May 2011
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Republic of Slovenia: 2011 Article IV Consultation—Staff Report; Public Information Notice on the Executive Board Discussion; Staff Statement; and Statement by the Executive Director for 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 2011 Article IV consultation with Slovenia, the following documents have been released and are included in this package:

- The staff report for the 2011 Article IV consultation, prepared by a staff team of the IMF, following discussions that ended on March 21, 2011, 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 4, 2011. The views expressed in the staff report are those of the staff team and do not necessarily reflect the views of the Executive Board of the IMF.

- A staff supplement of May 4, 2011, updating information on recent developments.

- A Public Information Notice (PIN) summarizing the views of the Executive Board as expressed during its May 20, 2011 discussion of the staff report that concluded the Article IV consultation.

- A staff statement of May 16, 2011, updating information on recent developments.

- A statement by the Executive Director for the Republic of Slovenia.

The policy of publication of staff reports and other documents allows for the deletion of market-sensitive information.

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INTERNATIONAL MONETARY FUND

REPUBLIC OF SLOVENIA

Staff Report for the 2011 Article IV Consultation

Prepared by the Staff Representatives for the 2011 Article IV Consultation with the Republic of Slovenia

Approved by Juha Kähkönen and Jan Kees Martijn
May 4, 2011

Executive Summary

Background: After one of the largest GDP declines in the euro area, growth resumed only in Q2 2010 on the back of external demand. Lower potential output growth and weak domestic demand due to deleveraging are dampening growth prospects. Fiscal policy is tightening after a countercyclical stance, with the authorities committed to bringing fiscal deficit below 3 percent of GDP by 2013 mostly by freezing public wages and cutting investment. Pension reform was recently approved, but will be subjected to a referendum. Banks suffer from weak capitalization and deteriorating asset quality. Political support for reforms is weakening.

Challenges: (i) putting growth and public finances on a sustainable path; (ii) ensuring financial stability; and (iii) maintaining competitiveness.

Staff views: The broad fiscal targets are appropriate but 0.3 percent of GDP in additional fiscal measures per year in 2011–2013 will be needed to achieve them. Consolidation should rely more on durable measures. Pension reform is a critical step in the right direction but it is not enough to ensure fiscal sustainability. Banks should be further recapitalized and corporate governance strengthened, including through a larger role for the private sector. An exit strategy for the government's role as an investor in banks should be laid out. Wage growth should be restrained, labor markets should become more flexible, and products market reform is needed to attract FDI.

Authorities' views: The authorities agree with staff that fiscal consolidation including pension reform is key to ensure a sustainable recovery. The government considers that the recovery could be revived by stimulating credit expansion. The Bank of Slovenia emphasizes that banks' governance and capitalization should be enhanced, regardless of ownership. The authorities stressed also the importance of social consensus to implement reforms.

Mission team: Mr. Spilimbergo (Head), Ms. Mahieu, Mr. Simone (all EUR), and Mr. Blotevogel (MCD) visited Ljubljana March 9–21, 2011 and held discussions with the Mr. Križanič (Minister of Finance), Mr. Krajnec (Governor of the Bank of Slovenia) and other ministers, government officials and representatives of parliament, financial sector, labor, business, and media. Mr. Kavčič (Advisor to the Executive Director) attended also the meetings. Mr. Prader (Alternate Executive Director) attended the concluding meeting.

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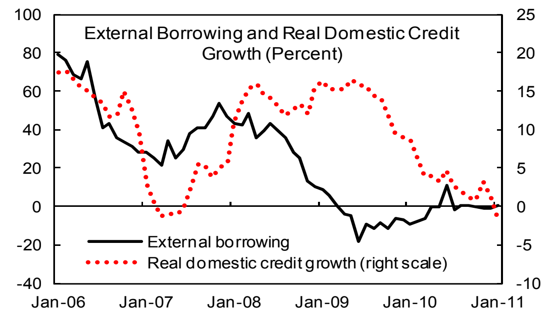
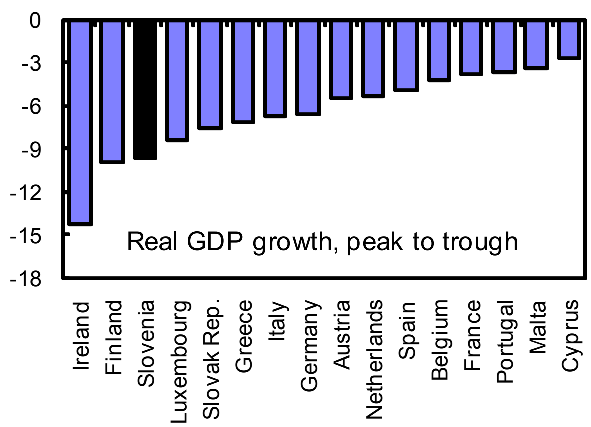
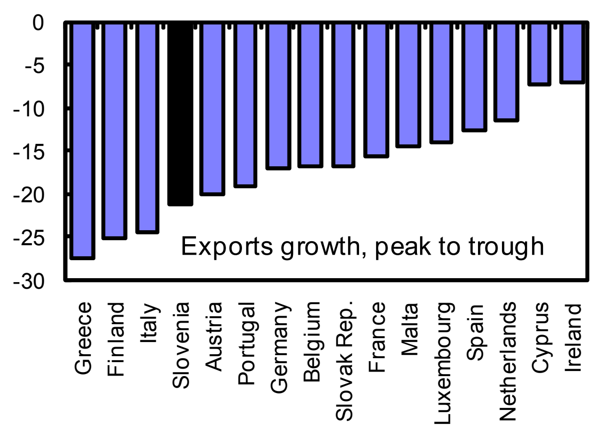
I. Context: From Sudden Stop to Difficult Deleveraging

1. **Slovenia experienced one of the sharpest GDP declines in the euro area during the crisis**. Real GDP declined over 10 percent from peak in Q3 2008 to trough in Q1 2010 owing to: a sharp decline in external demand affecting especially the manufacturing sector; a significant tightening in external credit conditions forcing banks to curtail domestic credit supply; and an abrupt end of a construction and housing price boom.

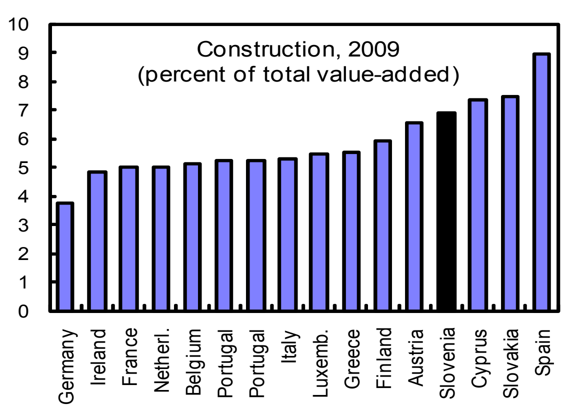


Source: Bank of Slovenia.

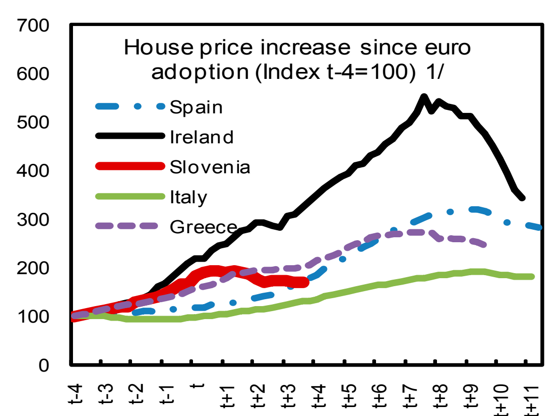




Source: Eurostat.



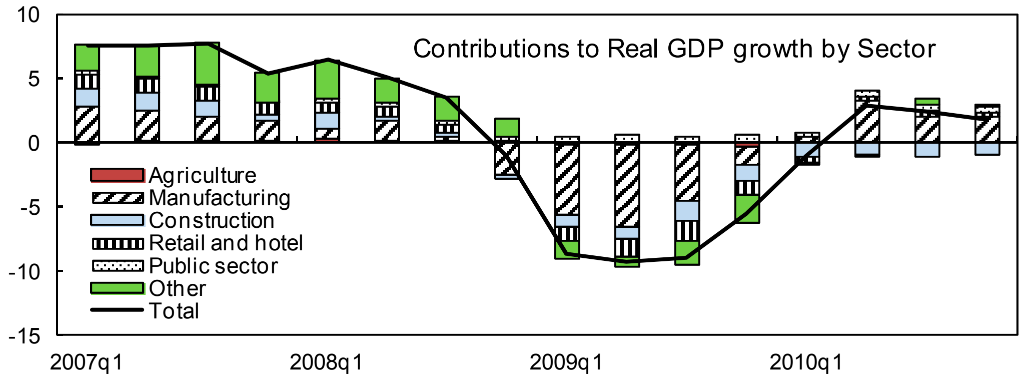
Source: Eurostat.



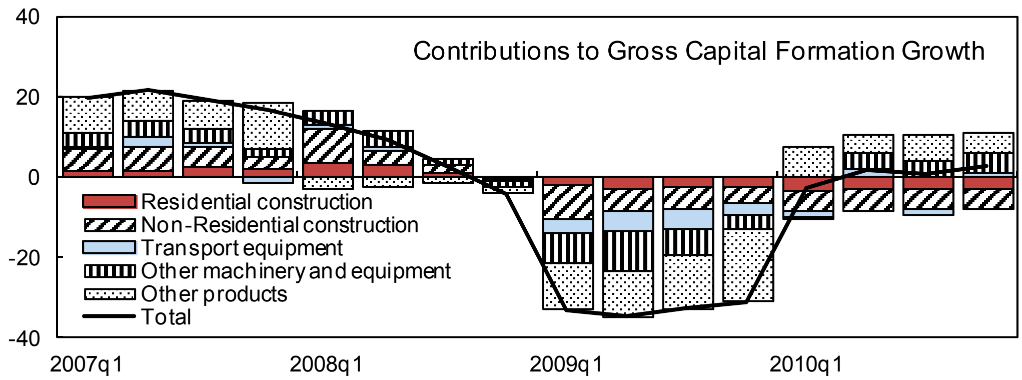
Source: IMF
1/ t is the euro adoption year in each country.

2. **Economic growth has been slowly recovering on the back of external demand**. Real GDP growth reached 1.2 percent in 2010. After declining in the first quarter of 2010, real GDP grew in the remaining three quarters, mainly driven by exports. However, domestic demand remains weak, with consumption only gaining 0.5 percent last year and investment

flat. The highly leveraged construction sector is contracting while manufacturing is recovering. The average unemployment rate was 7.2 percent in 2010.



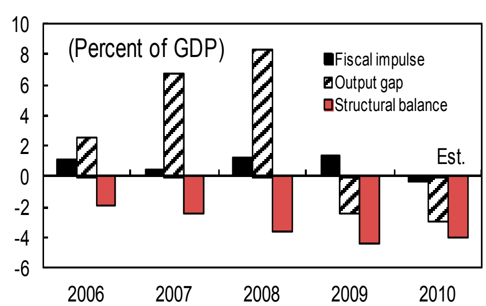
Source: Statistical Office of Slovenia.



Source: Statistical Office of Slovenia.

3. **Weak domestic demand led to negative core inflation and greatly reduced the current account deficit**. Average CPI inflation was 1.8 percent in 2010, mainly because of rising fuel and energy prices. The current account deficit shrank from 6.7 percentage points of GDP in 2008 to 1.2 in 2010, reflecting mainly the end of the construction boom.

4. **Fiscal policy turned countercyclical in 2009**. Automatic stabilizers were allowed to work and additional discretionary stimulus measures amounting to 1.8 percent of GDP in 2009, 0.2 in 2010, and 0.1 in 2011 were taken. Discretionary measures included subsidies to companies for shorter labor hours and R&D, a corporate income tax rate reduction, and the elimination of the payroll tax. Most subsidies, except subsidies for temporarily laid-off workers, were phased out by end-2010.

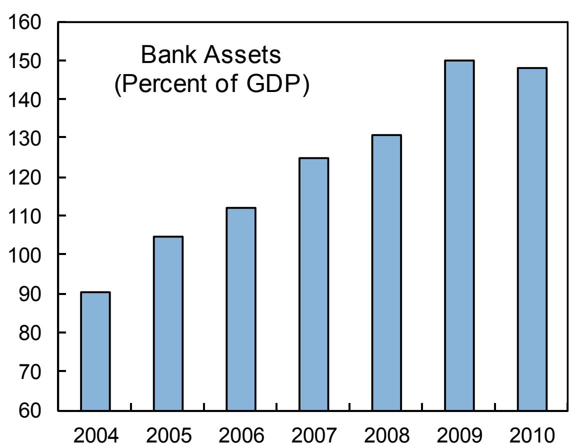


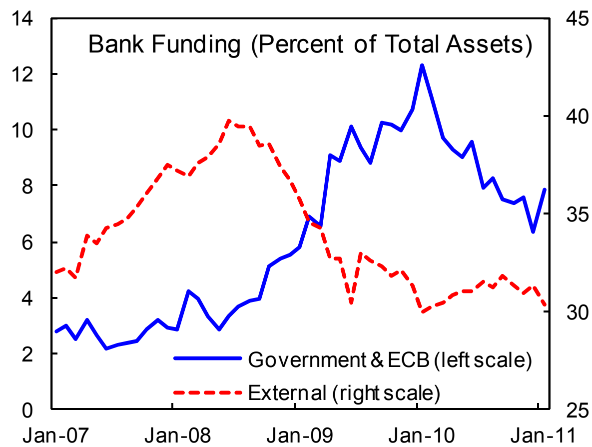
Sources: Ministry of Finance of Slovenia; and IMF staff estimates.

5. **The general government deficit narrowed in 2010**. After widening considerably during the crisis, the general government deficit declined to 5.2 percent in 2010. The main factors were one-off revenue gains, cuts in capital transfers, and containment of the wage

bill. The structural balance also improved by 0.5 percent of GDP after reaching its lowest point in 2009 (-4.5 percent of GDP).

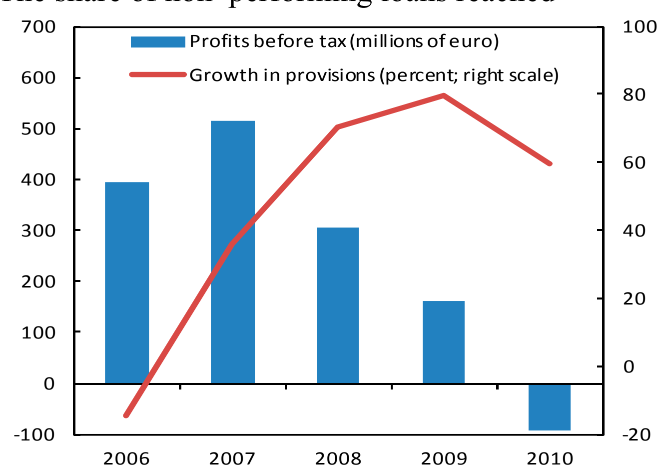
6. **The crisis exposed vulnerabilities in the financial sector.** The rapidly expanding credit growth financed with short-term external bank borrowing came to a sudden stop in 2008. During the crisis, the authorities supported bank liquidity by enhancing the deposit insurance scheme, placing government deposits with banks, and providing guarantees for banks' bond issuances. Banks also sought recourse to ECB funding. As a result, the funding profile of banks changed significantly.





Sources: Bank of Slovenia; and European Central Bank.

7. **Banks' profitability and asset quality deteriorated**. Their aggregate profits turned negative in 2010 due to high loan losses. The share of non–performing loans reached 3.6 percent, up from 2.3 percent the year before. Loan concentration, particularly to highly-leveraged corporate borrowers, is high. Nova Ljubljanska Banka (NLB), Slovenia's biggest bank with a 28 percent market share by assets, barely passed the Council of European Banking Supervisors (CEBS) stress test in July 2010. Moody's downgraded Slovenia's three largest banks in September last year, while retaining their negative outlooks.



8. **The political context has not been favorable to the implementation of structural reforms**. The political support for labor market and pension reforms is weak. Trade unions succeeded in holding a referendum on the recently approved revisions to pension and labor

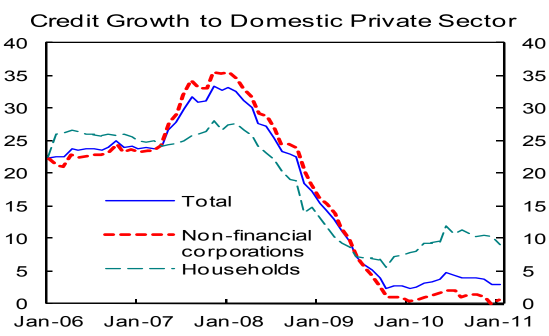
market legislations in spring (Boxes 2 and 4). Upcoming elections in 2012 are also likely to complicate reform implementation.

II. Policy Discussions

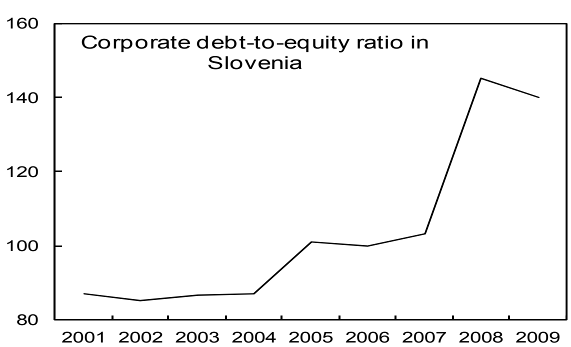
9. Policy discussions focused, for the short term, on the strength of the recovery in the context of deleveraging, bank vulnerabilities, and the fiscal exit strategy. For the medium term, the discussions were focused on pension reform and competitiveness.

A. Outlook: Deleveraging and Lower Potential Growth Are Constraining the Recovery

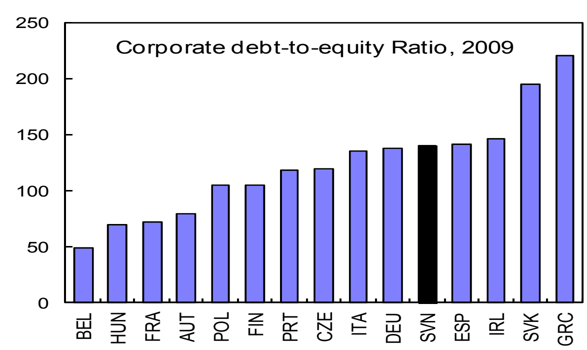
10. **Pervasive deleveraging will limit growth**. Credit growth to the domestic private–sector fell to below 4 percent in 2010 from 33 in 2007, as banks tried to protect their capital positions and meet debt redemptions. The highly leveraged corporate sector has stopped borrowing, muting demand. Lending to households was the exception to the downward trend in 2010, mainly due to low initial debt levels and attempts by banks to shift risk away from construction companies.



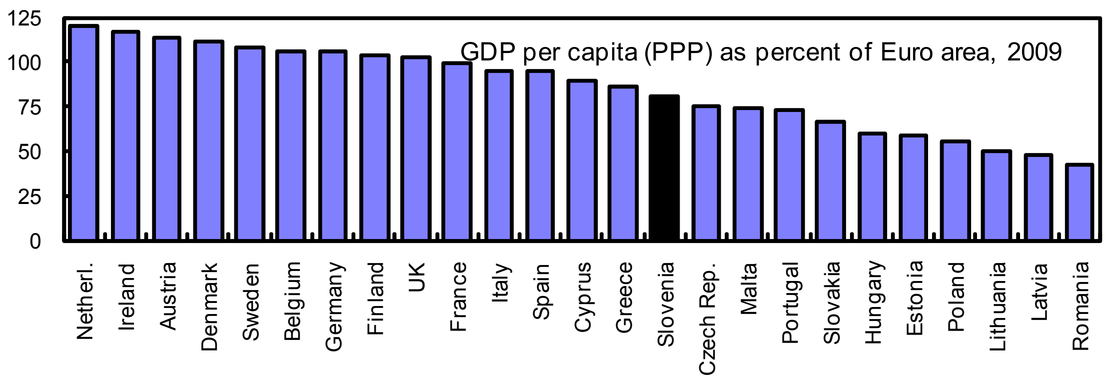
Source: Bank of Slovenia.



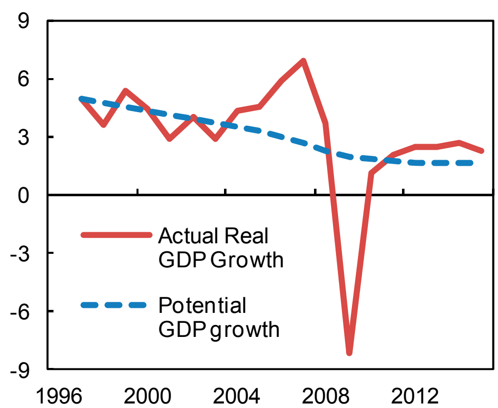
Source: OECD.



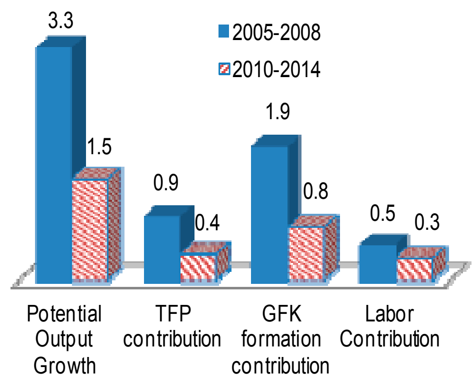
11. **Supply factors are also constraining the recovery.** Slovenia's GDP is already at 88 percent of the average euro area GDP, reducing the scope for further catching up. Moreover, post-crisis potential output growth estimates by the OECD, the European Commission, IMAD, and staff (see charts below) declined to a range of 1.3 to 2.5 percent from a pre-crisis range of 3 to 3.4, primarily on account of the lower gross capital formation. The output gap is projected to close gradually over the medium term.



Source: Eurostat.

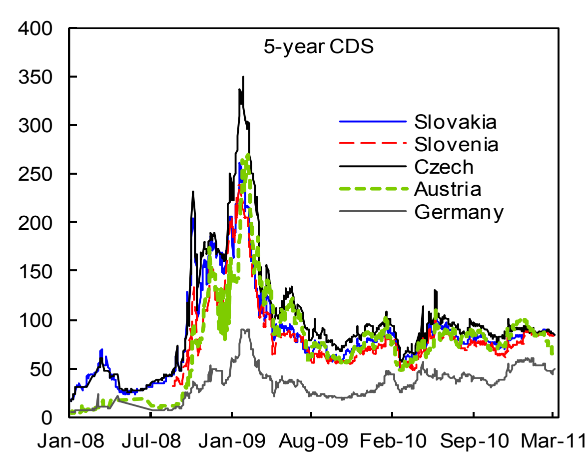


Source: IMF staff estimates.



Source: IMF staff estimates.

12. **GDP growth is projected at 2 percent in 2011 and 2.4 in 2012**. The pick-up in growth reflects mainly a recovery in the manufacturing sector and inventory rebuilding. However, investment will likely be low due to deleveraging. High unemployment and fiscal retrenchment will weigh on consumption growth. Average inflation is projected to gradually pick up to 3.1 in 2012 on the back of high commodity prices. The current account deficit is expected to widen again as the economy recovers, but not as much as in pre-crisis times. The authorities broadly agreed with staff's forecasts.



Source: Bloomberg.

13. **Spillovers from the European sovereign debt crisis have been contained so far, but vulnerabilities remain**. This resilience reflects Slovenia's moderate debt-to-GDP ratio, limited refinancing risk of public debt, and solid household balance sheets. However, the near-term dependence of the recovery on external demand and significant contingent public liabilities from entitlement spending and banks

are ongoing risks. The postponement of pension and labor market reforms could also lead to further deterioration in competitiveness and potential output growth.

B. Fiscal: The Challenges of Lasting Consolidation

14. **The authorities' fiscal exit strategy envisions a gradual reduction of the general government deficit to below 3 percent by 2013 in compliance with the EU's Excessive Deficit Procedure (EDP) (Box 1)**. Measures include freezes in basic wage, cuts in allowances, and reduction in public employment. Non-pension entitlement growth is expected to be contained by slowing down indexation. Structural fiscal reforms are also envisioned to support the consolidation.

15. **Staff agreed with the contour of the authorities' exit strategy but pointed out that additional and durable measures are needed**. While general government debt is likely to remain sustainable, fiscal consolidation is necessary in light of the uncertainty in financial markets and contingent liabilities.[1] The government guaranteed €2.2 billion (6 percent of GDP) of banks' bonds during the crisis, which will mature next year, and may have to inject more capital into state banks, depending on market interest. However, staff's baseline scenario illustrates that measures envisaged so far fall short by 0.9 percent of GDP (in ESA95 terms) to reach the authorities' targets. The shortfall results from less optimistic assumptions on transfers and the wage bill.[2] The authorities agreed with the need of a durable adjustment, underlining the role of pension and health care reforms. The pension reform recently approved by the parliament but subject to referendum is a step in the right direction but is insufficient in the long run (Box 2).

16. **Staff and the authorities agreed on the composition and pace of adjustment**. Consolidation should take place on the expenditure rather than the revenue side given an already high tax burden, especially on labor. To the extent that compliance with the EDP is restored by 2013 and borrowing constraints permitting, the focus should be on the quality of the adjustment measures.

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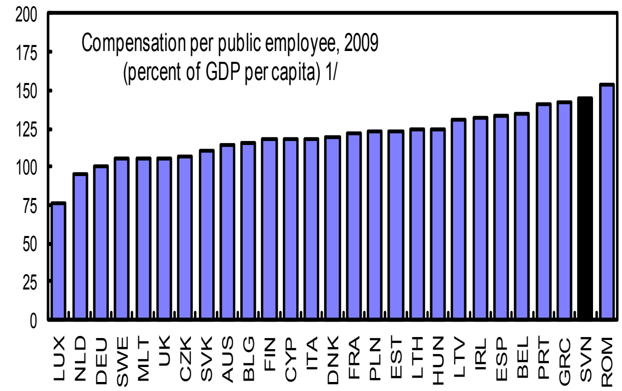
[1] Debt sustainability analysis suggests that debt would remain sustainable and at or below 60 percent of GDP under a variety of scenarios with the exception of one with significantly lower growth. Standard & Poor's put Slovenia on negative outlook on account of its seemingly weakened commitment to fiscal consolidation.

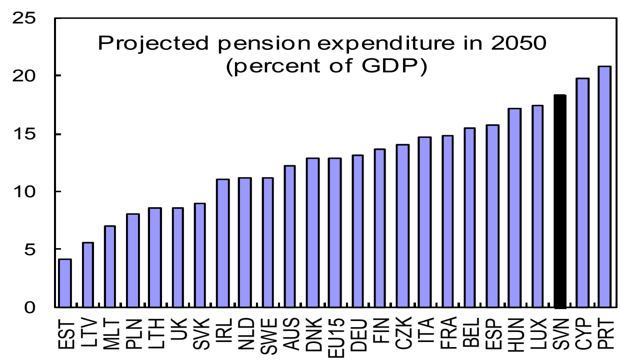
[2] The fiscal deficit could be higher by 0.7 percent of GDP in 2011 if Eurostat classifies the recently approved recapitalization of state banks as state aid for EDP compliance purposes. Eurostat's opinion would also determine the impact on the fiscal deficit of any additional recapitalization.

17. **Staff proposed durable expenditure measures**. Suggestions included: preventing the policy adopted in 2008 to reduce wage disparities in the public sector from increasing the wage bill; rationalizing government employment; and reforms to strengthen the targeting of transfer programs and tighten eligibility.[3] The authorities reiterated their commitment to consolidation. They agreed that additional measures over and above those announced would likely be needed to bring the general government deficit below 3 percent by 2013.

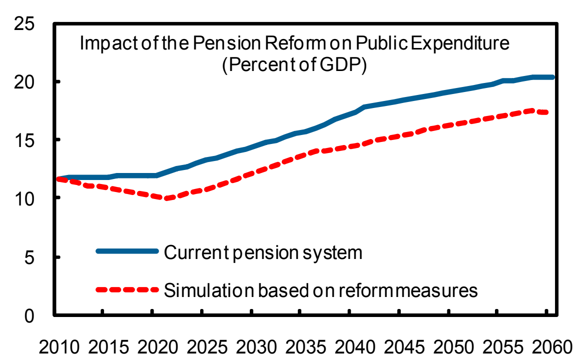


Sources: World Economic Outlook; Eurostat; and Statistical Office of the European Communities.
1/ Latest data available for Portugal and Romania, 2007 and 2008 respectively.

18. **Staff indicated that the pension reform goes in the right direction but is insufficient to ensure long-term fiscal sustainability**. Slovenia is projected to have one of the largest pension expenditures in the EU by 2050 if no reform is implemented. This is due to a combination of rapid ageing, low effective retirement ages, and wage indexation of benefits. The pension reform would contain the increase to about 6 percent of GDP by 2060, but would still imply unsustainable transfers from the state budget. Staff recommended further reducing the replacement rate and increasing more rapidly the effective retirement age to 65 years by: (i) increasing the penalty for early retirement to 6–7 percent per year; (ii) moving indexation gradually towards price indexation; and (iii) automatically adjusting retirement age to life expectancy at retirement once the pensionable age reaches 65 for women and men. Finally, the private pillar should be expanded to compensate for the public benefit cuts while ensuring the portability of the



Source: European Commission

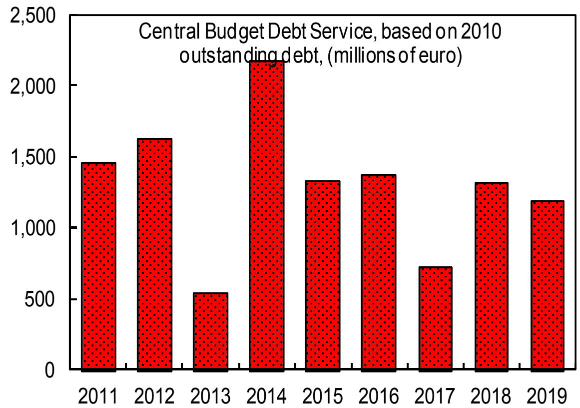


Source: OECD.

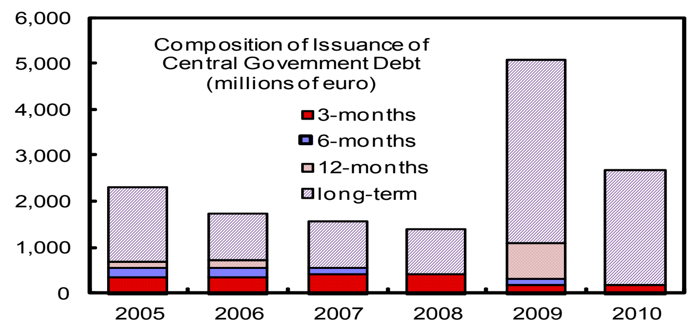
[3] Reducing government employment by 1 percent each year for two years as proposed in the 2009 stability program update could save 0.2 and 0.4 percent of GDP in 2011 and 2012 respectively.

benefits. The authorities agreed with staff that additional measures beyond the current pension reform will be needed to ensure long-term sustainability and noted that the defined contribution private pension pillar is also being reformed (Box 2).

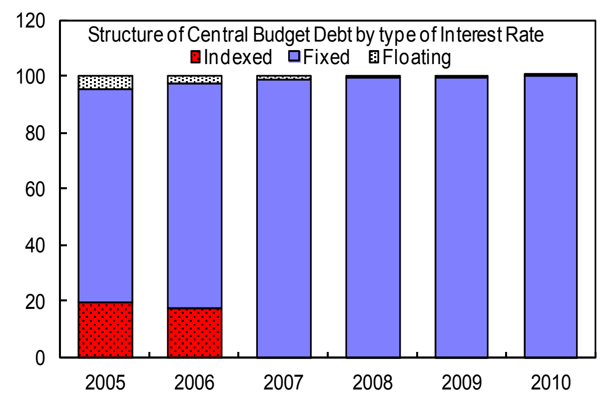
19. **Public debt management has been broadly adequate.** Long-term syndicated loans issued at fixed rates were used to pre-finance the deficit while limited quantities of short-term treasury bills were issued to manage treasury liquidity. Staff recommended that the authorities continue to pre-finance to hedge against refinancing risk.



Source: Slovenia Ministry of Finance.



Source: Slovenia Ministry of Finance.



Source: Slovenia Ministry of Finance.

Box 1. Slovenia's Fiscal Exit Strategy

The authorities' exit strategy seeks to achieve near-term fiscal consolidation and address sustainability challenges arising from age-related spending. In addition to the withdrawal of the crisis-related discretionary measures, the plan includes:

- **Expenditure-based fiscal consolidation.** Key elements are rationalizing the wage bill, social benefits, and goods and services. Wage bill growth would be contained by the abrogation of regular performance bonuses until 2011, the postponement of the implementation of the wage disparity policy in the public sector, the non-indexation of wages to inflation in 2011 and 2012, and the reduction of public employment by 1 percent in 2011 and 2012. The growth of social benefits would be curtailed by using a less generous indexation. Goods and services would be rationalized by introducing a unified system of public procurement.
- **Fiscal structural reforms.** These include pension, health care and financial management reforms. Health care reform aims at increasing the use of generic drugs, tightening the eligibility for sick leave benefits, changing the ratio of health services and medicine covered by mandatory and voluntary health insurance, and widening the income base for the collection of health contributions. In the public financial management area, reforms include performance budgeting and changes to the Public Finance Law. The changes will introduce in the legislation a medium-term framework (MTF), institute a formula for computing the expenditure ceilings based on MTF ("fiscal rule"), set a debt ceiling of 45 percent of GDP, and 13 percent of GDP on government guarantees, and define the responsibilities and accountability structure for the recently created fiscal council.

Box 2. Pension Reform

The government approved a pension reform in November 2010 which will be challenged in a referendum in late spring. The main elements are the following:

- **An increase in the full and minimum retirement ages.** The statutory retirement age will be lifted to 65 and the minimum retirement age will be 60. The gap between the retirement ages of men and women progressively disappears. The retirement age for workers with longer careers also increases to 60 for men and 58 for women.
- **A gradual extension of the period for calculating the pension base from the 18 best consecutive years to 27 years.** The extension will decrease the pension rating base by 12.1 percent for men and 10.5 percent for women. However, the replacement rate will be capped at 60 percent.
- **A change in the indexation of pension benefits.** Instead of only indexing to nominal wage growth, the new approach also links pension benefits to prices (40 percent weight until 2015; 30 percent thereafter).
- **Changes in the incentive system.** Individuals who are eligible for a pension, but continue to work full time, will be able to claim 20 percent of their pension entitlement. The permanent penalty for early retirement will be increased to 0.3 percent per month before the age of 65.
- **Additional incentives to work past the pension eligibility age.** Partial retirement will be extended, allowing for greater flexibility in combining work and pension benefits.
- **Financial incentives for employers to employ older workers.** Employers will pay 30 percent lower social security contributions for workers above the age of 60. Hiring workers with long careers over the transitional period until 2017 results in a 50 percent reduction in social security contributions for employers.
- **Introduction of portfolio choices for workers opting to participate in the voluntary occupation scheme and a revised minimum return guarantee.**

C. The Financial Sector: State Involvement and Financial Stability

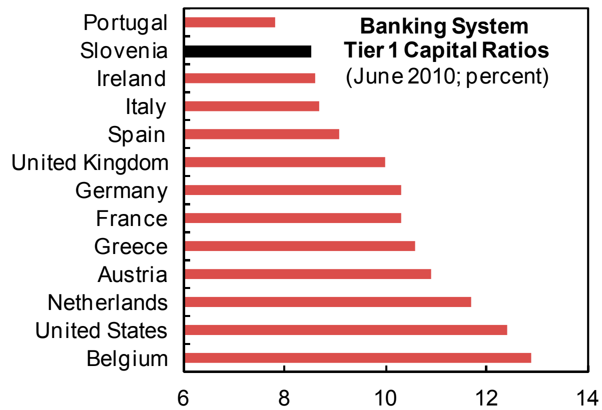
20. **Banks are coping with declining profitability**. The deterioration in banks' asset quality, evidenced by rising arrears, provisions, and non-performing loans, will moderate only slowly under staff's baseline scenario. Provisions are expected to continue to act as a drag on banks' profits. This limits the scope for retained earnings to boost capital in the near term.

21. **The highly indebted corporate sector is driving loan losses**. The debt-to-equity ratio in the non-financial corporate sector jumped to 140 percent in 2009, up from 90 percent in 2000. Leverage is also high compared to other euro area members. Borrowing by construction, real estate and leveraged holding companies grew particularly fast, with these sectors accounting for a quarter of all corporate lending at the end of 2010. Given the unfavorable environment for these sectors, banks are likely to realize further losses on the associated exposures. The authorities are considering a tax on banks' assets to incentivize lending to the corporate sector. While appreciating the need to ensure adequate credit supply for credit-worthy companies, staff noted that a tax penalizing banks for scaling back exposures to risky borrowers would distort banks' risk management. But staff saw some merit in having a systemic approach to the management and selling of stakes in non-financial companies that banks seized as collateral following bankruptcies. This solution should aim at making banks' portfolio more transparent and accelerating the restructuring of companies if necessary. However, the approach chosen should have no fiscal implications.

22. **The recent pickup in mortgage lending warrants careful monitoring**. While households remain less indebted than in other EU countries, their debt-to-GDP and debt-to-income ratios have deteriorated relatively quickly since the EU accession in 2004. The near-term dangers of imbalances in the housing market are limited by relatively stringent limits on loan-to-value and debt servicing-to-income ratios. But given the risks posed by large stocks of unsold apartments and rising interest rates, with most loans contracted at variable interest rates, the authorities agreed with staff that lending to households should be monitored carefully. The Bank of Slovenia (BoS) indicated their willingness to tighten prudential regulation further if necessary.

23. **Banks' funding is set to become more expensive**. Acute liquidity pressures are absent, but at 146 percent, banks' domestic loan-to-deposit ratio is high, indicating significant refinancing needs of foreign liabilities. With borrowings from the ECB and the government recently scaled back and foreign funding restricted, banks shrunk their total assets in 2010. Given the limited scale of the local deposit market and continued strains in international wholesale markets, funding costs are bound to increase when banks' lending activities will resume across the board, with negative effects for net interest margins.

24. **Under Basel III, banks will have to strengthen their capital ratios**. Slovenian banks are thinly capitalized. The introduction of Basel III will exacerbate this problem, though less than in other countries thanks to more limited use of hybrid capital and tighter supervisory requirements. Preliminary estimates by the BoS found that Tier 1 capital ratios would fall by at least 0.7 percentage points on average, assuming that Basel III rules take effect immediately. Staff's stress test also indicates a need to raise additional capital, which would allow banks to maintain prudent buffers even in a severe adverse scenario. The BoS broadly agreed with the results, but emphasized that stress tests are sensitive to the severity of the assumptions used (Box 3).



Sources: EU Consolidated Banking Data; and FDIC.

25. **Strengthening capital buffers is key for financial stability**. Even in the absence of shocks, additional capital is desirable to bring capital adequacy to more prudent levels, bolster confidence, and create new lending capacity. The two largest banks are currently raising capital from the government and markets but the amounts are probably insufficient to meet current market standards of capitalization. Staff encouraged the authorities to pave the way for a greater role of private investors. This can be achieved by laying out an exit strategy for the government as investor in banks, strengthening governance, disposing non-strategic assets, and removing doubts about asset quality through strict capital and provisioning requirements. Raising additional capital would ease the need to shrink domestic lending in a difficult time, moderating the fallout from large-scale bankruptcies in the construction sector. The authorities agreed with staff about the importance of adequate capitalization. They have started to examine options for further recapitalization, including through partial divestment.

Box 3. Staff Stress Test

Staff conducted a stress test to assess the resilience of Slovenia's two largest banks in an adverse scenario. The methodology is based on the background analysis carried out for the April 2011 Global Financial Stability Report, with some inputs taken from the EU stress tests organized by CEBS in July 2010. The adverse scenario covers the financial years 2011 and 2012 and features three shocks: (i) *a loan loss shock*; (ii) *a sovereign shock* reducing the value of banks' sovereign bond holdings; and (iii) *a Slovenia–specific funding shock* squeezing net interest margins. Staff's test is on balance more severe than CEBS' exercise. To illustrate, staff's two standard deviation shock to loan loss rates gives annual provisions of 2.9 percent of gross loans for NLB, compared to 2 percent in the CEBS test from last year. The staff test's main assumptions are that balance sheets remain constant and that net non–interest income equals the average of 2008/09. The results reflect already announced recapitalizations at the end of March and are summarized in the following table:

Capital needs in addition to already announced recapitalizations to meet Tier 1 targets (in € million)	
Net income after shocks	-490
in percent of current risk-weighted assets	2.3%
Capital needed for Tier 1 to reach 6%	50
in percent of current Tier 1	4%
in percent of 2010 GDP	0.1%
Capital needed for Tier 1 to reach 8%	420
in percent of current Tier 1	30%
in percent of 2010 GDP	1.2%
Capital needed for Tier 1 to reach 10%	840
in percent of current Tier 1	61%
in percent of 2010 GDP	2.3%

These results need to be interpreted with caution. The exercise is stylized, and does not take banks' possible mitigation measures into account. The results are particularly sensitive to changes in the loan loss shock. That said, the test shows that the banks could benefit from raising additional capital to bolster confidence in their ability to withstand harsh, but low–probability, events.

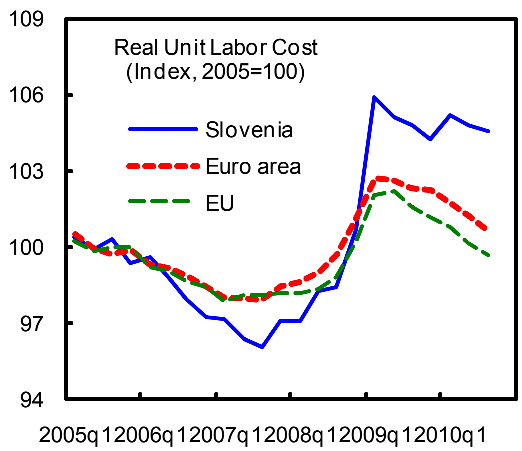
D. Structural Issues: Overdue Reforms to Boost Potential Output

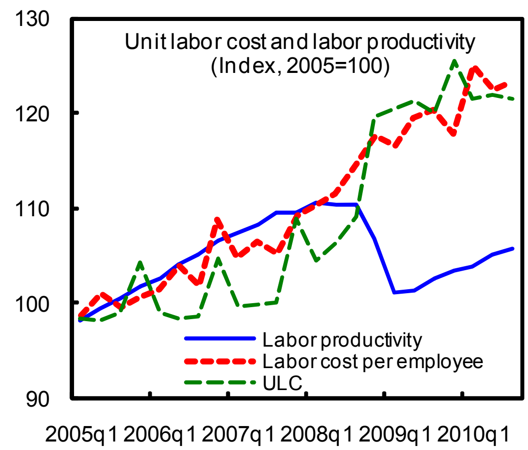
26. **While the real effective exchange rate is broadly in line with fundamentals, the authorities agreed that maintaining competitiveness will be crucial**. The crisis induced a sharp correction of current account imbalances, but indicators of price and cost competitiveness further deteriorated since then (see charts). Slovenia's world market share in labor-intensive products has declined, unlike many of its neighbors. Given the large share of labor-intensive products in Slovenian exports, worsened cost competitiveness, if not addressed, will constrain export growth.

Equilibrium exchange rate estimates using CGER methodology (percent) 1/

Macroeconomic balance	1.5
Reduced-form equilibrium exchange rate 2/	-12
External sustainability	1.0

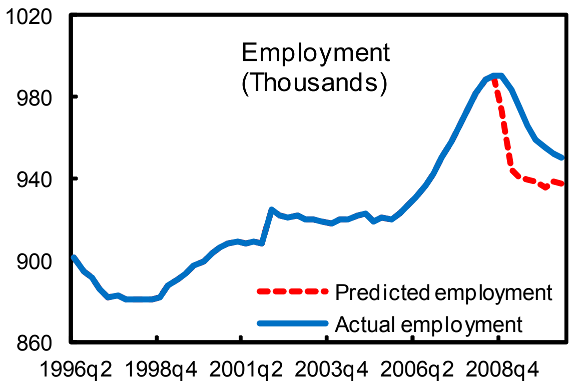
1/ Positive numbers indicate that REER is above equilibrium.
Estimations based on fall WEO data except updated Slovenian CA projection.
2/ The sharp appreciation of the REER forecasted by the model is entirely due to a strong trend in relative productivity of the tradable sector

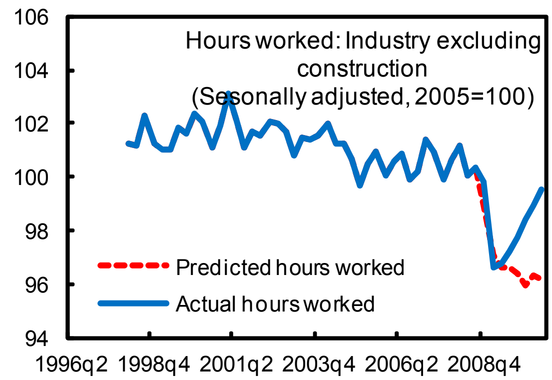




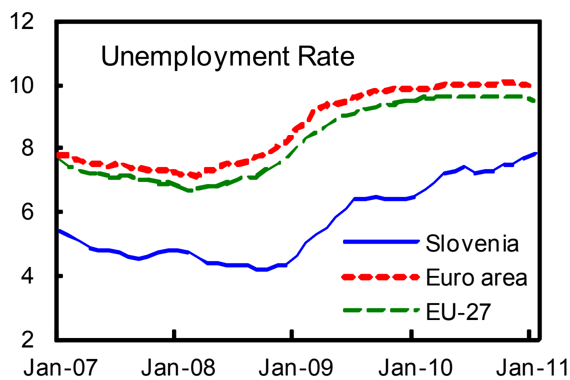
Sources: Eurostat; and IMF staff estimates.

27. **The crisis threatens to have a durable dampening impact on employment**. Subsidies for full-time working hours and temporary laid-off workers mitigated the increase in unemployment, although the return of foreign workers to their home countries may also have helped. Unemployment compares favorably to other euro area countries. However, the many job losses in the construction sector are probably permanent.





Sources: Statistical Office of Slovenia; and IMF staff calculations.
The predicted paths are based on a regression of total employment (left panel) or hours worked in industry excluding construction (right panel) on contemporaneous real GDP growth (left panel) or on valued-added excluding construction (right panel) during 2000q1-2008-q3. The estimated coefficients are used to predict the employment/hours worked path from 2008q4 onwards.

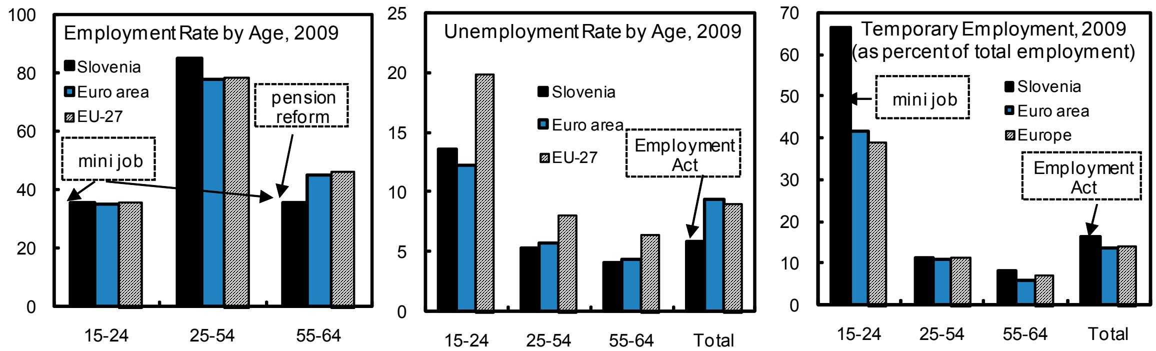


Source: Eurostat.

28. **Labor market flexibility should therefore be increased**. The Mini-Jobs Act regulating student work (Box 4) and the pension reform could contribute to increasing employment. In addition, staff advocated reducing regular workers' employment protection, which remains among the highest in OECD countries. In particular, staff recommended rapid enactment of the envisaged reduction in notice periods and severance payments as this would help avoid increasing labor market dualism and foster FDI inflows. The authorities share staff's assessment but pointed to the need to reach a social consensus.

Box 4: New Labor Market Legislation

The Slovenian labor market suffers from low participation of older workers; low employment rate of the young; and a dual labor market. Permanent contracts impose a high cost on firms due to the obligation of paying high social security contributions, long notice periods for dismissal, high severance payment, and restrictions on dismissals. The student job status did not carry many of these restrictions, and was therefore misused as a substitute for standard employment.



Source: Eurostat.

The government has adopted two new legislative measures mainly aimed at reducing the segmentation of the labor market, while increasing social protection of the young:

The Act on Mini Jobs improves the regulation of student work by restricting its possible use and increasing social security and pension contributions. The Act also expands the pool of potential users to pensioners and unemployed. The Act has been adopted in the Parliament but could be repealed in a referendum.

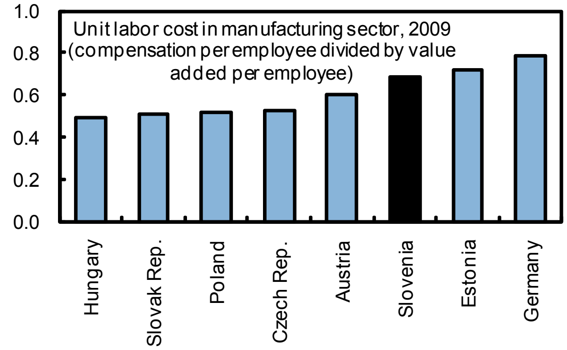
The new draft Labor Market Regulation Act primarily aims at increasing young workers' social protection by extending unemployment benefits to workers employed for nine months during the previous 24 months. The Act also increases unemployment benefits to an 80 percent replacement rate during the first three months.

In order to increase labor market flexibility, changes to the Employment Act are envisaged to shorten the notice periods for dismissals of workers and reduce the severance payments.

29. **Staff indicated that the increase in minimum wage implemented in 2010 will have adverse effects on competitiveness and employment**. At about 50 percent of the average wage, the minimum wage was already higher than in most EU countries. The 23 percent increase prevented wages to fully respond to the downturn. It hurt employment in labor intensive sectors and put upward pressure on the general wage level, exacerbating already high unit labor cost compared to regional peers. The increase is also likely to reduce incentives for workers to increase their human capital by compressing the wage differential between unskilled and specialized low-skilled workers. The authorities stressed that the increase responded to a request of social partners and has so far not had significant impact on employment, although they recognized that it resulted in wage compression and could have negative effects on competitiveness. Staff suggested that eliminating the mandatory wage

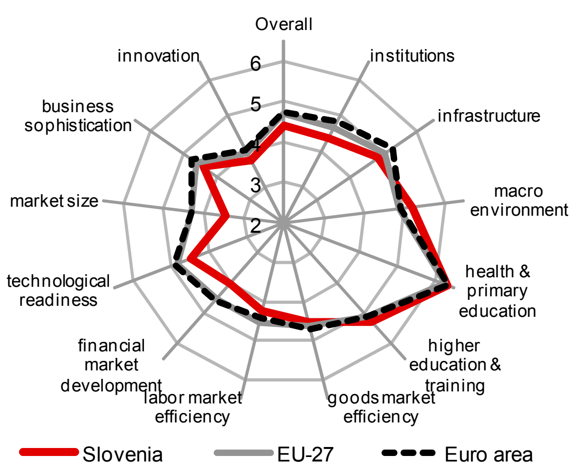
supplement for years of service could foster employment, particularly of older workers. Consideration should be also given to avoid any further indexation of the minimum wage.

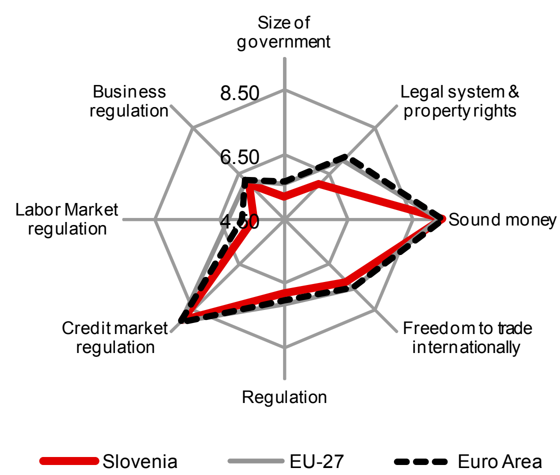
Source: OECD.



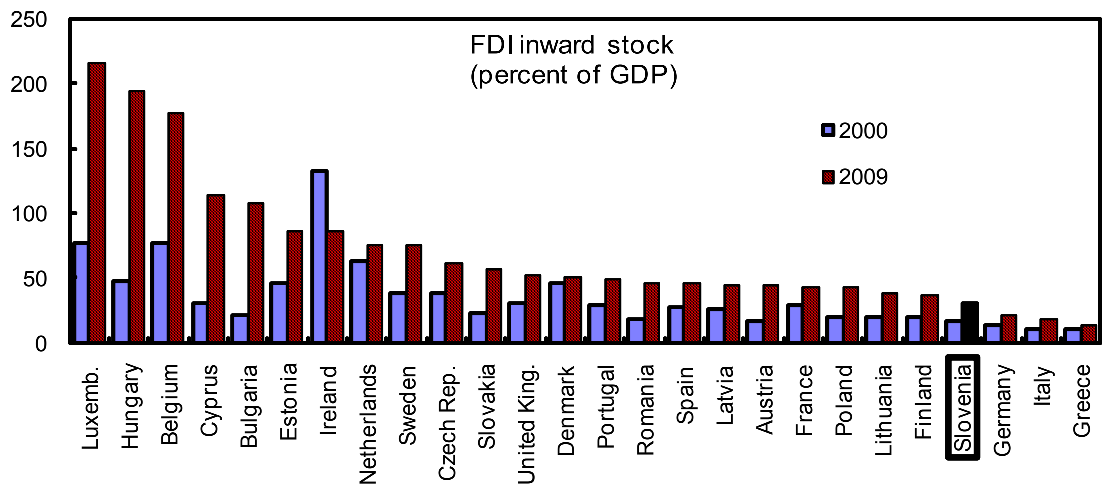
Source: OECD.

30. **Improvement in the business environment would enhance FDI attractiveness and boost productivity**. Slovenia ranks relatively low in indices of competitiveness and ease of doing business. FDI inflows have therefore been weak, notably in manufacturing and network industries. In the last two years, the authorities have adopted several measures to improve business environment, including the creation of one-stop shops for establishing new companies. Further initiatives are currently contemplated to reduce administrative burden, facilitate procedures to obtain construction permits, accelerate bankruptcy procedures, and introduce a cap on social security contributions, compensating any potential revenue loss. Staff supported these initiatives as they could help enhance Slovenia's attractiveness as a destination for FDI.





Sources: Global competitiveness Report 2010-2011, *World Economic Forum*; and Economic Freedom of the World: 2010 Report, *Fraser Institute*.
A higher value indicates a better performance.



Source: UNCTAD, FDI/TNC database.

III. Staff Appraisal

31. **The global crisis exacerbated the Slovenian economy's previous imbalances in the fiscal, financial, and real sectors**. Easy external financing conditions and expansionary fiscal policy before the crisis led to a credit boom, rising debt in the corporate sector, and increasing wages. The global financial crisis and the sharp fall in external demand brought the domestic boom to an abrupt end. The legacy of the boom-bust cycle is an over-indebted corporate sector and weaker banks. This cycle also contributed to current large fiscal deficits, higher unemployment, and deteriorated competitiveness. Also, high pre–crisis growth led to unfounded expectations that Slovenia could grow out of its structural problems, leading to postponement of long-overdue reforms. Policy makers and social partners should recognize that structural reforms are needed for potential output growth to return to pre–crisis levels.

32. **Fiscal consolidation targets are appropriate but the measures announced so far are insufficient to achieve these goals.** In light of the uncertainty in financial markets and contingent liabilities, the planned consolidation is necessary. The authorities are committed to the consolidation path. However, additional measures over and above those announced so far are needed to sustainably bring the general government deficit below 3 percent by 2013. Measures are mostly temporary and largely rely on extending policies introduced in 2011.

33. **Durable consolidation measures should be specified and implemented**. The policy of removing disparities in public sector wages should not increase the general government wage bill, and social programs should be better targeted and their eligibility criteria tightened. The government should also reduce public sector employment by 1 percent per year in 2011 and 2012 as planned in the stability program. The rise in the minimum wage that was already implemented last year may put pressure on the public wage bill when the temporary containment measures are lifted; lasting consolidation measures should be introduced to offset this effect if it materializes.

34. **The pension reform approved by the parliament is a step in the right direction but is insufficient in the long run.** Slovenia is projected to have one of the largest pension expenditures in the EU by 2050. By increasing retirement age and lowering the replacement rate, the pension reform will improve fiscal sustainability. However, projections suggest that transfers from the state budget to the pension fund would remain very large even after the pension reform. Additional measures will need to be implemented going forward to ensure sustainability, including: a more rapid increase in the effective retirement age to 65 years of age for both men and women; moving indexation gradually towards full price indexation; and automatically indexing the retirement age to life expectancy at retirement once an effective retirement age of 65 has been attained. In case of rejection of the pension reform in the referendum, temporary measures such as a freeze in pensions until a new pension reform is approved, will be needed.

35. **Banks need to be further capitalized**. Publicly announced recapitalizations for the systemic banks are a good start, but probably insufficient. The authorities should further tighten capital requirements and stand ready to inject public funds if private investors are not forthcoming. Higher capitalization will keep the banks' franchise value and contain the cost of borrowing.

36. **Banks' governance should be improved, including by broadening the investor base.** Expanding ownership to include private and foreign investors will help address long-standing governance and risk management weaknesses by reducing possible state interference in credit allocation. The authorities should set out clear divestment strategies and commit to their implementation.

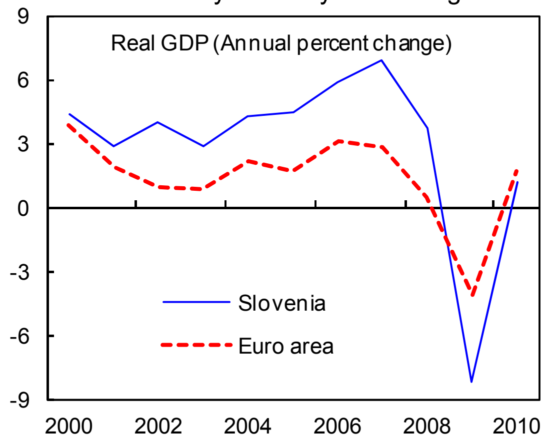
37. **Lending practices should not be distorted but monitored carefully**. The proposal to tax banks' balance sheet to incentivize borrowing to the over-indebted corporate sector is distortive, and should not be implemented. Given ongoing risks to house prices and the prospect of rising interest rates, the authorities should take care to prevent recent surges in mortgage lending from creating new imbalances. The authorities' willingness to tighten prudential regulations if necessary is welcome.

38. **Structural reforms in the labor and product markets are critical to boost potential growth, which has been lagging after the crisis.** Labor market restrictions—especially for dismissals—should be loosened. This, together with accelerating privatization and measures to enhance competition in product and financial markets, will help foster FDI inflows. Cancelling any remaining indexation of the minimum wage and eliminating the mandatory wage supplement for years of service would better align wage and productivity growth, helping avoiding a further degradation in unit labor cost.

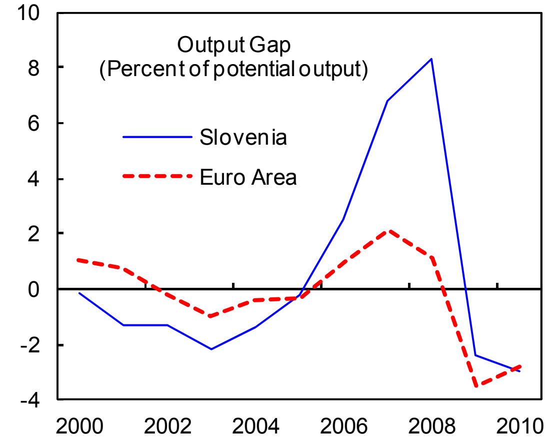
39. **It is proposed that the next Article IV consultation be held on the usual 24-month cycle.**

Figure 1. Slovenia: Economic Indicators

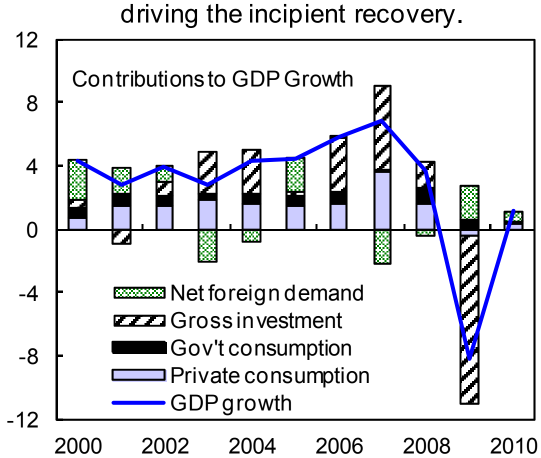
After being hit by the crisis in 2009, the economy is slowly recovering.



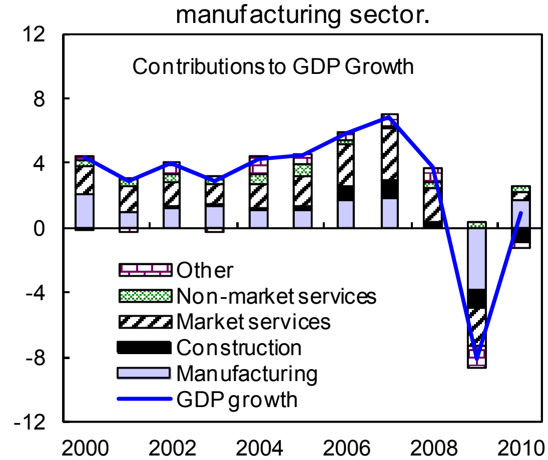
The output gap has remained negative as in the rest of the euro area.



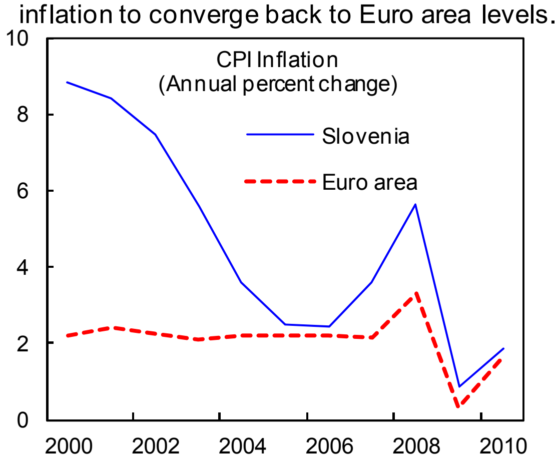
Net foreign demand has been the main factor driving the incipient recovery.



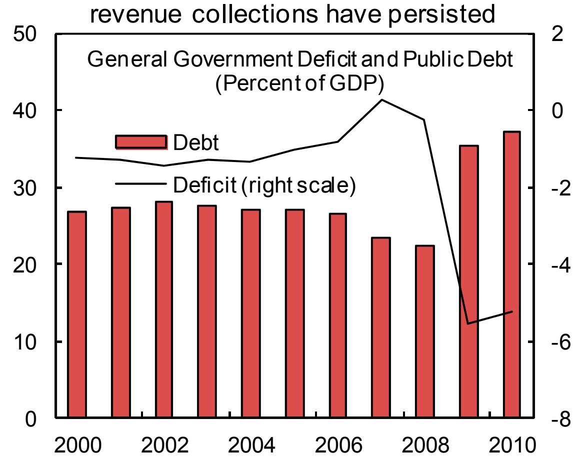
Permitting a recovery of the manufacturing sector.



The weak domestic demand has helped CPI inflation to converge back to Euro area levels.

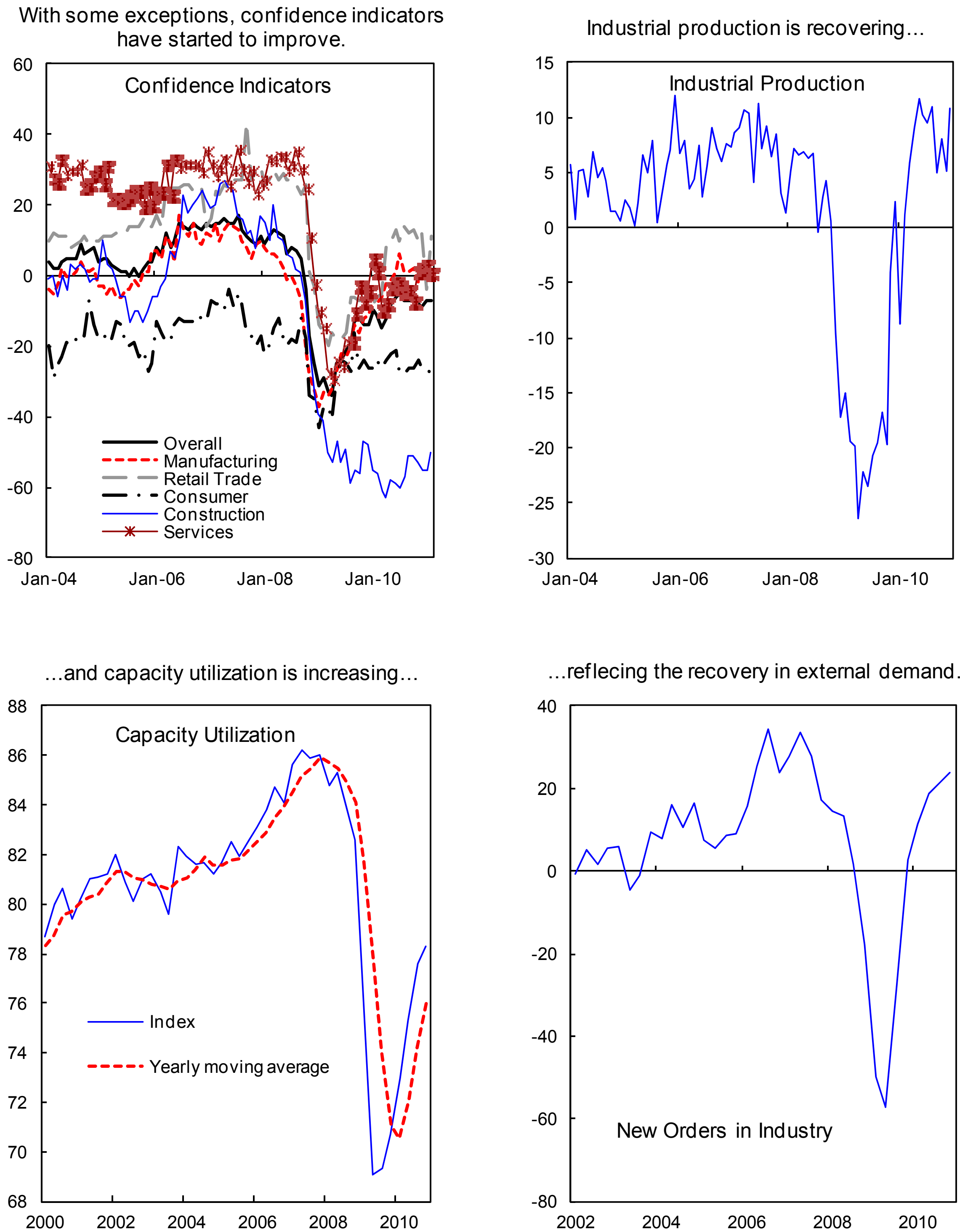


The deficit has narrowed in 2010 but weak revenue collections have persisted



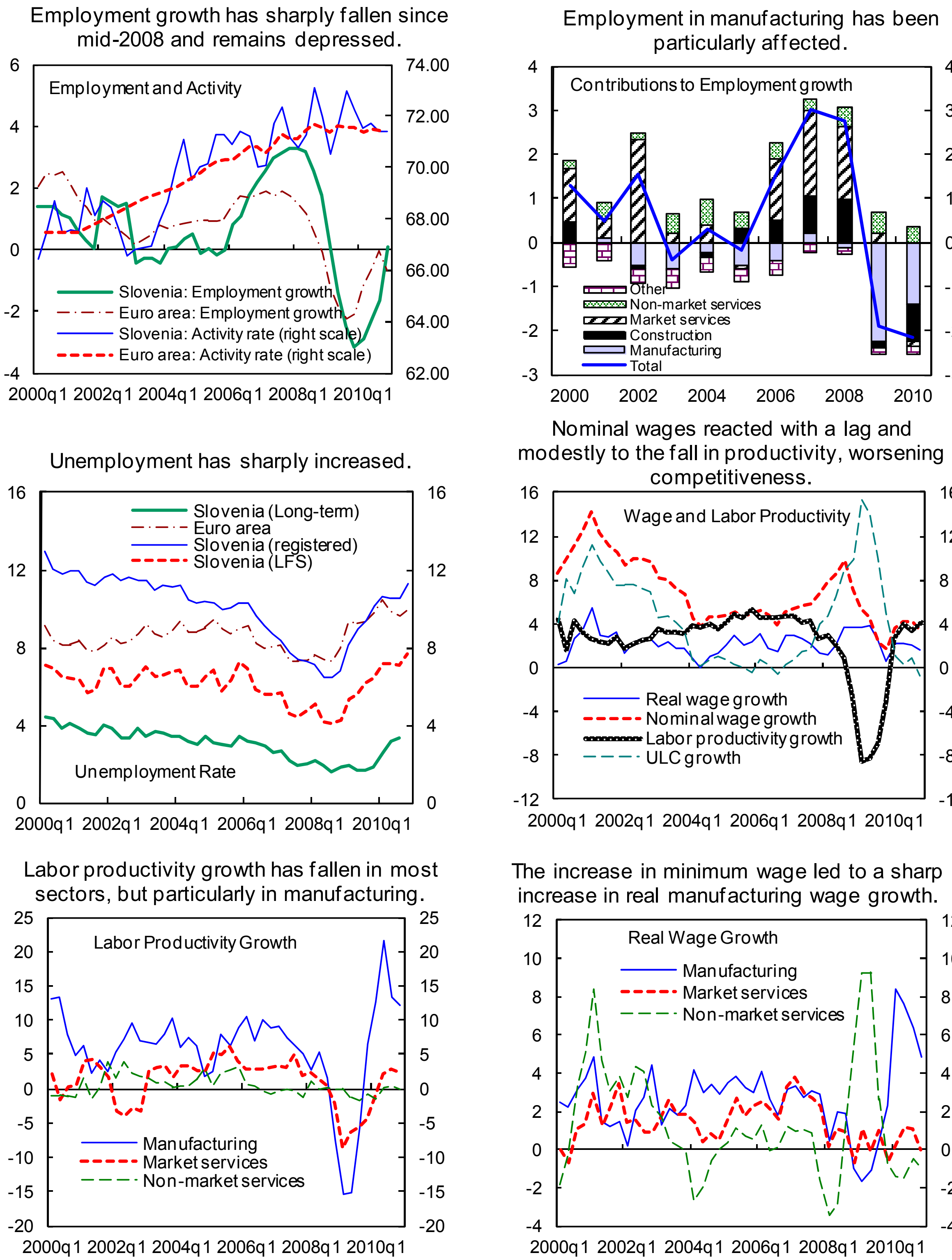
Sources: Bank of Slovenia; Ministry of Finance; Statistical Office; and IMF staff projections.

Figure 2. Slovenia: Short-term Indicators
(Year-on-year percent change, seasonally adjusted, unless otherwise indicated)



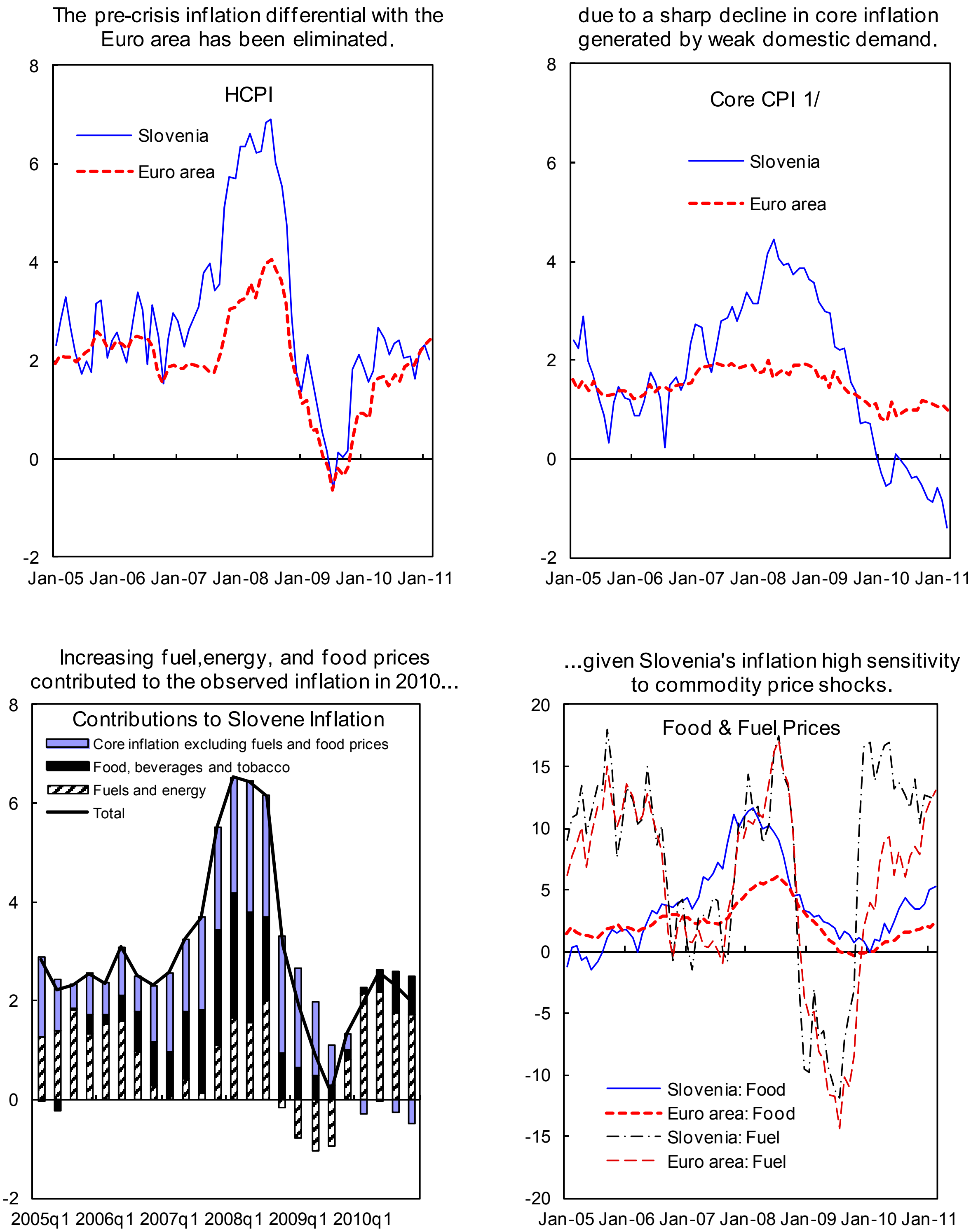
Sources: Statistical Office of the Republic of Slovenia; European Commission; and IMF staff estimates.

Figure 3. Slovenia: Labor Market Indicators



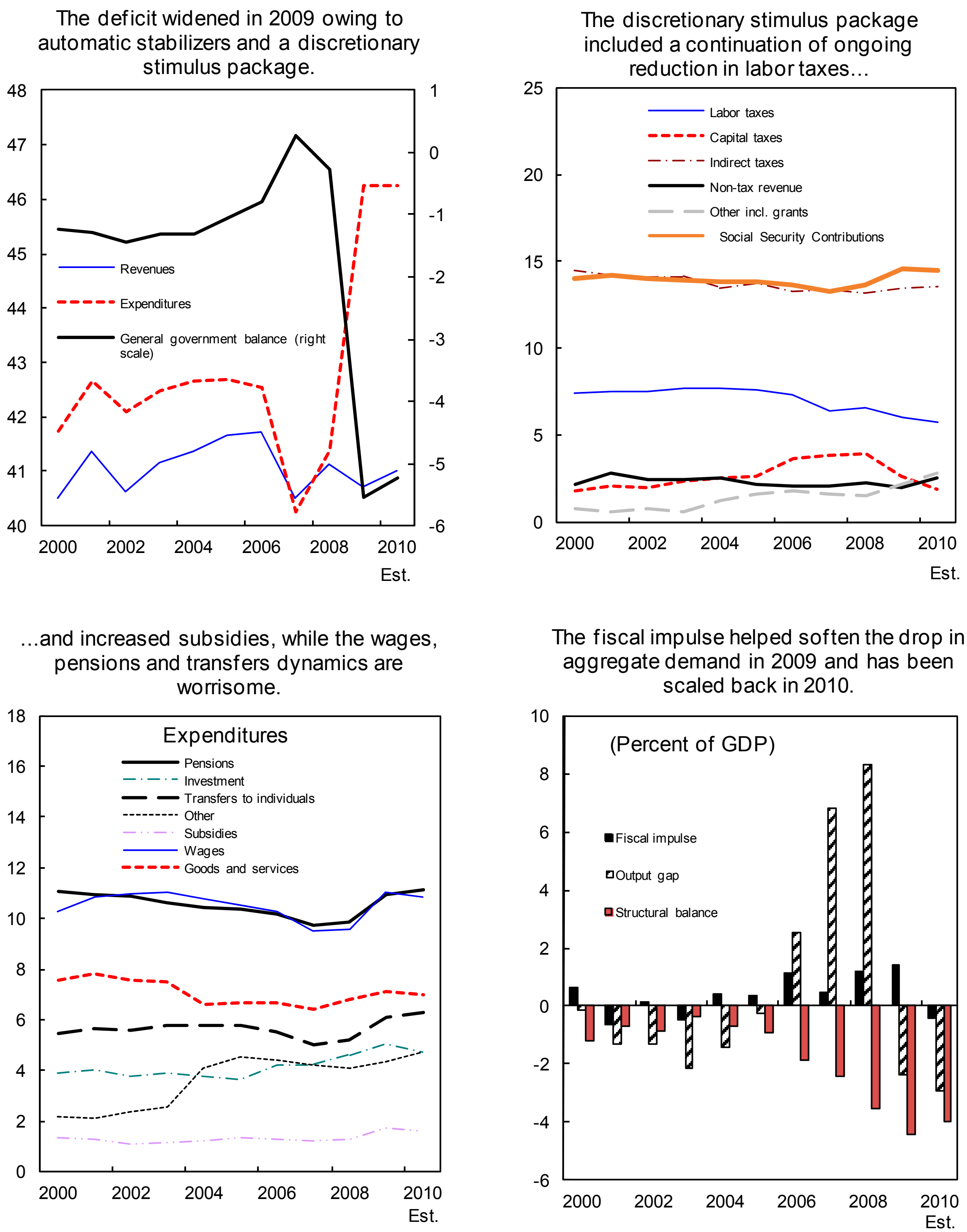
Sources: Statistical Office of the Republic of Slovenia; Eurostat; WEO; and IMF staff estimates.

Figure 4. Slovenia: CPI Inflation and Components
(Year-on-year percent change)



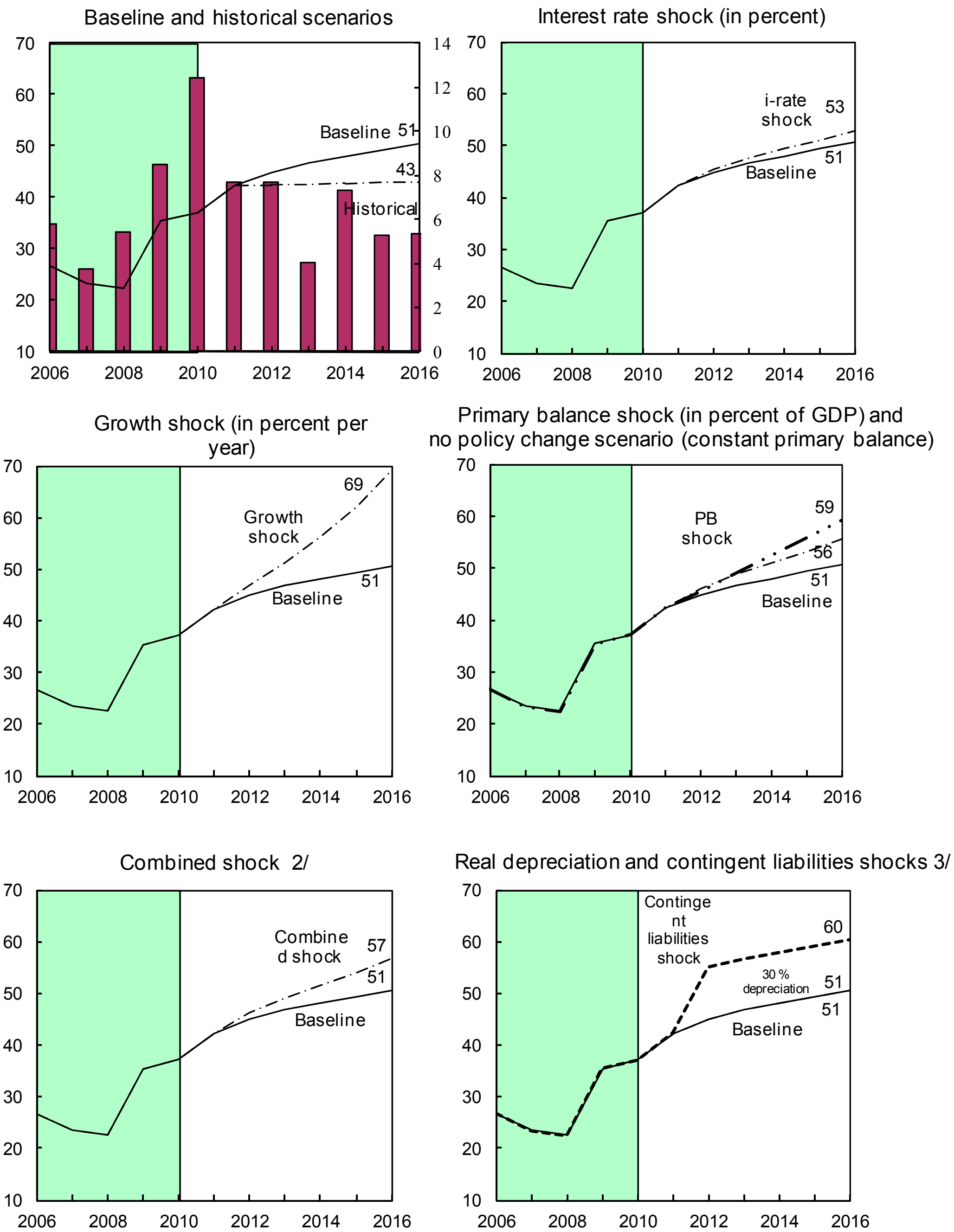
Sources: Eurostat; and IMF staff estimates.
1/ Core CPI is defined as total HCPI excluding energy, food, alcohol, and tobacco.

Figure 5. Slovenia: Fiscal Sector
(Percent of GDP)



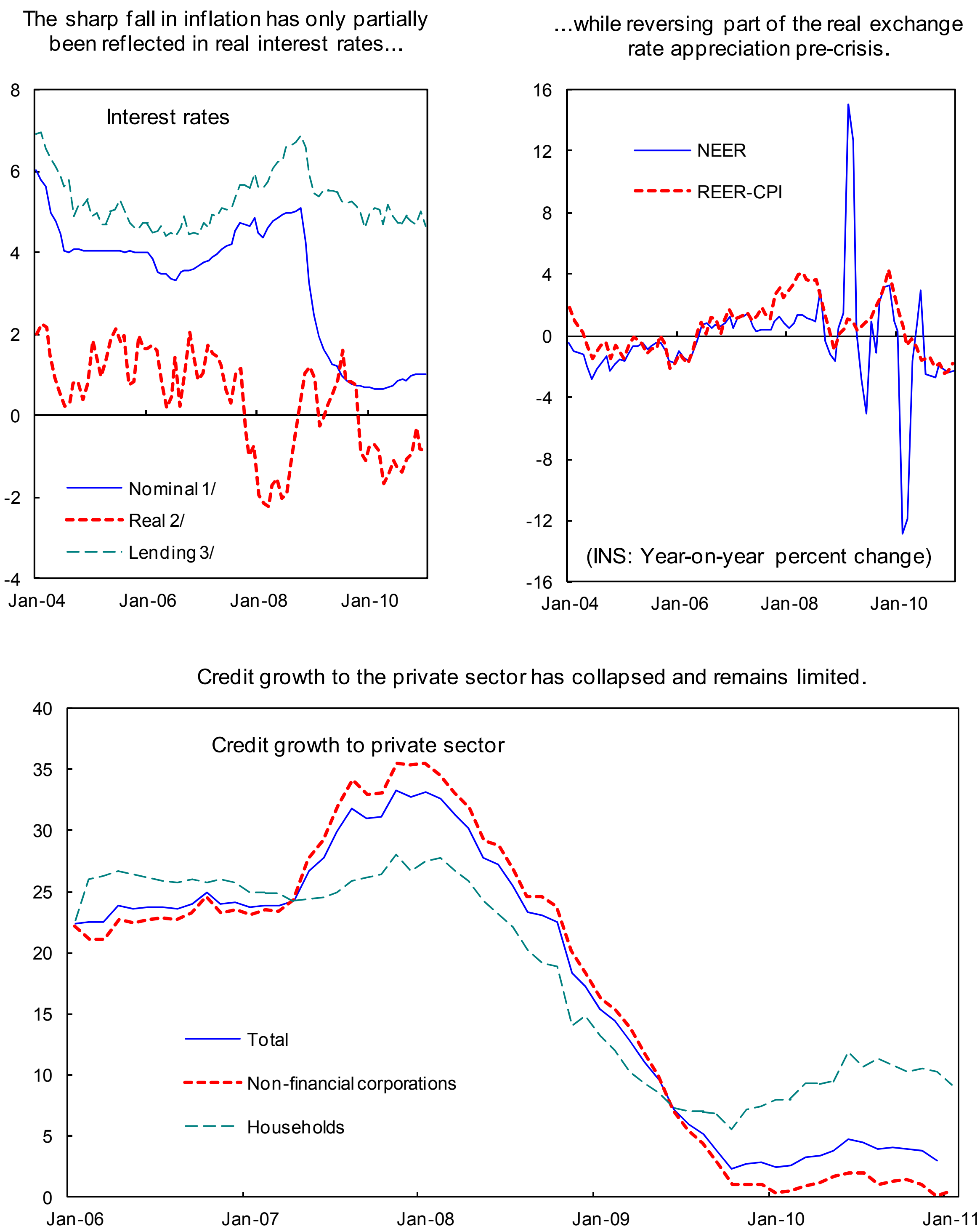
Sources: Ministry of Finance of the Republic of Slovenia; and IMF staff estimates.

Figure 6. Slovenia: Public Debt Sustainability: Bound Tests 1/
(Public debt in percent of GDP)



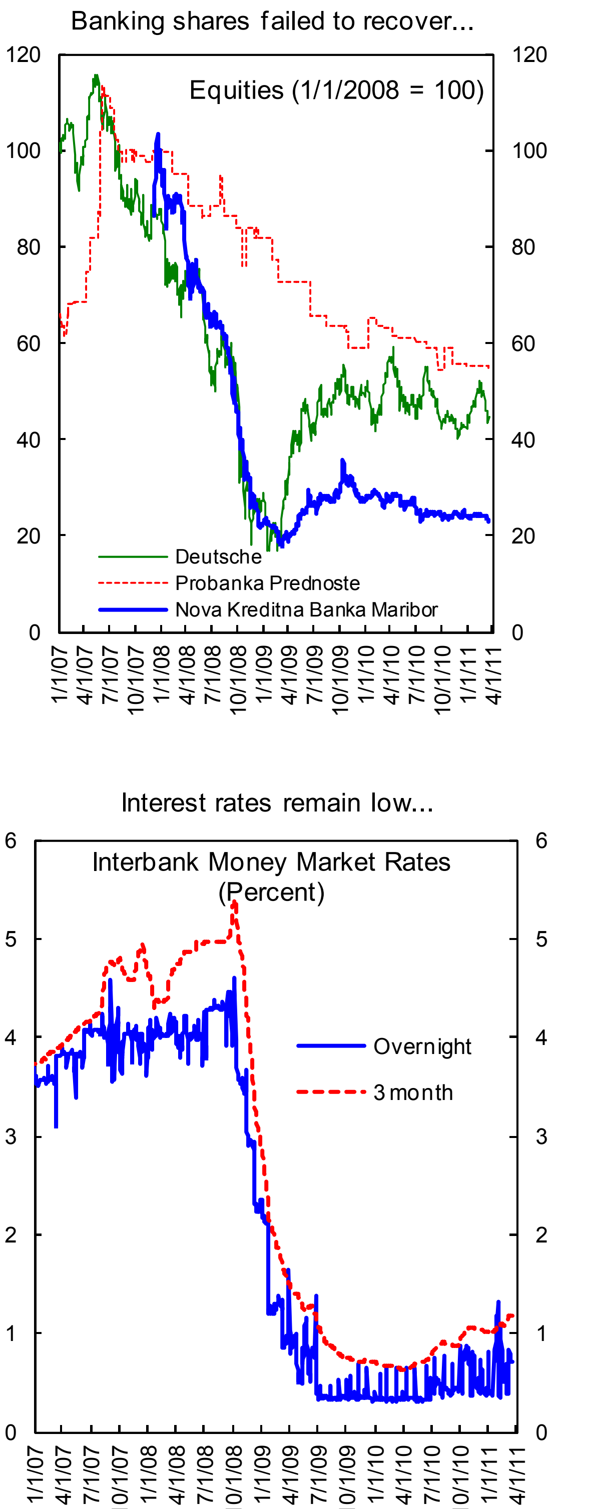
Sources: International Monetary Fund, country desk data, and staff estimates.
1/ Shaded areas represent actual data. Individual shocks are permanent one-half standard deviation shocks. Figures in the boxes represent average projections for the respective variables in the baseline and scenario being presented. Ten-year historical average for the variable is also shown.
2/ Permanent 1/4 standard deviation shocks applied to real interest rate, growth rate, and primary balance.
3/ One-time real depreciation of 30 percent and 10 percent of GDP shock to contingent liabilities occur in 2010, with real depreciation defined as nominal depreciation (measured by percentage fall in dollar value of local currency) minus domestic inflation (based on GDP deflator).

Figure 7. Slovenia: Monetary Conditions
(Percent, unless otherwise indicated)



Sources: Bank of Slovenia; and IMF staff estimates.
1/ SITIBOR / EURIBOR 3 month interest rate.
2/ Nominal 3-month interest rate deflated by HCPI year-on-year percent change.
3/ Floating and up to 1 year initial rate fixation on loans over 1 million euro.

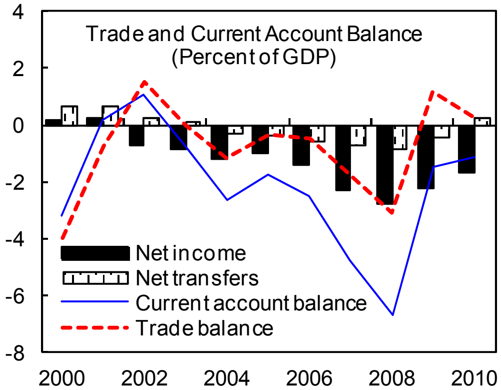
Figure 8. Slovenia: High-Frequency Financial Indicators 1/



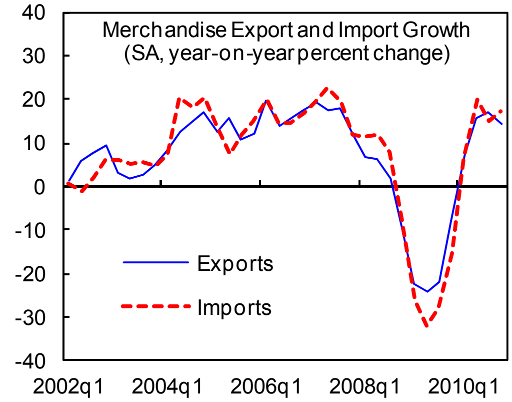
Sources: Thomson Financial/DataStream; and Bloomberg.
1/ The latest observation is as of March 21, 2011.

Figure 9. Slovenia: External Sector Developments

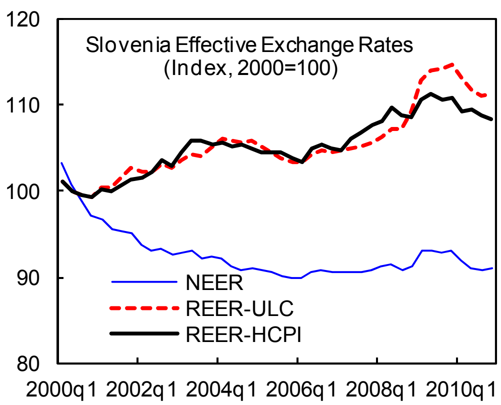
The trade and current account deficits have narrowed substantially during the crisis.



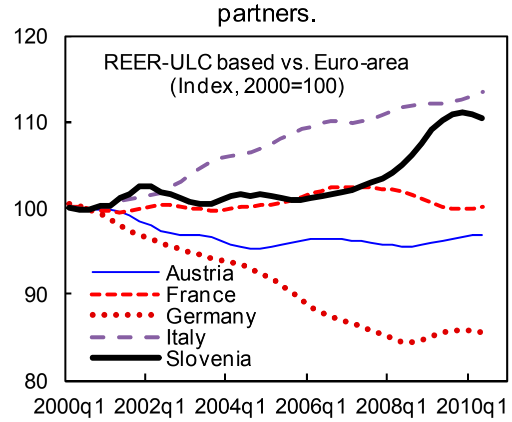
As goods imports declined more than goods exports.



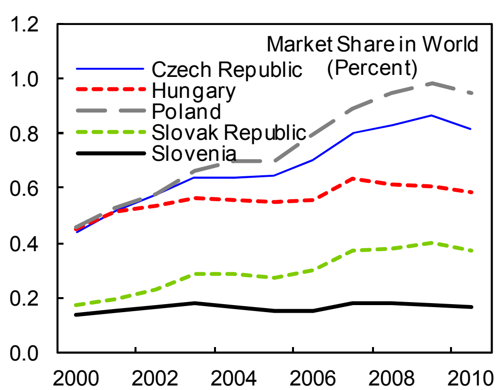
Despite some crisis-related improvement...



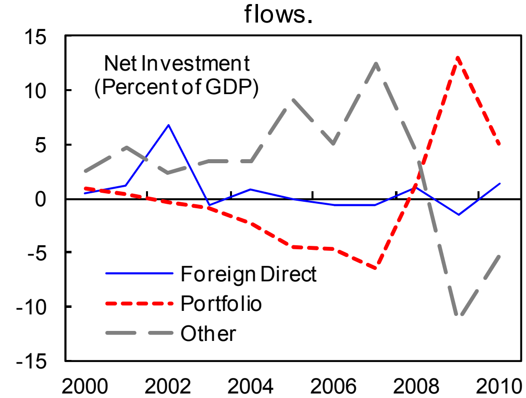
...Slovenia's cost competitiveness deteriorated much more than in main trading partners.



Market shares have been broadly constant.

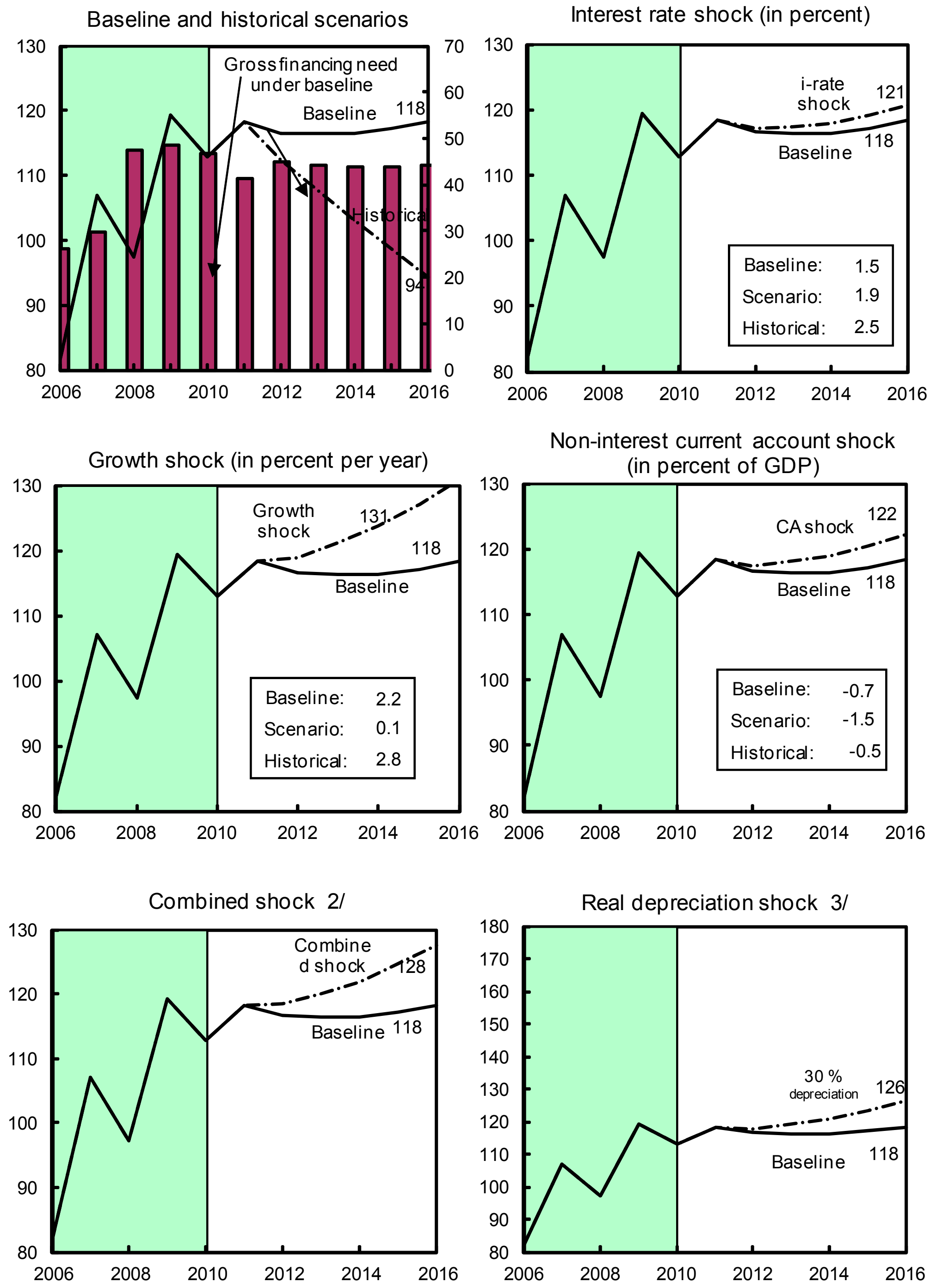


The large current account deficit reduction mirrored a reversal in cross-border lending flows.



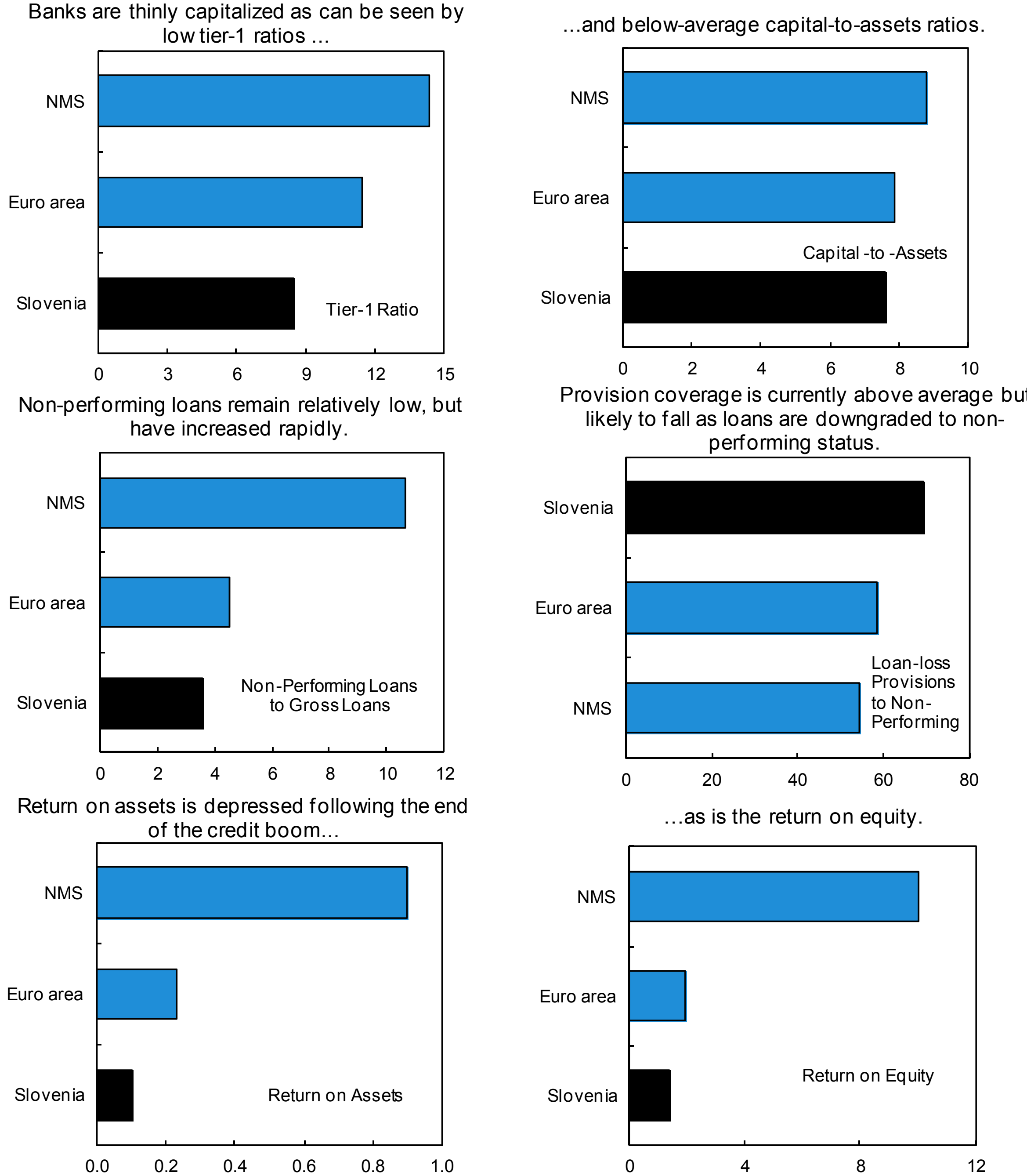
Sources: Bank of Slovenia; European Central Bank; Direction of Trade Statistics; and IMF staff estimates.

Figure 10. Slovenia: External Debt Sustainability: Bound Tests 1/
(External debt in percent of GDP)



Sources: International Monetary Fund, Country desk data, and IMF staff estimates.
1/ Shaded areas represent actual data. Individual shocks are permanent one-half standard deviation shocks. Figures in the boxes represent average projections for the respective variables in the baseline and scenario being presented. Ten-year historical average for the variable is also shown.
2/ Permanent 1/4 standard deviation shocks applied to real interest rate, growth rate, and current account balance.
3/ One-time real depreciation of 30 percent occurs in 2010.

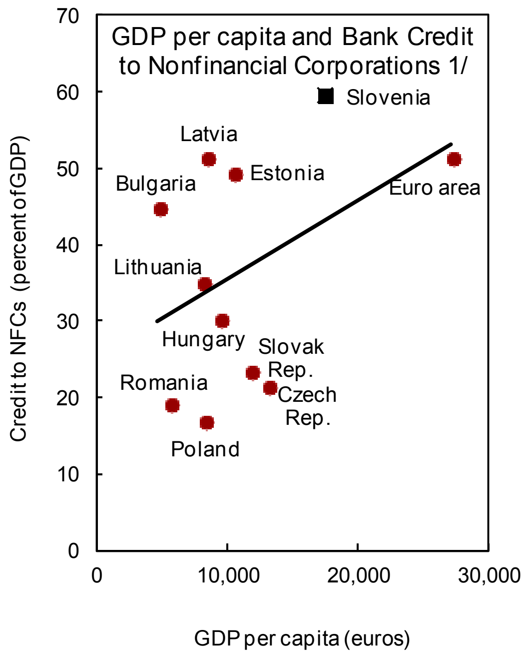
Figure 11. Slovenia: Financial Soundness Indicators, 2010 1/
(Percent)



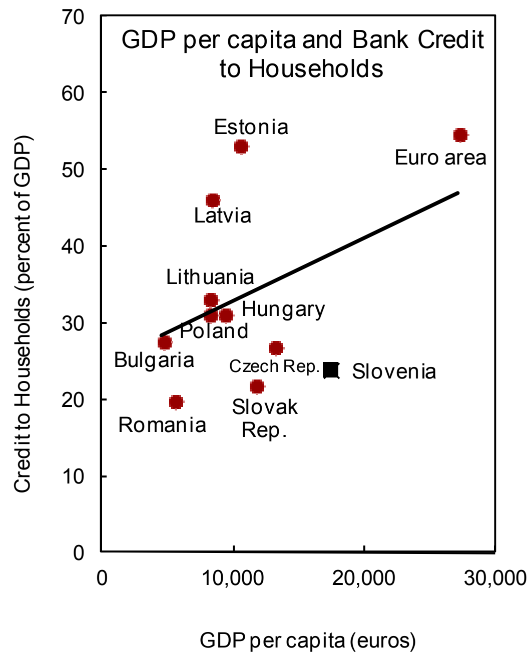
Sources: European Central Bank: IMF, *Global Financial Stability Report*; and Bank of Slovenia.
1/ NMS includes: Czech Republic, Estonia, Hungary, Latvia, Lithuania, Poland, and Slovak Republic.

Figure 12. Bank Credit to Households and Nonfinancial Corporations in European Emerging Markets, 2009

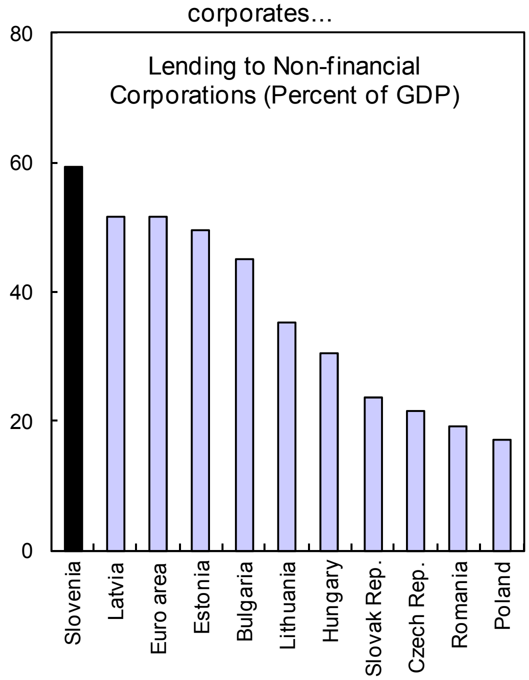
Bank credit to non-financial corporates is high relative to Slovenia's level income...



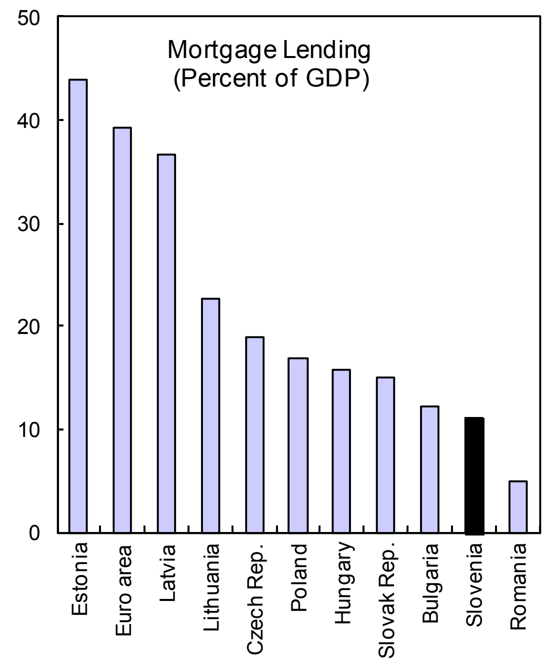
...while houshold credit is lower than income alone would suggest.



Bank credit is the only significant source of external financing for non-financial corporates...

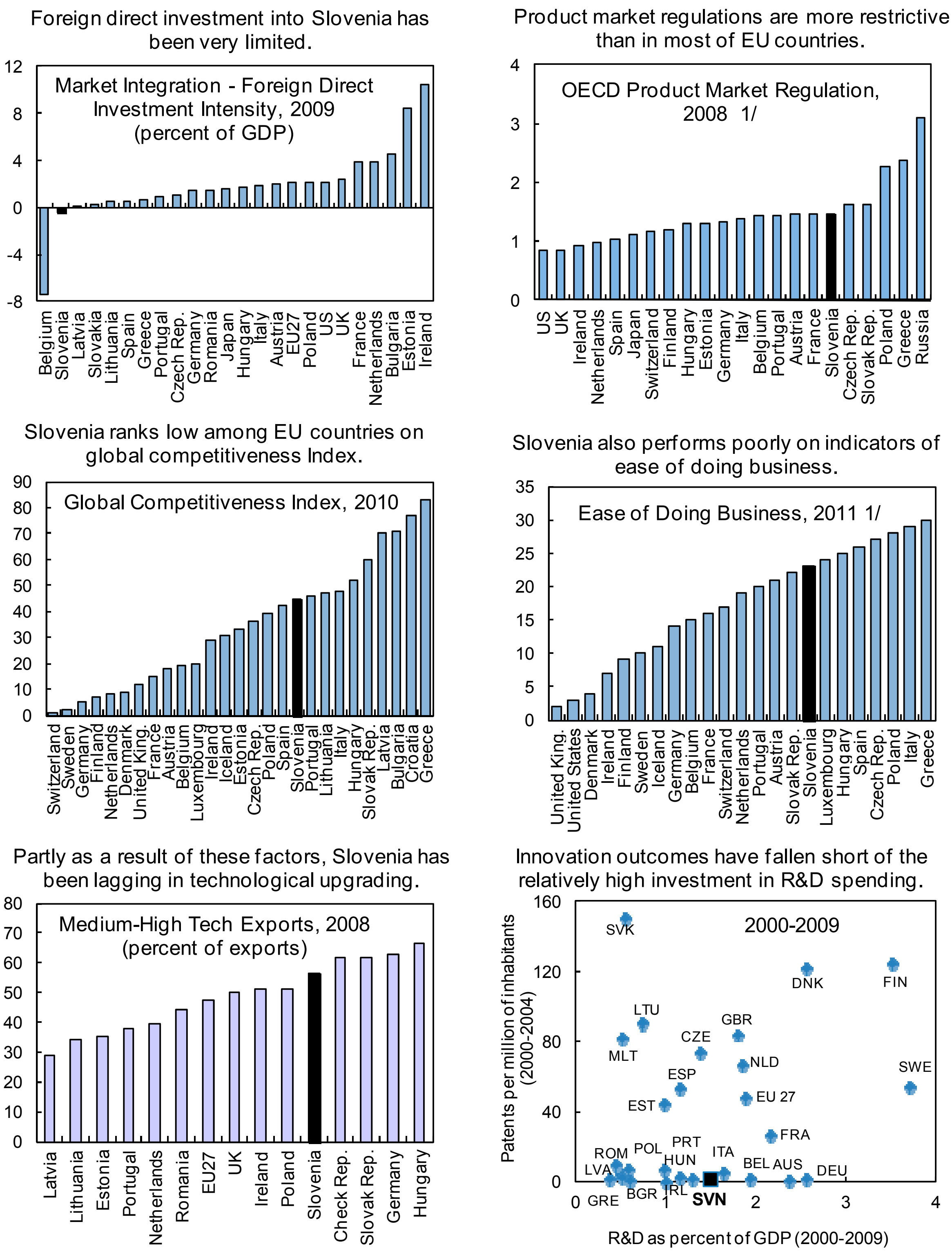


...but households do not overly rely on borrowing from banks.



Sources: Eurostat; European Central Bank; and IMF staff estimates.

Figure 13. Structural Indicators of the Product Market



Sources: World Bank, *Doing Business*; World Economic Forum; European Commission, *European Innovation Scoreboard*.
1/ A lower value indicates a better performance.

Table 1. Slovenia: Selected Economic Indicators, 2006–2013
(Annual percentage change, unless noted otherwise)

						Projections		
	2006	2007	2008	2009	2010	2011	2012	2013
Real GDP	5.9	6.9	3.7	-8.1	1.2	2.0	2.4	2.5
Domestic demand	5.7	8.9	4.1	-10.1	0.4	1.0	2.2	2.6
Private consumption	2.9	6.7	2.9	-0.8	0.5	1.2	2.2	2.3
Public consumption	4.0	0.7	6.2	3.0	0.8	-2.4	-1.0	0.7
Gross capital formation	12.2	18.2	4.9	-32.0	0.0	3.5	4.5	4.6
Net exports (contribution to growth)	0.1	-2.2	-0.5	2.2	0.7	1.0	0.2	-0.1
Exports of goods and services	12.5	13.7	3.3	-17.7	7.8	6.8	5.7	5.5
Imports of goods and services	12.2	16.7	3.8	-19.7	6.6	5.3	5.4	5.6
Output gap (in percent of potential GDP)	2.5	6.8	8.3	-2.4	-3.0	-2.6	-2.0	-1.1
Prices								
GDP deflator	2.0	4.2	4.0	3.2	0.7	0.7	2.7	2.4
Consumer prices (national definition, period average)	2.5	3.6	5.7	0.9	1.8	2.2	3.1	2.3
HICP (period average)	2.5	3.8	5.5	0.9	2.1	2.4	3.3	2.6
Differential with euro area average	0.3	1.6	2.2	0.6	0.5	…	…	…
Core inflation (period average) 1/	1.3	2.7	3.8	1.7	-0.4	…	…	…
Employment and wages								
Unemployment rate (in percent, ILO definition)	6.0	4.9	4.4	5.9	7.2	7.5	7.2	6.9
Unemployment rate (in percent, registered)	9.4	7.7	6.7	9.2	10.7	11.1	10.6	10.2
Employment (Full employment basis, National accounts)	1.5	3.0	2.8	-1.9	-2.2	-0.3	0.4	0.6
Nominal wages (all sectors)	4.8	5.9	8.3	3.5	3.9	3.9	4.3	3.6
Real wages (all sectors)	2.3	2.2	2.5	2.6	2.0	2.3	1.9	1.9
Unit labor cost (all sectors)	0.5	2.1	7.3	10.5	0.4	1.5	2.3	1.7
Public finance (percent of GDP)								
General government balance 2/	-0.8	0.3	-0.3	-5.5	-5.2	-4.8	-4.3	-3.5
Primary balance	0.3	1.2	0.5	-4.7	-4.0	-3.4	-2.8	-1.9
Structural balance	-1.9	-2.4	-3.6	-4.5	-4.0	-3.7	-3.4	-3.0
General government debt	26.7	23.4	22.5	35.4	37.2	42.3	44.9	46.7
Monetary and financial indicators								
Credit to the private sector	26.5	34.1	17.2	3.2	2.0	…	…	…
Lending rates 3/	5.4	5.2	6.2	5.3	4.9	…	…	…
Deposit rates 4/	3.0	3.4	4.3	2.5	1.8	…	…	…
Government bond yield (10-year, average) 5/	3.9	4.5	4.7	4.4	3.8	…	…	…
Balance of payments (percent of GDP)								
Trade balance (goods)	-3.7	-4.8	-7.1	-2.0	-2.7	-3.1	-3.2	-3.2
Current account balance	-2.5	-4.8	-6.7	-1.5	-1.2	-2.0	-2.1	-2.1
Gross official reserves (EUR billions)	5,418.5	723.8	687.3	749.6	730.2	…	…	…
Gross external debt (percent of GDP, end-period)	77.5	100.6	105.2	113.8	113.3	114.4	112.8	112.6
Nominal effective exchange rate (2000=100)	100.0	100.8	101.4	104.0	100.6	…	…	…
Real effective exchange rate (2000=100, CPI-based)	100.1	101.8	104.0	106.8	101.9	…	…	…

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

1/ HICP: Total excl Energy, Food, Alcohol, Tobacco (NSA, 2005=100), period average.

2/ The fiscal deficit could be higher by 0.7 percent of GDP in 2011 if Eurostat classifies the recently approved recapitalization of state banks as state aid for EDP compliance purposes.

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

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

5/ Eurostat Data.

Table 2. Slovenia: Consolidated General Government Operations (cash basis), 2007–2013
(Percent of GDP)

	2006 Outturn	2007 Outturn	2008 Outturn	2009 Outturn	2010 Preliminary Estimate	2011 Staff Projections 1/	2012 Staff Projections	2013 Staff Projections
Total revenues	41.7	40.5	41.1	40.7	41.0	40.7	40.5	40.4
Tax revenues	37.9	36.9	37.4	36.6	35.6	36.1	36.2	36.2
Personal income tax	5.8	5.2	5.9	5.9	5.7	5.7	5.8	5.8
Corporate income tax	3.0	3.2	3.4	2.0	1.2	1.4	1.4	1.4
Social security contributions	13.6	13.3	13.7	14.6	14.5	14.7	14.8	14.8
Taxes on payroll and workforce	1.5	1.2	0.7	0.1	0.1	0.1	0.1	0.1
Domestic taxes on goods and services	13.1	13.0	12.9	13.2	13.3	13.3	13.3	13.3
VAT	8.7	8.4	8.4	8.0	8.2	8.2	8.2	8.2
Excise taxes	3.1	3.3	3.3	4.0	4.0	4.0	4.0	4.0
Other	1.3	1.3	1.2	1.2	1.1	1.1	1.1	1.1
Taxes on international trade	0.2	0.3	0.3	0.3	0.3	0.3	0.3	0.3
Taxes on property	0.6	0.6	0.6	0.6	0.6	0.6	0.6	0.6
Other taxes	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Nontax revenues	2.0	2.1	2.3	1.9	2.6	2.2	2.0	2.0
Capital revenues and grants	0.7	0.6	0.5	0.5	0.8	0.5	0.4	0.4
Receipts from the EU budget	1.1	1.0	1.0	1.7	2.0	2.0	1.9	1.9
Total expenditures	42.5	40.3	41.4	46.3	46.2	45.5	44.8	43.9
Current expenditures	38.3	36.0	36.8	41.2	41.5	41.5	40.9	39.8
Wages and social security contributions	10.2	9.5	9.6	11.1	10.9	10.7	10.4	10.0
Central and local government	3.6	3.4	3.5	4.0	3.9	3.9	3.8	3.6
Other public institutions	6.6	6.1	6.1	7.1	6.9	6.8	6.6	6.4
Expenditure on goods and services	6.7	6.4	6.8	7.1	7.0	6.6	6.4	6.5
Central and local government	3.2	3.1	3.2	3.4	3.3	3.1	3.1	3.1
Other public institutions	3.5	3.3	3.6	3.7	3.6	3.4	3.4	3.4
Interest payments	1.2	1.0	0.9	0.9	1.4	1.4	1.6	1.7
Transfers to individuals and households	5.5	5.0	5.2	6.1	6.3	6.5	6.2	5.8
Pensions	10.2	9.7	9.9	10.9	11.1	11.4	11.2	11.1
Subsidies	1.3	1.2	1.3	1.7	1.6	1.5	1.5	1.3
Other current transfers	2.3	2.1	2.0	2.1	2.3	2.3	2.4	2.4
Capital expenditures and transfers	4.2	4.2	4.6	5.1	4.7	4.0	3.9	4.1
Acquisition of capital assets	2.9	3.3	3.4	3.7	3.6	3.3	3.3	3.5
Capital transfers	1.3	1.0	1.2	1.4	1.1	0.7	0.6	0.6
Transfers to the EU budget	0.9	1.0	1.1	1.2	1.1	1.1	1.1	1.0
General government balance	-0.8	0.3	-0.3	-5.5	-5.2	-4.8	-4.3	-3.5
Primary balance	0.3	1.2	0.5	-4.7	-4.0	-3.4	-2.8	-1.9
Memorandum items:								
General government balance (ESA 95)	-1.2	0.5	-0.7	-6.0	-5.6	-5.1	-4.6	-3.8
Structural budget balance	-1.9	-2.4	-3.6	-4.5	-4.0	-3.7	-3.4	-3.0
Structural primary balance	-0.8	-1.5	-2.8	-3.6	-2.7	-2.3	-1.9	-1.4
General government debt	26.7	23.4	22.5	35.4	37.2	42.3	44.9	46.7
Nominal GDP (millions of euro)	31,050	34,568	37,305	35,384	36,061	37,037	38,944	40,859

Sources: Ministry of Finance; and IMF staff calculations.

1/ The fiscal deficit could be higher by 0.7 percent of GDP in 2011 if Eurostat classifies the recapitalization of state banks as state aid.

Table 3. Slovenia: Balance of Payments, 2006–2013
(Millions of euros, unless otherwise noted)

					Projections			
	2006	2007	2008	2009	2010	2011	2012	2013
Current account	-771	-1,646	-2,489	-526	-419	-741	-817	-857
Trade balance, goods and services	-158	-619	-1,157	415	91	-86	-123	-116
Goods	-1,151	-1,666	-2,650	-699	-964	-1,166	-1,257	-1,305
Exports f.o.b.	17,028	19,799	20,048	16,167	18,362	20,487	22,452	24,353
Imports f.o.b.	-18,179	-21,464	-22,699	-16,866	-19,326	-21,653	-23,708	-25,658
Services	993	1,047	1,493	1,114	1,055	1,080	1,134	1,189
Exports	3,572	4,145	5,043	4,301	4,352	4,696	4,958	5,200
Imports	-2,580	-3,098	-3,549	-3,187	-3,297	-3,617	-3,824	-4,011
Income, net	-440	-789	-1,030	-782	-613	-762	-807	-859
Current transfers, net	-173	-239	-302	-159	104	107	113	118
Capital account	-132	-52	-25	-9	11	0	0	0
Financial account, excl. reserves	-58	1,832	2,550	63	322	741	817	857
Direct investment, net	-174	-210	381	-539	516	333	389	409
In Slovenia	513	1,106	1,330	-419	630	593	857	981
Abroad	-687	-1,317	-949	-121	-114	-259	-467	-572
Portfolio investment, net	-1,443	-2,255	572	4,624	1,838	444	428	-327
Financial derivatives	-13	-21	6	6	0	0	0	0
Other investment, net	1,571	4,313	1,551	-4,021	-1,942	-37	-1	775
Government	-115	-43	-29	-22	-3	-37	-39	-41
Bank of Slovenia	-1	-45	-6	-1	99	0	0	0
Commercial banks	1,960	5,555	1,499	-3,957	-1,075	30	129	613
Nonbank private sector	-273	-281	-397	-821	-916	-493	-620	-519
Loans	479	341	576	45	-242	78	81	284
Household currency and deposits	-805	-655	-685	-947	-840	-467	-545	-631
Trade credits	36	100	-215	-42	138	-37	-78	-82
Other	17	-66	-73	123	27	-67	-78	-90
Net errors and omissions	-321	-274	-56	305	67	0	0	0
Overall balance	-1,281	-140	-21	-167	-19	0	0	0
Change in official reserves (-: increase)	1,281	140	21	167	19	0	0	0
Memorandum items:								
Current account balance (percent of GDP)	-2.5	-4.8	-6.7	-1.5	-1.2	-2.0	-2.1	-2.1
Export of goods (percent change in value)	16.6	16.3	1.3	-19.4	13.6	11.6	9.6	8.5
Import of goods (percent change in value)	16.4	18.1	5.7	-25.6	14.6	11.8	9.5	8.2
Terms of trade (percent change)	-0.4	0.6	-1.8	4.7	-3.2	-0.2	0.0	0.0
Gross external debt	24,067	34,783	39,234	40,276	40,851	42,366	43,924	46,024
(percent of GDP)	77.5	100.6	105.2	113.8	113.3	114.4	112.8	112.6
Net external debt (liabilities - assets) 1/	3394.0	6352.0	9976.0	10682.0	11332.0	11513.5	11747.8	11762.8
(percent of GDP)	10.9	18.4	26.7	30.2	31.4	31.1	30.2	28.8

1/ A negative number indicates net creditor position.

Table 4. Slovenia: Macroeconomic Framework, 2006–2015

					Projections					
	2006	2007	2008	2009	2010	2011	2012	2013	2014	2015
Real GDP (percent change)	5.9	6.9	3.7	-8.1	1.2	2.0	2.4	2.5	2.3	2.0
Contribution										
Domestic demand	5.8	9.0	4.2	-10.5	0.4	1.0	2.2	2.6	2.4	2.1
Private consumption	1.6	3.6	1.5	-0.4	0.3	0.7	1.2	1.3	1.2	1.0
Government consumption	0.7	0.1	1.1	0.5	0.2	-0.5	-0.2	0.1	0.1	0.1
Gross investment	3.4	5.4	1.6	-10.6	0.0	0.8	1.1	1.1	1.1	1.0
Net foreign demand	0.1	-2.2	-0.5	2.2	0.7	1.0	0.2	-0.1	-0.1	-0.1
Exports of goods and services	8.2	9.6	2.5	-13.1	5.1	4.8	4.2	4.2	4.2	4.4
Imports of goods and services	-8.1	-11.8	-3.0	15.3	-4.5	-3.8	-4.0	-4.2	-4.3	-4.4
Output gap (in percent of potential)	2.5	6.8	8.3	-2.4	-3.0	-2.6	-2.0	-1.1	-0.5	-0.1
Growth rates										
Domestic demand	5.7	8.9	4.1	-10.1	0.4	1.0	2.2	2.6	2.5	2.1
Consumption	3.2	5.1	3.7	0.2	0.6	0.2	1.4	1.9	1.8	1.5
Government	4.0	0.7	6.2	3.0	0.8	-2.4	-1.0	0.7	0.4	0.5
Non-government	2.9	6.7	2.9	-0.8	0.5	1.2	2.2	2.3	2.2	1.8
Gross capital formation	12.2	18.2	4.9	-32.0	0.0	3.5	4.5	4.6	4.4	3.9
Fixed investment	10.1	12.8	8.5	-21.6	-6.7	1.0	4.7	4.8	4.6	4.0
Change in stocks (contribution to GDP growth	0.8	1.9	-0.8	-4.1	1.7	0.6	0.0	0.0	0.0	0.0
Exports of goods and services	12.5	13.7	3.3	-17.7	7.8	6.8	5.7	5.5	5.4	5.4
Imports of goods and services	12.2	16.7	3.8	-19.7	6.6	5.3	5.4	5.6	5.5	5.5
Savings and investment (percent of GDP)										
National saving	26.5	26.9	25.3	21.5	22.0	22.1	22.5	23.0	23.3	23.6
Government	3.4	4.5	4.3	-0.5	-0.5	-0.8	-0.4	0.7	1.1	1.2
Non-government	23.1	22.4	21.0	22.0	22.5	22.9	22.9	22.3	22.3	22.4
Gross capital formation	28.9	31.7	31.9	23.0	23.1	24.1	24.6	25.1	25.5	26.0
Government 1/	2.9	3.3	3.4	3.7	3.6	3.3	3.3	3.5	3.5	3.5
Non-government	26.0	28.4	28.6	19.4	19.5	20.8	21.4	21.6	22.0	22.5
Foreign saving	-2.5	-4.8	-6.7	-1.5	-1.2	-2.0	-2.1	-2.1	-2.2	-2.4
Prices										
Consumer price inflation	2.5	3.6	5.7	0.9	1.8	2.2	3.1	2.3	2.3	2.4
GDP deflator	2.0	4.2	4.0	3.2	0.7	0.7	2.7	2.4	2.5	2.3
Employment (percent change)	1.5	3.0	2.8	-1.9	-2.2	-0.3	0.4	0.6	0.6	0.5
Unemployment rate (ILO, percent)	6.0	4.9	4.4	5.9	7.2	7.5	7.2	6.9	6.5	5.9
Real wages (percent change)	2.3	2.2	2.5	2.6	2.0	2.3	1.9	1.9	1.7	1.5
Government budget (percent of GDP)										
Revenue	41.7	40.5	41.1	40.7	41.0	40.7	40.5	40.4	40.4	40.4
Expenditure	42.5	40.3	41.4	46.3	46.2	45.5	44.8	43.9	43.4	43.3
General government balance	-0.8	0.3	-0.3	-5.5	-5.2	-4.8	-4.3	-3.5	-3.1	-2.9
Structural government balance	-1.9	-2.4	-3.6	-4.5	-4.0	-3.7	-3.4	-3.0	-2.9	-2.9
General government debt		23.4	22.5	35.4	37.2	42.3	44.9	46.7	48.0	49.3
Merchandise trade (percent change)										
Export volume	13.4	13.9	0.6	-18.1	10.2	7.6	6.3	6.0	5.8	5.8
Import volume	12.7	16.2	3.1	-20.9	7.6	4.9	6.0	6.1	6.0	5.9
Export value	16.6	16.3	1.3	-19.4	13.6	11.6	9.6	8.5	8.3	8.4
Import value	16.3	18.1	5.7	-25.6	14.6	11.8	9.5	8.2	7.9	8.5
External balances (in billions of euros)										
Trade balance	-1.2	-1.7	-2.7	-0.7	-1.0	-1.2	-1.3	-1.3	-1.3	-1.5
In percent of GDP	-3.7	-4.8	-7.1	-2.0	-2.7	-3.1	-3.2	-3.2	-3.1	-3.3
Exports of goods	17.0	19.8	20.0	16.2	18.4	20.5	22.5	24.4	26.4	28.6
Imports of goods	18.2	21.5	22.7	16.9	19.3	21.7	23.7	25.7	27.7	30.0
Current account	-0.8	-1.6	-2.5	-0.5	-0.4	-0.7	-0.8	-0.9	-0.9	-1.1
In percent of GDP	-2.5	-4.8	-6.7	-1.5	-1.2	-2.0	-2.1	-2.1	-2.2	-2.4

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

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

Table 5. Slovenia: External Debt Sustainability Framework, 2006-2016
(In percent of GDP, unless otherwise indicated)

	Actual					Projections						
	2006	2007	2008	2009	2010	2011	2012	2013	2014	2015	2016	**Debt-stabilizing non-interest current account 6/**
Baseline: External debt	81.6	107.0	97.3	119.3	112.9	**118.3**	**116.5**	**116.4**	**116.4**	**117.2**	**118.3**	**-4.1**
Change in external debt	13.7	25.5	-9.7	22.0	-6.5	5.4	-1.7	-0.2	0.0	0.8	1.1	
Identified external debt-creating flows (4+8+9)	-3.0	-9.6	-1.5	8.2	-2.9	-1.2	-1.6	-1.7	-1.4	-0.9	-0.5	
Current account deficit, excluding interest payments	0.8	2.3	3.5	-0.1	0.2	0.4	0.5	0.5	0.6	0.8	1.0	
Deficit in balance of goods and services	0.5	1.8	3.1	-1.2	-0.3	0.2	0.3	0.3	0.2	0.4	0.5	
Exports	66.3	69.3	67.3	57.8	63.0	70.3	73.0	75.0	77.0	79.6	82.4	
Imports	66.9	71.1	70.4	56.7	62.7	70.6	73.3	75.3	77.2	80.0	82.9	
Net non-debt creating capital inflows (negative)	0.1	0.0	-0.5	1.5	-1.8	-1.0	-1.1	-1.1	-1.1	-1.1	-1.1	
Automatic debt dynamics 1/	-3.9	-11.9	-4.4	6.8	-1.3	-0.6	-1.0	-1.1	-0.9	-0.6	-0.4	
Contribution from nominal interest rate	1.7	2.5	3.2	1.6	1.0	1.7	1.6	1.7	1.7	1.7	1.8	
Contribution from real GDP growth	-3.6	-4.6	-3.5	8.8	-1.5	-2.2	-2.7	-2.8	-2.6	-2.3	-2.2	
Contribution from price and exchange rate changes 2/	-1.9	-9.7	-4.2	-3.6	-0.8	…	…	…	…	…	…	
Residual, incl. change in gross foreign assets (2-3) 3/	16.7	35.0	-8.2	13.8	-3.5	6.6	-0.1	1.5	1.4	1.7	1.6	
External debt-to-exports ratio (in percent)	122.9	154.5	144.7	206.3	179.2	168.2	159.7	155.1	151.1	147.2	143.5	
Gross external financing need (in billions of US dollars) 4/	10.2	14.1	26.0	23.8	22.4	20.3	22.9	23.5	24.3	25.2	26.2	
in percent of GDP	26.1	29.7	47.4	48.4	46.9	41.5	44.8	44.1	43.9	44.0	44.2	
Scenario with key variables at their historical averages 5/						**118.3**	**112.3**	**107.6**	**103.1**	**98.7**	**94.4**	**-7.7**
Key Macroeconomic Assumptions Underlying Baseline												
Nominal GDP (US dollars)	39.0	47.4	54.9	49.3	47.8	49.0	51.2	53.3	55.4	57.3	59.3	
Real GDP growth (in percent)	5.9	6.9	3.7	-8.1	1.2	2.0	2.4	2.5	2.3	2.0	1.9	
Exchange rate appreciation (US dollar value of local currency, char	0.8	9.2	7.4	-5.4	-4.7	-0.3	-0.7	-0.8	-0.8	-0.8	-0.8	
GDP deflator (change in domestic currency)	2.0	4.2	4.0	3.2	0.7	0.7	2.7	2.4	2.5	2.3	2.3	
GDP deflator in US dollars (change in percent)	2.9	13.7	11.7	-2.3	-4.1	0.4	2.0	1.6	1.6	1.4	1.5	
Nominal external interest rate (in percent)	2.7	3.7	3.5	1.4	0.8	1.5	1.4	1.5	1.5	1.5	1.5	
Growth of exports (US dollar terms, in percent)	16.6	26.9	12.5	-22.8	5.7	14.4	8.3	7.0	6.8	7.0	7.0	
Growth of imports (US dollar terms, in percent)	16.8	29.2	14.7	-27.7	7.5	15.2	8.4	6.9	6.7	7.2	7.2	
Current account balance, excluding interest payments	-0.8	-2.3	-3.5	0.1	-0.2	-0.4	-0.5	-0.5	-0.6	-0.8	-1.0	
Net non-debt creating capital inflows	-0.1	0.0	0.5	-1.5	1.8	1.0	1.1	1.1	1.1	1.1	1.1	

1/ Derived as $[r - g - \rho(1+g) + \varepsilon\alpha(1+r)]/(1+g+\rho+g\rho)$ times previous period debt stock, with r = nominal effective interest rate on external debt; ρ = change in domestic GDP deflator in US dollar terms, g = real GDP growth rate, ε = nominal appreciation (increase in dollar value of domestic currency), and α = share of domestic-currency denominated debt in total external debt.

2/ The contribution from price and exchange rate changes is defined as $[-\rho(1+g) + \varepsilon\alpha(1+r)]/(1+g+\rho+g\rho)$ times previous period debt stock. ρ increases with an appreciating domestic currency ($\varepsilon > 0$) 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.

Table 6. Slovenia: Public Sector Debt Sustainability Framework, 2006-2016
(In percent of GDP, unless otherwise indicated)

	Actual					Projections						
	2006	2007	2008	2009	2010	2011	2012	2013	2014	2015	2016	Debt-stabilizing primary balance 9/
Baseline: Public sector debt 1/	26.7	23.4	22.5	35.4	37.2	**42.3**	**44.9**	**46.7**	**48.0**	**49.3**	**50.6**	**-0.2**
o/w foreign-currency denominated	8.2	0.1	0.1	0.1	0.1	0.2	0.2	0.2	0.2	0.2	0.2	
Change in public sector debt	-0.3	-3.3	-0.9	12.9	1.8	5.2	2.6	1.8	1.3	1.3	1.3	
Identified debt-creating flows (4+7+12)	-2.5	-7.9	-1.6	6.5	4.6	3.8	2.2	1.4	0.9	0.9	0.9	
Primary deficit	-0.4	-1.3	-0.6	4.6	3.9	3.4	2.7	1.8	1.3	1.1	1.1	
Revenue and grants	41.7	40.5	41.1	40.7	41.0	40.7	40.5	40.4	40.4	40.4	40.4	
Primary (noninterest) expenditure	41.3	39.2	40.5	45.3	44.9	44.1	43.2	42.2	41.7	41.5	41.5	
Automatic debt dynamics 2/	-1.7	-2.4	-0.8	2.2	0.7	0.5	-0.5	-0.4	-0.4	-0.2	-0.1	
Contribution from interest rate/growth differential 3/	-0.8	-1.7	-0.8	2.2	0.7	0.5	-0.5	-0.4	-0.4	-0.2	-0.1	
Of which contribution from real interest rate	0.7	0.0	0.0	0.2	1.1	1.2	0.5	0.6	0.6	0.7	0.8	
Of which contribution from real GDP growth	-1.5	-1.6	-0.8	1.9	-0.4	-0.7	-0.9	-1.1	-1.0	-0.9	-0.9	
Contribution from exchange rate depreciation 4/	-0.9	-0.7	0.0	0.0	0.0	...	...	...	...	...	...	
Other identified debt-creating flows	-0.4	-4.2	-0.2	-0.2	0.0	0.0	0.0	0.0	0.0	0.0	0.0	
Privatization receipts (negative)	-0.4	-4.2	-0.2	-0.2	0.0	0.0	0.0	0.0	0.0	0.0	0.0	
Recognition of implicit or contingent liabilities	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	
Other (specify, e.g. bank recapitalization)	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	
Residual, including asset changes (2-3) 5/	2.2	4.6	0.7	6.3	-2.8	1.3	0.4	0.4	0.4	0.4	0.4	
Public sector debt-to-revenue ratio 1/	64.0	57.7	54.7	86.9	90.6	104.0	110.9	115.5	119.0	122.1	125.2	
Gross financing need 6/	5.8	3.8	5.4	8.5	12.5	7.7	7.7	4.0	7.3	5.3	5.3	
in billions of U.S. dollars	2.2	1.8	3.0	4.2	6.0	3.8	3.9	2.2	4.1	3.0	3.2	
Scenario with key variables at their historical averages 7/						**42.3**	**42.5**	**42.6**	**42.7**	**42.8**	**42.9**	**-0.8**
Scenario with no policy change (constant primary balance) in 2011-2016						**42.3**	**45.6**	**48.9**	**52.2**	**55.7**	**59.3**	**-0.2**
Key Macroeconomic and Fiscal Assumptions Underlying Baseline												
Real GDP growth (in percent)	5.9	6.9	3.7	-8.1	1.2	2.0	2.4	2.5	2.3	2.0	1.9	
Average nominal interest rate on public debt (in percent) 8/	4.9	4.3	4.1	4.0	3.9	4.0	4.0	3.9	3.9	3.9	3.9	
Average real interest rate (nominal rate minus change in GDP deflator, in p	2.8	0.1	0.1	0.8	3.2	3.3	1.2	1.5	1.4	1.6	1.6	
Nominal appreciation (increase in US dollar value of local currency, in perc	11.5	10.3	-6.6	7.2	-9.5	...	...	...	...	...	...	
Inflation rate (GDP deflator, in percent)	2.0	4.2	4.0	3.2	0.7	0.7	2.7	2.4	2.5	2.3	2.3	
Growth of real primary spending (deflated by GDP deflator, in percent)	5.7	1.4	7.1	2.8	0.3	0.2	0.3	0.2	1.1	1.6	1.8	
Primary deficit	-0.4	-1.3	-0.6	4.6	3.9	3.4	2.7	1.8	1.3	1.1	1.1	

1/ Indicate coverage of public sector, e.g., general government or nonfinancial public sector. Also whether net or gross debt is used.
2/ Derived as $[(r - \pi(1+g) - g + \alpha\varepsilon(1+r)]/(1+g+\pi+g\pi))$ times previous period debt ratio, with r = interest rate; π = growth rate of GDP deflator; g = real GDP growth rate; α = share of foreign-currency denominated debt; and ε = nominal exchange rate depreciation (measured by increase in local currency value of U.S. dollar).
3/ The real interest rate contribution is derived from the denominator in footnote 2/ as $r - \pi(1+g)$ and the real growth contribution as -g.
4/ The exchange rate contribution is derived from the numerator in footnote 2/ as $\alpha\varepsilon(1+r)$.
5/ For projections, this line includes exchange rate changes.
6/ Defined as public sector deficit, plus amortization of medium and long-term public sector debt, plus short-term debt at end of previous period.
7/ The key variables include real GDP growth; real interest rate; and primary balance in percent of GDP.
8/ Derived as nominal interest expenditure divided by previous period debt stock.
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.

Table 7. Banking Sector Soundness Indicators 1/
(Percent, end of period)

	2005	2006	2007	2008	2009	2010 2/
Capital adequacy						
Regulatory capital to risk-weighted assets	10.5	11.1	11.2	11.7	11.6	11.5
Regulatory Tier 1 capital to risk-weighted assets	8.9	9.4	8.9	9.2	9.3	9.3
Capital (net worth) to assets	8.5	8.4	8.4	8.4	8.3	8.2
Asset quality						
Non-performing loans to total assets	2.9	2.5	1.8	1.8	2.3	3.6
Specific provisions to non-performing loans	80.6	84.3	86.4	79.3	75.9	72.6
Large exposures to capital	226.2	222.9	217.4	127.5	112.6	99.2
Earnings and profitability						
Net interest margin on average interest bearing assets	2.6	2.4	2.3	2.2	2.0	2.1
Operating expenses to average assets	2.5	2.2	2.0	1.7	1.5	1.5
Return on average assets (before tax)	1.0	1.3	1.4	0.7	0.3	-0.2
Return on average equity (before tax)	13.8	15.1	16.3	8.1	3.9	-2.3
Liquidity						
Average liquid assets to average total assets	4.8	4.5	3.6	14.0	13.9	14.3
Average liquid assets to average short-term deposits	9.51	9.72	8.4	34.6	36.1	42.9
Foreign exchange risk						
Foreign currency-denominated loans to total loans	48.7	55.9	6.0	6.1	5.1	4.7
Foreign currency-denominated liabilities to total liabilities	49.4	53.3	4.9	4.8	3.4	3.6
Net open position in foreign exchange to capital	58.8	7.7	…	0.2	0.9	…
Market risk						
Assets with maturity of more than 1 year (percent of total loans to non-bank sector)	32.3	33.4	35.1	37.6	31.7	27.1
Liabilities with maturity of less than 3 months (percent of total liabilities to non-bank sector)	66.9	68.2	66.3	57.1	46.6	47.0
Memorandum item:						
Ownership of banking sector (percent of equity capital)						
Nonresidents	34.9	37.7	37.7	38.2	36.6	37.1
Central government	18.2	17.4	15.1	17.7	20.5	20.1
Other domestic entities	46.9	44.6	47.2	44.1	43.0	42.9

Source: Bank of Slovenia

1/ Indicators after 2007 are subject to change. Missing observations are expected to be obtained from the authorities during the mission.

2/ Latest month for which information was available

Table 8. Slovenia: Vulnerability Indicators, 2005–2010

(Percent of GDP, unless otherwise indicated)

	2005	2006	2007	2008	2009	2010 3/
Financial Indicators (end of period)						
General government debt	27.0	26.7	23.4	22.5	35.4	37.2
Domestic Credit to Non Financial Institutions	68.0	76.5	86.0	91.6	103.6	103.6
Private sector credit (percent change) 1/	23.4	23.8	32.5	17.2	2.8	3.2
Foreign exchange deposits (in billions of euros) 2/	5.3	5.7	0.5	0.4	0.4	0.4
Banks' nonperforming loans (percent of total gross loans)	2.5	2.5	1.8	1.8	2.3	3.6
Capital adequacy ratio	10.5	11.0	11.2	11.7	11.6	11.5
Financial Market Indicators (end of period)						
Stock market index	4,630	6,383	11,370	3,696	4,079	3281.4
Stock market index (Blue Chip Index)	941	1,473	2,519	854	983	807.9
Stock market capitalization	23.3	37.1	57.0	22.7	23.9	19.4
Sovereign Credit Rating (S&P)	AA-	AA	AA	AA	AA	AA
External Indicators						
Exports of goods and services (percent change, value in euros)	13.3	15.7	16.2	4.8	-18.4	11.0
Imports of goods and services (percent change, value in euros)	11.7	15.9	18.3	6.9	-23.6	12.8
Current account balance	-1.7	-2.5	-4.8	-6.7	-1.5	-1.2
Net foreign assets of commercial banks (in billions of euros) 2/	-5.1	-6.1	-6.5	-8.6	-7.0	-7.8
Short-term foreign assets of commercial banks (in billions of euros)	1.8	2.0	4.2	3.5	4.4	3.8
Short-term foreign liabilities of commercial banks (in billions of euros)	1.5	1.6	3.1	3.6	2.3	2.3
Foreign currency exposure of commercial banks (in billions of euros) 2/	-13.9	-16.8	-16.7	-18.3	-17.1	-17.0
Gross official reserves (in billions of euros)	6.9	5.4	0.7	0.7	0.7	0.7
Gross official reserves (in months of imports of goods and services)	4.6	3.1	0.4	0.3	0.4	0.4
Net international reserves (in billions of euros)	5.3	4.9	0.7	0.6	0.7	0.7
Total external debt	71.3	77.5	100.6	105.2	113.8	113.3
Of which: Public and publicly guaranteed	13.2	14.0	23.4	24.5	39.5	47.4
Total external debt (in percent of exports of goods and services)	115.1	116.8	145.3	156.4	196.8	179.9
Total external debt service payments (in percent of exports of goods and services)	15.1	17.8	19.2	23.7	29.6	29.1
External interest payment (in percent of exports of goods and services)	2.7	3.1	4.2	5.4	3.9	3.5
External amortization payments (in percent of exports of goods and services)	12.5	14.7	15.0	18.2	25.7	25.6
REER (CPI-based, period-average basis, an increase indicates appreciation)	-0.9	0.1	2.1	2.5	1.2	0.5

Sources: Data provided by the Slovene authorities; Bloomberg; and IMF staff calculations.

1/ Credit including loans and other claims. Series presents a structural break in 2007 due to entry in the Euro zone.

2/ Series present a structural break in 2007 due to the entry in the Euro Zone.

3/ Latest observations available.

INTERNATIONAL MONETARY FUND

REPUBLIC OF SLOVENIA

Staff Report for the 2011 Article IV Consultation—Informational Annex

Prepared by the European Department

May 4, 2011

Contents Pages

Appendices

APPENDIX I: REPUBLIC OF SLOVENIA: FUND RELATIONS

(As of March 31, 2011)

I. **Membership Status**: Joined: 12/14/1992; Article VIII status as from September 1, 2005.

II. **General Resources Account**	**SDR Million**	**% Quota**
Quota	275.00	100.00
Fund holdings of currency	198.37	72.14
Reserve Tranche position	76.65	27.86
Lending to the Fund	24.30	

III. **SDR Department**		
Net cumulative allocation	215.88	100.00
Holdings	187.39	86.80

IV. **Projected Payments to Fund**[4]
(SDR Million; based on existing use of resources and present holdings of SDRs):

	Forthcoming				
	2011	**2012**	**2013**	**2014**	**2015**
Charges/Interest	0.09	0.14	0.14	0.14	0.14
Total	0.09	0.14	0.14	0.14	0.14

V. **Exchange Rate Arrangement**

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

VI. **2011 Article IV Consultation**

Slovenia is on the 24-month Article IV consultation cycle. The 2011 mission visited Ljubljana during March 9–21, 2011 and held discussions with the Minister of Finance, the Governor of the Bank of Slovenia, and other key economic ministers, government officials and representatives of the Parliament, financial sector, labor, business and media. Mr. Kavčič

[4] When a member has overdue financial obligations outstanding for more than three months, the amount of such arrears will be shown in this section.

(Advisor to the Executive Director) attended the meetings. Mr. Prader (Alternate Executive Director) attended the concluding meeting.

The mission comprised: Mr. Spilimbergo (Head), Ms. Mahieu, Mr. Simone (all EUR), and Mr. Blotevogel (MCD).

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

VII. **FSAP Participation and ROSCs**

An FSAP mission took place during November 6–20, 2000. A FSSA report (SM/01/129) was prepared on April 24, 2001 and published on September 18, 2001 (Country Report No. 01/161). An FSAP Update mission visited Ljubljana during November 10–21, 2003. An FSSA report (SM/04/152) was issued on April 26, 2004.

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

VIII. **Technical Assistance**

Date	**Dept.**	**Subject/Identified Need**
August 2001	FAD	VAT.
November 2001	FAD	Direct Tax Reform.
November 2003	FAD	Expenditure Rationalization.
April–May 2004	FAD	Performance Information to Support Better Budgeting.
November 2004	STA	Recording Transactions in International Trade in Services
April 2006	STA	Government Finance Statistics
December 2009	MCM	Financial Supervisory Architecture

APPENDIX II: REPUBLIC OF SLOVENIA: STATISTICAL ISSUES

1. **Data provision** is adequate for surveillance purposes.

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

3. **Real Sector Statistics:** The Statistical Office of the Republic of Slovenia (SORS) follows the European System of Accounts 1995 (ESA95). Quarterly GDP estimates by industry and expenditure categories are compiled in both current and constant prices, and are published within 80 days after the reference quarter. In September 2005, the SORS changed the base year for compiling constant prices GDP from 2000 to the previous year's prices and started using the chain–link index methodology.

4. The SORS compiles the Harmonized Index of Consumer Prices (HICP) for monitoring compliance with the Maastricht inflation criterion. However, price collection is restricted to four cities and their surrounding rural areas. The weights are based on the three-year average of expenditure data for consumer goods from continuous Household Budget Surveys for 2002, 2003, and 2004. It also compiles a retail price index (RPI), which differs from the consumer price index in weights only.

5. **Government Finance Statistics:** Slovenian fiscal statistics are timely and of a high quality. The ministry of finance publishes a comprehensive monthly *Bulletin of Government Finance*, which presents monthly data on the operations of the "state budget" (Budgetary Central Government), local governments, social security (Pension and Health funds), and the consolidated general government. The coverage of general government excludes the operations of extra-budgetary funds and own revenues of general government agencies *(zavods)*. However, these operations are small in size. Monthly fiscal indicators are reported for publication in *IFS* on a timely basis and annual statistics covering general government operations, including the operations of the extra-budgetary funds are reported for publication in the *Government Finance Statistic Yearbook* (*GFS Yearbook*).

6. The data published in the *Bulletin of Government Finance* are on a cash basis and broadly use the analytical framework and classification system of the IMF's 1986 government finance statistics methodology. The data reported for publication in the *GFS Yearbook* are also on a cash basis but are recast in the analytical framework and classifications of the *Manual on Government Finance Statistics 2001*(*GFSM 2001*).

7. The Slovenian authorities adopted the *GFSM 2001* methodology, which is used as a building block for the compilation of the ESA 95–based data jointly by the Ministry of Finance and the SORS for reporting to the European Commission. To assist the Ministry of Finance resolve several classification issues and develop a migration path, a STA technical assistance mission visited Ljubljana in April 2006. The introduction in 2008 of a new chart of

accounts for all public entities based on accrual principles greatly facilitated the adoption of the new methodology.

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

9. **Balance of Payments Statistics:** Balance of payments data are comprehensive and of high quality. The data have been published in the *Balance of Payments Statistics Yearbook* since 1993 (with estimates of the international investment position published since 1994). In 2002, the Bank of Slovenia revised the balance of payments statistics going back to 1994; the most significant revisions were related to the income component of the current account and to the other investment component of the financial account.

10. **External Debt Statistics:** External debt statistics were revised and brought in line with the SDDS in August 2003. The main change comprised the inclusion of trade credits in the debt data.

REPUBLIC OF SLOVENIA: TABLE OF COMMON INDICATORS REQUIRED FOR SURVEILLANCE

AS OF MARCH 31, 2011

	Date of latest observation	Date received or posted	Frequency of Data[6]	Frequency of Reporting[6]	Frequency of publication[6]
Exchange Rates	3/31/11	3/31/11	D	D	D
International Reserve Assets and Reserve Liabilities of the Monetary Authorities[1]	2/11	3/11	M	M	M
Reserve/Base Money	2/11	3/11	M	M	M
Broad Money	2/11	3/11	M	M	M
Central Bank Balance Sheet	2/11	3/11	M	M	M
Consolidated Balance Sheet of the Banking System	2/11	3/11	M	M	M
Interest Rates[2]	2/11	3/11	M	M	M
Consumer Price Index	2/11	3/11	M	M	M
Revenue, Expenditure, Balance and Composition of Financing[3] – General Government[4]	1/11	3/11	M	M	M
Revenue, Expenditure, Balance and Composition of Financing[3]– Central Government	2/11	3/11	M	M	M
Stocks of Central Government and Central Government-Guaranteed Debt[5]	12/10,9/10	3/11	M	M	M
External Current Account Balance	1/11	3/11	M	M	M
Exports and Imports of Goods and Services	1/11	3/11	M	M	M
GDP/GNP	Q4/10	3/11	Q	Q	Q
Gross External Debt	1/11	3/11	M	M	M
International Investment Position	12/10	3/11	Q	Q	Q

[1] Includes reserve assets pledged or otherwise encumbered as well as net derivative positions.
[2] Both market-based and officially-determined, including discount rates, money market rates, rates on treasury bills, notes and bonds.
[3] Foreign, domestic bank, and domestic nonbank financing.
[4] The general government consists of the central government (budgetary funds, extra budgetary funds, and social security funds) and state and local governments.
[5] Including currency and maturity composition. The first date corresponds to the stock of central government debt while the second to the stock of central government guaranteed debt.
[6] Daily (D), Weekly (W), Monthly (M), Quarterly (Q), Annually (A); Irregular (I); Not Available (NA).

INTERNATIONAL MONETARY FUND
Public Information Notice
EXTERNAL RELATIONS DEPARTMENT

Public Information Notice (PIN) No. 11/66
FOR IMMEDIATE RELEASE
May 31, 2011

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

IMF Executive Board Concludes 2011 Article IV Consultation with the Republic of Slovenia

On May 20, 2011, the Executive Board of the International Monetary Fund (IMF) concluded the Article IV consultation with the Republic of Slovenia.[1]

Background

Slovenia's economy is gradually recovering following one of the sharpest GDP declines in the euro area during the crisis. Real GDP declined over 10 percent from peak to trough owing to: a sharp decline in external demand; a significant tightening in external credit conditions forcing banks to curtail domestic credit supply; and an abrupt end of a construction and housing price boom. Real GDP growth reached 1.2 percent in 2010, led by rising exports. Weak domestic demand led to negative core inflation and greatly reduced the current account deficit. The current account deficit shrank from 6.7 percent of GDP in 2008 to 1.2 in 2010, reflecting mainly the end of the construction boom. Average CPI inflation was 1.8 percent in 2010, mainly because of rising fuel and energy prices. The average unemployment rate increased to 7.2 percent in 2010 up from 4.8 percent at end 2008.

GDP growth is projected at 2 percent in 2011. The pick–up in growth reflects mainly a recovery in the manufacturing sector and inventory rebuilding. However, investment will likely be low due to deleveraging in the highly indebted corporate sector. High unemployment and fiscal retrenchment will weigh on consumption growth. Average inflation is projected to gradually pick up on the back of high commodity prices. The current account deficit is expected to widen again

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

as the economy recovers, but not as much as in pre-crisis times. The main risks to the outlook are the near–term dependence of the recovery on external demand and significant contingent public liabilities from entitlement spending and banks. The postponement of pension and labor market reforms could also lead to further deterioration in competitiveness and potential output growth.

The general government fiscal deficit narrowed in 2010. After widening considerably during the crisis, the general government deficit declined to 5.2 percent in 2010. The main factors were one-off revenue gains, cuts in capital transfers, and containment of the wage bill. The deficit is expected to continue narrowing in 2011 primarily through further wage bill rationalizations, reduced indexation of pensions and other entitlements, and capital expenditure and capital transfer cuts. The authorities aim to reduce the fiscal deficit to below 3 percent by 2013. In the long term, pension expenditure poses a challenge to fiscal sustainability. Slovenia is projected to have one of the largest pension expenditures in the EU by 2050 if no reform is implemented. The authorities started addressing the challenge with the pension reform that will increase the effective retirement age and lower the replacement rate. But additional reforms will be needed to ensure sustainability of the system in the long run.

The crisis exposed vulnerabilities in the financial sector. The rapidly expanding credit growth financed with short–term external bank borrowing came to a sudden stop in 2008. Banks' profitability and asset quality deteriorated with aggregate profits turning negative in 2010 due to high loan losses to the highly indebted corporate sector. Total assets declined and corporate credit growth remained anemic. Slovenian banks are among the most thinly capitalized in the EU, particularly the systemic domestic banks. Publicly announced recapitalizations are sufficient to offset the accumulated losses of the last two years. But, given the thin capitalization at the eve of the crisis, they will not be sufficient to create new lending capacity.

Executive Board Assessment

Executive Directors noted that, inspite of the authorities' commendable policy response, Slovenia experienced one of the largest drops in output in the euro area. The domestic boom, fueled by easy external financing conditions and an expansionary fiscal policy, came abruptly to an end with the global financial crisis. While a gradual recovery is underway, important challenges remain. Directors emphasized the need to keep the recovery on track, safeguard the sustainability of public finances, enhance financial sector resilience, and strengthen competitiveness.

Directors supported the authorities' fiscal consolidation targets, but stressed the importance of specifying and implementing additional and durable consolidation measures. Social programs should be better targeted, and the planned reduction in public sector employment should be implemented.

Directors emphasized the crucial role of pension reform. While the current reform is a step in the right direction, it will likely fall short in generating the needed savings in the long run. Directors considered that additional measures should include a more rapid increase in the effective retirement age and moving indexation gradually toward full-price indexation. Directors stressed the importance of a strengthened communication strategy to help build social consensus for reform. They also encouraged the authorities to prepare contingency measures in case of rejection of the pension reform.

Directors highlighted the risks associated with the thinly capitalized banking sector. The near-term priority should be on further increasing banks' capital buffers, along with strengthened supervision. The recently completed recapitalizations for the systemic banks are a good start, but probably insufficient. Directors also encouraged further tightening of capital requirements to reinforce the recapitalizations. They considered expanding ownership to include private and foreign investors as a key measure to help address governance and risk management weaknesses, as well as to acquire additional capital. Directors encouraged the authorities to set out and implement clear divestment strategies for their ownership stakes in domestic banks.

Directors cautioned that lending activity should be monitored carefully, but not distorted with ad-hoc measures, such as the recently taken measure of taxing banks' balance sheets to incentivize borrowing by the over-indebted corporate sector. They encouraged the authorities to monitor housing price developments closely to prevent recent surges in mortgage lending from creating new imbalances. Directors welcomed the authorities' willingness to tighten prudential regulations if necessary.

To address the slowdown in the economy's growth potential and to boost competitiveness, Directors agreed that structural reforms in labor and product markets will play a crucial role. They viewed the loosening of labor market restrictions, phasing-out of wage indexation schemes, and eliminating of pay increases unrelated to productivity gains as key in helping reduce unemployment. Directors also encouraged the authorities to enhance competition in product and financial markets to foster foreign direct investment (FDI) inflows.

It is expected that the next Article IV consultation with Slovenia will be held on a 12-month cycle.

Public Information Notices (PINs) form part of the IMF's efforts to promote transparency of the IMF's views and analysis of economic developments and policies. With the consent of the country (or countries) concerned, PINs are issued after Executive Board discussions of Article IV consultations with member countries, of its surveillance of developments at the regional level, of post-program monitoring, and of ex post assessments of member countries with longer-term program engagements. PINs are also issued after Executive Board discussions of general policy matters, unless otherwise decided by the Executive Board in a particular case. The staff report (use the free Adobe Acrobat Reader to view this pdf file) for the 2011 Article IV Consultation with Slovenia is also available.

Slovenia: Selected Economic Indicators, 2007–2012

					Projections	
	2007	**2008**	**2009**	**2010**	**2011**	**2012**
	(Annual percentage change)					
Real GDP	6.9	3.7	-8.1	1.2	2.0	2.4
Domestic demand	8.9	4.1	-10.1	0.4	1.0	2.2
Consumer prices						
Period average	3.6	5.7	0.9	1.8	2.2	3.1
Real wages (all sectors)	2.2	2.5	2.6	2.0	2.3	1.9
Average unemployment rate (in percent, ILO definition	4.9	4.4	5.9	7.2	7.5	7.2
	(In percent of GDP)					
Public finance						
General government balance 1/	0.3	-0.3	-5.5	-5.2	-4.8	-4.3
General government debt	23.4	22.5	35.4	37.2	42.3	44.9
	(Percentage change, end-period)					
Money and credit						
Credit to Private Sector	34.1	17.2	3.2	2.0	…	…
Government bond yield (10 year, in percent) 2/	4.5	4.7	4.4	3.8	…	…
Balance of payments	(In percent of GDP)					
Trade balance (goods)	-4.8	-7.1	-2.0	-2.7	-3.1	-3.2
Current account balance	-4.8	-6.7	-1.5	-1.2	-2.0	-2.1
External debt (percent of GDP, end-period)	100.6	105.2	113.8	113.3	114.4	112.8
Exchange rate						
Exchange regime	Member of EMU					
Nominal effective exchange rate (2000=100) period average)	100.8	101.4	104.0	100.6	…	…
Real effective exchange rate						
(CPI based, 2000=100, period average)	101.8	104.0	106.8	101.9	…	…

"Sources: Data provided by the Slovene authorities; and IMF staff calculations and projections"
1/ Revenue and expenditure exclude social security contributions paid for government employees.
2/ Eurostat data.

Statement by the IMF Staff Representative on Slovenia
May 16, 2011

1. This statement provides additional information on economic developments and policy action in Slovenia since the Article IV mission complementing the staff report (SM/11/92). The additional information does not change the thrust of the staff appraisal.

2. **The announced state bank recapitalizations were completed.** The government of Slovenia bought most of the 250 million euros in newly issued shares of Nova Ljubljanska Banka (NLB) at end March. The other large shareholder, KBC, bought less than 7 million euros. Similarly, Nova Kreditna Banka Maribor (NKBM), the second largest Slovenian bank, completed a capital increase of about 104 million euros at end April. The publicly owned electricity and postal companies bought 51 percent of the newly issued shares while the remainder was placed with private shareholders. After the recapitalizations, the overall governments' stake considering holdings by all publicly owned entities in NLB is estimated to have increased to 59 percent while the stake in NKBM remained unchanged at 51 percent.

3. **The recapitalizations will have a one off fiscal impact of about 0.7 percent of GDP on the 2011 general government deficit.** This fiscal impact is generated by the recapitalization of NLB. A decision from the European Commission adopted during April indicated that the funds used for NLB's recapitalization should be treated as state aid thus increasing the general government fiscal deficit for 2011. The authorities have already incorporated the 0.7 percent of GDP impact in their stability program, and given the one off nature, will not require offsetting measures. Unlike NLB's recapitalization, NKBM's recapitalization does not affect the general government deficit given that publicly owned companies not belonging to the general government purchased the shares.

4. **The government approved a tax on bank assets**. The government adopted in April a bill introducing a tax on total assets of banks. The tax was announced as a temporary measure. The need for the measure will be reassessed in 2013. Banks which are active in giving out loans to businesses will get certain incentives and could be exempt from the new tax. Those who are not exempt will have to pay tax in the amount of 0.1 percent of their total assets for the year. Given that the large state banks which dominate the banking system are likely going to benefit from the exemptions, the revenue yield from the tax is expected to be negligible.

5. **The law on mini-jobs was overwhelmingly rejected in a referendum in early April and the referendum on the pension reform is scheduled for early June**. The rejection by referendum will postpone the labor market reforms the mini jobs act was supposed to implement by at least one year given legal constraints to legislate again on the same topic before this time period. Current polls suggest that the pension reform is also likely to be rejected.

Statement by Johann Prader, Alternate Executive Director for Slovenia, and Andrej Kavcic, Advisor to the Executive Director for Slovenia
May 20, 2011

We would like to thank staff for the fruitful and constructive dialogue during the 2011 Article IV mission to Slovenia. The Slovenian authorities broadly agree with staff's analysis and recommendations.

Economic developments

Even though Slovenia largely avoided the first wave of the financial crisis, it was severely hit when the crisis affected the real sector. As an export-dependent economy, Slovenia experienced a sharp GDP decline in 2009 (- 8.1 percent), which was aggravated by the concurrent phasing out of the national highway construction program. The sharp decline in external demand and curtailed credit supply weighed heavily on the highly leveraged corporate sector, particularly construction. Due to the relatively low debt-to-GDP ratio and solid household balance sheets Slovenia managed to avoid spillovers from the European sovereign debt crisis.

The crisis left a strong mark on the Slovenian economy. An export-led recovery is under way, but remains gradual. Whereas the export-oriented manufacturing sector is rebounding relatively fast, the recovery in other sectors is sluggish due to persistent high unemployment, a very low level of investment and weak domestic demand. The unemployment rate, which increased to 7.2 percent in 2010, is expected to peak this year at 7.5 percent but is likely to start decreasing gradually in 2012 and thereafter. Against this background, GDP growth, which turned to a positive 1.2 percent in 2010, is estimated at 2.0 percent this year, although most international forecasters, including the OECD, the European Commission and staff tend to be somewhat more optimistic than the authorities' conservative approach. The relatively gradual economic recovery is heavily influenced by the continuous deleveraging in the construction sector, which was over-dimensioned before the crisis, and the relatively limited activity in the financial sector.

Fiscal consolidation

During the crisis fiscal policy turned countercyclical, with automatic stabilizers working and discretional stimulus measures amounting to 1.8 percent of GDP in 2009 and 0.2 percent in 2010, thereby increasing the deficit. After a moderate surplus in 2007 and a moderate deficit in 2008, the deficit widened to 5.5 percent of GDP in 2009 and 5.2 percent in 2010. The government has been continuing with the consolidation efforts in 2011 and targeted a reduction to 4.8 percent. However, the government's participation in the recapitalization of the systemic bank Nova Ljubljanska Banka (NLB) in the amount of EUR 243 million is increasing the deficit. The European Commission classified this participation as state aid (Commission Decision of March 8, 2011), thereby increasing the nominal deficit in 2011 by 0.7 percentage points higher (totaling 5.5 percent) than originally scheduled. Given that the measure is one-off, this move does not impact the underlying consolidation of the structural deficit.

The authorities are committed to bringing the fiscal deficit to below 3 percent of GDP by 2013. They find the staff scenario overly pessimistic, especially in view of Slovenia's proven track-record of better-than-budgeted outcomes. Under the government's exit strategy, all stimulus measures except subsidies for temporarily laid-off workers were phased out by the end of 2010. In line with the EU's Excessive Deficit Procedure (EDP), a program of gradually reducing the general government deficit to below 3 percent by 2013 was prepared. In light of the already relatively high tax burden, fiscal consolidation will be expenditure-based, primarily comprising measures in the area of wages, pensions and social benefits. Among the short-term measures, wage bill growth will be contained by the reduction in aggregate salary by 2.2 percent in nominal terms and non-indexation of wages to inflation in 2011 and 2012. The policy of reducing employment in the public sector by 1 percent annually will continue. To underpin the necessary fiscal consolidation an intervention act was passed for the 2011 budget implementation. The government is contemplating additional measures by means of a new intervention act to safeguard the deficit–reduction process.

To ensure sustainability of public finances in the long run, the government has embarked on fiscal structural reforms which include pension, health care and financial management reforms. The pension reform, which is crucial, was adopted by the Parliament in December 2010, and includes an increase in the minimum and full retirement ages (to 60 and 65, respectively), a gradual extension of the period for calculating the pension base from the 18 best consecutive years to 34 years, a change in the indexation of pension benefits and changes in the system of incentives. Unfortunately, the reform will be challenged in a referendum on June 5, 2011, and the outcome remains uncertain. Pending the outcome of the referendum, the government is designing contingency measures. One of the alternative measures is a temporary freeze of pensions and the immediate submission of a new proposal.

In the public financial management area, performance budgeting has been gradually introduced across all ministries. In addition, changes to the Public Finance Law are under way and are expected to be passed by the parliament not later than by the end of the year. They will introduce a medium-term budgetary framework (MTF), expenditure ceilings ("fiscal rule"), a debt ceiling of 45 percent of GDP, and a ceiling for all government guarantees. The new act will also further strengthen the responsibilities and accountability structure for the recently created fiscal council.

The financial system

The global crisis exacerbated the weaknesses of the financial system characterized mainly by short-term external bank borrowing and over-indebted corporate sector. As a consequence, weakened banks are coping with declining profitability incurred by loan losses of the highly indebted non-financial corporate sector, especially construction and leveraged holding companies. Despite aggregate loan losses in 2009 and 2010, which were mainly due to very conservative provisioning, banks are expected to turn profitable (in aggregate) again in 2011.

The authorities are aware that Basel III will require higher capital ratios and concur with staff that strengthening capital buffers is necessary. In this context, the central bank has accelerated efforts to comply with Basel III. As the first step, the two largest banks, NLB and Nova kreditna Banka Maribor (NKBM) were recapitalized. The latest recapitalization of the systemically most important bank, NLB, will ensure a Tier 1 capital ratio of almost 8 percent, while the raising of additional capital will be explored as needed. In line with OECD recommendations and staff encouragement to ensure a greater role of private investors and to strengthen governance of the financial sector, the government adopted the Strategy for the Financial Sector Development in April 2011, as the first one in a series of sectoral strategies under preparation. The strategy advocates the creation of 3 financial pillars centered round the two largest banks (NLB and NKBM) and the largest insurance group, Triglav. While the state maintains shareholdings in all three financial groups, the Strategy envisages systematical divesting over time, whereby the state would limit its shareholding to 25 percent at the most. Following the OECD recommendations to delink state ownership in the companies from their management, an independent Capital Asset Management Agency was established. Besides managing the state assets in such companies and restructuring them for sale, the agency will prepare a recommendation on the disposal of non-strategic assets, based on sectoral strategies. In order to stimulate the credit activity of banks to the non-financial sector the government put forward a proposal for a tax on banks' assets, aimed at taxing all banks' assets while a tax allowance is introduced for banks which are expanding their credit activity. The draft legislation is currently discussed by the parliament with a view of enforcement by July 1, 2011.

Structural issues

The authorities agree with staff that maintaining competitiveness is crucial for Slovenia as a small and export dependent economy, especially due to the large share of labor-intensive products. In dialogue with the social partners, the government has been trying to introduce a greater level of flexible arrangements in the labor market and ensure prudent trends in the growth of unit labor costs. While consensus on increasing security can be quickly reached, increasing labor market flexibility has met with political resistance. As a consequence, the Mini-Jobs Act, regulating student work and aiming to contribute to increasing employment, was repealed in a referendum in April 2011. Reduction of regular workers' employment protection, in particular rapid reduction in notice periods and severance payments, recommended by staff, is being considered by the government along with other measures in the labor market. To enhance FDI attractiveness and boost productivity new initiatives are currently being considered to reduce and facilitate administrative procedures in starting new businesses, as well as to accelerate bankruptcy procedures, and potentially reduce social security contributions.