SLOVENIA

Highlights

- **Economic growth remained strong in 2015.** After growing 3.1 per cent in 2014, the economy expanded by 2.3 per cent in 2015 on the back of net exports and private consumption.
- **Consolidation of public finances continued.** As the budget deficit dropped to 2.7 per cent of GDP in 2015, the European Commission (EC) recommended that Slovenia be taken out of the Excessive Deficit Procedure. The improved fiscal performance eased the government's access to borrowing in international markets and reduced the cost of debt.
- **The government has proceeded with privatisations, but challenges remain.** Since 2013 the Slovenian Sovereign Holding (SSH) has sold nine out of 15 companies from the initial privatisation list. In 2016 the SSH has also initiated sales of several smaller companies outside the initial list.

Key priorities for 2017

- **Corporate restructuring and privatisation of state owned enterprises (SOEs) are crucial to increase productivity and investments.** High corporate indebtedness and the dominance of underperforming SOEs in the economy weigh on investments, which remain far below pre-2008 levels. Corporate restructuring and privatisation should be speeded up in order to enhance operating efficiency and stimulate new investments.
- **Efforts to restructure the banking sector should continue.** The level of non-performing loans (NPLs) remains high and further resolution efforts should focus on small and medium-sized enterprise (SME) restructuring. The privatisation of the largest bank, NLB, should proceed.
- **Business environment reforms are needed to reduce large gaps in certain areas.** Further reforms are needed to improve contract enforcement and judicial practices related to the duration of insolvency proceedings, support the development of local equity market and private equity financing, facilitate the issuance of construction permits, increase labour market flexibility and stimulate research and development investments.

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Main macroeconomic indicators %

	2012	2013	2014	2015	2016 proj.
GDP growth	-2.7	-1.1	3.1	2.3	2.2
Inflation (average)	2.6	1.8	0.2	-0.5	-0.1
Government balance/GDP	-4.1	-15.0	-5.0	-2.7	-2.3
Current account balance/GDP	2.6	4.9	6.2	5.2	7.2
Net FDI/GDP (neg. sign = inflows)	-1.3	-0.2	-1.6	-3.2	-2.2
External debt/GDP	119.1	116.6	124.6	116.6	n.a.
Gross reserves/GDP	2.1	1.9	2.1	2.0	n.a.
Credit to private sector/GDP	79.9	66.3	55.0	50.2	n.a.

Macroeconomic performance

Economic growth remained robust in 2015. After growth of 3.1 per cent in 2014, on the back of a strong net export performance, economic growth remained robust at 2.3 per cent in 2015, driven by net exports, amid the slowly recovering external environment, and private consumption on the back of an improving labour market. EU funds supported public investments, while private investments also positively contributed to growth on the back of a slow-down in corporate loan contraction and rising industrial confidence. Growth picked up to 2.5 per cent year-on-year in the first half of 2016, influenced by the acceleration of consumption and exports, while investments dropped due to the termination of the previous EU funding cycle. Inflation remains low – at 0.2 per cent in September 2016 – reflecting the decline in global oil prices.

The consolidation of public finances continued in 2015. Following a large-scale bank recapitalisation in 2013, when the general government deficit peaked at 15.0 per cent of GDP, fiscal performance has been improving. The general government deficit dropped to 2.7 per cent of GDP in 2015. As a result, the European Council decided to take Slovenia out of the Excessive Deficit Procedure in June 2016. The improved fiscal performance brought a decline in the country's risk premium, eased the government's access to borrowing in international markets and reduced the cost of debt. However, public debt remained high at 83 per cent of GDP in 2015, and further consolidation measures are needed to achieve the medium-term objective of a balanced budget by 2020. Despite some improvement in 2015, external debt remains high at 117 per cent of GDP. External risks are mitigated by a strong current account surplus which remained high at 5.2 per cent of GDP in 2015 on the back of robust export performance of both goods and services.

Rating agencies upgraded Slovenia's sovereign rating on continuing budget consolidation, strengthening domestic demand and an improving labour market. Fitch raised the country's rating to A- in September 2016, while Moody's improved Slovenia's Baa3 sovereign rating outlook to positive in the same month. Standard & Poor's upgraded the sovereign rating to A with a stable outlook in June 2016. Further improvements in the country's rating are conditional on a quicker pace of public debt reduction, faster GDP growth, further strengthening of the banking sector and reduction of the state's role in the economy.

Slovenia's economy is expected to grow by 2.2 per cent in 2016 and by 2.3 per cent in 2017. Domestic demand will be the main growth driver, mainly on the back of improved labour market conditions and the recovering housing market, while the termination of availability of funds from the previous EU funding period will weigh on investments. Continuing recovery in investments and consumption will support growth in 2017. While exports are to remain robust, the contribution of net exports is expected to decline significantly, as imports will catch up on the back of stronger demand. Inflation is to remain subdued, due to low commodity prices.

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Major structural reform developments

Improvements in the business environment have been limited. Slovenia ranked 30th among 190 countries in the World Bank's *Doing Business 2017* report, unchanged compared with the last year.[1] Although Slovenia has made some efforts over the last couple of years to ease dealing with construction permits, the country continues to score poorly, alongside enforcement of contracts and getting credit as still-high NPLs in some banks continue to constrain lending. On the positive side, the getting electricity ranking is up by 19 places on improved reliability of supply. Slovenia's competitiveness remains low according to the *Global Competitiveness Index* (ranked 56th out of 138 countries, up by three places compared with last year) published by the World Economic Forum. The main obstacles are labour market inefficiency and underdeveloped financial markets.

Steps have been taken to enhance the business environment. Efforts to privatise and improve the management of SOEs, restructure highly indebted companies and consolidate the banking sector continued in the past year. Labour market reforms were initiated in November 2015 by changing the composition of the minimum wage, followed by this year's increase in the support to programmes tackling skills mismatches among youth and improving the employability of older workers. The government also decided to partially liberalise premium petrol and heating oil prices as of April 2016.

Privatisation is moving forward, but challenges remain. Since 2013 the SSH sold nine out of 15 companies from the initial privatisation list. Companies privatised over the past year include: the national carrier Adria Airways; the aeroplane maintenance company Adria Airways Tehnika; the bank NKBM; the food producer Zito and car parts plant Cimos. In addition, the sale (via recapitalisation) of the tissue maker Paloma has been approved, while the sale of toolmaker Unior is under way. SSH delayed privatisation of the largest bank, NLB, while the sale of metal maker MLM failed due to lack of interest. After a failed privatisation, there are no clear plans for Telekom Slovenia, which in October 2015 increased its market share by acquiring Debitel, the fourth biggest mobile operator in the country. The state asset management strategy approved in July 2015 outlines the course of privatisation in the coming period. Transactions outside the initial list have also been initiated in 2016, including the sale of minority stakes in 13 small companies.

Despite ongoing privatisation efforts, state ownership in the economy remains high and corporate governance of SOEs is to be strengthened further. The strategy for managing SOEs and the recently adopted performance criteria for managers of SOEs are important steps in introducing economic and commercial principles in the management of these companies. A change in legislation introduced in January 2016 expanded the authority of the BAMC (Bank Asset Management Company) over bank restructuring and extended its term to 2022, acknowledging the complexity and time requirement of restructuring and divesting processes. The BAMC also started selling stakes in companies acquired through the process of restructuring troubled banks. However, the dismissal of the BAMC's top managers over pay disputes in October 2015 undermined the independence of the institution.

Banking sector consolidation continues. In line with the EC recommendations, a new bail-in law was adopted in June 2016 with the aim of ensuring that no public funds are used in bank bailouts. Meanwhile, the US equity fund Apollo and the EBRD acquired NKBM, the second largest bank in the country, from the Slovenian government. Consolidation of the banking sector continued, with mergers of Abanka and Banka Celje, PBS and NKBM, the recapitalisation of Gorenjska Banka, the revocation of banking licences from Faktor Banka and Probanka and a plan to privatise NLB.

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[1] The rating for 2016 reflects the change in the methodology. According to the old methodology Slovenia was ranked 29th in 2016.

A large proportion of corporate NPLs have been transferred to BAMC and banks continued to clean their balance sheets, but significant NPLs still remain in the banking sector. Despite the decrease in the overall ratio following the transfer of NPLs from eligible banks to the BAMC and NPL sales, there is a large diversity of NPL ratios across the banking sector. While the overall NPL ratio stood at 8.2 per cent in March 2016, the share of NPLs is much higher among the largest Slovenian banks (for example, at the end of 2015 the ratio stood at 16.5 per cent in NLB, 15.2 per cent in Abanka and at 33.7 per cent in NKBM, according to the most recent IMF Article IV report). While ongoing restructuring has reduced excess debt and the NPLs of large corporations, many SMEs remain highly indebted. Further efforts to tackle high NPLs will focus on the restructuring of viable SMEs by implementing guidelines published by the Bank Association and the Bank of Slovenia.

Financial market development was supported by the regional integration of stock exchanges. Earlier this year the Ljubljana Stock Exchange, owned by Zagreb Stock Exchange, joined the SEE Link platform (with the Bulgarian, Serbian, Macedonian and Croatian stock exchanges), allowing improved access to the Slovenian equity market.

Progress in reforming the pension and health care system has been limited. Preparations for health care system reform have started as a comprehensive review has been completed and a strategic document, the Resolution on the National Healthcare Plan 2016-2025, was adopted by the parliament in March 2016. Reforms in the area are much needed to reduce the negative fiscal implications of an ageing population.

The government approved a plan to restructure the tax system in September 2016. The plan envisages a cut in the tax burden on labour and a cut in excise tax for large electricity consumption which will be partially financed by a corporate income tax hike. Amendments to the Tax Procedure Law aim to facilitate tax payments via elimination of some of the administrative hurdles in paying social security contributions.