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REPUBLIC OF SLOVENIA

May 2021

2021 ARTICLE IV CONSULTATION—PRESS RELEASE; STAFF REPORT; AND STATEMENT BY THE EXECUTIVE DIRECTOR FOR THE REPUBLIC OF SLOVENIA

Under Article IV of the IMF's Articles of Agreement, the IMF holds bilateral discussions with members, usually every year. In the context of the 2021 Article IV consultation with the Republic of Slovenia, the following documents have been released and are included in this package:

- A **Press Release** summarizing the views of the Executive Board as expressed during its May 19, 2021 consideration of 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 May 19, 2021, following discussions that ended on March 19, 2021, with the officials of the Republic of Slovenia on economic developments and policies. Based on information available at the time of these discussions, the staff report was completed on May 3, 2021.
- An **Informational Annex** prepared by the IMF staff.
- A **Statement by the Executive Director** for the Republic of Slovenia.

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.

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International Monetary Fund
Washington, D.C.

IMF Executive Board Concludes 2021 Article IV Consultation with the Republic of Slovenia

FOR IMMEDIATE RELEASE

Washington, DC – **May 26, 2021:** On May 19, 2021, The Executive Board of the International Monetary Fund (IMF) concluded the Article IV consultation[1] with the Republic of Slovenia.

The pandemic is inflicting much suffering, which has been met with swift, substantial, and well-coordinated policy responses. The anti-crisis measures have helped preserve jobs, provide liquidity to companies and income support to vulnerable groups. They averted a much larger decline in output and kept unemployment under control. However, real GDP still dropped by 5.5 percent in 2020, as containment measures led to falling economic activity. The COVID-related spending, together with lower revenue, drove up the fiscal deficit and public debt rose to about 81 percent of GDP, from about 65.5 percent in 2019. The current account surplus rose to about 7 percent of GDP, driven by an increase of private sector saving relative to investment.

A strong economic rebound is expected as the pandemic abates, with GDP growing by 3.9 percent this year and 4.5 percent in 2022. However, the outlook is clouded by significant uncertainty and risks are tilted to the downside. Delays in mass vaccination and the spread of new virus variants could require stricter containment measures with adverse economic effects. Other risks include weak external demand and worsening financial market conditions.

Executive Board Assessment[2]

Directors commended the authorities for their swift, substantial, and coordinated policy response. The anti-crisis measures have mitigated the economic and social consequences of the pandemic, including by preserving jobs and providing liquidity and income support to firms and households. The recovery is expected to be driven by a rebound in consumption and investment, including public investment supported by EU funds. Uncertainty around the outlook is high and there are downside risks, mainly related to epidemiological developments.

Directors recommended maintaining the strong fiscal support in the near term, with well-targeted policies that are continuously assessed and adjusted to the evolving conditions. Once the recovery is entrenched, the emergency measures should be withdrawn, and the focus should shift toward consolidation. The large fiscal deficit should be reduced gradually over the medium term to maintain buffers, and fiscal rules should continue to play a strong role. The ambitious public investment plans call for improved public finance management to mitigate execution risks.

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

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

Although bankruptcies have not increased so far, risks to financial stability have risen. Directors stressed the need for continuing the close monitoring of banks' asset quality. Given that the exit from loan moratoria has started, the phasing out of measures should be gradual and well-coordinated to avoid cliff-edge effects. Macroprudential policies should continue to be reviewed on a regular basis to ensure an appropriate balance between financial stability and the need for credit to the economy.

The pandemic has had an uneven impact on employment. Directors encouraged the authorities to continue to adapt policies to facilitate labor reallocation and provide support to those affected the most—low-skilled workers, women and youth. Active labor market programs could effectively be used to help transition between jobs. These programs could be supplemented with measures to improve the business environment and to strengthen the social safety net.

Directors welcomed the authorities' focus on digitalization and climate change mitigation. Improving the digital infrastructure, building human capital, and promoting digital inclusion would boost productivity and resilience. The goal of reaching carbon neutrality by 2050 would be best achieved by combining investment in green technologies with taxation of polluting industries. The Next Generation EU instrument could play a key role in Slovenia's digital and green transformation.

Slovenia: Selected Economic Indicators, 2018–23
(Annual percentage change, unless indicated otherwise)

	2018	2019	2020	2021	2022	2023
				Staff Projections		
Nominal GDP (EUR millions)	45,863	48,393	46,297	48,522	51,444	54,138
GDP per Capita (EUR)	22,189	23,255	22,090	23,061	24,377	25,607
Real economy						
Real GDP	4.4	3.2	-5.5	3.9	4.5	3.6
Domestic demand (contribution to growth)	5.0	3.4	-5.9	4.3	4.9	3.9
Private consumption	3.6	4.8	-9.8	4.3	4.6	3.7
Public consumption	3.0	1.7	1.8	1.5	1.6	0.5
Gross capital formation	10.3	1.5	-5.8	9.8	10.4	8.4
Net exports (contribution to growth)	-0.1	0.1	0.4	-0.5	-0.4	-0.3
Exports of goods and services	6.3	4.1	-8.7	8.8	6.0	3.8
Imports of goods and services	7.2	4.4	-10.2	10.5	7.1	4.5
Output gap (in percent of potential GDP)	0.3	0.6	-4.5	-3.5	-1.8	-1.0
Prices						
Consumer prices (national definition, period average)	1.7	1.6	-0.1	0.6	1.2	1.5
Employment and wages						
Unemployment rate (in percent, ILO definition)	5.1	4.5	5.0	5.3	4.9	4.8
Real wages (all sectors)	1.6	2.7	6.0	4.0	3.1	2.8
Public finance (percent of GDP)						
General government balance 1/	0.7	0.4	-8.4	-8.0	-4.8	-3.3
Structural balance 2/	0.3	0.0	-6.3	-6.3	-3.9	-2.7
Structural primary balance 2/	2.3	1.7	-4.7	-4.9	-2.7	-1.7
General government debt 3/	70.3	65.6	80.8	81.8	80.5	79.7
Monetary and financial indicators						
Credit to the private sector	2.5	3.4	-0.2	5.3	6.3	5.8
Lending rates 4/	2.1	1.6	1.8	...	...	...
Deposit rates 5/	0.2	0.2	0.1	...	...	...
Balance of payments (percent of GDP)						
Trade balance (goods and services)	8.5	8.5	9.7	8.8	8.5	7.9
Current account balance	5.8	5.6	7.1	6.5	6.3	6.1
Gross external debt (percent of GDP, end-period)	91.9	90.5	104.1	103.1	98.2	94.8
Nominal effective exchange rate (2010=100)	105.2	104.8	106.9	...	...	...
Real effective exchange rate (2010=100, CPI-based)	97.9	97.2	97.8	...	...	...

Sources: Slovenia authorities and IMF staff calculations and projections.
1/ Accrual basis.

2/ Excludes one-offs and adjusted for the output gap and calendar year shifts between receipt and expenditure of earmarked EU funds.
3/ Includes EUR 1.1 bn in 2013 and EUR 0.7 bn in 2014 of debt issuance of the Bank Asset Management Company (BAMC).
4/ Floating or up-to-one-year fixed rate for new loans to non-financial corporations over 1 million euros.
5/ For household time deposits with maturity up to one year.

INTERNATIONAL MONETARY FUND

REPUBLIC OF SLOVENIA

STAFF REPORT FOR THE 2021 ARTICLE IV CONSULTATION

May 3, 2021

KEY ISSUES

Context: The pandemic is inflicting much suffering, which has been met with swift, substantial, and well-coordinated policy responses. The anti-crisis measures have helped preserve jobs, provide liquidity to companies and income support to the vulnerable groups. They averted a larger decline in output and kept unemployment under control. After contracting by 5.5 percent in 2020, real GDP is projected to grow by 3.9 percent in 2021 and 4.5 percent in 2022, as vaccinations help achieve herd immunity. However, risks to the outlook are large and tilted to the downside, given the epidemiological situation.

Key Policy Recommendations: The overriding priority remains saving lives and livelihoods. Therefore, policies should remain supportive in the near term and adjusted flexibly to the evolving conditions. As the recovery becomes entrenched, they should shift toward facilitating reallocation and fostering stronger, smarter, and greener growth.

- Fiscal policy should remain supportive until the recovery is entrenched. Thereafter, fiscal consolidation should start, guided by staff's past advice, and supported by a fiscal rule.

- Banks' asset quality should continue to be monitored closely, especially for banks exposed to SMEs and COVID-affected sectors. The exit from the support measures should be carefully planned and executed to minimize risks to financial stability.

- Labor market policies should switch from job preservation to facilitating reallocation and strengthening the social safety net.

- Investment in digital and green technologies will boost productivity and ensure a sustainable recovery.

Approved By
Jörg Decressin (EUR) and Anna Ilyina (SPR)

Discussions took place by video conference during March 8–19, 2021. The staff team comprised B. Akitoby (mission head), M. Hassine, R. Rozenov and J. Sandhu (all EUR), and was assisted at headquarters by E. Espinoza and H. Baldev (all EUR). J. Garrido (LEG) and M. Stone (FAD) participated in selected meetings. D. Palotai and M. Pucnik (all OED) also joined the discussions. Staff met virtually with the Bank of Slovenia Governor Boštjan Vasle, Minister of Finance Andrej Šircelj, President Robert Polnar and members of the Parliamentary Committee on Finance and Monetary Policy, other senior officials, representatives of the private sector and labor unions.

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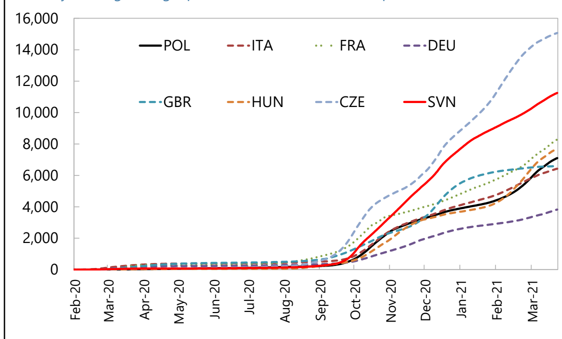
CONTEXT

1. **After containing the first wave of COVID-19, Slovenia witnessed an exponential increase of cases during the second wave.** Since the first confirmed COVID-19 infection on March 4, 2020, there have been over 200 thousand cases (10 percent of the population) and more than 4,000 deaths. The first wave of infections was relatively contained, and the authorities lifted most restrictions in May. COVID-19 cases surged in the fall, prompting another lockdown in October, and a third one in April 2021. The share of old-age population and prevalence of comorbidities have contributed to a high death rate.

COVID-19: Cumulative Reported Cases
(7-day moving average, per 100,000 residents, as of April 23)



Source: Bloomberg

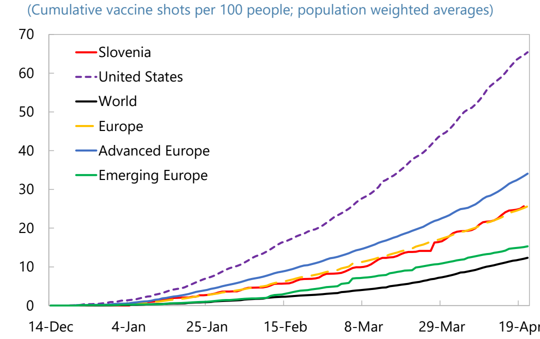
2. **Meanwhile, mass vaccination has progressed, notably among the elderly population, thus reducing the pressure on hospitals.** About 18 percent of the population have received at least one dose as of end-March (Box 1). The well-developed network of primary care has helped to give a strong start to the vaccination campaign.

Box 1. Covid-19 Testing, Vaccination and Containment

To limit the spread of the coronavirus by detecting asymptomatic cases, the authorities launched a mass-testing program in December and the average number of daily tests more than tripled in Q1:2021 compared to Q4:2020.

Besides mass testing and contact tracing (where possible), the authorities consider vaccination as the most effective public health measure to combat COVID-19. Slovenia received the first doses of COVID-19 vaccines on December 26, 2020 and started vaccination the following day. To reduce the incidence of severe forms of the coronavirus disease and mortality, priority was given to elderly people and residents of care facilities. The strategy helped decrease hospitalizations by 60 percent in March relative to December, and the number of deaths by 85 percent. The authorities aim to vaccinate 60 percent of the adult population in the first half of the year.

Covid-19 Administered Vaccine Doses
(Cumulative vaccine shots per 100 people; population weighted averages)



Source: Bloomberg; WEO; and IMF staff calculations

The containment policy entails five phases (black, red, orange, yellow and green) and envisages lifting restrictions based on seven-day averages of the number of new infections and hospitalizations. The transition between phases is done by region and in compliance with the guidelines of the National Institute of Public Health.

As of end-March, three regions were in the red phase, six regions in the orange phase and three regions in the yellow phase. Yet, to counteract an emerging third wave of COVID-19 infections, the government decided to impose an 11-day lockdown.

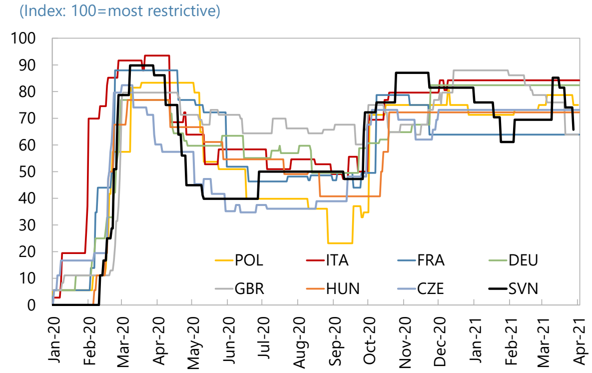
THE ECONOMIC IMPACT OF THE COVID-19 CRISIS AND POLICY RESPONSES

3. **Prior to the pandemic, Slovenia's economy was enjoying broad-based growth, but structural challenges remained.** Growth was above the euro area average which helped bring down unemployment and assisted in consolidating the fiscal accounts. Inflation remained in check, while the external position continued to record large surpluses. Financial sector stability improved, notwithstanding continued deleveraging and legacy imbalances from the 2013 crisis. Structural challenges persist, however, with aging population, low productivity growth, skills shortages, high tax wedge, heavy regulatory system, and extensive presence of state-owned enterprises (SOEs).

4. **The COVID-19 crisis triggered a sizeable economic contraction, falling prices and rising unemployment.**

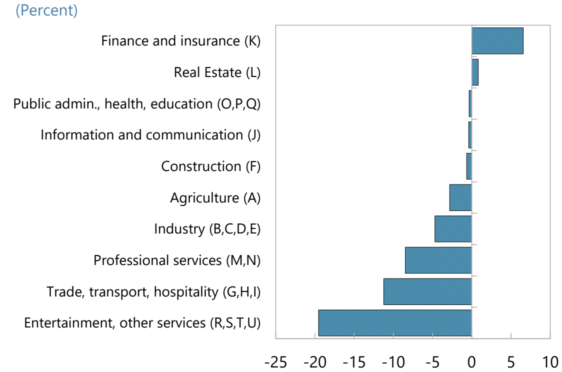
- *Real GDP* declined by 5.5 percent in 2020, as containment measures led to falling economic activity. Gross value added decreased in most sectors, but especially in those directly affected by the lockdowns (entertainment, accommodation and food services, trade). On the demand side, household consumption was the main contributor to the decline, reflecting limited spending opportunities and increased precautionary savings.

COVID-19 Government Response Stringency Index
(Index: 100=most restrictive)



Source: Our World in Data

Sectoral Real GVA Change, 2019-2020
(Percent)



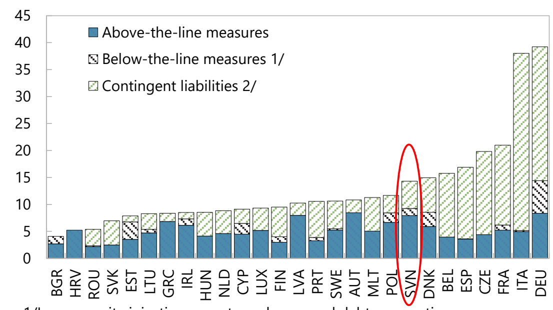
Source: Haver Analytics, IMF staff calculations

- *Inflation* turned negative in 2020 (-1.1 percent in December, year-on-year), mainly reflecting weak domestic demand and lower energy prices. Core inflation (HICP excluding food, energy, alcohol, and tobacco) stood at 0.1 percent in end-2020.

- *Labor market* conditions deteriorated but thanks to various support measures the unemployment rate rose only to 5.0 percent, from 4.5 percent in 2019. Earnings, on the other hand, increased on average, including due to increases in the minimum and public sector wages and bonus payments to frontline workers.

5. **The current account surplus rose further, driven by an increase of private sector saving relative to investment.** Lower net imports of energy goods and recovering manufacturing exports contributed to an increase in the trade surplus and further strengthening of the current account to 7.1 percent of GDP. Financial flows in 2020 reflected the higher reliance on public debt, while the private sector continued its long-term deleveraging trend, amid thinning net FDI inflows.

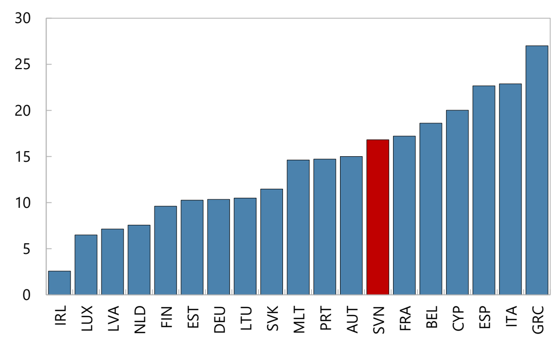
EU-27: Fiscal Response to COVID-19 Pandemic
(Percent of GDP)



1/Loans, equity injections, asset purchases, and debt assumptions.
2/Guarantees and quasi-fiscal operations.
Source: October 2020 Fiscal Monitor

6. **The fiscal deficit increased, and public debt soared.** In 2020, revenue declined by 4.6 percent, while expenditure increased by 14.8 percent, driven by COVID-related spending. As a result, the headline fiscal deficit jumped to 8.4 percent of GDP (Table 2). Public debt soared to 80.8 percent of GDP at end-2020, from 65.6 percent at end-2019; contingent liabilities increased as well.

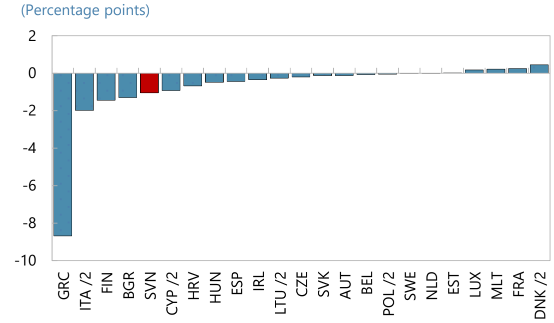
Change in the Debt-to-GDP ratio (2019-2020)
(Percent Y-on-Y)



Sources: Oct'20 World Economic Outlook

7. **The crisis has added to legacy problems in the banking sector.** Non-Performing Loans (NPL) have remained low overall at 3 percent on account of the freeze on bankruptcies for excessive indebtedness and support to corporate liquidity, but in some contact-intensive sectors NPLs have risen above 10 percent of total loans. Banks' margins continue to decline because of decreasing net interest income, high competition among the banks, and high operating costs. Overall credit growth has continued to stagnate; as of February 2021, corporate loans declined by 2.8 percent and household loans by 0.7 percent, mainly driven by a decline in consumer lending (-8.6 percent).[1]

Change in Non-Performing Loans, 2019 Q3 -2020 Q3 1/
(Percentage points)



Source: IMF (Financial Soundness Indicators)
1/ Non-performing loans to total gross loans
2/ Data for 2019 Q2 -2020 Q2

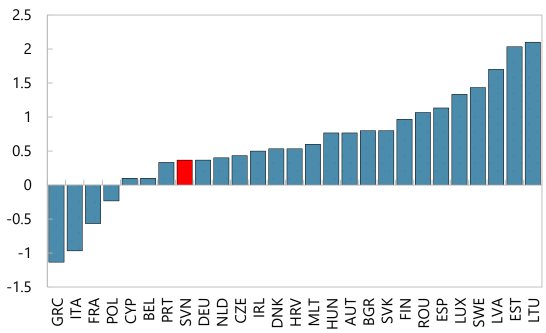
8. **The authorities' policy response was swift, substantial, and well-coordinated, but the take-up of some measures remains low.** As of end- March, eight packages of stimulus measures (13.6 percent of GDP, broadly in line with peers) have been adopted (Annex I), but the take-up has been low for new loans guarantees, due to weak demand for credit and complex application requirements. In addition, the Bank of Slovenia (BoS)—as part of the Eurosystem—extended the ECB

[1] Absent loan moratoria on interest and capital, which kept outstanding loans at a higher level, the decline in credit would have been larger.

prudential flexibility measures for banks under the single supervisory mechanism to all banks and savings banks in Slovenia to ensure equal treatment.

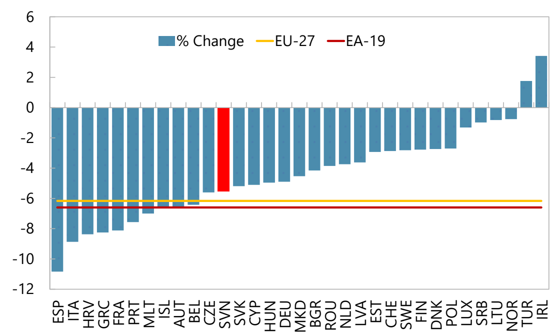
9. The anti-crisis measures have been instrumental in mitigating the economic and social impact of COVID-19. Additional funding for healthcare ensured that the system had adequate resources to fight the pandemic; wage compensations for temporary lay-offs, subsidies for shorter work hours and basic monthly income prevented a much more severe downturn in the labor market (Annex II), and liquidity support and loan moratoria helped avoid massive bankruptcies. Slovenia experienced a lesser decline in GDP than the EU average and a smaller increase in unemployment than most other EU countries.

Change in the Unemployment Rate
(2020-2019, Q1-Q3 average, in ppt)



Sources: Eurostat, IMF staff calculations

Decline in GDP, 2020
(Percent change)



Sources: Eurostat and IMF staff calculations

Slovenia: COVID-19 Response Measures
(percent of GDP)

	Budgeted	Estimated use (Feb. 2021)
Budget measures		
Revenue measures (tax deferrals)	**0.9**	**0.9**
Deferred tax payments, unpaid CIT prepayments	0.9	0.9
Expenditure measures	**6.1**	**5.5**
Wage subsidies and monthly basic income	2.0	2.0
Social contributions for private sector workers	1.0	0.9
Bonuses for frontline workers	0.7	0.7
Solidarity payments	0.4	0.4
Healthcare	0.8	0.6
Tourist vouchers	0.7	0.3
Compensation for fixed costs	0.3	0.3
Other measures	0.4	0.4
Total budget measures	**7.0**	**6.4**
Off-budget measures		
Liquidity support	1.8	1.5
Public guarantees	4.7	0.4
Total off-budget measures	**6.6**	**1.9**
Total	**13.6**	**8.3**

Sources: Slovenian authorities and IMF staff estimates

OUTLOOK AND RISKS

10. A strong economic recovery is expected once the pandemic abates and restrictions are lifted. Real GDP is projected to grow by 3.9 percent this year and 4.5 percent in 2022. Consumption and investment are expected to be the main drivers, the latter benefitting also from the EU funds. Assuming continuation but adaptation of support measures while the crisis lasts, the baseline scenario projects that output would return to its pre-crisis level in 2022. Inflation would remain subdued in the near term and the current account surplus would be reduced as consumption and investment pick up.

11. Uncertainty remains unusually high and risks to the outlook are tilted to the downside (Annex III).

- If new infections accelerate, longer-lasting national lockdowns might become necessary, with adverse economic impacts. Moreover, delays in mass vaccination and the spread of new virus variants could also require stricter containment measures.

- The crisis may have permanent effects on output and employment, especially in hard-hit sectors. Although corporate bankruptcies have not risen so far, the situation may change when the exceptional policy support is unwound.

- External risks relate to a protracted COVID-19 pandemic, falling demand in main trading partners and faster-than-expected tightening of global financial markets conditions**.**

12. The external position is assessed as substantially stronger than the level implied by medium-term fundamentals and desirable policies, but the current account surplus is expected to decrease toward its norm (Annex IV). Based on the EBA methodology, staff assesses that a country with Slovenia's characteristics should have a current account surplus of about 1.7 percent of GDP in 2020, implying a gap of 5.7 percent of GDP. The relative policy gap is estimated at 2 percent of GDP.[2] The external surplus is expected to moderate in the medium term as consumption and investment gradually recover. Policies to address legacy problems and product and service-market reforms, together with the surge in EU-financed public investment, could boost investment and help reduce the current account surplus. The current account gap translates into a 10.3 percent REER undervaluation at standard elasticities. However, the large swing in the current account

Slovenia: Model Estimates for 2020 (in percent of GDP)

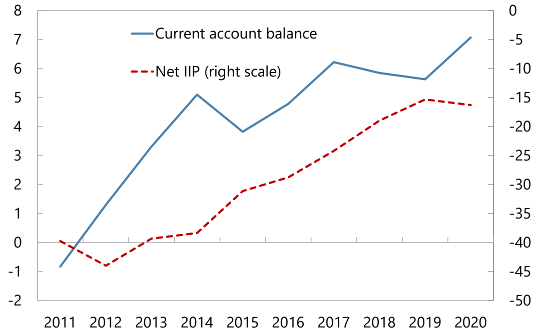
	CA model	REER model
CA-Actual	**7.1**	
Cyclical contributions (from model) (-)	0.4	
COVID-19 adjustor (+) 1/	0.7	
Additional temporary/statistical factors (+)	0.0	
Natural disasters and conflicts (-)	-0.1	
Adjusted CA	**7.5**	
CA Norm (from model) 2/	**1.7**	
Adjustments to the norm (+)	0.0	
Adjusted CA Norm	**1.7**	
CA Gap	**5.7**	**0.0**
o/w Relative policy gap	2.0	
Elasticity	-0.55	
REER Gap (in percent)	**-10.3**	**0.0**

1/ Additional cyclical adjustment to account for the temporary impact of the pandemic on oil trade balances (+2.4 percent of GDP) and on tourism (-1.8 percent of GDP).
2/ Cyclically adjusted, including multilateral consistency adjustments.

[2] In 2020, the temporary lockdown due to COVID-19 caused forced savings resulting from constrained consumption. High uncertainty depressed investment, and reduced mobility led to a drop in oil imports (about 2 percent of GDP).

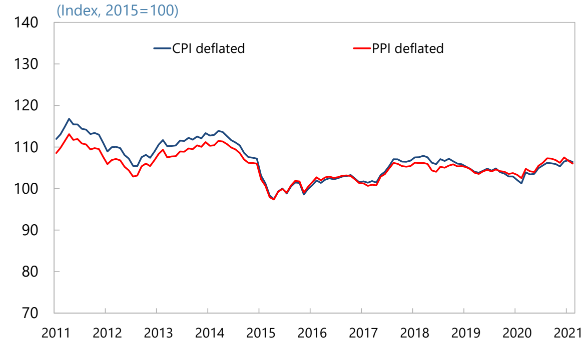
balance over the past decade, despite a relatively stable REER, suggests that the surplus was caused by factors unrelated to the REER (e.g., the above-mentioned deleveraging). External debt remains sustainable but vulnerable to shocks (Annex V). Slovenia introduced FDI screening in May 2020 to address concerns about increasing risks to strategic sectors, including healthcare. It is important that restrictions to address risks, including on national security grounds, are used judiciously to avoid distorting FDI flows to the broader economy.

Current Account and Net IIP
(Percent of GDP)



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

Real Effective Exchange Rate
(Index, 2015=100)



Sources: Haver Analytics and IMF staff calculations.

Authorities' Views

13. **The authorities broadly agreed with staff's assessment but foresaw a slightly stronger recovery in 2021.** They noted that the better-than-expected outcome in 2020 reflects an improved targeting of the containment measures during the second wave and better adaptation of the economy, along with a smaller slowdown in Slovenia's main trading partners compared to initial expectations. The government's forecasting arm (IMAD) estimated that without the measures to mitigate the COVID-19 epidemic, GDP would have declined by at least 4 percentage points more in 2020. Both IMAD and the BoS concurred that consumption and investment will be the main drivers of growth going forward, but anticipate a faster and stronger rebound, with GDP growth above 4 percent this year. The authorities agreed that the main risk is still the epidemiological developments. The authorities attributed the strong performance of the external sector in 2020 to the improved terms-of-trade and lower energy imports, as well as the ongoing recovery of manufacturing and transport, indicating that these sectors were much less affected by the second wave of infections. They agreed that the high current account surplus last year also reflects increased savings in the private sector and depressed investment in the context of the COVID-19 pandemic. Taking a longer-term perspective, they shared staff' assessment that the current account surplus will likely decline because of the stepped-up investment.

POLICY DISCUSSIONS: SECURING A STRONG RECOVERY AND SUSTAINABLE GROWTH

Discussions focused on the authorities' response to the COVID-19 pandemic. Policies should remain supportive in the near term and should be adjusted flexibly to the evolving conditions. As the recovery becomes entrenched, policies should shift toward facilitating reallocation and securing smarter, greener, and more inclusive growth.

A. Fiscal Policy: Sustainably Supporting the Recovery

14. The authorities' budget for 2021 envisages continued support, with big plans for investment to bolster an inclusive, smart, and green recovery. Discretionary fiscal measures played a crucial role in combating the consequences of the pandemic, by forestalling a vicious circle of falling activity and escalating debt burdens. While most of the COVID-19 measures are temporary and are due to expire in the second half of 2021, the short-time work program will be retained to strengthen the social safety net. Supported by the Next Generation EU (NGEU) funds, public investment is projected to increase this year by almost half of its 2020 level in nominal terms. Spending priorities will be health and social protection, infrastructure, green investment, and digitalization. Overall, the headline fiscal deficit is projected at 8.6 percent of GDP in 2021, declining to 5.7 percent in 2022 on the back of the economic rebound and phasing out of measures. The national fiscal rule escape clause applies in 2021, while decision about 2022 will follow the EU-wide decision.

15. Fiscal policy should remain supportive until the recovery firms up. Fiscal support needs to remain available until the recovery is well-established. At the same time, the effectiveness of the measures deployed should be assessed and adjustments should be made where necessary. Targeting and efficiency will remain key to preserve valuable fiscal space. All COVID-19-related transactions should be reported transparently and audited independently, and information on awarded contracts should be publicly available. More generally, Slovenia's recent adherence to IMF's Special Data Dissemination Standard Plus—the highest tier of the Data Standards Initiatives—is a welcome step to increasing the transparency in the compilation and dissemination of statistics.

16. Once the recovery is entrenched, fiscal support should be re-purposed toward "building forward better" and reestablishing policy space. The emergency relief measures should be gradually withdrawn and repurposed toward building a better economy once the recovery is on a solid footing, with due consideration to economic and social implications. Public debt remains sustainable; after peaking at 80.8 percent of GDP last year, public debt would start to decline but stay at elevated levels (Annex VI). Additional fiscal effort would likely be needed to reduce the budget deficit. In terms of measures, staff's past recommendations can guide the consolidation plan.[3] These include structural fiscal reforms in the areas of pensions, health and long-term care, public wage policy, and tax rebalancing. Fiscal risks, in particular those related to the SOE sector and contingent liabilities, should be carefully assessed and managed.

[3] See IMF Country Report No. 19/58.

Box 2. Next Generation EU and Slovenia

Slovenia is eligible to receive €2.2 billion (excluding loans available under the RRF) under the Next Generation EU instrument to help deal with the consequences of the COVID-19 pandemic and support a sustainable and greener recovery.

In October 2020, the Slovenian government approved the draft National Recovery and Resilience Plan (NRRP), which provides a blueprint for the use of €0.3 billion of grants to support reforms and €1.7 billion of grants and €2.9 billion of loans for projects.

The largest amounts will be allocated to financing the green transition (€0.7 billion) and digitalization (€0.3 billion). The NRRP is expected to be finalized by end-April 2021. Funds available under REACT-EU would be used for projects in health, labor market, infrastructure, and development of entrepreneurship.

Next Generation EU Allocations to Slovenia

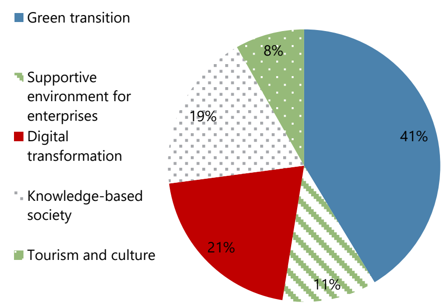
(EUR billion at cuurent prices, unless noted otherwise)

Instrument	Allocation
Recovery and Resilience Facility (RRF) grants	1.80
Recovery Assistance for Cohesion and the Territories of Europe (REACT-EU)	0.24
Just Transition Fund 1/	0.13
Agricultural Fund for Rural Development	0.07
Total	2.24

1/ At 2018 prices.

Source: European Commission

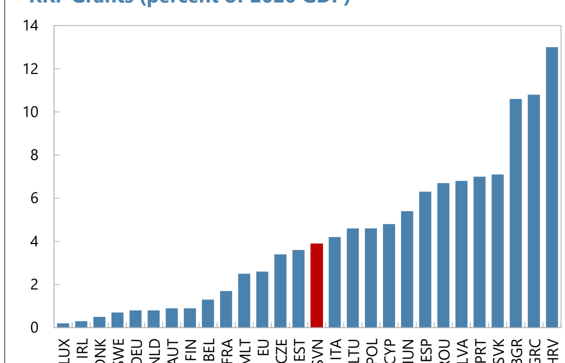
Breakdown of RRF Grants Use by Project Area



Source: Government Office for Development and European Cohesion Policy

17. High governance standards should accompany the ambitious investment plan to achieve value for money. Slovenia is due to receive €2.2 billion (4.8 percent of GDP) under the Next Generation EU instrument (Box 2). The efficient use of these resources can boost the economy's productive potential and facilitate its digital and green transformation. However, the planned rapid increase in investment bears execution risks and improving public investment management is critical. While projects in priority areas should advance without delays, safeguards need to be in place to ensure that decisions are based on robust selection criteria; and procurement, project management, and oversight are effective and transparent.

RRF Grants (percent of 2020 GDP)



Source: EC Debt Sustainability Monitor

18. The credibility of the medium-term fiscal framework (MTFF) should continue to be supported by fiscal rules. Fiscal consolidation should not start until the recovery is entrenched but the planning process should begin now. Slovenia's MTFF is guided by the EU fiscal rules under the Stability and Growth Pact (SGP) and it requires a balanced structural budget over the business cycle. As the EU fiscal rules are currently being reviewed, the authorities may need to reexamine their national rule to ensure proper alignment.

Authorities' Views

19. The authorities agreed that fiscal support should be maintained in the near term. They emphasized that their comprehensive policy measures averted a larger output loss and prevented massive unemployment and bankruptcies. In line with staff advice, the authorities will maintain support to fight the COVID-19 crisis as needed in 2021 and 2022, while improving the targeting and efficiency of these policy measures. They noted that, by law, the COVID-19 measures remain temporary, except for the short-time work scheme, which will be made permanent to further strengthen social protection and reduce inequality. The authorities also noted that like any other spending in the budget, all COVID-19 expenditures are reported transparently and audited independently by the Court of Audit. They agreed that the withdrawal of crisis measures should be gradual to support the recovery and avoid cliff-edge effects. The authorities stressed that their ambitious public investment plan is needed to support smart, inclusive, and green recovery and accelerate economic transformation. While acknowledging the absorptive capacity constraints, they emphasized that steps are being taken to expeditiously scale up their administrative capacity in public investment management. In this regard, they welcomed the mission's presentation on PIMA, including the cross-country experiences.

20. The authorities noted that fiscal consolidation should commence after the crisis has ended. They stressed that, due to the high uncertainty in estimating the output gap, consolidation should start after most containment measures are withdrawn. They agreed that additional measures and structural changes, particularly related to ageing costs, would be needed to bring fiscal policy back on track and reduce the debt-to-GDP ratio to close to the pre-crisis level. They clarified that part of the increase in public debt last year helped improve the risk profile of debt and build cash buffers to cushion the impact of future shocks.

B. Financial Sector Policies: Safeguarding Financial Stability and Reviving Credit Growth

21. Risks to financial stability have risen, although banks entered the crisis with high capital and liquidity positions. The anemic credit activity, together with the low interest rate environment kept bank interest margins thin, thus reducing profits in 2020. Non-performing exposures (NPE) for COVID-sensitive sectors have begun to rise (e.g., 11 percent in accommodation and food service), heightening the risks of cliff-edge effects as the legislative moratoria expired at end-March 2021. Overall, the liquidity and regulatory capital positions have so far hovered comfortably above requirements, but buffers are running lower in a few banks.

Box 3. Impact of COVID-19 and Policy Responses on Banks' Capital

Slovenia's policy response using banking capital took several forms in conjunction with European measures:

Moratoria on legacy loans: At end-March 2020, existing loans could receive moratoria on capital amortization and interest payments up to 12 months; this was opened to firms and households within broad conditions. The Slovenian legislation, adopted before the EBA adopted its rules, introduced comparatively longer eligibility and extended application dates. Later in the year, the second wave of COVID-19 prompted the authorities to renew the moratoria provisions, dovetailing the EBA guidelines. At end-December 2020, banking exposure under moratoria reached €2.7 billion (about 6 percent of total exposures), including €2.2 billion to non-financial corporations.

Public guarantees to support credit growth: The €0.8 billion available to companies and households before the COVID-19 crisis was supplemented with two new public guarantee schemes; a new €2 billion public guarantee scheme for liquidity loans and €0.2 billion guarantee scheme for deferred loans, both open until end-June 2021. The state guarantee for liquidity loans covers 70 percent of the loan principal for large firms and 80 percent for SMEs. At end-December, €70 million had been used. A fraction of the loans under legislative moratoria receive public guarantee—25 percent of deferred instalments for all borrowers and 50 percent for the borrowers directly impacted by the lockdown.

Macroprudential measures were amended to mitigate the impact of COVID-related temporary income shock on the creditworthiness of households. From June 2020, limited conditions allow banks to avoid disqualifying borrowers whose income declined during the crisis. Banks may exclude the months when the borrower's income was lower due to the pandemic when calculating the debt service to income (DSTI) ratio. The revised income rule added flexibility to the macroprudential toolkit that goes beyond the allowed deviation already admitted under the rule.

Rules on profit distribution. Dividend distribution and share buy-backs by banks were frozen until end-September 2021 and are not to exceed the lower of 15 percent of the bank's cumulative profit on an individual basis from the 2019 and 2020 financial years, or 0.2 percent of the bank's common equity Tier 1 capital on an individual basis as of end-2020.

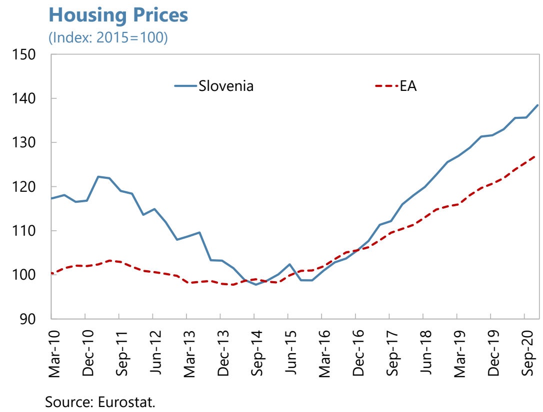
European rules on banking capital:

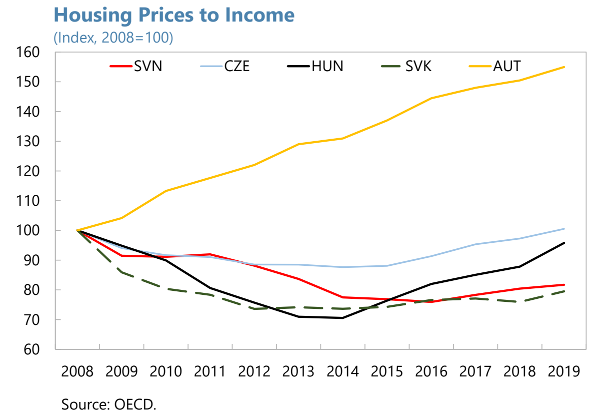
Slovenia applied the targeted amendments to the Capital Requirement Regulation (CRR "quick fix") adopted at end-June 2020. These include reducing the impact of marked-to market recognition of identified losses, lessening the cost of lending to SMEs and infrastructure funding, and supporting digitalization in banking.

Under EBA Guidelines, banks could use flexibility in the classification requirements and expected loan loss provisioning for non-performing loans. Payment moratoria do not automatically trigger classification as forbearance and distressed restructuring allowing an exposure to remain classified as Stage 1 for reporting.

Monitoring of the banks was strengthened, as ECB's Single Supervisory Mechanism (SSM) rules were expanded to the whole banking sector.

22. **Risks in housing loans appear moderate.** Mortgage loans grew at a sustained pace of 4 percent, with only about 10 percent of households carrying a mortgage (compared with 19 percent in the euro area). Meanwhile, residential real estate (RRE) prices have moderated to 4.6 percent in 2020, against an average growth of 6.7 percent during 2016–19. The housing market is not seen as a major source of risks at this juncture, given appreciating collateral and low non-performing exposure (1.7 percent of gross outstanding loans), but developments should continue to be closely watched.





23. A regular, risk-based monitoring of banks' asset quality should continue and measures be taken as needed to avoid cliff effects as the support measures are unwound. Supervisors should continue to focus on banks with lower capital base and those exposed to COVID-sensitive sectors and SMEs. The BoS conducted a stress test and has increased the monitoring of NPE. Since March 2020, banks could fully use regulatory easing under European Banking Authority (EBA) rules, which allowed flexibility in loan classification requirements, expectation on loss provisioning for NPE, and accounting and prudential treatment of the claims under debt moratoria. The exit from loan moratoria has already started, which calls for a close monitoring and coordination to plan the phase-out process and design it in gradual steps to avoid cliff effects. Other support measures (loan guarantees, labor market measures) that remain in place would help cushion the impact of the expiration of moratoria. Intensive supervisory monitoring is necessary until regulatory relief measures (e.g., moratoria, government guarantees) are withdrawn. Supervision should continue to ensure that non-SSM banks are subject to the same extraordinary monitoring applied to the SSM banks and require banks to continually assess borrowers' creditworthiness. The BoS should continue to collect information from banks on interest income accrued but not received and assess the macro-financial conditions under different scenarios, including through stress testing, to ensure that banks are prepared to tackle high NPL levels.

24. Frequent reviews of macroprudential measures should continue to ensure the right balance between financial stability and the need for credit in the economy. The DSTI provisions from November 2019 sought to cap household lending through strictly binding rules, while loan maturity was capped at seven years for the rapidly growing non-collateralized high-interest consumer loans. In spring 2020, concerns emerged that binding rules could price out a wide range of borrowers, given the acute crisis. This prompted the BoS to revise the calculation formula used for the DSTI by allowing temporarily that income over the 12 previous months could serve to qualify for new lending. The current macroprudential measures and calibration strike an appropriate balance between maintaining financial stability and the need to support credit to the economy. The BoS should continue to undertake a frequent review of the macroprudential measures and use its communication strategy to engage with stakeholders. Consideration should also be given to requiring high and prompt provisioning of non-collateralized risky loans.

25. The exit strategy from the support measures will require a careful balancing act. Although bankruptcies in 2020 have so far remained stable compared to 2019, they could start rising as the moratoria expire, posing a significant risk to financial stability. To avoid this cliff-edge effect, existing schemes should be phased out gradually as the recovery proceeds, and eligibility criteria should be tightened to better target, on a temporary basis, viable or potentially viable companies, operating in hard-hit sectors (e.g., tourism and hospitality). As the recovery strengthens, prudential standards should be normalized—and clearly communicated—so that problem assets can be dealt with in a timely manner. The insolvency regime should be strengthened to facilitate the swift repair of bank balance sheets and prevent the rise of "zombie" firms. If NPLs risk rising to a systemic level, a holistic unwinding strategy to flatten the insolvency curve is warranted and should be informed by a triage of companies (into viable, viable with restructuring, and unviable) to identify the policy trade-offs, given fiscal and financial stability constraints.[4] The authorities should expedite the ongoing reform process and complete the transposition of the EU Directive on Preventive Restructuring Frameworks.

Authorities' Views

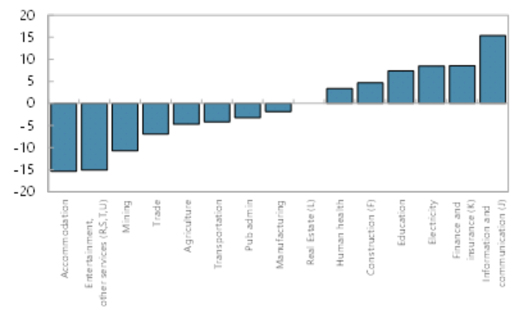
26. The authorities agreed with staff's analysis and advice. They noted that successful financial sector reforms after the 2013 banking crisis have improved banks' capital and liquidity positions. However, the current crisis has strengthened the trend of declining corporate credit, which is significantly lower than a decade ago and, in real terms, than in the period of stable growth (2003–06) before the global financial crisis. In turn, this has heightened risks to banks' business models. They stressed that vigorous on-site supervision continues to be in place to ensure timely and proper loan classification and provisioning, given the risks of cliff effects once policy support measures have been withdrawn. They concurred that frequent reviews of macroprudential measures are critical in view of the high uncertainty. They considered the macroprudential framework adequate, with its current calibration responding properly to credit conditions, and remain vigilant on emerging systemic risks. They highlighted that flexibility under the macroprudential rules has been only sparsely used. The authorities stressed that the exit from the financial sector support measures will be gradual, well sequenced, and coordinated. The guarantee scheme will be reviewed to better support, on a temporary basis, viable or potentially viable companies hard-hit by the COVID-19 crisis.

27. The authorities emphasized that efforts are underway to further strengthen their insolvency regime. Investment and upgrades of ICT and sufficient number of insolvency administrators and court staff are necessary to help relieve court congestion and materially speed up insolvency procedures to manage a possible upcoming wave of bankruptcies. Moreover, the transposition of the EU Directive on Preventive Restructuring Frameworks will be accelerated to help SMEs.

[4] The government would be expected to be involved in the triage in the cases where government support is under consideration, and banks would do the assessment of creditworthiness of their borrowers.

C. Structural Policies: Building the Foundation for Sustainable, Inclusive, and Greener Growth

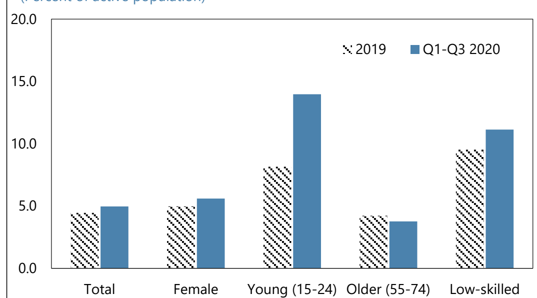
Change in Employment by Sector, 2019-2020
(Percent)



Source: Eurostat

28. The effects from the crisis on the labor market could be long-lasting and uneven. Wage subsidies are keeping unemployment in check, but this is only a near-term solution. Labor reallocation is already taking place and some sectors (trade, transport, hospitality services) could face a permanent fall in demand, leading to long-term unemployment. The loss of jobs and income would affect disproportionally certain segments of the population; in particular, low-skilled workers, women and youth are at risk.

Unemployment Rates for Selected Groups
(Percent of active population)



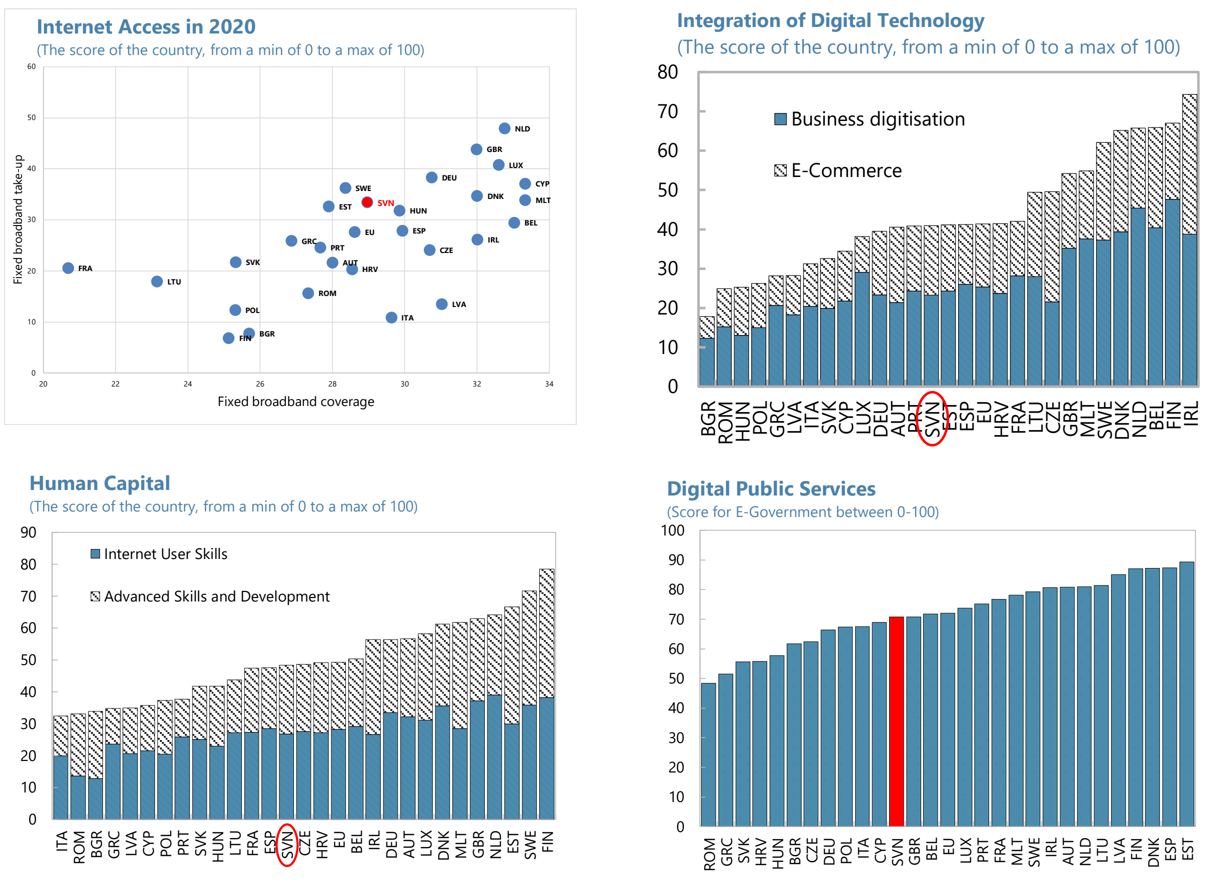
Source: Eurostat

29. Ensuring smooth reallocation of labor and upskilling would minimize the economic and social costs of the pandemic. Labor market policy should remain nimble and flexible. As the longer-term consequences of the crisis become clearer, the focus should shift from protecting jobs to facilitating reallocation, while continuing to provide support to the unemployed. Eligibility criteria for support schemes should also be informed by reallocation considerations; other policies, e.g., investment in digital and green technologies (see below) would help in the process. Active labor market policy should be used to assist the transition of workers between jobs, including through training, job search services, and reducing the hiring costs for firms. Programs specifically targeted at youth, low-skilled and older workers would improve employability of these groups and inclusivity. These can be supplemented with measures aimed at improving the business environment and strengthening the social safety net to support those unable to return to work. Specifically, the design and coverage of the guaranteed minimum income benefits could be improved.

30. The authorities have rightly identified digitalization as one of the key areas for investment. Slovenia has achieved substantial progress across a number of dimensions of digitalization in the last few years (access to open data, automation and robotization of manufacturing). The country's overall score of EU's Digital Economy and Society Index (DESI) has improved and is close to the EU average, but it lags behind the leaders in areas like the quality of digital public services, digital skills, use of internet services (including in banking), and internet security (Figure 1).

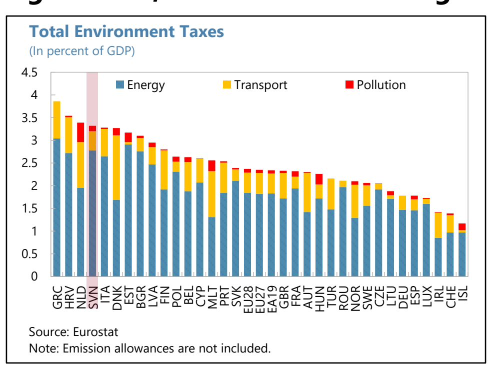
31. Slovenia should embrace the opportunity presented by the RRF to press ahead with its digitalization agenda. Efforts should be targeted at improving the digital infrastructure and access to internet, building human capital through investing in education, and creating an enabling environment through regulations and incentives. The government's draft Recovery and Resilience Plan envisages an allocation of about €0.3 billion of grants to projects in digitalization which, if spent well, would help Slovenia close important gaps and have a catalytic effect for private sector investments. Online banking and fintech are among the promising areas, given the high operating costs of financial institutions.

Figure 1. Internet Access and Digitalization



Source: The Digital Economy and Society Index (DESI).

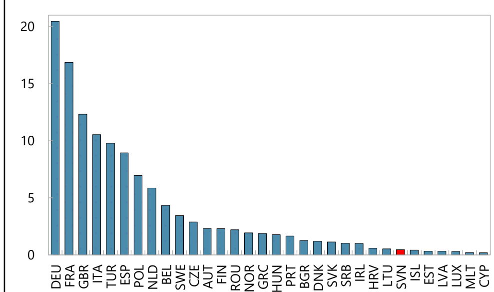
32. **To deliver on its commitments under the Paris Agreement, Slovenia could strengthen taxation of polluting industries, especially transport.** The yield from environmental taxes is one of the largest in the EU, as tax policy is extensively used to steer environment protection, mainly through the taxation of energy. But the share of greenhouse gases (GHG) covered by taxes is only about a quarter of the total (and the fourth lowest in the EU), including due to tax exemptions in transportation, while the energy intensity in the transport sector is among the highest in the EU. These exemptions should be reconsidered in the context of a broader strategy for



transport development. So far, only industry and residential and commercial users pay an excise tax and the CO_2 tax. Certain fuels in combined heating are tax exempt. The proceeds from carbon taxation should be used to support the transition to clean energy. Several of the energy-intensive sectors (including thermal power plants, chemical, aluminum, and cement producers) generating a quarter of CO_2 emissions in Slovenia participate in the EU free emission allowances (Emission Trading System, ETS). However, the total ETS allowance for Slovenia is not binding given the reduced usage (about 44 percent of the annual free allowance) and the low tax rate per ton (€17.4) for carbon emissions, which is about half of the average EU tax rate in 2020.

33. **The National Action Plan on climate is ambitious in its goals and could be better fleshed out.** Slovenia has had two competing goals—carbon neutrality by 2050 and securing energy supply. The authorities opted to reach carbon neutrality through a lower use of fossil fuels and sustainable solutions for transport, housing, and industry. However, the measures to reach the goal—which mainly seek efficiency through investment but give sparse attention to reducing mobility-related GHG—could prove insufficient. The EU has raised this issue and a follow-up will be needed in the authorities' revised strategy. User industries may be reluctant to accept the higher costs due to expansion of the tax bases and limited ability to pass them through to the final customers. Also, the growth of the share of renewable energy is still low in comparison with European peers.

Renewable Energy
(In share of total (EU-27))



Source: Eurostat

Authorities' Views

34. **The authorities agreed that economic transformation will require efficient labor reallocation and upskilling.** They believe that during the transition period, employment support measures should be time-bound and phased out gradually to avoid a sudden surge of layoffs, while becoming better adapted to the needs of specific sectors and categories of employees. Firms could also be required to bear some of the costs of support measures. Once conditions normalize, efforts would shift to active and flexible labor market policies to support reallocation and business transformation. Emphasis is put on training to develop competencies and skills for the future (e.g., digital skills). Targeted programs are also being implemented to enhance the employability of youth, elderly and low-skilled workers.

35. **The authorities emphasized that digitalization is critical to their smart growth strategy.** While pointing out progress in digital inclusion, digital public services, and cybersecurity, they acknowledged that further steps are needed to build digital and innovation ecosystems and invest in the digital transformation of processes. In this regard, they are providing building blocks for different functionalities (data gathering, trust services, platform for e-procedures) and are stepping up the promotion of digital services. They expected to start issuing the first national electronic identity cards for companies by the end of the year. Efforts to support the digital transformation of SMEs, including through the Digital Innovation Hub, are underway.

36. The authorities agreed with staff's advice and the importance of implementing their strategy for a low-carbon economy. The NECP envisages CO2 tax on all fossil fuel usage for sectors not covered by ETS, namely heating and transport, and proceeds from it are expected to increase gradually as the level of charges approaches the price of ETS allowances, and exemptions are gradually phased out. They noted that Slovenia was an early participant in the ETS and that the proceeds are earmarked for green projects. Regarding transport, the authorities plan to modernize the railway network and promote sustainable mobility. They are also preparing an exit strategy from the usage of coal in electricity production and are seeking to increase the share of renewable sources in the energy mix**.**

STAFF APPRAISAL

37. The authorities' swift, substantial, and well-coordinated policy response has been instrumental in mitigating the economic and social impact of COVID-19. Although the crisis triggered a sizeable economic contraction in 2020, policy measures supported employment and averted a larger output loss.

38. A strong economic recovery is expected as vaccinations help achieve herd immunity, but there are many downside risks. Recovery would be driven by a rebound of private consumption, as containment measures are relaxed, and investment is supported by EU funds. Key downside risks include the potential for new variants of the virus to appear, slow vaccination, and unfavorable financial markets conditions. Slovenia's external position is assessed as substantially stronger than the level implied by fundamentals and desirable policies.

39. Fiscal support should continue until the recovery is entrenched, but the deficit should be reduced over the medium term. The budget for 2021 appropriately maintains support to fight the COVID-19 crisis but it is important to continue to assess the anti-crisis measures and adjust their overall envelope and specific features in line with the evolution of the pandemic. Targeting and efficiency remain key to foster an efficient adaption of the economy and preserve valuable fiscal space. Once the recovery is on a solid footing, the emergency relief should be phased out and support should switch toward building a better economy. Public debt remains sustainable, but the large fiscal deficits will need to be brought down gradually over time, so as to rebuild room for fiscal policy maneuver to counteract any future shocks. EU and national fiscal rules should continue to play an important role in supporting the credibility of fiscal policy.

40. The ambitious increase in capital outlays, supported by EU resources is welcome but execution risks need to be mitigated. To achieve value for money, improving public investment management is critical. Safeguards need to be in place to ensure that decisions are based on robust selection criteria; and procurement, project management and oversight are effective and transparent.

41. Continued risk-based monitoring of banks' asset quality remains critical. Supervisors' attention should continue to focus on banks with lower capital base and those exposed to COVID-sensitive sectors and SMEs. Although moderate so far, risks in the housing market need to be closely watched. It is important that banks be required to continually assess borrowers' creditworthiness until conditions have normalized. Regulatory easing and relaxation of macroprudential measures due to the COVID-19 crisis struck the right balance between financial stability considerations and the need to support credit. The Bank of Slovenia should continue its engagement with banks and other stakeholders.

42. The exit from support measures should be gradual. To avoid cliff-edge effects, existing schemes should be phased out gradually as the recovery proceeds, and eligibility criteria should be tightened to better target, on a temporary basis, viable or potentially viable companies, operating in hard-hit sectors. The insolvency regime should be strengthened to facilitate the swift repair of banks balance sheets.

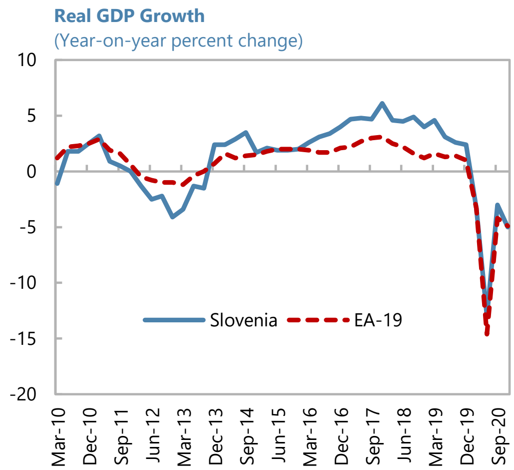
43. Ensuring smooth reallocation of labor and upskilling would minimize the economic and social costs of the pandemic. Maintaining wage subsidies and monthly basic income for self-employed is appropriate while the pandemic lasts. As the recovery firms up, the focus should shift from protecting jobs to facilitating reallocation and upskilling. Active labor market policy would assist the transition, supplemented with measures to improve the business environment, and strengthen the social safety net.

44. Investment in digital and green projects would increase productivity and resilience. The EU funding provides an opportunity to speed up Slovenia's digital transformation and greening the economy. In digitalization, efforts should be targeted at improving the digital infrastructure, building human capital, and creating an enabling environment through regulations and incentives. Investment in green projects should be combined with strengthened taxation of polluting industries.

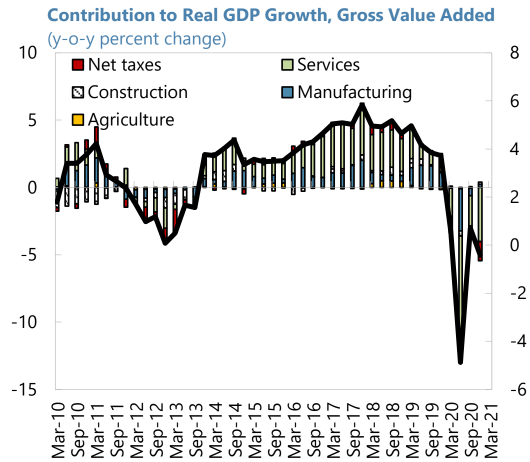
45. It is recommended that the next Article IV consultation take place on the regular 12-month cycle.

Figure 2. Macroeconomic Developments

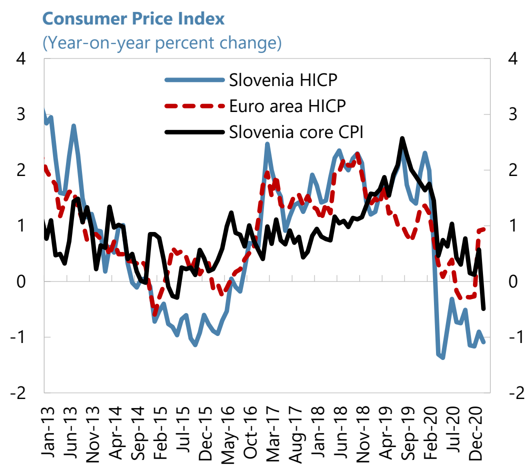
Growth declined sharply in 2020 due to COVID-19.



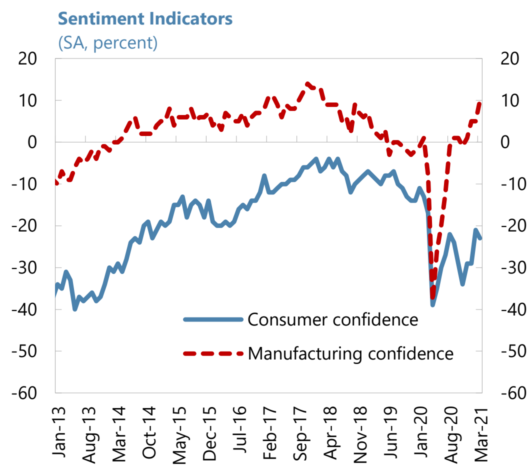
Services were particularly hard-hit.



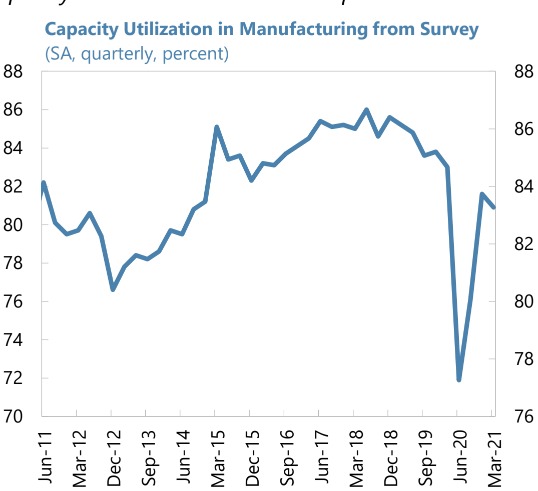
Headline inflation declined on account of energy prices and lower demand.



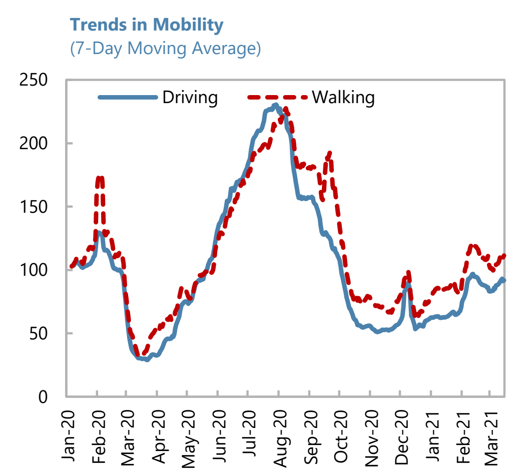
While business sentiment has recovered, consumer confidence remains low.



Capacity utilization is still below the pre-crisis level.



Mobility remains low due the continuing lockdown.

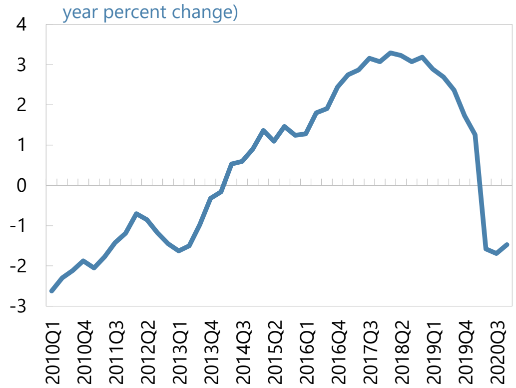


Sources: Bank of Slovenia; Eurostat; and Haver Analytics.

Figure 3. Labor Market

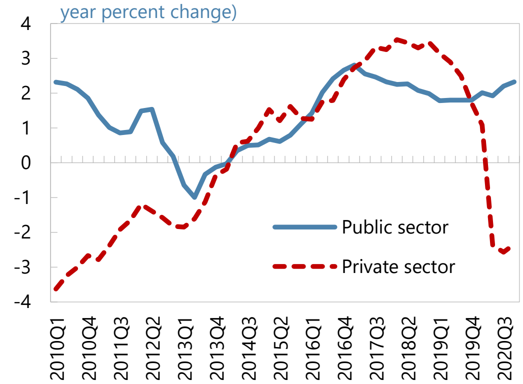
Employment declined ...

Employment Growth
(Seasonally and work day adjusted, year-on-year percent change)



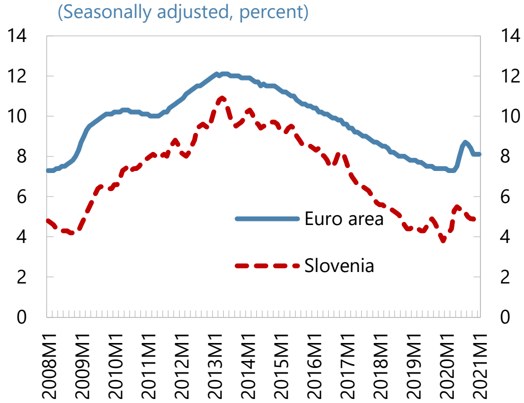
due to job losses in the private sector.

Employment Growth by Sectors
(Seasonally and work day adjusted, year-on-year percent change)



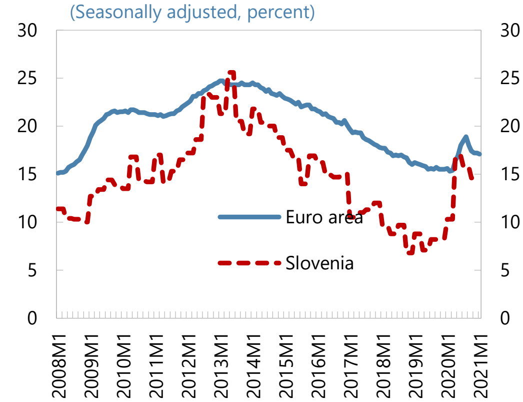
Unemployment increased...

Harmonized Unemployment Rate
(Seasonally adjusted, percent)



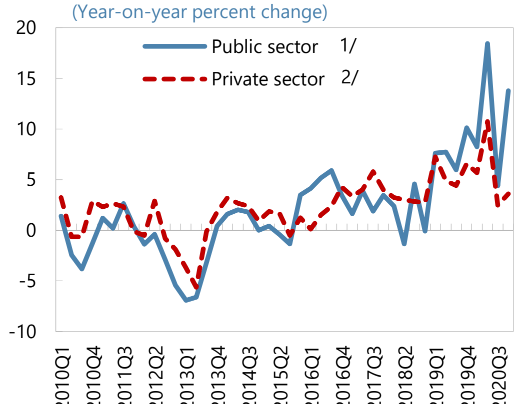
especially youth unemployment.

Youth Unemployment Rate
(Seasonally adjusted, percent)



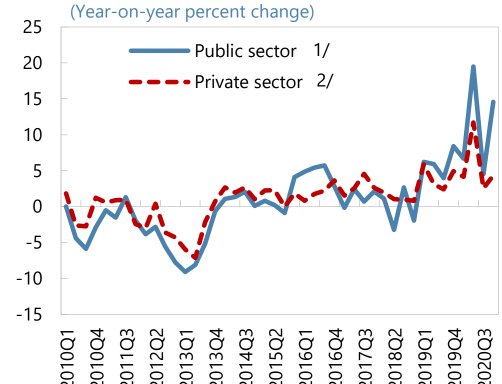
Wage growth continued ...

Nominal Gross Wage Growth
(Year-on-year percent change)



both in the private and public sectors.

Real Gross Wage Growth
(Year-on-year percent change)



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

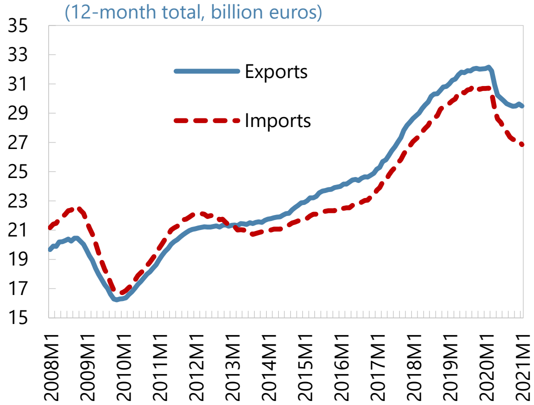
1/ Public administration and defense; compulsory social security; education; human health and social work activities; arts, entertainment and recreation; other service activities (NACE rev. 2).

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

Figure 4. External Sector Developments

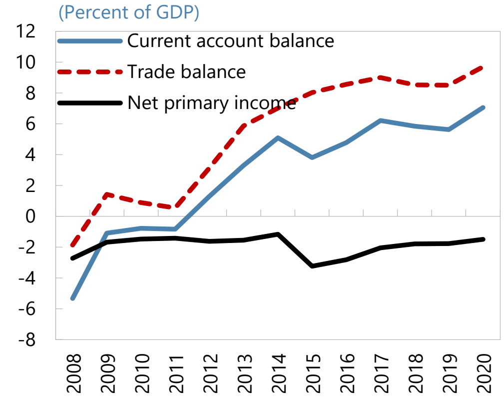
Both exports and imports declined, but imports by more...

Merchandise Exports and Imports
(12-month total, billion euros)



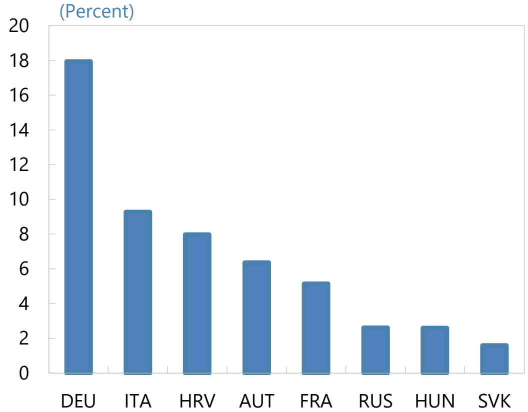
and the trade surplus increased.

Current Account Balance
(Percent of GDP)



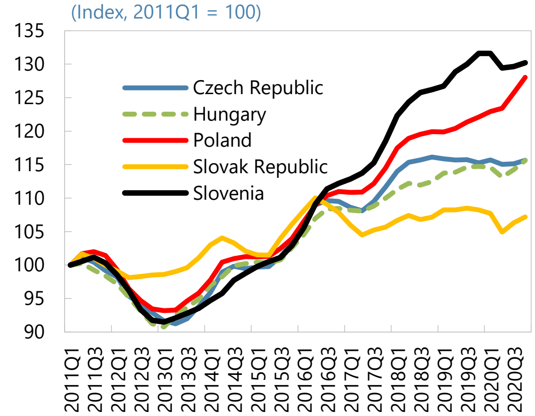
Exports are still strongly linked to global value chains...

Share of Slovenian Exports, 2020
(Percent)



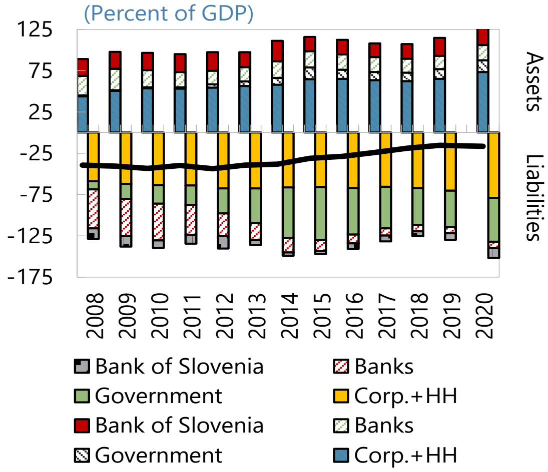
despite a small loss of market share.

Market Share in World Trade
(Index, 2011Q1 = 100)



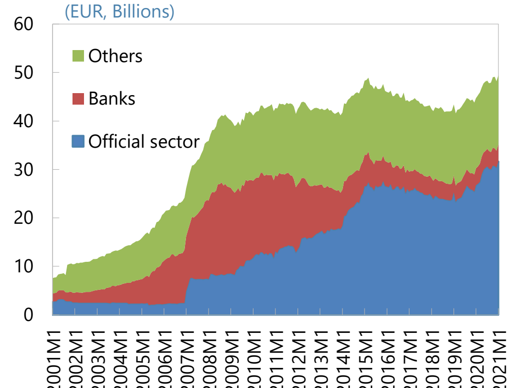
The net IIP remains negative...

IIP Components
(Percent of GDP)



...and external debt is again on a rising path.

External Debt
(EUR, Billions)

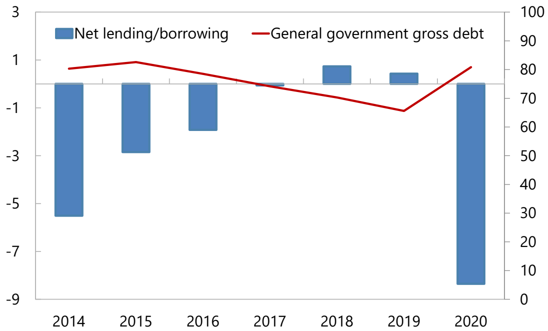


Sources: Bank of Slovenia; Direction of Trade Statistic; European Central Bank; Haver Analytics; Statistical Office of Slovenia; and IMF staff estimates.

Figure 5. Fiscal Developments

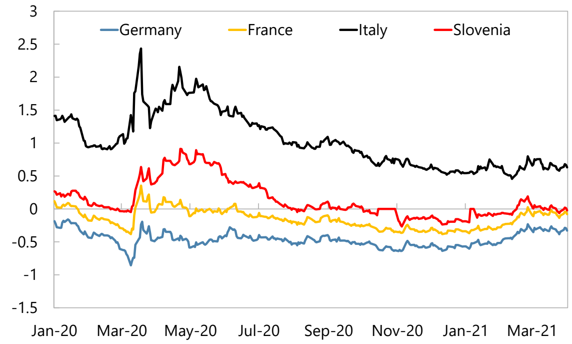
The fiscal balance deteriorated and debt increased.

Fiscal Deficit and Public Debt
(Percent of GDP)



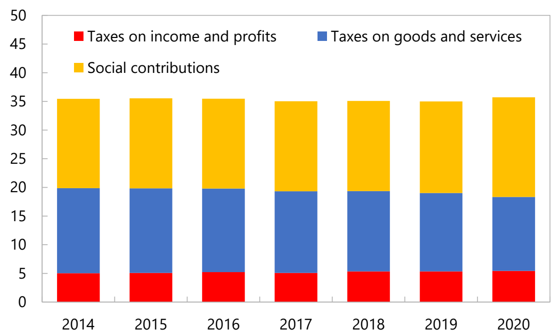
However, market conditions remain favorable.

10Y Bond Yields
(Percent)



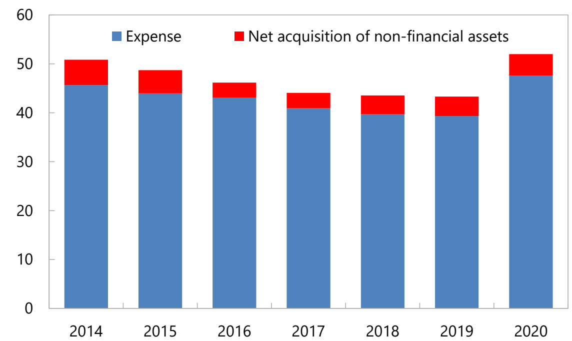
Tax revenue declined broadly in line with GDP.

Tax Revenue and Social Security Contributions
(Percent of GDP)



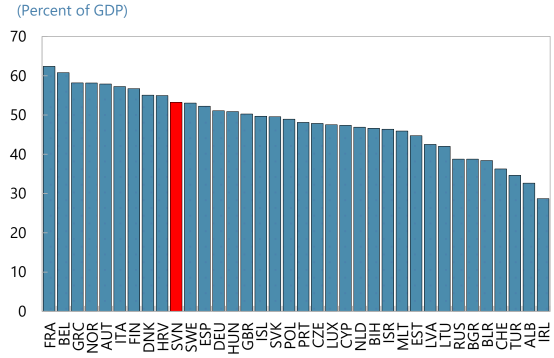
Expenditure jumped due to COVID-19 spending…

General Government Expenditure
(Percent of GDP)



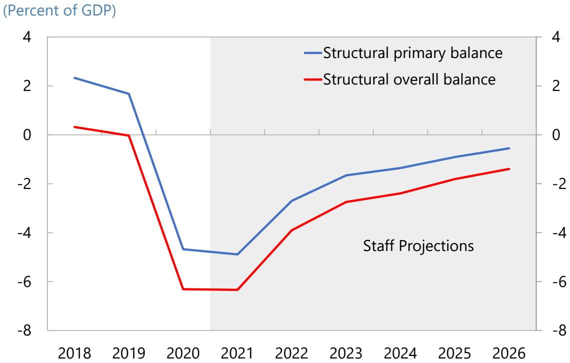
…as in most other countries.

General Government Expenditure, 2020
(Percent of GDP)



The fiscal deficit is projected to gradually decline in the medium term.

Structural Primary and Overall Fiscal Balance
(Percent of GDP)

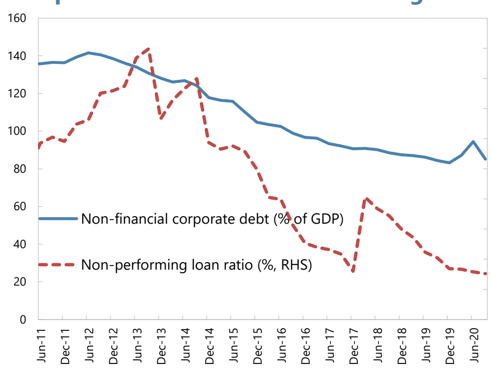


Sources: Bank of Slovenia; Eurostat, IMF staff calculations and Bloomberg

Figure 6. Financial Sector Developments

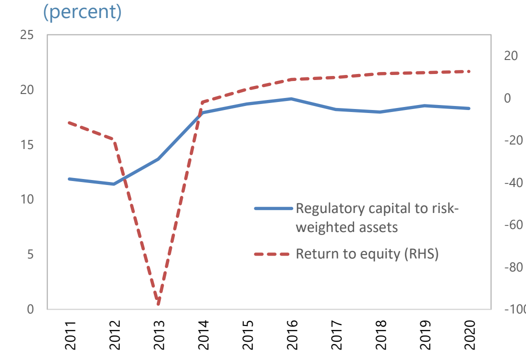
Despite the difficult environment, the NPL ratio remains low.

Corporate Debt and Non-Performing Loans



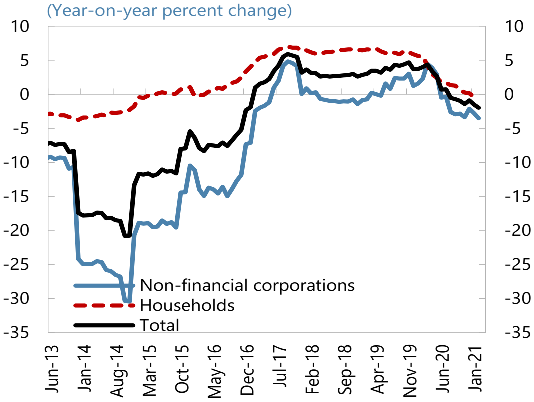
Slovenian banks are well-capitalized and remain profitable.

Bank Capital Adequacy and Profitability
(percent)



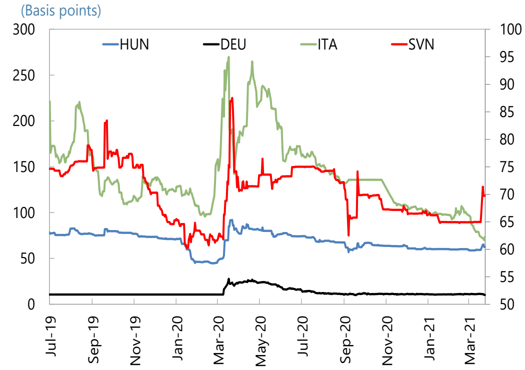
Credit to the private sector is stagnating.

Credit Growth to Private Sector 1/
(Year-on-year percent change)



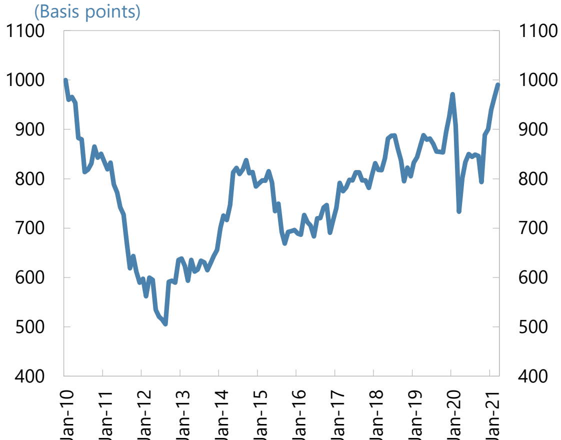
Market continues to perceive low sovereign risk.

5-year Sovereign CDS Spreads
(Basis points)



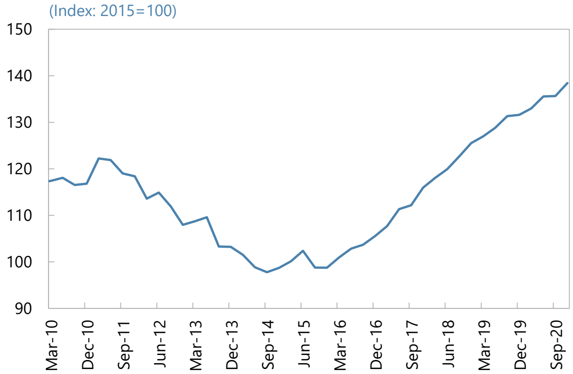
The stock market has recovered in recent months.

Ljubljana Stock Exchange Slovenian Blue-Chip SBITOP Index
(Basis points)



Housing prices continue to increase.

Housing Prices in Slovenia
(Index: 2015=100)



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

Table 1. Slovenia: Selected Economic Indicators, 2018–26

(Annual percentage change, unless indicated otherwise)

	2018	2019	2020	2021	2022	2023	2024	2025	2026
						Staff Proj.			
Nominal GDP (EUR millions)	45,863	48,393	46,297	48,522	51,444	54,138	56,794	59,495	62,416
Population (millions)	2.1	2.1	2.1	2.1	2.1	2.1	2.1	2.1	2.1
GDP per Capita (EUR)	22,189	23,255	22,090	23,061	24,377	25,607	26,845	28,135	29,533
Real economy									
Real GDP	4.4	3.2	-5.5	3.9	4.5	3.6	3.1	2.8	2.8
Domestic demand (contribution to growth)	5.0	3.4	-5.9	4.3	4.9	3.9	3.5	3.0	2.8
Private consumption	3.6	4.8	-9.8	4.3	4.6	3.7	3.1	2.7	2.7
Public consumption	3.0	1.7	1.8	1.5	1.6	0.5	1.1	0.8	1.1
Gross capital formation	10.3	1.5	-5.8	9.8	10.4	8.4	7.1	5.7	4.8
Net exports (contribution to growth)	-0.1	0.1	0.4	-0.5	-0.4	-0.3	-0.4	-0.2	0.0
Exports of goods and services	6.3	4.1	-8.7	8.8	6.0	3.8	4.1	3.1	2.7
Imports of goods and services	7.2	4.4	-10.2	10.5	7.1	4.5	4.8	3.5	3.0
Potential output growth	4.1	2.8	-0.5	2.8	2.7	2.7	2.6	2.6	2.5
Output gap (in percent of potential GDP)	0.3	0.6	-4.5	-3.5	-1.8	-1.0	-0.5	-0.3	0.0
Prices									
GDP deflator	2.2	2.3	1.3	0.9	1.4	1.6	1.7	1.9	2.1
Consumer prices (national definition, period average)	1.7	1.6	-0.1	0.6	1.2	1.5	1.7	1.9	2.1
Employment and wages									
Unemployment rate (in percent, ILO definition)	5.1	4.5	5.0	5.3	4.9	4.8	4.6	4.4	4.3
Public finance (percent of GDP)									
General government balance 1/	0.7	0.4	-8.4	-8.0	-4.8	-3.3	-2.7	-2.0	-1.5
Structural balance 2/	0.3	0.0	-6.3	-6.3	-3.9	-2.7	-2.4	-1.8	-1.4
Structural primary balance 2/	2.3	1.7	-4.7	-4.9	-2.7	-1.7	-1.4	-0.9	-0.6
General government debt 3/	70.3	65.6	80.8	81.8	80.5	79.7	78.7	77.1	75.0
Monetary and financial indicators									
Credit to the private sector	2.5	3.4	-0.2	5.3	6.3	5.8	5.4	5.2	5.4
Lending rates 4/	2.1	1.6	1.8	…	…	…	…	…	…
Deposit rates 5/	0.2	0.2	0.1	…	…	…	…	…	…
Balance of payments (percent of GDP)									
Trade balance (goods and services)	8.5	8.5	9.7	8.8	8.5	7.9	6.9	6.0	5.1
Current account balance	5.8	5.6	7.1	6.5	6.3	6.1	5.3	4.8	4.2
Gross external debt (percent of GDP, end-period)	91.9	90.5	104.1	103.1	98.2	94.8	92.0	89.5	87.1
Nominal effective exchange rate (2010=100)	105.2	104.8	106.9	…	…	…	…	…	…
Real effective exchange rate (2010=100, CPI-based)	97.9	97.2	97.7	…	…	…	…	…	…

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

1/ Accrual basis.

2/ Excludes one-offs and adjusted for calendar year shifts between receipts and expenditures of earmarked EU funds.

3/ Includes the 2013-14 debt issuances of the Bank Asset Management Company.

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

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

Table 2. Slovenia: General Government Operations, 2018–26
(Percent of GDP, unless indicated otherwise)

	2018	2019	2020	2021	2022	2023	2024	2025	2026
						Projections			
Revenue	44.3	43.7	43.6	43.9	43.9	43.4	42.8	42.9	42.9
Taxes	21.9	21.6	20.3	20.3	20.4	20.7	20.7	20.8	20.9
Taxes on income, profits, and capital gains	7.9	7.8	7.4	7.2	7.4	7.5	7.5	7.5	7.5
Payable by individuals	5.4	5.3	5.4	5.2	5.2	5.2	5.2	5.2	5.2
Payable by corporations and other enterprises	1.9	2.0	1.3	1.5	1.6	1.8	1.8	1.8	1.8
Taxes on goods & services	14.0	13.7	12.9	13.0	13.0	13.1	13.2	13.2	13.4
VAT	8.2	8.0	7.7	7.7	7.7	7.7	7.8	7.8	7.8
Taxes on products (except VAT and imp. taxes)	4.6	4.4	4.0	4.1	4.0	4.1	4.2	4.2	4.3
Taxes on international trade & transactions	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Taxes not elsewhere classified	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Social contributions 1/	15.7	16.0	17.4	16.9	16.4	16.0	15.9	15.9	15.8
Social security contributions	15.4	15.7	17.1	16.6	16.1	15.7	15.6	15.6	15.5
Grants	1.7	1.7	1.5	2.3	2.7	2.4	1.8	1.8	1.8
Other revenue	5.0	4.5	4.4	4.4	4.4	4.4	4.4	4.4	4.4
Interest income	0.2	0.2	0.2	0.2	0.2	0.2	0.2	0.2	0.2
Expenditure	43.5	43.3	52.0	52.0	48.7	46.7	45.5	44.9	44.4
Expense	39.7	39.3	47.6	45.6	42.3	41.0	40.2	39.5	39.1
Compensation of employees	11.1	11.3	12.7	12.5	12.1	11.6	11.2	11.0	10.8
Purchases/use of goods & services	6.2	6.1	6.6	6.5	6.4	6.1	6.1	6.1	6.1
Interest	2.0	1.7	1.6	1.4	1.2	1.1	1.0	0.9	0.8
Social benefits	17.5	17.4	19.7	20.1	19.1	18.6	18.2	17.9	17.9
Subsidies	0.7	0.7	3.9	2.1	1.0	1.0	1.0	0.9	0.9
Other transfers and grants	1.7	1.7	2.7	2.5	2.3	2.3	2.3	2.3	2.3
Other current expense	0.4	0.4	0.3	0.3	0.3	0.3	0.3	0.3	0.3
Net acquisition of non-financial assets	3.8	4.0	4.4	6.4	6.4	5.7	5.3	5.4	5.3
Net lending/borrowing	0.7	0.4	-8.4	-8.0	-4.8	-3.3	-2.7	-2.0	-1.5
Memorandum item:									
General government balance (ESA 2010)	0.7	0.4	-8.4	-8.0	-4.8	-3.3	-2.7	-2.0	-1.5
Primary balance	2.5	1.9	-6.9	-6.8	-3.8	-2.4	-1.9	-1.3	-0.9
Gross operating balance	4.6	4.4	-3.9	-1.6	1.6	2.5	2.6	3.4	3.8
Structural balance 2/	0.3	0.0	-6.3	-6.3	-3.9	-2.7	-2.4	-1.8	-1.4
Structural primary balance 2/	2.3	1.7	-4.7	-4.9	-2.7	-1.7	-1.4	-0.9	-0.6
General government debt 3/	70.3	65.6	80.8	81.8	80.5	79.7	78.7	77.1	75.0

Sources: Ministry of Finance; and IMF staff calculations.
1/ While most private sector workers were exempt from paying social security contributions in 2020, their contributions were covered by the budget (see Annex I).
2/ Excludes bank support and other one-offs. Adjusted for calendar year shifts between receipt and expenditure of earmarked EU funds.
3/ Includes EUR 1.1 bn in 2013 and EUR 0.7 bn in 2014 of debt issuance of the Bank Asset Management Company (BAMC).

Table 3. Slovenia: Balance of Payments, 2018–26

(Percent of GDP, unless indicated otherwise)

	2018	2019	2020	2021	2022	2023	2024	2025	2026
				Projections					
Current account	5.8	5.6	7.1	6.5	6.3	6.1	5.3	4.8	4.2
Trade balance, goods and services	8.5	8.5	9.7	8.8	8.5	7.9	6.9	6.0	5.1
Goods	2.8	2.7	5.4	4.0	2.8	2.6	1.3	0.5	-0.1
Exports f.o.b.	67.2	66.2	64.0	67.0	67.8	68.8	69.4	69.4	69.1
Imports f.o.b.	64.4	63.4	58.6	63.0	65.0	66.2	68.1	68.9	69.2
Services	5.7	5.8	4.3	4.8	5.6	5.3	5.5	5.4	5.3
Exports	17.7	17.7	14.8	16.2	16.9	16.4	16.5	16.5	16.4
Imports	11.9	11.9	10.6	11.4	11.2	11.1	11.0	11.1	11.2
Primary Income, net	-1.8	-1.8	-1.5	-1.4	-1.3	-1.1	-1.0	-0.8	-0.7
Secondary Income, net	-0.9	-1.1	-1.1	-0.9	-0.8	-0.7	-0.6	-0.4	-0.3
Capital account	-0.5	-0.4	-0.3	0.2	0.7	0.8	0.3	0.2	0.1
Financial account, excl. reserves	5.4	5.0	3.8	6.6	6.9	6.8	5.6	4.9	4.2
Direct investment, net	-2.0	-1.5	-0.1	-1.3	-0.8	-1.2	-1.0	-0.9	-0.8
In Slovenia	2.9	3.1	1.7	2.6	2.4	2.2	2.0	1.9	1.7
Abroad	0.8	1.6	1.5	1.3	1.6	1.0	1.0	1.0	1.0
Portfolio investment, net	1.6	1.6	-3.8	-5.6	-0.1	-0.8	-0.9	-1.1	-1.4
Equity	-0.9	-0.1	1.1	-11.1	-6.0	-5.7	-5.6	-5.0	-4.8
Debt	2.6	1.7	-4.9	5.6	5.9	4.9	4.7	3.9	3.4
Financial derivatives	-0.2	-0.3	0.1	-4.9	4.0	2.8	2.0	1.7	1.5
Other investment, net	6.0	5.2	7.8	18.4	3.7	5.9	5.5	5.2	4.8
Loans	1.5	1.2	1.4	2.0	1.5	1.4	1.2	1.2	0.4
Currency and deposits	4.4	3.9	6.6	21.2	7.0	7.9	6.7	6.5	6.2
Trade credits	-0.1	0.0	-0.1	-0.1	-0.1	-0.1	-0.1	-0.1	-0.1
Other	0.1	0.2	-0.1	-0.2	-0.2	-0.1	-0.2	-0.1	-0.1
Net errors and omissions	0.2	-0.2	-2.2	0.0	0.0	0.0	0.0	0.0	0.0
Overall balance	0.1	0.1	0.7	0.1	0.1	0.1	0.1	0.1	0.1
Change in official reserves (+: increase)	0.1	0.1	0.4	0.1	0.1	0.1	0.1	0.1	0.1
Memorandum items:									
Nominal GDP (million euros)	45,863	48,393	46,297	48,522	51,444	54,138	56,794	59,495	62,416
Current account balance (percent of GDP)	5.8	5.6	7.1	6.5	6.3	6.1	5.3	4.8	4.2
Export of goods (percent change in value)	8.6	3.9	-7.4	9.7	7.4	6.7	5.9	4.8	4.4
Import of goods (percent change in value)	10.4	3.9	-11.6	12.8	9.5	7.2	7.9	6.0	5.4
Terms of trade (percent change)	0.0	0.4	1.2	-0.3	0.0	-0.3	-0.4	-0.4	-0.4
Gross external debt (billions of euros)	42.1	43.8	48.2	50.0	50.5	51.3	52.2	53.3	54.4
(percent of GDP)	91.9	90.5	104.1	103.1	98.2	94.8	92.0	89.5	87.1
Net int'l investment position (percent GDP)	-19.0	-15.4	-16.3	-14.5	-13.9	-12.5	-11.0	-9.6	-8.6

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

Note: in 2018, FDI flows benefitted from one significant project whose investment cycle has now come to an end. The increase in currency and deposits could be related to increased confidence and the repatriation of funds held abroad during the crisis, as well as funds moved to Slovenia in anticipation of privatization.

Table 4. Slovenia: Vulnerability Indicators, 2011–20
(Percent of GDP, unless indicated otherwise)

	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020
External Indicators										
Current account balance	-0.8	1.3	3.3	5.1	3.8	4.8	6.2	5.8	5.6	7.1
Capital and financial account balance	-0.9	0.2	4.9	6.3	5.6	2.2	4.2	5.0	4.7	3.9
Of which										
Inward portfolio investment (debt securities, etc.)	4.9	-1.0	10.2	11.7	-2.4	-7.4	-0.3	-0.5	-0.1	5.8
Inward foreign direct investment	1.7	0.1	0.2	2.0	4.0	3.2	2.5	2.9	3.1	1.5
Other investment (net)	5.6	0.5	15.7	18.0	0.6	-6.5	-0.7	6.0	5.2	7.8
Euros per U.S. dollar (period average)	0.7	0.8	0.8	0.8	0.9	0.9	0.9	0.8	0.9	0.8
Market Indicators										
Financial Markets										
10-year government bond (percentage points)	5.0	6.0	6.2	3.4	1.7	1.2	1.1	1.1	0.4	0.2
10-year government bond (United States)	2.8	1.8	2.4	2.5	2.1	1.8	2.3	2.9	2.1	0.9
Spread with US bond (percentage points)	2.2	4.2	3.8	0.9	-0.5	-0.7	-1.2	-1.9	-1.7	-0.7
Stock market index (period average, 1995=100)	80.5	63.7	70.1	83.1	83.0	79.5	88.4	89.2	89.5	89.9
Real estate prices (index, 2010=100, period average)	102.7	95.6	90.6	84.6	85.3	88.1	95.4	103.7	110.7	115.7
Credit markets (end-of-period 12-month growth rates)										
Credit to the private sector	-1.9	-5.4	-17.4	-13.4	-5.5	-2.7	3.3	3.3	3.7	-0.2
Bank credit to households	1.9	-2.0	-3.8	-1.7	1.1	3.4	6.4	6.5	5.9	0.2
Housing Loans	6.8	1.9	0.9	0.8	3.3	3.5	4.6	4.4	5.6	4.2
Sectoral risk indicators										
Household sector										
Household savings ratio (percent)	11.2	9.0	11.2	11.3	11.8	11.8	13.2	13.6	13.4	-
Gross disposable income	63,548	63,459	63,161	61,829	60,948	61,103	60,248	59,903	60,034	-
Personal income	51,060	50,994	49,578	48,913	48,737	49,368	49,386	49,751	50,800	53,693
Corporate sector										
Business investment	11.9	11.3	11.8	10.5	10.3	10.7	11.5	11.7	12.0	-
Investment rate NFCs (percent)	22.5	20.9	22.4	19.5	19.0	19.6	21.2	21.4	21.4	-
Gross profit share NFCs (percent)	33.3	33.6	35.1	35.6	35.3	34.9	35.7	35.0	34.3	-
Net return after taxes NFCs (percent)	5.4	3.0	5.6	7.8	9.1	10.1	11.7	11.4	11.4	-
Banking sector (percent)										
Share of housing loans in bank credit to the private sector	31.8	33.0	38.5	43.6	46.7	49.5	51.0	52.6	53.8	54.0
Share of nonperforming loans in total loans	11.8	15.2	13.3	11.7	10.0	5.1	3.2	6.0	3.4	3.0
Ratio of nonperforming loans net of provisions to capital	71.0	85.8	55.3	36.7	25.0	10.8	6.3	12.6	5.2	4.1
Liquid assets to total short-term liabilities	40.3	43.5	45.6	62.9	54.8	53.5	51.9	32.5	34.0	36.1
Return on assets	-0.9	-1.5	-7.3	-0.2	0.5	1.1	1.2	1.4	1.5	1.4
Return on equity	-11.8	-19.6	-97.6	-1.9	4.2	8.8	9.8	11.5	12.0	12.6
Regulatory capital to risk-weighted assets	11.9	11.4	13.7	18.0	18.8	19.2	18.2	17.9	18.5	18.3

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

Table 5. Slovenia: Core Financial Soundness Indicators, 2012–20

(Percent unless indicated otherwise)

	2012	2013	2014	2015	2016	2017	2018	2019	2020
Capital									
Regulatory capital to risk-weighted assets	11.4	14.1	18.0	18.8	19.2	18.2	17.9	18.5	18.3
Regulatory Tier 1 capital to risk-weighted assets	9.8	13.3	17.3	18.1	18.7	17.8	17.6	17.8	16.7
Profitability									
Return on assets	-1.5	-7.1	-0.2	0.5	1.1	1.2	1.4	1.5	1.4
Return on equity	-19.6	-94.9	-1.9	4.2	8.8	9.8	11.5	12.0	12.6
Interest margin to gross income	58.0	53.9	55.4	57.4	54.2	55.3	52.2	52.3	43.1
Noninterest expenses to gross income	63.9	77.2	60.9	66.7	83.9	87.1	65.9	64.1	53.7
Liquidity									
Liquid assets to total assets	14.7	17.5	27.8	26.7	29.4	30.5	24.1	26.0	27.9
Liquid assets to short-term liabilities	43.5	45.6	62.9	54.8	53.5	51.9	32.5	34.0	36.1
Sensitivity to market risk									
Net open position in foreign exchange to capital	-2.7	-4.0	-1.1	0.9	0.6	10.8	12.0	10.7	21.7
Asset quality									
Nonperforming loans to total gross loans	15.2	13.3	11.7	10.0	5.1	3.2	6.0	3.4	3.0
Non-performing loans net of provisions to capital	85.8	55.6	36.7	25.0	10.8	6.3	12.6	5.2	4.1
Sectoral distribution of loans									
Central Bank	2.2	4.5	4.3	5.1	7.2	8.8	12.1	14.7	23.1
General Government	8.6	9.3	10.3	10.5	9.8	9.0	5.5	5.0	4.4
Financial corporations	12.1	9.7	8.2	6.8	6.0	6.5	7.8	7.1	4.8
Nonfinancial Corporations	44.8	40.1	35.3	34.4	32.8	32.5	36.2	34.6	31.7
Other Domestic Sectors	21.0	23.3	25.4	27.8	30.1	31.7	38.4	38.6	36.0
Nonresidents	11.2	13.0	16.5	15.4	14.1	11.6	-	-	-

Sources: Bank of Slovenia and IMF FSI.

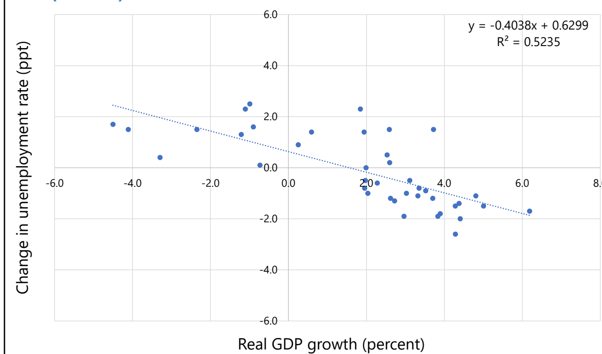
Annex I. Key Measures in Response to COVID-19

Measure	Description	Objectives
Healthcare	Emergency spending on healthcare, including purchase of protective equipment, medical supplies, COVID-19 tests, and vaccines, as well paying out bonuses to health workers.	Ensure an effective response to the COVID-19 crisis and access to health services.
Labor market	Two main measures: (i) "temporary lay-offs", whereby a wage subsidy of 80 percent but no less than the minimum wage is provided to furloughed workers (100 percent under certain conditions since November); (ii) "short-time work" aimed at maintaining employment through temporarily reducing working hours; the wage subsidy depends on the numbers of hours worked per week.	Maintain employer-employee relations and protect jobs.
Social security contributions	Exemption of payment of social security contributions (SSC) for private sector employees, except those in the finance and insurance sector. The SSC for those workers are covered by the budget.	Reduce the cost of firms that remained operational during the pandemic.
Social assistance	Approximately 30 different measures, including payment of monthly basic income and social security contributions of farmers, self-employed, religious workers, etc., solidarity bonuses for pensioners, students and recipients of social assistance, coverage of kindergarten fees, provision of meals, etc. A temporary unemployment benefit was introduced for those who were not eligible for the regular benefits. Unemployed who lost their jobs as a result of the epidemic also received a one-time solidarity allowance.	Provide support to the vulnerable groups.
Tax deferrals and loan moratoria	Deferral of CIT (in April and May 2020) or payment in installments for all taxes for 24 months. Moratorium on bank loan repayments (principal and interest) for 12 months (reduced to 9 months since end-2020).	Alleviate liquidity pressures
Tourist vouchers	Tourist vouchers to be used domestically in the amount of €200 per adult and €50 per child.	Support tourism
Compensation for fixed costs	Companies experiencing drop in revenue between 40 and 70 percent can receive 0.6 percent of their annual income per month; the compensation for those with loss of revenue more than 70 percent is 1.2 percent.	Cover the fixed costs of companies that cannot operate normally due to the containment measures.
Liquidity support	Financing of large companies and SMEs provided through the Slovenian Export and Development Bank to address problems arising from the fall in demand and disruption of supply chains.	Address liquidity problems
Public guarantees	Public guarantee schemes to banks for (i) loans affected by legislative moratoria (25 percent of deferred installments or 50 percent if borrower's activity was affected by COVID-19 measures) and (ii) new loan agreements concluded after March 12 (70 percent of the principal for large companies and 80 percent for SMEs and micro firms).	Support credit

Annex II. Labor Market Measures and Outcomes

1. Prior to the pandemic, the unemployment rate in Slovenia was on a declining trend. It fell from 10 percent in 2013 to 4.2 percent (seasonally adjusted) in Q1:2020. The lockdown introduced in March 2020 to limit the spread of the coronavirus, however, reversed this trend and put the labor market under considerable strain. Unemployment rose to 5.4 percent in Q2 as companies started to shed labor in response to the shock; it declined by 0.2 percentage points in Q3, after the containment measures were relaxed, and remained broadly unchanged for the rest of the year. In comparison with other EU countries, the pickup in unemployment in Slovenia was relatively moderate as the government adopted quickly comprehensive labor market measures. Based on the historical relationship between real GDP growth and the change in unemployment, without these measures, the unemployment rate would be more than a third higher; however, given the scope and the unprecedented nature of the crisis, this could be an underestimate.

GDP Growth and Change in Unemployment
(2010-19)



Source: Haver Analytics, IMF staff calculations

2. The government introduced two main labor market measures aimed at preserving jobs for the duration of the pandemic: (i) temporary lay-offs (furlough); and (ii) short-time work (STW).

- The furlough scheme was adopted shortly after the COVID-19 outbreak in March 2020 and is targeted primarily at firms which were unable to continue their normal operations due to the lockdown. Eligible firms receive a wage subsidy that covers 80 percent of the salary compensation up to the average wage.[1] To be eligible for the wage subsidy, companies need to demonstrate a decline in revenues by more than 20 percent in 2020 relative to 2019 (increased from 10 percent since last September). The measure is open to all employers, except companies with state participation of more than 70 percent and those in the finance and insurance sector.[2] The measure has been extended till end-May 2021, with a possibility to extend it further till June.

- The purpose of the STW scheme, introduced in June 2020, is to maintain full-time employment by allowing businesses to reduce working hours for their employees. This measure is mostly for businesses that continue to operate during the lockdown but at reduced capacity. Employers

[1] With the latest change from February 2021, the reference point is the October average wage; previously it was the average wage, and prior to November 2020, the maximum amount of the unemployment benefit. Also from November, employers can claim 100 percent reimbursement of the salary compensation if the total amount of state aid does not exceed €1.8 million (previously €0.8 million) per company.

[2] Other exceptions include foreign diplomatic missions and consulates, international organizations, missions of international organizations and institutions, bodies and agencies of the European Union in the Republic of Slovenia.

receive wage subsidies based on the reduction in the working hours of the employees. The subsidy is set as a fixed amount.[3] Eligible are all companies with less than 50 percent state participation if they are unable to provide at least 90 percent of the work to at least 10 percent of the employees in a given month. The measure is in force until end-June 2021, but currently draft legislation is being prepared to make it permanent to ensure a swift policy response to future shocks. It is one of the proposed reforms to be supported by the EU Recovery and Resilience Facility.

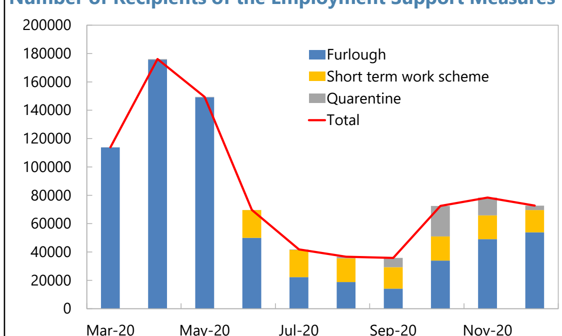
Beneficiaries of the Employment Protection Measures and Amount of Subsidies (as of February, 2021)

Labor market measure	Number of employees	Number of business entities	Wage subsidies (EUR, million)
Temporary layoff	210,564	30,933	415.26
Short-time work	41,933	7,905	36.67

3. The job retention programs have attracted considerable interest. About 210 thousand employees (20 percent of the labor force) were covered by the wage subsidies under the furlough and 42 thousand participated in the STW scheme. The number of employees and the sectoral composition of firms participating in the programs reflect broader economic developments. Thus, for example, the STW uptake was relatively strong by firms in manufacturing in the initial months but as the sector recovered from the shock, the number of beneficiaries declined significantly. On the other hand, hospitality services and trade have maintained a relatively large share in both programs.

4. Besides the furlough and STW, the authorities adopted last year a number of measures to support those who could not benefit from the two programs but were also impacted by the crisis. In particular, compensation of up to 100 percent of the wage was offered to employees under quarantine, self-employed received the minimum basic income, and the government covered the payment of social security contributions for all workers in the private sector (except those in finance and insurance). These measures have helped maintain employment by reducing the pressure on firms operating at reduced capacity. For employees who lost their jobs due to COVID-19 and were not eligible for regular unemployment benefits, the government introduced a temporary unemployment benefit.

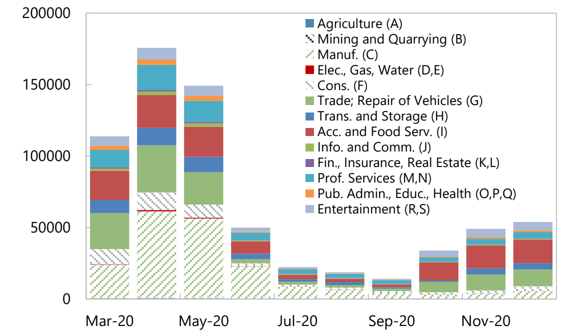
Number of Recipients of the Employment Support Measures



Sources: Employment Service of Slovenia, Ministry of Labor, Family, Social Affairs and Equal Opportunities

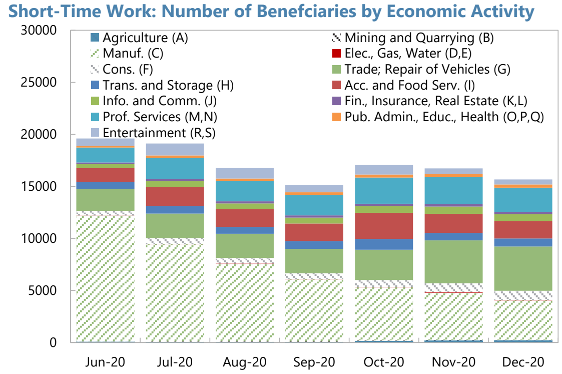
[3] The amounts vary as follows: (i) €448 per month per worker for part-time work from 20 to 24 hours per week; (ii) €336 for 25 to 29 hours per week; (iii) €224 for 30 to 34 hours per week; and (iv) €112 for 35 hours per week. The subsidy is reduced in the case of absence of work (such as sick leave or annual leave).

Furlough: Number of Benefciaries by Economic Activity



Source: Employment Service of Slovenia, Ministry of Labor, Family, Social Affairs and Equal Opportunities

Short-Time Work: Number of Benefciaries by Economic Activity



Source: Employment Service of Slovenia, Ministry of Labor, Family, Social Affairs and Equal Opportunities

5. **In parallel to the job retention schemes, the authorities have been regularly reviewing and adjusting their active labor market programs (ALMPs)** to align them better with the needs of the labor market during and after the COVID-19 pandemic. The Ministry of Labor, Family, Social Affairs and Equal Opportunities (MoLFSAEO) operates an array of ALMPs, targeted at different segments of the labor market and addressing specific needs. These include, among others, programs to increase employability of older workers and delay retirement (ASI), increase competencies and skills among vulnerable groups (non-formal education and training), improve human resource development (KOC), providing education and training for employees at risk of losing their jobs (SPIN) and hiring subsidies for employers (Employ.me 2020 and Incentive for Sustainable Youth Employment). Some of these programs have been adapted to the crisis situation (Employ.me 2020 and Non-formal education and training) and are achieving good results in promoting employment. In December 2020, the Employment Service of Slovenia issued two calls for public works programs to activate long-term unemployed; an estimated 3,000 long-term unemployed would be hired under these programs.

6. **Looking beyond the pandemic,** the authorities plan to develop ALMPs further with a view to supporting labor reallocation in the transition to a "new normal". The main focus will be on training and education to respond to the needs of the labor market; specifically, to reduce the skills mismatch, with an emphasis on the skills for the future, e.g., digital skills. A new project is being prepared by MoLFSAEO in cooperation with relevant stakeholders—Skills Forecasting Platform—to develop a system to forecast future knowledge/skills needs and identify gaps in competences, as well as to connect stakeholders to ensure that the labor market responds to the changing economic conditions.

Annex III. Risk Assessment Matrix

Source of Risk	Likelihood of Risk	Expected Impact	Policy Response
Unexpected shifts in the COVID-19 pandemic. The disease proves harder to eradicate (e.g., due to new virus strains, short effectiveness of vaccines, or widespread unwillingness to take them), requiring costly containment efforts and prompting persistent behavioral changes rendering many activities unviable.	**Medium**	**High** Demand will remain weak for a longer period and the pressure on firms in affected sectors, especially in contact-intensive services will increase, leading to more bankruptcies and higher unemployment, with likely effects on the banking sector.	Continue monitoring, maintain partial to full containment measures, provide additional resources to healthcare, increase testing and step up vaccination, if possible. Continue with targeted support to affected firms and households, in particular to the vulnerable groups.
Sharp rise in global risk premia exposes financial and fiscal vulnerabilities. Higher risk premia generate financing difficulties for leveraged firms and households and financing difficulties extend to sovereigns.	**Medium**	**Medium** Tightening of financing conditions will affect the cost of borrowing for the government but the impact is mitigated by long maturities and buffers. High savings and low corporate sector leverage would limit the impact.	Continue active asset-liability management. Accelerate absorption of available EU funds to finance public investment. Provide liquidity support to viable firms.
Widespread social discontent and political instability. Social tensions erupt as the pandemic and inadequate policy response cause socio-economic hardship. Growing political polarization and instability weaken policymaking and confidence.	**High**	**Medium** A prolonged lockdown in combination with rising unemployment and falling incomes could increase the tensions in society and lead to protests.	Maintain job retention schemes where possible and facilitate labor reallocation. Expand unemployment benefits coverage and social support for the most vulnerable groups.
Accelerating de-globalization. Despite renewed efforts to reach multilateral solutions to existing tensions, geopolitical competition leads to further fragmentation.	**Medium**	**High** Slovenia is highly integrated in the global economy and reduced trade would have a significant impact on potential growth.	Accelerate structural reforms to boost investment, productivity, and competitiveness.

Source of Risk	Likelihood of Risk	Expected Impact	Policy Response
Weaker growth in main trading partners. Recovery of main trading partners is delayed.	**High**	**High** Weak external demand will significantly impact Slovenia's near-term growth outlook due to the country's high trade openness.	Increase EU-funded public investment, notably from the RRF, to prop up domestic demand. Continue to provide assistance to low-income households to support private consumption.
A wave of bankruptcies in sectors affected by COVID-19. Demand decreases permanently in contact-intensive services, causing bankruptcies and deterioration of banks' asset quality.	**Medium**	**Medium** If demand in important sectors like tourism and transport does not recover, firms will be forced to exit the market and NPLs will rise. Banks' current strong capital and liquidity positions are a mitigating factor.	Monitor closely the developments in affected sectors and banks' balance sheets. Use available buffers in the banking system, secure the swift liquidation of insolvent companies and ensure that the solvent ones continue to have access to credit.
Slow absorption of the NGEU funds. Capacity constraints delay the implementation of public investment projects.	**Medium**	**High** EU-funded capital spending is set to be one of the main drivers of growth in the near- and medium-term.	Project appraisal should be expedited, and selection should be based on their economic, social, and environmental impact, as well as the timeframe for implementation. Capacity constraints to quickly scale up public investment should be identified and addressed early in the process.

Annex IV. External Sector Assessment

Foreign Assets and Liabilities	*Background:* Slovenia's NIIP reached -16.3 percent of GDP at the end of 2020 compared to -15.4 percent of GDP in 2019. In 2020, foreign assets reached 135.6 percent of GDP and foreign liabilities 151.9 percent of GDP. The NIIP has been gradually improving since the global financial crisis (GFC), supported by the current account surplus as investment and consumption were reduced. The external debt ratio, estimated at 104.1 percent of GDP, increased by 13.6 percent of GDP from 2019, mainly on the back of new government debt and lower GDP. The banking sector continued deleveraging and its external debt declined by 1 percent. *Assessment:* The NIIP is negative and the current account surplus should be viewed from this perspective.	**Overall Assessment:** The external position of Slovenia in 2020 was substantially stronger than the level implied by medium term fundamentals and desirable policies. Private sector deleveraging and precautionary and forced savings explain the deviation from the norm. As the NIIP is still relatively large and negative, the current account surplus is helping to improve the negative NIIP. **Policy Responses:** Slovenia's current account surplus is expected to moderate as consumption and investment fully recover from the current crisis.
Current Account	*Background:* Slovenia's current account balance shifted significantly from -4.1 percent of GDP to 7.1 percent of GDP between 2007 and 2020. The improvement was driven mainly by strong exports growth and the concomitant and temporary collapse in investment and consumption in the aftermath of the GFC. Oil imports contracted in 2020 by about €1.1 billion (2.4 percent of GDP), offsetting the decline in exports of travel services. Hence, the current account surplus reflects the temporary rise in the private sector's saving, boosted by precautionary and forced savings due to COVID-19. The negative NIIP elicits high outflows in the primary income account related to a significant stock of FDIs. *Assessment:* The EBA-lite current account model, adjusted for lower tourism (-1.8 percent of GDP) and lower oil imports (-2.4 percent of GDP, finds that the current account surplus is 5.7 percentage points higher than implied by medium term fundamentals and desirable policies. Actual CA: 7.1 Cyclically adjusted CA: 7.5 CA Norm: 1.7 CA gap: 5.7 Policy Gap: 2.0	
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. However, during 2020 the REER had an appreciation of 0.6 percent, mostly due to slightly lower inflation in Slovenia compared to its trading partners. *Assessment:* Using standard elasticities at -0.55 for trade to the REER, the current account gap implies a 10.3 percent REER undervaluation, while the REER model does not suggest a gap. However, considering the poor fit of the REER model for Slovenia in a context of large imbalances following the COVID-19 crisis, the overall assessment relies on the current account model. Relatively modest movements in the REER over the last 25 years also suggest that temporary factors related to COVID-19 are primarily responsible for the deviation of the current account from its norm in 2020. Actual REER: 4.57 REER Norm: 4.57 REER gap: -0.007 Implied REER gap (from CA model): -10.3	
Capital and Financial Accounts	*Background:* Current account surpluses since 2012 occurred as the banking and corporate sectors accumulated assets and reduced investment liabilities. Inward FDI flows, near zero in 2012, are estimated at 1.7 percent of GDP in 2020. Government external debt, which reached a peak of 64 percent of GDP in 2015, gradually declined until 2019. Due to COVID-19, government's external debt swelled by 9 percent of GDP and reached 54 percent of GDP at end-2020. It is expected to decline only gradually over the forecast horizon. *Assessment:* Slovenia has reduced net external liabilities, particularly through deleveraging by banks and the acquisition of portfolio assets abroad. As demand and imports pick up more quickly than exports, Slovenia's current account surplus is expected to contract in the medium term.	
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 V. External Debt Sustainability Analysis

1. **Slovenia's external debt declined in recent years but is expected to remain high over the forecast horizon due to the gradual normalization after the COVID-19 crisis.** From 2014 to 2019, the external debt ratio fell by over 30 percentage points, reaching 90.5 percent of GDP in 2019. This was mainly due to bank deleveraging following the 2013 banking crisis and the decline in public debt. However, in 2020 the external debt ratio rose again to 104.1 percent, mainly on account of higher public external borrowing and a decline in GDP. Over the medium term, external debt is expected to gradually decline as percent of GDP to below 90 percent.

2. **The net international investment position (NIIP) remains negative and is expected to gradually decline in the medium term.** The corporate sector deleveraged in recent years, while FDI inflows in Slovenia created a strong export-oriented industrial sector, benefiting from tight association with European global supply chains (e.g., automobiles and pharmaceutical products). More recently, private savings increased on the back of withheld consumption and precautionary savings, resulting in a widening current account surplus. 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 IV).

3. **External debt remains sustainable under a range of standard shocks.** The context of COVID-19 has made the external assessment considerably more delicate and complex. Slovenia was confronted with an unprecedented real shock, disruptions in external markets, and stalling financial flows, amid large uncertainties. In staff's analysis, Slovenia's external debt is mainly vulnerable to a real depreciation by 30 percent, which would substantially increase the debt ratio. Other standard shocks would yield more manageable debt levels, within a 10-percentage point range (Figure).

Table 1. Slovenia: External Debt Sustainability Framework, 2016–26

(Percent of GDP, unless otherwise indicated)

	Actual							Projections						
	2016	2017	2018	2019	2020			2021	2022	2023	2024	2025	2026	**Debt-stabilizing non-interest current account 6/**
Baseline: External debt	104.4	105.4	88.6	89.8	111.0			**103.8**	**98.4**	**94.9**	**92.0**	**89.5**	**87.1**	**-8.2**
Change in external debt	-12.1	0.9	-16.8	1.3	21.2			-7.2	-5.5	-3.5	-2.9	-2.5	-2.4	
Identified external debt-creating flows (4+8+9)	-11.3	-15.7	-20.0	-7.3	-4.9			-23.7	-18.2	-16.8	-15.0	-13.2	-12.4	
Current account deficit, excluding interest payments	-7.7	-8.7	-8.0	-7.7	-9.1			-8.8	-8.7	-8.0	-7.2	-6.5	-5.9	
Deficit in balance of goods and services	-8.6	-9.0	-8.5	-8.5	-9.7			-8.8	-8.5	-7.9	-6.9	-6.0	-5.1	
Exports	77.6	83.2	84.9	83.8	78.8			83.2	84.7	85.2	85.9	86.0	85.5	
Imports	69.1	74.2	76.3	75.3	69.1			74.4	76.2	77.3	79.1	80.0	80.4	
Net non-debt creating capital inflows (negative)	-2.3	-1.2	-3.2	-1.7	-0.1			-13.3	-7.4	-7.4	-6.9	-6.0	-5.8	
Automatic debt dynamics 1/	-1.3	-5.7	-8.8	2.1	4.3			-1.6	-2.0	-1.5	-0.9	-0.6	-0.7	
Contribution from nominal interest rate	3.0	2.5	2.1	2.1	2.0			2.3	2.4	1.9	1.9	1.8	1.7	
Contribution from real GDP growth	-3.6	-4.6	-4.1	-2.8	5.1			-3.8	-4.4	-3.4	-2.8	-2.4	-2.4	
Contribution from price and exchange rate changes 2/	-0.7	-3.6	-6.8	2.8	-2.8			...	...	...	...	...	...	
Residual, incl. change in gross foreign assets (2-3) 3/	-0.8	16.6	3.2	8.6	26.1			16.5	12.7	13.3	12.2	10.7	10.0	
External debt-to-exports ratio (in percent)	134.5	126.7	104.3	107.2	140.8			124.8	116.1	111.4	107.0	104.1	101.8	
Gross external financing need (in billions of US dollars) 4/	10.3	10.2	11.1	10.8	11.0			14.5	14.3	15.7	16.4	16.9	16.8	
in percent of GDP	22.9	21.0	20.4	20.0	20.9	10-Year	10-Year	24.5	22.5	23.4	23.3	22.9	21.8	
Scenario with key variables at their historical averages 5/								**103.8**	**112.9**	**122.3**	**131.1**	**138.9**	**146.5**	**0.0**
						Historical	Standard							
Key Macroeconomic Assumptions Underlying Baseline						Average	Deviation							
Real GDP growth (in percent)	3.2	4.8	4.4	3.2	-5.5	1.2	3.3	3.9	4.5	3.6	3.1	2.8	2.8	
GDP deflator in US dollars (change in percent)	0.6	3.6	6.9	-3.1	3.2	0.0	7.0	7.7	2.8	1.8	1.8	1.9	2.0	
Nominal external interest rate (in percent)	2.6	2.6	2.3	2.4	2.2	2.4	0.2	2.3	2.4	2.0	2.1	2.0	2.0	
Growth of exports (US dollar terms, in percent)	4.7	16.2	13.9	-1.2	-8.3	3.5	10.4	18.1	9.4	6.1	6.0	4.8	4.4	
Growth of imports (US dollar terms, in percent)	4.0	16.5	14.9	-1.4	-10.5	2.4	11.4	20.4	10.1	7.0	7.4	6.0	5.4	
Current account balance, excluding interest payments	7.7	8.7	8.0	7.7	9.1	6.8	2.2	8.8	8.7	8.0	7.2	6.5	5.9	
Net non-debt creating capital inflows	2.3	1.2	3.2	1.7	0.1	1.8	1.0	13.3	7.4	7.4	6.9	6.0	5.8	

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

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

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

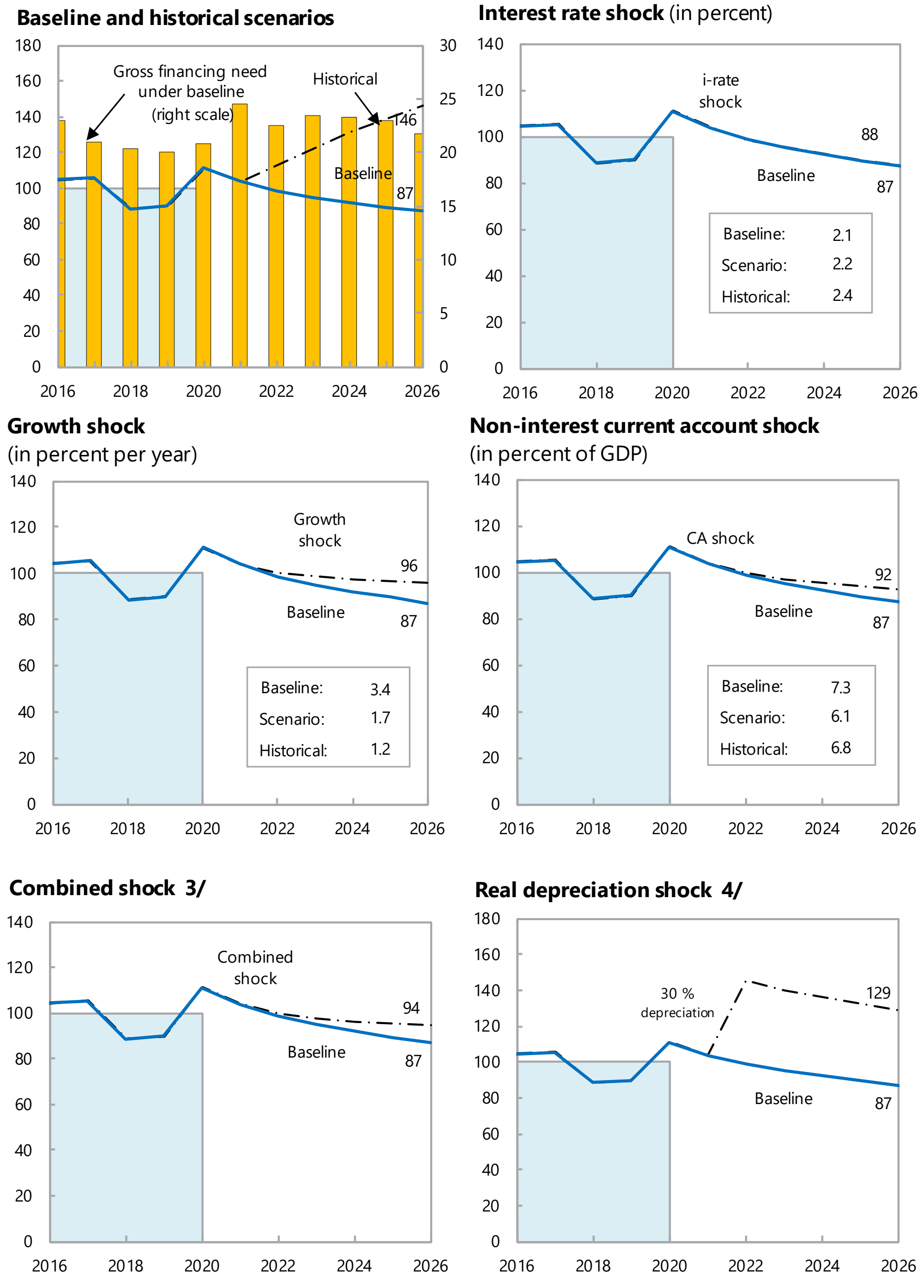
4/ Defined as current account deficit, plus amortization on medium- and long-term debt, plus short-term debt at end of previous period.

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

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

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

(External debt in percent of GDP)



Sources: International Monetary Fund, Country desk data, and staff estimates.
1/ Shaded areas represent actual data. Individual shocks are permanent one-half standard deviation shocks. Figures in the boxes represent average projections for the respective variables in the baseline and scenario being presented. Ten-year historical average for the variable is also shown.
2/ For historical scenarios, the historical averages are calculated over the ten-year period, and the information is used to project debt dynamics five years ahead.
3/ Permanent 1/4 standard deviation shocks applied to real interest rate, growth rate, and current account balance.
4/ One-time real depreciation of 30 percent occurs in 2021.

Annex VI. Public Sector Debt Sustainability Analysis

Slovenia's public debt increased sharply in 2020 due to the authorities' policy response to the COVID-19 outbreak. The public debt-to-GDP ratio rose from 65.6 percent in 2019 to 80.8 percent in 2020. Debt remains sustainable and is projected to decline gradually as percent of GDP over the medium term. Combined macro-fiscal shocks and shocks to contingent liabilities pose major risks to the baseline scenario. They could push up public debt to over 90 percent of GDP and put it on a rising trajectory. This calls for active measures to mitigate pressures on the debt ratio after the pandemic is over and the recovery is well-established. To rebuild room for fiscal policy maneuver, fiscal policy will need to move toward fiscal balance over the medium term and structural reforms need to support sustained growth.

1. Fiscal consolidation and robust growth helped Slovenia to reduce public debt significantly during 2016–19, but the debt ratio rose steeply in 2020 due to COVID-19. The authorities' recapitalization of banks following the 2013 banking sector crisis resulted in a spike in public debt to close to 83 percent of GDP in 2015. Decisive fiscal consolidation measures and strong growth underpinned a steady decline of the debt ratio to 65.6 percent of GDP in 2019. However, the trend was abruptly reversed in 2020 when the combination of a sharp contraction of economic activity and the authorities' policy response to the coronavirus pandemic caused debt to jump by about 15 percent of GDP to 80.8 percent. The authorities are taking advantage of the favorable market conditions and are issuing more debt than implied by the government's financing needs. Pre-financing executed in 2020 amounted to €3.5 billion; in January 2021 they issued a €1.75 billion 10-year bond with a negative yield (-0.1 percent) and a €500 million 60-year bond at 0.7 percent. They are implementing active liability management and are building cash buffers. Nevertheless, in the absence of active consolidation policies, staff projects the debt ratio to remain elevated in the medium term, mitigated by debt service that would be relatively low.

2. The baseline scenario assumes a gradual recovery and withdrawal of stimulus measures. It is based on the following assumptions:

- Economic activity is expected to remain weak in Q1:2021 due to the continuing lockdown, and real GDP growth for this year is projected at 3.9 percent. The recovery would gather speed in 2022 when growth accelerates to 4.5 percent, before returning gradually to close to potential. Domestic demand would be the main driver of growth, especially investment which would benefit from the NGEU funds. Inflation is expected to converge to 2 percent in the medium term.

- With most of the COVID-19 containment measures still in place, support to the economy would continue at least into Q2 which, in combination with the authorities' plans for significantly stepping up public investment, would keep the fiscal deficit at an elevated level this year. There is still some uncertainty regarding the application of the fiscal rules beyond 2021, and the authorities currently are focusing on responding to the crisis. Staff's projections are based on the assumption that over time, most revenue and expenditure categories would move toward their pre-crisis levels relative to GDP.

- The baseline projections are underpinned by realistic assumptions. Over 2011–19, staff projections of the main macroeconomic variables were close to or more conservative than the median, except for the crisis period around 2012–13. In the recent years before the COVID-19 outbreak, growth and fiscal outturns have exceeded projections on average. In addition, the projected fiscal adjustments are close to the median of those achieved in comparator countries.

3. Slovenia's public debt remains sustainable but the debt dynamics are vulnerable to specific shocks as suggested by stress tests:

- **A shock to GDP growth would worsen the debt ratio significantly.** A negative one-standard deviation growth shock over two years would push the debt-to-GDP ratio to 92 percent by 2023. This illustrates the sensitivity of debt dynamics to the assumptions about the pace and strength of the economic recovery and underscores the need to carefully calibrate the fiscal policy actions.

- **Contingent fiscal liabilities are a potential source of vulnerability.** The total amount of government guarantees outstanding as of 2020 was €5.1 billion (11 percent of GDP), which includes €2.2 billion in loan guarantees provided as part of the COVID-19 policy response. A specific contingent liability shock could create a rising trajectory of public debt, which would approach 100 percent of GDP by 2026.

- **A combined macro-fiscal shock would result in high and persistent public debt.** The combination includes shocks to GDP growth, inflation, fiscal balance, exchange rate, and interest rate spread. In such an adverse scenario the debt ratio would rise to 93 percent of GDP and remain at this level throughout the projection period. This underscores the importance of a credible fiscal policy and measures to boost productivity in the medium term.

4. While the debt level remains high and vulnerable to shocks, there are mitigating factors. The share of foreign currency debt is very small (less than 4 percent of total) and it is fully hedged. Over 30 percent of the central government debt has residual maturity of more than 10 years and 99 percent is at fixed interest rates. In addition, the government has sizeable cash holdings which can be used to cushion adverse market developments.

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

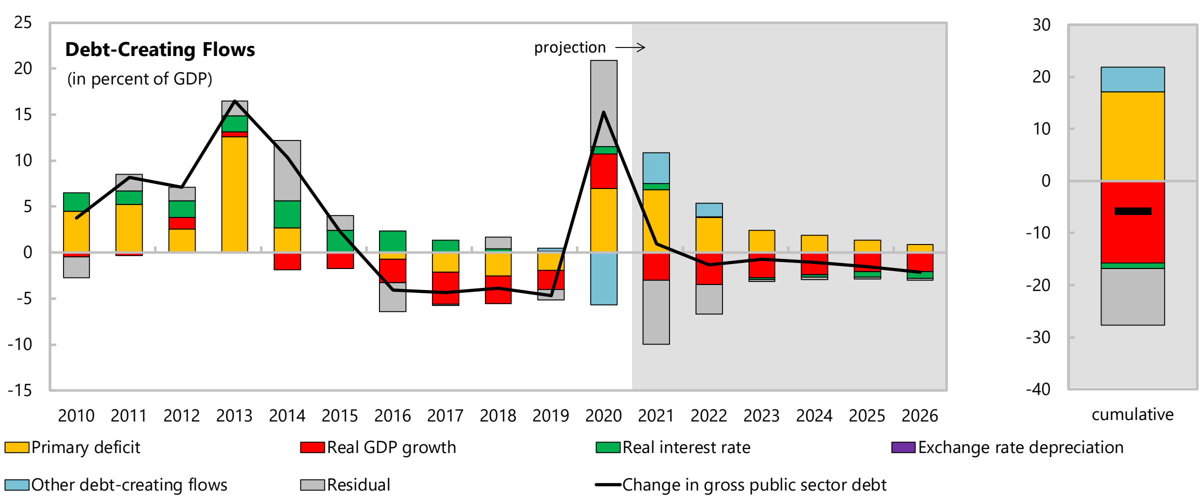
(in percent of GDP unless otherwise indicated)

Debt, Economic and Market Indicators [1]

	Actual			Projections						As of April 05, 2021		
	2010-2018 [2]	2019	2020	2021	2022	2023	2024	2025	2026	Sovereign Spreads		
Nominal gross public debt	66.0	65.6	80.8	81.8	80.5	79.7	78.7	77.1	75.0	EMBIG (bp) 3/		31
Public gross financing needs	16.3	5.6	12.7	15.0	9.7	10.2	9.4	8.2	6.0	5Y CDS (bp)		68
Real GDP growth (in percent)	1.8	3.2	-5.5	3.9	4.5	3.6	3.1	2.8	2.8	Ratings	Foreign	Local
Inflation (GDP deflator, in percent)	0.9	2.3	1.3	0.9	1.4	1.6	1.7	1.9	2.1	Moody's	A3	A3
Nominal GDP growth (in percent)	2.7	5.5	-4.3	4.8	6.0	5.2	4.9	4.8	4.9	S&Ps	AA-	AA-
Effective interest rate (in percent) [4]	4.2	2.6	2.4	1.9	1.6	1.4	1.4	1.2	1.1	Fitch	A	A

Contribution to Changes in Public Debt

	Actual			Projections							
	2010-2018	2019	2020	2021	2022	2023	2024	2025	2026	cumulative	debt-stabilizing
Change in gross public sector debt	4.0	-4.7	15.2	0.9	-1.3	-0.7	-1.0	-1.6	-2.1	-5.8	primary
Identified debt-creating flows	3.0	-3.6	5.9	7.9	1.9	-0.5	-0.8	-1.3	-1.9	5.2	balance [9]
Primary deficit	2.5	-1.9	6.9	6.8	3.8	2.4	1.9	1.3	0.9	17.1	-2.8
Primary (noninterest) revenue and grants	44.4	43.5	43.4	43.7	43.7	43.2	42.6	42.7	42.7	258.5	
Primary (noninterest) expenditure	46.9	41.6	50.3	50.5	47.5	45.6	44.4	44.0	43.5	275.6	
Automatic debt dynamics [5]	0.5	-2.0	4.6	-2.3	-3.4	-2.9	-2.7	-2.7	-2.8	-16.7	
Interest rate/growth differential [6]	0.5	-2.0	4.6	-2.3	-3.4	-2.9	-2.7	-2.7	-2.8	-16.7	
Of which: real interest rate	1.8	0.2	0.8	0.7	0.1	-0.2	-0.3	-0.6	-0.7	-1.0	
Of which: real GDP growth	-1.3	-2.1	3.8	-3.0	-3.5	-2.8	-2.4	-2.1	-2.0	-15.7	
Exchange rate depreciation [7]	0.0	0.0	0.0	…	…	…	…	…	…	…	
Other identified debt-creating flows	0.0	0.3	-5.7	3.3	1.5	0.0	0.0	0.0	0.0	4.8	
Privatization/Drawdown of Deposits	0.0	0.3	-5.7	3.3	1.5	0.0	0.0	0.0	0.0	4.8	
Contingent liabilities	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	
Other debt-creating flows	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	
Residual, including asset changes [8]	1.0	-1.1	9.4	-6.9	-3.2	-0.2	-0.2	-0.2	-0.2	-11.0	



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 $[(r - \pi(1+g) - g + ae(1+r)]/(1+g+\pi+g\pi))$ 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 $r - \pi (1+g)$ and the real growth contribution as $-g$.

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

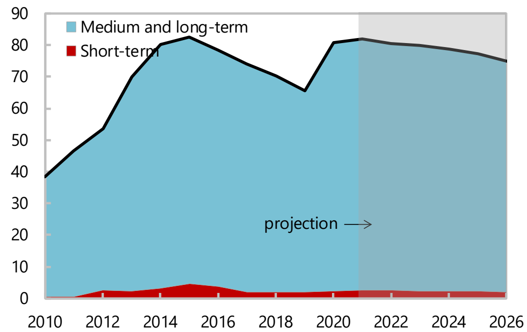
8/ Includes asset changes and interest revenues (if any). For projections, includes exchange rate changes during the projection period.

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.

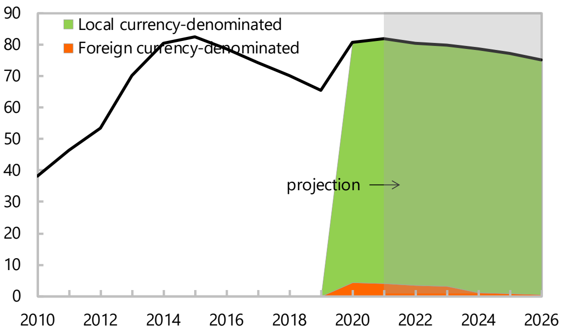
Figure 2. Slovenia: Public DSA—Composition of Public Debt and Alternative Scenarios

Composition of Public Debt

By Maturity
(in percent of GDP)



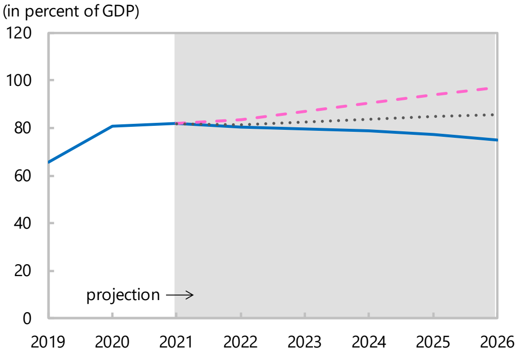
By Currency
(in percent of GDP)



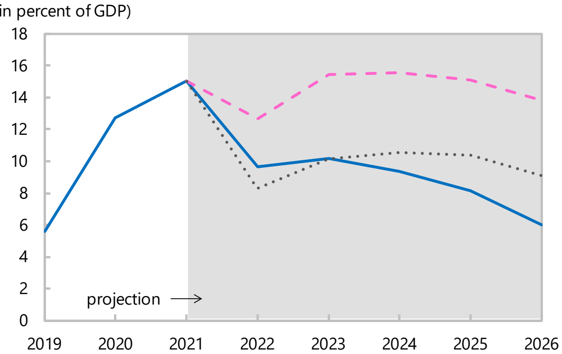
Alternative Scenarios

Baseline Historical Constant Primary Balance

Gross Nominal Public Debt
(in percent of GDP)



Public Gross Financing Needs
(in percent of GDP)



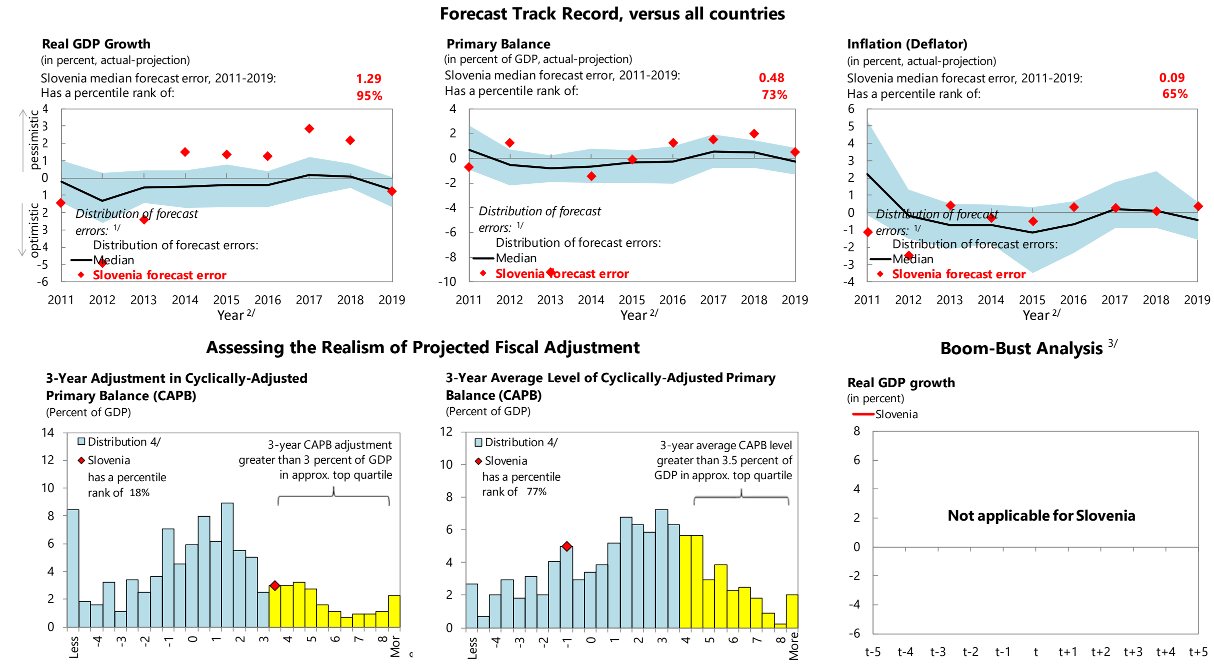
Underlying Assumptions
(in percent)

Baseline Scenario	2021	2022	2023	2024	2025	2026
Real GDP growth	3.9	4.5	3.6	3.1	2.8	2.8
Inflation	0.9	1.4	1.6	1.7	1.9	2.1
Primary Balance	-6.8	-3.8	-2.4	-1.9	-1.3	-0.9
Effective interest rate	1.9	1.6	1.4	1.4	1.2	1.1
Constant Primary Balance Scenario						
Real GDP growth	3.9	4.5	3.6	3.1	2.8	2.8
Inflation	0.9	1.4	1.6	1.7	1.9	2.1
Primary Balance	-6.8	-6.8	-6.8	-6.8	-6.8	-6.8
Effective interest rate	1.9	1.6	1.4	1.3	1.1	1.1

Historical Scenario	2021	2022	2023	2024	2025	2026
Real GDP growth	3.9	1.2	1.2	1.2	1.2	1.2
Inflation	0.9	1.4	1.6	1.7	1.9	2.1
Primary Balance	-6.8	-2.3	-2.3	-2.3	-2.3	-2.3
Effective interest rate	1.9	1.6	1.6	1.8	1.9	2.0

Source: IMF staff.

Figure 3. Slovenia: Public DSA—Realism of Baseline Assumptions



Source : IMF Staff.

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

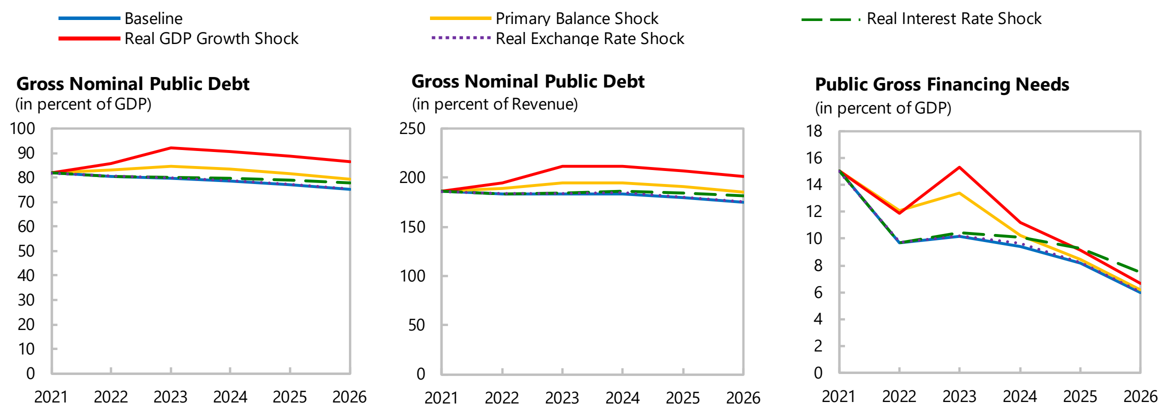
2/ Projections made in the spring WEO vintage of the preceding year.

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

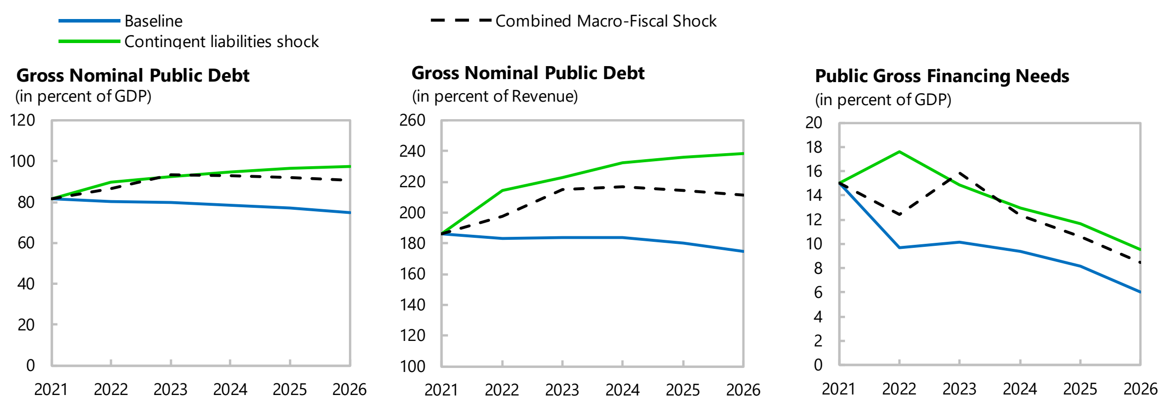
4/ Data cover annual obervations from 1990 to 2011 for advanced and emerging economies with debt greater than 60 percent of GDP. Percent of sample on vertical axis.

Figure 4. Slovenia: Public DSA—Stress Tests

Macro-Fiscal Stress Tests



Additional Stress Tests



Underlying Assumptions

(in percent)

	2021	2022	2023	2024	2025	2026
Primary Balance Shock						
Real GDP growth	3.9	4.5	3.6	3.1	2.8	2.8
Inflation	0.9	1.4	1.6	1.7	1.9	2.1
Primary balance	-6.8	-6.3	-4.8	-1.9	-1.3	-0.9
Effective interest rate	1.9	1.6	1.5	1.4	1.3	1.2
Real Interest Rate Shock						
Real GDP growth	3.9	4.5	3.6	3.1	2.8	2.8
Inflation	0.9	1.4	1.6	1.7	1.9	2.1
Primary balance	-6.8	-3.8	-2.4	-1.9	-1.3	-0.9
Effective interest rate	1.9	1.6	1.8	2.2	2.4	2.7
Combined Shock						
Real GDP growth	3.9	1.2	0.3	3.1	2.8	2.8
Inflation	0.9	0.6	0.7	1.7	1.9	2.1
Primary balance	-6.8	-6.3	-6.3	-1.9	-1.3	-0.9
Effective interest rate	1.9	1.6	1.9	2.3	2.6	2.8

	2021	2022	2023	2024	2025	2026
Real GDP Growth Shock						
Real GDP growth	3.9	1.2	0.3	3.1	2.8	2.8
Inflation	0.9	0.6	0.7	1.7	1.9	2.1
Primary balance	-6.8	-5.8	-6.3	-1.9	-1.3	-0.9
Effective interest rate	1.9	1.6	1.5	1.5	1.3	1.3
Real Exchange Rate Shock						
Real GDP growth	3.9	4.5	3.6	3.1	2.8	2.8
Inflation	0.9	1.8	1.6	1.7	1.9	2.1
Primary balance	-6.8	-3.8	-2.4	-1.9	-1.3	-0.9
Effective interest rate	1.9	1.6	1.4	1.4	1.2	1.1

Source: IMF staff.

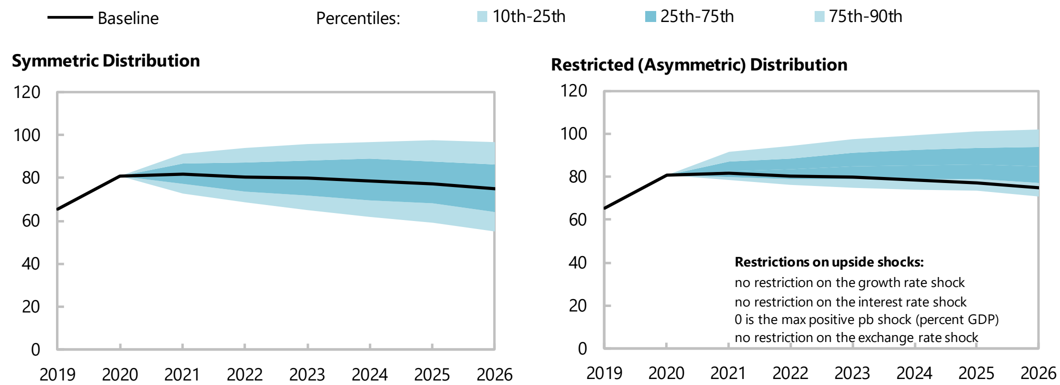
Slovenia: Public DSA—Risk Assessment

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

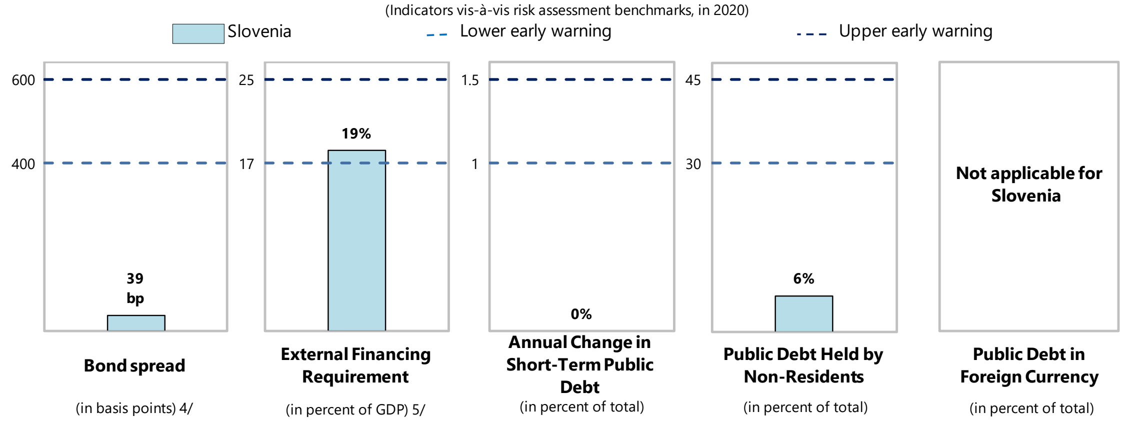
Evolution of Predictive Densities of Gross Nominal Public Debt

(in percent of GDP)



Debt Profile Vulnerabilities

(Indicators vis-à-vis risk assessment benchmarks, in 2020)



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, 05-Jan-21 through 05-Apr-21.

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.

INTERNATIONAL MONETARY FUND

REPUBLIC OF SLOVENIA

STAFF REPORT FOR THE 2021 ARTICLE IV CONSULTATION—INFORMATIONAL ANNEX

May 3, 2021

Prepared By

European Department
(In Consultation with Other Departments)

CONTENTS

FUND RELATIONS

(As of February 28, 2021)

Membership Status: Joined December 14,1992; Article VIII

General Resources Account:

	SDR Million	Percent of Quota
Quota	586.5	100
Fund holdings of currency	441.56	75.29
Reserve position	144.96	24.72
Lending to the Fund		
Borrowing Agreement		

SDR Department:

	SDR Million	Percent of Allocation
Net cumulative allocation	215.88	100.00
Holdings	199.07	92.21

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	0.01	0.01	0.01	0.01	0.01
Total	0.01	0.01	0.01	0.01	0.01

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. Discussions were conducted by video conference during March 8–19, 2021 with the Bank of Slovenia Governor Boštjan Vasle, Minister of Finance Andrej Šircelj, President Robert Polnar and members of the parliamentary committee on finance and monetary policy, other senior officials, representatives of the private sector and labor unions. The team also held a conference call with the Single Supervisory Mechanism. Mr. Pucnik (OED) attended most meetings and Mr. Palotai (OED) joined the concluding meeting.

The mission comprised Mr. Akitoby (Head), Ms. Hassine, Mr. Rozenov and Ms. Sandhu (all EUR). The mission held a press conference on March 19, 2021.

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, 2001–21

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 Performance Information to Support Better Budgeting
	October 2004	Strengthening the Public Financial Management Framework
	April 2014	
	May 2015	Establishing a Spending Review Process
	October 2015	The 2013 Property Tax Act: Evaluation of its Design and the Employed Mass Valuation System Estimating Fiscal Multipliers of Public Investment
	December 2020	
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 joined the Special Data Dissemination Standard Plus (SDDS Plus) — the highest tier of the Data Standards Initiatives — in February 2020, and posts its metadata on the Fund's Dissemination Standards Bulletin Board on the Internet: https://dsbb.imf.org/sddsplus/country/SVN/category

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 2019. 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 and international investment position data are comprehensive and of high quality. 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 April 2021)

	Date of Latest Observation	Date Received or Posted	Frequency of Data[6]	Frequency of Reporting[6]	Frequency of Publication[6]
Exchange Rates	04/2021	04/2021	D	D	D
International Reserve Assets and Reserve Liabilities of the Monetary Authorities[1]	03/2021	04/2021	M	M	M
Reserve/Base Money	03/2021	04/2021	M	M	M
Broad Money	03/2021	04/2021	M	M	M
Central Bank Balance Sheet	03/2021	04/2021	M	M	M
Consolidated Balance Sheet of the Banking System	03/2021	04/2021	M	M	M
Interest Rates[2]	04/2021	04/2021	D	D	D
Consumer Price Index	03/2021	04/2021	M	M	M
Revenue, Expenditure, Balance and Composition of Financing[3] – General Government[4]	02/2021	04/2021	M	M	M
Revenue, Expenditure, Balance and Composition of Financing[3]– Central Government	02/2021	04/2021	M	M	M
Stocks of Central Government and Central Government-Guaranteed Debt[5]	02/2021	04/2021	M	M	M
External Current Account Balance	02/2021	04/2021	M	M	M
Merchandise Trade	02/2021	04/2021	M	M	M
GDP/GNP	Q4:2020	03/2021	Q	Q	Q
Gross External Debt	02/2021	04/2021	M	M	M
International Investment Position	Q4:2020	03/2021	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).

Statement by Daniel Palotai, Executive Director for the Republic of Slovenia and Miha Pucnik, Advisor the Executive Director
May 19, 2021

On behalf of our Slovenian authorities, we would like to thank staff for the constructive dialogue during the 2021 Article IV Consultation with Slovenia, and for their comprehensive and candid analysis. The Slovenian authorities broadly agree with staff's assessment of the economic developments and outlook in Slovenia, as well as with the policy challenges.

Economic performance and outlook

Slovenia had been experiencing solid economic growth and a strong fiscal position in the years prior to the COVID-19 pandemic. The gap in economic development with the EU average had been gradually narrowing and employment reached record highs. This was reflected in higher household income, favorable labor market developments, and a significant movement in the state of public finances after a deterioration during the economic and financial crisis.

The COVID-19 pandemic and the accompanying containment measures strongly impacted the Slovenian economy. The annual decline in economic activity amounted to 5.5 percent in 2020, which was less than expected and better than the euro average. Household consumption, due to limited spending possibilities and increased precautionary as well as forced saving, significantly contributed to the fall in GDP in 2020. Despite a worsening of epidemiological conditions in the wake of the pandemic's second wave at the end of 2020, real GDP declined only by 1.0 percent in the final quarter of last year, mainly reflecting the economy's effective adaptation to operating in the adverse situation. The macroeconomic risks remains high, although they have begun to decline due to the accelerating vaccination progress.

The authorities acted swiftly to deal with the adverse effects of the COVID-19 crisis. They adopted numerous emergency measures that supported enterprises and employees, preventing a higher drop in GDP and employment. The measures were defined in several COVID-19-related legislation packages, most notably the Emergency Fiscal Measures Act, Wages and Social Security Contributions Act, and the Deferral of Borrowers' Liabilities Act. The impact of the emergency measures and investments originating from the EU Recovery and Resilience Fund (RRF) are expected to improve the much worse outlook that could have otherwise prevailed in their absence. The emergency measures will continue to mitigate COVID-19's negative impact, particularly in the first half of 2021, and will be lifted only gradually.

The COVID-19 crisis had an uneven impact on the economy. The implementation of emergency measures prevented a collapse of some particularly exposed sectors. The most affected sectors were in the non-tradeable part of the economy, which is mainly due to the nature of containment measures (physical distancing and wearing masks). The sharpest drops were in accommodation and food service activities, entertainment, sports, recreational and personal services, and a large part of trade. In 2020, only high-technology sectors such as pharmaceutical and ICT equipment manufacturing increased production.

The authorities are more optimistic about the growth outlook than Fund staff. They are striving for strong and sustainable growth above 4 percent in 2021, driven by bolstered investment and higher household consumption. The current account surplus continues to strengthen during the COVID-19 pandemic. The increase occurred through a widening of the savings-investment gap (surplus of gross savings over investment), and has been strongly influenced by the narrowing of the general government deficit and stronger household savings.

The outlook remains highly uncertain. The prolongation of support measures depends on the pandemic's evolution, vaccine availability and vaccination, related health restriction measures, and the evolution of demand in main trading partners. In the remaining part of the year, it will be crucial to carefully replace emergency measures with recovery measures in order to ensure a sustainable recovery and long-term growth. The premature removal of measures could lead to reduced economic activities and higher unemployment. In this regard, the authorities appreciate staff's advice that fiscal support should continue until the recovery is entrenched. The authorities acknowledge the importance of continuing the assessment of anti-crisis measures in order to execute their gradual and well-planned lifting.

The COVID-19 response

Slovenia has experienced three waves of the COVID-19 epidemic, with lockdowns of varying lengths imposed during each wave. The surge in cases during the last wave in April 2021 was attributed to the prevalence of new, more potent strains of the virus, which temporarily resulted in a deterioration of the epidemiological situation.

The authorities reacted quickly and decisively to the COVID-19 pandemic. They implemented a number of strict social distancing measures to limit and contain the spread of the pandemic, while providing support measures to help alleviate the epidemic's impact on businesses and households.

With the partial lifting of restrictions in Spring 2021, the economic circumstances began to improve, although there are still considerable uncertainties surrounding the pandemic's evolution. Given the current epidemiological and economic situation, some key measures will be extended to preserve lives and livelihoods.

The vaccination campaign started at the end of December 2020 with vaccines approved by the European Medicines Agency. The interest in vaccination among people exceeds the quantity of available vaccines, which might hamper reaching the set objective of at least 60 percent vaccination of the country's population before Summer 2021 in order to attain herd immunity.

Fiscal policy

The COVID-19 pandemic considerably impacted budgetary revenues and especially expenditure in 2020. General government revenues were down 4.6 percent in 2020, driven primarily by falls in direct and indirect taxes. Expenditure increased by 14.8 percent, largely in connection with supporting measures to alleviate the pandemic's impact. Public debt had reached 80.8 percent by the end of 2020, which is approximately a 15-percentage points increase from the previous year.

The rise in debt was driven by the large deficit and major decline in economic activity. However, Slovenia is one of the less indebted EU Member States in terms of gross and net external debt. The escape clause allowing deviations from the fiscal rules was activated.

The authorities implemented a comprehensive package of supporting fiscal measures that significantly mitigated pandemic-related income losses of the economy and the population, and provided enterprises with liquidity and support to cope with the negative consequences. The total value of these measures is estimated at EUR 3 billion. By February 2021, EUR 2.5 billion in expenditures were realized from supporting measures on the central budget. The largest expenditure was made on the furlough scheme (wages and social contributions), additional payments to employees working during the crisis, basic income to different vulnerable groups of population, tourist vouchers, and others. In order to achieve a sustainable recovery, the impact of the supporting measures will also be crucial in 2021.

The recovery will be a long-term process and will largely depend on how the pandemic evolves. The fiscal policy will support the recovery, which will remain differentiated across sectors. The authorities are mindful of the fiscal risks in this respect and have made all efforts to contain them.

In May 2021, the Slovenian government adopted amendments to three tax laws in a bid to reduce labor taxation, and help businesses and individuals in the post-COVID recovery, including by increasing the general personal income allowance and reducing tax on capital. The amendments will enter into force on January 1, 2022.

Financial sector policy

The banking sector entered the pandemic well-capitalized, liquid, and profitable. As a result of the COVID-19 pandemic and the accompanying measures, credit growth slowed sharply, and the trend of weak corporate lending was further amplified. Credit risk is rising, also in view of the anticipated gradual withdrawal of supporting measures to businesses and households. The prolonged low interest rate environment further decreased bank profitability. Nevertheless, the banking system continues to be liquid and profitable. Performance on regulatory ratios has remained strong to date, with the banking system's total capital ratio of 18.3 percent on a consolidated basis at the end of 2020, well above the statutory requirements. The banking system also remains highly resilient as a whole. There are, however, considerable variations in the levels of resilience at individual banks, given the differences in the structure and quality of their credit portfolios and capital surpluses.

The authorities have implemented several measures to cushion the pandemic's impact on the financial position of corporates and households, most notably the loan moratoria and government loan guarantees. The loan moratoria are in line with the European Banking Authority (EBA) guidelines[1] and allow payments deriving from liabilities to be deferred for up to 12 months. As a

[1] More information available at: https://eba.europa.eu/eba-publishes-guidelines-treatment-public-and-private-moratoria-light-covid-19-measures.

result, interest income temporarily declined to some extent, but will eventually be higher as borrowers will have to pay interest for the period of moratoria.

Macroprudential policy shifted from predominantly restrictive to easing, noticeably in releasing existing and adopting additional instruments to maintain stable financing conditions. With this background, the authorities adjusted the macroprudential restrictions on consumer and mortgage lending so that a temporary decline in a consumer's income during the course of the pandemic can be excluded from the calculation of their creditworthiness. Additionally, the authorities introduced, and later adjusted and extended, a temporary restriction on profit distribution for banks and leasing enterprises. The purpose of the measure is to ensure the retention of capital at banks and leasing enterprises so that the Slovenian banking system would be better able to withstand potential losses, and further supply credit to business and households. With a view of providing timely and in-depth information, the Bank of Slovenia regularly communicates with stakeholders regarding implemented measures. Gradual adjustments in the macroprudential policy will be performed alongside changes in the risks to financial stability. The 2017 Strategic Framework for Macroprudential Policy for the banking sector was updated in January 2020.

The measures taken have cushioned the pandemic's impact on the financial positions of businesses and households. However, some sectors, as well as households, have been more affected, and their financial positions have been weakened to a greater extent. With the gradual termination of supporting measures, the quality of the credit portfolio may deteriorate. Non-performing exposures can increase, particularly in sectors that were hit the hardest by COVID-19. Credit risks elevated by the pandemic might be evident after a lag of several months. Despite growing real estate prices even in 2020, there are no major imbalances in the real estate market per se.

Increased banks' capital and liquidity positions are the legacy of financial sector reforms following the 2013 banking crisis. In this regard, the authorities appreciate staff's analysis and advice during that time. The authorities are, however, aware that the banking sector faces further structural challenges. A particularly pronounced one originates from the banks' shift from corporate to household lending. As a result, banks are faced with transformed asset portfolios and increased reliance on customer deposit funding. Subsequently, banks will have to rethink their business models.

The European Central Bank (ECB) responded to the downturn caused by the COVID-19 pandemic with supportive monetary policy. Providing sufficient liquidity at favorable terms is important for the euro area and Slovenia, as banks continue to play a key role in financial intermediation. In addition to a sharp expansion in securities purchases, the ECB introduced extra refinancing operations and changes in the collateral terms.

Structural policy

The authorities are focused on promoting inclusive and sustainable economic growth, as well as employment. Measures designed to help the economy to recover from the COVID-19 pandemic will be combined with structural reforms to make the economy and society more resilient to future shocks.

Slovenia faced the COVID-19 pandemic with some unresolved development challenges that only deepened with the pandemic. Slovenia's identified key long-term development challenges eligible for investment are enhancing productivity growth; inclusive social development and inter-generational solidarity; a faster transition to a low-carbon circular economy; and strengthening the state and its agencies' development role. In this regard, the authorities appreciate staff's advice regarding the importance of implementing the strategy for a low-carbon economy.

The EU's recovery funds, such as the Next Generation EU instrument, present an opportunity to play a key role in ensuring the recovery from the pandemic crisis, while at the same time addressing key developing challenges. These funds will be used efficiently with respect to the limited fiscal space as a result of the increase in public debt. Their utilization will improve economic sentiment in Slovenia, foster investment in digital and green technologies, growth in production, and final consumption.

In April 2021, the authorities submitted to the European Commission a Recovery and Resilience Plan, which specifies reforms and public investment projects that Slovenia intends to implement with the support of the EU Recovery and Resilience mechanism. The plan addresses structural reforms and is structured around four priority pillars: The green transition; digital transformation; smart, sustainable, and inclusive growth; and health and welfare, including investments and reforms in long-term care and social housing. The plan envisages the use of all EUR 1.8 billion in grants, and EUR 666 million out of EUR 3.6 billion in available loans. Out of the EUR 2.5 billion requested under Slovenia's plan, 43 percent or more than EUR 1 billion is intended for green goals, and 20 percent or more than EUR 330 million for digital objectives. The remaining two segments are smart, sustainable, and inclusive growth, for which almost EUR 750 million is planned to be invested; and healthcare and social security, which is to receive EUR 364 million[2].

As a result of the fiscal policy measures to alleviate the impact of the COVID-19 pandemic, the labor market has remained stable. Job preservation measures were related to the partial coverage of wage compensation during temporary lay-offs, the crisis bonus, monthly basic income, and relief from the payment of social security contributions for eligible workers. These measures helped maintain household purchasing power, and enabled further growth in households' disposable income. The fall in employment was not significant as a result of these job preservation measures. With improvements in the epidemiological conditions, employment growth will continue to strengthen amid further economic recovery, while unemployment will remain higher than in 2019. Going forward, reallocation measures such as supplementary training, education, job search services, and lowering costs for enterprises to employ new workers, will be used to assist workers in the transition between economic sectors in light of economic transformation in the post COVID-19 world.

[2] More information available at: https://www.eu-skladi.si/en/post-2020-1/recovery-and-resilience-plan.