growth	2.6	1.9	1.7	1.8	1.8	1.8
Inflation	0.0	-2.0	-1.3	-0.5	1.4	1.5
Primary balance	-1.9	-1.1	-0.4	-0.2	0.0	0.0
Effective interest rate	4.2	4.3	4.6	4.7	4.7	4.8
Combined Macro-Fiscal Shock						
Real GDP growth	2.6	-2.6	-2.7	1.8	1.8	1.8
Inflation	0.0	-1.1	-0.4	1.5	1.4	1.5
Primary balance	-1.9	-3.5	-5.2	-0.2	0.0	0.0
Effective interest rate	4.2	4.5	5.1	5.5	5.8	6.0

Real GDP Growth Shock	2014	2015	2016	2017	2018	2019
Real GDP growth	2.6	-2.6	-2.7	1.8	1.8	1.8
Inflation	0.0	-1.1	-0.4	1.5	1.4	1.5
Primary balance	-1.9	-3.5	-5.2	-0.2	0.0	0.0
Effective interest rate	4.2	4.3	4.7	5.1	5.0	5.0
Real Exchange Rate Shock						
Real GDP growth	2.6	1.9	1.7	1.8	1.8	1.8
Inflation	0.0	0.3	0.7	1.5	1.4	1.5
Primary balance	-1.9	-1.1	-0.4	-0.2	0.0	0.0
Effective interest rate	4.2	4.5	4.7	4.8	4.8	4.9
Government Guarantee Shock						
Real GDP growth	2.6	1.9	1.7	1.8	1.8	1.8
Inflation	0.0	0.0	0.7	1.5	1.4	1.5
Primary balance	-1.9	-1.1	-0.4	-0.2	0.0	0.0
Effective interest rate	4.2	4.3	4.9	5.1	5.2	5.1
Staff recommended scenario						
Real GDP growth	1.4	1.4	1.5	1.8	1.9	1.9
Inflation	0.5	1.0	1.6	1.6	1.9	1.9
Primary balance	-1.9	-0.9	0.8	1.7	2.4	3.1
Effective interest rate	4.2	4.4	4.6	4.7	4.8	4.9

Source: IMF staff.

Annex II. External Debt Sustainability Analysis

The gross external debt ratio is expected to fall gradually to around 94 percent of GDP by 2020. External debt rose by about 10 percent of GDP in 2014 due to external issuances to pre-finance 2015 needs. In the medium term, external public debt is expected to decline gradually, as additional government debt issuance is expected to be more than offset by a reduction in private sector external liabilities. The net international investment position is expected to reach broad balance by 2020.

External debt dynamics are vulnerable to shocks. In particular, a growth shock (involving a reduction by one-half of a standard deviation relative to the baseline) could push external debt up to close to 120 percent of GDP. A worse-than expected current account (also by one-half of a standard deviation relative to the baseline), also results in an increase in the external debt/GDP ratio to 110 percent of GDP, with a combined shock bringing the external debt-to-GDP ratio to 115 percent of GDP.

Slovenia: External Debt Sustainability Framework, 2009–20

(In percent of GDP, unless otherwise indicated)

	2009	2010	2011	2012	2013	10-Year Historical Average	10-Year Standard Deviation	Projections 2014	2015	2016	2017	2018	2019	2020	Debt-stabilizing non-interest current account 6/
1 Baseline: External debt	111.5	112.4	108.8	114.6	110.5			119.0	115.3	110.7	105.2	100.2	96.5	94.0	-3.1
2 Change in external debt	8.1	1.0	-3.7	5.8	-4.1			8.5	-3.6	-4.6	-5.5	-5.0	-3.7	-2.5	
3 Identified external debt-creating flows (4+8+9)	13.6	4.1	-11.0	7.6	-9.4			-9.5	-10.3	-9.6	-8.5	-7.9	-8.1	-10.8	
4 Current account deficit, excluding interest payments	-1.8	-2.0	-3.0	-5.3	-8.3			-8.2	-9.0	-8.4	-8.0	-7.4	-6.7	-6.0	
5 Deficit in balance of goods and services	-113.7	-128.9	-141.2	-144.1	-144.4			-147.7	-149.6	-152.9	-156.3	-160.0	-163.9	-167.9	
6 Exports	57.8	65.1	71.3	74.2	75.8			77.9	79.3	81.0	82.4	84.0	85.7	87.3	
7 Imports	-55.8	-63.8	-69.9	-69.9	-68.6			-69.8	-70.2	-72.0	-73.9	-76.0	-78.2	-80.5	
8 Net non-debt creating capital inflows (negative)	1.8	-1.5	-3.4	-1.5	0.5			-1.3	-2.0	-2.0	-1.3	-1.3	-1.4	-1.4	
9 Automatic debt dynamics 1/	13.6	7.7	-4.6	14.4	-1.7			0.0	0.6	0.8	0.7	0.8	0.0	-3.4	
10 Contribution from nominal interest rate	2.4	2.3	2.5	2.6	2.4			2.7	2.7	2.7	2.7	2.6	2.6	2.5	
11 Contribution from real GDP growth	8.9	-1.4	-0.6	3.2	1.1			-2.8	-2.2	-1.9	-2.0	-1.8	-1.7	-1.6	
12 Contribution from price and exchange rate changes 2/	2.3	6.8	-6.5	8.6	-5.2			...	...	...	...	...	...		
13 Residual, incl. change in gross foreign assets (2-3) 3/	-5.5	-3.1	7.3	-1.7	5.3			18.0	6.7	5.0	3.1	3.0	3.5	4.1	
External debt-to-exports ratio (in percent)	192.7	172.8	152.5	154.5	145.8			152.7	145.3	136.7	127.7	119.3	112.7	107.6	
Gross external financing need (in millions of euros) 4/	17296	15843	14743	13557	14501			10970	10673	10674	10585	10557	10656	10877	
in percent of GDP	47.8	43.7	40.0	37.7	40.1			29.6	30.6	29.7	28.3	27.0	26.1	25.5	
Scenario with key variables at their historical averages 5/								118.9	121.0	121.9	121.7	121.2	121.1		-2.8
Key Macroeconomic Assumptions Underlying Baseline															
Real GDP growth (in percent)	-7.8	1.2	0.6	-2.6	-1.0	1.5	4.4	2.6	1.9	1.7	1.8	1.8	1.8	1.7	
GDP deflator in US dollars (change in percent)	-2.2	-5.7	6.1	-7.3	4.8	4.0	7.6	0.1	-7.8	1.4	2.4	2.6	2.7	2.7	
Nominal external interest rate (in percent)	2.1	2.0	2.4	2.2	2.2	2.8	0.8	2.5	2.3	2.4	2.5	2.6	2.7	2.8	
Growth of exports (US dollar terms, in percent)	-17.9	12.7	11.6	1.6	2.5	7.5	10.4	5.4	3.8	4.5	5.2	5.2	5.2	5.2	
Growth of imports (US dollar terms, in percent)	-22.9	14.5	11.5	-2.4	-1.5	6.7	12.6	4.4	2.5	4.9	6.1	6.2	6.3	6.3	
Current account balance, excluding interest payments	1.8	2.0	3.0	5.3	8.3	1.7	3.2	8.2	9.0	8.4	8.0	7.4	6.7	6.0	
Net non-debt creating capital inflows	-1.8	1.5	3.4	1.5	-0.5	-0.3	1.8	1.3	2.0	2.0	1.3	1.3	1.4	1.4	

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

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

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

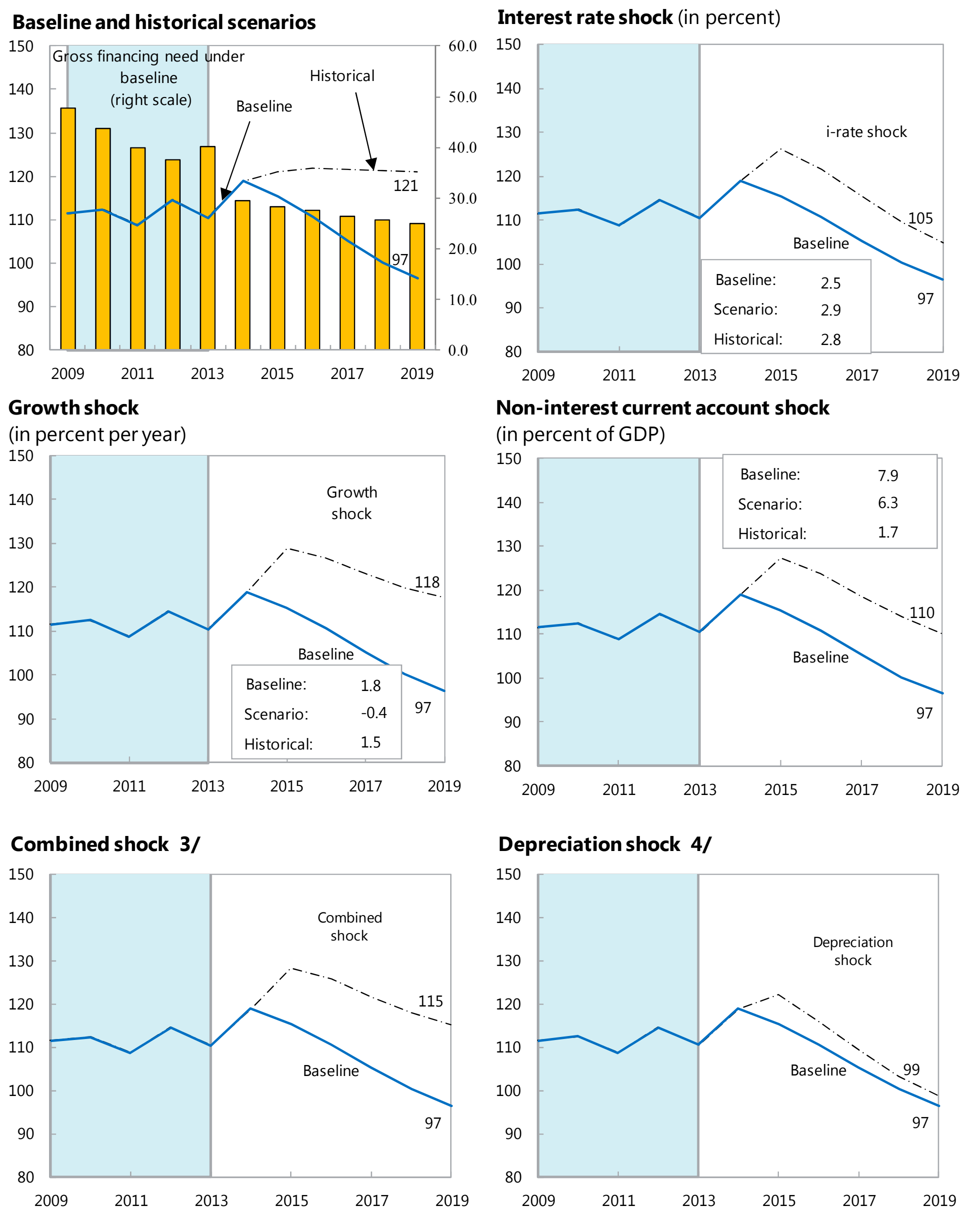
4/ Defined as current account deficit, plus amortization on medium- and long-term debt, plus short-term debt at end of previous period.

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

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

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

(External debt in percent of GDP)



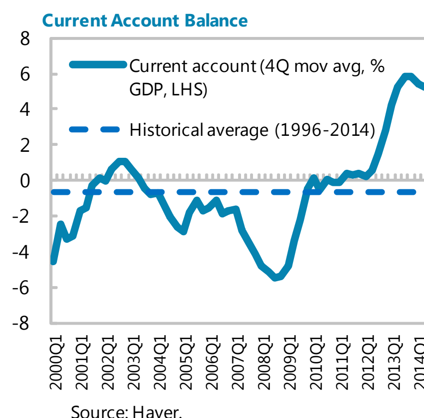
Sources: International Monetary Fund, Country desk data, and staff estimates.
1/ Shaded areas represent actual data. Individual shocks are permanent one-half standard deviation shocks. Figures in the boxes represent average projections for the respective variables in the baseline and scenario being presented. Ten-year historical average for the variable is also shown.
2/ For historical scenarios, the historical averages are calculated over the ten-year period, and the information is used to project debt dynamics five years ahead.
3/ Permanent 1/4 standard deviation shocks applied to real interest rate, growth rate, and current account balance.
4/ One-time real depreciation of 30 percent occurs in 2014.

Annex III. External Assessment

Various indicators of the external balance and real exchange rate suggest that, on balance, Slovenia does not appear to suffer from competitiveness problems, as also evidenced by strong export performance and broadly stable market shares. This suggests that the current account and the real exchange rate are broadly consistent with medium-term fundamentals and desirable policies. Model-based indicators of the real exchange rate give a mixed picture; their results should be interpreted with care, given the models' weak fit for Slovenia after the crisis period.

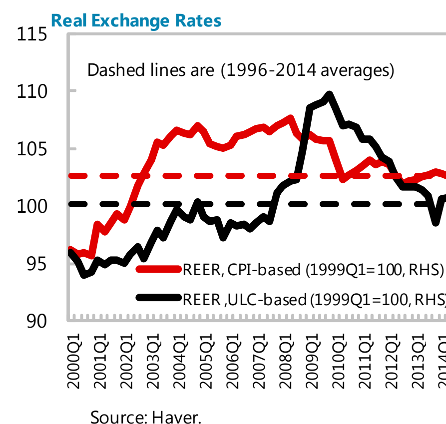
The current account (CA) has adjusted sharply following the crisis. It went from a deficit of 5.3 percent of GDP in 2008 to a surplus of 5.8 percent in 2013. Resilient exports contributed to the adjustment, owing to integration in core euro-area supply chains. But import compression also played a significant role, as domestic demand and in particular import-intensive investment plunged, offset in part by the large import-component of exports. The income deficit remained at around 1½ percent of GDP as rising labor income from abroad was offset by rising interest payments. This year, the current account is expected to remain in surplus of about 5.6 percent of GDP, well above its long-term (1996–2008) average of -1 percent of GDP.

The large current account reversal was largely driven by capital flows. Slovenia's investment boom during 2004–08 was mainly financed by domestic banks making use of cheap foreign funds. The combination of low FDI inflows, high corporate leverage, focus on non-tradable investment, and a local boom in mergers & acquisitions did not prepare Slovenia well for the eventual turn of the tide. As Slovenian banks lost access to external markets in 2008–09, they had to repay large external maturities, with an attendant collapse of investment. Between mid-2008 and end-2013, the net reduction in banks' external liabilities reached €11.8 billion, ¼ of the end-2008 aggregate balance sheet, or 30 percent of GDP.



Source: Haver.

The real exchange rate has also adjusted. The CPI-based REER declined by about 5 percent relative to its peak, and ULC-based REER adjusted by about 10 percent from its peak. Both stand close to their long-run historical averages. Still, the external competiveness impact of the reduction in the ULC-based indicator has been limited, as it was largely driven by gains in the non-traded goods sector, in particular the public sector, where wage cuts of about 6 percent were implemented over 2012–13. In contrast, ULCs in the tradable-goods sector have remained broadly flat, as productivity



Source: Haver.

growth due to employment reductions was offset by rising wages. Market shares have remained broadly flat.

Model-based indicators of the real exchange rate (REER) give a mixed picture, in part due to difficulties in capturing structural factors during the post-crisis adjustment. In particular, the models do not appear to capture well the specifics of the Slovenian case, such as the large collapse in demand and 11 percent of GDP CA reversal, the sudden stop in credit (which went from growth of 34 percent in 2007 to a 6 percent decline in 2013), and the large external deleveraging of banks since the crisis (by about 30 percent of GDP). As such, the results should be interpreted with caution:

- **CGER-like methodologies paint a mixed picture.** On one hand, the method estimating the REER deviation from an equilibrium value based on fundamentals suggests that, despite the depreciation to date, the REER remains slightly above its equilibrium value (by close to 4 percent). On the other hand, the macro-balance (MB) model points to an undervaluation of the REER (of 12 ½ percent), as the gap between the medium-term CA and its "norm" is estimated at around 7 percent of GDP. Finally, the external sustainability approach points to a REER undervaluation of 7 percent, given that the CA deficit required to maintain the IIP at the current level is higher than the long-term projected CA.

CGER-like Methodology

CGER Methods	REER misallignment relative to equilibrium 1/	*Current account norm (percent GDP)*	*Deviation from current account norm (percent GDP)*
Macroeconomc Balance	-12.6	-2.9	6.8
Equilibrium Exchange Rate	4.3	n.a.	n.a.
External Sustainability	-7.1	-0.3	4.2

1/ percent deviation; positive indicates overvaluation

- **The EBA-lite model points to an undervaluation of the REER.** Given a sizeable gap (7.5 percent of GDP) between the actual CA and its calculated norm (the latter is based on a cross-country panel regression model and an extended sample of variables compared to the MB model), the REER appears to be undervalued by close to 15 percent.

EBA-lite Methodology

Summary Table			
CA-Actual	5.8%	CA-Fitted	-3.5%
CA-Norm	-1.7%	Residual	9.3%
CA-GAP	**7.5%**	Policy gap	-1.8%
Elasticity	-0.51		
Real Exchange Rate Gap	**-14.7%**	Cyclical Contributions	0.3%
		Cyclically adjusted CA	5.5%
		Cyclically adjusted CA Norm	-2.0%

Annex IV. Slovenia: Risk Assessment Matrix[1]

Potential Deviations from Baseline

Nature/Sources of Main Risks	Overall Level of Concern	
	Relative Likelihood (high, medium, or low)	**Impact if Realized** (high, medium, or low)
Domestic Risks		
1. Inadequate progress with private-sector balance-sheet clean up, restructuring, and privatization	**High** • Political complacency can result in failure to lower NPLs, inability to restructure the corporate sector, reduce its indebtedness, and privatize SOEs and banks.	**High** • High corporate leverage and NPLs and weak governance prevent a recovery in credit and foster inefficiencies, weakening investment and growth.
2. Failure to credibly address fiscal slippages	**High** • Political resistance can result in a watering down of fiscal measures, falling significantly short of targets, eroding credibility of fiscal policy, and pushing debt higher.	**Medium** • Increased debt sustainability concerns push borrowing costs higher, eroding confidence, and potentially curtailing market access.
3. Deflation sets in	**Medium** • A deflationary spiral can emerge, as public and private sector real debt burdens rise.	**Medium** • Domestic demand weakens and debt dynamics worsen.
External Risks		
4. Protracted period of slower growth in advanced economies	**High** • Lower-than-anticipated potential growth and persistently low inflation due to a failure to fully address legacies of the financial crisis, leading to secular stagnation.	**High** • Exports decline, leading to lower growth; debt dynamics deteriorate further, eroding confidence.
5. Geopolitical fragmentation persists	**Medium** • Sustained tensions in Russia/Ukraine depress business confidence and heighten risk aversion, amid disturbances in global financial, trade and commodity markets.	**Medium** • Exports to Russia and third parties decline and energy costs increase, depressing growth.

1/ The RAM shows events that could materially alter the baseline path discussed in this report (the scenario most likely to materialize in the view of the staff). The relative likelihood of risks listed is the staff's subjective assessment of the risks surrounding this baseline ("low" is meant to indicate a probability below 10 percent, "medium" a probability between 10 and 30 percent, and "high" a probability between 30 and 50 percent). The RAM reflects staff's views on the source of risks and overall level of concerns as of the time of discussions with the authorities. Non-mutually exclusive risks may interact and materialize jointly.

INTERNATIONAL MONETARY FUND

REPUBLIC OF SLOVENIA

STAFF REPORT FOR THE 2014 ARTICLE IV CONSULTATION—INFORMATIONAL ANNEX

January 29, 2015

Prepared By: European Department

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FUND RELATIONS

(As of January 9, 2015)

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

General Resources Account:

	SDR Million	Percent of Quota
Quota	275.0	100
Fund holdings of currency	171.37	62.32
Reserve position	103.65	37.69
Lending to the Fund		
Borrowing Agreement	17.68	

SDR Department:

	SDR Million	Percent of Allocation
Net cumulative allocation	215.88	100
Holdings	207.01	95.89

Outstanding Purchases and Loans: None

Financial Arrangements: None

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

	Forthcoming				
	2015	2016	2017	2018	2019
Principal					
Charges/Interest	0.01	0.01	0.01	0.01	0.01
Total	0.01	0.01	0.01	0.01	0.01

Exchange Rate Arrangement:

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

Article IV Consultation:

Slovenia is on the 12-month Article IV consultation cycle. The 2014 mission visited Ljubljana during December 2–12, 2014 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 the Parliament, financial sector, labor, business and media. Mr. Repansek (Adviser to the Executive Director) attended the meetings. Mr. Çanakçı (Executive Director) attended the concluding meeting.

The mission comprised: Ms. Velculescu (Head), Mr. Dalgic, Mr. Halikias, Mr. Lombardo (all EUR), Mr. Craig (SPR), Mr. Garrido (LEG), and Mr. Jaramillo-Vallejo (MCM). The mission held a press conference on the concluding statement. The authorities have agreed to the publication of the staff report.

FSAP Participation and ROSCs:

An FSAP mission took place during November 6–20, 2000. A FSSA report (SM/01/129) 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 (SM/04/152) was issued on April 26, 2004, accompanied by the ROSCs on Banking Supervision and Insurance Supervision (May, 2004).

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

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

Technical Assistance: See the attached table.

Resident Representative Post: None (closed at end-April 2004).

Table 1. Republic of Slovenia: Technical Assistance, 2001–14

Department	Timing	Purpose
MCM	December 2009	Financial Supervisory Architecture
	October 2012	Bank Resolution
	December 2012	Bank Asset Management Company
	November 2013	Stress testing Workshop
	December 2013	Peripatetic expert, Financial Stability
	May 2014	Bank supervision
	December 2014	Bank resolution framework
LEG	October 2013	Insolvency Law
FAD	August 2001	VAT
	November 2001	Direct Tax Reform
	November 2003	Expenditure Rationalization
	May 2004	Options for Short-Term Public Expenditure Rationalization
	October 2004	Performance Information to Support Better Budgeting
	April 2014	Strengthening the Public Financial Management Framework
STA	November 2004	Recording Transactions in International Trade in Services
	April 2006	Government Finance Statistics

STATISTICAL ISSUES

Data provision is adequate for surveillance purposes.

Special Data Dissemination Standard: Slovenia has subscribed to the Special Data Dissemination Standard (SDDS), meets SDDS specifications, and 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 adopted the *GFSM 2001* methodology, which is 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. The introduction in 2008 of a new chart of accounts for all public entities based on accrual principles greatly facilitated the adoption of the new methodology.

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

Balance of Payments Statistics: Balance of payments data are comprehensive and of high quality. The data have been published in the *Balance of Payments Statistics Yearbook* since 1993 (with estimates of the international investment position published since 1994). In 2002, the Bank of Slovenia revised 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.

Republic of Slovenia: Table of Common Indicators Required for Surveillance

(As of January 9, 2015)

	Date of Latest Observation	Date Received or Posted	Frequency of Data[6]	Frequency of Reporting[6]	Frequency of Publication[6]
Exchange Rates	1/9/15	1/9/15	D	D	D
International Reserve Assets and Reserve Liabilities of the Monetary Authorities[1]	12/14	1/15	M	M	M
Reserve/Base Money	11/14	12/14	M	M	M
Broad Money	11/14	12/14	M	M	M
Central Bank Balance Sheet	11/14	12/14	M	M	M
Consolidated Balance Sheet of the Banking System	11/14	12/14	M	M	M
Interest Rates[2]	12/14	12/14	M	M	M
Consumer Price Index	12/14	12/14	M	M	M
Revenue, Expenditure, Balance and Composition of Financing[3] – General Government[4]	10/14	12/14	M	M	M
Revenue, Expenditure, Balance and Composition of Financing[3]– Central Government	10/14	12/14	M	M	M
Stocks of Central Government and Central Government-Guaranteed Debt[5]	9/14	12/14	M	M	M
External Current Account Balance	10/14	1/15	M	M	M
Exports and Imports of Goods and Services	10/14	12/14	M	M	M
GDP/GNP	Q3/14	12/14	Q	Q	Q
Gross External Debt	9/14	11/14	M	M	M
International Investment Position	Q3/14	12/14	Q	Q	Q

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

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

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

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

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

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

INTERNATIONAL MONETARY FUND

REPUBLIC OF SLOVENIA

STAFF REPORT FOR THE 2014 ARTICLE IV CONSULTATION—SUPPLEMENTARY INFORMATION

February 9, 2015

Approved By | Philip Gerson and Ranil Salgado

This supplement provides information that has become available since the Staff Report was circulated to the Executive Board on January 30, 2015. The information does not alter the thrust of the staff appraisal.

Economic Developments and Prospects

Preliminary data through end-2014 suggest that the general government deficit reached 5.8 percent of GDP (cash basis, excluding extra-budgetary entities and including bank-related costs). Net of bank-related costs, the deficit is estimated at 3.5 percent of GDP,[1] 0.2 percent of GDP lower than the Staff Report projection (which was based on end-October data). The difference is due to lower spending (0.5 percent of GDP) on public investment, capital transfers, and public wages, which was partly offset by lower revenues (0.3 percent of GDP) from indirect taxes and EU receipts. Assuming adherence to the expenditure targets included in the 2015 supplementary budget—which was recently approved by the cabinet—the better-than-expected 2014 fiscal outturn does not materially affect staff's projections for 2015 and the medium term nor the related policy advice.

[1] Staff's definition of the interest bill includes interest on BAMC bonds of about 0.1 percent of GDP.

Republic of Slovenia: General Government Operations, 2013–15

(in percent of GDP)

	2014		2015	
	Est.		Proj.	
	SR	*Revised*	*SR*	*Revised*
Revenue	41.9	41.6	41.0	40.9
Taxes	21.4	21.4	21.4	21.3
of which: Taxes on goods and services	14.3	14.2	14.2	14.1
Social contributions	14.2	14.2	14.2	14.2
Other revenue	6.2	6.0	5.4	5.4
Expenditure	47.9	47.4	45.1	45.0
Compensation of employees	9.8	9.7	9.6	9.5
Purchases of goods and services	6.0	6.0	6.4	6.4
Interest	3.1	3.1	3.0	3.0
Transfers to individuals and households	17.1	17.1	16.8	16.8
Subsidies	1.3	1.3	0.9	0.9
Other transfers	6.7	6.5	4.4	4.3
of which: capital transfers	2.0	1.9	1.0	1.0
Net acquisition of non-financial assets	3.9	3.7	3.9	4.0
Net lending / Net borrowing	-6.0	-5.8	-4.0	-4.0
(excluding bank restructuring)	-3.7	-3.5	-4.0	-4.0

Sources: Ministry of Finance; and IMF staff calculations.

INTERNATIONAL MONETARY FUND

COM COMMUNICATIONS DEPARTMENT

Press Release No. 15/62
FOR IMMEDIATE RELEASE
February 19, 2015

International Monetary Fund
700 19th Street, NW
Washington, D. C. 20431 USA

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

On February 13, 2015, the Executive Board of the International Monetary Fund (IMF) concluded the Article IV consultation[1] with the Republic of Slovenia.

Slovenia is recovering from a deep crisis. Growth is estimated to have reached around 2.6 percent in 2014, supported by strong exports and EU-funded public investment. The financial sector has stabilized following recapitalization of the major banks by the state. Government bonds yields have declined markedly.

Nevertheless, the legacies of the crisis weigh on the outlook. Output remains below pre-crisis levels, unemployment is high, and strained public and private balance sheets continue to weigh on domestic demand. Growth is thus projected at around 1.9 and 1.7 percent in 2015 and 2016, respectively, with potential growth well below pre-crisis levels. Risks are tilted to the downside, and include those of insufficient reform implementation and weaker-than-expected external demand.

The key policy challenges include (i) strengthening the health of the banking sector to enable it to support the economy; (ii) accelerating corporate restructuring to address the large debt overhang and reduce the role of the state in the economy; (iii) putting public finances on a sustainable path; and (v) further boosting the economy's potential growth through ambitious structural reforms.

Executive Board Assessment[2]

Executive Directors welcomed that Slovenia's economy is recovering and commended the authorities for their efforts to mend the banking system, facilitate corporate debt restructuring,

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

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

and consolidate the public finances. Nevertheless, continued comprehensive actions are needed to restore the health of the financial and corporate sectors, ensure fiscal and debt sustainability, and foster sustainable long-term growth.

Directors agreed that reducing the still high non-performing loans (NPLs) is a key priority. Measures to be considered in this context are additional transfers to the bank asset management company (BAMC), the development of guidelines for voluntary negotiations with SMEs, and the setting of ambitious NPL reduction targets by the supervisory authorities with monitoring of progress against them. Directors urged the authorities to press ahead with efforts to strengthen bank governance, and privatize state-owned banks. They also encouraged the authorities to address remaining capital shortfalls promptly and transparently, while minimizing fiscal costs, and to strengthen risk management and oversight on connected lending.

Directors highlighted the need to accelerate the restructuring of corporate debt by using all available tools. They emphasized that the BAMC should play a leading role in this process and stressed the importance of safeguarding its independence from political interference. Directors noted that increasing the effectiveness of the new insolvency framework by addressing operational bottlenecks can help facilitate restructurings. They also highlighted the importance of strengthening corporate governance to facilitate the sector's restructuring and attract much needed equity, and of stepping up privatization efforts, while avoiding fire sales.

Directors welcomed the authorities' renewed fiscal consolidation efforts, aiming to bring the budget deficit in check, and the progress towards implementing a fiscal rule. Most Directors recommended a somewhat more ambitious structural improvement, while being mindful of the still nascent recovery, to achieve fiscal balance and place debt on a sustained downward path. Structural fiscal reforms should underpin the durability of the adjustment. In this context, Directors emphasized the importance of pension reforms to address looming demographic pressures; tax reforms, including revamping the property tax system; and efforts to increase efficiency in health, education, and the public administration.

Directors called for continued structural reforms to support employment and growth. Noting the positive impact of earlier labor market reforms, they encouraged additional efforts to reduce the protection of open-ended contracts to facilitate labor reallocation as the corporate sector restructures and boost long-term employment prospects for the youth. Further reforms to improve the business environment, including by cutting red tape, to spur domestic and foreign investment are also important.

Slovenia: Selected Economic Indicators, 2010–16

(annual percentage change, unless otherwise indicated)

					Est.	Projections	
	2010	2011	2012	2013	2014	2015	2016
Nominal GDP (EUR millions)	36,220	36,868	36,006	36,144	37,079	37,768	38,681
GDP per Capita (EUR)	17,694	17,983	17,517	17,556	17,981	18,285	18,697
Real economy							
Real GDP	1.2	0.6	-2.6	-1.0	2.6	1.9	1.7
Domestic demand	-0.9	-0.8	-5.6	-2.1	0.9	1.0	1.8
Private consumption	1.0	-0.1	-3.0	-3.9	0.4	0.8	1.6
Public consumption	0.1	-1.3	-1.5	-1.1	-0.6	-0.6	0.7
Gross capital formation	-6.3	-1.8	-16.5	2.2	5.6	3.1	3.2
Net exports (contribution to growth)	2.3	1.5	3.1	1.1	1.4	0.8	0.1
Exports of goods and services	10.1	7.0	0.3	2.6	5.8	4.1	3.8
Imports of goods and services	6.6	5.0	-3.9	1.4	4.5	3.7	4.2
Output gap (in percent of potential GDP)	-1.6	-1.3	-3.8	-4.5	-2.3	-0.9	-0.2
Prices							
Consumer prices (national definition, period average)	1.8	1.8	2.6	1.8	0.2	-0.2	0.8
Core inflation (period average)	-0.4	-0.4	0.7	0.9	0.3	...	...
Employment and wages							
Unemployment rate (in percent, ILO definition)	7.3	8.2	8.9	10.1	9.7	9.0	8.4
Employment (Full time basis, national accounts)	-2.2	-1.6	-0.8	-1.5	0.6	0.7	0.7
Nominal wages (all sectors)	3.9	2.0	0.1	-0.1	1.1	0.4	1.1
Real wages (all sectors)	2.0	0.2	-2.5	-1.9	1.1	0.6	0.3
Public finance (percent of GDP)							
General government balance 1/	-5.2	-5.5	-3.1	-13.8	-6.0	-4.0	-3.5
General government balance excl. bank support 1/	-5.2	-4.2	-3.1	-4.3	-3.7	-4.0	-3.5
Structural balance 2/	-4.6	-4.1	-2.2	-2.2	-3.5	-2.9	-3.4
Structural primary balance 2/	-3.4	-2.8	-0.5	0.1	-0.4	0.1	-0.2
General government debt 3/	37.9	46.2	53.3	70.0	83.2	80.5	82.9
Monetary and financial indicators							
Credit to the private sector 4/	2.9	-1.9	-5.4	-6.9	-6.8	-4.6	-2.8
Lending rates 5/	4.9	5.0	4.7	4.5	4.2	...	...
Deposit rates 6/	1.8	2.2	2.3	1.9	1.0	...	...
Government bond yield (10-year)	3.8	5.0	5.8	5.8	3.3	...	...
Balance of payments (percent of GDP)							
Trade balance (goods and services)	-2.3	-2.6	-0.5	1.8	3.2	4.1	4.1
Current account balance	-0.1	0.4	2.8	5.8	5.5	6.2	5.7
Gross external debt (percent of GDP, end-period)	112.4	108.8	114.6	110.5	119.0	115.3	110.7
Nominal effective exchange rate (2010=100)	100.0	100.4	99.3	100.7	...	...	...
Real effective exchange rate (2010=100, CPI-based)	100.0	99.4	98.2	99.7	...	...	...

Sources: Data provided by the Slovenian authorities; and IMF staff calculations and projections.
1/ Includes 9.5 percent of GDP in 2013 and 2.3 percent of GDP in 2014 in capital injections into banks and support for deposit redemptions in banks being wound down.
2/ Excludes bank support and other one-offs. Adjusted for calendar year shifts between receipt and expenditure of earmarked EU funds.
3/ Includes EUR 1.1 bn in 2013 and EUR 0.7 bn in 2014 of debt issuance of the Bank Asset Management Company (BAMC).
4/ 2013 and 2014 data are adjusted to exclude the impact of transfers to the BAMC. 2014 data reflects November 2014.
5/ Floating or up-to-one-year fixed rate for new loans to non-financial corporations over 1 million euros. 2014 entry is the January-November average.
6/ For household time deposits with maturity up to one year. 2014 entry is the January-November average.

Statement by Ibrahim Halil Çanakci, Executive Director for the Republic of Slovenia and by Borut Repansek, Advisor to the Executive Director
February 13, 2015

The Slovenian authorities thank the mission team for the candid and constructive discussions, and appreciate the Fund's technical assistance. They broadly share staff's views, with the exceptions reflected in the authorities' views in the Staff Report. The authorities consider that the reform momentum has already been reignited, but are aware that the substantial policy challenges ahead leave no room for complacency.

Slovenia's economic growth has resumed and macroeconomic developments are broadly positive.

GDP growth in 2014 is estimated at 2.6 percent, while year-on-year data show 3.2 percent growth in the third quarter of 2014. The January 2015 business sentiment indicator points to an annual increase of 11.5 percent. Growth has largely been driven by improved cost competitiveness and the export-oriented part of the corporate sector, indicating that problems are not spread across the entire sector. The inflation rate is close to zero. Furthermore, employment growth rebounded in 2014. Although still high, the unemployment rate is stabilized at around 9.3 percent, which is below the EU average.

The current account is in surplus and the trust of the markets has been regained.

The 2014 and 2015 current account surpluses are projected at 5.5 percent and 6.2 percent of GDP, respectively. Slovenia has been repaying external liabilities regularly, as reflected in the negative balance in the financial account of the balance of payments, and in the rebalancing of private to public debt. Nevertheless, private sector deleveraging more than offsets the increase in public sector debt, which will result in a lowering of the total external debt. Slovenia's export market share has increased. Lastly, the financial markets' perceptions of Slovenia significantly improved after the banks' balance sheet strengthening. Since Slovenia joined the euro area in 2007, yields on its government bonds have never been lower than in recent months.

The signed social agreement provides broader support for reforms.

Slovenia held European and local elections in 2014. The early parliamentary elections took place in July, and the new government took office in September 2014. Maintaining sufficient public support and social cohesion while implementing comprehensive measures, is a challenge for every government. In this context, the recent social agreement between the authorities and social partners, which was reached after two months of intensive negotiations, is an encouraging development. The agreement, which includes 140 measures, covers the period 2015–16 and provides the basis for social consensus on reform policy implementation.

With regard to fiscal policy, the authorities took important steps on the revenue and expenditure sides in 2014.

- On the revenue side, they preserved the four income tax brackets, raised the tax on financial services and insurance operations, as well as the environment tax (due to CO2 emissions). A number of measures were adopted to increase the efficiency of tax collection and the reduction of the "shadow economy". The personal income tax was adjusted by eliminating the automatic indexation of the tax base and tax allowances. Some additional measures were also introduced to eliminate the senior allowance and benefits for daily migrants, while the decision against lowering the corporate income tax supported consolidation efforts. Certain excise duties were increased, such as on tobacco products, alcohol and alcoholic beverages other than wine, and certain fuels. The exemption from the excise duty on bio fuels enjoyed by petroleum product retailers was abolished.
- On the spending side, measures aimed at lowering expenditures initiated in October 2014 are gradually being implemented. They include the centralization of the public procurement and IT systems, as well as of the state asset management; the reduction of labor costs in the public sector; measures in municipality funding; changes to the student work system; streamlining of public services; changing some subsidies into refundable resources; and sector-specific measures by individual ministries.
- Preliminary data on the consolidated general government deficit for all of 2014 became available very recently. The consolidated general government deficit in cash terms stood at 3.4 percent of GDP, and the total deficit in ESA terms was registered at 5.3 percent of GDP. This includes one-off expenditures for the *Ljubljanska banka* depositors based on the European Court for Human Rights' (ECHR) ruling and bank recapitalizations (in the amount of 1.9 percent of GDP) which is in line with the Eurostat methodology.

Fiscal consolidation in 2015 follows the commitments of the 2014 Stability Program and the need for maintaining the growth momentum.

Fiscal policy targets for 2015 take into account the requirements and recommendations of the European Council and the commitments made in the 2014 Stability Program. At the end of January 2015, the government approved the draft 2015 revised budget, based on the 2014 budget's realization and the updated macro-economic forecasts predicting 2 percent GDP growth in 2015. The draft 2015 revised budget set the general government deficit on a cash basis at 3.62 percent of GDP. After recalculating to an accrual basis and taking into consideration the expected balance of other government units, the general government deficit in 2015 is expected to be less than 3 percent of GDP under the ESA methodology. The bulk of the difference is due to the system of execution of EU funds, where part of the cash funds will be withheld by the EU until future years (in line with EU rules).

The authorities are preparing further measures to improve tax collection, including a redesigned real estate tax and a system of certified cash registers with online connection to the tax authorities, both slated for introduction at the beginning of 2016. The draft 2015 revised budget expenditure structure is more investment-oriented, as reflected in the increase of construction expenditures and investment transfers. It also incorporates the aforementioned reduction in public sector labor costs and the replacement of some subsidies by refundable financing, as well as reduced transfers to individuals and households through better targeting.

The authorities and staff have differing views with regard to the medium-term fiscal outlook.

The authorities consider the 0.5 percent structural deficit consolidation over the medium term (lower than staff's 0.75 percent recommendation) to be appropriate in view of the ongoing economic recovery and corporate balance sheet repair, and the uncertainties concerning the size of the estimated output gap.

The authorities do not share the assessment that under the current policies, debt will increase to just below 90 percent of GDP by the end of the decade. In their view, in the medium term, debt will stabilize at around 82 percent of GDP in ESA 2010 terms due to the following:

(i) 4.2 percent of GDP of the general government debt reflects bonds issued by the Bank Assets Management Company (BAMC) under a government guarantee, which are intended to be redeemed throughout the BAMC's lifespan through the use of proceeds from the sale of assets which the BAMC received in exchange for the bonds.

(ii) 4.2 percent of GDP of the general government debt reflects the Republic of Slovenia's contribution to the European Stability Mechanism. It is expected that this contribution will be partially recovered in the medium term.

(iii) The government's policy stance over the medium term, including the use of privatization proceeds, will result in debt stabilization at the lower level.

The authorities find the scenario of a materialization of half of the outstanding government guarantees highly unlikely. The largest guarantees were issued in favor of DARS (the company managing the highway system that collects tolls), which can repay its obligations on this basis; and to the BAMC, which is already included in the government debt.

The process of implementing a fiscal rule is proceeding well. The implementation law passed the first reading in parliament with substantial support a few days ago.

However, the authorities agree that realizing the medium-term fiscal objectives is a challenge and the implementation of structural reforms is crucial. In that respect, they highly appreciate the comprehensive analyses in the Selected Issues Paper.

Slovenia's banking sector is comfortably liquid and solvent.

According to the data for the first eleven months of 2014, the banking sector has become profitable again. The increase in deposits reflects the trust of depositors. On the other hand, the income risk warrants attention, while the problem of non-performing loans (NPLs) remains, which is closely related to the slow pace and quality of the corporate sector balance sheet repair.

In terms of banking sector supervision, last year's introduction of the Single Supervisory Mechanism was a significant step forward. In parallel, the central bank is committed to strengthening banking supervision. Adjustments in the macro-prudential toolkit can be expected along with changes in risks to financial stability.

The credit-less growth of the Slovenian economy has reasons on the supply and demand side of the credit market. On the supply side, even foreign-owned banks in Slovenia are not very active on the market. Creditworthy corporates have increasingly been raising loans abroad at more favorable terms than in Slovenia. However, in 2014, corporate sector credit demand showed some increase in Slovenia for the first time in the last four years.

The BAMC took over EUR 4.865 billion of bad assets from the banks in 2014 (i.e. EUR 1.365 billion on top of EUR 3.5 billion as of the end of September last year). In addition, the value of the 36 bank-led multilateral restructuring agreements amounts to EUR 2 billion. These, in comparison to the total loans of the Slovenian banking sector to corporates, currently standing at around EUR 9.8 billion, reflects the size of the ongoing restructuring process. Moreover, banks now are well-equipped to handle their NPLs internally and in line with their own strategies, with the overall process closely monitored by the Bank of Slovenia. Given all this, as well as considering its adverse impact on public debt, the authorities do not agree with staff that additional asset transfers to the BAMC are warranted.

Continuing to address non-performing loans and the corporate sector overhang, as well as strengthening governance in the banking sector remain key priorities.

The improvements in the insolvency legal framework are reaping results and the Fund's recent advice to increase its effectiveness instead of another reform of the insolvency legal framework, is most welcome. The wind-down procedures in two banks are proceeding faster than expected. In the process of the sale of the second largest bank, binding offers of potential buyers were recently submitted. In the approval procedures of state aid, the Republic of Slovenia committed to divest its equity shares in banks. Being mindful of this commitment, the authorities steadfastly prepared a comprehensive strategy of state-owned assets management. It aims at transparently clarifying goals, methods, criteria, procedures, and equal treatment of buyers, and covers the financial and corporate sectors. The strategy will be discussed by the parliament and is expected to be approved by the end of March