INTERNATIONAL MONETARY FUND

IMF Country Report No. 19/58

REPUBLIC OF SLOVENIA

February 2019

2018 ARTICLE IV CONSULTATION—PRESS RELEASE; STAFF REPORT; AND STATEMENT BY THE EXECUTIVE DIRECTOR FOR 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 2018 Article IV consultation with Republic of Slovenia, the following documents have been released and are included in this package:

- A **Press Release** on the staff report that concluded the Article IV consultation with the Republic of Slovenia.
- The **Staff Report** prepared by a staff team of the IMF for the Executive Board's consideration on lapse of time basis, following discussions that ended on December 11, 2018 with the officials of Republic of Slovenia on economic developments and policies. Based on information available at the time of these discussions, the staff report was completed on January 29, 2019.
- An **Informational Annex** prepared by the IMF staff.
- A **Supplementary Information** updating information on recent developments.

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

Selected Issues

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

Copies of this report are available to the public from

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

International Monetary Fund
Washington, D.C.

© 2019 International Monetary Fund

Press Release No. 19/47
FOR IMMEDIATE RELEASE
February 18, 2019

International Monetary Fund
Washington, D.C. 20431 USA

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

On February 14, 2018, the Executive Board of the International Monetary Fund (IMF) concluded the Article IV consultation[1] with the Republic of Slovenia and considered and endorsed the staff appraisal without a meeting.[2]

A broad-based recovery continued in Slovenia in 2018, lowering unemployment, swinging the headline fiscal balance into surplus, and reducing the public debt ratio. Inflation has been subdued, while the external position has continued to strengthen, reflecting strong exports and continued deleveraging. Financial sector stability has improved as banks are well capitalized and liquid, and overall asset quality improved. Progress was made in resolving non-performing loans (NPL), although Small and Medium Enterprises' NPLs remain elevated. The authorities implemented macro-prudential policies, and the privatization of the largest bank also advanced.

Near-term growth prospects are positive, but the medium-term outlook is less favorable. In 2019, growth is projected to slow to 3.4 percent, as export demand eases and capacity constraints becomes more severe. A projected fiscal expansion will support domestic demand in 2019. Inflation is projected to reach 2.2 percent, driven by still strong economic activity and wage pressures. The current account surplus is projected to decline as domestic demand outpaces exports. The medium-term outlook is less favorable as the rapidly aging population will reduce potential growth. Risks are titled to the downside. Major risks include trade protectionism, uncertainty in Europe, and weaker-than-expected global demand.

The authorities' reform agenda is geared toward rebuilding macroeconomic buffers and promoting long-term growth through structural reforms. Progress has been made in reforming the tax-benefit system, strengthening training and the labor market, improving the pension system, and streamlining spatial planning and construction regulation.

---

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

[2] The Executive Board takes decisions under its lapse-of-time procedure when the Board agrees that a proposal can be considered without convening formal discussions.

Executive Board Assessment

In concluding the 2018 Article IV Consultation with Republic of Slovenia, Executive Directors endorsed staff's appraisal as follows:

As Slovenia continues its post-crisis recovery, growth remains well above the euro area average, helped by sound policies. Growth is expected to remain robust in the near term, although the medium-term prospects would be constrained by adverse demographic outlook. Therefore, going forward the authorities should take advantage of the positive economic cycle to deepen fiscal and structural reforms, rebuild fiscal buffers, and increase productivity growth.

The gains from past fiscal consolidation should be preserved, and a procyclical fiscal expansion should be avoided. The authorities' MTO of structural fiscal balance is an appropriate anchor, and it will help bring down the high public debt gradually towards 60 percent of GDP and build fiscal buffers. This target was estimated to be met in 2018, but the amended DBP for 2019 envisages higher spending that will result in a sizable structural deterioration. Considering the strong current economic performance and positive output gap, higher spending should be accommodated through fiscal savings as part of structural reforms.

There is scope for fiscal reforms that generates permanent savings while modernizing government operations. These reforms would help mitigate the medium-term fiscal impact of the unfavorable demographic outlook. They should focus on pensions, health, education, and the wage bill. They should be complemented by a growth-enhancing tax rebalancing away from social security contributions towards property taxes and by rationalizing tax expenditures.

Slovenia's external position in 2018 is assessed as substantially stronger than suggested by fundamentals and desirable policies, but the current account is expected to revert toward its norm in the medium term. As the NIIP is still relatively large and negative, the large current account surplus is helping reduce external vulnerabilities and reflects needed deleveraging by the private sector. Slovenia's current account surplus is expected to moderate as consumption and investment fully recover from the crisis and the NIIP improves. In this regard, policies to address legacy problems and product and service-market reforms could accelerate the recovery of investment.

Financial stability has improved, thanks to the decisive restructuring of ailing banks and prudent macroeconomic policies. Bank of Slovenia's (BOS) NPL guideline and supervisory dialogue, as well as the measures introduced by the European Central Bank for the three directly supervised institutions, helped banks make progress in resolving NPLs. Large banks have adopted a proactive management of their NPLs, and supervisory authorities should continue to encourage and support these efforts.

Emerging risks in the housing market need enhanced vigilance. Although the relatively low price-income ratio does not point to any overheating yet, the recent double-digit increases in housing prices warranted close monitoring. In this regard, BoS's proactive decision to build the macroprudential toolkit is welcome.

Continued structural reforms are key to ensure long-term prosperity, while strengthening the economy's resilience to shocks. Effective implementation of the recently enacted reforms of vocational training, apprenticeship, and adult education would help address skill shortages, support employment of younger and older people, and boost productivity growth. There is still scope to further increase labor market flexibility and reform the tax-benefit system to make work pay. Similarly, the administrative and regulatory burden needs to be reduced further to support investment and firm growth. Accelerating the privatization program would inject capital and technological know-how that would benefit the broader economy.

Slovenia: Selected Economic Indicators, 2015–20

(Annual percentage change, unless indicated otherwise)

	2015	2016	2017	2018	2019	2020
				Projections		
Nominal GDP (EUR millions)	38,866	40,357	43,000	45,937	48,510	50,935
GDP per Capita (EUR)	18,841	19,551	20,814	22,218	23,442	24,594
Real economy						
Real GDP	2.3	3.1	4.9	4.5	3.4	2.8
Domestic demand	1.9	2.9	3.9	4.8	4.1	3.8
Private consumption	2.3	3.9	1.9	3.4	2.8	2.6
Public consumption	2.4	2.7	0.5	3.7	3.8	2.9
Gross capital formation	0.1	0.0	13.2	9.9	8.0	7.5
Net exports (contribution to growth)	0.6	0.5	1.3	0.0	-0.4	-0.7
Exports of goods and services	5.0	6.4	10.7	7.1	6.3	5.5
Imports of goods and services	4.7	6.6	10.3	7.9	7.5	6.9
Potential output growth	1.7	1.8	2.5	2.7	2.8	2.8
Output gap (in percent of potential GDP)	-3.9	-2.7	-0.5	1.2	1.8	1.9
Prices						
Consumer prices (national definition, period average)	-0.5	-0.1	1.4	1.9	2.2	2.2
Employment and wages						
Unemployment rate (in percent, ILO definition)	9.0	8.0	6.6	5.1	4.8	4.9
Employment (domestic concept, period average)	1.2	1.9	2.8	2.8	1.4	1.0
Nominal wages (all sectors)	0.7	1.8	2.7	3.9	5.4	5.1
Real wages (all sectors)	1.2	1.9	1.2	2.0	3.5	3.1
Public finance (percent of GDP)						
General government balance	-3.3	-1.7	-0.8	0.4	0.0	-0.1
Structural balance 1/	-0.9	-0.2	0.5	0.0	-0.7	-0.8
Structural primary balance 1/	1.9	2.5	2.8	2.0	1.0	0.8
General government debt 2/	82.6	78.7	74.1	68.8	66.1	64.0
Monetary and financial indicators						
Credit to the private sector	-5.5	-2.7	3.3	4.6	5.7	5.8
Lending rates 3/	2.9	2.2	2.3	...	...	...
Deposit rates 4/	0.4	0.2	0.1	...	...	...
Balance of payments (percent of GDP)						
Trade balance (goods and services)	8.8	9.4	10.0	9.7	8.4	7.3
Current account balance	4.5	5.5	7.2	6.4	5.2	4.3
Gross external debt (percent of GDP, end-period)	120.0	111.0	100.3	94.3	89.9	85.9
Nominal effective exchange rate (2010=100)	100.3	101.3	101.8	...	...	...
Real effective exchange rate (2010=100, CPI-based)	97.2	97.5	97.6	...	...	...

Sources: Data provided by the Slovenian authorities; and IMF staff calculations and projections.
1/ Reflected national account data update by the authorities as of November 30, 2018.
2/ The stock includes debt issuances of the Bank Asset Management Company (BAMC) in 2013-14.
3/ Floating or up-to-one-year fixed rate for new loans to non-financial corporations over 1 million euros.
4/ For household time deposits with maturity up to one year.

REPUBLIC OF SLOVENIA

STAFF REPORT FOR THE 2018 ARTICLE IV CONSULTATION

January 29, 2019

KEY ISSUES

Context: A broad-based recovery continued in 2018, lowering unemployment, swinging the headline fiscal balance into surplus, and reducing the public debt ratio. Growth is expected to slow moderately to 3.4 percent in 2019, and risks remain tilted to the downside, notably related to a rise in protectionism, political and policy uncertainty in Europe.

Challenges: The population is now ageing more rapidly than in most other Organization for Economic Co-operation and Development (OECD) and European Union (EU) countries, posing risks to fiscal sustainability and long-term growth. Fiscal challenges are, therefore, prominent, with still high public debt and one of the largest projected increase in age-related spending among EU countries. Macro-financial legacy issues remain in bank and corporate balance sheets, including small and medium enterprises' (SME) nonperforming loans (NPLs). Structural challenges persist with low productivity growth, skills shortages, high tax wedge, heavy regulatory system, and extensive presence of state-owned enterprises (SOEs).

Policies: Policies should focus on fiscal and structural reforms to rebuild fiscal buffers and increase productivity. Policy priorities are:

- Safeguard the fiscal consolidation achieved in 2018 by maintaining a balanced structural budget and avoiding a pro-cyclical fiscal expansion in 2019.

- Continue structural fiscal reforms in the areas of pensions, health and long-term care, public wage policy, and tax rebalancing.

- Complete the repair of bank and corporate balance sheets by accelerating the resolution of SME NPLs; and closely monitor emerging credit and housing market risks.

- Deepen labor market reforms by increasing labor market flexibility.

- Accelerate the privatization program, notably in non-financial and non-network sectors.

Approved By
Enrica Detragiache (EUR) and Zuzana Murgasova (SPR)

Discussions took place in Ljubljana during November 28–December 11, 2018. The staff team comprised Mr. Akitoby (Head), Messrs. Cui and Reinke (all EUR), and Grote (FAD) and was assisted at headquarters by Messrs. Andrle (RES), Park, and Smith (Both EUR). Staff met with State Secretaries Dragonja and Jazbec of the Ministry of Finance, Acting Bank of Slovenia Governor Dolenc, other ministers and senior government and Bank of Slovenia officials, as well as representatives of parliament, financial sector, labor, business, and academics. The team also held a conference call with the Single Supervisory Mechanism. Mr. Rampre (OED) attended most meetings. A press conference was held at the end of the mission.

CONTENTS

ANNEXES

CONTEXT

1. The post-crisis recovery continues.

- Growth accelerated to 4.9 percent in 2017 mainly led by strong exports, and it is estimated to have reached 4.5 percent in 2018, still well above potential growth. Domestic demand, particularly public investment, has picked up recently, complementing exports as the key driver of growth.

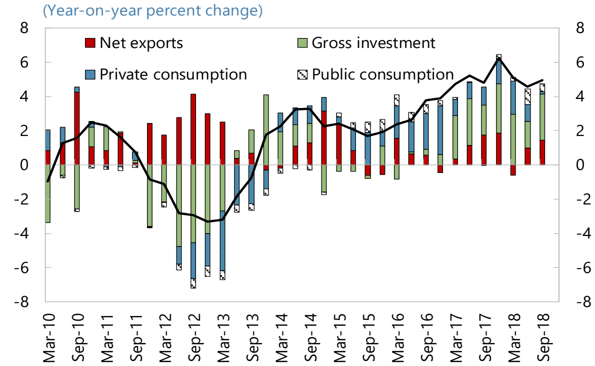
- Labor market conditions are increasingly tight. The unemployment rate has declined to about 5 percent, the lowest level in a decade, while real wage grew by 2 percent in 2018. Skills shortages are emerging.

- Inflation has been subdued, with the average headline inflation estimated at 1.9 percent in 2018. Core inflation remained low at around 1 percent, slightly above the euro area average.

- The fiscal balance continues to improve, mainly driven by increased tax collection associated with strong growth. Thus, the fiscal deficit was halved in 2017 to 0.8 percent of Gross Domestic Product (GDP), followed by a fiscal surplus of about ½ percent of GDP in 2018.

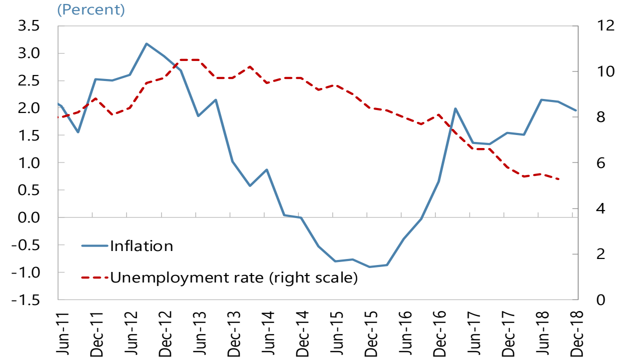
- Financial sector soundness continues to improve. However, SME NPLs remain elevated.

Contribution to Real GDP Growth
(Year-on-year percent change)



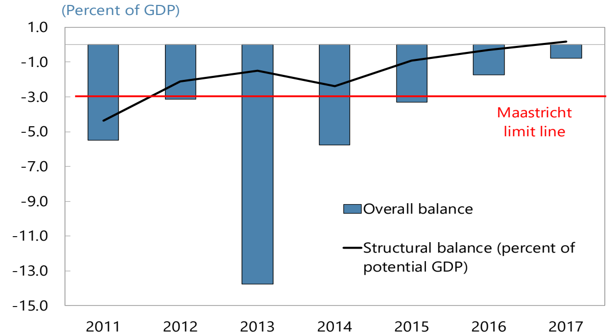
Source: Haver Analytics.

Unemployment Rate and Inflation
(Percent)



Source: Haver Analytics.

Fiscal Balance
(Percent of GDP)



Sources: Slovenia authorities and IMF staff calculations.

- Income inequality is low, with a GINI index at 0.24, compared to the OECD average of 0.32.[1]

[1] OECD, 2019, Income Inequality (indicator).

However, the share of people at risk of poverty and social exclusion (19.9 percent in 2016) remains above the EU average of 17.7 percent.[2]

- The first minority coalition government in history took office in September 2018. The new government is supported by a five-party coalition and another party from the opposition.

OUTLOOK

2. Near-term growth prospects are positive.

- Staff expects growth to slow moderately to 3.4 percent in 2019, as export demand will continue to ease, and capacity limitations and skill shortages will become more severe. After years of weakness, private investment is starting to pick up. EU-financed public investment should grow strongly as well, and a projected fiscal expansion will also support domestic demand. The current account surplus is projected to decline somewhat to about 5 percent of GDP in 2019, as export growth moderates and domestic demand continues to recover.

- Inflation is projected to reach 2.2 percent in 2019, as robust economic activity and wage pressures will keep price pressure up. In the medium term, higher core inflation is partially offset by a decline in energy prices.

Text Table 1. Selected Economic Indicators, 2018–23
(Percent of GDP, unless noted otherwise)

	2018	2019	2020	2021	2022	2023
	Staff Proj.					
Real GDP (annual percentage change)	4.5	3.4	2.8	2.7	2.3	2.1
Potential output growth (annual percentage change)	2.7	2.8	2.8	2.8	2.7	2.5
Output gap (in percent of potential GDP)	1.2	1.8	1.9	1.7	1.3	0.9
Headline inflation (percent, period average)	1.9	2.2	2.2	2.1	2.0	2.0
Core inflation (percent, period average)	1.1	1.3	1.4	1.4	1.4	1.4
Unemployment rate (in percent, ILO definition)	5.1	4.8	4.9	5.0	5.1	5.1
General government balance	0.4	0.0	-0.1	-0.1	-0.1	0.0
Structural balance	0.0	-0.7	-0.8	-0.8	-0.6	-0.4
General government debt	68.8	66.1	64.0	62.1	60.4	58.7
Current account balance	6.4	5.2	4.3	3.5	2.5	1.5

Sources: Slovenian authorities and IMF staff.

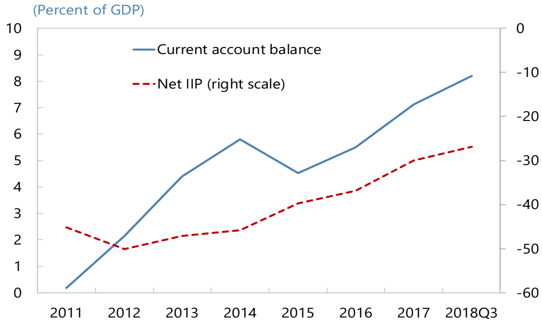
3. The medium-term outlook is less favorable. Growth is projected to decline gradually to 2.1 percent in 2023, with output remaining above its potential level. In the medium run, the potential growth rate is constrained by adverse demographic trends (Annex V on Output Gap Estimates). The positive output gap will decline over time but not fully close, as a euro area accommodative monetary policy and waning private sector deleveraging will support domestic demand.

[2] European Commission, 2018. Country Report—Slovenia.

4. Risks remain tilted to the downside (Annex I). Externally, a rise in protectionism would hit Slovenia hard given its reliance on exports and integration in global value chains. Intensified policy uncertainty in Europe or weaker-than-expected global demand could affect Slovenia through confidence, trade, and financial channels, thereby slowing investment and hiring. A faster-than-expected euro area monetary normalization could weaken public and private balance sheets. Domestically, rule by a five-party minority government entails risks to policymaking and consensus building, which may slow down structural reforms.

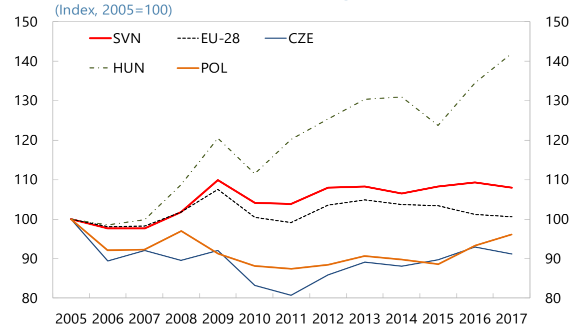
5. The external position is assessed as *substantially stronger* than suggested by fundamentals and desirable policies, but the current account is expected to revert toward its norm in the medium term (Annex II). The current account balance has risen from a deficit of 4.1 percent of GDP in 2007 to a surplus of 6.4 percent of GDP in 2018. Based on the Fund's methodology, staff assesses that a country with Slovenia's characteristics would have a current account surplus of about 1.9 percent of GDP in 2018, implying a gap of 4.5 percent of GDP. With the policy gap being virtually zero (-0.02 percent of GDP), the gap of 4.5 percent of GDP is not explained by the model but could be caused by temporarily weak consumption and investment (a legacy of the financial crises). As the net international investment position (NIIP) is still relatively large and negative, reflecting the imbalances created by the recent banking crisis, the large external surplus helps reduce external vulnerabilities and reflects a desirable deleveraging process in the private sector. The external surplus is expected to moderate in the medium term as consumption and investment fully recover from the crisis. Policies to address legacy problems (¶15) and product and service-market reforms (¶26) could boost investment and help reduce the current account surplus. The current account gap translates into an 8 percent REER undervaluation at standard elasticities. However, the large change in the current account balance over the past 10 years despite a relatively stable REER suggests that the higher than expected surplus was caused by factors unrelated to the REER.

Current Account and Net IIP
(Percent of GDP)



Sources: Statistical office of Slovenia; Bank of Slovenia; and Haver Analytics.

Unit Labor Cost - Manufacturing
(Index, 2005=100)



Sources: Haver Analytics; and IMF staff calculations.

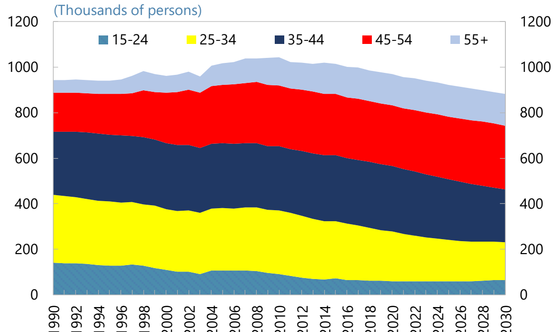
Authorities' Views

6. The authorities broadly agreed with staff's economic outlook and risks. For 2019, the central bank's growth and inflation projections coincided with staff's views. The authorities concurred that growth will decelerate in the medium term while rebalancing toward domestic demand as consumption and investment continue to recover. The authorities stressed that the main risks to the outlook are rising trade conflicts and political tensions, notably in the three largest euro area economies. The central bank agreed that the large current account surplus might decline faster than expected in its latest projections given high probability of faster growth in domestic spending due to stronger government investment and faster growth in wages, while at the same time risks surrounding export growth have been increasing. The government's forecasting arm (IMAD) saw persistent high current account in the medium term, considering the strong private sector savings and high uncertainties on investment prospects. However, IMAD noted that risks to the current account balance is tilted to the downside.

POLICY DISCUSSIONS

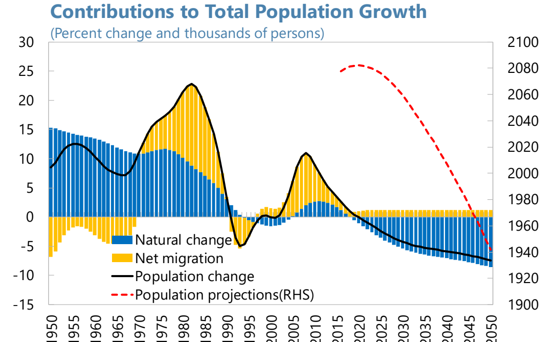
7. Population ageing is emerging as the dominant challenge to longer-term prosperity. Slovenia enjoyed healthy natural population growth until 1990. During the last 20 years, net migration has boosted population while natural growth was anemic and is expected to turn strongly negative in the immediate future. Although currently the long-term old-age dependency ratio is broadly in line with the EU average (50.2 versus 51.2), the population is ageing more rapidly than in most other OECD countries, posing risks to fiscal sustainability and long-term growth. In fact, Slovenia has one of the largest projected increase in age-related spending (see text figure in Section A). Fiscal and structural policies are needed to prepare the economy for these challenges.

Size of the Labor Force and Age Composition
(Thousands of persons)



Source: ILO Labour Force Estimates and Projections (LFEP) Database.

Contributions to Total Population Growth
(Percent change and thousands of persons)



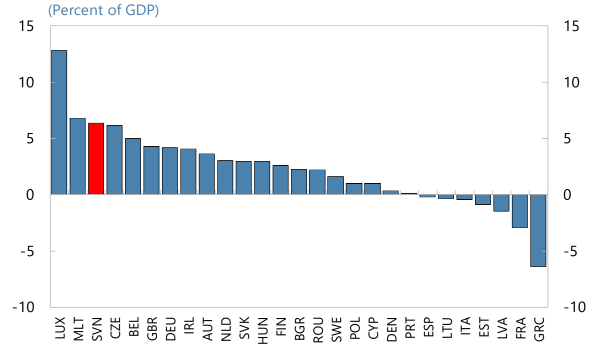
Sources: United Nations World Population Prospects 2017; and IMF staff calculations.

A. Fiscal Policy: Rebuild Fiscal Buffers and Ensure Sustainability

8. Slovenia has achieved substantial fiscal consolidation since the 2013 banking crisis. The structural fiscal balance improved by 2.3 percentage points of GDP between 2013 and 2017. Consolidation was achieved by a mix of structural measures (e.g., pension reform, VAT rate increases, and debt reprofiling) and crisis-motivated temporary measures (e.g., one-off freeze on wages and social transfers indexation, and cut in non-EU-financed public investment). These consolidation efforts allowed Slovenia to exit the Excessive Deficit Procedure (EDP) of the European Commission (EC) in 2016.

9. However, fiscal vulnerabilities remain. At about 69 percent of GDP, public debt is constraining the fiscal space for countercyclical response to external shocks in a small open economy with significant contingent liabilities (Annex IV on DSA). Moreover, public debt is above the rule of 60 percent of GDP under the Stability and Growth Pact (Text Table 2). Finally, as Slovenia has one of the largest projected long-run increase in age-related public spending in the EU, public debt will start growing rapidly in the medium term. Overall, fiscal space is at risk with or without fiscal rules.

Change in Age-Related Public Expenditure, 2016-70
(Percent of GDP)

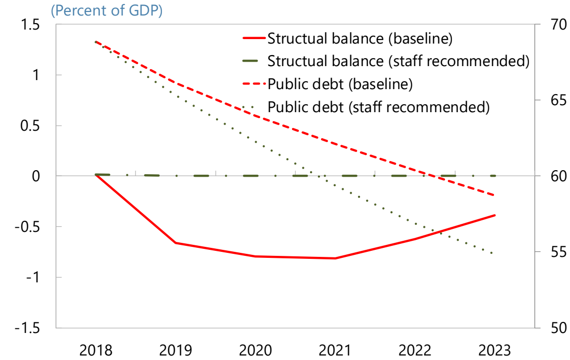


Source: European Commission 2018 Aging Report.

10. The amended Draft Budgetary Plan (DBP) for 2019 envisages a fiscal expansion. The headline fiscal surplus was estimated at 0.4 percent of GDP in 2018, corresponding to a balanced structural position. The amended DBP will likely result in an increase in the structural deficit by 0.7 percent of GDP in 2019 mostly because of increased social transfers and wages with no offsetting spending or tax measures. Specifically, staff estimated that public sector wages will increase by about 0.3 percent of GDP in 2019, followed by further wage increases in 2020.

11. The authorities should avoid a pro-cyclical fiscal expansion and preserve structural fiscal balance in 2019. The Medium-Term Objective (MTO) of structural balance is an appropriate fiscal anchor in view of the need to reduce high public debt, while the favorable cyclical position suggests that there is no cyclical need for fiscal relaxation. Additional spending plans should be reversed or postponed until they can be accommodated through spending cuts elsewhere or tax-base broadening as part of structural fiscal reforms that generate permanent savings while modernizing government (see below). The Fiscal Council urged the government to keep public finances in structural balance in 2019. It also emphasized the need to adopt measures in 2019 to address long-term fiscal challenges.

Structural balance and public debt
(Percent of GDP)



Source: IMF staff estimates.

Text Table 2. Medium-Term Budget Targets, 2018–23
(Percent of GDP, unless noted otherwise)

	2018	2019	2020	2021	2022	2023
			Staff Proj.			
Headline fiscal balance						
Staff projection (baseline)	0.4	0.0	-0.1	-0.1	-0.1	0.0
Staff recommendation	0.4	0.8	0.8	0.8	0.6	0.3
Structural balance						
Staff projection (baseline)	0.0	-0.7	-0.8	-0.8	-0.6	-0.4
Staff recommendation	0.0	0.0	0.0	0.0	0.0	0.0
Public debt						
Staff projection (baseline)	68.8	66.1	64.0	62.1	60.4	58.7
Staff recommendation	68.8	65.3	62.2	59.4	56.9	54.8

Sources: Slovenian authorities and IMF staff.

12. To prepare the budget for pressures coming from population ageing, spending reforms should focus on pension, health, education, and the wage bill.

- **Pension system.** Despite the 2012 pension reform, further actions are needed to ensure the adequacy and the sustainability of the pension system. The government's White Paper proposals to raise the retirement age to 67 and automatically adjust it to demographic trends, as well as to restrict early retirement further, should be taken up. Additional reforms could include: (i) indexing pensions to inflation only rather than wages; and (ii) abolishing the pension bonus. To increase the effective retirement age, staff suggested gradually eliminating the long-service early retirement provision (40 years rule) and discontinuing the arrangement whereby up to 5 years of service time can be purchased prior to retirement. Together, all the above reforms would ensure sustainability of the pension system.

- **Health and education reforms.** Recent studies have found efficiency gaps compared to euro area peers.[3] Potential reforms include: (i) expanding centralized procurement to benefit from more supplier competition and economies of scale; (ii) improving means-testing financial support for tertiary students; and (iii) linking university funding to students' labor market outcomes.[4]

- **Wage bill.** Since the public wage bill is high in international comparison despite the recent freeze during the crisis, the authorities should undertake a functional and institutional review to prepare a reform of public employment (Figure 3). The reformed system should link public wage dynamic with economic conditions and motivate employees by rewarding good performance rather than providing automatic, seniority-based wage hikes. A multi-annual remuneration framework, with separate limits for the number of employees and for wage increases by sector, would also be useful.

13. New emphasis should be put on growth-enhancing tax reform. Slovenia has a relatively high tax wedge (Figure 3). The average worker in Slovenia faced a tax wedge that is higher than that of the euro area average (Box 1). The wedge could be reduced by cutting social security contributions and broadening the base for the value-added tax (VAT) and personal income tax (PIT), or increasing market value-based property taxes, and environmental taxes. Higher revenues could also come from rationalizing tax

Text Table 3. Potential Fiscal Savings by 2020
(In percent of GDP)

	Cumulative
Revenue	**0.5**
Real estate tax	0.8
Indexation of excises	0.2
Broadening of VAT, CIT, PIT bases	0.7
Labor tax wedge reform 1/	-1.2
Expenditure	**1.2**
Health care 2/	0.3
Education 2/	0.2
Pensions	0.5
Transfers and subsidies	0.2
Total Savings	**1.7**

Source: Staff calculations.
1/ Based on the OECD (2018) estimate on the option of cutting the labor tax wedge by 5 percentage points.
2/ By closing part of the gap to the efficiency frontier of OECD countries, including lower wage bill.

[3] See IMF Country Report No. 17/125 and OECD, 2017, *Economic Survey of Slovenia.*

[4] See OECD (2017) and European Commission, 2018. *Country Report—Slovenia*.

expenditures in the immovable property tax and capital net gains tax. Staff estimated that these tax and spending reforms measures could generate a potential saving of 1.7 percent of GDP. This could help offset the rising fiscal burden of an ageing population as well as make room for additional spending on growth-enhancing measures, such as training and active labor market policies (Section C). On the other hand, a reform shifting the tax burden from labor to consumption and other taxes in a revenue-neutral way could increase Slovenia's output level by 0.5 percent in the medium- to long-term.

Box 1. Growth-Enhancing Tax Reform[1/]

Tax reform presents strong potential to raise revenue more efficiently while incentivizing work and boosting growth in Slovenia. While labor is heavily taxed (the tax wedge was 42.7 percent in 2016 compared to 40.3 percent in the EU28), generous tax incentives such as reduced rates and exclusions erode revenues from the PIT, VAT, and corporate income tax (CIT). Property tax revenue is well below the EU average. Tax expenditures stand at 4.9 percent of GDP (compared to 0.6 percent in Germany). Revenue-neutral tax reform could accelerate employment growth by shifting the tax burden to less distortive sources of revenue and by rationalizing tax expenditure. It would help improve efficient resource allocation, encourage labor participation, and reduce informality.

Options for reform include the following:

- **Broadening the PIT base.** The PIT base, currently eroded by PIT tax expenditure costs of 2.1 percent of GDP, could be broadened by withdrawing the exemptions for the reimbursement of home-to-work travel expenses and the tax-free meals provided during work.

- **Rationalizing PIT allowances.** The PIT system is granting multiple tax allowances. Converting allowances, which give a larger tax reduction to high-income earners, into cost-effective tax credits could finance downward PIT rate adjustments.

- **Reducing tax exemption on benefits.** Benefits that are currently exempted from taxation (performance, Christmas, and holiday bonuses) could be made taxable as ordinary income.

- **Broadening the VAT base.** Broadening the VAT base by applying the standard rate (22 percent) to poorly-targeted reduced-rate (9.5 percent) supplies could raise revenue by 0.5 percent of GDP.

- **Reforming the capital gains tax (CGT).** Capital gains are taxed at a flat rate of 25 percent, but the rate tapers out to zero percent after an asset holding period of 20 years. By eliminating the CGT taper relief, capital income taxes will become more progressive.

Other core tax instruments also offer opportunities for raising revenue to compensate lower labor taxes. The main options include introducing a value-based property tax, tightening the application of the flat-rate business tax, and adopting stricter debt/equity limits for tax purposes.

Tax reform could substantially invigorate growth. A simulation exercise indicates that shifting the tax burden from labor to consumption and other taxes in a revenue-neutral way could increase Slovenia's output level by 0.5 percent in the medium- to long-term.

[1/] See the accompanying Selected Issues Paper for details

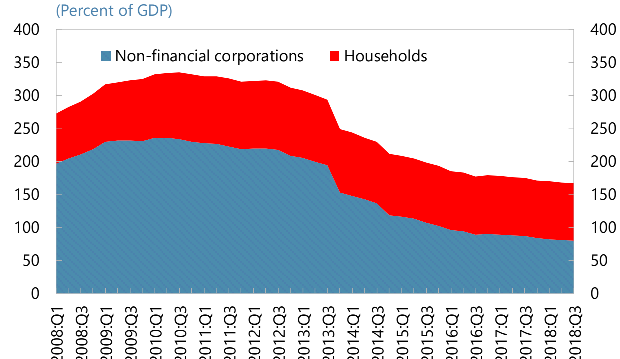
Authorities' Views

14. The authorities reiterated their commitment to fiscal consolidation through structural fiscal reforms. They noted Slovenia was one of the euro area's best performers in reducing public debt over 2015–18 and is set to keep this path as a key policy priority. With a goal to reduce public debt below 60 percent of GDP in the medium term, they plan to further improve the fiscal space. This could impact the calculation of the MTO. For the short term, they noted that the headline surplus—despite the sizable fiscal impact of the public wage negotiations—would help advance public debt reduction in 2019. They explained that the structural balance could not improve, because the coalition government, after years of strong economic growth and gradual relaxation of crisis-related freeze on wages and social transfers, decided to improve the incomes of civil servants and social transfers recipients, with the aim to boost economic growth through consumption. They believe that some of the fiscal space can be used to address these spending needs while maintaining medium-term consolidation. They also cautioned that the envisaged structural reforms in 2019 would need broad consensus within the five-party coalition. Nevertheless, they stressed that several fiscal reforms would be needed in 2020, including revenue-neutral tax rebalancing. On pensions, they explained that the current annual bonus helps address pension adequacy for poor pensioners. On health, the authorities stressed that their priority is to reduce the waiting time, including through digitalization. Regarding wages, they noted that the successful wage negotiations are a basis for broader mid-term, public wage reform.

B. Financial Policy: Address Legacy Problems and Emerging Risks

15. Since the 2013 banking crisis, financial sector stability has improved though some legacy problems remain (Figure 5). Banks are well capitalized and liquid, and overall asset quality has improved. Profitability also increased, but largely because of the one-off release of impairment provisions. The deleveraging process of the corporate sector is well advanced. The privatization of the largest bank, Nova Ljubljanska Banka (NLB), has advanced, as the government sold 65 percent of the bank in 2018 and plans to sell another 10 percent in 2019; meanwhile, the third largest bank, Abanka, is expected to be privatized in 2019.[5] However, since 2012, banks' net interest income has declined markedly, and it is likely to fall further as the policy interest rate remains low and banks face uneven recovery in lending activity, with lagging corporate lending. Although progress was made in resolving overall NPLs, SME NPLs remain elevated in the low double digits. Staff welcomed the adoption of the toolkit and handbook for resolving

Outstanding Credit to Private Sector
(Percent of GDP)



Sources: Haver Analytics; and IMF staff calculations.

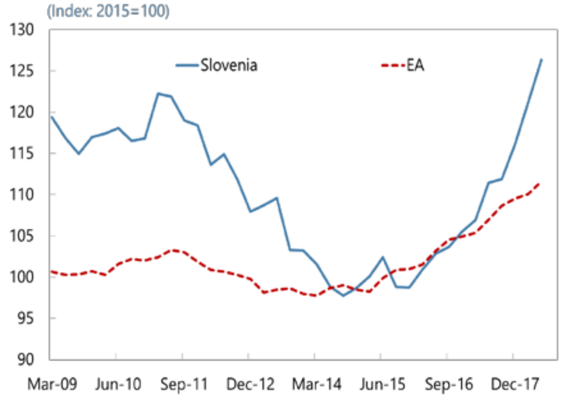
[5] Privatization of banks can facilitate access to firms, thus enabling them to invest, hire, and grow (see IMF Country Report No. 15/42). Most of the privatization proceeds are devoted to debt reduction.

SME NPLs in addition to the NPL guidelines, the European Central Bank's measures for the three banks it oversees, and the large banks' proactive management of NPLs. Supervisors should actively engage with banks on business models in light of the declining net interest income, and they should push banks to speed up the resolution of SME NPLs. Further efforts in strengthening insolvency procedures for SMEs would also help.[6]

16. Meanwhile, new financial vulnerabilities could emerge, including in the housing market. Credit risks could emerge due to the elevated share of high variable-interest loans to both households and non-financial corporations. In addition, risks in the housing market need to be closely watched. At 13.4 percent in 2018: Q2, Slovenia's housing price growth rate was one of the highest in the euro area, but the relatively low price-income ratio does not point to any overheating yet (see Annex VII). Moreover, only about 10 percent of households have a mortgage (19 percent in the euro area), and about a third of the recent housing transactions was carried out with equity (i.e., without bank financing).

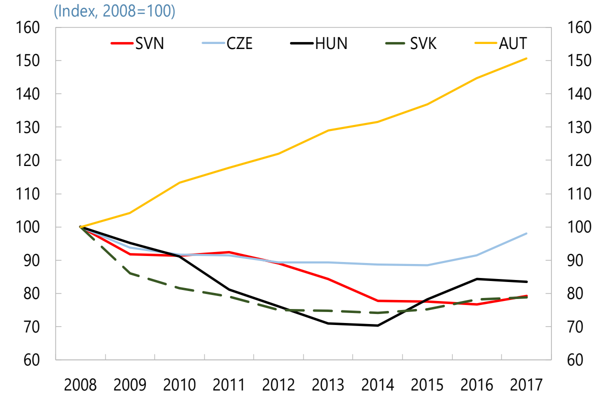
17. The decision to broaden the scope of macroprudential tools for the real estate market to cover total household lending is welcome. The Bank of Slovenia (BoS) maintains its macro-prudential guidance as recommendation to banks. It recommends that the loan to value ratio not exceed 80 percent and the debt service to income (DSTI) ratio be limited to 50 percent for lower incomes and 67 percent for higher incomes. It is also recommended that consumer credit maturities not exceed 120 months. But the limits could be made mandatory and be set at more binding levels when needed.

Housing Prices
(Index: 2015=100)



Source: Eurostat.

Housing Prices to Income
(Index, 2008=100)



Source: OECD.

18. The shortcomings of the AML/CFT framework identified in the 2017 Moneyval report should be addressed. Notably, the authorities should take steps to enhance targeted financial sanctions related to proliferation financing (i.e., financing that facilitates the proliferation of weapons of mass destruction). In this regard, BoS should strengthen the supervision of banks' implementation of national requirements.

[6] IMF Country No. 17/126.

Authorities' Views

19. The authorities agreed with staff's analysis and advice. They stressed their recent successes in helping banks to substantially reduce NPLs, increase asset quality, and improve core business profitability. They agreed on the need to continue such efforts to further reduce SME NPLs. Continued progress in their planned bank privatization is also expected to further strengthen bank's efficiency and governance. The government reiterated its commitment to complete the privatization of NLB and the sale of Abanka in 2019. The national authorities agreed to closely monitor risks in the housing market and take further macroprudential measures if needed. Regarding AML/CFT, the national authority has completed a progress report on addressing the main recommendations from the 2017 Moneyval report, including taking steps to enhance targeted sanctions related to proliferation financing.

C. Structural Reforms: Support Employment and Productivity Growth

20. Higher productivity will be required to mitigate the impact of ageing. Since the population is ageing rapidly, economic growth will increasingly depend on productivity growth and the higher levels of supportive skills, notably information technology specialists, scientists, and engineers. Further reforms of labor markets, SOEs, and product and service markets will raise Slovenia potential output and productivity growth.[7]

Labor Markets and Skill Development Reforms

21. Recent reforms of apprenticeship and vocational training are welcome, and their effectiveness should be monitored. Reforms include the Apprenticeship Act, aimed to promote employability of young people through a closer integration of the business sector and education; the amended Vocational Education Act, which seeks to improve education outcome quality and provide internationally comparable vocational qualifications; and a new Adult Education Act re-establishing a public network of institutions to train adults and vulnerable groups to foster a culture of lifelong learning. If well-implemented, these reforms will also promote inclusion, as low-performing and disadvantaged students are highly concentrated in vocational programs. Moreover, they will help address the increasing skills shortages.[8] The authorities should closely monitor the effects of the reforms and reinforce them if needed.

22. The recently amended Labor Market Act provides stronger incentive for low-skilled unemployed to take up full-time employment. Low-after-tax earnings and relatively generous unemployment benefits reduce incentives to work. For instance, the replacement rate of unemployment benefits has been above 80 percent in the first months of unemployment for

[7] IMF Country Reports No. 15/42 and No. 17/125.

[8] The Employment Service of Slovenia reported in 2017 skills shortages in vocational occupations, such as drivers of heavy vehicles, manufacturing workers, masons, waiters, and toolmakers.

low-wage earners, higher than the EU average (67 percent).[9] With the new Act, however, when taking a full-time job, a worker will enjoy an additional 20 percent of the last unemployment benefit on top of his salary until expiration of the unemployment benefit. For older workers, the Act exempts wages from social security contributions. This should improve work incentives and reduce structural unemployment.

23. The authorities should pursue additional reforms as follows:

- *Further reforming the tax-benefit system*. Rebalancing taxation from labor to consumption and wealth, as discussed above, would stimulate labor supply broadly. In addition, the government could bring down the replacement rate of unemployment benefits closer to the EU average.
- *Further increase the flexibility of labor market.* Worker protection of open-ended contracts is still perceived by employers to be excessive relative to peer countries, mainly because of high layoff costs. Recent staff analysis also finds consistent evidence that calls for further actions.[10] A reform of unemployment benefits to "protect workers rather than jobs" would be desirable.
- *Developing training in entrepreneurship and new technologies.* Entrepreneurship education is well below the EU average.[11] Together with new technology training, entrepreneurship skills should help workers adapt to and succeed in the digital economy and fast-changing technological world.

SOEs Reforms

24. Extensive presence of SOEs in the economy may impede private investment and productivity growth and privatization should be accelerated. SOEs account for 20 percent of non-financial employment and make the government the largest asset holder.[12] SOEs are dominant in the network sectors (telecom, energy, transportation) and even present in competitive sectors like tourism and textiles. EC analysis suggests that total factor productivity of large SOEs lags that of private companies. Slovenia has underperformed in large-scale privatization relative to other CESEE countries.[13] With the investment to GDP ratio still well below the pre-crisis level, accelerating the privatization program could boost private and foreign investment and technological know-how that would benefit the broader economy.[14] In this regard, the list of companies classified as "strategic" and "important" should be reduced.

---

[9] European Commission, 2017. European Semester Thematic Factsheet—unemployment benefits.

[10] See Selected Issues *Labor Market Reform in Slovenia*. IMF Country Report 17/126.

[11] Global Entrepreneurship Research Association, 2016. *Global Entrepreneurship Monitor Report*. Indicators used in this report and other third-party indicators cited in the section, including the EBRD indicators on privatization, OECD indicators on product market and regulations, and indicators on occupational regulation are subject to measurement uncertainties and methodological limitations.

[12] European Commission, 2015. *Country Report—Slovenia*.

[13] EBRD, 2015. *Transition Indicators: Index on Large Scale Privatization.*

[14] IMF Country Reports No. 17/125.

25. The authorities should closely monitor the SOEs governance framework. Effective enforcement will help to ensure that SOEs consistently comply with international standards in the following key areas: (i) financial reporting and auditing standards; (ii) timely and accurate disclosure rules; (iii) supervisory board; and (iv) equitable treatment of minority and foreign shareholders. Monitoring fiscal risks stemming from SOEs drawing on best practices is also desirable.[15]

Product and Service-Market Reforms

26. The regulatory burden in product and services markets should be reduced to support investment and firm growth. Slovenia maintains a more restrictive regulatory system than the OECD average and that of most EU members. Notably, it has 220 regulated professions, which places the country among the largest in EU countries and four times more than that in the least regulated countries (Sweden and the Baltics).[16] The number of regulated professions should be reduced to enhance competition and increase productivity. New legislation entered into force in mid-2018 should simplify building permits acquisition procedures and reduce administrative burden and risks for SMEs. Rapid progress to implement the new legislation and further streamline spatial planning and construction regulation would benefit the housing market and investment.

Authorities' Views

27. The authorities concurred that more could be done to further reform the tax-benefit system. However, they cautioned that no new structural reforms are planned on these fronts in 2019, as consultations continue. Meanwhile, the government will forge ahead with its implementation plan for active employment measure that will seek to activate long-term unemployed, younger and older unemployed, and people with low levels of education.

28. Regarding labor market flexibility, the authorities thought an in-depth analysis of the impact of the 2013 reform would be needed before introducing new measures. They also viewed low participation by older workers and the increasing use of atypical forms of work and precarious work as problematic.

29. They reiterated their commitment to pursue the privatization program. They noted that recent successful initial public offering of the NLB will provide a new momentum. They explained that it would take time for the parliament to reconsider the list of companies where the state would retain control. Regarding the SOEs governance framework, the authorities stressed that effective implementation of the OECD guidelines will address staff's advice.

30. The authorities highlighted ongoing initiatives to reduce administrative burden to support enterprise development. Notably, they pointed to their SME test in assessing the impact

[15] IMF, 2016. *Analyzing and Managing Fiscal Risks—Best Practices.*

[16] Koumenta, M., A. Humphreis, M. Kleiner, and M. Pagliero. 2014. *Occupational Regulation in the EU and UK: Prevalence and Labour Market Impacts.* Final Report, Department for Business, Innovation and Skills, School of Business and Management, Queen Mary University of London, London.

of the administrative burden of new regulations on SMEs and the one-stop shop program that coordinate all government services in one place to investors. They agreed to closely monitor the impact of the streamlined spatial planning and construction regulation and take additional steps if needed.

STAFF APPRAISAL

31. As Slovenia continues its post-crisis recovery, growth remains well above the euro area average, helped by sound policies. Growth is expected to remain robust in the near term, although the medium-term prospects would be constrained by adverse demographic outlook. Therefore, going forward the authorities should take advantage of the positive economic cycle to deepen fiscal and structural reforms, rebuild fiscal buffers, and increase productivity growth.

32. The gains from past fiscal consolidation should be preserved, and a procyclical fiscal expansion should be avoided. The authorities' MTO of structural fiscal balance is an appropriate anchor, and it will help bring down the high public debt gradually towards 60 percent of GDP and build fiscal buffers. This target was estimated to be met in 2018, but the amended DBP for 2019 envisages higher spending that will result in a sizable structural deterioration. Considering the strong current economic performance and positive output gap, higher spending should be accommodated through fiscal savings as part of structural reforms.

33. There is scope for fiscal reforms that generates permanent savings while modernizing government operations. These reforms would help mitigate the medium-term fiscal impact of the unfavorable demographic outlook. They should focus on pensions, health, education, and the wage bill. They should be complemented by a growth-enhancing tax rebalancing away from social security contributions towards property taxes and by rationalizing tax expenditures.

34. Slovenia's external position in 2018 is assessed as substantially stronger than suggested by fundamentals and desirable policies, but the current account is expected to revert toward its norm in the medium term. As the NIIP is still relatively large and negative, the large current account surplus is helping reduce external vulnerabilities and reflects needed deleveraging by the private sector. Slovenia's current account surplus is expected to moderate as consumption and investment fully recover from the crisis and the NIIP improves. In this regard, policies to address legacy problems and product and service-market reforms could accelerate the recovery of investment.

35. Financial stability has improved, thanks to the decisive restructuring of ailing banks and prudent macroeconomic policies. BoS's NPL guideline and supervisory dialogue, as well as the measures introduced by the European Central Bank for the three directly supervised institutions, helped banks make progress in resolving NPLs. Large banks have adopted a proactive management of their NPLs, and supervisory authorities should continue to encourage and support these efforts.

36. Emerging risks in the housing market need enhanced vigilance. Although the relatively low price-income ratio does not point to any overheating yet, the recent double-digit increases in housing prices warranted close monitoring. In this regard, BoS's proactive decision to build the macroprudential toolkit is welcome.

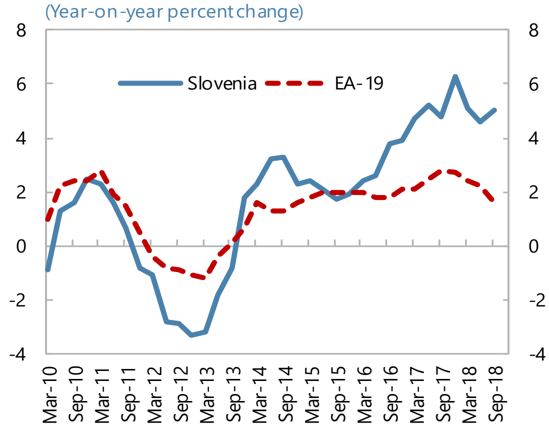
37. Continued structural reforms are key to ensure long-term prosperity, while strengthening the economy's resilience to shocks. Effective implementation of the recently enacted reforms of vocational training, apprenticeship, and adult education would help address skill shortages, support employment of younger and older people, and boost productivity growth. There is still scope to further increase labor market flexibility and reform the tax-benefit system to make work pay. Similarly, the administrative and regulatory burden needs to be reduced further to support investment and firm growth. Accelerating the privatization program would inject capital and technological know-how that would benefit the broader economy.

38. It is proposed that the next Article IV consultation take place on the standard 12-month cycle.

Figure 1. Macroeconomic Developments

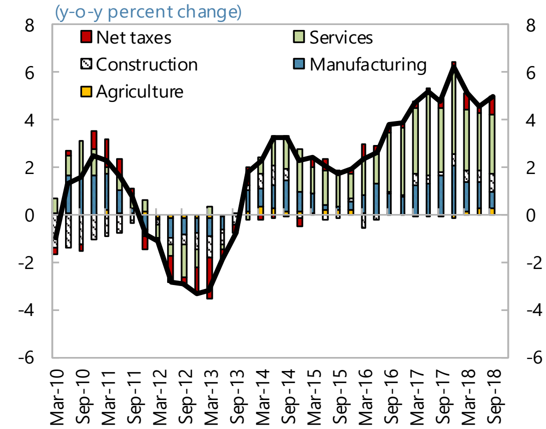
Growth recovery continues with a rate well above the euro area average in recent years.

Real GDP Growth
(Year-on-year percent change)



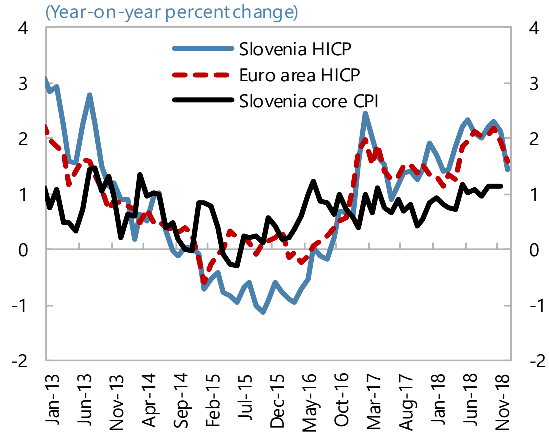
Service and manufacturing sectors are major drivers.

Contribution to Real GDP Growth, Gross Value Added
(y-o-y percent change)



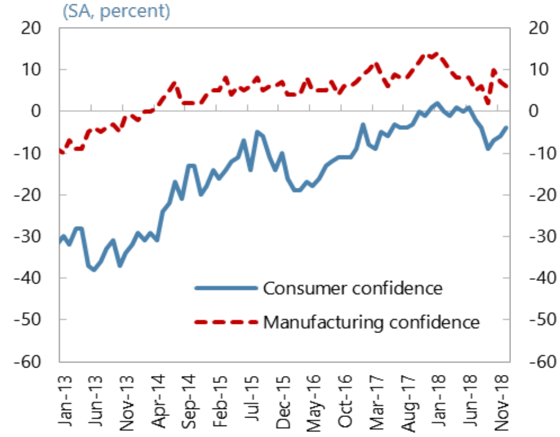
Headline and core inflation remain broadly subdued.

Consumer Price Index
(Year-on-year percent change)



Sentiment remains stable, with some recent uptick.

Sentiment Indicators
(SA, percent)

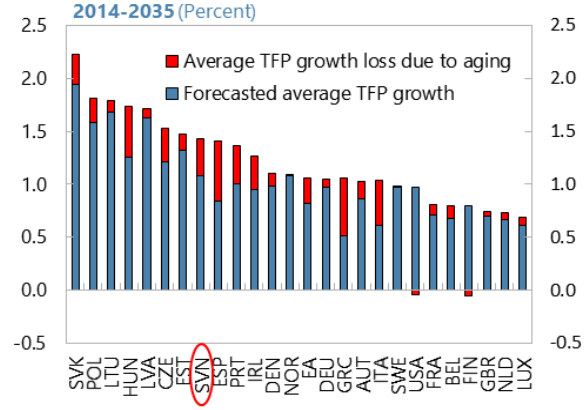


Capacity utilization has reached unprecedented levels.

Capacity Utilization in Manufacturing from Survey
(SA, quarterly, percent)

Ageing is projected to significantly reduce productivity.

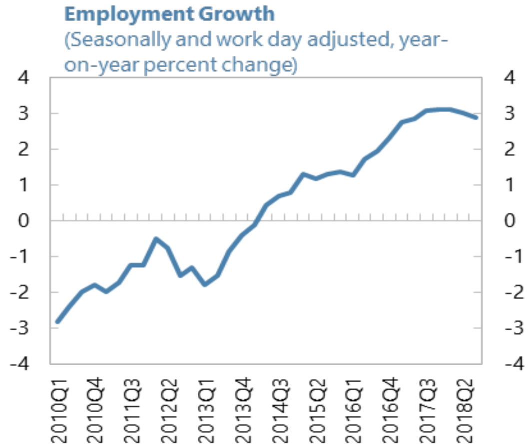
Estimated Impact of Ageing on Productivity, 2014-2035 (Percent)



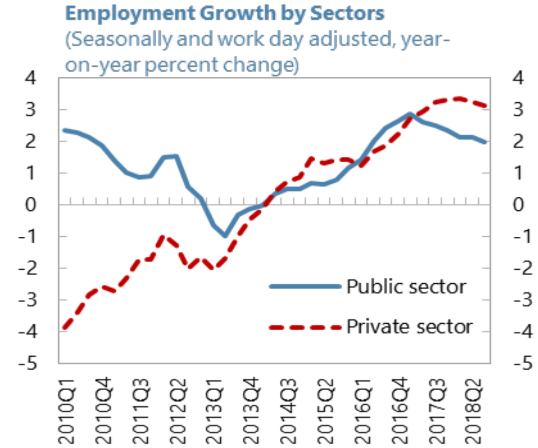
Sources: Slovenia authorities; Eurostat; and Haver Analytics.

Figure 2. Labor Market

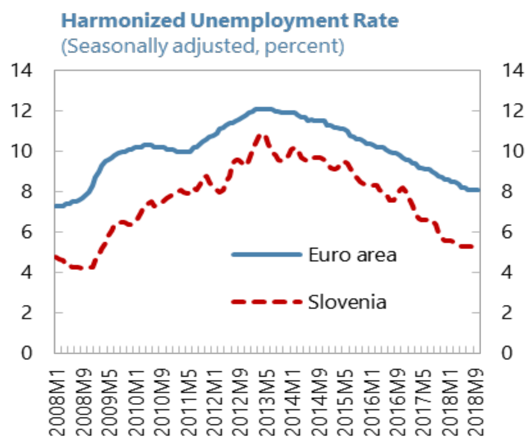
Employment growth has peaked…



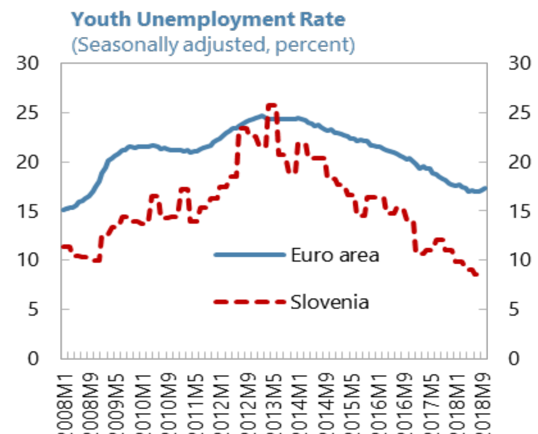
both in the public and private sectors.



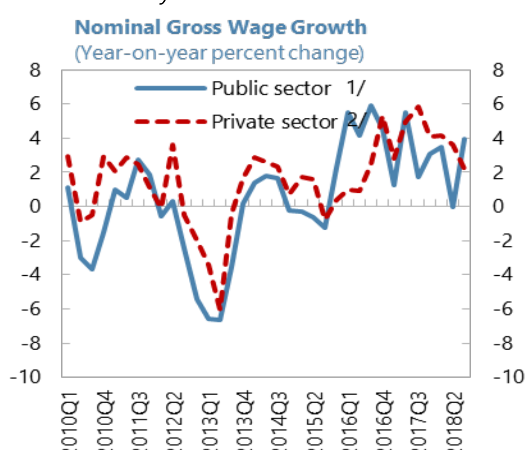
Total unemployment continues to fall…



as well as youth unemployment.



Nominal wage growth in the public sector lags the private sector until recently …



…and real wages followed a similar pattern.

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

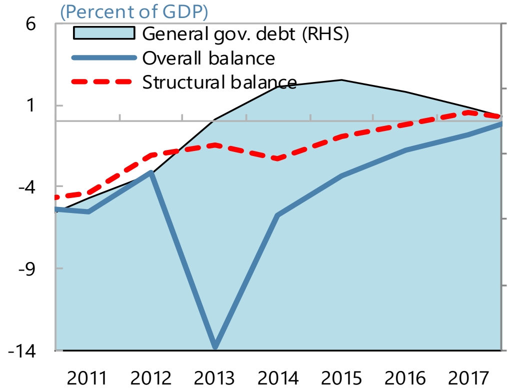
1/ Public administration and defense; compulsory social security; education; human health and social work activities; arts, entertainment and recreation; other service activities (NACE rev. 2).

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

Figure 3. Fiscal Context

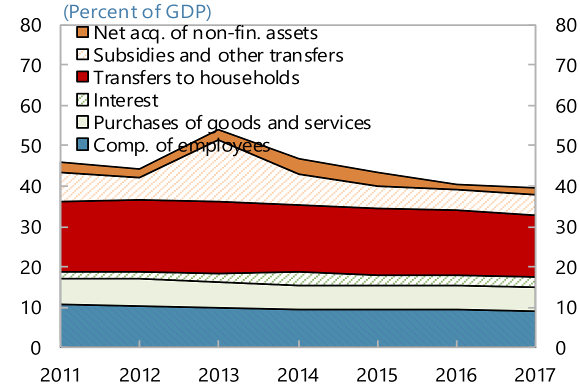
Recent fiscal consolidation contributed to lower public debt.

General Government Balance and Debt
(Percent of GDP)



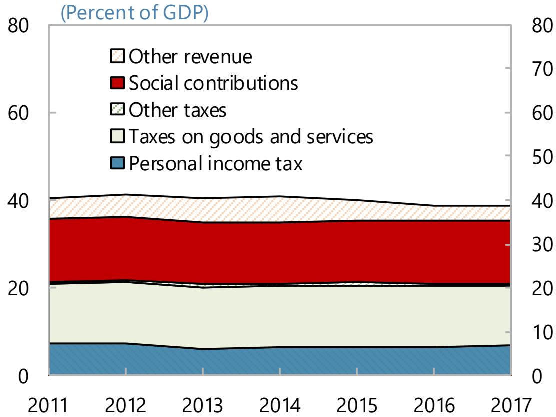
Expenditure restraints played a major role in achieving recent consolidation.

Expenditure Composition
(Percent of GDP)



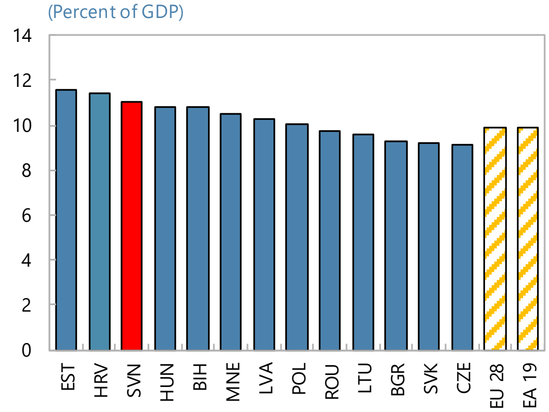
Tax collections have been broadly stable, while social contributions increased marginally.

Revenue Composition
(Percent of GDP)



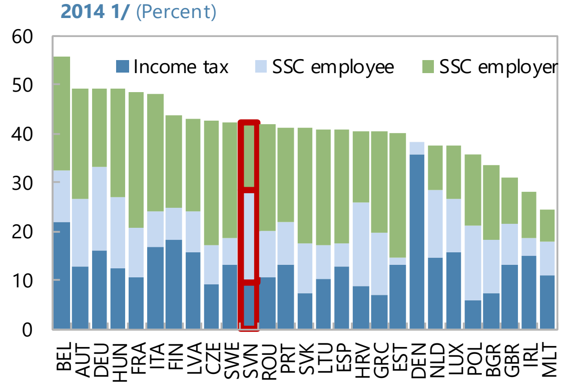
The government wage bill is high compared to those in peer countries.

General Government Compensation of Employees, 2017 2/
(Percent of GDP)



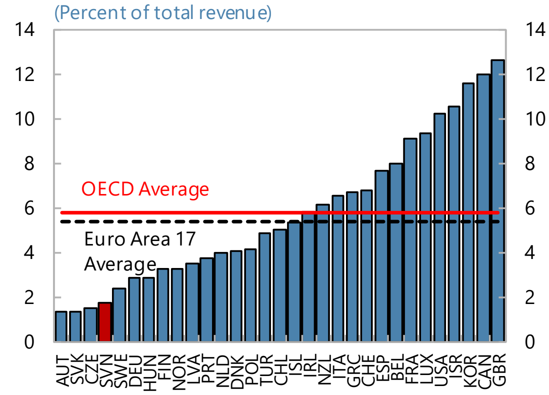
SSC for employees is high in international comparison.

Tax Wedge of Average Wage Earners by Component, 2014 1/ (Percent)



Property tax has potential to raise more revenue.

Tax on Property, 2016
(Percent of total revenue)

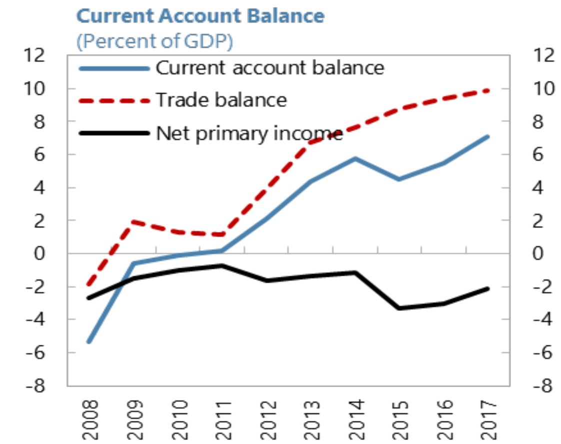


Sources: Slovenia authorities; OECD (2018); Eurostat; Haver Analytics; and IMF staff.
1/ Tax wedge for singles with no child earning the average wage. Based on Joint EC – OECD Tax & benefits indicators.
2/ Compensation of employees includes wages and salaries and employer's social contribution.

Figure 4. External Sector Developments

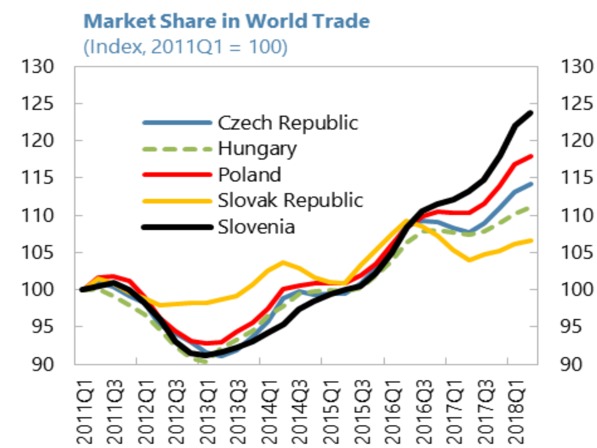
The export boom is continuing …

and the current account surplus increased.

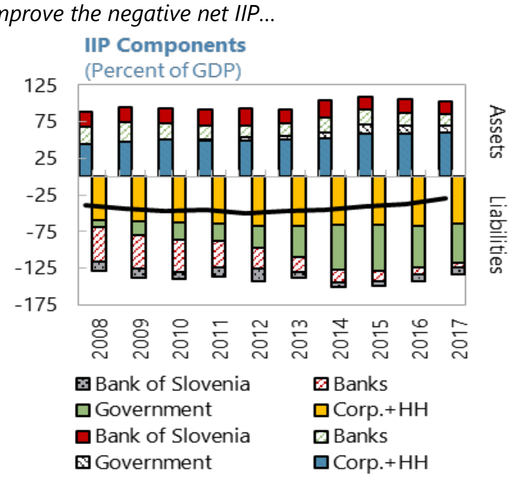


Exports are strongly linked to global value chains …

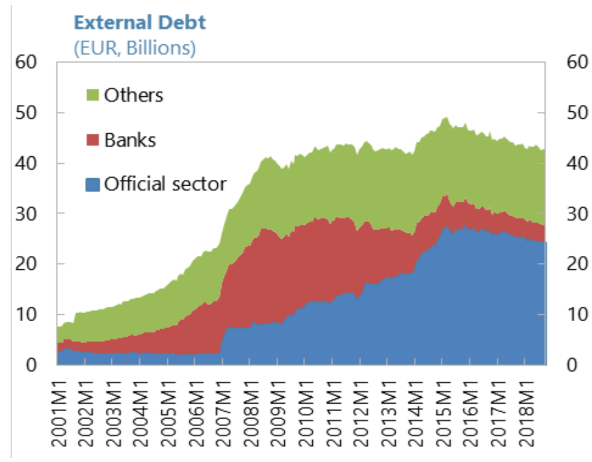
Deepening the integration in the global trade.



Fiscal consolidation and bank deleveraging helped to improve the negative net IIP…



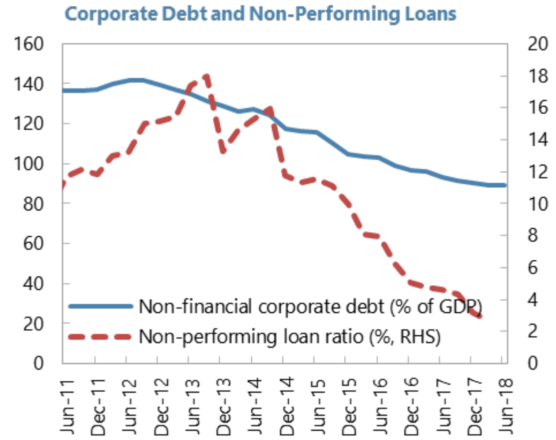
…while also reducing external debt.



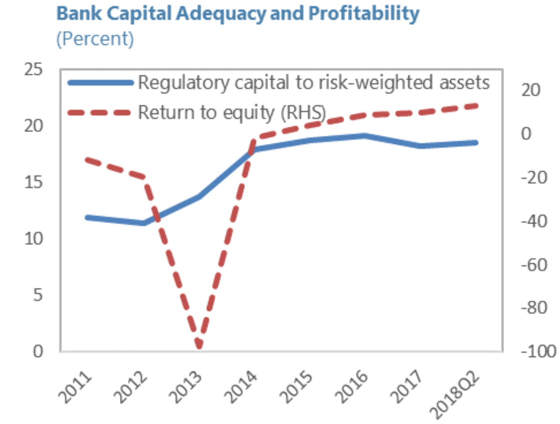
Sources: Bank of Slovenia; Direction of Trade Statistic; European Central Bank; Haver Analytics; Statistical Office of Slovenia; and IMF staff estimates.

Figure 5. Financial Sector Developments

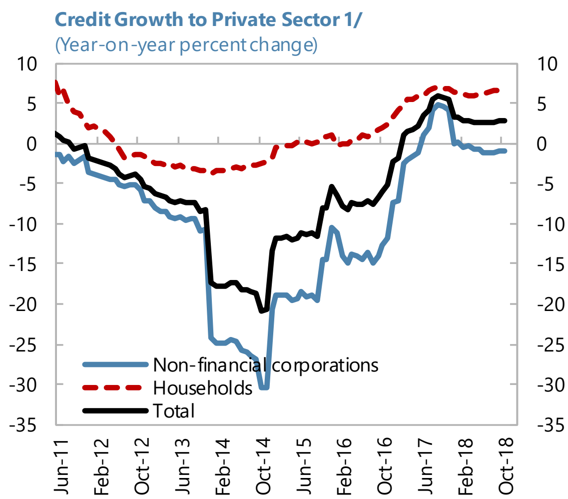
The NPL ratio has declined, while corporate deleveraging continued.



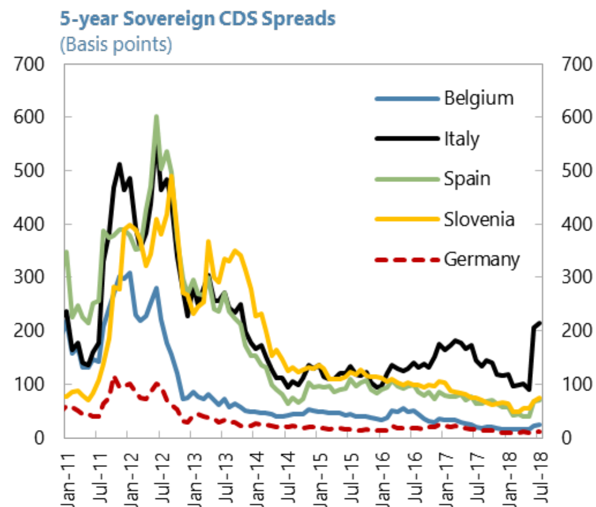
Slovenian banks have increased capital adequacy, while profitability also increased.



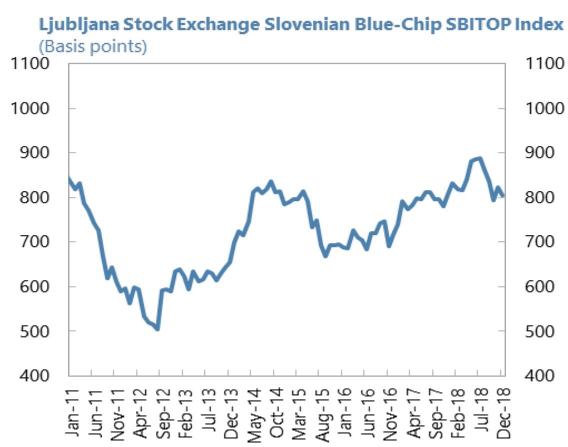
Credit growth recovered recently, driven by consumer loans.



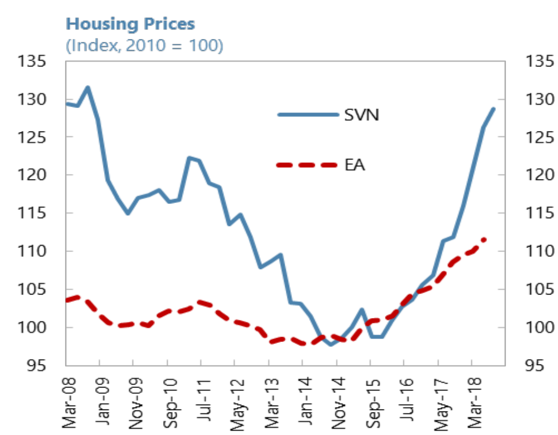
Market continues to perceive low sovereign risk.



Stock market index increased steadily.



Housing price increased recently.



Sources: Slovenia authorities; Eurostat; and Haver Analytics.

1/ Due to the 2012–13 crisis, credit growth for non-financial corporations had a sharp contraction in 2013–14 and then experienced recovery with the support of crisis measures.

Table 1. Selected Economic Indicators, 2015–23

(Annual percentage change, unless indicated otherwise)

	2015	2016	2017	2018	2019	2020	2021	2022	2023
				Projections					
Nominal GDP (EUR millions)	38,866	40,357	43,000	45,937	48,510	50,935	53,380	55,782	58,181
GDP per Capita (EUR)	18,841	19,551	20,814	22,218	23,442	24,594	25,753	26,890	28,023
Real economy									
Real GDP	2.3	3.1	4.9	4.5	3.4	2.8	2.7	2.3	2.1
Domestic demand	1.9	2.9	3.9	4.8	4.1	3.8	3.5	3.1	3.1
Private consumption	2.3	3.9	1.9	3.4	2.8	2.6	2.6	2.7	2.7
Public consumption	2.4	2.7	0.5	3.7	3.8	2.9	3.0	1.9	1.9
Gross capital formation	0.1	0.0	13.2	9.9	8.0	7.5	5.9	5.0	5.0
Net exports (contribution to growth)	0.6	0.5	1.3	0.0	-0.4	-0.7	-0.5	-0.6	-0.8
Exports of goods and services	5.0	6.4	10.7	7.1	6.3	5.5	4.9	4.6	4.3
Imports of goods and services	4.7	6.6	10.3	7.9	7.5	6.9	6.0	5.6	5.5
Potential output growth	1.7	1.8	2.5	2.7	2.8	2.8	2.8	2.7	2.5
Output gap (in percent of potential GDP)	-3.9	-2.7	-0.5	1.2	1.8	1.9	1.7	1.3	0.9
Prices									
Consumer prices (national definition, period average)	-0.5	-0.1	1.4	1.9	2.2	2.2	2.1	2.0	2.0
Employment and wages									
Unemployment rate (in percent, ILO definition)	9.0	8.0	6.6	5.1	4.8	4.9	5.0	5.1	5.1
Employment (domestic concept, period average)	1.2	1.9	2.8	2.8	1.4	1.0	1.0	1.0	1.0
Nominal wages (all sectors)	0.7	1.8	2.7	3.9	5.4	5.1	4.0	4.0	4.0
Real wages (all sectors)	1.2	1.9	1.2	2.0	3.5	3.1	2.0	2.0	2.0
Public finance (percent of GDP)									
General government balance	-3.3	-1.7	-0.8	0.4	0.0	-0.1	-0.1	-0.1	0.0
Structural balance 1/	-0.9	-0.2	0.5	0.0	-0.7	-0.8	-0.8	-0.6	-0.4
Structural primary balance 1/	1.9	2.5	2.8	2.0	1.0	0.8	0.7	0.9	1.2
General government debt 2/	82.6	78.7	74.1	68.8	66.1	64.0	62.1	60.4	58.7
Monetary and financial indicators									
Credit to the private sector	-5.5	-2.7	3.3	4.6	5.7	5.8	6.0	6.2	6.0
Lending rates 3/	2.9	2.2	2.3	...	...	...	...	...	...
Deposit rates 4/	0.4	0.2	0.1	...	...	...	...	...	...
Balance of payments (percent of GDP)									
Trade balance (goods and services)	8.8	9.4	10.0	9.7	8.4	7.3	6.4	5.3	4.3
Current account balance	4.5	5.5	7.2	6.4	5.2	4.3	3.5	2.5	1.5
Gross external debt (percent of GDP, end-period)	120.0	111.0	100.3	94.3	89.9	85.9	82.4	79.2	76.2
Nominal effective exchange rate (2010=100)	100.3	101.3	101.8	...	...	...	...	...	...
Real effective exchange rate (2010=100, CPI-based)	97.2	97.5	97.6	...	...	...	...	...	...

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

1/ Reflected national account data update by the authorities as of November 30, 2018.

2/ The stock includes debt issuances of the Bank Asset Management Company (BAMC) in 2013-14.

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

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

Table 2. General Government Operations, 2015–23
(Percent of GDP, unless indicated otherwise)

	2015	2016	2017	2018	2019	2020	2021	2022	2023
				Projections					
Revenue	40.1	38.9	38.7	38.8	38.8	38.9	38.9	39.2	39.4
Taxes	21.3	21.1	21.1	20.3	20.2	20.2	20.2	20.3	20.4
Taxes on income, profit, payroll	6.7	6.7	6.9	7.0	7.1	7.2	7.2	7.3	7.3
Taxes on goods and services	14.0	13.7	13.5	12.7	12.5	12.5	12.4	12.4	12.4
Other taxes	0.6	0.8	0.7	0.6	0.6	0.6	0.6	0.6	0.6
Social contributions	14.1	14.2	14.2	14.2	14.3	14.4	14.5	14.6	14.7
Other revenue	4.7	3.6	3.5	4.3	4.2	4.2	4.3	4.3	4.3
Expenditure	43.4	40.6	39.5	38.4	38.7	38.9	39.1	39.3	39.4
Expense	39.8	39.0	37.8	36.9	37.0	37.2	37.2	37.3	37.5
Compensation of employees	9.3	9.4	9.2	9.0	9.3	9.5	9.5	9.6	9.7
Purchases of goods and services	5.9	5.9	5.8	5.7	5.8	5.8	5.8	5.8	5.8
Interest	2.8	2.8	2.4	2.0	1.7	1.6	1.5	1.6	1.6
Transfers to individuals and households	16.4	16.1	15.5	15.1	15.2	15.3	15.4	15.4	15.4
of which: pensions	10.8	10.5	10.0	9.7	9.8	9.9	9.9	10.0	10.1
Subsidies	1.0	1.0	1.0	0.9	0.9	0.9	0.9	0.9	0.9
Other transfers	4.4	3.9	4.0	4.1	4.1	4.1	4.1	4.1	4.1
of which: capital transfers	0.8	0.4	0.4	0.6	0.6	0.6	0.6	0.6	0.6
transfers to the EU budget	1.1	1.1	0.9	0.9	0.9	0.9	0.9	0.9	0.9
Net acquisition of non-financial assets	3.6	1.6	1.7	1.6	1.8	1.8	1.9	1.9	2.0
Gross operating balance	0.3	-0.2	0.9	2.0	1.8	1.7	1.8	1.8	1.9
Net lending / Net borrowing	-3.3	-1.7	-0.8	0.4	0.0	-0.1	-0.1	-0.1	0.0
Memorandum item:									
General government balance (ESA 2010)	-2.8	-1.9	0.1	...	...	...	...	...	...
Primary balance	-0.6	1.0	1.5	2.3	1.7	1.5	1.3	1.5	1.5
Structural budget balance 1/	-0.9	-0.2	0.5	0.0	-0.7	-0.8	-0.8	-0.6	-0.4
Structural primary balance 1/	1.9	2.5	2.8	2.0	1.0	0.8	0.7	0.9	1.2
General government debt 2/	82.6	78.7	74.1	68.8	66.1	64.0	62.1	60.4	58.7

Sources: Ministry of Finance; and IMF staff calculations.

1/ Excludes one-offs and includes cylical adjustments and calendar year shifts between receipt and expenditure of earmarked EU funds.

2/ The stock includes debt issuances of the Bank Asset Management Company (BAMC) in 2013-14. Bank privatization receipts have contributed to reduce public debt, and so will future privatization.

Table 3. Balance of Payments, 2015–23
(Percent of GDP, unless indicated otherwise)

	2015	2016	2017	2018	2019	2020	2021	2022	2023
				Projections					
Current account	4.5	5.5	7.2	6.4	5.2	4.3	3.5	2.5	1.5
Trade balance, goods and services	8.8	9.4	10.0	9.7	8.4	7.3	6.4	5.3	4.3
Goods	3.8	3.8	3.6	3.1	2.1	1.4	0.8	-0.1	-1.0
Exports f.o.b.	61.9	61.9	66.2	66.4	68.3	69.1	69.7	69.7	69.9
Imports f.o.b.	58.1	58.1	62.6	63.2	66.1	67.6	68.9	69.8	70.8
Services	5.0	5.6	6.3	6.6	6.2	5.8	5.6	5.4	5.2
Exports	15.3	16.1	16.9	17.2	17.3	17.4	17.5	17.7	17.9
Imports	10.3	10.5	10.6	10.6	11.1	11.5	11.9	12.3	12.7
Primary income, net	-3.3	-3.0	-2.2	-2.5	-2.3	-2.1	-2.0	-2.0	-1.9
Secondary income, net	-0.9	-0.9	-0.6	-0.8	-0.8	-0.8	-0.8	-0.8	-0.8
Capital account	1.1	-0.8	-0.8	0.0	0.0	0.0	0.0	0.0	0.0
Financial account, excl. reserves	4.7	3.1	3.9	6.4	5.2	4.3	3.5	2.5	1.5
Direct investment, net	-3.3	-2.1	-1.0	-1.2	-0.6	-0.5	-0.1	-0.2	-0.2
In Slovenia	4.0	3.2	2.2	2.7	2.0	2.0	1.6	1.6	1.5
Abroad	0.7	1.1	1.3	1.5	1.5	1.5	1.6	1.3	1.3
Portfolio investment, net	7.6	12.6	6.9	5.9	3.9	2.8	1.4	0.5	-0.4
Equity	0.2	-0.3	0.6	1.6	1.6	1.6	1.6	1.6	1.6
Debt	7.4	12.9	6.3	4.3	2.3	1.2	-0.2	-1.2	-2.0
Financial derivatives	-0.3	-0.5	-0.6	0.0	0.0	0.0	0.0	0.0	0.0
Other investment, net	0.6	-6.8	-1.5	1.7	1.8	2.0	2.1	2.2	2.1
Loans	-0.2	1.5	4.0	0.8	0.8	0.8	0.9	0.9	0.8
Currency and deposits	-0.3	-8.4	-6.1	2.2	2.2	2.2	2.2	2.2	2.2
Trade credits	0.2	0.0	0.4	0.7	0.7	0.7	0.7	0.7	0.7
Other	0.9	0.0	0.2	0.2	0.2	0.2	0.2	0.2	0.2
Net errors and omissions	-1.2	-1.9	-2.3	0.0	0.0	0.0	0.0	0.0	0.0
Overall balance	-0.3	-0.2	0.2	0.0	0.0	0.0	0.0	0.0	0.0
Change in official reserves (+: increase)	-0.3	-0.2	0.2	0.0	0.0	0.0	0.0	0.0	0.0
Memorandum items:									
Export of goods (percent change in value)	4.7	4.0	13.8	7.1	8.7	6.2	5.7	4.5	4.6
Import of goods (percent change in value)	3.2	3.9	14.4	8.0	10.2	7.2	6.7	5.9	5.9
Terms of trade (percent change)	1.3	0.8	-0.6	0.3	-0.8	0.0	-0.1	-0.5	-0.2
Gross external debt (billions of euros)	46.6	44.8	43.1	43.3	43.6	43.8	44.0	44.2	44.3
(percent of GDP)	120.0	111.0	100.3	94.3	89.9	85.9	82.4	79.2	76.2
Net int'l investment position (percent GDP)	-39.6	-36.8	-30.2	-19.7	-11.4	-4.6	1.0	5.3	8.3

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

Table 4. Vulnerability Indicators, 2009–17
(Percent of GDP, unless indicated otherwise)

	2009	2010	2011	2012	2013	2014	2015	2016	2017
External Indicators									
Current account balance	-0.6	-0.1	0.2	2.1	4.4	5.8	4.5	5.5	7.2
Capital and financial account balance	-3.5	-3.9	-2.3	-0.3	3.2	6.2	5.5	2.1	3.3
Of which									
Inward portfolio investment (debt securities, etc.)	12.6	6.4	5.0	-1.0	10.2	11.7	-2.4	-7.4	-0.3
Inward foreign direct investment	-0.7	0.6	1.7	0.1	0.2	2.0	4.0	3.2	2.2
Other investment (net)	7.8	1.4	4.5	0.1	14.3	18.0	0.6	-6.8	-1.5
Euros per U.S. dollar (period average)	0.7	0.8	0.7	0.8	0.8	0.8	0.9	0.9	0.9
Market Indicators									
Financial Markets									
10-year government bond (percentage points)	4.4	3.8	5.0	5.8	5.8	3.3	1.7	1.1	1.0
10-year government bond (United States)	3.3	3.2	2.8	1.8	2.4	2.5	2.1	1.8	2.4
Spread with US bond (percentage points)	1.1	0.6	2.2	4.0	3.5	0.7	-0.4	-0.7	-1.4
Stock market index (period average, 1995=100)	108.8	99.3	80.5	63.7	70.1	83.1	83.0	79.5	88.4
Real estate prices (index, 2010=100, period average)	99.9	100.0	102.7	95.6	90.6	84.6	85.3	88.1	95.2
Credit markets (end-of-period 12-month growth rates)									
Credit to the private sector	3.1	2.9	-1.9	-5.4	-17.4	-13.4	-5.5	-2.7	3.3
Bank credit to households	7.5	10.3	1.9	-2.0	-3.8	-1.7	1.1	3.4	6.4
Housing Loans	15.7	23.2	6.8	1.9	0.9	0.8	3.3	3.5	4.6
Sectoral risk indicators									
Household sector									
Household savings ratio (percent)	14.5	13.0	12.4	10.2	12.8	12.5	12.4	13.0	14.0
Gross disposable income	63.3	63.7	63.8	63.6	63.5	62.0	60.9	61.1	60.0
Personal income	52.0	52.5	51.3	51.2	49.9	49.0	48.6	49.3	49.3
Corporate sector									
Business investment	14.3	11.9	12.1	11.5	12.0	10.8	10.6	10.9	11.8
Investment rate NFCs (percent)	27.5	22.7	22.9	21.2	22.7	20.0	19.5	20.0	21.6
Gross profit share NFCs (percent)	32.8	32.1	32.9	33.2	34.6	35.6	35.5	35.1	36.0
Net return after taxes NFCs (percent)	3.5	2.4	4.3	2.1	4.5	7.6	9.0	9.9	11.3
Banking sector (percent)									
Share of housing loans in bank credit to the private sector	28.6	30.6	31.8	33.0	38.5	43.6	46.7	49.5	51.0
Share of nonperforming loans in total loans	5.8	8.2	11.8	15.2	13.3	11.7	10.0	5.1	3.2
Ratio of nonperforming loans net of provisions to capital	37.4	50.5	71.0	85.8	55.6	36.7	25.0	10.8	6.3
Liquid assets to total short-term liabilities	36.2	42.9	40.3	43.5	45.6	62.9	54.8	53.5	51.9
Return on assets	0.2	-0.2	-0.9	-1.5	-7.1	-0.2	0.5	1.1	1.2
Return on equity	2.2	-3.2	-11.8	-19.6	-94.9	-1.9	4.2	8.8	9.8
Regulatory capital to risk-weighted assets	11.7	11.3	11.9	11.4	14.1	18.0	18.7	19.2	18.2

Sources: Slovenia Statistics Office; Bank of Slovenia; Haver; International Financial Statistics; OECD; and Bloomberg.

Table 5. Core Financial Soundness Indicators, 2012–18

(Percent, unless indicated otherwise)

	2012	2013	2014	2015	2016	2017	2018Q2
Capital							
Regulatory capital to risk-weighted assets	11.4	14.1	18.0	18.7	19.2	18.2	18.9
Regulatory Tier 1 capital to risk-weighted assets	9.8	13.3	17.3	18.1	18.7	17.8	18.6
Profitability							
Return on assets	-1.5	-7.1	-0.2	0.5	1.1	1.2	1.7
Return on equity	-19.6	-94.9	-1.9	4.2	8.8	9.8	12.8
Interest margin to gross income	58.0	53.9	55.4	57.4	54.2	55.3	51.9
Noninterest expenses to gross income	63.9	77.2	60.9	66.7	83.9	87.1	81.6
Liquidity							
Liquid assets to total assets	14.7	17.5	27.8	26.7	29.4	30.5	30.3
Liquid assets to short-term liabilities	43.5	45.6	62.9	54.8	53.5	51.9	50.2
Sensitivity to market risk							
Net open position in foreign exchange to capital	-2.7	-4.0	-1.1	0.9	0.6	10.8	10.4
Asset quality							
Nonperforming loans to total gross loans	15.2	13.3	11.7	10.0	5.1	3.2	2.5
Non-performing loans net of provisions to capital	85.8	55.6	36.7	25.0	10.8	6.3	4.4
Sectoral distribution of loans							
Central Bank	2.2	4.5	4.3	5.1	7.2	8.8	8.1
General Government	8.6	9.3	10.3	10.5	9.8	9.0	9.4
Financial corporations	12.1	9.7	8.2	6.8	6.0	6.5	6.0
Nonfinancial Corporations	44.8	40.1	35.3	34.4	32.8	32.5	30.0
Other Domestic Sectors	21.0	23.3	25.4	27.8	30.1	31.7	31.0
Nonresidents	11.2	13.0	16.5	15.4	14.1	11.6	15.6

Sources: Bank of Slovenia and IMF FSI.

Annex I. Risk Assessment Matrix[1]

Source of Risk	Likelihood of Risk	Time Horizon	Expected Impact	Policy Response
External risks				
Rising protectionism and retreat from multilateralism. Economic isolationism could reduce global and regional policy collaboration with negative consequences for trade, FDI, and growth.	**High**	**Short to Medium Term**	**High:** Large impact on growth, given Slovenia's integration in global supply chains and high exports. Mainly indirect as Slovenia's EU partners with higher global trade exposure are affected.	Accelerate structural reforms that strengthen competitiveness and raise potential growth, including labor market reforms. Step up retraining and vocational education to reduce skills mismatches. Accelerate privatization to cut public debt and raise productivity.
Unsustainable macroeconomic policies. Policies in systemically important countries to boost near-term activity beyond sustainable levels exacerbate underlying vulnerabilities and potentially hurt confidence and global growth.	**Medium**	**Short to Medium Term**	**Medium:** Mainly indirect effects through Slovenia's EU partners, except in case of Italy, a core trade and investment partner.	Strengthen domestic investment if externally financed investment declines. Accelerate absorption of available EU funds.
Sharp tightening of global financial conditions: causes higher debt service and refinancing risks; stress on leveraged firms, households, and vulnerable sovereigns, and a broad-based downturn.	**High**	**Short Term**	**Low:** Tightening of export financing possible. Public debt servicing cost would rise, but impact mitigated by long debt maturities.	Accelerate development of equity and bond financing. Accelerate bank and enterprise balance sheet repair.
Weaker global growth: • Euro Area • US • China	 **Medium** **Medium** **Low to Medium**	 **Medium Term** **Medium Term** **Short to medium Term**	**High:** Slower EU growth directly depresses growth potential and lowers export growth. Growth shocks from US and China would mainly be indirect.	Accelerate structural reforms to spur investment, productivity and competitiveness, including labor market reforms. Accelerate privatization to cut public debt and raise productivity. Step up efforts to reduce skills mismatches.

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

Source of Risk	Likelihood of Risk	Time Horizon	Expected Impact	Policy Response
Intensification of the risks of security dislocation, leading to socio-economic disruptions and a sharp rise in migrant flows into Europe.	**High**	**Short to medium term**	**Low:** Fiscal impact of migrant flows has so far been manageable.	Rebuild fiscal buffers to accommodate shock within broader consolidation envelope.
Sizeable deviation from baseline energy prices: Risks to oil price are broadly balanced.	**Medium**	**Short to medium term**	**Medium:** energy prices affect costs and prices; low impact on relative competitiveness versus regional peers.	Maintain market-determined energy prices and encourage sufficient buffers to absorb price shocks.
Cyber-attacks on critical global financial, transport or communication infrastructure trigger systemic financial instability or widespread disruptions.	**Medium**	**Short to medium term**	**Low**: as an open, trade-dependent economy, disruptions in the Euro Area would be directly felt.	Strengthen domestic defenses including back-up systems and financial cushions and promote international cooperation.
Domestic Risks				
Failure to design and implement credible reform-based fiscal consolidation strategy; entering unsustainable expenditure commitments (e.g., related to public pensions).	**Medium**	**Medium Term**	**Medium:** Insufficient capacity to counter growth shocks and to finance pro-growth investment, inability to prepare adequately for ageing.	Announce and implement a reform-based consolidation strategy with measures that optimize spending in health care and education, further reform the pension system, and close revenue gaps.
Delays in completing the resolution of NPLs, especially of SMEs, and cleaning of bank and company balance sheets.	**Low**	**Short/ Medium term**	**Medium:** Companies with burdened balance sheets will continue to be cut off bank financing.	Closely monitor implementation of guidelines for SME NPL resolution. Let the BAMC restructure companies under its control.

Annex II. External Sector Assessment

Foreign Assets and Liabilities	*Background:* Slovenia's NIIP is estimated at about -20 percent of GDP at the end of 2018 (with gross external debt at about 94 percent of GDP). With the global financial crisis (GFC), Slovenia's NIIP plummeted rapidly to -50 percent of GDP as external debt rose to about 119 percent of GDP. The relative improvement in the NIIP, during 2012–18, was supported by the current account surplus as investment and consumption were reduced. *Assessment:* As the NIIP is still relatively large and negative, the current account surplus should be viewed from this perspective	***Overall Assessment:*** *The external position was substantially stronger* than implied by medium-term fundamentals and desirable policies. As the NIIP is still relatively large and negative, the large external surplus helps reduce external vulnerabilities. ***Policy Responses:*** Slovenia's current account surplus is expected to moderate as consumption and investment fully recover from the global financial crisis and the NIIP improves and becomes positive. Policies to address legacy problems (¶15) and product and service-market reforms (¶26) could boost investment and help reduce the current account surplus.
Current Account	*Background:* Slovenia's current account balance shifted significantly from -4.1 percent of GDP to 6.4 percent of GDP between 2007 and 2018. The improvement was driven mainly by strong exports growth and the concomitant and temporary collapse in investment and consumption after the GFC. The current account surplus reflects the temporary rise in the private sector's saving to help deleverage and improve the negative NIIP. *Assessment:* The EBA-lite current account model finds that the current account surplus is 4.5 percentage points higher than expected. As the NIIP is still relatively large and negative, the current surplus is helping to deleverage the private sector. Actual CA: 6.4 CA Norm: 1.9 CA gap: 4.5 Policy Gap: -0.02 Implied REER gap: -8	
Real Exchange Rate	*Background:* The real effective exchange rate has remained relatively stable in recent years, due to Slovenia's high level of integration in the euro zone. The REER experienced an appreciation of 0.4 percent during 2018, mostly due to slightly lower inflation in Slovenia compared to its trading partners. Using standard elasticities, the current account norm implies a 8 percent REER undervaluation, while the REER model translates into a minor REER gap of 0.03, well within the models' margin of error. *Assessment:* The exchange rate appears in line with medium-term fundamentals and desirable policies. However, considering the poor fit of the REER model for Slovenia, the overall assessment relies on the current account model. Relatively little movement in the REER over the last 25 years also suggests that temporary factors are primarily responsible for the current account surplus. Actual REER: 4.59 REER Norm: 4.56 REER gap: 0.03	
Capital and Financial Accounts	*Background:* Current account surpluses since 2012 allowed the bank and corporate sectors to accumulate assets and reduce investment liabilities. Inward FDI flows, near zero percent of GDP in 2012, is projected to be below 3 percent of GDP in 2018. Government external debt, which reached a peak of 64 percent of GDP in 2015, is now trending down. *Assessment:* Slovenia has reduced net external liabilities, particularly through the acquisition of portfolio assets abroad. As demand and imports pick up and Slovenia's current account surplus declines, net financial outflows should also decline.	
Foreign Exchange Intervention and Reserves	*Background and Assessment:* The euro is a global reserve currency. Reserves held by the euro area are typically low relative to standard metrics, but the currency is free floating.	

Annex III. External Debt Sustainability Analysis

1. The gross external debt ratio is projected to fall gradually from 100 percent of GDP in 2017 to 76 percent of GDP in 2023. Between end-2016 and end-2017, external debt fell by 11 percentage points of GDP, contributed by falling public external debt and external liabilities of banks. Over the medium term, the private sector is expected to continue to reduce external debt significantly while public external debt is projected to decline by about 6 percentage points to 45 percent of GDP in 2023.

2. Slovenia's NIIP remains negative but has been improving. The current account surplus in recent years have helped deleverage the corporate sector and improve the negative NIIP, which has increased from the trough of -50 percent of GDP in 2012 to about -30 percent of GDP at end-2017. In addition, the projected sizable, albeit declining, current account surpluses over the medium term will further support closing the gap toward a balanced NIIP (Annex II).

3. External debt dynamics show moderate vulnerability to standard shocks. With low interest rates over the last several years and most debt euro-denominated, an increase in nominal interest rates or a depreciation are not expected to materially affect the outlook for external debt. A shock to current account (about 1.8 percent of GDP) would push the external debt up by about 9 percentage points to 85 percent of GDP in 2023, while a shock to real GDP growth (about 1.9 percentage points) or a combination of smaller shocks to interest rates, growth, and the current account would push external debt up by about 8 percentage points. [1] In addition, while the scenario with key variables at their historical averages shows that the external debt-to-GDP ratio would rise above 99 percent in 2023, this was mainly driven by debt accumulation by financial institutions as experienced during the global financial crisis and Slovenia's 2012–13 banking crisis. The impact of crisis was successfully addressed by the authorities' bank recapitalization and burden sharing with the banks' creditors. Thus, a repeat of the historical scenario appears unlikely.

[1] The size of the permanent shock is based on ½ standard deviation of respective data series in the last five years.

Table 1. External Debt Sustainability Framework, 2013–23

(Percent of GDP, unless otherwise indicated)

	Actual							Projections						
	2013	2014	2015	2016	2017			2018	2019	2020	2021	2022	2023	Debt-stabilizing non-interest current account 6/
Baseline: External debt	114.9	125.8	120.0	111.0	100.3			**94.3**	**89.9**	**85.9**	**82.4**	**79.2**	**76.2**	**-1.7**
Of which: external public debt	42.6	62.0	63.9	56.9	51.2			51.0	49.5	48.1	47.0	45.8	44.8	
Change in external debt	-3.9	10.8	-5.8	-8.9	-10.7			-6.1	-4.4	-3.9	-3.5	-3.2	-3.0	
Identified external debt-creating flows (4+8+9)	-5.0	-11.9	-7.6	-12.6	-15.3			-12.0	-9.1	-7.5	-6.1	-4.8	-3.6	
Current account deficit, excluding interest payments	-6.9	-8.7	-7.3	-8.5	-9.6			-8.7	-7.5	-6.6	-5.7	-4.6	-3.6	
Deficit in balance of goods and services	-6.7	-7.7	-8.8	-9.4	-10.0			-9.7	-8.4	-7.3	-6.4	-5.3	-4.3	
Exports	74.5	75.8	77.1	78.0	83.1			83.5	85.6	86.4	87.2	87.4	87.8	
Imports	67.8	68.2	68.4	68.6	73.2			73.8	77.2	79.2	80.8	82.1	83.5	
Net non-debt creating capital inflows (negative)	-0.1	-2.0	-4.0	-2.8	-0.8			-1.5	-0.9	-0.8	-0.4	-0.5	-0.4	
Automatic debt dynamics 1/	2.0	-1.2	3.7	-1.4	-4.9			-1.8	-0.7	-0.1	0.0	0.3	0.4	
Contribution from nominal interest rate	2.4	2.9	3.3	3.0	2.4			2.2	2.4	2.2	2.2	2.1	2.0	
Contribution from real GDP growth	1.3	-3.3	-3.4	-3.6	-5.0			-4.0	-3.1	-2.4	-2.2	-1.8	-1.6	
Contribution from price and exchange rate changes 2/	-1.8	-0.9	3.7	-0.8	-2.4			...	...	...	...	...	...	
Residual, incl. change in gross foreign assets (2-3) 3/	1.2	22.8	1.8	3.7	4.6			5.9	4.7	3.5	2.5	1.6	0.6	
External debt-to-exports ratio (in percent)	154.2	165.8	155.6	142.4	120.7			112.9	105.1	99.4	94.5	90.6	86.8	
Gross external financing need (in billions of US dollars) 4/	14.2	10.4	9.7	11.2	2.8			2.5	2.9	2.2	3.0	2.2	2.3	
in percent of GDP	39.3	27.6	24.9	27.7	6.5	10-Year	10-Year	5.2	5.7	4.1	5.2	3.6	3.7	
Scenario with key variables at their historical averages 5/								**94.3**	**95.5**	**98.3**	**99.4**	**100.0**	**99.0**	**1.4**
Key Macroeconomic Assumptions Underlying Baseline						Historical Average	Standard Deviation							
Real GDP growth (in percent)	-1.1	3.0	2.3	3.1	4.9	0.7	3.7	4.5	3.4	2.8	2.7	2.3	2.1	
GDP deflator in US dollars (change in percent)	5.0	0.8	-15.6	0.5	3.7	-0.2	7.9	7.4	0.7	3.5	2.7	3.0	2.6	
Nominal external interest rate (in percent)	2.1	2.7	2.3	2.6	2.4	2.5	0.7	2.5	2.7	2.7	2.7	2.7	2.7	
Growth of exports (US dollar terms, in percent)	2.5	5.6	5.1	5.0	13.5	4.6	8.8	7.4	8.2	6.1	5.7	4.7	4.8	
Growth of imports (US dollar terms, in percent)	-1.5	4.4	3.6	4.2	13.6	3.2	10.7	7.8	10.4	7.7	7.0	6.1	6.1	
Current account balance, excluding interest payments	6.9	8.7	7.3	8.5	9.6	5.1	3.6	8.7	7.5	6.6	5.7	4.6	3.6	
Net non-debt creating capital inflows	0.1	2.0	4.0	2.8	0.8	1.0	1.6	1.5	0.9	0.8	0.4	0.5	0.4	

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

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

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

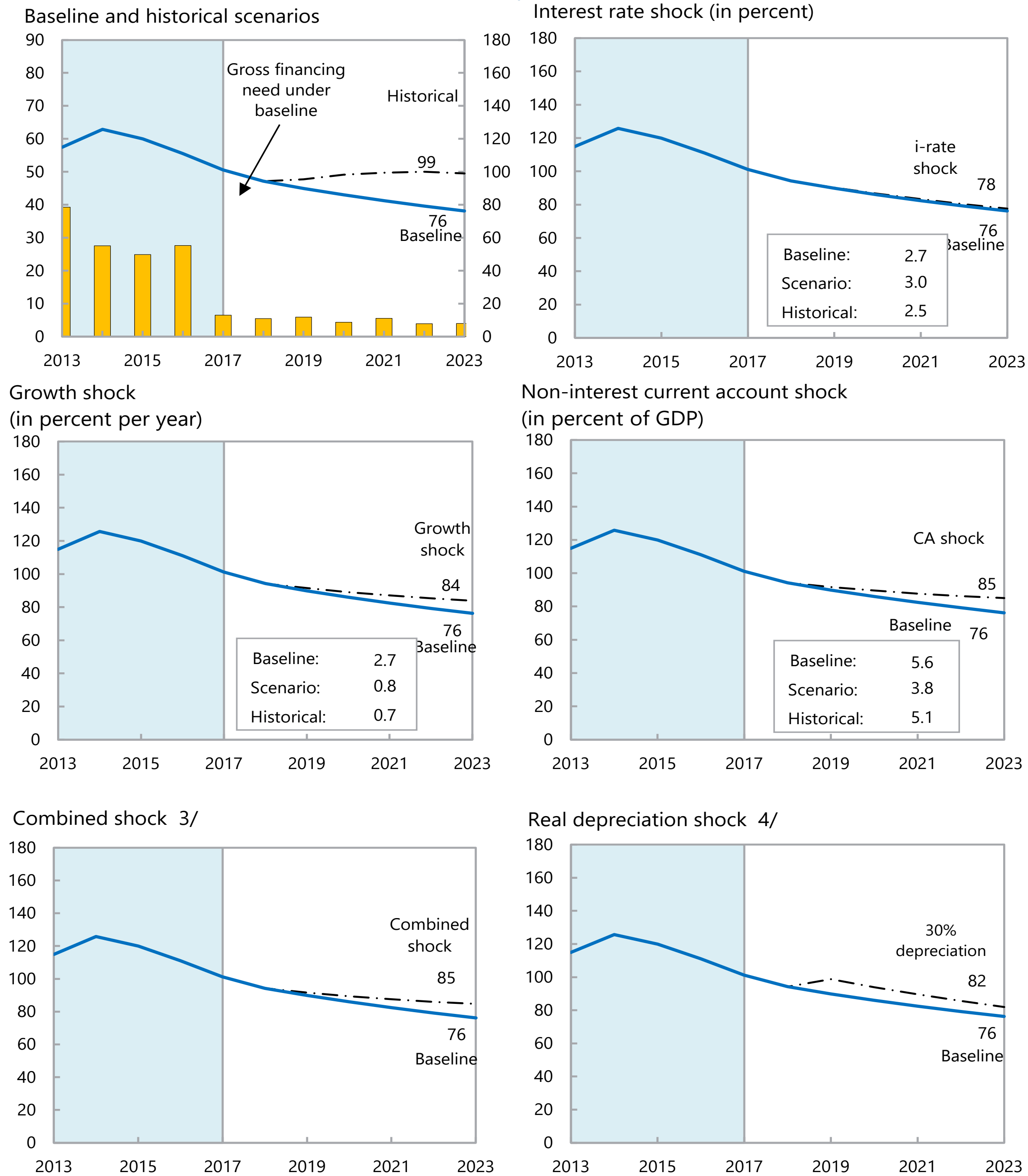
4/ Defined as current account deficit, plus amortization on medium- and long-term debt, plus short-term debt at end of previous period.

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

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

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

(External debt in percent of GDP)



Sources: International Monetary Fund, Country desk data, and staff estimates.
1/ Shaded areas represent actual data. Individual shocks are permanent one-half standard deviation shocks. Figures in the boxes represent average projections for the respective variables in the baseline and scenario being presented. Ten-year historical average for the variable is also shown.
2/ For historical scenarios, the historical averages are calculated over the ten-year period, and the information is used to project debt dynamics five years ahead.
3/ Permanent 1/4 standard deviation shocks applied to real interest rate, growth rate, and current account balance.
4/ One-time real depreciation of 30 percent occurs in 2018.

Annex IV. Public Sector Debt Sustainability Analysis

Slovenia's elevated public debt decreased due to continued fiscal consolidation and favorable growth developments, but substantial vulnerabilities remain. The public debt-to-GDP ratio fell from 79 percent in 2016 to 74 percent in 2017 and is projected to further decline to below 60 percent by 2023. Combined macro-fiscal shocks and shocks to growth or contingent liabilities pose major risks to this baseline scenario. This underscores the importance of continued fiscal consolidation and further structural reforms to boost growth while addressing the fiscal challenges from rapid ageing.

1. Fiscal consolidation has helped reduce public debt and improve Slovenia's medium-term public debt dynamics. The authorities' recapitalization of banks in addressing the 2013 banking sector crisis resulted in a spike in public debt, which peaked at 83 percent of GDP in 2015. Since then, decisive fiscal consolidation has included raising revenue from VAT increase and restraining spending from pension reforms and some one-off measures. Meanwhile, robust exports to the EU have driven a strong growth recovery, which boosted revenue and contributed to lower the debt-to-GDP ratio. Public debt fell to 74 percent of GDP in 2017. The progress allowed Slovenia to exit the EC's EDP in 2016. This has also improved Slovenia's medium-term public debt dynamics, with debt level projected to decline to below 60 percent of GDP by 2023.

2. The baseline scenario assumes a small and gradual fiscal consolidation after 2019. This is underlined by the following assumptions:

- Real GDP Growth is forecasted to slow down from 4.5 percent in 2018 to 2.1 percent in 2023. Domestic demand is projected to gradually replace net exports in contributing to growth. Inflation is to remain moderate at around 2 percent. Despite a structural fiscal expansion in 2019, some gradual fiscal consolidation would resume in the medium term.

- The authorities continue to implement ongoing structural reforms in the medium term. This includes completing the planned bank privatization and strengthening the implementation of labor market reforms that have started to enhance flexibility and improve human capital. However, these are not sufficient to achieve structural balance by 2020.

- The baseline projections are underpinned by realistic assumptions that are within the range achieved by similar countries. Over 2008–17, staff projections of main macroeconomic variables remained close to or more conservative than the median, except for the crisis period around 2012–13. In recent years after the crisis, growth and fiscal outturns have exceeded projections. In addition, the projected fiscal adjustments are close to the median of those achieved in comparator countries.

3. Despite improvements, Slovenia's debt dynamics are vulnerable to specific shocks as shown in the stress tests:

- **A shock to GDP growth would worsen the debt dynamics significantly.** A negative one-standard deviation growth shock over two years would push the debt-to-GDP ratio close to 80 percent by 2020 and remain above 70 percent in the medium term. This illustrates the importance of structural reforms to put Slovenia on a high and sustainable growth path, particularly in light of the challenges from rapid ageing in the medium to long term.
- **Contingent fiscal liabilities are a potential source of vulnerability.** The authorities estimate that contingent liabilities are about 12.7 percent of GDP in 2018, including guarantees provided to SOEs.[1] Based on this, a specific contingent liability shock could create a rising trajectory of public debt, which would exceed 80 percent of GDP by 2023. However, the authorities have made strong progress in privatizing the largest state-owned bank, NLB, while the third largest state-owned bank is planned to be privatized in 2019. Also, the Single Resolution Mechanism would help mitigate the potential impact of contingent liabilities from the banking sector on public debt as experienced during the 2013–14 crisis period.
- **A combined macro-fiscal shock could also result in high and persistent public debt in the medium term.** The combination includes shocks to GDP growth, inflation, fiscal balance, exchange rate, and interest rate spread. As a result, public debt could remain above 70 percent of GDP for a prolonged period. Furthermore, recent estimates suggest that rapid population ageing could reduce potential growth by about 0.5 percentage point by 2035, making such a shock more likely.[2] This also underscores the importance of a credible medium-term fiscal policy.
- **In addition, the elevated share of non-resident holding of public debt also presents a risk.** At 69 percent of total public debt in 2017, the ratio is higher than cross-country benchmarks. However, the authorities' recent efforts in debt re-profiling and continued prudent debt management would help reduce the risk over time.

4. Building fiscal buffers now will help address the vulnerabilities of public debt. Given that the economic recovery has matured, and rapid ageing is raising challenges to growth and fiscal sustainability, the authorities' MTO is appropriate. Structural reforms need to be accelerated to achieve structural balance by 2020 and further cut public debt to below 60 percent to meet the requirements of the Stability and Growth Pact. An active scenario of fiscal adjustment along the lines

[1] Other contingent liabilities are related to the government's participation in the financial sector.

[2] Aiyar, S. C. Ebeke, and X. Shao, 2016. "The Impact of Workforce Aging on European Productivity." IMF Working Paper 16/238.

of staff's recommendations would achieve structural fiscal balance by 2020 while bringing down the debt-to-GDP ratio to below 60 percent by 2021. These could include structural fiscal reforms on taxes, wages, and other public spending as discussed in the staff report. Moreover, further structural reforms to improve the labor market, privatize SOEs, and stimulate private investment and productivity growth would further enhance growth and economic resilience while reducing public debt.

Figure 1. Public Sector Debt Sustainability Analysis (DSA)—Baseline Scenario

(in percent of GDP unless otherwise indicated)

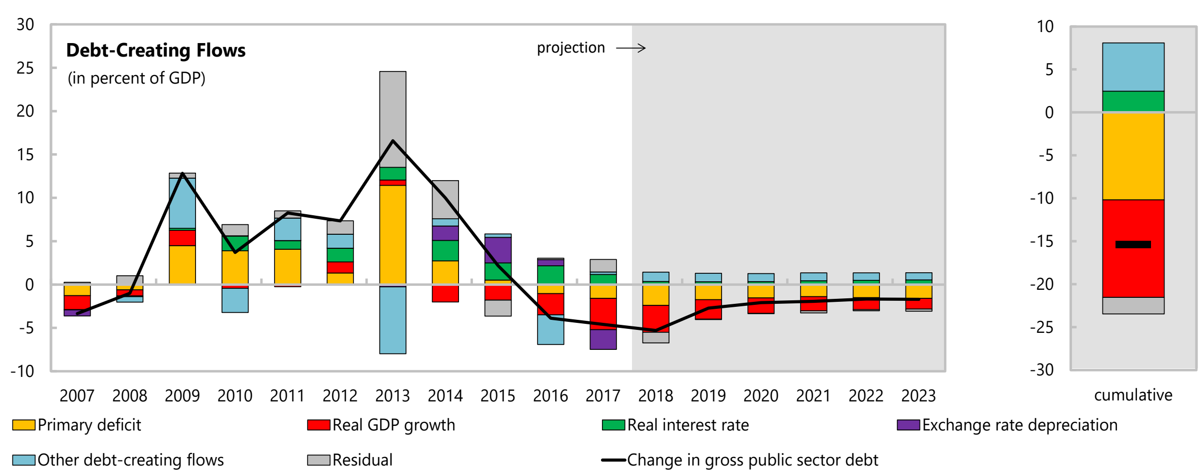
Debt, Economic and Market Indicators [1/]

	Actual			Projections					
	2007-2015 [2/]	2016	2017	2018	2019	2020	2021	2022	2023
Nominal gross public debt	50.1	78.7	74.1	68.8	66.1	64.0	62.1	60.4	58.7
Public gross financing needs	9.2	10.8	7.4	5.2	4.5	4.5	6.1	3.2	1.0
Real GDP growth (in percent)	0.6	3.1	4.9	4.5	3.4	2.8	2.7	2.3	2.1
Inflation (GDP deflator, in percent)	1.8	0.7	1.6	2.3	2.1	2.1	2.1	2.1	2.1
Nominal GDP growth (in percent)	2.4	3.8	6.5	6.8	5.6	5.0	4.8	4.5	4.3
Effective interest rate (in percent) [4/]	4.1	3.5	3.2	2.9	2.7	2.7	2.9	3.0	3.1

As of October 29, 2018		
Sovereign Spreads		
EMBIG (bp) 3/		33
5Y CDS (bp)		74
Ratings	Foreign	Local
Moody's	Baa1	Baa1
S&Ps	A+	A+
Fitch	A-	A-

Contribution to Changes in Public Debt

	Actual			Projections							
	2007-2015	2016	2017	2018	2019	2020	2021	2022	2023	cumulative	debt-stabilizing primary balance [9/]
Change in gross public sector debt	6.3	-3.9	-4.6	-5.3	-2.7	-2.1	-1.9	-1.7	-1.7	-15.4	
Identified debt-creating flows	4.2	-4.0	-6.0	-4.1	-2.7	-2.0	-1.7	-1.5	-1.5	-13.5	
Primary deficit	3.0	-1.0	-1.6	-2.4	-1.7	-1.5	-1.4	-1.5	-1.6	-10.2	0.1
Primary (noninterest) revenue and grants	40.6	39.3	39.1	39.3	39.3	39.4	39.4	39.7	39.9	237.0	
Primary (noninterest) expenditure	43.6	38.2	37.5	36.9	37.5	37.8	38.0	38.1	38.3	226.8	
Automatic debt dynamics [5/]	1.2	0.4	-4.7	-2.7	-1.9	-1.4	-1.2	-0.9	-0.7	-8.9	
Interest rate/growth differential [6/]	0.8	-0.3	-2.4	-2.7	-1.9	-1.4	-1.2	-0.9	-0.7	-8.9	
Of which: real interest rate	1.1	2.2	1.2	0.4	0.3	0.3	0.4	0.5	0.5	2.5	
Of which: real GDP growth	-0.3	-2.4	-3.6	-3.1	-2.2	-1.8	-1.6	-1.4	-1.2	-11.4	
Exchange rate depreciation [7/]	0.4	0.7	-2.3	…	…	…	…	…	…	…	
Other identified debt-creating flows	0.0	-3.4	0.3	1.1	1.0	0.9	0.9	0.9	0.8	5.6	
FIS: Other (specify, e.g. bank recapitalization) (neg	-2.0	0.0		0.0	0.0	0.0	0.0	0.0	0.0	-0.2	
Contingent liabilities	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	
FIS: Other financing sources	2.1	-3.4	1.4	1.1	1.0	1.0	0.9	0.9	0.9	5.8	
Residual, including asset changes [8/]	2.1	0.2	1.4	-1.2	0.0	0.0	-0.3	-0.1	-0.2	-1.9	



Source: IMF staff.

1/ Public sector is defined as general government.

2/ Based on available data.

3/ Long-term bond spread over German bonds.

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

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

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

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

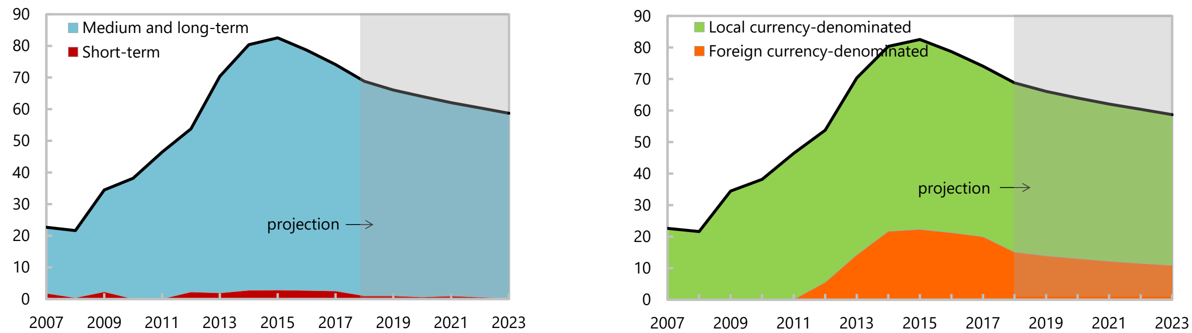
8/ Includes asset changes and interest revenues (if any). For projections, includes exchange rate changes during the projection period.

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

Figure 2. Public DSA—Composition of Public Debt and Alternative Scenarios

Composition of Public Debt

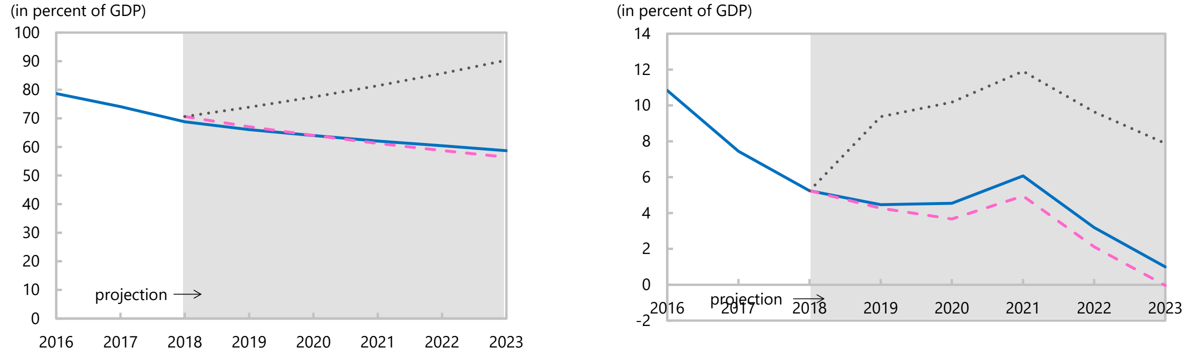
By Maturity (in percent of GDP) | **By Currency** (in percent of GDP)



Alternative Scenarios

Baseline | Historical | Constant Primary Balance

Gross Nominal Public Debt (in percent of GDP) | **Public Gross Financing Needs** (in percent of GDP)



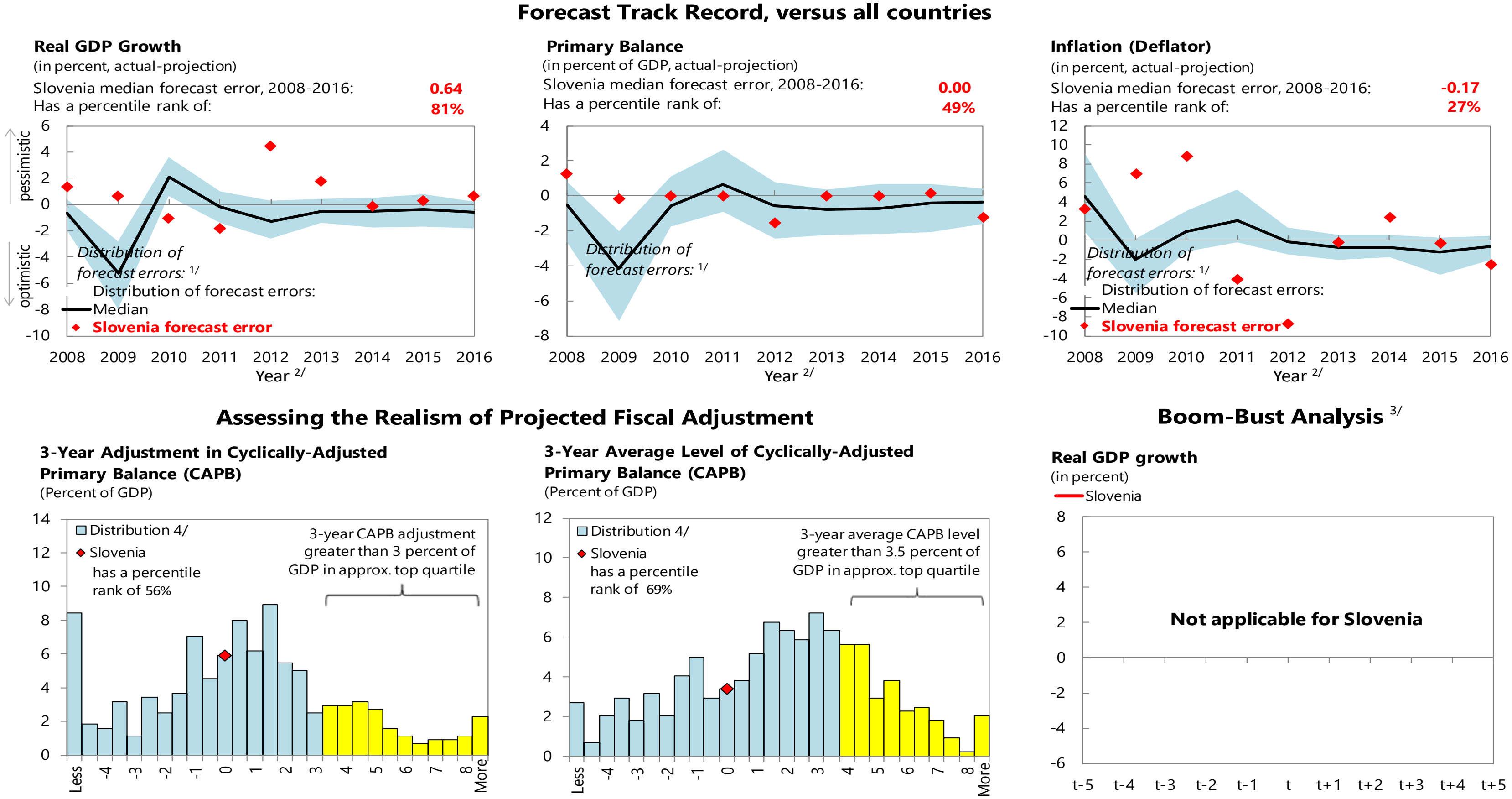
Underlying Assumptions
(in percent)

Baseline Scenario	2018	2019	2020	2021	2022	2023
Real GDP growth	4.5	3.4	2.8	2.7	2.3	2.1
Inflation	2.3	2.1	2.1	2.1	2.1	2.1
Primary Balance	2.4	1.7	1.5	1.4	1.5	1.6
Effective interest rate	2.9	2.7	2.7	2.9	3.0	3.1
Constant Primary Balance Scenario						
Real GDP growth	4.5	3.4	2.8	2.7	2.3	2.1
Inflation	2.3	2.1	2.1	2.1	2.1	2.1
Primary Balance	2.4	2.4	2.4	2.4	2.4	2.4
Effective interest rate	2.9	2.7	2.7	2.9	3.0	3.0

Historical Scenario	2018	2019	2020	2021	2022	2023
Real GDP growth	4.5	0.7	0.7	0.7	0.7	0.7
Inflation	2.3	2.1	2.1	2.1	2.1	2.1
Primary Balance	2.4	-2.5	-2.5	-2.5	-2.5	-2.5
Effective interest rate	2.9	2.7	3.1	3.5	4.0	4.3

Source: IMF staff.

Figure 3. Public DSA—Realism of Baseline Assumptions



Source : IMF Staff.

1/ Plotted distribution includes all countries, percentile rank refers to all countries.

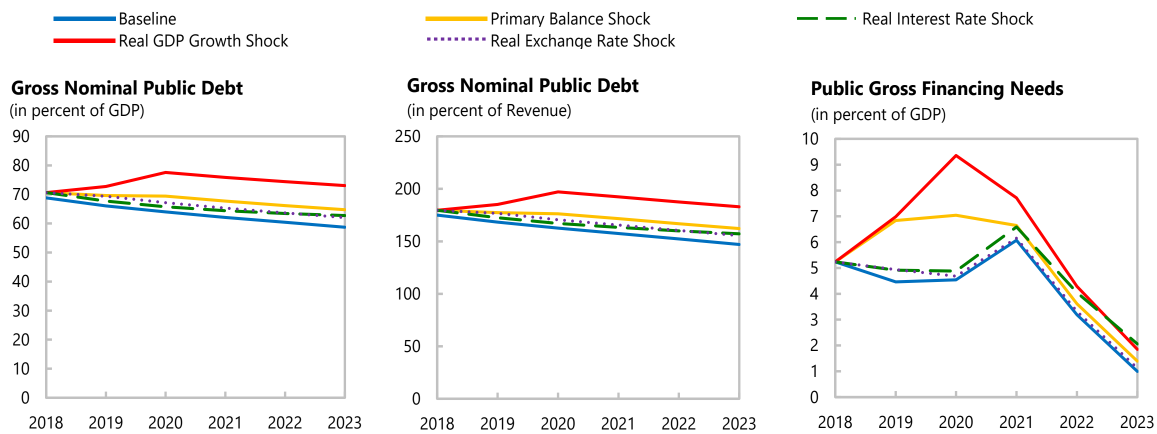
2/ Projections made in the spring WEO vintage of the preceding year.

3/ Not applicable for Slovenia, as it meets neither the positive output gap criterion nor the private credit growth criterion.

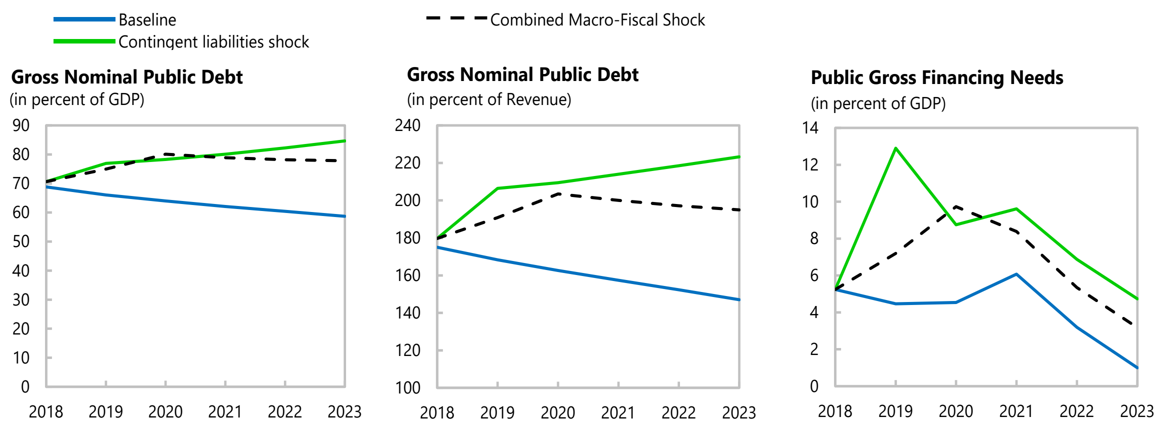
4/ Data cover annual obervations from 1990 to 2011 for advanced and emerging economies with debt greater than 60 percent of GDP. Percent of sample on vertical axis.

Figure 4. Public DSA—Stress Tests

Macro-Fiscal Stress Tests



Additional Stress Tests



Underlying Assumptions
(in percent)

Primary Balance Shock	2018	2019	2020	2021	2022	2023
Real GDP growth	4.5	3.4	2.8	2.7	2.3	2.1
Inflation	2.3	2.1	2.1	2.1	2.1	2.1
Primary balance	2.4	-0.2	-0.4	1.4	1.5	1.6
Effective interest rate	2.9	2.7	2.8	3.1	3.2	3.3
Real Interest Rate Shock						
Real GDP growth	4.5	3.4	2.8	2.7	2.3	2.1
Inflation	2.3	2.1	2.1	2.1	2.1	2.1
Primary balance	2.4	1.7	1.5	1.4	1.5	1.6
Effective interest rate	2.9	2.7	3.1	3.5	4.1	4.5
Combined Shock						
Real GDP growth	4.5	-0.3	-0.9	2.7	2.3	2.1
Inflation	2.3	1.2	1.2	2.1	2.1	2.1
Primary balance	2.4	-0.2	-2.1	1.4	1.5	1.6
Effective interest rate	2.9	2.7	3.2	3.9	4.5	4.8

Real GDP Growth Shock	2018	2019	2020	2021	2022	2023
Real GDP growth	4.5	-0.3	-0.9	2.7	2.3	2.1
Inflation	2.3	1.2	1.2	2.1	2.1	2.1
Primary balance	2.4	0.0	-2.1	1.4	1.5	1.6
Effective interest rate	2.9	2.7	2.8	3.2	3.3	3.4
Real Exchange Rate Shock						
Real GDP growth	4.5	3.4	2.8	2.7	2.3	2.1
Inflation	2.3	2.5	2.1	2.1	2.1	2.1
Primary balance	2.4	1.7	1.5	1.4	1.5	1.6
Effective interest rate	2.9	2.7	2.7	2.8	3.0	3.1

Source: IMF staff.

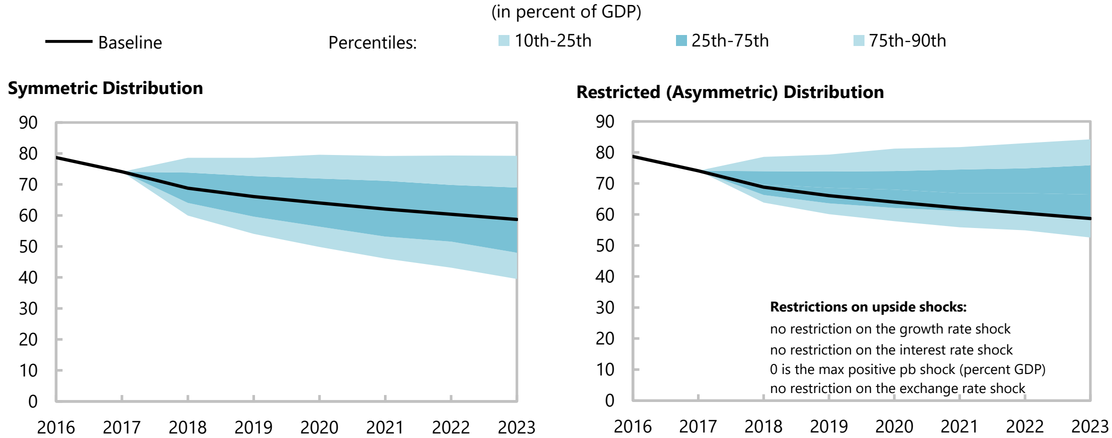
Figure 5. Public DSA—Risk Assessment

Heat Map

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

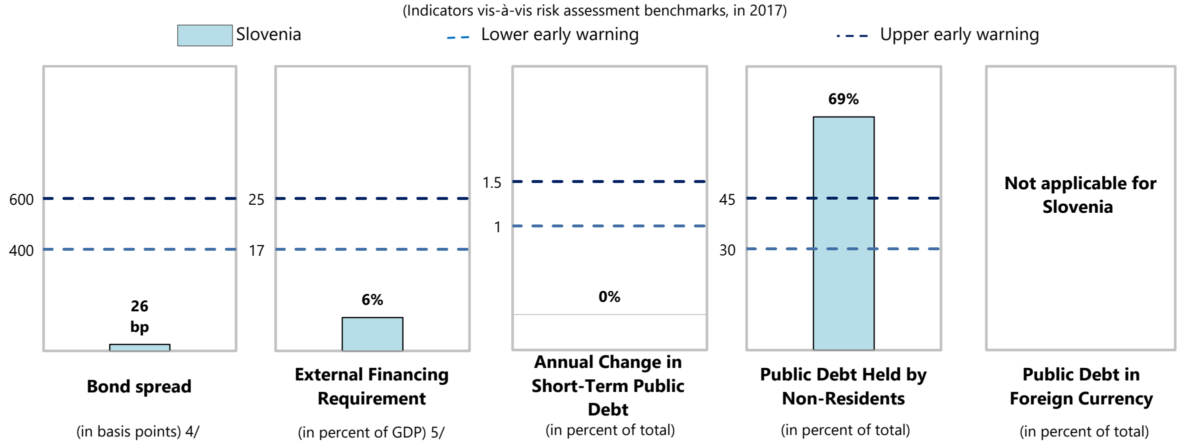
Evolution of Predictive Densities of Gross Nominal Public Debt

(in percent of GDP)



Debt Profile Vulnerabilities

(Indicators vis-à-vis risk assessment benchmarks, in 2017)



Source: IMF staff.

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

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

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

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

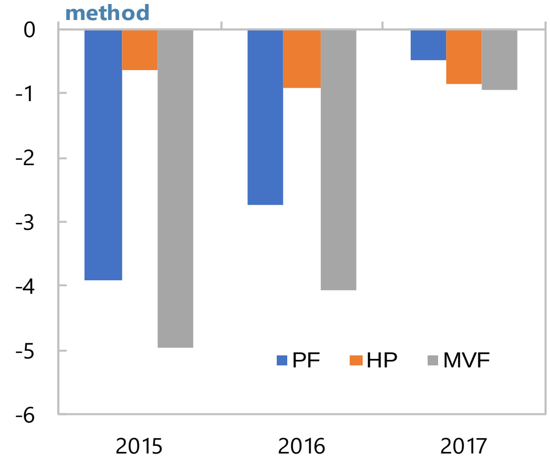
4/ Long-term bond spread over German bonds, an average over the last 3 months, 31-Jul-18 through 29-Oct-18.

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

Annex V. Output Gap Estimate

1. A combination of analytical tools and judgement is used to assess the output gap in Slovenia. The baseline method is the production function (PF) approach, which is complemented by the Hodrick Prescott (HP) filter and a multivariate filter (MVF) method. The PF applies filters to the key inputs of capital, labor, and productivity measures in estimating potential growth and output gap, while HP apply statistical filters directly to output.[1] The MVF takes into account credit growth and housing prices in addition to inflation and capacity utilization to obtain a sustainable output estimate, which captures the link between financial cycles and output gaps.[2] However, MVF is constrained by the short time-series of housing price data—which are available after 2008 and thus are concentrated in a bust cycle in Slovenia—but the method would improve over time with more data covering the boom cycle become available. Finally, staff judgement based on capacity utilization and other relevant data are used to fine tune the estimates, such as to address the end-of-period bias in applying HP to inputs in PF. The three methods show a consistent trend of closing output gap in recent years, although MVF estimates show a more negative output gap.

Recent output gap estimates by method



2. The estimates suggest that the negative output gap in Slovenia was closed in 2017, and a positive gap emerged in 2018. In addition, the positive gap is projected to remain significant at 2019–20 and gradually decline through the medium term (Table 1). The rapid population ageing is projected to constrain potential output growth. For example, ageing could reduce productivity growth by about 0.5 percentage point in Slovenia by 2035.[3]

3. Furthermore, the output gap estimates in Slovenia exhibit high volatility. Using a common PF method, Slovenia's estimates are found to have higher standard deviations compared to euro area countries. This is also consistent with recent studies that find high degree of uncertainty in real-time output gap estimates of the EC, IMF, and OECD for the euro area countries.[4] Correlation analysis suggests that factors, such as high openness in trade, and the small size of the economy

[1] For more details of the PF methodology for Slovenia, see Annex IV of IMF Country Report No. 16/121.

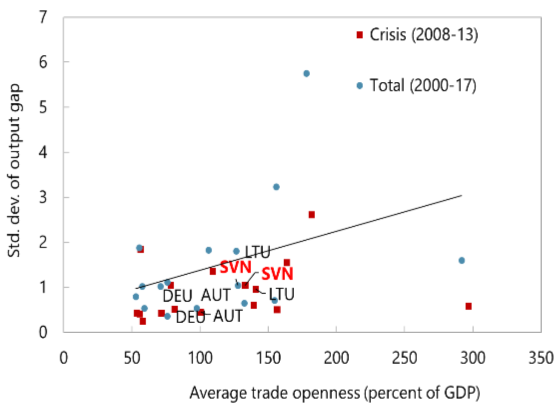
[2] For a more detailed description of the MVF methodology, see Podpiera J., F. Raei, and A. Stepanyan, 2017, "A Fresh Look at Potential Output in Central, Eastern, and Southeastern European Countries." IMF Working Paper 17/37.

[3] Aiyar, S. C. Ebeke, and X. Shao, 2016. "The Impact of Workforce Aging on European Productivity." IMF Working Paper 16/238.

[4] See ECB, 2011, "Recent evidence on the uncertainty surrounding real-time estimates of the euro area output gap," Monthly Bulletin, Economic and Monetary Developments, November 2011, Box 5; and Marcellino, M. and Musso, A., 2011, "The reliability of real-time estimates of the euro area output gap," Economic Modelling, 28(4), pp. 1842-1856.

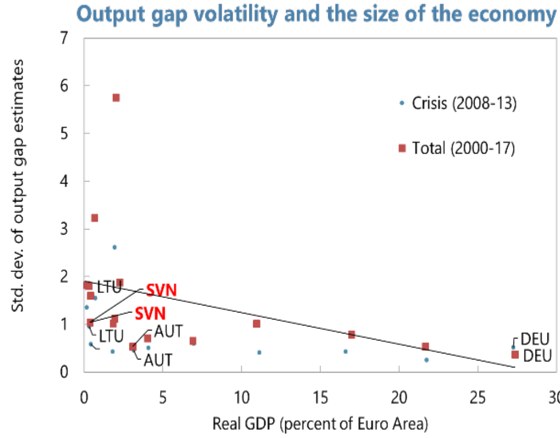
could explain the volatility of output. In addition, recent cross-country analyses suggest optimism bias also affects estimates of the output gap. The IMF 2015 World Economic Outlook finds that potential growth estimates are frequently revised downwards in the aftermath of the global financial crisis. Another recent study also finds that real-time output gap estimates tend to have sizable negative averages that are revised away over time in European countries.[5] Therefore, using multiple methods and incorporating balanced consideration of the uncertainty can best inform the interpretation of the output estimates.

Output gap volatility and trade openness



Sources: World Economic Outlook; Haver; Bloomberg; and IMF staff estimations.

Output gap volatility and the size of the economy



Sources: World Economic Outlook; Haver; Bloomberg; and IMF staff estimations.

4. Advancing structural reforms would help address the high volatility of actual and potential output in Slovenia as a small open economy. These include efforts to diversifying the economy and building buffers.

[5] Kangur, A., K. Kirabaeva, J. Natal, and S. Voigts, forthcoming, "How Large is the European Output Gap in Real Time?"

Annex VI. Authorities' Response to Past IMF Recommendations

Key 2017 IMF Recommendations	Authorities' Response
Fiscal Policy	
Continue medium-term consolidation with additional fiscal structural reforms on a sustainable public wage system, further pension reforms, efficiency-enhancing health and education reforms, and the real estate tax.	Consolidation continued by some revenue measures, one-off restraints on wage, pension, and benefits, and debt management operations that reduced interest costs.
Financial Sector Reforms	
Accelerate bank privatization.	The privatization of the largest bank advanced in 2018 while that of the third largest bank is planned for 2019.
Further reduce the stock of NPLs, particularly for those by the SMEs, and strengthen banks' core business models.	An independent Bank Asset Management Company continued to reduce NPLs, although the progress has been less pronounced for SMEs.
Structural Reforms	
Address labor market frictions and complete the clean-up of bank and company balance sheets.	The authorities continued reforms that reduced rigidity of open-ended contracts and launched programs to support life-long learning, vocational training, and apprenticeships. The deleveraging process of the corporate sector has been well advanced, while banks' overall asset quality improved.
Revise the Slovenia Sovereign Holding (SSH) strategy to facilitate the infusion of private capital, including by accelerating privatization of some SOEs in sectors amenable for private businesses.	While the SSH has continued to strengthen setting operational targets for SOEs to help improve their financial performance, no new strategy has been formulated to reduce the number of companies classified as "strategic" or "important."

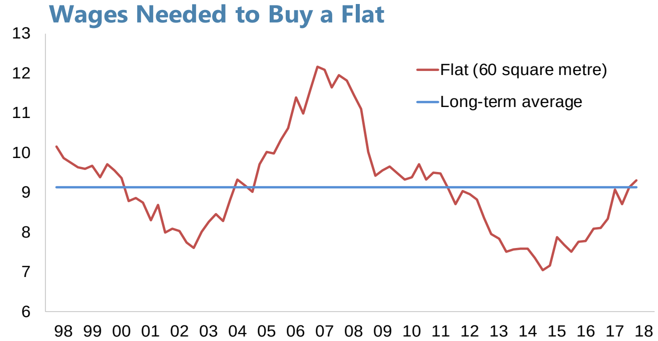
Annex VII. Housing Market Developments

Housing prices have completed their recovery from the deep slump during the double-dip crisis (2008–14) and continue to grow robustly, but current valuations do not point to overheating. The authorities have adopted macroprudential policy tools preemptively and continue to monitor developments. Easing supply constraints on the housing market could help to moderate future price increases.

1. **Residential real estate prices rose at their fastest pace in 2017 since the outbreak of the crisis, recording the third highest rate in the euro area and a record number of transaction.** Prices of used apartments in Ljubljana increased by 14.8 percent during 2017, compared to the national average increase of 11.8 percent. The overall housing price index rose 13.4 percent during the year to 2018: Q2.

2. **Housing remains affordable in historical and international comparison, and further appreciation in real house prices is likely.** Wages and disposable incomes have increased since 2008, while real estate prices have only just reached their pre-crisis level. By some measures, the ratio of real estate prices to incomes stood at their long-term average in 2018 (Figure 1). At 54.4 percent, Slovenia has the second-lowest urbanization rate in the EU. Continued urbanization and growth in household incomes are expected to fuel continued appreciation of real estate prices.

Figure 1. Price to Income Ratio: Years of Average Wages Needed to Buy a Flat



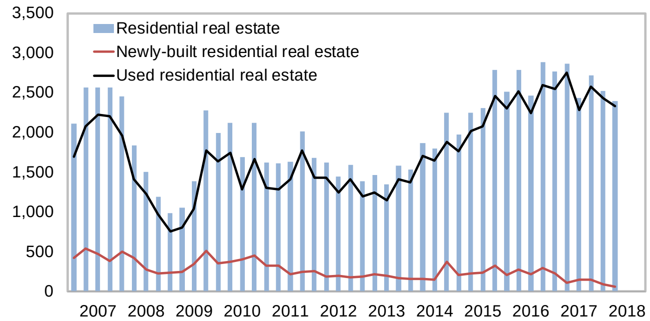
Source: Bank of Slovenia.

3. **The supply of new residential housing has failed to keep pace with demand.** The stock of housing in Slovenia is low by regional standards with 410 units per 1000 residents (compared to 547 in Austria and 524 in Croatia). The number of residential real estate transactions has been rising after 2013, yet the sales of newly-built units has dropped further from very low levels (Figure 2). The lack of supply response is related to the bankruptcy of major construction companies during the crisis years, the reluctance of banks to finance new construction, and constraints placed on new construction by urban planning and regulation.

4. **Mortgage financing is not a significant driver of housing price developments.** Slovenia has a comparatively high level of owner-occupied housing (77 percent of households, compared to 60 percent in the euro area, but comparable to other CEE countries). Only about 10 percent of households have a mortgage (19 percent in the euro area), and about a third of recent housing transactions was carried out with equity (i.e., without bank financing). The growth in mortgage lending has been positive since 2013, nearly reaching 5 percent year-on-year in 2017, but has since fallen back to below 4 percent.

5. The BoS has adopted macro-prudential policy tools as a preemptive step. Current data do not point to an overheating housing market or exposure by the banking sector. However, continued price increases and the inflexible supply response suggest the need for close monitoring. Guidance to banks on loan-to-value and DSTI ratios related to residential real estate transactions and a countercyclical capital buffer were implemented in 2016. In 2018, the applicability of the ratios was expanded to include not only mortgages but all household debt, prompted by rapidly growing consumer lending (albeit from a low level). Early adoption of the tools affords the banking sector time to adjust and monitor lending practices accordingly.

Figure 2. Number of Transactions in Residential Real Estate



Source: Bank of Slovenia.

6. The government seeks to improve the supply of social housing. In 2015, Slovenia adopted its National Housing Program 2015–25 which calls for a new rental policy and an increase in social housing stock for the benefit of vulnerable groups, including young families and the elderly. The National Housing Fund, currently financing social housing investments by municipalities, could become a direct supplier, alleviating shortages of affordable housing.

7. Urban planning practices could be reformed to ease the supply of new housing. Zoning restrictions and the effort and time required to obtain all required permits before starting new construction projects impede the market response to rising house prices. Regulatory reform could therefore help to increase supply and slow the increases in real estate prices and rents.

REPUBLIC OF SLOVENIA

STAFF REPORT FOR THE 2018 ARTICLE IV CONSULTATION—INFORMATIONAL ANNEX

January 29, 2019

Prepared By

European Department
(In Consultation with Other Departments)

CONTENTS

FUND RELATIONS

(As of September 30, 2018)

Membership Status: Joined December 14,1992; Article VIII

General Resources Account:

	SDR Million	Percent of Quota
Quota	586.5	100
Fund holdings of currency	489.86	83.52
Reserve position	96.66	16.48
Lending to the Fund		
Borrowing Agreement		

SDR Department:

	SDR Million	Percent of Allocation
Net cumulative allocation	215.88	100.00
Holdings	198.17	91.79

Outstanding Purchases and Loans: None

Financial Arrangements: None

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

	Forthcoming				
	2018	**2019**	**2020**	**2021**	**2022**
Principal					
Charges/Interest	0.04	0.18	0.18	0.18	0.18
Total	0.04	0.18	0.18	0.18	0.18

Exchange Rate Arrangement:

Slovenia is a member state of the euro area whose de jure exchange rate arrangement is free floating. The common currency, euro, floats freely and independently against other currencies. Slovenia has no separate legal tender. Slovenia maintains an exchange system that is free of multiple currency practices and restrictions on the making of payments and transfers for current international transactions, with the exception of exchange restrictions maintained for security reasons, which have been notified to the Fund pursuant to Decision No. 144-(52/51).

Article IV Consultation:

Slovenia is on the 12-month Article IV consultation cycle. The 2018 mission visited Ljubljana November 28–December 11, 2018 and held discussions with State Secretaries Dragonja and Jazbec of the Ministry of Finance, Acting Bank of Slovenia Governor Dolenc, other ministers, government and Bank of Slovenia officials, as well as representatives of parliament, financial sector, labor, business, and academics. The team also held a conference call with the Single Supervisory Mechanism. Mr. Rampre (OED) attended most meetings.

The mission comprised Mr. Akitoby (Head), Mr. Cui, Mr. Reinke (all EUR), and Mr. Grote (FAD). The mission held a press conference on December 11, 2018.

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

An FSAP mission took place November 6–20, 2000, and an FSSA report was published in September 2001 (Country Report No. 01/161).

The fiscal transparency module of the fiscal ROSC was published in June 2002 (Country Report No. 02/115).

An FSAP Update mission visited Ljubljana November 10–21, 2003. An FSSA report was published with ROSCs on Banking Supervision and Insurance Supervision in May 2004 (Country Report No. 04/137).

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

Technical Assistance: See attached table.

Resident Representative Post: None.

Table 1. Republic of Slovenia: Technical Assistance, 2001–18

Department	Timing	Purpose
MCM	February 2016	Bank Intervention and Resolution and Deposit Guaranty System -Follow Up
	November 2015	Macroprudential Framework - Follow-up
	July 2015	Bank Intervention and Resolution and Deposit Guaranty System
	June 2015	Macroprudential Framework Scoping Mission and Participation in Staff Visit
	December 2014	Bank Resolution and Deposit Insurance
	September 2014	Strengthening bank resolution framework and deposit guarantee scheme
	July 2014	Financial Stability
	May 2014	Financial Stability
	May 2014	Strengthen Supervision for Risk Assessment
	April 2014	Financial Stability
	January 2014	Financial Stability
	December 2013	Financial Stability
	November 2013	Stress Testing/AQR Workshop
	December 2013	Bank Resolution (participation in EUR staff visit)
	January 2013	Bank Resolution
	October 2012	Bank Resolution
	September 2012	Bank Resolution with Article IV
	December 2009	Supervisory Architecture
LEG	October 2013	Insolvency Law
FAD	August 2001	VAT
	November 2001	Direct Tax Reform
	November 2003	Expenditure Rationalization
	May 2004	Options for Short-Term Public Expenditure Rationalization
	October 2004	Performance Information to Support Better Budgeting
	April 2014	Strengthening the Public Financial Management Framework
	May 2015	Establishing a Spending Review Process
	October 2015	The 2013 Property Tax Act: Evaluation of its Design and the Employed Mass Valuation System

STA	November 2004	Recording Transactions in International Trade in Services
	April 2006	Government Finance Statistics
	February 2007	Balance of Payments Statistics (course)
	April 2007	Government Finance Statistics Compilation (workshop)
	March 2008	Balance of Payments: Coordinated Direct Investment Survey

STATISTICAL ISSUES

Data provision is adequate for surveillance purposes.

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

Real Sector Statistics: The Statistical Office of the Republic of Slovenia (SORS) follows the European System of Accounts 2010 (ESA10). Quarterly GDP estimates by industry and expenditure categories are compiled in both current and constant prices and 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 Harmonized Index of Consumer Prices (HICP) is compiled for monitoring compliance with the Maastricht inflation criterion. However, price collection is restricted to four cities and their surrounding rural areas. The weights are based on expenditure data for consumer goods from Household Budget Surveys for 2015. It also compiles a consumer price index (CPI), which differs from the HICP in weights only and a house price index

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 consolidated fiscal accounts in the national presentation 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 to the IMF Annual and Quarterly Database and for publication in the *Government Finance Statistic Yearbook* (*GFS Yearbook*). Annual and high frequency fiscal data are compiled on ESA 2010 basis. Fiscal data in the *GFSM 2014* framework is reported through the Eurostat convergence project with the IMF.

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

Balance of Payments Statistics: Balance of payments data are comprehensive and of high quality. The data have been published in the *Balance of Payments Statistics Yearbook* since 1993 (with estimates of the international investment position published since 1994). In June 2014, the Bank of Slovenia began reporting balance of payments and international investment position data according to the methodology of the sixth edition of the Balance of Payments Manual (BPM6). In September 2014, the Bank of Slovenia started reporting financial accounts according to the European System of National and Regional Accounts 2010 (ESA2010). Slovenia reports coordinated direct investment and coordinated portfolio investment statistics as well as monthly reserve statistics to the IMF Statistics Department for dissemination.

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

Republic of Slovenia: Table of Common Indicators Required for Surveillance
(As of December 2018)

	Date of Latest Observation	Date Received or Posted	Frequency of Data[6]	Frequency of Reporting[6]	Frequency of Publication[6]
Exchange Rates	11/2018	11/2018	D	D	D
International Reserve Assets and Reserve Liabilities of the Monetary Authorities[1]	11/2018	12/2018	M	M	M
Reserve/Base Money	11/2018	12/2018	M	M	M
Broad Money	11/2018	12/2018	M	M	M
Central Bank Balance Sheet	11/2018	12/2018	M	M	M
Consolidated Balance Sheet of the Banking System	10/2018	11/2018	M	M	M
Interest Rates[2]	11/2018	11/2018	D	D	D
Consumer Price Index	11/2018	11/2018	M	M	M
Revenue, Expenditure, Balance and Composition of Financing[3] – General Government[4]	10/2018	12/2018	M	M	M
Revenue, Expenditure, Balance and Composition of Financing[3]– Central Government	10/2018	12/2018	M	M	M
Stocks of Central Government and Central Government-Guaranteed Debt[5]	10/2018	12/2018	M	M	M
External Current Account Balance	11/2018	12/2018	M	M	M
Merchandise Trade	10/2018	12/2018	M	M	M
GDP/GNP	Q3:2018	11/2018	Q	Q	Q
Gross External Debt	10/2018	12/2018	M	M	M
International Investment Position	Q3:2018	12/2018	Q	Q	Q

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

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

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

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

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

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

INTERNATIONAL MONETARY FUND

REPUBLIC OF SLOVENIA

February 11, 2019

STAFF REPORT FOR THE 2018 ARTICLE IV CONSULTATION—SUPPLEMENTARY INFORMATION

Prepared By	European Department

This supplement provides information that has become available since the issuance of the staff report. The information does not alter the thrust of the staff appraisal.

The following updates reflect the release of 2018 data and the authorities' recent update of the Draft Budget Plan (DBP) for 2019.

- The authorities' updated DBP for 2019 shows a smaller fiscal expansion than earlier planned (0.5 percent compared with 0.7 percent) with no major structural fiscal reforms.

- Reflecting the updated plans as well as the preliminary 2018 fiscal outturn data, staff projects that the 2019 budget will result in a deterioration of the structural fiscal balance of about 0.6 percent of GDP, compared to 0.7 percent in the staff report. The basis for staff appraisal remains unchanged.