

**Republic of Slovenia: 2012 Article IV Consultation—Staff Report; Informational Annex; Public Information Notice on the Executive Board Discussion; 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 2012 Article IV consultation with the Republic of Slovenia, the following documents have been released and are included in this package:

- The staff report for the 2012 Article IV consultation, prepared by a staff team of the IMF, following discussions that ended on October 3, 2012, with the officials of Slovenia on economic developments and policies. Based on information available at the time of these discussions, the staff report was completed on November 1, 2012. The views expressed in the staff report are those of the staff team and do not necessarily reflect the views of the Executive Board of the IMF.
- An Informational Annex, dated November 1, 2012
- A Public Information Notice (PIN) summarizing the views of the Executive Board as expressed during its November 21, 2012 discussion of the staff report that concluded the Article IV consultation.
- Statement by the Executive Director for the Republic of Slovenia

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# REPUBLIC OF SLOVENIA

## STAFF REPORT FOR THE 2012 ARTICLE IV CONSULTATION

November 1, 2012

### KEY ISSUES

**Context:** After a timid recovery, the economy went into recession in 2011 and is suffering from the negative feedback loops of weak activity, corporate over-indebtedness, and bank strains and deleveraging amidst challenging external conditions. After a strong fiscal effort, the headline deficit is set to decline to 3½ percent of GDP in 2012 from 4.3 percent in 2011 (cash-based, net of capital injections). Public debt, at 47 percent of GDP in end-2011, is still increasing while significant fiscal risks stem from the financial sector. Slovenia is lagging on many structural indicators but the government recently announced an ambitious plan, including an asset management company to deal with bad bank loans, pension and labor market reforms, and privatizations.

**Challenges:** (1) restructure and recapitalize banks to ensure financial stability and reinvigorate growth; (2) continue fiscal consolidation; (3) implement ambitious pension and labor market reforms and privatization.

**Staff views:** Bank restructuring, recapitalization, and privatization are needed to break the vicious spiral of deleveraging and economic contraction. With banks under pressure and the corporate sector highly leveraged it has become critical to attract fresh external equity capital. The announced front-loaded, expenditure-based fiscal consolidation to balance the structural budget by 2015 (net of bank restructuring cost) is appropriate. Pension and labor market reforms remain a priority. Labor market segmentation hinders competitiveness.

**Authorities' views:** The authorities broadly agreed that with the assessment and the recommendations. While the government has set the general goals, the authorities are still finalizing the details of the bank asset management company, the pension and labor market reforms, and privatization. They also emphasized the need to build public consensus on pension and labor market reforms.

Approved By  
**Rodrigo Valdés and  
 Christian Mumssen**

The mission took place in Ljubljana from September 19 to October 3, 2012. The team comprised Messrs. Spilimbergo (head), Dalgıç, Steinlein, Prokopenko, Rayner, and Jaramillo-Vallejo, and was assisted at headquarters by Mr. Winnekens, and Ms. Moraes Rego. The mission held discussions with the Mr. Šušteršič (Minister of Finance), Mr. Kranjec (Governor of the Bank of Slovenia) and other ministers, government officials and representatives of parliament, financial sector, labor, business, and media. Mr. Kavčič (Adviser to the Executive Director) attended also the meetings. Mr. Prader (OED) attended the concluding meeting.

## CONTENTS

<b>CONTEXT</b>	<b>4</b>
A. Policy Discussions	7
B. Outlook: A Double-Dip Recession	8
C. Financial Sector: Dealing with NPLs and Improving Bank Governance	9
D. Fiscal Policy: Implementing Structural Fiscal Consolidation and Reforming Pensions	13
E. Structural Issues: Regaining Competitiveness and Ensuring Equity	17
<b>STAFF APPRAISAL</b>	<b>19</b>
<b>BOXES</b>	
1. Slovenia's High Corporate Debt and Falling Investment	5
2. Growth Performance	9
3. Key Recommendations of the FSAP	11
4. The Public Finance Balance Act	14
5. The Government's Pension Reform Plan	16
6. Slovenia's Competitiveness	18
<b>FIGURES</b>	
1. Macroeconomic Developments	21
2. Financial Markets Indicators	22
3. External Sector Developments	23
4. Selected Banking Sector Indicators	24
5. FSIs in Comparison to Peer Countries, August 2012	25
6. Fiscal Developments	26
7. Public Debt Sustainability: Bound Tests	27
8. External Debt Sustainability: Bound Tests	28
<b>TABLES</b>	
1. Selected Economic Indicators, 2008–14	29
2. Macroeconomic Framework, 2008–17	30
3. Balance of Payments, 2008–17	31
4. Financial Soundness Indicators by Banking Group, 2009–11	32
5. Consolidated General Government Operations (cash basis), 2008–17	33

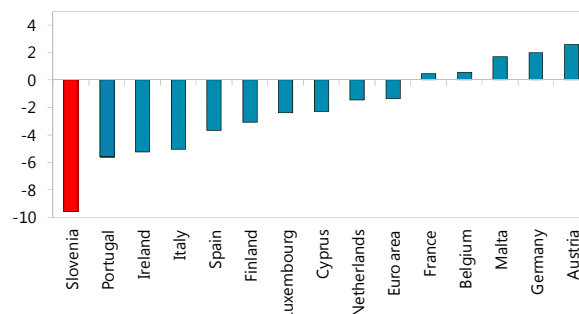
6. External Debt Sustainability Framework, 2007–17	34
7. Public Sector Debt Sustainability Framework, 2007–17	35
8. General Government Balance Sheet, 2008–11	36

## CONTEXT

**1. With a loss of more than 8 percent of GDP, Slovenia experienced the largest economic contraction since 2008 among euro area countries, excluding Greece.** After

independence in 1991, Slovenia grew steadily to achieve the highest income level in transition countries, but failed to complete structural reforms. A foreign-financed credit boom facilitated by euro adoption fueled a construction bubble and aggressive leveraging of the corporate sector, resulting in a rapid deterioration of the net international investment position (IIP). The 2008–09 crisis brought a sudden stop of capital inflows, an abrupt fall in GDP, a quick correction in the current account deficit, and broad stabilization of the IIP at levels which seem sustainable.

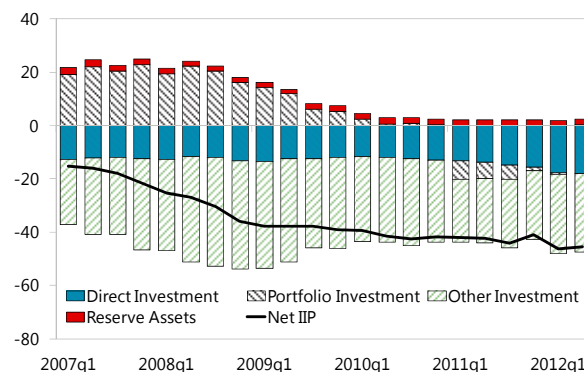
**Post-crisis Growth Performance in the Euro area**  
(Percent change in real GDP between 2008 Q3 and 2012 Q2, SA) 1/



1/ Euro area members as of 2008. Excluding Greece, due to the absence of seasonally adjusted data. Last observation for Luxembourg is 2012 Q1. Sources: Eurostat; and IMF staff calculations.

**2. Economic activity faltered once again in 2011.** The timid externally-driven recovery observed in 2010 faded as export growth slowed, deleveraging picked up pace, and fiscal consolidation started. Recession intensified in 2012, as euro area growth decelerated, external financial conditions worsened, and private consumption growth turned negative. Unemployment reached 8.4 percent in August 2012.

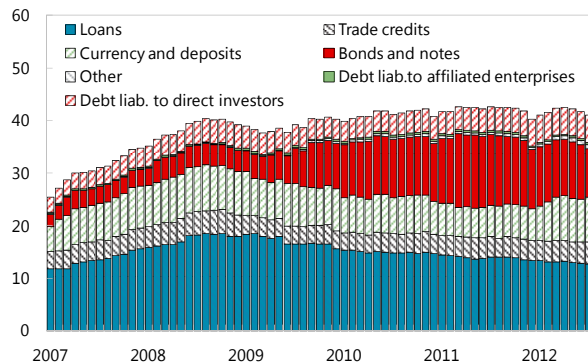
**Net International Investment Position**  
(Percent of GDP)



Source: Bank of Slovenia.

**3. Macroeconomic imbalances are unwinding, but corporate debt remains very high and investment very low** (Box 1). Inflation has been kept in check by weak demand and core indicators averaged below the euro area aggregate. The current account reached broad balance in 2011 and a moderate surplus is expected for this year, largely as a result of import compression. External competitiveness remains an issue and external debt remains high. Construction sector value added dropped below its pre-crisis share in total value added. Private investment fell to 15.7 percent of GDP in 2011, compared with an average of about 24 percent in the 2000–08.

**External Debt, 2007–12**  
(In billion euro)



Source: Bank of Slovenia.

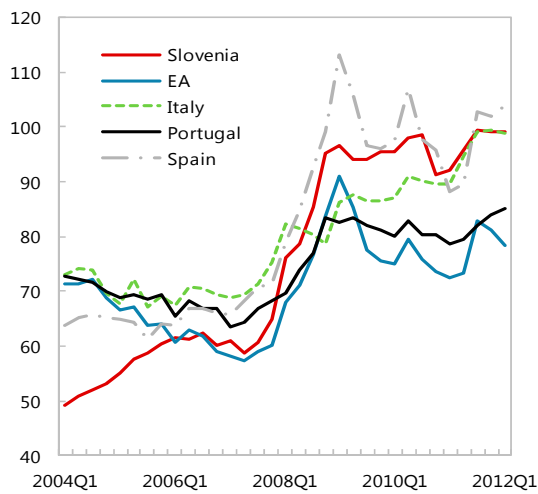
### Box 1. Slovenia's High Corporate Debt and Falling Investment

A key challenge facing Slovenia is the high level of nonfinancial corporate debt, especially relative to equity. Unlike in some other euro area countries, the pre-crisis boom in Slovenia was not primarily fueled by household debt. Instead, it was fuelled by rapid accumulation of corporate debt with domestic banks rapidly increasing leverage. This debt financing in place of equity financing has been a major drag on economic growth as financial conditions deteriorated and has contributed to one of the largest declines in private nonresidential investment in the euro area. Resolving corporate debt and attracting more equity finance (including FDI) will be critical to restore the corporate sector as the engine of economic growth.

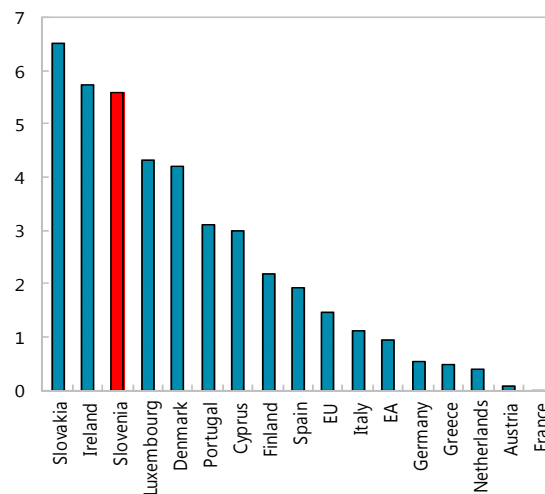
During the boom, non-financial corporations in Slovenia financed investment mostly through debt rather than equity...

...which led to one of the sharpest decline in private nonresidential investment in the euro area during the crisis.

**Nonfinancial Corporations Debt-to-Equity Ratio (Percent)**



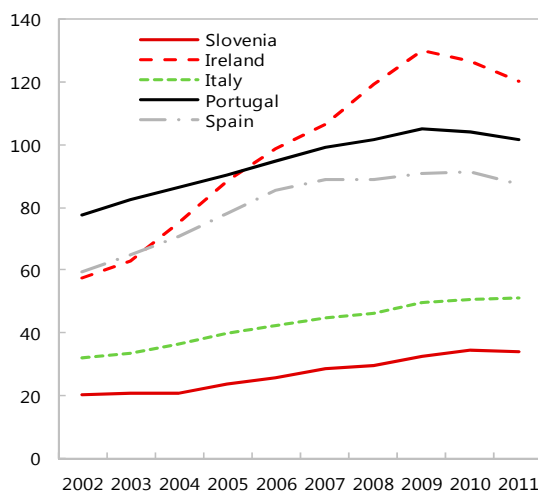
**Decline in Private Nonresidential Investment 2007-11 (Percent of GDP)**



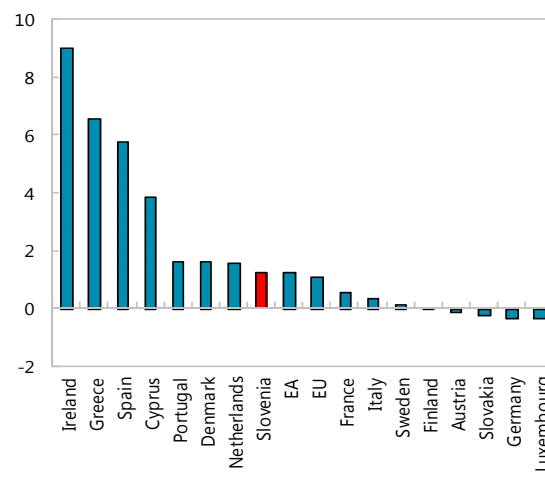
By contrast, household debt has remained very low...

...and residential investment has been relatively stable.

**Household Debt (Percent of GDP)**



**Decline in Residential Investment 2007-11 (Percent of GDP)**



Sources: ECB; Eurostat; Haver; and IMF staff calculations.

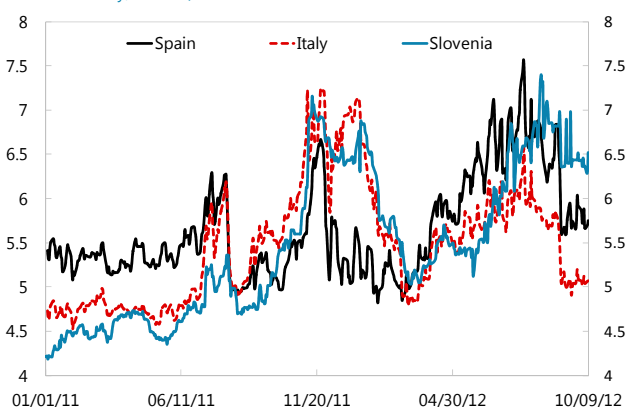
**4. Financial conditions have worsened, especially during the summer, but the sovereign issued a 10-year dollar-denominated bond in mid-October.**

Markets have been reevaluating Slovenia's riskiness as repeated rating downgrades towards the lower end of investment grade range highlighted long-standing issues, and spillovers from the financial crisis in the euro area have intensified. The 5-year CDS spread has risen to around 500 basis points in the

summer of 2012 but has declined since. In mid-October, the sovereign issued a US\$ 2.25 billion 10-year bond with a yield of 5.7 percent. The bond, which was Slovenia's first denominated in dollars since 1996, marks a return of the sovereign to long-term capital markets after 18 months.

**10-year Government Bond Yields**

(Yield-to-Maturity, Percent)



**5. Bank asset quality deteriorated and the externally-funded lending model remains under pressure.** Foreign banks have reduced their net exposure to the Slovenian banks by about \$9.6 billion (about 21 percent of estimated 2012 GDP) since the beginning of the crisis. Faced with pressures on funding and asset quality, local banks are restraining credit to the economy. Credit to the non-financial corporate sector declined by 4½ percent year-on-year in the first eight months of 2012. Firms, facing subdued demand conditions and difficulty in accessing fresh credit, are increasingly failing to meet their financial obligations. Non-performing loans (NPLs) have reached 13.2 percent of total classified claims (mostly loans) in June 2012, with NPLs of non-bank corporates hovering around 20 percent and those of households around 4.5 percent. Home mortgages do not entail a major risk for the banking system at this stage, representing about one fourth of all lending and with an NPL ratio around 3 percent. In the corporate sector, NPLs have grown the most in the construction sector (mostly infrastructure) and in the financial holding companies which were used to privatize through leveraged buy-outs, the sum of which accounted for about 21 percent of total loans in December 2011. Within the banking system, the NPLs ratio is worse in large domestic banks (24 percent in comparison to 9 percent in foreign owned banks).

**6. With a headline fiscal deficit of 5.6 percent of GDP (including capital injections), the debt-to-GDP ratio reached 47 percent at end-2011.** From a moderate pre-crisis surplus, the budget balance deteriorated sharply and the deficit has hovered around 5½ percent of GDP (in cash terms) since 2009, with pre-crisis debt more than doubling. The structural balance decreased from around 5 percent of GDP in 2010 to 3.7 percent of GDP in 2011.

**7. The new center-right coalition government has accelerated fiscal consolidation and has begun an ambitious reform program.** The intensification of the crisis has highlighted the need for reform. Social dialogue on pension and labor market reforms is ongoing. Privatization, especially of the state-owned banks, and reduction in public employment, a keystone in the government's fiscal consolidation, are very controversial.

## A. Policy Discussions

**8. Policy discussions focused on the growth outlook, bank restructuring, fiscal consolidation, pension and labor market reforms, and competitiveness.** The authorities adopted only some of the measures recommended in the 2011 Article IV mission (see table below.) They agreed that the failure to implement pension and labor market reforms and the delays in restructuring the financial sector had been key factors behind market jitters.

**Recommendations of the 2011 Article IV staff report and actions taken by the authorities**

General goals	Specific measures recommended	Actions by government
Fiscal consolidation with the goal of reducing the general government deficit to below 3 percent of GDP by 2013	Expenditure-based adjustment by reducing the public wage bill (both through wage moderation/cuts and staff reductions) and better targeting of social programs,	A reduction of the wage bill has been taking place, with a focus on wage cuts in 2012 and staff reductions in 2013. Social benefits have been reduced, although only partly through better targeting.
Strengthening the financial sector	Banks' capitalization needs to be strengthened.	Yes / Ongoing
	Improve banks' governance	Ongoing
	Broaden banks' investor base	No. On the contrary, the government has increased its share in the main publicly-owned bank
Pension Reform	Repeal tax on banks' balance sheet	No
	A more rapid increase in the effective retirement age to 65 years of age for both men and women; moving indexation gradually towards full price indexation; automatically indexing the retirement age to life expectancy at retirement.	No. The previous reform was canceled in a referendum. Current proposal addresses some of these issues
Labor Market	Reform to reduce labor market duality and improve flexibility, Reduce the dismissal cost for protected workers. Cancelling any further indexation of the minimum wage. Reform of the "mini-jobs" for students	No, but the government and social partners are working on a new bill
Product markets	Privatization and measures to enhance competition in product and financial markets to fostering FDI inflows.	No, but the government and social partners are working on a new bill



## B. Outlook: A Double-Dip Recession

**9. The growth outlook is difficult and risks are on the downside** (see Risk Assessment Matrix). With stringent financial and economic conditions continuing in the euro area, deleveraging, and fiscal consolidation, staff expects the economy to contract by 2¼ percent in 2012 with growth resuming in the second half of 2013 led by the projected euro area recovery. An intensification of the euro area crisis could further restrict access to external finance; banks' funding and capital strains may lead to an extended balance-sheet recession and to a further weakening of the economy, and contingent liabilities could lead to rapid increases in public debt. Slippages in the implementation of structural reforms could undermine confidence and recovery. Aggressive deleveraging in Slovenian banks could result in negative spillovers for countries in the region, including Kosovo, Macedonia, and Montenegro. In the medium-term, resuming the pre-crisis growth seems unfeasible in light of the adverse demographic dynamics, the closing income gap with the rest of the EU, and the declining investment (see Box 2).

**10. The authorities agreed broadly with staff's outlook and the assessment of risks.** There was consensus that economic activity faced strong headwinds from bank deleveraging, corporate indebtedness, difficulty of accessing external finance, and the needed fiscal consolidation.

## Box 2. Growth Performance

**Slovenia's pre-crisis growth performance was strong.** Real GDP growth averaged 4 percent in 1997-2005, and accelerated to 5½ percent in 2006-08, showing a strong convergence to the EU average given Slovenia's high initial income. Throughout this period, growth was supported by a relatively high investment rate and to a somewhat lesser extent by productivity growth.

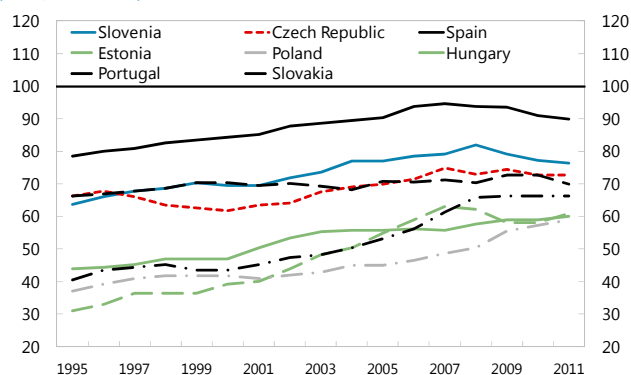
**Investment increased sharply, but was mostly allocated to the nontradable sector during the boom period.** The 2006-08 acceleration was underpinned by increased access to external finance, and a credit and investment boom that

were supported by the accommodative global financial conditions as well as Slovenia's EU entry in 2004 and euro accession in 2007. The fixed investment rate increased from 24.7 percent in 1997-2005 to 27.6 percent in 2006-08, but this increase was explained entirely by the increase in non-tradable investment, of which half was due to the increase in real estate and construction activities.

**Pre-crisis growth rates appear to be unfeasible going forward.** A low population growth rate and a high reliance on relatively stagnant European markets suggest that Slovenia's long-term growth rate is unlikely to go up to the pre-crisis range. Staff's baseline growth forecast for the medium-term is 2½ percent given the debt overhang in the corporate sector and the financial sector. Looking further ahead, using World Economic Outlook's global projections and assuming the pace of convergence matches the 1995-2011 average, Slovenia's long-term growth can reach 3 percent, assuming that structural bottlenecks are addressed.

### GDP per Capita in PPP Relative to Euro area

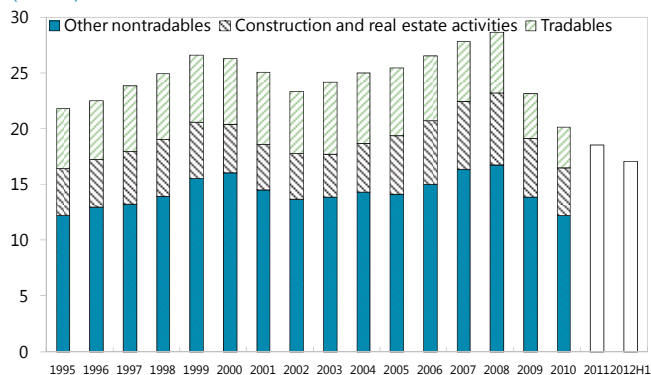
(Index, EU15 = 100)



Source: Eurostat.

### Share of Investment in GDP

(Percent)



Sources: Statistical Office of Slovenia; and IMF staff calculations.

## C. Financial Sector: Dealing with NPLs and Improving Bank Governance

**11. The performance of Slovenian banks deteriorated markedly in recent years as a result of the unfavorable operating environment and weak governance.** Bank asset quality worsened substantially since 2007, with a heavy concentration in the large publicly-owned banks. Of particular concern are loans to the over-indebted corporate sector, which is facing sluggish domestic and external demand. The largest firms, especially in the construction sector (mostly infrastructure), have been the worst hit. The increase in NPLs resulted in substantial impairment

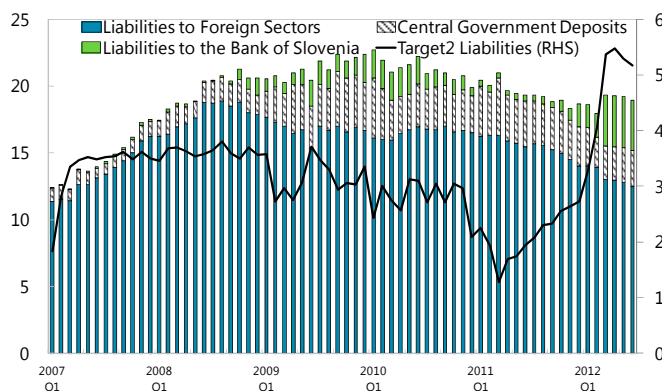
charges, leading to system-wide bank losses in the last two years and repeated downgrades of bank ratings with the largest publicly-owned banks losing investment grade.

**12. Although capital adequacy improved in 2011, many banks will need further capital increases.** The aggregate total capital adequacy ratio stood at 12 percent as of December 2011, up from 11.3 percent in 2010, mainly due to capital injections in six banks for €458 million and deleveraging. However, banks' continuing losses are eroding their capital. To meet EBA requirements, the largest publicly-owned bank Nova Ljubljanska Banka (NLB), was recapitalized again by €383 million in June 2012, and further recapitalization of this and some other banks may be needed after the planned restructuring. While the recent capital injection included €320 million through a contingent convertible bond, the ECB has noted that it generally prefers issuances of shares against cash contributions for financial stability reasons. The authorities have taken note of this preference and plan to act accordingly.

**13. Despite some deleveraging, banks are still heavily dependent on wholesale funding from abroad, and increasingly on the ECB.** Although banks have lost access to external commercial funding since 2009, the loan-to-deposit ratio remains high at 137 percent at end-March 2012. Banks have replaced external funding with government deposits and ECB financing, which increased by €3.4 billion mostly as result of LTROs. Target2 liabilities have increased to over €5.0 billion. The ratio of domestic deposits to GDP has been broadly stable so far, and the government's deposits are mostly long term. Thanks to the large use of the LTRO facility and the ample availability of ECB-eligible collateral, the bank liquidity position is still comfortable.

**Selected Liabilities of MFIs, 2007-12**

(In billion euro)



Source: Bank of Slovenia Monthly Bulletin (Jun. 2012).

However, further downgrades of the sovereign could reduce the pool of eligible assets and domestic deposits may decline in relation to GDP.

**14. The authorities are moving to strengthen the financial sector broadly in line with FSAP recommendations.** The FSAP noted that the risks to systemic financial stability stemmed mainly from the negative macroeconomic outlook and the high dependence of banks on external funding. With real estate being a major form of collateral, the real estate price risk is of particular concern.

### Box 3. Key Recommendations of the FSAP

The recently conducted FSAP highlighted the need to address important structural challenges, in particular to reform state-controlled banks that have been performing consistently weaker than any other group of banks in the last few years. Deepening the commercial orientation of state-controlled banks would require tackling the long-standing weaknesses in the governance and risk management practices of these banks, which were put into the spotlight by the crisis.

The FSAP also highlighted the need to clean up bank balance sheets and ensure adequate bank capitalization. The incurred losses should be fully recognized so that greater attention of bank management can then be devoted to new sources of income rather than resolving legacy problems. The establishment of an asset management company can enhance the bank capital and liquidity position and also trigger economies of scale in managing bad debt. However, such an entity needs to be carefully designed in order to avoid creating incentives for further rounds of similar bank cleansing; the determination of the type of assets considered and their transfer price are complex decisions.

The FSAP found the regulatory and supervisory frameworks broadly in line with international standards, though some specific weaknesses exist. It was noted that the supervision of financial institutions should be complemented with macroprudential oversight. Some elements of the crisis preparedness and management framework need significant strengthening, including the Bank of Slovenia's powers to deal with failing banks, the role of the deposit guarantee scheme, and the arrangements for official liquidity and solvency support.

**15. The authorities announced a comprehensive plan to address financial sector vulnerabilities.** The authorities have moved to obtain an external assessment of the size and distribution of bank losses, to create an asset management company, and to define a strategy for capitalizing and restructuring troubled banks and non-financial corporates.

- **Diagnostic process.** According to the standard definition used by the Bank of Slovenia (i.e. assets with more than 90 days arrears) total NPLs were € 6.3 billion as of June 2012 (13.2 percent of classified claims). Based also on due diligence exercises (already completed for NLB and to be completed by the end of the year for Nova Kreditna Banka Maribor and Abanka), the government intends to transfer up to €3 billion of assets from the banks to the new asset management company (see below), comprising both non-performing and high-risk ones.
- **Bank Asset Management Company (BAMC).** In October, the parliament voted the law on financial stability creating the BAMC as a public agency, which is subject to oversight by the supreme audit institution and the parliament. The new agency should be operational by the end-2012 or early-2013. The BAMC can issue a maximum €4 billion of government-guaranteed bonds (about 11 percent of GDP). The acquisition price for impaired assets will be the "real long-term value," following the EC State Aide guidelines. The BAMC will have the instruments and the power to seek a quick resolution of the impaired assets, be it by restructuring the corporate or by liquidating it and selling its collateral and assets. Bankruptcy procedures where the BAMC is involved are to be concluded within six months. The BAMC is to be wound down after five years, at which point the remaining assets will be

transferred to the Slovenia Sovereign Holding (SSH) company. One of the main purposes of the law establishing BAMC is to privatize the banks once they have been cleaned up and recapitalized. While public debt will increase when the BAMC's bonds are issued, this debt should be partially repaid with the proceeds from the liquidation of assets, including the privatization of the banks and other corporations that end up in the BAMC's portfolio.

- **Bank capitalization and restructuring.** Banks needing recapitalization after selling their impaired assets to the BAMC will have to prepare a restructuring plan, which will be submitted to the EC within six months of receiving recapitalization. The government estimates that banks may need to be recapitalized for up to € 1 billion (2¾ percent of GDP) to cover the losses due to the difference between the book value of the transferred assets net of provisions and the actual price paid by the BAMC as well as future losses deriving from the possible worsening of the bank assets in the future.
- **The SSH.** Also in October, the parliament passed a law to create the SSH to unify the management of all publicly owned corporations, clean up their finances, and define a strategy that includes the target stakes in different types of corporations and sectors, including full and partial privatizations. Addressing the financial weakness of the corporate sector is a necessary complement to the restructuring of the banks.

**16. Yet the implementation of the plan as well as some of the FSAP recommendations will need the authorities' strong effort.** The steps taken thus far are substantial, but are just the initial ones.

- **Bank recapitalization and restructuring.** The authorities and staff agreed that the BAMC should be independent and free of political pressures, appropriately funded, able to hire the best talent, fully accountable for its actions, transparent, and subject to external professional auditing. Staff noted that bringing banks back to a healthy state requires addressing the corporate sector debt overhang, possibly through debt to equity swaps. They should move at once to transfer the impaired assets out of the troubled banks and to subsequently recapitalize those banks. To determine capitalization needs in addition to those arising from the below-book value asset transfers to the BAMC, staff recommended thorough stress tests on the banks' remaining assets. Staff welcomed the clear and short deadlines set in the law for the acquisition of the assets and their subsequent sale, as well as the provisions to reinforce the transparency of its governance. Staff also encouraged the authorities to engage at least one international expert in the board of the BAMC to ensure its effectiveness and the adoption of solid international practices.
- **Bank privatization and governance.** Staff also encouraged the authorities to move quickly to privatize banks to bring about the needed change in their governance and commercial cultures. The changes in the management of the two largest banks may not be enough to end the public sector's interference with the commercial orientation of banks. The authorities agreed that privatization is important but noted that reducing public ownership to below the blocking minority share of 25 percent requires broader political support.

- **Crisis preparedness.** Staff recommended a prompt discussion and adoption of the draft Banking and Recovery and Resolution Acts, which enhance the powers and resources of the Bank of Slovenia to deal effectively with financial sector crises. These drafts provide adequate legal protection of bank supervisors in civil and criminal court proceedings, and empower the Bank of Slovenia to define the requirements for major acquisitions by banks, subjecting them to its approval. In addition, staff recommended periodic stress tests to monitor the quality of bank assets as well as capital adequacy as economic conditions continue to be challenging.

## D. Fiscal Policy: Implementing Structural Fiscal Consolidation and Reforming Pensions

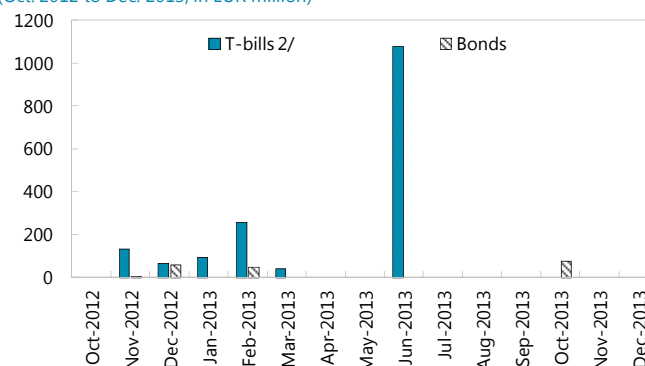
**17. The fiscal deficit is falling.** The headline deficit is set to drop to around 3½ percent of GDP in 2012 from 4.3 percent of GDP in 2011 (excluding capital injections to publicly-owned banks and corporations). This is slightly higher than planned in the May 2012 supplementary budget, mainly due to weaker revenue. The 2013 headline deficit target is 2.8 percent of GDP in spite of weaker-than-expected economic activity.

**18. Budget financing, bank restructuring costs, and T-bill rollover constitute the bulk of financing needs until end-2013.** However, the buffer provided by the recent bond issue has considerably alleviated funding pressure. Government deposits are considerable, but available only to a limited extent given their maturity structure and the implications for bank liquidity.

**19. The authorities target a structurally-balanced budget by 2015, with adjustment heavily frontloaded in 2012 and 2013.** In these two years, the cumulative structural adjustment would be around 3 percentage points of GDP. Consolidation measures in 2012 were based on a wide range of expenditure cuts. Part of these measures will also have an impact in the following years (see box 4). Additional consolidation measures in the planned 2013 budget concentrate on a reduction in public employment. Expenditure reductions are partly counteracted by gradual corporate income tax cuts and offset by a planned increase in the use of EU funds.

### Maturing Debt 1/

(Oct. 2012 to Dec. 2013, in EUR million)



1/ As of mid-September 2012.

2/ Includes a 18-months T-bill issue from Dec. 2011 in the amount of EUR 907 million.

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

### Box 4. The Public Finance Balance Act

The Slovenian Public Finance Balance Act passed in May 2012 will reduce public wages and social benefits. In addition, the accompanying budget amendment includes discretionary cuts to the purchase of goods and services, subsidies and capital expenditure in 2012 by roughly 1 percent of GDP. In 2013, further cuts in the public wage bill (not yet incorporated in the Public Finance Balance Act) are planned to fall mostly on staffing.

Slovenia: Expenditure-reducing Impact of the 2012 Public Finance Balance Act 1/  
in million euro (unless indicated otherwise)

	2012	2013	2014
Wage bill 2/	133	256	204
Social benefits 3/	153	241	185
Health care	55	115	115
Other	67	56	43
<b>Total:</b>	<b>408</b>	<b>668</b>	<b>547</b>
<i>(in percent of GDP)</i>	<i>1.1</i>	<i>1.9</i>	<i>1.5</i>

1/ as estimated by authorities

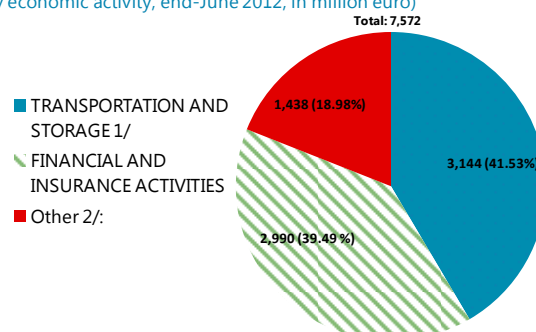
2/ predominantly related to wages and benefits

3/ e.g. family benefits and pensions

**20. Debt will increase because of bank restructuring costs.** Fiscal costs related to bank restructuring, which includes both estimated bank recapitalization and funding for the BAMC, could initially increase public debt by up to 11 percent of GDP, before the BAMC disposes of the bad loans. Bank recapitalization would result in a higher deficit. However, after the bank restructuring, banks should be able to serve their liabilities and associated government guarantees would become relatively unlikely to be called (*see text chart*). Non-financial government guarantees are mostly related to the national highway company DARS. Its ability to pay back debt will depend on future decisions on highway tolls. While the risk that these guarantees will be called is relatively low as well, DARS and its debt could be fully reclassified into general government when revised ESA rules come into effect in 2014.

#### Central Government Guarantees

(By economic activity, end-June 2012, in million euro)



1/ Mainly for national highway company (DARS) (EUR 2,897 million) and Slovene Railways (EUR 238 million)

2/ Includes EFSF (EUR 1,154 million), manufacturing (EUR 77 million), construction (EUR 27 million), wholesale and retail trade (EUR 18 million).

Source: Ministry of Finance Slovenia.

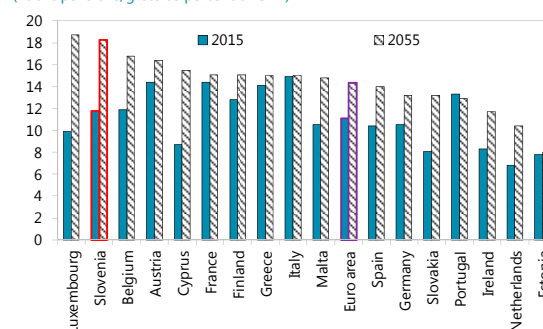
**21. Barring still higher bank restructuring cost and other contingencies and shocks, debt dynamics would still be manageable.** The staff baseline includes conservatively the aforementioned debt shock of 11 percent of GDP in 2013 (partly through an increase of the primary deficit by 2.8 percent of GDP). Under this scenario, the debt-to-GDP ratio would peak at 70 percent around 2016. Debt dynamics are less favorable, however, if further shocks occur, especially if GDP growth turns out lower than expected (see figure 7).

**22. However, aging costs loom large.**

Slovenia has one of the most adverse pension expenditure dynamics in the euro area. The 2012 Aging Report by the EC projects an increase in pension spending of 6½ percentage points of GDP between 2015 and 2055. The government and social partners are negotiating a pension reform, which appears to have better prospects than the 2011 reform. However, the current plans would rein in the long-term expenditure increase only by about 1½ percentage points of GDP, according to the authorities' estimate.

**Pension Expenditure Dynamics in the Euro Area**

(Public pensions, gross as percent of GDP)



Sources: European Commission; EPC; and IMF staff calculations.

**23. A new fiscal rule is under discussion.** Motivated by pertinent stipulations at the EU level, the government has introduced a proposal for a constitutional fiscal rule in parliament. The rule would anchor a structurally-balanced budget after 2015. Important design details will still need to be fleshed out, including the exact correction mechanism for deviations from targets (“debt brake”).

**24. Staff and authorities concurred on the need to implement the medium-term structural adjustment path.** While modest slippages in the headline deficit are acceptable given the overall economic situation, there was agreement that the medium-term target of a structural balance by 2015 should be maintained in light of financial sector restructuring cost and an aging population. Staff argued that this target should now be defined net of bank restructuring cost (including higher interest payments). Bank restructuring costs should rather be offset more gradually in economically stronger years. Staff commended the expenditure-based consolidation approach but pointed out that additional measures would need to be identified after 2013 for continued adjustment.



### Box 5. The Government's Pension Reform Plan

Key elements of the reform plans are adjustments to the retirement age, the assessment base, wage valorization, and pension indexation in the almost exclusively pay-as-you-go-based pension system:

- The standard retirement age would increase to 65 for both men and women by 2019, with an exception for long-time insured (40 years of work-related contributions), who could retire at 60, and an early retirement option with a relatively low discount.
- The assessment base is extended from 18 to 28 consecutive years with the highest earnings.
- The valorization of wages for calculating pension payments will be less favorable.
- The indexation of pensions will be based 60 percent on wages and 40 percent on inflation.

In addition, there are measures to foster the re-integration of disabled into work and strengthen the small voluntary pension pillars.

#### 25. The quality of adjustment measures and fiscal governance should be strengthened.

Efforts to rein in negative incentive effects of the planned wage bill cuts are welcome and should maintain sufficient wage differentiation for rewarding performance, while employment cuts should be selective. The authorities' intention to speed up EU fund absorption is laudable and will help contain negative consolidation effects on public investment and growth. Staff also recommended revisiting the planned reductions in the corporate income tax rate and generous allowances for investment, and emphasized the importance of non-financial incentives for domestic and foreign investment. However, the authorities pointed to existing political commitments on the tax cuts. Staff and authorities concurred that any future privatization revenues should be used for debt reduction. Finally, staff and authorities agreed that a constitutional debt brake and a medium-term fiscal framework would help anchor fiscal consolidation.

**26. The authorities agreed that the current pension reform is only a first step in the right direction.** The current pension reform adjusts several parameters of the pay-as-you-go system, with a focus on increasing actual and statutory retirement ages. However, it will leave Slovenia among the euro area countries with the highest pension expenditure as ratio of GDP, thus putting planned medium-term consolidation achievements in jeopardy in the longer run. The authorities concurred that a further reform will need to be initiated to ensure sustainability in the long term. Important elements that could be considered are the introduction of automatic adjusters, such as an automatic link of the retirement age and/or benefits to life expectancy, actuarially fairer pension discounts for early retirement, and the introduction of a mandatory second pillar.

## E. Structural Issues: Regaining Competitiveness and Ensuring Equity

**27. Slovenia's rebalancing requires relying on supply side policies, in particular in the labor market.** Against a background of weak domestic demand, Slovenia needs to shift resources to the tradable sector and regain competitiveness. In parallel, significant restructuring within sectors is necessary to boost productivity, given the corporate debt overhang. Wage growth has moderated in 2011 to about 1½ percent. Going forward, a consensus by the social partners on wage restraint would accelerate the adjustment and limit involuntary unemployment. Minimum wages are high relative to the average wages, especially after the 23 percent hike in 2010. Avoiding such discretionary increases and holding off the indexation mechanism, as foreseen in the 2013 budget execution, could alleviate the problem going forward.

**28. Labor market duality should be addressed.** Employment protection for workers with permanent contracts is very high despite some recent improvements, which hinders the much-needed allocation of labor between sectors and companies. Most of the burden thus falls on unprotected workers, who are typically younger and female, leading to inefficient and unfair segmentation in the labor market. The authorities agreed that labor market rigidity and segmentation is a significant problem, and noted that the changes to labor market regulation currently under discussion with social partners is intended to address this issue. While these plans fall short of the single open-ended contract goal, staff views them as a step in the right direction.

**29. With the banking system under pressure and the corporate sector highly leveraged, it has become critical to attract external equity capital.** Slovenia has a low stock of FDI by regional standards. This is partly a result of a relatively unattractive business climate characterized by rigid labor markets and a high administrative burden, but partly reflects a desire to sustain national ownership of key industries. However, this preference has led to interconnected holdings between public banks, holding companies, and large corporates, weak governance, and low levels of capital relative to debt. Authorities and staff concurred that FDI inflows can help mitigate these problems by injecting equity to existing firms and improving their governance. Moreover, foreign capital is likely to bring about much needed technology transfers.

**30. Privatization is an important conduit to higher FDI inflows and improved corporate governance.** Staff argued that, to attract FDI, the authorities should level the playing field between incumbents and new entrants. Privatization can also help reduce public debt and signal openness to foreign investment. The authorities agreed on the signaling role of privatization, and noted that the SSH will prepare a list of companies to be privatized. In addition, they highlighted that the aim of bank restructuring is to pave the ground for privatizing the publicly-owned banks.

### Box 6. Slovenia's Competitiveness

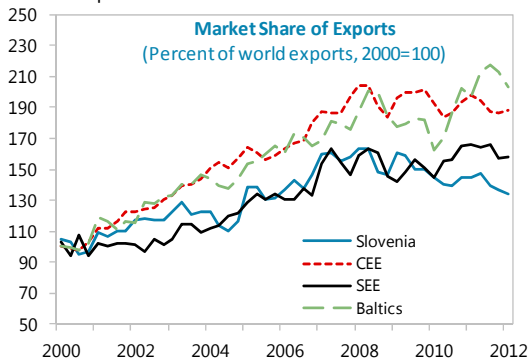
Slovenia has been losing competitiveness in recent years. Slovenia's market share of exports has steadily declined since 2008, while those of its competitors have continued to improve. Some of this poor performance is a result of the slowing demand in Slovenia's largest export markets, but most reflects deep-seated price and cost factors. Although Slovenia's real effective exchange rate appears to be broadly in line with equilibrium, some of Slovenia's non-Euro peers have been able to take advantage of exchange rate flexibility to maintain their competitiveness. Manufacturing wages also remain high relative to regional peers. Going forward, high wages will continue to be a drag on competitiveness now that the full effect of the 2010 increase in minimum wages by 23 percent has taken hold and passed through to the entire wage structure. Recent depreciation of the euro may provide a small boost to short-term competitiveness, but structural reforms, including in the labor market, are needed to improve competitiveness in the long-term.

#### Equilibrium Exchange Rate Overvaluation<sup>1</sup> (CGER estimates, percent)

Macroeconomic balance	0.6
Equilibrium exchange rate	2.0
External sustainability	-1.2

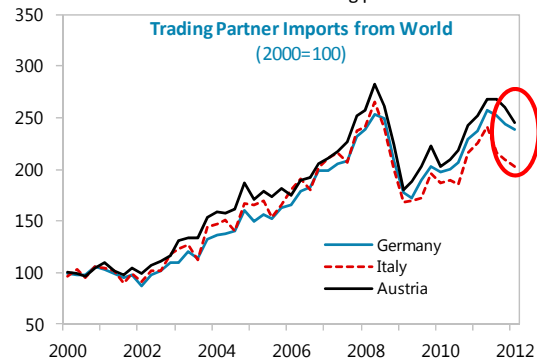
<sup>1/</sup> Multilaterally consistent estimates based on April 2012 WEO data.

Slovenia's exports have lagged behind its main competitors...



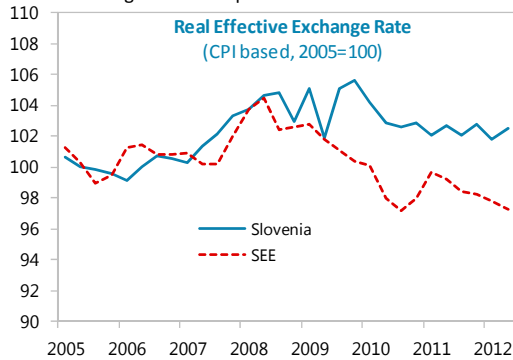
Sources: IMF, Direction of Trade Statistics; and IMF staff calculations.

...in part because of recently declining import demand in Slovenia's main trading partners ...



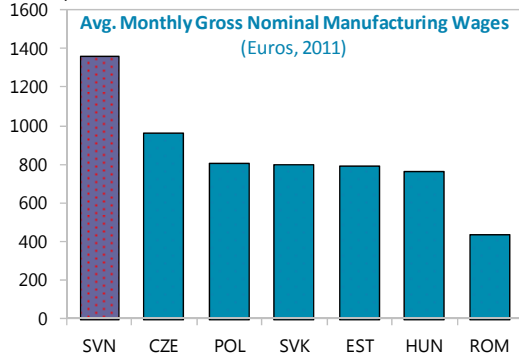
Sources: IMF, Direction of Trade Statistics; and IMF staff calculations.

...and non-Euro competitors' ability to allow their exchange rates to depreciate...



Sources: INS; and IMF staff calculations.

...and wages that are still high compared to regional peers.



Sources: Haver; and IMF staff calculations.

## STAFF APPRAISAL

**31. The economy is now suffering from the negative feedback loops of recession, bank deleveraging, and corporate distress against the background of pre-existing structural weaknesses. Financial conditions have worsened.** Amid stress in a number of countries in the euro area, markets have been reevaluating Slovenia's riskiness. The failure to address long-existing weaknesses in the financial sector, to implement pension and labor market reforms, and political uncertainties have contributed to markets' concerns. The recent sovereign long-term bond issuance gives a key time window to address these feedback loops and long-standing structural issues.

**32. Strong and prompt policy actions are necessary to address the structural weaknesses.** The government has announced an ambitious and comprehensive set of reforms, which includes a plan to deal with NPLs, improve management of public assets, accelerate fiscal consolidation, and implement pension and labor market reforms. Swift implementation of these reforms is essential to resolve the current crisis and to realize the economy's potential.

**33. The BAMC is an important first step to address the building-up of NPLs, but implementation is of the essence.** The Law to Strengthen the Stability of Banks will help to address the financial distress faced by many large non-financial corporations. Clear and short deadlines for the acquisition of the assets and their subsequent sale and BAMC's transparency are key for the BAMC's effectiveness.

**34. Publicly-controlled banks and corporates should improve governance and be ultimately privatized.** Political interference should be removed from bank management. To this end, the government should move decisively to privatize banks and corporations (critically to below a blocking minority share, which would help attract strategic investors) in order to change their governance and commercial culture. Improving bank governance will alleviate the bank-sovereign feedback loop.

**35. The regulatory framework should be strengthened further.** The mission welcomes the authorities' efforts to address FSAP recommendations. In particular, the mission endorses the authorities' action plan to strengthen the regulatory and supervisory frameworks, and improve macroprudential oversight and the crisis contingency arrangement. The mission also stresses the importance of maintaining the current supervisory architecture in a period of financial turbulence.

**36. The envisaged front-loaded, expenditure-based consolidation is necessary to bolster market confidence.** The structural adjustment in 2012 is already significant but further consolidation is necessary in light of financial sector restructuring costs and an aging population. Fiscal policy should focus on the structural balance rather than on headline targets. The goal of a balanced budget in structural terms (net of bank restructuring cost) by 2015 is appropriate.

**37. Fiscal governance and the quality of adjustment should be strengthened.** The proposed cut in the wage bill is very ambitious and staff welcomes efforts to avoid excessive wage compression, while employment cuts should be selective. A constitutional structural balance rule with a debt brake, complemented by enhanced medium-term fiscal planning, would anchor fiscal consolidation in the medium run.

**38. Pension reform is of the essence for long-term fiscal sustainability.** Current reform proposals focus on the retirement age and are a step in the right direction. However, they will leave Slovenia still among the euro area countries with the highest pension expenditure, and a more decisive reform will be necessary to ensure debt sustainability in the longer term.

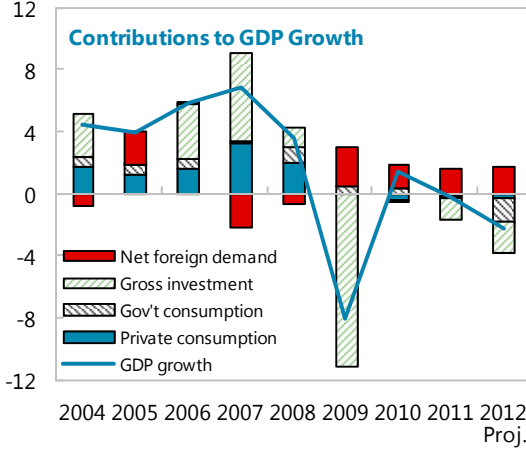
**39. Labor market reform is necessary to reduce labor market dualism and to improve competitiveness.** Employment protection for workers with permanent contracts is still very high. Unprotected workers are disproportionately young and female, leading to an inefficient and unfair segmentation in the labor market.

**40. With the banks under pressure and the corporate sector highly leveraged, it has become critical to attract external equity capital.** A preference for national ownership is at the core of weak governance, and low levels of capital relative to debt.

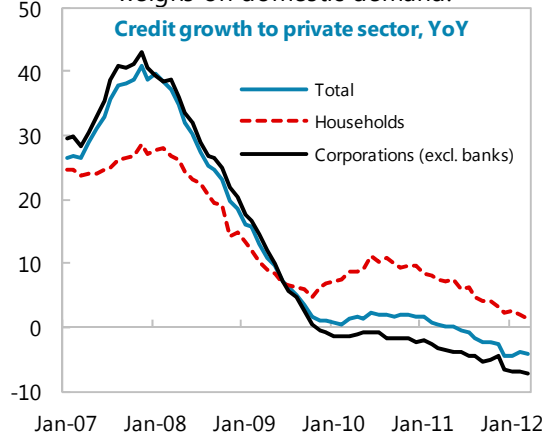
**41.** It is proposed that the next Article IV consultation be held on the 12-month cycle.

**Figure 1. Slovenia: Macroeconomic Developments**

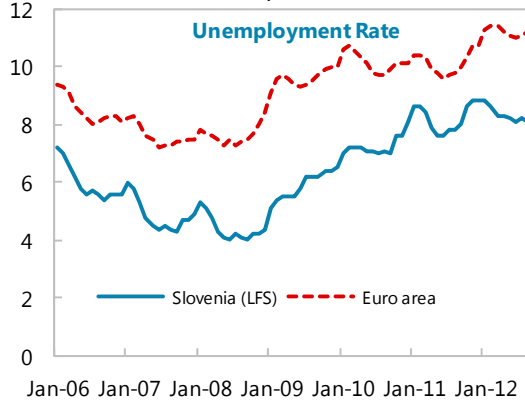
GDP has been contracting since 2011 despite positive net foreign demand...



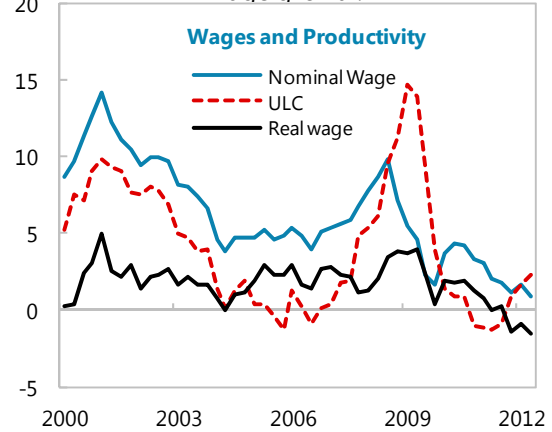
...as deleveraging in the banking sector weighs on domestic demand.



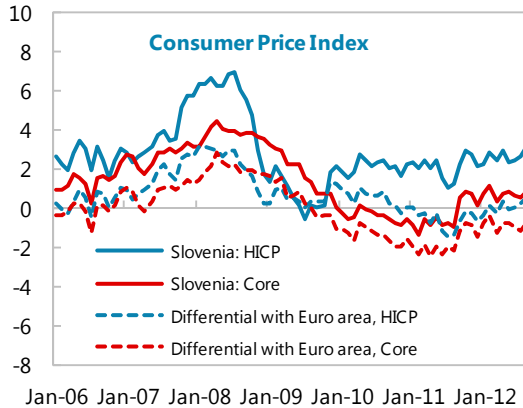
Unemployment is relatively contained given the scale of output losses...



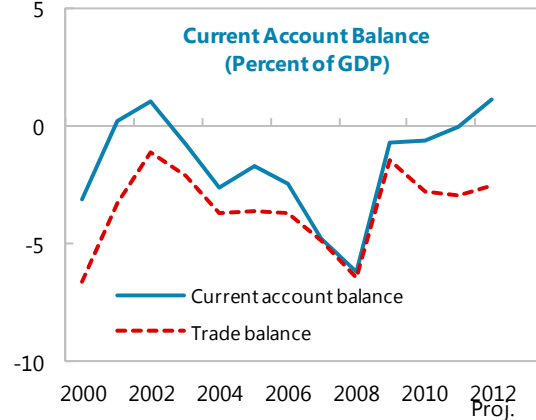
...but exerting downward pressure on the wage growth.



Weak domestic conditions have contributed to the subdued inflation...



...and to an improvement of the current account balance.

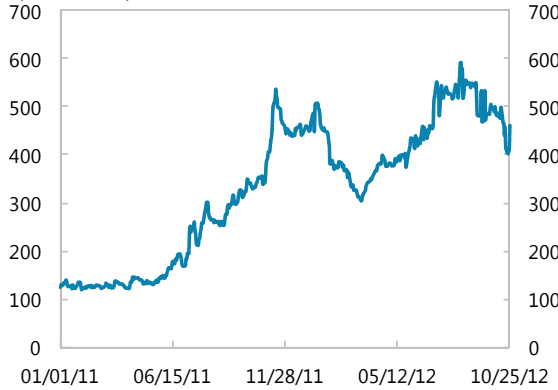


Sources: Bank of Slovenia; Ministry of Finance; Statistical Office of Slovenia; and IMF staff projections.

**Figure 2. Slovenia: Financial Markets Indicators**

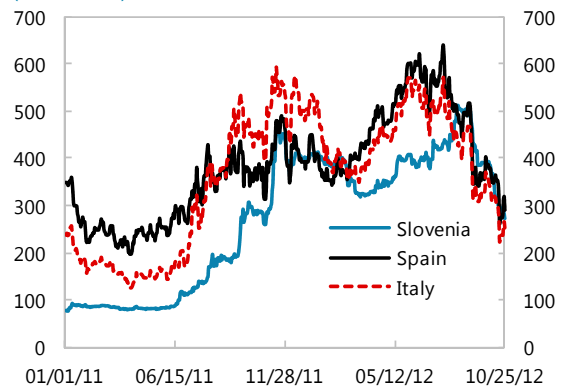
Slovenian bonds now trade significantly above core euro area rates...

**Slovenia 10-year Government Bond Spread vs. Germany 1/**  
(Basis Points)



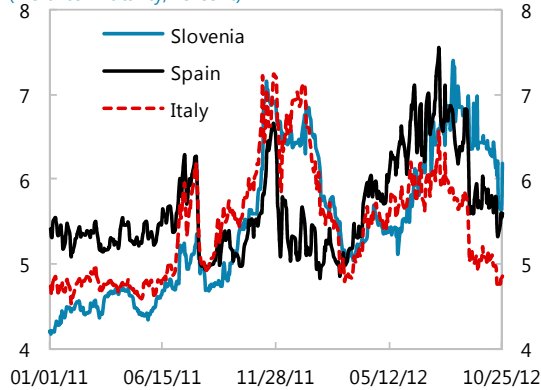
...reflecting market's reevaluation of Slovenia risks since late last year.

**5-year Sovereign CDS Spreads**  
(Basis Points)



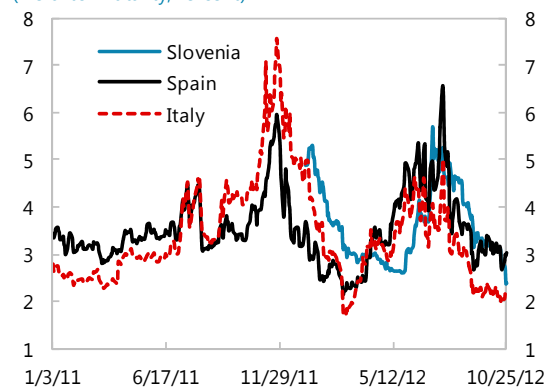
Slovenian bonds face higher yields than the bigger periphery countries, despite its better ratings...

**10-year Government Bond Yields 1/**  
(Yield-to-Maturity, Percent)



...in shorter maturities as well as the longer end.

**2-year Government Bond Yields 2/**  
(Yield-to-Maturity, Percent)



Equity prices have fallen...

**Ljubljana Stock Exchange Slovenian Blue Chip SBITOP Index**  
(Index, 3/31/2006 = 1000)



**Prices of Existing Dwellings**  
(Percent change, YoY)



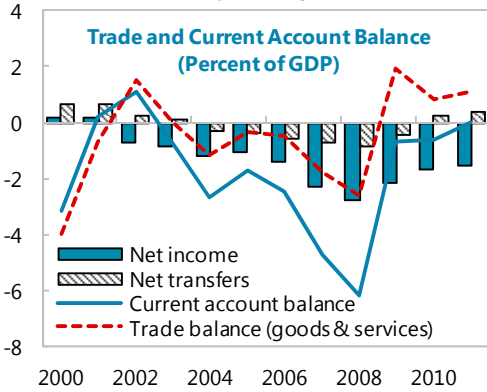
Source: Bloomberg; Statistical Office of Slovenia; and IMF staff calculations.

1/ Average of SLOREP 4.375 01/18/21 and SLOREP 4.625 09/09/24 used for Slovenia.

2/ Bloomberg 2-year generic bond yields.

**Figure 3. Slovenia: External Sector Developments**

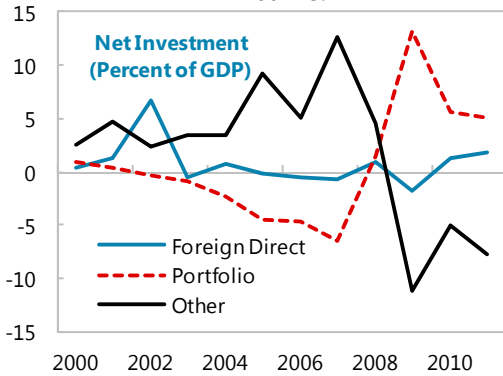
The current account deficit has narrowed substantially during the crisis...



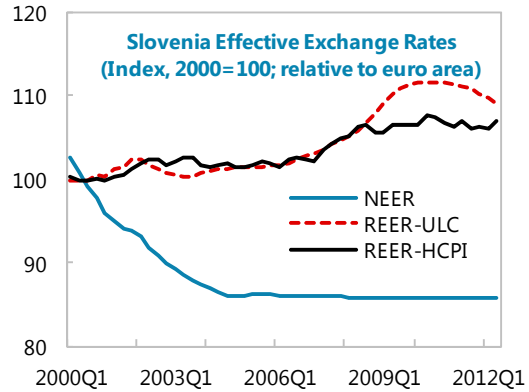
...as imports declined more than exports.



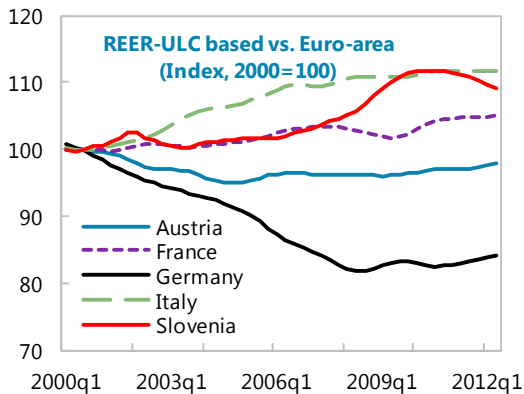
Portfolio inflows related to government issuance helped fund repayments by the banks.



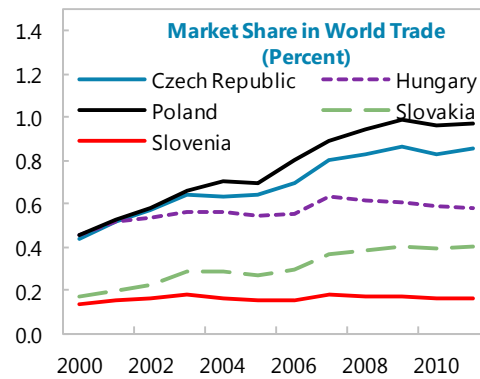
Despite some crisis-related improvement...



...Slovenia's cost competitiveness deteriorated much more than in main trading partners...



...and its market share largely underperformed the new member states.

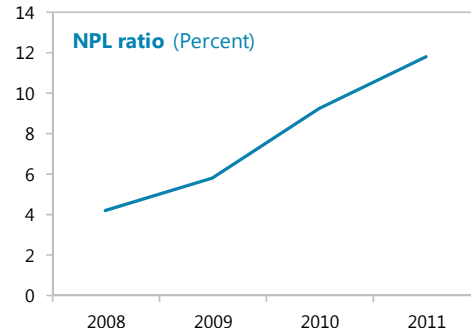
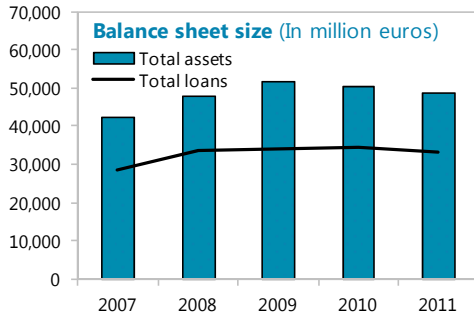


Sources: Bank of Slovenia; Statistical Office of Slovenia; European Central Bank; Direction of Trade Statistics; and IMF staff estimates.

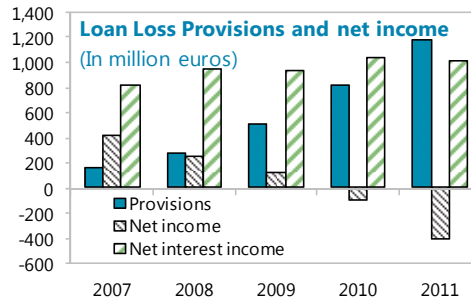
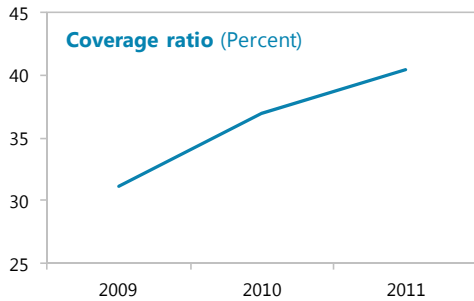


**Figure 4. Slovenia: Selected Banking Sector Indicators**

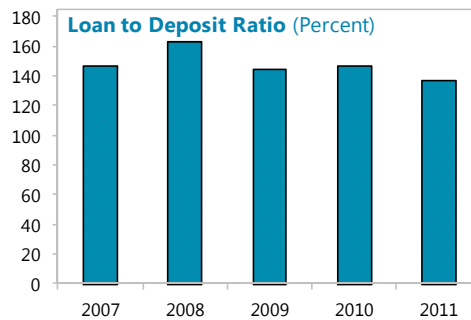
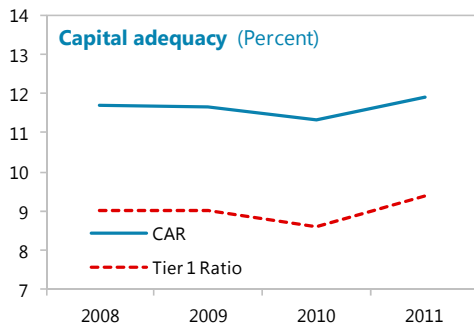
Credit to the private sector declined in 2011 reflecting started banks' deleveraging, while NPLs continued to rise...



...resulting in increased loan loss provisioning, which in addition to decreased net interest income, in turn led to substantial bank losses...

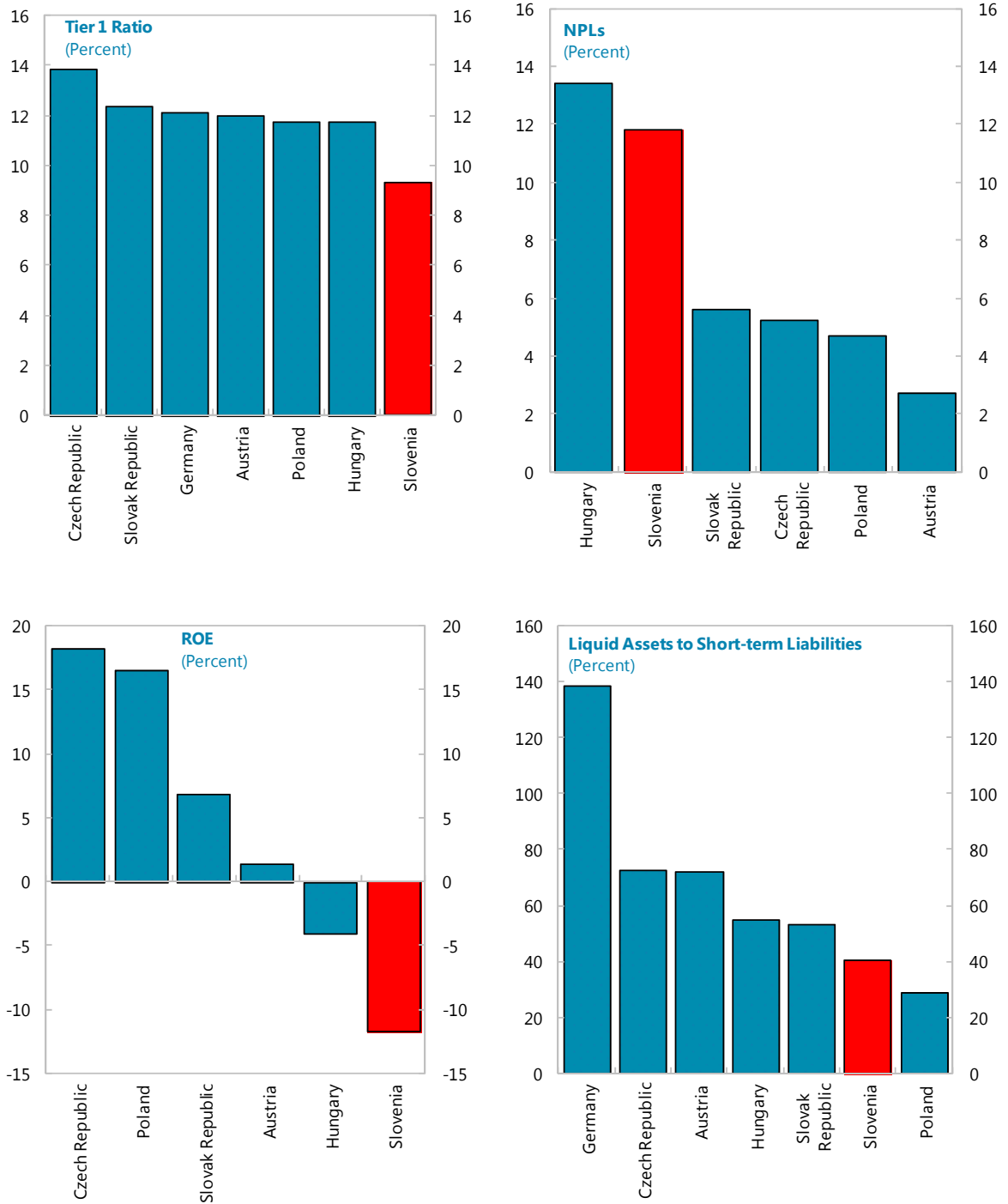


...Nevertheless, capital adequacy improved following fresh capital injections and banks' deleveraging and divestments of none core activities, while dependence on wholesale funding subsided owing to challenging capital markets.



Source: Bank of Slovenia

**Figure 5. Slovenia: FSIs in Comparison to Peer Countries, August 2012**

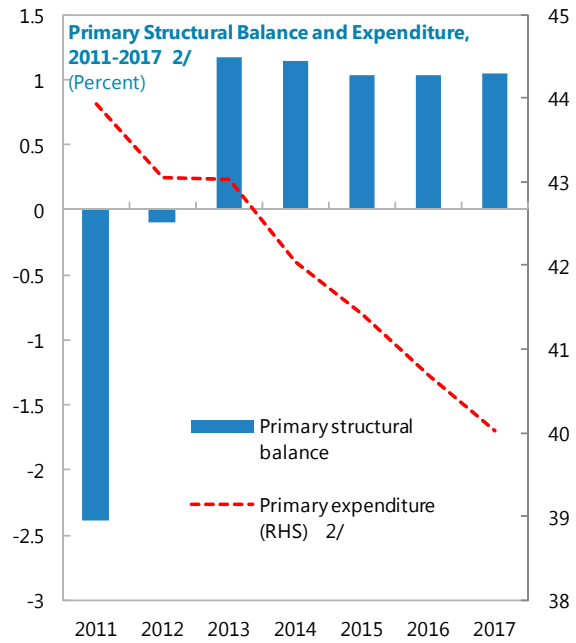
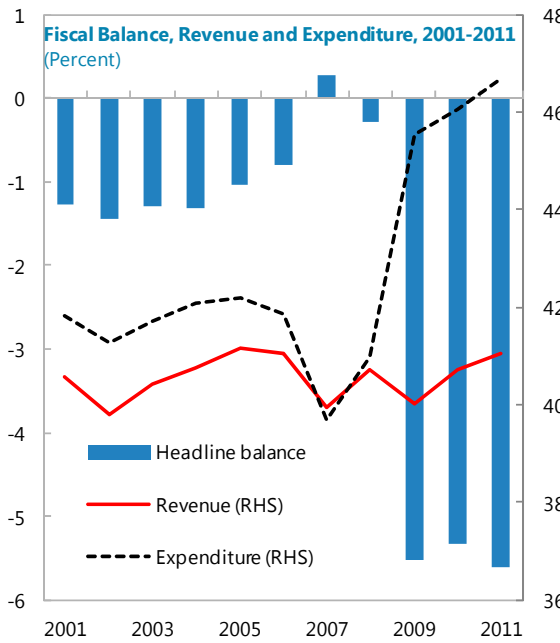


Source: IMF staff estimates.  
 Note: Data is of end-2011.

**Figure 6. Slovenia: Fiscal Developments 1/**

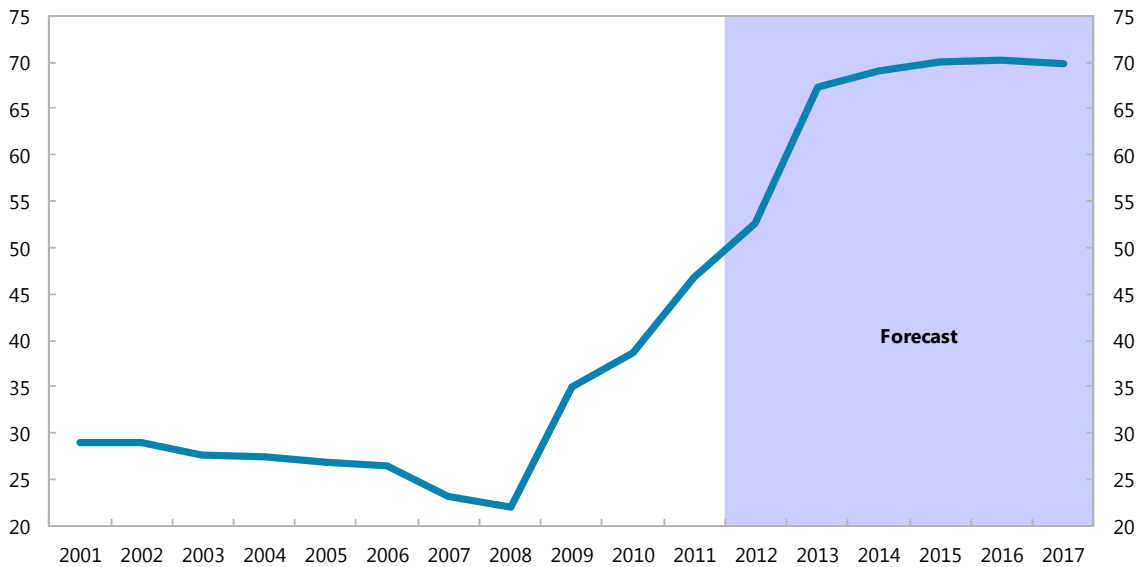
The fiscal balance has deteriorated substantially since 2008.

In spite of fiscal consolidation...



...debt will ratchet up further due to bank restructuring.

**Debt-to-GDP Ratio, 2001-2017 (Percent)**

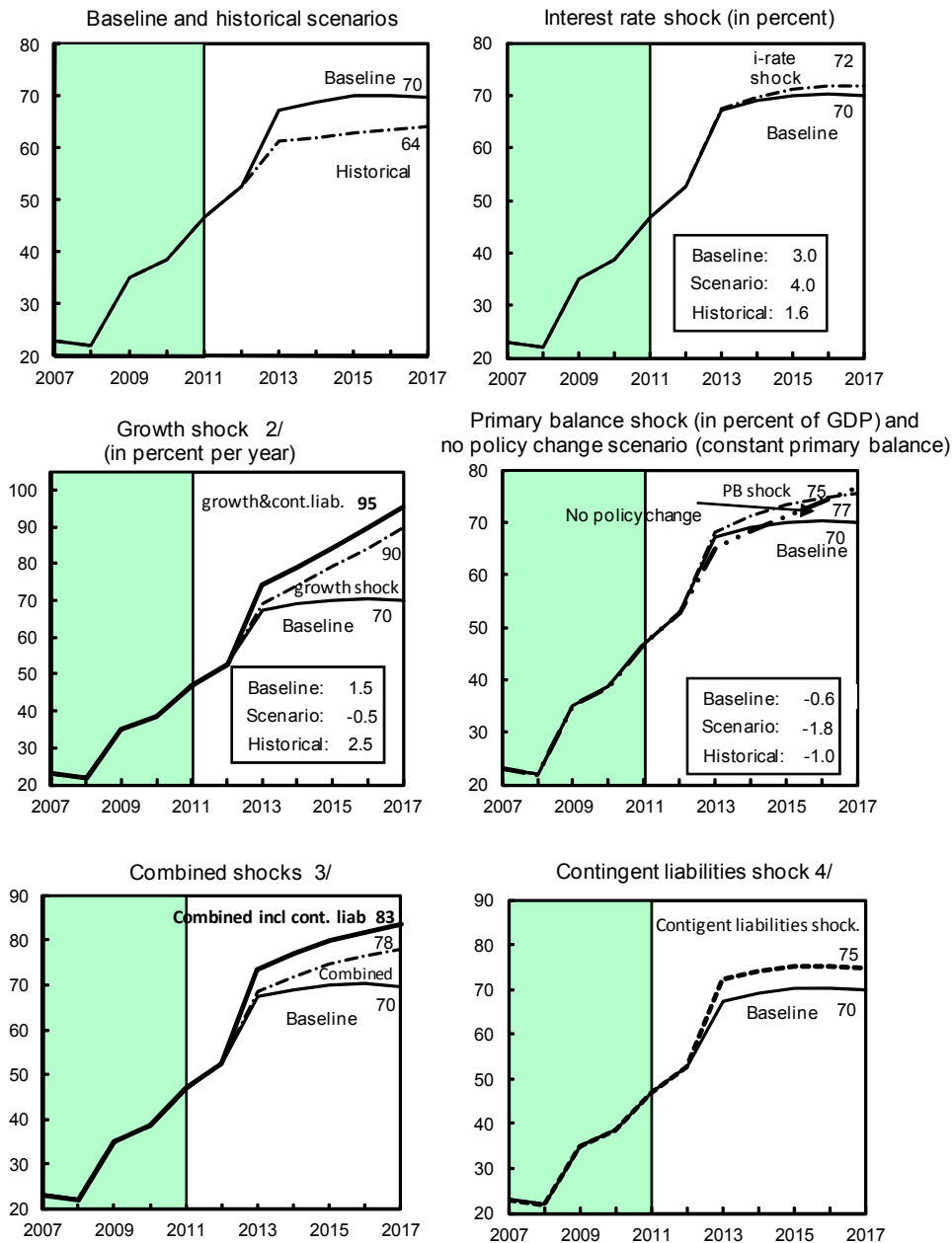


Sources: Ministry of Finance; and IMF staff estimates and projections.

1/ Baseline, which includes the following assumptions about the effects of bank restructuring in 2013: (a) debt shock of EUR 3 billion (8.3 percent of GDP) from AMC bond issuance for bad loan carve-out; (b) primary balance shock of EUR 1 billion (2.8 percent of GDP) from capital injections into banks. Furthermore, the baseline includes capital injections into financial and non-financial enterprises in the amount of 1.3 percent of GDP in 2011, but not most of the NLB support operation in June 2012 (0.9 percent of GDP, contingent convertible bond).

2/ Excludes capital injections into financial and non-financial enterprises.

**Figure 7. Slovenia: Public Debt Sustainability: Bound Tests 1/**  
(Public debt in percent of GDP)



Sources: International Monetary Fund, country desk data, and staff estimates.

1/ Baseline includes the following assumptions about the effects of bank restructuring in 2013: (a) debt shock of EUR 3 billion (8.3 percent of GDP) from AMC bond issuance for bad loan carve-out; (b) primary balance shock of EUR 1 billion (2.8 percent of GDP) from capital injections into banks. Furthermore, baseline includes capital injections into financial and non-financial enterprises in the amount of 1.3 percent of GDP in 2011, but not most of the NLB support operation in June 2012 (0.9 percent of GDP, contingent convertible bond).

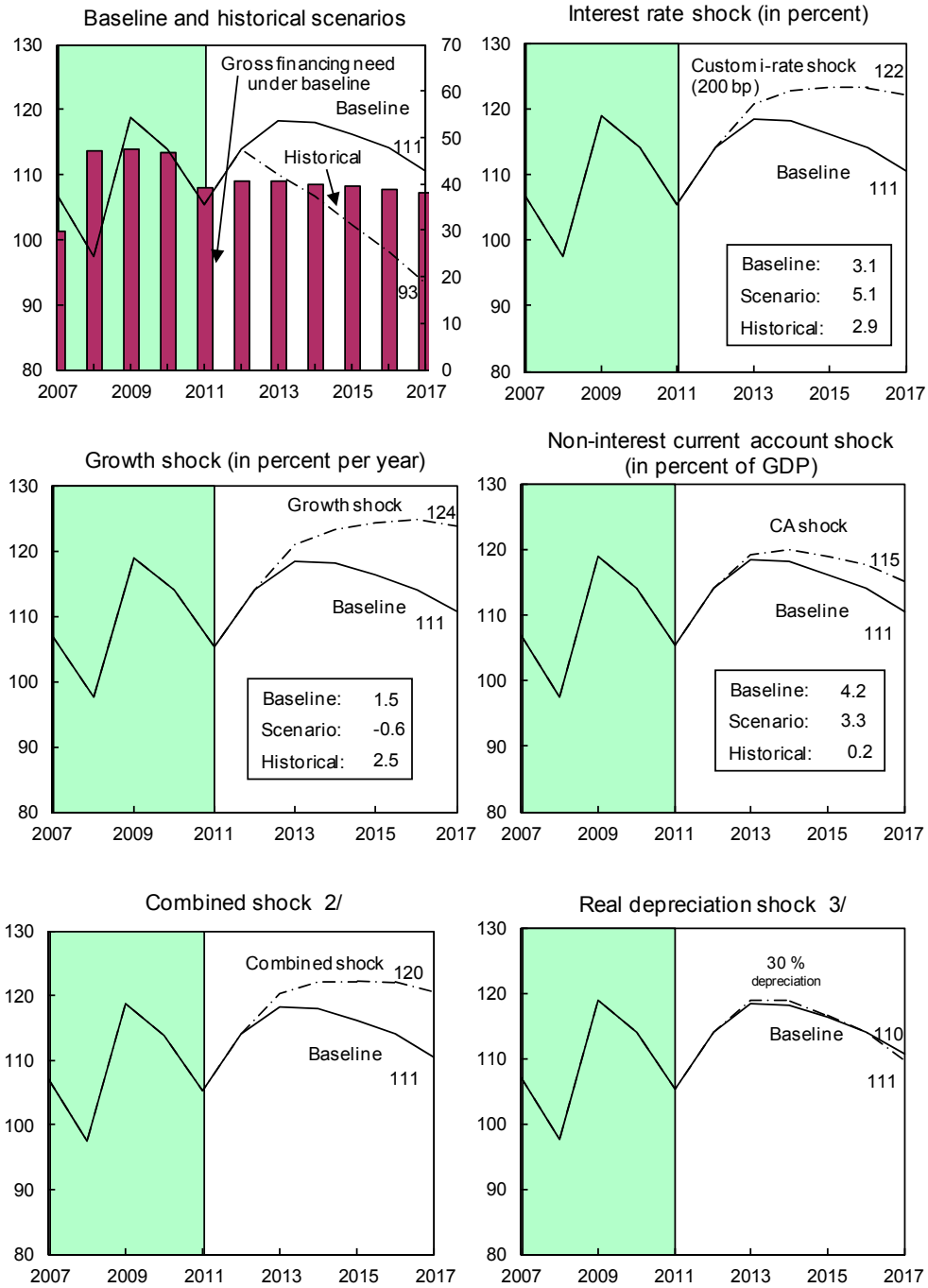
1a/ Shaded areas represent actual data. In individual shocks are permanent one-half standard deviation shocks. Figures in the boxes represent average projections for the respective variables in the baseline and scenario being presented. Ten-year historical average for the variable is also shown.

2/ "Growth&cont.liab": A 5 percent of GDP contingent liability shock occurs in 2013 in addition to lower growth.

3/ "Combined": Permanent 1/4 standard deviation shocks applied to real interest rate, growth rate, and primary balance; "Combined incl. cont. liabilities": in addition, 5 percent of GDP contingent liability shock in 2013.

4/ A 5 percent of GDP contingent liability shock occurs in 2013.

**Figure 8. Slovenia: External Debt Sustainability: Bound Tests 1/**



Sources: International Monetary Fund, Country desk data, and IMF 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/ Permanent 1/4 standard deviation shocks applied to real interest rate, growth rate, and current account balance.  
 3/ One-time real depreciation of 30 percent occurs in 2013.

**Table 1. Slovenia: Selected Economic Indicators, 2008–14**

(Annual percentage change, unless noted otherwise)

Key Export Markets: Germany, Italy, Countries of Former Yugoslavia, France, Austria

Population (2011): 2 million

Quota (as of August 31, 2012): SDR 275 million

Literacy Rate (in percent): 99.5

Main products/exports: Road Vehicles, Electrical Machinery-Appliances, Tourism, Transportation

Poverty Rate (in percent, 2009): 11

	2008	2009	2010	2011	Projections		
					2012	2013	2014
Nominal GDP (EUR millions)	37,244	35,556	35,607	36,172	35,873	35,981	37,164
GDP per Capita (EUR)	18,420	17,415	17,379	17,620	17,452	17,479	18,028
Real GDP	3.4	-7.8	1.2	0.6	-2.2	-1.0	1.7
Domestic demand	3.2	-10.0	-0.2	-0.7	-4.2	-1.9	1.2
Private consumption	2.3	0.1	1.3	0.9	-0.7	-0.9	1.5
Public consumption	5.9	2.5	1.5	-1.2	-7.9	-3.1	0.1
Gross capital formation	3.1	-33.8	-5.8	-4.6	-9.4	-3.5	1.5
Net exports (contribution to growth)	0.1	2.7	1.5	1.4	1.6	0.8	0.5
Exports of goods and services	4.0	-16.7	10.1	7.0	1.4	2.6	4.1
Imports of goods and services	3.7	-19.5	7.9	5.2	-0.7	1.7	3.7
Output gap (in percent of potential GDP)	9.2	-1.0	-0.9	-1.3	-4.1	-5.5	-4.3
Prices							
GDP deflator	4.1	3.6	-1.1	1.0	1.4	1.3	1.5
Consumer prices (national definition, period average)	5.7	0.9	1.8	1.8	2.2	1.5	1.9
Employment and wages							
Unemployment rate (in percent, ILO definition)	4.4	5.9	7.3	8.2	8.8	9.0	8.7
Unemployment rate (in percent, registered)	6.7	9.1	10.7	11.8	12.4	12.6	12.3
Nominal wages (all sectors)	8.3	3.5	3.9	2.0	0.4	-0.6	2.1
Real wages (all sectors)	2.5	2.6	2.0	0.2	-1.2	-1.9	0.4
Unit labor cost (all sectors)	7.5	10.2	0.4	-0.3	0.5	-0.4	0.8
Public finance (percent of GDP)							
General government balance 1/	-0.3	-5.5	-5.3	-5.6	-3.8	-6.2	-3.6
Primary balance 1/	0.5	-4.6	-4.1	-4.3	-2.1	-4.0	-0.7
Structural balance 2/	-3.9	-5.1	-4.9	-3.7	-1.8	-0.9	-1.7
General government debt 3/	22.0	35.0	38.6	46.9	52.7	67.3	69.0
Monetary and financial indicators							
Credit to the private sector	16.7	3.2	1.9	-2.6	...	...	...
Lending rates 4/	6.2	5.3	4.9	5.0	...	...	...
Deposit rates 5/	4.3	2.5	1.8	2.2	...	...	...
Government bond yield (10-year, average) 6/	4.7	4.4	3.8	4.2	...	...	...
Balance of payments (percent of GDP)							
Trade balance (goods)	-6.4	-1.4	-2.8	-2.9	-2.0	-1.8	-1.8
Current account balance	-6.2	-0.7	-0.6	0.0	0.7	1.0	1.0
Gross external debt (percent of GDP, end-period)	105.3	113.3	114.4	111.2	116.5	118.5	118.3
Nominal effective exchange rate (2000=100)	101.4	104.0	100.6	101.1	...	...	...
Real effective exchange rate (2000=100, CPI-based)	104.0	106.7	103.1	102.4	...	...	...
Savings and investment (percent of GDP)							
National saving	25.6	21.5	20.5	20.1	19.1	19.6	20.4
Government	4.3	-0.5	-0.5	-0.5	0.0	0.8	1.3
Non-government	21.3	21.9	21.0	20.6	19.1	18.9	19.1
Gross capital formation	31.8	22.1	21.1	20.1	18.4	18.6	19.3
Government	3.4	3.6	3.7	2.8	2.7	3.4	4.0
Non-government	28.4	18.5	17.4	17.3	15.8	15.3	15.4
Foreign saving	-6.2	-0.7	-0.6	0.0	0.7	1.0	1.0

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

1/ Includes an assumed capital injection into banks of EUR 1 billion (2.8 percent of GDP) in 2013; and support for financial and non-financial enterprises of 1.3 percent of GDP in 2011. Excludes most of a June 2012 support operation for NLB (0.9 percent of GDP, contingent convertible bond).

2/ Excludes an assumed capital injection into banks of EUR 1 billion (2.8 percent of GDP) in 2013; and support for financial and non-financial enterprises of 1.3 percent of GDP in 2011. Excludes most of a June 2012 support operation for NLB (0.9 percent of GDP, contingent convertible bond).

3/ Includes a debt shock of EUR 3 billion (8.3 percent of GDP) in 2013 due to assumed debt issuance of the new Asset Management Company for loan carve-outs.

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

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

6/ Eurostat Data

Table 2. Slovenia: Macroeconomic Framework, 2008–17

	2008	2009	2010	2011	Projections					
					2012	2013	2014	2015	2016	2017
Real GDP (percent change)	3.4	-7.8	1.2	0.6	-2.2	-1.0	1.7	2.1	2.3	2.4
Contributions to growth										
Domestic demand	3.3	-10.2	-0.2	-0.7	-4.1	-1.8	1.2	2.0	2.2	2.2
Private consumption	1.2	0.1	0.7	0.5	-0.4	-0.5	0.9	1.3	1.4	1.4
Government consumption	1.0	0.4	0.3	-0.2	-1.5	-0.6	0.0	0.1	0.1	0.1
Gross capital formation	1.0	-11.2	-1.4	-1.0	-2.0	-0.7	0.3	0.7	0.7	0.7
Net exports (contribution to growth)	0.1	2.7	1.5	1.4	1.6	0.8	0.5	0.1	0.2	0.2
Exports of goods and services	3.0	-12.4	6.8	5.1	1.1	2.1	3.4	3.8	3.9	4.0
Imports of goods and services	-2.8	15.1	-5.3	-3.7	0.5	-1.3	-2.9	-3.7	-3.8	-3.9
Growth rates										
Domestic demand	3.2	-10.0	-0.2	-0.7	-4.2	-1.9	1.2	2.1	2.3	2.4
Consumption	3.2	0.7	1.4	0.4	-2.5	-1.4	1.2	1.8	2.0	2.0
Private	2.3	0.1	1.3	0.9	-0.7	-0.9	1.5	2.2	2.4	2.4
Public	5.9	2.5	1.5	-1.2	-7.9	-3.1	0.1	0.3	0.5	0.6
Gross capital formation	3.1	-33.8	-5.8	-4.6	-9.4	-3.5	1.5	3.5	3.6	3.7
Fixed investment	7.1	-23.2	-13.8	-8.1	-10.2	-3.9	1.7	3.9	3.9	4.0
Change in stocks (contribution to GDP grow	-1.0	-4.3	2.0	0.7	0.0	0.0	0.0	0.0	0.0	0.0
Exports of goods and services	4.0	-16.7	10.1	7.0	1.4	2.6	4.1	4.4	4.5	4.5
Imports of goods and services	3.7	-19.5	7.9	5.2	-0.7	1.7	3.7	4.6	4.6	4.6
Output gap (in percent of potential)	9.2	-1.0	-0.9	-1.3	-4.1	-5.5	-4.3	-2.9	-1.4	0.1
Savings and investment (percent of GDP)										
National saving	25.6	21.5	20.5	20.1	19.1	19.6	20.4	20.5	20.8	21.1
Government	4.3	-0.5	-0.5	-0.5	0.0	0.8	1.3	1.3	1.7	2.0
Non-government	21.3	21.9	21.0	20.6	19.1	18.9	19.1	19.1	19.1	19.1
Gross capital formation	31.8	22.1	21.1	20.1	18.4	18.6	19.3	19.8	20.2	20.6
Government 1/	3.4	3.6	3.7	2.8	2.7	3.4	4.0	3.8	3.7	3.5
Non-government	28.4	18.5	17.4	17.3	15.8	15.3	15.4	16.0	16.6	17.1
Foreign saving	-6.2	-0.7	-0.6	0.0	0.7	1.0	1.0	0.7	0.6	0.5
Prices										
Consumer price inflation	5.7	0.9	1.8	1.8	2.2	1.5	1.9	2.0	2.1	2.1
GDP deflator	4.1	3.6	-1.1	1.0	1.4	1.3	1.5	1.8	2.1	2.0
Employment (percent change)	2.6	-1.8	-2.2	-1.6	-2.1	-0.7	0.4	0.5	0.6	0.6
Unemployment rate (ILO, percent)	4.4	5.9	7.3	8.2	8.8	9.0	8.7	8.3	7.9	7.5
Real wages (percent change)	2.5	2.6	2.0	0.2	-1.2	-1.9	0.4	0.7	0.8	0.9
Government budget (percent of GDP)										
Revenue	41.2	40.5	41.5	41.4	41.6	42.4	42.1	42.0	42.0	41.9
Expenditure 2/	41.5	46.0	46.9	47.0	45.4	48.6	45.7	45.3	44.8	44.2
General government balance 2/	-0.3	-5.5	-5.3	-5.6	-3.8	-6.2	-3.6	-3.3	-2.9	-2.3
Structural government balance 3/	-3.9	-5.1	-4.9	-3.7	-1.8	-0.9	-1.7	-2.1	-2.3	-2.3
General government debt 4/	22.0	35.0	38.6	46.9	52.7	67.3	69.0	70.1	70.2	69.8
Merchandise trade (percent change)										
Export volume	1.8	-17.4	11.9	8.5	1.0	2.7	4.4	4.7	4.8	4.8
Import volume	3.0	-20.7	8.9	6.1	-1.1	1.9	4.0	5.0	4.9	4.9
Export value	2.5	-19.1	14.3	13.3	3.2	5.1	6.4	6.8	7.0	7.0
Import value	5.6	-25.4	16.8	12.9	1.5	4.5	6.3	7.2	6.9	6.9
External balances (in billions of euros)										
Trade balance (merchandise)	-2.4	-0.5	-1.0	-1.0	-0.7	-0.6	-0.7	-0.8	-0.8	-0.9
In percent of GDP	-6.4	-1.4	-2.8	-2.9	-2.0	-1.8	-1.8	-2.0	-2.0	-2.1
Exports of goods	20.3	16.4	18.8	21.3	22.0	23.1	24.5	26.2	28.0	30.0
Imports of goods	22.7	16.9	19.8	22.3	22.7	23.7	25.2	27.0	28.9	30.9
Current account	-2.3	-0.2	-0.2	0.0	0.2	0.4	0.4	0.3	0.2	0.2
In percent of GDP	-6.2	-0.7	-0.6	0.0	0.7	1.0	1.0	0.7	0.6	0.5

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

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

2/ Includes an assumed capital injection into banks of EUR 1 billion (2.8 percent of GDP) in 2013; and support for financial and non-financial enterprises of 1.3 percent of GDP in 2011. Excludes most of a June 2012 support operation for NLB (0.9 percent of GDP, contingent convertible bond).

3/ Excludes an assumed capital injection into banks of EUR 1 billion (2.8 percent of GDP) in 2013; and support for financial and non-financial enterprises of 1.3 percent of GDP in 2011. Excludes most of a June 2012 support operation for NLB (0.9 percent of GDP, contingent convertible bond).

4/ Includes a debt shock of EUR 3 billion (8.3 percent of GDP) in 2013 due to assumed debt issuance of the new Asset Management Company for loan carve-outs.

**Table 3. Slovenia: Balance of Payments, 2008–17**

	2008	2009	2010	2011	Projections					
					2012	2013	2014	2015	2016	2017
	(Millions of Euros)									
Current account	-2,295	-246	-209	1	249	351	374	257	232	213
Trade balance, goods and services	-962	667	288	399	872	1,054	1,137	1,097	1,155	1,214
Goods	-2,385	-498	-997	-1,043	-727	-638	-650	-785	-826	-871
Exports f.o.b.	20,295	16,410	18,762	21,265	21,952	23,066	24,538	26,217	28,050	30,009
Imports f.o.b.	-22,681	-16,908	-19,759	-22,308	-22,679	-23,704	-25,188	-27,001	-28,875	-30,880
Services	1,424	1,165	1,285	1,443	1,599	1,691	1,787	1,881	1,981	2,085
Exports	4,957	4,347	4,616	4,839	5,057	5,240	5,473	5,739	6,024	6,322
Imports	-3,533	-3,182	-3,331	-3,396	-3,458	-3,548	-3,686	-3,858	-4,043	-4,237
Income, net	-1,030	-754	-599	-550	-708	-786	-849	-930	-1,017	-1,100
Current transfers, net	-303	-159	103	152	84	84	87	90	94	99
Capital account, net	-25	14	53	-102	12	7	26	-1	40	19
Financial account, net	2,623	161	482	-350	-261	-359	-400	-256	-272	-232
Direct investment, net	327	-657	431	638	502	432	372	386	403	421
Portfolio investment, net	572	4,628	1,956	1,838	-91	136	222	275	282	178
Financial derivatives	45	-1	-116	-136	0	0	0	0	0	0
Other investment, net	1,656	-3,976	-1,806	-2,762	-672	-926	-994	-917	-957	-831
Reserves (-: increase)	21	167	19	72	0	0	0	0	0	0
Errors and omissions	-302	71	-326	450	0	0	0	0	0	0
	(Percent of GDP)									
Current account	-6.2	-0.7	-0.6	0.0	0.7	1.0	1.0	0.7	0.6	0.5
Trade balance, goods and services	-2.6	1.9	0.8	1.1	2.4	2.9	3.1	2.8	2.9	2.9
Goods	-6.4	-1.4	-2.8	-2.9	-2.0	-1.8	-1.8	-2.0	-2.0	-2.1
Exports f.o.b.	54.5	46.2	52.7	58.8	61.2	64.1	66.0	67.9	69.6	71.3
Imports f.o.b.	-60.9	-47.6	-55.5	-61.7	-63.2	-65.9	-67.8	-69.9	-71.6	-73.3
Services	3.8	3.3	3.6	4.0	4.5	4.7	4.8	4.9	4.9	5.0
Exports	13.3	12.2	13.0	13.4	14.1	14.6	14.7	14.9	14.9	15.0
Imports	-9.5	-8.9	-9.4	-9.4	-9.6	-9.9	-9.9	-10.0	-10.0	-10.1
Income, net	-2.8	-2.1	-1.7	-1.5	-2.0	-2.2	-2.3	-2.4	-2.5	-2.6
Current transfers, net	-0.8	-0.4	0.3	0.4	0.2	0.2	0.2	0.2	0.2	0.2
Capital account, net	-0.1	0.0	0.1	-0.3	0.0	0.0	0.1	0.0	0.1	0.0
Financial account	7.0	0.5	1.4	-1.0	-0.7	-1.0	-1.1	-0.7	-0.7	-0.6
Direct investment, net	0.9	-1.8	1.2	1.8	1.4	1.2	1.0	1.0	1.0	1.0
Portfolio investment, net	1.5	13.0	5.5	5.1	-0.3	0.4	0.6	0.7	0.7	0.4
Financial derivatives	0.1	0.0	-0.3	-0.4	0.0	0.0	0.0	0.0	0.0	0.0
Other investment, net	4.4	-11.2	-5.1	-7.6	-1.9	-2.6	-2.7	-2.4	-2.4	-2.0
Reserves (-: increase)	0.1	0.5	0.1	0.2	0.0	0.0	0.0	0.0	0.0	0.0
Errors and omissions	-0.8	0.2	-0.9	1.2	0.0	0.0	0.0	0.0	0.0	0.0
Memorandum items:										
Export of goods (percent change in value)	2.5	-19.1	14.3	13.3	3.2	5.1	6.4	6.8	7.0	7.0
Import of goods (percent change in value)	5.6	-25.4	16.8	12.9	1.5	4.5	6.3	7.2	6.9	6.9
Gross external debt (millions of Euros)	39,234	40,294	40,723	40,241	41,788	42,633	43,959	44,949	46,057	46,635
(percent of GDP)	105.3	113.3	114.4	111.2	116.5	118.5	118.3	116.4	114.3	110.7
Net external debt (millions of Euros)	39,234	40,294	40,723	40,241	39,666	39,066	38,566	38,066	37,556	36,980
(percent of GDP)	105.3	113.3	114.4	111.2	110.6	108.6	103.8	98.6	93.2	87.8

Source: Bank of Slovenia, and IMF staff estimates and projections.



**Table 4. Slovenia: Financial Soundness Indicators by Banking Group, 2009–11**

	2009				2010				2011			
	Total banking sector	Large domestic banks	Small domestic banks 1/	Foreign banks 2/	Total banking sector	Large domestic banks	Small domestic banks 1/	Foreign banks 2/	Total banking sector	Large domestic banks	Small domestic banks 1/	Foreign banks 2/
<b>Capitalization</b>												
Regulatory capital to risk-weighted assets	11.7	11.9	11.4	11.3	11.3	11.3	11.3	11.4	11.9	11.7	11.6	12.3
Regulatory Tier 1 capital to risk-weighted assets	9.0	8.9	8.9	9.5	8.6	8.2	8.9	9.7	9.3	8.8	9.4	10.7
<b>Asset Quality 3/</b>												
Nonperforming loans net of provisions to capital	36.5	37.7	31.0	35.3	49.8	54.1	51.7	39.2	69.9	85.0	76.0	37.3
Nonperforming loans to total gross loans	5.7	6.3	5.6	4.7	8.2	9.2	8.3	6.1	11.8	14.3	12.1	6.2
<b>Sectoral distribution of loans (classified claims)</b>												
Manufacturing	13.8	13.8	12.0	14.4	13.5	13.7	11.6	13.7	13.2	13.3	12.1	13.2
Construction and real estate	9.1	9.1	10.5	8.8	9.5	9.7	9.8	9.0	9.6	9.9	9.8	8.7
Wholesale and trade	9.8	8.3	12.4	12.1	9.6	8.2	11.4	12.1	9.2	8.0	10.6	11.2
Transportation	4.6	4.6	1.4	5.3	4.6	4.6	1.1	5.6	4.7	4.6	1.1	6.1
Financial	16.0	18.5	15.2	11.2	17.5	20.1	18.5	11.4	17.4	20.4	20.1	10.3
Households	16.9	14.7	12.1	22.6	18.2	14.9	12.5	27.4	18.7	14.7	12.5	29.0
Non residents	8.2	10.6	10.5	2.8	8.2	10.6	10.5	2.2	7.2	9.2	9.5	2.4
Other	21.6	20.5	26.0	22.8	18.8	18.1	24.6	18.7	20.0	19.8	24.4	19.1
Provisions to nonperforming Loans	31.4	31.1	36.2	30.6	37.1	37.9	31.7	36.6	40.8	42.6	33.0	35.9
Off-balance-sheet assets to total assets 4/	13.1	14.1	8.0	12.5	12.5	13.5	6.7	11.9	12.3	11.9	10.1	13.8
FX-loans to total loans	5.2	4.7	0.9	7.1	4.6	3.8	0.7	7.1	5.7	4.1	0.9	10.2
FX-loans to total loans (nonbanking sector)	4.8	4.2	0.6	7.0	4.3	3.6	0.5	6.5	5.2	3.5	0.5	9.2
<b>Profitability</b>												
Return on assets	0.2	0.0	0.4	0.5	-0.2	-0.5	0.1	0.3	-0.9	-1.3	-0.7	0.2
Return on equity	2.2	0.5	4.1	5.9	-3.2	-6.2	1.4	3.0	-11.7	-17.8	-12.6	2.5
Interest margin to gross income	61.2	60.6	54.8	64.8	63.5	61.9	65.8	67.7	65.2	64.8	61.1	67.3
Noninterest expenses to gross income	55.0	52.3	59.4	61.8	58.1	58.3	59.4	57.1	63.2	63.8	65.1	61.0
<b>Liquidity</b>												
Liquid assets to total assets 3/	13.9	17.3	16.1	6.1	14.3	17.4	15.3	7.0	13.5	15.8	15.3	7.7
Liquid assets to short-term liabilities 3/	36.0	41.9	32.4	20.3	42.5	51.5	36.0	22.9	40.0	47.1	38.5	23.9
Net open position in foreign exchange to capital	-0.9	-1.3	1.0	-0.4	-1.2	-2.0	1.1	0.1	-1.8	-3.0	1.5	0.3

Source: Bank of Slovenia.

1/ Small domestic banks and saving banks.

2/ Foreign branches not included.

3/ Solo basis.

4/ Classified off balance sheet items to total classified claims.

**Table 5. Slovenia: Consolidated General Government Operations (cash basis), 2008–17**

(In percent of GDP, unless indicated otherwise)

	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017
	Projections									
Revenue	40.7	40.0	40.7	41.1	41.2	41.9	41.4	41.3	41.2	41.2
Taxes	23.8	21.9	21.4	22.0	21.8	21.9	21.9	21.9	21.9	21.9
Taxes on income, profit, payroll	9.9	8.0	7.1	7.6	7.2	6.8	6.7	6.7	6.7	6.7
Taxes on goods and services	13.2	13.4	13.7	13.7	14.0	14.4	14.5	14.5	14.5	14.5
Other taxes	0.6	0.6	0.6	0.6	0.6	0.7	0.7	0.7	0.7	0.7
Social contributions	13.7	14.5	14.7	14.6	14.6	14.4	14.4	14.3	14.3	14.2
Other revenue	3.3	3.6	4.6	4.5	4.8	5.5	5.1	5.1	5.1	5.1
Expenditure	41.0	45.6	46.0	46.7	45.0	48.0	44.9	44.6	44.1	43.5
Expense	38.1	42.4	43.2	44.2	42.7	45.2	41.7	41.5	41.2	40.7
Compensation of employees	9.6	11.0	11.0	10.7	10.6	10.0	9.6	9.4	9.2	8.9
Purchases of goods and services	6.8	7.1	7.1	6.8	6.5	6.4	6.1	6.0	5.8	5.6
Interest	0.9	0.9	1.4	1.5	1.8	2.2	2.9	3.2	3.4	3.5
Transfers to individuals and households	15.1	16.9	17.6	18.1	17.9	17.9	17.3	17.4	17.4	17.4
Subsidies	1.3	1.7	1.6	1.4	1.3	1.5	1.2	1.2	1.1	1.1
Other transfers	4.4	4.8	4.5	5.8	4.6	7.3	4.5	4.4	4.3	4.2
Net acquisition of non-financial assets	2.9	3.2	2.8	2.5	2.3	2.8	3.2	3.1	2.9	2.8
Gross operating balance <sup>1/</sup>	2.6	-2.4	-2.5	-3.1	-1.5	-3.4	-0.3	-0.3	0.1	0.4
Net lending / Net borrowing <sup>1/</sup>	-0.3	-5.5	-5.3	-5.6	-3.8	-6.2	-3.6	-3.3	-2.9	-2.3
Net acquisition of financial assets	-0.6	5.9	-2.9	2.7	...	...	...	...	...	...
Net incurrence of liabilities	-0.4	11.4	2.5	8.3	...	...	...	...	...	...
Memorandum item:										
General government balance (ESA 95)	-1.9	-6.0	-5.7	-6.4	...	...	...	...	...	...
Structural budget balance <sup>2/</sup>	-3.9	-5.1	-4.9	-3.7	-1.8	-0.9	-1.7	-2.1	-2.3	-2.3
Structural primary balance <sup>2/</sup>	-3.2	-4.2	-3.7	-2.4	-0.1	1.2	1.1	1.0	1.0	1.0
General government debt <sup>3/</sup>	22.0	35.0	38.6	46.9	52.7	67.3	69.0	70.1	70.2	69.8
Nominal GDP (millions of euro)	37244	35556	35607	36172	35872	35985	37166	38607	40314	42111

Sources: Ministry of Finance; and IMF staff calculations.

1/ includes an assumed capital injection into banks of EUR 1 billion (2.8 percent of GDP) in 2013; and support for financial and non-financial enterprises of 1.3 percent of GDP in 2011. Excludes most of a June 2012 support operation for NLB (0.9 percent of GDP, contingent convertible bond).

2/ excludes an assumed capital injection into banks of EUR 1 billion (2.8 percent of GDP) in 2013; and support for financial and non-financial enterprises of 1.3 percent of GDP in 2011. Excludes most of a June 2012 support operation for NLB (0.9 percent of GDP, contingent convertible bond).

3/ includes a debt shock of EUR 3 billion (8.3 percent of GDP) in 2013 due to assumed debt issuance of the new Asset Management Company for loan carve-outs.

Table 6. Slovenia: External Debt Sustainability Framework, 2007–17

(In percent of GDP, unless otherwise indicated)												
	2007	2008	Actual			Projections						Debt-stabilizing non-interest current account 6/ -1.8
			2009	2010	2011	2012	2013	2014	2015	2016	2017	
<b>Baseline: External debt 1/</b>	106.9	97.5	118.8	113.9	105.4	<b>114.0</b>	<b>118.3</b>	<b>118.0</b>	<b>116.2</b>	<b>114.0</b>	<b>110.5</b>	
Change in external debt	25.4	-9.4	21.3	-4.9	-8.6	8.6	4.3	-0.3	-1.8	-2.2	-3.5	
Identified external debt-creating flows (4+8+9)	-5.7	-2.9	7.3	0.0	-4.7	0.9	-0.6	-3.4	-3.5	-3.6	-3.7	
Current account deficit, excluding interest payments	1.8	2.5	-1.6	-1.6	-2.7	-3.7	-4.2	-4.4	-4.2	-4.2	-4.2	
Deficit in balance of goods and services	1.8	2.6	-1.9	-0.8	-1.1	-2.4	-2.9	-3.1	-2.8	-2.9	-2.9	
Exports	69.2	67.8	58.4	65.7	72.2	75.3	78.7	80.8	82.8	84.5	86.3	
Imports	71.0	70.4	56.5	64.8	71.1	72.9	75.7	77.7	79.9	81.7	83.4	
Net non-debt creating capital inflows (negative)	4.0	-1.7	2.1	-0.3	-3.0	-1.0	-0.8	-0.4	-0.5	-0.4	-0.7	
Automatic debt dynamics 2/	-11.5	-3.7	6.8	1.9	1.1	5.6	4.3	1.4	1.1	1.0	1.1	
Contribution from nominal interest rate	2.9	3.7	2.3	2.2	2.7	3.0	3.2	3.4	3.5	3.6	3.7	
Contribution from real GDP growth	-4.7	-3.1	8.5	-1.5	-0.6	2.6	1.1	-2.0	-2.4	-2.6	-2.6	
Contribution from price and exchange rate changes 3/	-9.7	-4.2	-3.9	1.3	-1.0	...	...	...	...	...	...	
Residual, incl. change in gross foreign assets (2-3) 4/	31.1	-6.6	14.0	-4.9	-3.9	7.7	4.9	3.1	1.7	1.4	0.2	
External debt-to-exports ratio (in percent)	154.5	143.8	203.5	173.5	146.0	151.4	150.4	146.2	140.4	134.9	128.1	
<b>Gross external financing need (in billions of US dollars) 5/</b>	14.1	25.8	23.5	22.1	19.7	18.4	18.0	18.3	18.8	19.2	19.5	
in percent of GDP	29.7	47.0	47.4	46.7	39.1	40.5	40.5	39.9	39.7	38.9	38.1	
<b>Scenario with key variables at their historical averages 6/</b>						<b>114.0</b>	<b>110.1</b>	<b>106.8</b>	<b>102.4</b>	<b>98.1</b>	<b>93.2</b>	<b>-6.2</b>
<b>Key Macroeconomic Assumptions Underlying Baseline</b>												
Real GDP growth (in percent)	7.0	3.4	-7.8	1.2	0.6	-2.2	-1.0	1.7	2.1	2.3	2.3	
GDP deflator in US dollars (change in percent)	13.7	11.8	-2.0	-5.8	5.9	-7.7	-0.9	1.2	1.3	1.6	1.7	
Nominal external interest rate (in percent)	4.3	3.9	2.1	1.8	2.5	2.5	2.7	2.9	3.1	3.2	3.3	
Growth of exports (US dollar terms, in percent)	26.9	13.2	-22.2	7.3	17.1	-5.8	2.5	5.7	6.0	6.2	6.2	
Growth of imports (US dollar terms, in percent)	29.2	14.6	-27.5	9.5	16.7	-7.5	2.0	5.6	6.4	6.2	6.2	
Current account balance, excluding interest payments	-1.8	-2.5	1.6	1.6	2.7	3.7	4.2	4.4	4.2	4.2	4.2	
Net non-debt creating capital inflows	-4.0	1.7	-2.1	0.3	3.0	1.0	0.8	0.4	0.5	0.4	0.7	

1/ Difference with numbers reported in staff report tables is due to differences in period average and end-of-period exchange rates.

2/ 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.

3/ 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).

4/ For projection, line includes the impact of price and exchange rate changes and reflects differences in period average and end-of-period exchange rates in the conversion to U.S. dollars.

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

6/ 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.

7/ 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.

**Table 7. Slovenia: Public Sector Debt Sustainability Framework, 2007–17**

(In percent of GDP, unless otherwise indicated)

	Actual					Projections						Debt-stabilizing primary balance 10/ 0.5
	2007	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017	
<b>Baseline: General government gross debt 1/</b>	23.1	22.0	35.0	38.6	46.9	<b>52.7</b>	<b>67.3</b>	<b>69.0</b>	<b>70.1</b>	<b>70.2</b>	<b>69.8</b>	
o/w foreign-currency denominated	0.1	0.1	0.1	0.1	0.1	4.9	4.9	4.8	4.6	4.4	4.2	
Change in public sector debt	-3.4	-1.1	13.1	3.6	8.3	5.8	14.6	1.7	1.0	0.2	-0.4	
Identified debt-creating flows (4+7+12)	-5.1	-1.4	6.6	5.2	5.1	4.0	14.3	1.4	0.7	-0.1	-0.7	
Primary deficit 2/	-1.3	-0.6	4.6	4.0	4.2	2.0	3.9	0.7	0.1	-0.5	-1.1	
Revenue and grants	39.9	40.7	40.0	40.7	41.1	41.2	41.9	41.4	41.3	41.2	41.2	
Primary (noninterest) expenditure	38.6	40.1	44.6	44.7	45.2	43.2	45.8	42.0	41.4	40.7	40.0	
Automatic debt dynamics 3/	-2.4	-0.7	2.1	1.3	0.9	2.0	2.0	0.8	0.6	0.4	0.4	
Contribution from interest rate/growth differential 4/	-1.7	-0.7	2.1	1.3	0.9	2.0	2.0	0.8	0.6	0.4	0.4	
Of which contribution from real interest rate	0.0	0.0	0.3	1.7	1.2	1.0	1.5	1.9	2.0	2.0	2.0	
Of which contribution from real GDP growth	-1.7	-0.7	1.8	-0.4	-0.2	1.0	0.5	-1.1	-1.4	-1.6	-1.6	
Contribution from exchange rate depreciation 5/	-0.7	0.0	0.0	0.0	0.0	...	...	...	...	...	...	
Other identified debt-creating flows	-1.5	-0.1	-0.1	0.0	0.0	0.0	8.3	0.0	0.0	0.0	0.0	
Privatization receipts (negative)	-1.5	-0.1	-0.1	-0.1	-0.1	0.0	0.0	0.0	0.0	0.0	0.0	
Recognition of implicit or contingent liabilities 6/	0.0	0.0	0.0	0.0	0.1	0.0	0.0	0.0	0.0	0.0	0.0	
Bank restructuring (AMC bond issuance)	0.0	0.0	0.0	0.0	0.0	0.0	8.3	0.0	0.0	0.0	0.0	
Residual, including asset changes (2-3) 7/	1.8	0.3	6.4	-1.7	3.2	1.8	0.3	0.3	0.3	0.3	0.3	
Public sector debt-to-revenue ratio 1/	57.8	54.0	87.5	94.8	114.1	127.7	160.8	166.8	169.7	170.4	169.6	
<b>Gross financing need 8/</b>	3.7	5.4	8.5	12.7	8.5	7.3	12.8	12.0	9.7	9.4	7.0	
in billions of U.S. dollars	1.8	3.0	4.2	6.0	4.3	3.3	5.7	5.5	4.6	4.6	3.6	
<b>Scenario with key variables at their historical averages 9/</b>						<b>52.7</b>	<b>61.5</b>	<b>62.2</b>	<b>62.9</b>	<b>63.5</b>	<b>64.2</b>	<b>-0.6</b>
<b>Scenario with no policy change (constant primary balance) in 2012-2017</b>						<b>52.7</b>	<b>65.2</b>	<b>68.3</b>	<b>71.1</b>	<b>73.8</b>	<b>76.5</b>	<b>0.5</b>
<b>Key Macroeconomic and Fiscal Assumptions Underlying Baseline</b>												
Real GDP growth (in percent)	7.0	3.4	-7.8	1.2	0.6	-2.2	-1.0	1.7	2.1	2.3	2.4	
Average nominal interest rate on public debt (in percent) 10/	4.4	4.2	4.1	3.9	3.8	3.8	4.2	4.5	4.8	5.0	5.2	
Average real interest rate (nominal rate minus change in GDP deflator, in percent)	0.2	0.1	1.1	5.0	3.0	2.0	2.9	2.9	3.0	3.0	3.1	
Nominal appreciation (increase in US dollar value of local currency, in percent)	10.3	-6.6	7.2	-9.5	-0.3	...	...	...	...	...	...	
Inflation rate (GDP deflator, in percent)	4.2	4.1	3.0	-1.1	0.8	1.8	1.3	1.6	1.8	2.1	2.1	
Growth of real primary spending (deflated by GDP deflator, in percent)	0.0	7.2	3.2	1.4	2.0	-6.9	4.9	-6.7	0.5	0.5	0.7	
Primary deficit	-1.3	-0.6	4.6	4.0	4.2	2.0	3.9	0.7	0.1	-0.5	-1.1	

1/ Baseline includes the following assumptions about the effects of bank restructuring in 2013: (a) debt shock of EUR 3 billion (8.3 percent of GDP) from AMC bond issuance for bad loan carve-out (see line 15 above); (b) primary balance shock of EUR 1 billion (2.8 percent of GDP) from capital injections into banks (see line 4 above). Furthermore, baseline includes capital injections into financial and non-financial enterprises in the amount of 1.3 percent of GDP in 2011, but not most of the NLB support operation in June 2012 (0.9 percent of GDP, contingent convertible bond).

2/ The primary deficit includes support for financial and non-financial enterprises of 1.3 percent of GDP in 2011.

3/ 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).

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

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

6/ Guarantees are not included in the analysis.

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

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

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

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

11/ 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.

**Table 8. Slovenia: General Government Balance Sheet, 2008–11**

(In percent of GDP, unless indicated otherwise)

	2008	2009	2010	2011
Net worth	...	...	...	...
Nonfinancial assets	...	...	...	...
Net financial worth	5.0	-0.1	-1.0	-3.7
Financial assets	35.4	43.9	47.2	48.4
Currency & deposits	6.1	12.2	9.8	11.9
Securities other than shares	0.8	0.8	0.8	0.6
Loans	1.2	0.8	1.1	1.9
Shares and other equity	21.0	24.1	29.5	28.2
Insurance technical reserves	0.0	0.0	0.0	0.0
Financial derivatives	0.0	0.0	0.0	0.0
Other accounts receivable	6.3	6.0	5.9	5.8
Liabilities	30.4	44.0	48.2	52.1
Currency & deposits	0.2	0.2	0.3	0.3
Securities other than shares	20.4	33.6	36.5	39.3
Loans	2.3	2.9	4.2	4.9
Shares and other equity	0.0	0.0	0.0	0.1
Insurance technical reserves	0.0	0.0	0.0	0.0
Financial derivatives	0.0	0.0	0.0	0.0
Other accounts payable	7.5	7.2	7.2	7.5

Sources: Statistical Office of Slovenia and Eurostat.

## SLOVENIA: RISK ASSESSMENT MATRIX<sup>1</sup>

Nature/Source of Main Risks	Overall Level of Concern	
	Relative Likelihood (high, medium, or low)	Impact if Realized (high, medium, or low)
<b>1. Strong intensification of the euro area crisis</b>	<p style="text-align: center;"><b>Medium</b></p> <ul style="list-style-type: none"> <li>• Market stress could intensify.</li> <li>• Deleveraging and fiscal drag could affect the outlook for the euro area, with potential knock on effects on the financial sector.</li> </ul>	<p style="text-align: center;"><b>High</b></p> <ul style="list-style-type: none"> <li>• Direct effects through lower export demand and inward financial spillovers, indirect effects through deleveraging and uncertainty.</li> <li>• Funding pressures could create a negative feedback loop, where spillovers to bank funding and higher domestic interest rates hurt growth, and weaken the sovereign further.</li> </ul>
<b>2. Banking sector funding risks and recapitalization</b>	<p style="text-align: center;"><b>High</b></p> <ul style="list-style-type: none"> <li>• Banks' market financing could be impaired for an extended period, causing increased dependence on ECB financing.</li> <li>• Capital needs could be larger than expected.</li> <li>• Real estate price decline could intensify and corporate and mortgage NPLs further rise.</li> </ul>	<p style="text-align: center;"><b>High</b></p> <ul style="list-style-type: none"> <li>• Further ratings downgrades could worsen liquidity situation of certain banks, potentially requiring ELA.</li> </ul>
<b>3. Fiscal slippage and public debt build-up</b>	<p style="text-align: center;"><b>High</b></p> <ul style="list-style-type: none"> <li>• Implementation of fiscal adjustment plans may falter amid recession.</li> <li>• Debt could be further increased by contingent liabilities.</li> <li>• Higher-than-expected fiscal multipliers could lead to a sharper downturn, making it more difficult to stabilize the debt ratio.</li> </ul>	<p style="text-align: center;"><b>High</b></p> <ul style="list-style-type: none"> <li>• Although the debt level is currently manageable, fiscal slippages and contingent liabilities could delay market reaccess.</li> </ul>
<b>4. Structural reforms slippage</b>	<p style="text-align: center;"><b>Medium</b></p> <ul style="list-style-type: none"> <li>• Reform implementation may stall due to politics or social opposition.</li> <li>• The short-run effects of reform on growth and employment may be less positive than anticipated or medium-run effects may fail to fully materialize.</li> </ul>	<p style="text-align: center;"><b>Medium</b></p> <ul style="list-style-type: none"> <li>• Insufficient reform may keep growth low for a protracted period, undermining fiscal consolidation.</li> </ul>
<b>5. Protracted balance-sheet recession</b>	<p style="text-align: center;"><b>High</b></p> <ul style="list-style-type: none"> <li>• High corporate sector debt may give rise to a prolonged deleveraging cycle.</li> <li>• Further declines in real estate prices could exacerbate the deleveraging cycle.</li> </ul>	<p style="text-align: center;"><b>High</b></p> <ul style="list-style-type: none"> <li>• Dampen activity in the short and medium-term.</li> <li>• Could lead to deflation and worsen debt sustainability for both private and public sectors.</li> </ul>

<sup>1</sup>The RAM shows relatively low probability events that could materially alter the baseline discussed in this report. The relative likelihood of risks listed is the staff's subjective assessment of risks surrounding this baseline.



# REPUBLIC OF SLOVENIA

## STAFF REPORT FOR THE 2012 ARTICLE IV CONSULTATION—INFORMATIONAL ANNEX

November 1, 2012

Prepared By

European Department

### CONTENTS

<b>FUND RELATIONS</b>	2
<b>STATISTICAL ISSUES</b>	5

## FUND RELATIONS

(As of August 31, 2012)

I. **Membership Status:** Joined 12/14/1992; Article VIII

II. **General Resources Account:**

	SDR Million	Percent of Quota
Quota	275.0	100
Fund holdings of currency	184.37	67.05
Reserve position	90.63	32.96
Lending to the Fund	33.10	

III. **SDR Department:**

	SDR Million	Percent of Allocation
Net cumulative allocation	215.88	100
Holdings	208.15	96.42

IV. **Outstanding Purchases and Loans:** None

V. **Financial Arrangements:** None

VI. **Projected Payments to Fund:**

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

	Forthcoming				
	2012	2013	2014	2015	2016
Principal					
Charges/Interest	0.00	0.01	0.01	0.01	0.01
Total	0.00	0.01	0.01	0.01	0.01

VII. **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).



**VIII. Article IV Consultation:**

Slovenia is on the 12-month Article IV consultation cycle. The 2012 mission visited Ljubljana during September 19 – October 3, 2012 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. Kavčič (Adviser to the Executive Director) attended the meetings. Mr. Prader (Alternate Executive Director) attended the concluding meeting.

The mission comprised: Mr. Spilimbergo (Head), Mr. Dalgic, Mr. Steinlein (all EUR), Mr. Jaramillo-Vallejo (MCM) and Mr. Rayner (SPR). Mr. Prokopenko (MCM) joined to discuss the findings of the FSAP update mission.

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

**IX. FSAP Participation and ROSCs:**

An FSAP mission took place in November 2000. The FSSA was published on September 2001 (Country Report No. 01/161). An FSAP update mission visited Ljubljana during November 10–21, 2003. The FSSA Update was published May 2004.

The latest FSAP update mission took place in April 2012. The FSSA Update will accompany this report.

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

X. **Technical Assistance:** See the attached table.

XI. **Resident Representative Post:** None.

**Table 1. Republic of Slovenia: Technical Assistance, 2001–12**

Department	Timing	Purpose
MCM	December 2009	Financial Supervisory Architecture
FAD	August 2001	VAT
	November 2001	Direct Tax Reform
	November 2003	Expenditure Rationalization
	April – May 2004	Performance Information to Support Better Budgeting
STA	November 2004	Recording Transactions in International Trade in Services
	April 2006	Government Finance Statistics

## STATISTICAL ISSUES

1. **Data provision** is adequate for surveillance purposes.
2. **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, which can be reached at:  
<http://dsbb.imf.org/Applications/web/sddscountrycategorylist/?strcode=SVN>
3. **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 also compiles inflation statistics including the Harmonized Index of Consumer Prices (HICP). 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.
4. **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)*.
5. **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)*.
6. **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.

7. **Money and Banking Statistics:** Monetary statistics are timely and of good quality.
8. **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).
9. **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 October 10, 2012

	Date of latest observation	Date received or posted	Frequency of Data <sup>6</sup>	Frequency of Reporting <sup>6</sup>	Frequency of publication <sup>6</sup>
Exchange Rates	10/10/12	10/10/12	D	D	D
International Reserve Assets and Reserve Liabilities of the Monetary Authorities <sup>1</sup>	9/12	10/12	M	M	M
Reserve/Base Money	9/12	10/12	M	M	M
Broad Money	9/12	10/12	M	M	M
Central Bank Balance Sheet	9/12	10/12	M	M	M
Consolidated Balance Sheet of the Banking System	9/12	10/12	M	M	M
Interest Rates <sup>2</sup>	9/28/2012	9/28/2012	M	M	M
Consumer Price Index	10/5/2012	10/5/2012	M	M	M
Revenue, Expenditure, Balance and Composition of Financing <sup>3</sup> – General Government <sup>4</sup>	9/28/2012	9/28/2012	M	M	M
Revenue, Expenditure, Balance and Composition of Financing <sup>3</sup> – Central Government	9/28/2012	9/28/2012	M	M	M
Stocks of Central Government and Central Government-Guaranteed Debt <sup>5</sup>	9/28/2012	9/28/2012	M	M	M
External Current Account Balance	9/28/2012	9/28/2012	M	M	M
Exports and Imports of Goods and Services	10/9/2012	10/9/2012	M	M	M
GDP/GNP	Q2/12	9/4/2012	Q	Q	Q
Gross External Debt	9/28/2012	9/28/2012	M	M	M
International Investment Position	9/28/2012	9/28/2012	Q	Q	Q

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

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

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

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

<sup>5</sup>Including currency and maturity composition. The first date corresponds to the stock of central government debt while the second to the stock of central government guaranteed debt.

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



INTERNATIONAL MONETARY FUND

*Public Information Notice*

EXTERNAL  
RELATIONS  
DEPARTMENT

Public Information Notice (PIN) No. 12/134  
FOR IMMEDIATE RELEASE  
November 29, 2012

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

## **IMF Executive Board Concludes 2012 Article IV Consultation with the Republic of Slovenia**

On November 21, 2012, the Executive Board of the International Monetary Fund (IMF) concluded the Article IV consultation with Slovenia.<sup>1</sup>

### **Background**

With a loss of more than 8 percent of GDP, Slovenia experienced one of the largest economic contractions since 2008 among euro area countries. The timid externally-driven recovery observed in 2010 faded as export growth slowed, deleveraging picked up pace, and fiscal consolidation started. The recession intensified in 2012, as euro area growth decelerated, external financial conditions worsened, and private consumption growth turned negative. Unemployment reached 8.4 percent in August 2012. Inflation has been kept in check by weak demand and averaged below the euro area aggregate, more so in core indicators. The current account reached broad balance in 2011 and a moderate surplus is expected for this year, largely as a result of import compression. With stringent financial and economic conditions continuing in the euro area, deleveraging, and fiscal consolidation, staff expects the economy to contract by 2¼ percent in 2012 with growth resuming in the second half of 2013 led by the projected euro area recovery.

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<sup>1</sup> Under Article IV of the IMF's Articles of Agreement, the IMF holds bilateral discussions with members, usually every year. A staff team visits the country, collects economic and financial information, and discusses with officials the country's economic developments and policies. On return to headquarters, the staff prepares a report, which forms the basis for discussion by the Executive Board. At the conclusion of the discussion, the Managing Director, as Chairman of the Board, summarizes the views of Executive Directors, and this summary is transmitted to the country's authorities. An explanation of any qualifiers used in summings up can be found here: <http://www.imf.org/external/np/sec/misc/qualifiers.htm>.

The performance of Slovenian banks deteriorated markedly in recent years as a result of the unfavorable operating environment. Bank asset quality worsened substantially since 2007, especially in publicly-owned banks. Of particular concern are loans to the over-indebted corporate sector. The increase in non-performing loans (NPLs) resulted in substantial impairment charges, leading to system-wide bank losses in the last two years and repeated downgrades of bank ratings. Although capital adequacy improved in 2011, many banks will need further capital increases. The loan-to-deposit ratio remains high, and banks have replaced lost external commercial funding with government deposits and ECB financing. Alongside an external assessment of the size of bank losses, the government is creating an asset management company to deal with NPLs and is elaborating a strategy to reform governance of publicly-owned banks.

The headline deficit is set to drop to around 3½ percent of GDP in 2012 from 4.3 percent of GDP in 2011 (excluding capital injections to publicly-owned banks and corporations), and the 2013 headline deficit target is 2.8 percent of GDP in spite of weaker-than-expected economic activity. The authorities target a structurally-balanced budget by 2015, with adjustment frontloaded in 2012 and 2013. Under the staff's baseline scenario, which conservatively assumes a debt increase of about 11 percent of GDP in connection with bank restructuring, the debt-to-GDP ratio would peak around 70 percent of GDP around 2016 and gradually fall thereafter. However, Slovenia has one of the most adverse pension expenditure dynamics in the euro area, and further action will be required after the realization of current pension reform plans. After more than a year of absence from the long-term markets, the government cash position was alleviated thanks to a successful 10-year bond issuance in US dollars on October 19. This is Slovenia's first dollar-denominated bond since 1996.

### **Executive Board Assessment**

Executive Directors noted that Slovenia's economy is suffering from the negative feedback loops of recession, bank deleveraging, and corporate distress against a background of structural weaknesses, financial sector vulnerabilities, and weak domestic and external demand. They underlined the need for strong and prompt action to address these problems. In this regard, Directors considered appropriate the authorities' emphasis on fiscal consolidation and their plans for ambitious and comprehensive structural reforms to restore macroeconomic and financial stability and economic growth. They looked forward to swift implementation of the reform agenda.

Directors welcomed the proposed establishment of a Bank Asset Management Company to address the build-up of nonperforming loans, stressing that timely implementation will be of the essence. Directors noted that publicly-owned banks may need more capital, while the corporate sector is highly leveraged. They encouraged the authorities to move decisively to restructure, recapitalize and ultimately privatize banks and corporations, which will also help strengthen

governance. Directors welcomed the authorities' efforts to implement the FSAP recommendations. In particular, they emphasized the importance of strengthening the regulatory and supervisory framework and improving macroprudential oversight and crisis contingency arrangements.

Directors commended the progress with fiscal consolidation and the efforts to strengthen the fiscal framework. They supported the front-loaded, expenditure-based consolidation as necessary to bolster market confidence. They encouraged focusing on structural rather than on nominal targets, and endorsed the goal of a structural balanced budget by 2015 net of bank restructuring costs. Directors called for a strengthening of the quality of adjustment and fiscal governance, including through a constitutional structural balance rule with a debt brake and enhanced medium-term fiscal planning.

Directors emphasized the importance of structural reforms to ensure fiscal sustainability, enhance competitiveness, and spur growth. They considered the current pension reform proposals to be a step in the right direction, but observed that more decisive measures will be needed to ensure medium-term fiscal and debt sustainability. Directors welcomed the engagement with social partners on labor market reform, which is essential to reduce market segmentation and improve competitiveness. They also called for improvements to the business climate to attract foreign investment.

**Public Information Notices (PINs)** form part of the IMF's efforts to promote transparency of the IMF's views and analysis of economic developments and policies. With the consent of the country (or countries) concerned, PINs are issued after Executive Board discussions of Article IV consultations with member countries, of its surveillance of developments at the regional level, of post-program monitoring, and of ex post assessments of member countries with longer-term program engagements. PINs are also issued after Executive Board discussions of general policy matters, unless otherwise decided by the Executive Board in a particular case. The [staff report](#) (use the free [Adobe Acrobat Reader](#) to view this pdf file) for the 2012 Article IV Consultation with Slovenia is also available.



### Slovenia: Selected Economic indicators, 2008–14

(Annual percentage change, unless noted otherwise)							
Key Export Markets: Germany, Italy, Countries of Former Yugoslavia, France, Austria							
Population (2011): 2 million							
Quota (as of August 31, 2012): SDR 275 million							
Literacy Rate (in percent): 99.5							
Main products/exports: Road Vehicles, Electrical Machinery-Appliances, Tourism, Transportation							
Poverty Rate (in percent, 2009): 11							
	2008	2009	2010	2011	Projections		
					2012	2013	2014
Nominal GDP (EUR millions)	37,244	35,556	35,607	36,172	35,873	35,981	37,164
GDP per Capita (EUR thousands)	18,420	17,415	17,379	17,620	17,452	17,479	18,028
Real GDP	3.4	-7.8	1.2	0.6	-2.2	-1.0	1.7
Domestic demand	3.2	-10.0	-0.2	-0.7	-4.2	-1.9	1.2
Private consumption	2.3	0.1	1.3	0.9	-0.7	-0.9	1.5
Public consumption	5.9	2.5	1.5	-1.2	-7.9	-3.1	0.1
Gross capital formation	3.1	-33.8	-5.8	-4.6	-9.4	-3.5	1.5
Net exports (contribution to growth)	0.1	2.7	1.5	1.4	1.6	0.8	0.5
Exports of goods and services	4.0	-16.7	10.1	7.0	1.4	2.6	4.1
Imports of goods and services	3.7	-19.5	7.9	5.2	-0.7	1.7	3.7
Output gap (in percent of potential GDP)	9.2	-1.0	-0.9	-1.3	-4.1	-5.5	-4.3
Prices							
GDP deflator	4.1	3.6	-1.1	1.0	1.4	1.3	1.5
Consumer prices (national definition, period average)	5.7	0.9	1.8	1.8	2.2	1.5	1.9
Employment and wages							
Unemployment rate (in percent, ILO definition)	4.4	5.9	7.3	8.2	8.8	9.0	8.7
Unemployment rate (in percent, registered)	6.7	9.1	10.7	11.8	12.4	12.6	12.3
Nominal wages (all sectors)	8.3	3.5	3.9	2.0	0.4	-0.6	2.1
Real wages (all sectors)	2.5	2.6	2.0	0.2	-1.2	-1.9	0.4
Unit labor cost (all sectors)	7.5	10.2	0.4	-0.3	0.5	-0.4	0.8
Public finance (percent of GDP)							
General government balance 1/	-0.3	-5.5	-5.3	-5.6	-3.8	-6.2	-3.6
Primary balance 1/	0.5	-4.6	-4.1	-4.3	-2.1	-4.0	-0.7
Structural balance 2/	-3.9	-5.1	-4.9	-3.7	-1.8	-0.9	-1.7
General government debt 3/	22.0	35.0	38.6	46.9	52.7	67.3	69.0
Monetary and financial indicators							
Credit to the private sector	16.7	3.2	1.9	-2.6	...	...	...
Lending rates 4/	6.2	5.3	4.9	5.0	...	...	...
Deposit rates 5/	4.3	2.5	1.8	2.2	...	...	...
Government bond yield (10-year, average) 6/	4.7	4.4	3.8	4.2	...	...	...
Balance of payments (percent of GDP)							
Trade balance (goods)	-6.4	-1.4	-2.8	-2.9	-2.0	-1.8	-1.8
Current account balance	-6.2	-0.7	-0.6	0.0	0.7	1.0	1.0

	2008	2009	2010	2011	Projections		
					2012	2013	2014
Gross external debt (percent of GDP, end-period)	105.3	113.3	114.4	111.2	116.5	118.5	118.3
Nominal effective exchange rate (2000=100)	101.4	104.0	100.6	101.1	...	...	...
Real effective exchange rate (2000=100, CPI-based)	104.0	106.7	103.1	102.4	...	...	...
Savings and investment (percent of GDP)							
National saving	25.6	21.5	20.5	20.1	19.1	19.6	20.4
Government	4.3	-0.5	-0.5	-0.5	0.0	0.8	1.3
Non-government	21.3	21.9	21.0	20.6	19.1	18.9	19.1
Gross capital formation	31.8	22.1	21.1	20.1	18.4	18.6	19.3
Government	3.4	3.6	3.7	2.8	2.7	3.4	4.0
Non-government	28.4	18.5	17.4	17.3	15.8	15.3	15.4
Foreign saving	-6.2	-0.7	-0.6	0.0	0.7	1.0	1.0

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

1/ Includes an assumed capital injection into banks of EUR 1 billion (2.8 percent of GDP) in 2013; and support for financial and non-financial enterprises of 1.3 percent of GDP in 2011. Excludes most of a June 2012 support operation for NLB (0.9 percent of GDP, contingent convertible bond).

2/ Excludes an assumed capital injection into banks of EUR 1 billion (2.8 percent of GDP) in 2013; and support for financial and non-financial enterprises of 1.3 percent of GDP in 2011. Excludes most of a June 2012 support operation for NLB (0.9 percent of GDP, contingent convertible bond).

3/ Includes a debt shock of EUR 3 billion (8.3 percent of GDP) in 2013 due to assumed debt issuance of the new Asset Management Company for loan carve-outs.

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

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

6/ Eurostat Data

**Statement by Johann Prader, Executive Director for the Republic of Slovenia  
November 21, 2012**

The Slovenian authorities would like to thank the staff for the constructive dialogue during the 2012 Article IV mission to Slovenia in September, and for their comprehensive and candid analysis that provides an objective view of the macro-economic situation and the challenges ahead. The authorities also value the discussion and recommendations of the IMF staff related to the FSAP mission that took place in April and its update in connection with the September Article IV mission. They are in broad agreement with the staff's assessment of the economic developments and outlook in Slovenia as well as with its policy challenges.

After the early elections in November 2011, the new government took office in February this year. To reestablish growth, the government immediately embarked on the preparation of a comprehensive set of measures and structural reforms addressing the pressing issues primarily in the financial sector, especially those related to the restructuring and recapitalization of banks, in conjunction with the need to tackle the corporate debt overhang and the long term sustainability of public finances.

**Economic developments and Outlook**

When the crisis hit the real sector in 2009, Slovenia as a small and export-dependent economy experienced a 7.8 percent decline in GDP, one of the sharpest in the Euro area, particularly due to the collapse of the construction sector, which can partly be explained by the completion of the national highway construction program. The economy started an export-led recovery in 2010, but it was interrupted by the escalation of the euro area crisis in the second half of 2011, which led to a sharp decline in external demand and curtailed credit supply to the highly leveraged corporate sector. Consequently, GDP growth slowed down in 2011, and is projected to turn negative again in 2012.

The slow economic recovery in Slovenia's main trading partners, coupled with weak domestic demand and restrained banks' credit to the over-indebted corporate sector, weigh heavily on the outlook for growth. Due to a very low level of investment, the unemployment rate has been increasing continuously and is expected to reach 8.8 percent this year. It is projected to peak at 9.0 percent in 2013, and is likely to start declining gradually in 2014 and thereafter.

Another reason for the sluggish recovery, in addition to the external environment and the over-indebted corporate sector, is the fragile banking sector, which is heavily exposed to the corporate sector. Despite the deleveraging process and recapitalizations, which took place in 2011 and this year, this sector still faces the challenge of bad loans and restrained access to financing and may need to be further recapitalized. The government is trying to address these issues by setting up a special asset management company and a specialized agency, which is supposed to improve transparency and governance of the state-owned assets, and by reducing its share in the corporate sector by privatization.

The new government has started an aggressive, expenditure-based fiscal consolidation to lower the deficit below 3 percent GDP by 2013, and move further towards the structural balance over the medium term. To ensure long-term fiscal sustainability, the consolidation efforts are being supported by a package of economic measures and structural reforms, specifically the pension reform and the labor market reform.

Against this background, the authorities agree with the staff that the outlook for growth is on the downside. GDP is expected to contract by 2.2 percent this year and by an additional 1.0 percent in 2013, although the authorities tend to be slightly more optimistic than the staff regarding the 2012 outturn. Growth is expected to turn positive in 2014. Consequently, inflation will remain under control and is expected to fall from the estimated 2.2 percent in 2012 to 1.5 percent in 2013. The authorities believe that following the successful launch of a sovereign bond at the US market in October, downside risks will gradually subside, especially when the implementation of the reform package starts bearing fruits.

### **Financial sector**

The crisis most severely affected the Slovenian banking sector, which already before the crisis relied heavily on long-term foreign financing and generous lending to indebted corporates, especially in the construction sector. Having experienced an abrupt reduction of foreign resources once the crisis in the euro area had fully unfolded, and faced with the increasing share of non-performing loans (NPLs), banks have been considerably scaling back credit to the corporate sector, which declined by 4½ percent year-on-year in the first eight months of 2012. Companies are facing difficulties to access new credit and are therefore increasingly failing to meet their financial obligations, which in turn erodes the quality of banks' credit portfolios. As a result, banks ended 2011 with considerable aggregate losses. NPLs reached 13.2 percent (Euro 6.3 billion) in June 2012, with the share of NPLs of non-bank corporates amounting to around 20 percent.

Due to the sovereign credit rating downgrades and a continuous asset deterioration of the largest banks in the course of the last year, credit ratings of domestic banks were commensurately reduced, with the systemically most important bank (Nova Ljubljanska banka d.d. – NLB) losing investment grade rating. Following the recapitalization in 2011, in line with the requirements of the EBA and the Bank of Slovenia (BOS), NLB accelerated the deleveraging process and was further recapitalized in June this year by Euro 381 million, mainly through a contingent convertible bond (Euro 320 million) entirely bought by the government, as other principal shareholders of the bank (the Belgian KBC) were unable to participate. The authorities are aware that despite the improvement in the capital adequacy ratio (standing at 12 percent at the end of 2011), the predominantly long-term government deposits and a broadly stable ratio of domestic savings, further capital increases may be needed.

To address the weaknesses and to ensure the stability of the banking system, the government decided to tackle the issue of NPLs and to improve the access of banks to financing by proposing a Law on Stability of the Banking Sector, which envisages establishing a special Bank Asset Management Company (BAMC). In accordance with the law, which was adopted

by the parliament in October 2012, the government intends to transfer up to Euro 3 billion of non-performing and high risk loans from banks to the BAMC in return for government-guaranteed bonds. An additional Euro 1 billion guaranteed by the government will be used for the recapitalization of eligible banks, if needed. As one of the purposes of the law is the privatization of banks and state shares in the corporates, once they have been cleaned up and recapitalized, the law will enable a quick resolution of the impaired assets, whether by restructuring the corporates and banks concerned, or by liquidating them and selling their collateral and assets. The public debt related to the operation of the new agency should be partially repaid with the proceeds from the liquidation of assets, including those from the privatization of banks and other corporations that will end up in the agency's portfolio. The new agency should be operational by the end of 2012 or in early-2013, and is supposed to be wound down after five years. The authorities are preparing the implementation bylaws, which should ensure that the governance structure and the transparency of the BAMC would be in line with internationally accepted standards. They highly appreciate the Fund's technical assistance in their drafting.

As the resolving of the financial vulnerabilities of the corporate sector is a necessary complement to the restructuring of banks, the parliament passed the Slovenia Sovereign Holding Act in September. The act should streamline the management of state assets of the publicly owned corporates by establishing the Slovenia Sovereign Holding (SSH), which will merge four existing holdings (the Capital Assets Management Agency of the Republic of Slovenia, the Consulting and Management Company, the Restitution Fund and the Pension Fund Management Company) under a single umbrella. In line with the act, which is consistent with the OECD Guidelines on Corporate Governance of State-Owned Enterprises, the SSH's aim is to increase the value of the state's capital investments through a transparent and active management, as well as through efficient corporate governance in different types of corporations and sectors. The SSH's task is also to improve the finances of the publicly owned corporates, and define a strategy that includes the target public stakes in those corporations and sectors, including their full and partial privatization.

The entry into force and the implementation of the two laws are pending, due to the referenda initiative filed by opposition Members of Parliament (MPs) at the end of October. Scrapping of these laws, in particular the Law on Stability of the Banking Sector, would be detrimental for the stability of the financial sector, since it would preclude any swift resolution of the NPLs and banks' recapitalization. The government has already challenged the motion for a referendum on the SSH in front of the Constitutional Court and intends to make use of all available legal options to avert also the referendum on the Banking Sector Stability Law. At any rate, the government remains confident to be able to implement its financial sector reform as well as state-owned asset management strategy.

### **Fiscal consolidation**

The authorities are firmly committed to fiscal consolidation and long-term fiscal sustainability. Bringing the deficit, which increased to 5.7 percent of GDP in 2011 (on the cash flow basis), below the EU Treaty's reference value of 3 percent and balancing it in the medium term, is one of the top priorities.

The new government decided to considerably enhance and accelerate the fiscal consolidation efforts. In May 2012, the Public Finance Balancing Act (amending or changing around 40 existing laws and introducing additional measures) and a supplementary budget for 2012 were passed in order to enable a forceful front-loaded and expenditure-based fiscal consolidation aimed at bringing the fiscal deficit to below 3 percent of GDP by 2013, and balancing the structural budget by 2015 (net of bank restructuring cost). The measures, among others, include a further reduction of public sector wages, non-indexation of wages and pensions to inflation, cutting social benefits, discretionary reduction of expenditure on goods and services, lowering capital expenditure, and reducing subsidies and transfers. As a result, a headline deficit of around 3.5 percent of GDP on the cash flow basis is expected in 2012 (excluding capital injections to publicly owned banks and corporations), which is slightly higher than planned in the supplementary budget.

The envisaged cumulative structural adjustment in the range of around 3 percentage points of GDP by 2015 should send a clear signal to the markets about the government's determination to balance the budget and restore their confidence, along with the successful 10-year dollar-denominated sovereign bond issuance (in the amount of US\$ 2.25 billion) in October. In addition to the measures based on the Public Finance Balancing Act and enshrined into the supplementary budget for 2012, further reductions in the wage bill in the public sector in 2013 (set at around 5 percent in aggregate), combined with a selective reduction in employment, should contribute towards achieving the targeted 2.9 percent headline deficit in 2013. On the revenue side, the government intends to increase the absorption of EU funds by simplifying administrative procedures and relocation of the funds to ready-to-go projects; introducing a new financial services taxation act (a 6.5% rate, mostly on commissions which have so far been VAT exempt, will apply for 2013 and 2014 only); and closing some loopholes in taxation (reducing the list of lower VAT rate items).

The authorities are aware that in the long run, the increasing costs of an ageing population represent the main threat to the sustainability of public finances, and that the pension reform is crucial to address this issue. A year after the pension reform law of the former government was repealed in a referendum the government submitted a new proposal to the parliament for consideration. Even though the current proposal does not differ dramatically from the previous one in substance, it is the result of a broader and better dialogue between the government and social partners. While adjusting several parameters of the pay-as-you-go system, it introduces a 40-year work period with all contributions paid as the main criterion for the retirement for men and women alike. Provided that this criterion has been fulfilled, retirement will be possible at the age of 60 at the earliest. Otherwise, the mandatory pension eligibility age will be gradually prolonged to the age of 65 by 2019. Even though this solution will extend the average effective pension age, the government is aware that its impact will not be sufficient to ensure fiscal sustainability in the long term, and that further reforms will have to be initiated in the future.

### **Structural issues**

The authorities agree with the staff that resolving corporate debt is critical for restoring the corporate sector as the engine of economic growth. They are well aware that with a highly

indebted corporate sector and the banking system under pressure, the dependence on credit financing will have to be abandoned for good and replaced by a much higher share of equity, especially from abroad, and preferably in the form of FDIs. The establishment of the SSH in the government's view offers a possibility to attract equity through more expedient privatization of state assets in public companies.

To further attract FDI and boost competitiveness, which is crucial for Slovenia as a small and export dependent economy, the government has proposed to the parliament amendments to the Labor Market Regulation Act and a new Employment Relations Act. They are supposed to introduce a greater level of flexibility in the labor market and address labor market duality issues by providing a more level-playing field for the currently well protected workers with permanent contracts and unprotected workers, who are typically younger and female. Among other things, the laws envisage a reduction of labor costs related to the severance pay and payments during the notice period and an improvement in the regulation of indemnities for unjustified dismissals. In addition, they set the base for introducing a single open-ended contract and reduce the time needed for dismissal procedures and the notice period, while lowering administrative barriers. Negotiations between the government and social partners are difficult and still ongoing. Changes to the laws will be still possible during the parliamentary procedure, which has just started, since a qualified group of MPs requested an extraordinary session of the parliament, in which the law on the reform of the pension system would be considered as well. The main reason for calling an extraordinary session of the parliament is the intention to have the crucial reform legislation passed by the end of 2012, and entered into force as soon as possible, which demonstrates that the Slovenian authorities are aware that time is of the essence.

### **Financial System Stability Assessment**

Given the issues faced by the Slovenian financial sector, the IMF's Financial Stability Assessment Program (FSAP) mission to the country in April and its update in September were timely and useful. The authorities broadly agree with the findings and recommendations in the Financial System Stability Assessment (FSSA) report.

The authorities concur with the staff findings that the strengthening of the financial conditions of banks is necessary and that the cleaning up and readjustment of their balance sheets, along with the reduction of their dependence on wholesale and Eurosystem financing, is an appropriate starting point. They are also aware that despite banks' present adequate capitalization, further recapitalization may be needed soon. As explained above, the government has addressed some of these FSAP recommendations by proposing the establishment of the Bank Asset Management Company (BAMC). The respective law should provide the platform for the cleaning up of the impaired assets from banks' portfolios and the necessary funding for their recapitalization, as well as the privatization of the state's shares in banks, whether partly or in full. Given the extremely tight budgetary situation, the government would find it enormously difficult to recall the act imposing a tax on bank assets at this point in time also due to demonstration effects. However, amendments to this act envisage that its validity would not be extended beyond 2014.

The authorities recognize that within the regulatory and supervisory frameworks, which are broadly aligned with international standards, some weaknesses still exist. The BOS has fully implemented the Basel II capital framework and has been accelerating the introduction of Basel III. To improve the supervision framework and enable the BOS to improve the supervision and regulation in line with the FSAP recommendations, amendments to the banking law are being in the final stages of preparation. They are expected to be discussed and approved by the government shortly and sent to the parliament immediately thereafter. The law, which should be passed by the parliament and entered into force by the end of 2012, aims at strengthening the legal framework for bank resolution, requiring banks to obtain authorization prior to acquiring non-bank financial companies and ensuring adequate legal protection for bank supervisors. The authorities also intend to look into strengthening the mandate and means of the financial system supervisory agencies and tend to postpone their merger in line with the FSSA recommendation.