



REPUBLIC OF SLOVENIA

2013 ARTICLE IV CONSULTATION

January 2014

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 2013 Article IV consultation with the Republic of Slovenia, the following documents have been released and are included in this package:

- The **Staff Report** for the 2013 Article IV consultation, prepared by a staff team of the IMF for Executive Board's consideration on January 13, 2014, following discussions that ended on October 29, 2013, 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 December 27, 2013.
- An **Informational Annex** prepared by the IMF.
- An **Debit Sustainability Analysis (DSA)** prepared by the IMF.
- A **Press Release** summarizing the views of the Executive Board as expressed during its January 13, 2014 consideration of the staff report that concluded the Article IV Consultation with the Republic of Slovenia.
- A **Statement by the Executive Director** for the Republic of Slovenia.

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

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REPUBLIC OF SLOVENIA

STAFF REPORT FOR THE 2013 ARTICLE IV CONSULTATION

December 27, 2013

KEY ISSUES

Context: Slovenia is facing a deep recession resulting from a vicious circle of strained corporate and bank balance sheets, weak domestic demand, and necessary fiscal consolidation. The headline deficit remains around 4¼ percent of GDP in 2013 excluding bank restructuring costs, and public debt—55 percent of GDP at the end of 2012—is increasing rapidly. Concerns about growth, banks, and the fiscal gap and large fiscal contingent liabilities have kept sovereign borrowing rates high. Based on the asset quality review (AQR) and stress tests (ST), the government is recapitalizing state-owned banks.

Challenges: (i) building on the planned recapitalization, promptly restructure banks to ensure financial stability; (ii) restructure the corporate sector to avoid a recurrence of financial problems; (iii) pursue gradual fiscal consolidation over the medium term, including via further pension reform, to safeguard debt sustainability.

Staff views: The independent AQR and ST and recapitalization are key milestones. However, only restructuring the corporate and bank sectors, including a thorough clean-up of bank balance sheets, and reducing the role of the state in the economy can sustain durable growth. Without this, the bank recapitalization will be only a stop-gap—albeit expensive—measure. Corporate restructuring, involving debt-equity swaps to deleverage viable companies and liquidation of unviable ones, is needed. The bank asset management company (BAMC) and the new insolvency law can facilitate this but more nonperforming loans (NPLs) than currently proposed should be transferred to the BAMC. The authorities' plan appropriately envisions a reduction in the general government deficit (excluding bank restructuring and recapitalization costs) to 3½ percent of GDP in 2014 and below 3 percent of GDP in 2015, but additional, upfront measures of some 1 percent of GDP may be needed to achieve the 2014 target. In the medium term, additional consolidation is necessary to address the fiscal costs stemming from bank restructuring. In addition, pension reforms are needed in response to unfavorable demographic trends.

Authorities' views: After bank recapitalization, corporate restructuring facilitated by transferring part of the bad assets to the BAMC and by the new insolvency law is a priority, but expanding corporates' access to credit is also important. Privatization of 15 companies, including Telekom, NKBM, Abanka, and (partly) NLB, will further improve governance. While acknowledging fiscal risks for 2014, the authorities are optimistic about the fiscal measures, and will consider corrective actions later in the year if needed. A second round of pension reform will be considered after 2015 when the pension freeze will expire. Decisive implementation of reforms will decrease further the cost of borrowing.

Approved By
**Philip Gerson and
 Ranil Manohara
 Salgado**

The mission took place in Ljubljana from October 17 through 28, 2013. The team comprised Messrs. Spilimbergo (head), Craig, Dalgiç, Halikias, Jaramillo-Vallejo, Lombardo, Tapsoba, and Ms. Zakharova and was assisted at headquarters by Mr. Winnekens and Ms. Moraes Rego. The mission held discussions with Mr. Čufer (Minister of Finance), Mr. Jazbec (Governor of the Bank of Slovenia), other ministers, government officials and representatives of parliament, financial sector, labor, business, academy, and media. Mr. Repanšek (Advisor to the Executive Director) attended most meetings. Mr. Prader (Executive Director) attended the concluding meeting.

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CONTEXT

- 1. Slovenia remains in deep recession.** Around the period of euro adoption in 2007, Slovenia experienced an externally-financed construction and investment boom that masked pre-existing structural weaknesses. The global financial crisis caused a sudden stop in external financing and a sharp drop in GDP. After a brief stabilization in 2010, the recession resumed in 2011 and the economy now has contracted for eight consecutive quarters. While a sharp contraction in investment was the main driver of the downturn in the early stages, consumption—hitherto buffered by healthy household balance sheets—also started to decline from 2012, weighed down by deep fiscal cuts, stagnant wages, and growing uncertainty. In all, real GDP has fallen by 11 percent from its pre-crisis peak through mid-2013, the largest output loss among the euro area members after Greece.
- 2. Interlinked problems in the banking and corporate sectors are at the core of Slovenia's difficulties.** The sudden stop in external financing brought to the surface pervasive bank and corporate governance shortcomings. The combination of an overly indebted corporate sector and weak banks has limited credit availability and precipitated a vicious circle of deepening recession, mounting bankruptcies, rising NPLs, and further deleveraging.
- 3. Public debt has been increasing rapidly.** Before the global financial crisis public debt was low (22 percent of GDP) and the fiscal position close to balance, but the prolonged recession and the burden of supporting the state-owned banks have since put public finances under considerable strain. Public debt has more than doubled since 2008, reaching 55 percent of GDP by end-2012, and is set to increase sharply after bank restructuring. The deficit is slated to exceed 4 percent of GDP in 2013 (excluding bank support costs), despite a significant fiscal consolidation over the last three years. Reflecting in part concerns about the fiscal impact of bank restructuring, government bond yields reached about 2 percentage points higher than in similarly-rated Spain and Italy, posing a challenge for debt sustainability, before moderating to about 1¼ percent above Spain and Italy after the announcement of bank asset quality review results in December. In mid-November, the authorities made a €1.5 billion private placement of a 3-year euro bond, at a spread of 465 basis points above German paper.
- 4. The current account has moved into a substantial surplus, although largely through import compression.** The current account surplus rose by 3 percentage points in 2012 to 3.3 percent of GDP on a fall in imports of goods and services of 4.7 percent and largely flat exports. In 2013 H1, in contrast, the import contraction eased to around 1 percent (y-o-y) while exports of goods and services rebounded 2 percent (y-o-y). Improving competitiveness has contributed, with ULCs down 6 percent in 2013 Q2 from their peak one year earlier (Box 1).

Box 1. Slovenian Competitiveness Turns

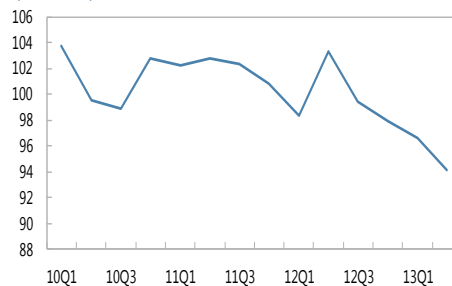
Slovenia’s competitiveness has improved over the last year. The real exchange rate depreciated modestly this year as unit labor costs turned down. The loss in export market share documented in last year’s report appears to have bottomed out and is recovering, with stronger export growth occurring in markets outside the E.U. The real exchange rate is close to equilibrium with different CGER methodologies showing deviations of less than 5 percent (Table). The bulk of the improvement in the current account, to around 6 percent of GDP this year, has been cyclical, but estimates of the underlying current account now stands significantly above the current account norm based on fundamentals, indicating that structural factors are playing a role. Slovenia’s net International Investment Position stood at negative 45 percent at end 2012, but should narrow over the medium term with the current account surplus and external deleveraging.

Slovenia: Equilibrium Exchange Rates

CGER Methodology	2013	2012
Macroeconomic Balance	-4.7	0.6
Equilibrium Exchange Rate	2.9	2.0
External sustainability	-4.3	-1.2

Slovenia: Unit Labor Cost

(2008 = 100)



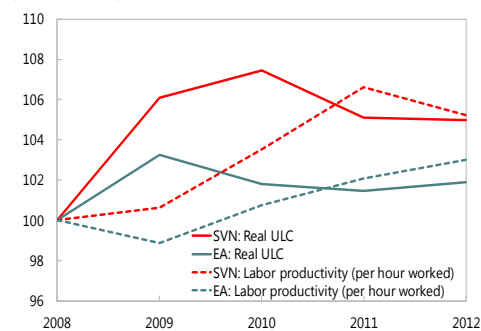
Source: Ministry of Finance Slovenia.

The improvement in competitiveness reflects the fall in unit labor costs (ULC) of around 6 percent from its level one year earlier (Figure). This has reversed some

of the rise in real ULCs relative to the EU countries (Figure). ULC gains reflect productivity growth that can be attributed largely to reductions in employment in the private and tradeable goods sector with declining wages playing a role only in the public sector (Figure). Productivity gains from labor shedding have helped maintain competitiveness but are not sustainable, and future gains will need to come increasingly from productivity enhancing investment.

Slovenia: ULC and Productivity relative to the E.U.

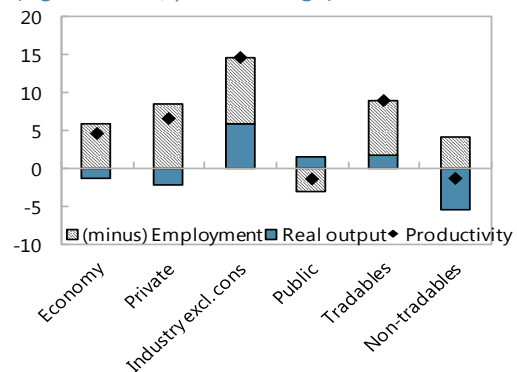
(Index, 2008 = 100)



Source: Haver, and IMF staff calculations.

Slovenia: Productivity

(log difference, peak to trough)



5. **The authorities are taking actions to address bank weaknesses.** On December 12, 2013, the authorities announced the results of independent AQR and ST and are

proceeding with banks' recapitalization (see paragraph 18). The authorities are also transferring some impaired assets to the BAMC.

6. **The government also has made some progress on other reforms but political situation remains complicated.** In the spring, parliament passed laws making referenda more difficult to call (the ease of calling referenda to block reforms was perceived as an important institutional problem) and introduced a (structurally) balanced budget rule in the constitution. Since the summer, the parliament approved key laws on corporate insolvency, bank resolution, and state holding company. Despite this important institutional progress, tough discussions on banks and the 2014 budget highlighted tensions within the government coalition.

A. Policy Discussions

7. **Policy discussions focused on the growth outlook, the asset quality review (AQR) and stress tests (ST) and their implications for bank recapitalization, corporate sector restructuring, fiscal consolidation, pension and labor market reforms, and competitiveness.**

Recommendations of the 2012 Article IV Staff Report and Actions Taken by the Authorities

General goals	Specific measures recommended	Actions by government
Fiscal consolidation with the goal of reaching structural balance in 2015	Expenditure-based adjustment by reducing the public wage bill (both through wage moderation/cuts and staff reductions). Revisit the planned CIT reduction.	Government froze public wages and pensions. CIT reductions were implemented as planned in 2013, but plans for further gradual cuts were shelved.
Strengthening the financial sector	Banks' capitalization needs to be strengthened.	Implementation underway based on comprehensive AQR and ST.
Strengthening the financial sector	Transfer problem assets to BAMC.	BAMC in place and some NPLs are being transferred, but the NPL ratio will remain high at about 12 percent.
Pension Reform	Reduce pension liabilities in the face of rising costs of aging.	Reforms introduced, with a pensions freeze in effect until end-2015.
Labor Market	Reduce labor market duality and improve flexibility.	Limited reforms, with notice periods and severance pay reduced, and hiring/firing procedures simplified.
Product markets	Privatization and encouraging FDI inflows.	15 public companies were identified for privatization with one privatized in October 2013.

B. Outlook and Risks: The Difficult Road Ahead

8. **The near-term economic outlook is difficult.** Poor asset quality and funding problems in the banks, debt overhang in the corporate sector, and large fiscal consolidation needs (including owing to the need to recapitalize banks) cloud the near-term horizon. Staff forecasts that the economy will continue to shrink in 2013 by 1.7 percent and—despite the expected recovery in the euro area—by a further 1.1 percent in 2014. The consensus and government growth forecasts range between 0 and -1 percent for 2014.

9. **The medium-term outlook depends upon the euro area recovery and the strength of domestic policies.** Staff projects growth to turn positive in 2015, led by exports benefitting from stronger euro area demand. Later, with healthier balance sheets and improved credit conditions, fixed investment and private consumption could sustain the recovery, closing the output gap by 2018. However, the recovery is contingent on strong policies in strengthening banks and cleaning their balance sheets, corporate restructuring, and creating an investment-friendly business climate (Box 2).

10. **Downside risks are large, especially if bank balance sheets are not cleaned adequately.** The authorities' response to the recent AQR and ST addressed the immediate market concerns about bank capital adequacy. However, the ECB comprehensive risk assessment expected in the fall of 2014 could show additional capital shortfalls, owing to possible differences in methodology, hurdle rate, and the change in coverage (along NLB and NKBM, the SID, Slovenia's development bank, will be covered for the first time). Slovenia's financing needs are substantial, and could be difficult to fund at affordable rates with an incomplete cleaning of domestic banks' balance sheets. Insufficient resolution of large and rising NPLs would prolong bank distress, despite the recapitalization. Also, ever-greened loans in bank balance sheets would require additional provisioning and damage future bank profitability. These loans would also crowd out the flow of credit to viable firms. This would deepen bank deleveraging and prolong the recession (see RAM).

11. **Banks will remain fragile unless the overleveraged corporate sector is also restructured.** Without this, the bank recapitalization will be only an expensive stop-gap solution with prolonged corporate weaknesses gradually eroding restored bank capital buffers. Insufficient corporate deleveraging and governance reform would exacerbate the risk that viable but overleveraged companies would fail to revive, prolonging the recession.

12. **Fiscal consolidation measures could fall short of what is needed for debt stabilization.** Reliance on large across-the-board expenditure cuts and possibly optimistic assumptions about yields from tax enforcement increase the risk that the deficit could be much larger than targeted. Contingency measures could partly compensate but there is a risk of doing too little, too late. Spending overruns, revenue shortfalls, an additional bank recapitalization, or materialization of other contingent liabilities could push public debt to a non-sustainable path.

13. **External risks derive largely from the re-emergence of euro area financial stress and slower European growth.** While Slovenian banks have already gone through a significant deleveraging in recent years, a failure of euro area countries to deliver on policy commitments or a negative result from the euro area AQR and ST could curtail the foreign bank credit on which export-oriented Slovenian firms rely. Slower euro area growth would undermine Slovenia's growth prospects and worsen its public debt dynamics. Possible outward spillovers are limited to countries where subsidiaries of Slovenian banks are present, including Bosnia and Herzegovina, Kosovo, Macedonia, Montenegro, and Serbia.

14. **The authorities broadly agreed with staff's outlook and the assessment of risks.** Official forecasts for 2014 growth are moderately better than staff's, but the authorities agreed that the risks to forecasts are to the downside. They broadly concurred with the classification of risks as in the RAM, but stressed that Slovenia is committed to the prompt implementation of the policy agenda so domestic risks are limited.

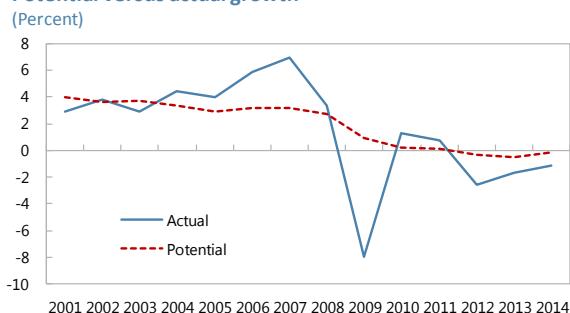
Box 2. Potential Output and Growth Prospects

Staff estimates that the output gap is around 4 percent of potential GDP. The large current account reversal underway suggests that staff estimates are on the conservative side. The current account balance is swinging to an estimated surplus of 6.8 percent this year from 0.4 percent in 2011, with only a moderate improvement in competitiveness.

However, growth will not come back rapidly. Production function methods indicate that potential output is shrinking at a rate of ½ to 1 percent annually, and that the output gap could be closed with several years of 1 to 2 percent growth. While such statistical methods are on the whole backward-looking, staff judges that growth is unlikely to rebound quickly in the current environment with the banks under severe stress.

Looking ahead, potential growth will depend upon many factors, including policy reforms. The potential growth rate of the economy depends on (i) how quickly the much needed bank and corporate restructuring is carried out, (ii) whether structural policies lead to a more growth-friendly business environment, and (iii) the extent to which growth prospects for the broader euro area improve.

Potential versus actual growth



C. Financial Sector: Moving Forward to Deal with the Crisis

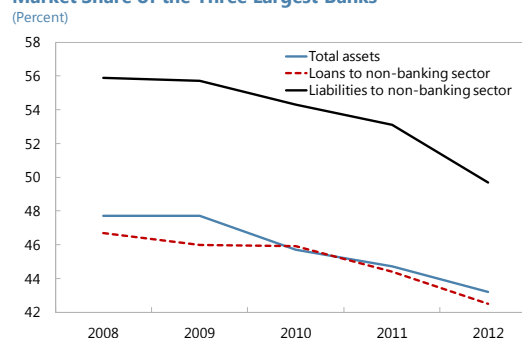
15. **Bank balance sheets continue to deteriorate.** Bank assets shrunk 6.3 percent last year and a further 3.4 percent in the first eight months of 2013. The loan-to-deposit ratio of domestic banks stands at around 110 percent and that of foreign subsidiaries at 171 percent, down from peaks of 138 and 267 percent, respectively. The three state-owned banks (NLB, NKBM, and

Abanka), which accounted for 42 percent of the assets of the system at end-2012 remain under severe stress. Furthermore, two distressed small banks accounting for 4.5 percent of total assets were intervened by the Bank of Slovenia in September 2013, and are being wound down.

16. Banks replaced lost foreign private financing with ECB sources. After repayments to

wholesale financial markets equal to about 10 percent of GDP in 2012, banks' reliance on foreign bank financing declined from 25 percent of liabilities in 2009 to 15 percent in March 2013; in particular, foreign subsidiaries reduced their share from 49 to 30 percent in the same period. To make up for part of the financing shortfall, banks have taken Eurosystem LTROs for about €4 billion in December 2011 and March 2012, making Slovenia one of the heaviest users of LTROs relative to bank assets.

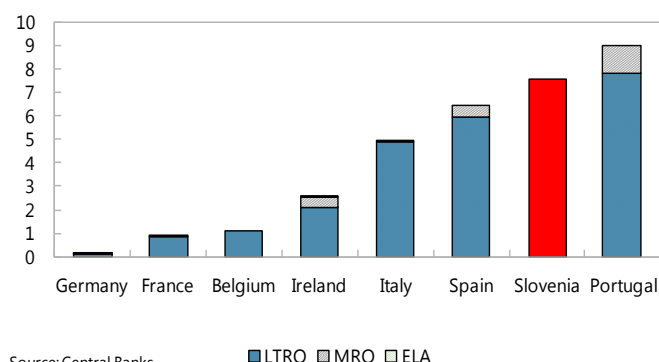
Market Share of the Three Largest Banks



Source: Bank of Slovenia.

ECB Lending to Credit Institution by Country, September 2013

(Percent of Banking System Assets)



Source: Central Banks.

17. NPLs swelled. NPLs (inclusive of guarantees) increased from about 13 percent of all loans at end-2011 to 20.9 percent by end-October 2013. At end-August 2013, the ratio at the three state-owned banks stood at 24.5 percent, with the NPL ratio for corporates reaching 38.3 percent. In contrast, foreign banks appear to be relatively more sound, with NPL ratios about half those of the three state-owned banks. NPLs are highly concentrated in large corporate debtors, with the 40 largest loans accounting for 34 percent of NPLs and an additional 200 or so loans accounting for another 33 percent. Households have low indebtedness. Restructuring of over-indebted corporates (possibly representing "ever-greening") accounts for more than half of all new loans (and 64 percent in the three state-owned banks).

18. State-owned banks are being recapitalized after undergoing a comprehensive AQR and ST. Under the aegis of EBA, ECB and EC, the authorities had foreign consultants carry out a comprehensive AQR and ST of eight banks, three of which are the largest and state-owned—NLB, NKBM and Abanka. Based on the outcome of this exercise, these banks are being recapitalized in the amount of €3.7 billion. Of this amount, the authorities have injected €3 billion in cash and marketable instruments, with the remainder coming from bailing-in junior debt and adjusting risk weighted assets (Box 3). After the AQR and recapitalization, the Tier 1 capital ratio is projected to be 15.0 percent for NLB, 16.8 percent per NKBM, and 9 percent for Abanka.

Box 3. Asset Quality Review, Stress Tests, and Recapitalization

Slovenia undertook a comprehensive AQR and ST exercise on its banks. The AQR covered eight banks, which comprise 70 percent of the system in terms of assets, and included verification of data completeness and integrity, a review of individual loans and collateral valuations, and an assessment of the adequacy of impairments and provisions. Based on the AQR data, the bank balance sheets were tested to assess the adequacy of capital in an adverse macroeconomic scenario, which involves a decline in real GDP of 9.5 percent over three years, as well as a 27 percent drop in average real estate prices, a 25 percent drop in equity prices, and a rise in bond yields to 8.5 percent. The AQR and the ST were carried out by independent consultants (Deloitte, Ernst & Young, and Oliver Wyman) and overseen by a committee comprising the Bank of Slovenia and the Ministry of Finance, with the European Commission, the European Central Bank and the European Banking Authority as observers. The results were announced on December 12, 2013.

The exercise found that the eight banks covered would need €4.8 billion in additional capital to withstand the adverse macroeconomic scenario. Of this, the three state-owned banks require €3.7 billion, the two private domestic banks €0.7 billion and three subsidiaries of foreign banks €0.4 billion.

The authorities have moved to address these capital needs. The three state-owned banks are being recapitalized through a combination of cash (€2.1 billion), marketable government bonds (€0.9 billion), bail-in of subordinated bondholders (€0.4 billion), and lower capital requirements thanks to a reduction in risk-weighted assets following the transfer of some NPLs to the BAMC (€0.3 billion). The two private domestic banks and the three foreign-owned subsidiaries, which are currently in compliance with Bank of Slovenia capital requirements, would be given until June 2014 to increase their capital to the level suggested by the ST results. If this proves infeasible, the government will provide the requisite capital backstops. In parallel, the authorities announced a capitalization of the two small banks that are in the process of being wound down, and of the BAMC. In addition and within the restructuring programs agreed with the EC's Directorate General of Competition (DG Comp) for state aid, the three large state-owned banks are transferring €4.6 billion in assets to the BAMC, which is paying €1.6 billion for them. The price is being approved by DG Comp and reflects the long term economic value as mandated by EU rules.

19. **Even after the transfer to BAMC, NPLs will remain high.** Concurrent with the recapitalization, the authorities are transferring about €4.6 billion of impaired loans (at a price of €1.6 billion) from the three state-owned banks to the BAMC. This transfer will not affect the capitalization ratio given the consistency with the AQR. The transfer, however, will only bring the NPL ratio down to just over 12 percent in 2014, which is still much higher than the 4-5 percent pre-crisis levels. Crucially, the transfer does not include most of the loans to corporates that have been restructured by rolling over principal and a portion of interest due.

20. **Staff discussed several actions to strengthen the financial system:**

Dealing with impaired assets. The recent AQR and ST and the subsequent recapitalization of the three state-owned banks are welcome steps. However, at about 12 percent the NPLs ratio in public banks remains too high; even if adequately provisioned, a large share of NPLs can create perverse incentives, especially in public banks. A thorough clean-up of bank balance sheets is essential, and a greater share of impaired assets should be transferred to the BAMC, starting with larger corporates. The transfer

should be as comprehensive as possible to reduce uncertainty, restore the banks' financial viability, and reduce their incentives for evergreening.

- **BAMC.** The BAMC will mitigate creditor coordination problems and reduce the capital needs in the banks by allowing a decline in their risk weighted assets (Box 4). The BAMC can also facilitate corporate restructuring, with the goal of maximizing recovery value. BAMC's independence is essential to achieve these goals. The BAMC should use the cash from asset sales to pay down its outstanding debt according to a cash protocol.
- **Bank governance and risk management.** Governance and risk management practices should be strengthened to address endemic connected lending and lax risk controls, especially for state-owned banks. Strong private ownership would be helpful in curbing political interference.
- **Bank resolution.** The authorities' approach to the recent liquidation of two small banks has highlighted shortcomings of the resolution framework. The authorities bailed out all creditors (except junior debt), including fiduciary accounts and liabilities that might belong to non-performing debtors. The fiscal burden will turn out to be higher because impaired assets and liabilities are not being netted out by client. While the authorities acted to safeguard financial stability, a concern which staff shares, the approach is problematic in terms of incentives and costs to the state. The authorities issued guarantees of about 3 percent of GDP, and estimate net resolution costs at about 1¼ percent of GDP for these two small banks accounting for 4.5 percent of the system. Future resolutions should aim at bailing-out only insured deposits and should net out assets and liabilities by client.
- **Bank consolidation.** Bank consolidation will likely be an important element in the authorities' resolution toolkit. Mergers should be private-sector driven but not leave banks with unqualified owners unable to keep banks well-capitalized in the face of ongoing asset quality deterioration.
- **The authorities have made good progress in implementing other FSAP recommendations,** especially in expanding the toolkit to safeguard financial stability, guard banks' investments and investments in banks, qualify bank officials and protect bank supervisors (Box 5).

Box 4. The BAMC

In late 2012, the authorities created the BAMC as a public agency, which is subject to oversight by the Court of Audit (supreme audit institution) and the parliament. The BAMC is governed by a board where the majority consists of well-known foreign experts; its purchases and business plans are approved by the Slovenian government.

By statute, the BAMC can issue up to €4 billion of government-guaranteed bonds (about 11 percent of GDP) to acquire bank impaired assets, restructure corporates or recapitalize banks. With prior authorization by the EC, the BAMC is buying from the three major state-owned banks about €4.6 billion of impaired assets; these assets are regarded as "non-core" and include mostly bankrupt financial holding and construction sector companies. The BAMC is paying only €1.6 billion for these impaired assets; the acquisition price follows the EC's State Aid Guidelines of the "real long-term value" and is cleared by the EC's DG Comp.

The BAMC has the legal instruments and the power to seek a quick resolution of impaired assets, be it by restructuring the corporate (when it holds more than 50 percent of the credits) or by liquidating it and selling its collateral and assets. Bankruptcy procedures where the BAMC is involved are to be concluded within six months. The BAMC has the option of acquiring credits of impaired creditors from other banks to facilitate corporate restructuring, but has to purchase those credits at market prices to avoid providing state aid.

A second wave of transfers is possible. The authorities may evaluate with EC's DG COMP whether a second wave of impaired assets transfer is warranted to ease the burden on the three state-owned banks, and will proceed accordingly. The BAMC is to be wound down after five years, with the remaining assets to be transferred to the Slovenia Sovereign Holding (SSH) company.

Measures are being taken to ensure a strong financial position of the BAMC. While public debt increases when the BAMC's bonds are issued, this debt should be partially repaid with the proceeds from the liquidation of assets, including the privatization of corporations that end up in the BAMC's portfolio. The Anticorruption Commission and the authorities are defining processes and operational principles that are highly transparent, while preserving the operational independence and confidentiality of the agency; these principles should be in place by the time of the first transfers. The authorities have also increased the capital of the BAMC by €200 million, which satisfies the entity's cash flow needs while limiting the burden on the government's cash position.

The authorities would like to extend the life of BAMC to ten years or more. While the details are not clear, two additional changes include allowing private investment in the capital of the BAMC, and relaxing the BAMC's obligation to sell at least 10 percent of its holdings every year. Although private investors have indicated interest in buying blocks of assets, the authorities regard the 10 percent rule as a fire-sale rule that fails to maximize the value for Slovenian taxpayers.

Box 5. FSAP Follow-Up

The authorities are making progress in implementing the recommendations of the 2012 FSAP, including through an AQR and ST that will lead to recapitalization of some banks.

In late 2012 the authorities revamped the Bank of Slovenia's (BoS) legislative framework (Banking Law, approved by Parliament in November), introducing the following main changes:

- *Financial system stability*: BoS now has powers over extraordinary receivership, sale of all of a bank's shares, mandating and carrying out increases in share capital, and transfers of the total or a partial share of a bank's assets and liabilities.
- *Investments in banks*: BoS must give its prior consent to any purchase of a qualifying holding in a bank, and BoS to be notified of any significant changes in ownership that could influence the assessment of the appropriateness of a qualifying holder. Violators (banks and individuals) are subject to repeated fines. This injunction also covers investments by Slovenian banks in financial sector entities in other EU Member States and third countries.
- *Oversight of bank investments*: BoS now has the legal power to request from corporations in which a bank acquires a qualifying holding a report outlining risks incurred by the bank.
- *Qualification of bank officials and limits to bank decisions*: BoS may disqualify a person from holding office as a member of a supervisory board, if they have breached their obligations as a member of a supervisory board.
- *Protection of bank supervisors*: BoS supervisors are now protected from civil and criminal law suits, provided their actions were lawful and conducted with expert diligence.

In the future, regulations will follow the Basel internal ratings based (IRB) approach definition of default to assess impairments and provisioning.

21. **The authorities broadly concurred with the staff's recommendations and said that they will assess the need for additional transfers once the first round is complete.**

Authorities stressed they are recapitalizing the banks as per the recommendations of the AQR and ST exercise, and are transferring some impaired assets to BAMC in line with the restructuring plans agreed with the EC. They also noted that governance in the banks will be addressed also via privatization. Staff reiterated that recapitalization is a first step to restructure financial and corporate sectors, and warned against complacency after a successful recapitalization.

D. Corporate Sector

22. **An overleveraged corporate sector is thwarting economic recovery.** Slovenian corporates are among the most highly leveraged in the euro area, mainly because of a lack of equity: the corporate debt to GDP ratio is about the euro area average. This is a legacy of the boom years, when bank financing was plentiful, enabling companies to expand beyond their core areas, engage in acquisitions, and invest heavily in risky projects without putting up their own money. The sudden stop in capital flows and the ensuing recession stopped credit availability, weakened cash flows, and exposed significant weaknesses in corporate management and governance. The average interest bill to earnings ratio has reached 90 percent, pushing into the

red companies that might be viable with lower debt. Credit availability and pricing has worsened as banks deleverage (Box 6).

Box 6. Corporate Sector Performance

Corporate sector performance worsened significantly in the post crisis period. Profits declined significantly after the global financial crisis, from both operations and financial investments. The biggest reversal of profit was in the services sector, while the construction sector also fell into aggregate loss-making. While there is some improvement from the 2010 trough in aggregate profitability, profits are still close to historical lows.

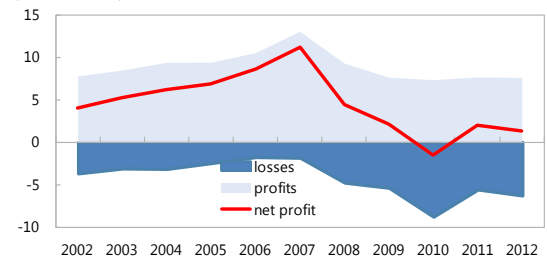
Debt overhang is a considerable burden. Corporates are overleveraged, both relative to their euro area peers and historical trends, mainly due to a lack of equity; corporate debt to GDP is below the euro area average. The debt-to-equity ratio has moderated from 165 percent in 2009 to 135 percent in 2012, but the ratio remains comparatively high, and is a constraint on investment. Bank of Slovenia's microeconomic analysis finds a significant negative link between leverage and firm performance in both pre-crisis and post-crisis periods, which suggests that the overleveraging is not simply a consequence of the economic shock, but also an explanatory factor for underperformance of the economy.

Many corporates have unsustainable debt servicing levels. Firms with earnings before interest and taxes (EBIT) less than the interest bill account for 16 percent of employment. At current levels of earnings and interest costs, many firms will either need to have their debt restructured, or squeeze investment and cut employment to make repayments and reduce their debt burden.

Profitability is better and debt service more manageable in exporters, industrial firms, and foreign-owned firms. Domestically-oriented firms, especially construction and financial services companies (diversified holding companies that grew fast in the pre-crisis period), have greater debt servicing problems, reflecting their higher leverage ratios.

Corporate Profits

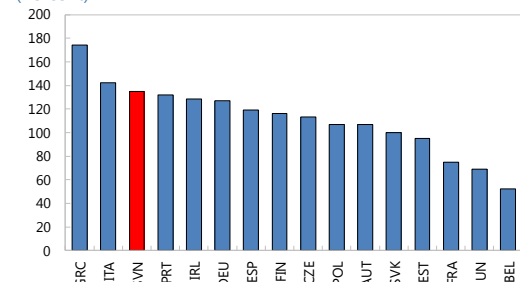
(Percent of GDP)



Source: Bank of Slovenia

Corporate Leverage, 2012 1/

(Percent)



Source: OECD.

1/ Defined as total liabilities over equity in non-financial corporates.

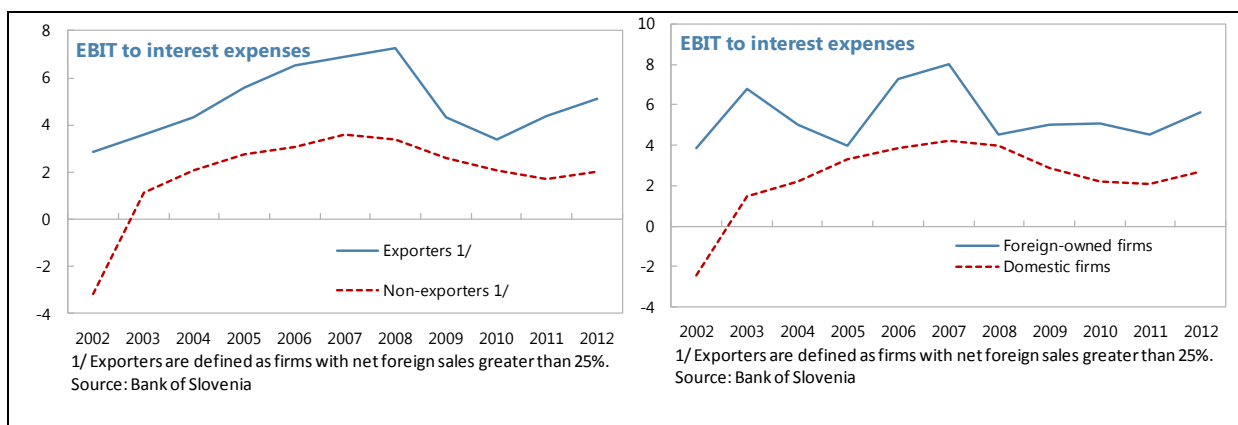
Share of Employment in Firms with Unsustainable Debt 1/

(Percent)



1/ Unsustainable debt is defined as earnings before interest and taxes below the interest expense.

Source: Bank of Slovenia.



23. Addressing corporate distress requires a multi-pronged approach:

- *Equity injections.* Equity in most corporates is limited, and owners have been unable or unwilling to inject equity in these companies. Diluting their investments or writing them off may be needed as a precondition to bring in new investors with equity and for effective debt restructuring. Barriers to entry should be removed to support the contribution of foreign equity to the corporate restructuring process. Government funds should not be used as a source of equity owing to the fiscal consequences.
- *Debt restructuring.* Viable companies should seek debt reduction from their creditors, use debt-equity swaps, sell assets, and spin off non-core businesses.
- *Banks as equity holders.* State-owned banks have ended up owning shares in some corporates, including supermarket chains, breweries, sparkling water companies, ski resorts, hotels, and newspapers. Should there be debt to equity swaps, banks (and the BAMC) may further increase their shares in restructured firms. A prudent enforcement of mark-to-market and existing limits on connected lending is necessary.
- *Reducing state involvement and improving corporate governance.* The state owns and controls substantial sections of the economy through an elaborate (and often nontransparent) holding structure. The European Commission (2013) estimates at least 11 percent of employment is in enterprises directly or indirectly owned by the state, including the banks. Using a broader definition, Ogorvec and Verbic (2011) estimate one third of assets in the economy can be traced to the state. The state can divest its holdings through privatization and strengthen corporate governance by encouraging the consolidation and simplification of ownership structures. Unified, independent, and professional management of state holdings is key in this respect.
- *From protecting the (past) owners to protecting (efficient) companies.* The existing legal framework has proved overly protective of shareholders, allowing them to block or delay restructuring, and made creditor coordination difficult. Bankruptcy cases take an estimated three years on average to close. To address this issue, the authorities have

proposed an amendment to the insolvency law, which was voted into law by parliament (Box 7).

Box 7. Reforming the Corporate Insolvency Regime

The corporate insolvency regime has been impeding restructuring of firms. Weaknesses included an ineffective rehabilitation procedure that provides excessive protection to existing shareholders and excludes secured creditors. The rigid procedural requirements in the rehabilitation process also discouraged efficient debt workouts (e.g. creditors need to pay at least 50 percent over a four year period).

The authorities drafted an amendment to the insolvency law with Fund staff Technical Assistance to help bring the insolvency regime into line with international best practices. The overarching goal is to facilitate the restructuring of viable companies. The key features of the amendment are as follows:

- A simplified pre-insolvency procedure for large and medium-sized firms to restructure financial claims (including secured claims) more efficiently and speedily, which includes a stay and majority voting;
- An enhanced compulsory settlement (CS) with:
 - Increased control of the CS proceeding by financial creditors, including the ability to initiate proceedings, to introduce a CS plan that takes precedence over the debtor's plan, and to take management control;
 - An absolute priority rule to ensure that if equity in the debtor is zero, debtor equity will be eliminated (effectively preventing existing owners from blocking the restructuring process);
 - Corporate restructuring features, including debt-for-equity swaps and corporate spin-offs to facilitate viable firms continuing as a going concern;
 - Secured creditors are included in CS and can pool collateral under a CS plan;
 - The write-down of collateral to market value with a corresponding conversion of the now unsecured portions of collateralized loans into unsecured claims is permitted; and
 - The possibility that requisite majorities of creditors can agree to reduce principal on unsecured debt, and to extend maturity and/or to reduce the interest rate for both secured and unsecured debt.
- *The bankruptcy and liquidation* of non-viable corporates (i.e., that cannot be relaunched in the CS stage) remains unchanged by the amendment.

The amendment significantly improves the corporate insolvency regime and, if properly implemented, can facilitate the rehabilitation of viable firms. The amendment addresses the immediate challenges facing Slovenia within its current institutional capacity and focuses on financial claims and does not address inter-company claims. Enhancing institutional capacity through the training of judges and insolvency administrators, and introducing proper incentives for stakeholders, would support the successful implementation of the amendment.

24. **The authorities agreed that the corporate sector is a barrier to recovery and an underlying cause of the banking sector troubles.** To address this, they drafted an amendment to the insolvency law. They also stressed limited credit availability as a major concern for corporates and are increasing resources to the development bank SID and the Slovene enterprise fund, and considering state equity injections. Staff argued the limited fiscal space should not be

used for shoring up corporations and urged reconsidering a planned transfer to SID of seed money for lending programs. In staff's view, only a decisive retrenchment of the state from the financial and corporate sector will bring a lasting solution.

E. Fiscal Policy

25. **Despite the deep recession, the authorities achieved major fiscal consolidation during 2011–12.** Staff estimates an improvement in the structural primary balance of some 3 percent of GDP during this period. The adjustment was broadly balanced between revenue increases and expenditure reductions, the latter including wage cuts and sharp reductions in public investment.

26. **The authorities target a general government deficit below 3 percent of GDP by 2015 and a balanced budget in structural terms by 2017.** This is consistent with the recent two-year extension of the corresponding deadline under the Excessive Deficit Procedure (EDP).

- *In line with these objectives, the original 2013 budget aimed at expenditure-based consolidation, supported by cuts in public wages and public consumption. In the event, the budget had to be revisited in mid-2013, owing to slippages in first-quarter indirect tax collections (later reversed), higher-than-budgeted increases in the interest bill and, especially, large shortfalls in corporate income tax collections.*
- *In their revised Stability Programme (SP), the authorities announced an ambitious set of additional measures covering the second half of 2013 and 2014 (see Table), exceeding 3 percent of GDP on a cumulative basis. The planned additional adjustment for 2013 was broadly balanced between revenue and expenditure, while that for 2014 was heavily tilted toward revenue because of an envisaged increase in personal income tax rates—although the authorities hoped to be able to avoid these if a new wage agreement could be reached that generated the required savings.*

Fiscal measures in Revised Stability Program (percent of GDP)			
	2013	2014	
Revenue	0.5	2.1	
o/w: Income taxes	--	0.9	
Social security contributions	0.1	0.1	
VAT	0.4	0.4	
Taxes on property	--	0.7	
Expenditure	-0.5	-0.4	
o/w: Wage bill	-0.3	-0.2	
Capital expenditures and transfers	-0.2	-0.2	

Source: Republic of Slovenia, Stability Programme, 2013 Update

27. **The supplementary budget for 2014 confirms the deficit target of the revised SP but is substantially weaker in terms of concrete supporting measures.** The budget, approved by parliament mid-November, still targets the 2014 deficit at 3½ percent of GDP (excluding bank restructuring and recapitalization costs), in line with EDP requirements. However, key measures are missing in the revised SP—including the increase in personal income tax rates and in social security contributions (or an equivalent reduction in the wage bill), which were expected to yield around 1 percent of GDP. Instead, the supplementary budget relies on across-the-board cuts in

the expenditure on goods and services by line ministries (11 percent year-on-year)—which are not supported by reforms—and in subsidies (12 percent year-on-year), without specifying which subsidies are to be reduced. On the revenue side, the authorities adopted a broad-based property tax increase expected to yield about $\frac{3}{4}$ percent of GDP, while also counting on uncertain revenue gains from stronger tax collection enforcement ($\frac{1}{4}$ percent of GDP), including tighter limits on cash transactions, stronger reporting requirements on offshore holdings, and enhanced cross-checking of income declarations against household assets.

28. **Staff expressed concern about the quality of fiscal measures underpinning the budget and called for additional measures.** While endorsing the property tax increase, staff was skeptical about the across-the-board expenditure cuts and large revenue yields from administrative improvements. In addition, domestic courts have mandated restitutions against a partial retroactive wage freeze imposed in early 2012 and European Courts have mandated payments of certain social benefits to residents of Slovenia who had not obtained Slovenian citizenship in 1991—neither of these payments are accounted for in the budget. These one-off items could increase the 2014 deficit by an additional 0.2 percent of GDP, and possibly more if they are relatively frontloaded. In sum, staff estimates an overall shortfall relative to the authorities' target of some 1 percent of GDP. As the bulk of concrete measures already taken related to the revenue side of the budget, there was a compelling case to focus the needed corrective measures on expenditure: staff recommended more ambitious public employment reduction, better targeting of social transfers, and specific cuts in transfers and subsidies.

29. **The authorities recognized the risks, but pointed out that any shortfall could be made up during the year.** They argued that expenditure controls have improved considerably, rendering across-the-board cuts more effective than in the past; yet they acknowledged that cuts of the magnitude budgeted entailed considerable risk. Furthermore, they thought that recent tax administration reforms constituted substantial improvements and viewed the expected revenue gains as moderate, but agreed that there were some risks. Overall, they thought that the fiscal risks could be addressed in the course of the year. Staff cautioned that significant delays in adopting offsetting measures would narrow available options, with public investment once again the most likely victim.

30. **Over the medium term and with unchanged policies, public debt will continue to increase rapidly.** The recent rising trend in the debt ratio is set to continue in the near term, as the effects of persistent recession are compounded by the fiscal cost of bank restructuring, bringing the projected debt ratio to a little under 80 percent of GDP by end-2014. Thereafter, the debt ratio would reach some 85 percent over the medium term. The public debt sustainability analysis (DSA) confirms that public debt has entered knife-edge territory, with sensitivity analysis pointing to the risk of explosive debt dynamics under plausible shocks.

31. **Further gradual fiscal adjustment is needed to restore debt sustainability.** To reverse the adverse debt dynamics and contain fiscal risks, fiscal consolidation would need to continue over the medium term, but the needed adjustment would be moderate. An improvement in the structural primary balance of $\frac{3}{4}$ percent of GDP per year during 2015–16 to a primary surplus of

some 3½ percent of GDP over the medium term should put the debt ratio on a steady downward path after 2015. These estimates assume that the fiscal costs of bank recapitalization remain at the level indicated by the AQR; should additional recapitalization prove necessary, faster adjustment would be called for. Maintaining this primary surplus over time would require continued consolidation efforts, however, since a rising interest bill, a reversal of the recent sharp cuts in public investment, and mounting pension expenditures imply a substantial underlying deterioration that would have to be offset by further spending cuts or revenue increases. Staff argued that measures to contain the wage bill and reform social benefits, and a broadening of the corporate income tax base, would be useful to get the debt dynamics under control. In addition, further difficult but critical reforms are necessary to contain the rising costs of the pension system in the medium term (Box 8). The authorities broadly agreed on the needed pace of consolidation, but noted that it may have to be reassessed in the context of bank and corporate restructuring. They noted that another round of pension reform was under preparation, and could be implemented after the 2014–15 suspension of pension indexation expires.

Box 8. Pension Trends and Reform

Slovenia’s pension system is facing adverse demographic trends. In recent years, the fertility rate remained below replacement and life expectancy improved markedly closing the gap with the EU, while the old-age dependency ratio increased. As a result, pension expenditure as a ratio to GDP has been rising rapidly.

The 2012 pension reform started addressing these challenges. The reform gradually increases the statutory age to 65 with a minimum 15-year contribution period; tightens conditions for early retirement by raising the age for early pensions to 60 with a minimum of 40 years of pensionable service; reduces the replacement rate by expanding the assessment base to 28 consecutive years with the highest earnings; and introduces a more price-based indexation formula.

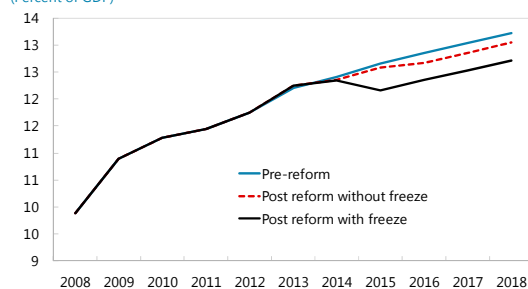
Even so, the reform is insufficient to put the system on a solid financial footing. The pace of increase in the retirement age is too slow, while replacement rates and early retirement and indexation rules remained generous. Consequently, the pension outlays will continue rising relative to GDP, even with the 2014–15 indexation freeze. Pension spending is projected to reach 13 percent of GDP by 2018, up from 11¾ percent in 2012, and 10 percent in 2008.

Therefore a further reform of the pension system is needed. The next reform should focus on gradually increasing the statutory retirement age to 67, maintaining life expectancy at retirement constant, shortening the gap between statutory and early retirement ages, reducing the length of noncontributory service period counting as service time, revising the accrual schedule to reward longer service time, and reducing the replacement rates. Finally, putting a greater weight on prices, rather than wages in the indexation of pensions could help keep costs down in the near term.

Demographic Trends, Slovenia and the European Union, 2002-11

	2002	2011
Life expectancy at birth (years)		
Slovenia	75.5	79.4
EU-27	77.2	79.7
Fertility rate		
Slovenia	1.2	1.6
EU-27	1.5	1.6
Slovenia’s replacement rate (1980)	2.1	2.1
Old-age-dependency ratio (percent)		
Slovenia	20.6	23.9

Pension Expenditure: Reform and Indexation Measures, 2008-18
(Percent of GDP)



Source: IMF staff estimates.

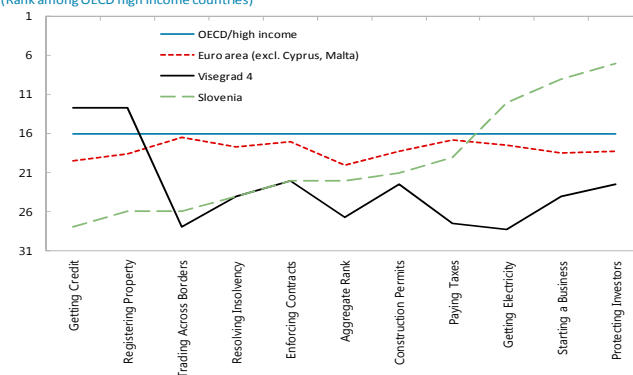
F. Structural Issues

32. **Financial imbalances and structural weaknesses thwart medium-term growth.** As noted above, undercapitalized banks and excess leverage in the corporate sector mean firms are unable to obtain new credit or equity to invest and expand employment. Shortcomings in corporate governance, pervasive state involvement, labor market rigidities, and weaknesses in the insolvency regime all impede the corporate restructuring needed to unleash Slovenia’s growth potential.

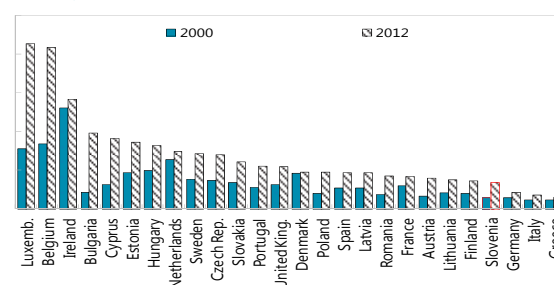
33. **Competitiveness has improved in sectors exposed to foreign competition.** This has contributed to the swing in the current account from a large deficit pre-crisis to a projected surplus of almost 7 percent of GDP in 2013: while compressed domestic demand has limited imports, exports have also benefited from improving competitiveness and increased foreign demand. This surplus will narrow over the medium term as domestic demand recovers but should remain positive on the back of steady growth in exports. Slovenia has a segment of strong, export-oriented firms that have been less affected by the broader corporate distress (Box 6). Unit labor costs have fallen to a greater extent in this segment than in the rest of the economy, where firms have boosted productivity but largely by shedding labor (Box 8). Labor shedding will play a role in improving competitiveness and in corporate restructuring but if growth rebounds and credit constraints ease, gains can come increasingly from employment-creating corporate investment.

34. **Foreign direct investment will boost growth by injecting new capital into the corporate sector and create jobs.** Slovenia’s record in attracting FDI, however, is one of the worst in Europe, despite a highly educated workforce, solid infrastructure, and a location close to European supply chains (chart). A high level of state control of the economy impedes entry, competition, and efficiency, and encourages moral hazard. The Doing Business Indicators show both strengths and key weakness that point to needed reforms, even if the level of specific indicators is open to question (chart).¹ FDI will provide

Doing business indicators 2012
(Rank among OECD high income countries)



FDI Inward Stock
(Percent of GDP)



Source: UNCTAD, FDI/TNC database.

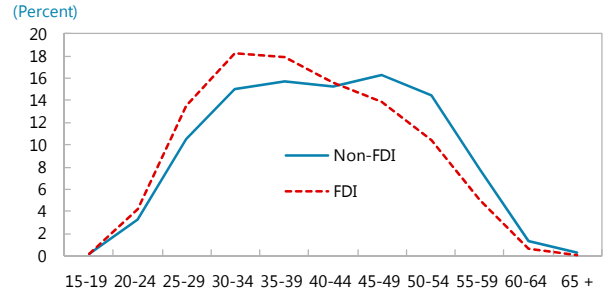
¹ These indicators should be interpreted with caution due to a limited number of respondents, a limited geographical coverage, and standardized assumptions on business constraints and information availability.

much-needed equity capital and help create jobs for the young. Slovenian companies are poorly capitalized and attracting foreign capital is key to help solving this problem. Moreover, FDI—which tends to employ young educated workers—will also create jobs for the youth, which suffered disproportionately during the crisis.

35. A relatively high level of employment protection results in an unfair and inefficient segmentation of the labor force.

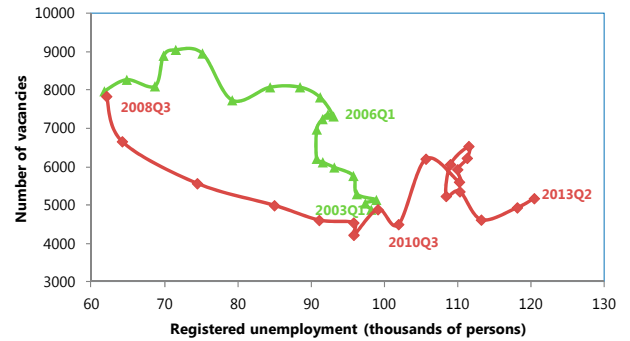
The recent labor market reform—including reductions in severance pay and notice periods—is a step in the right direction, but it is not sufficient to eliminate labor market segmentation. Temporary workers, who are typically younger, continue to bear the burden of labor force adjustments owing to the excessively protective permanent contracts. University students often extend their studies to avoid entering the labor force, and the consequent loss of on-the-job learning opportunities implies a permanent loss of output. Bringing the younger workers earlier into the workforce requires reducing employment protection in permanent contracts.

Employment Share by Age Groups



Source: Statistical Office of the Republic of Slovenia; and IMAD calculations.

Beveridge Curve 1/



Source: Statistical Office of the Republic of Slovenia; staff calculations. 1/ 2013Q2 is a forecast based on voluntary submissions; quarters before 2008 are intrapolated from annual data.

36. Improving corporate governance is of the essence, possibly through privatization.

The government has received parliamentary approval to sell public stakes in 15 companies, chief among them the telecom company and the second largest bank (NKBM). The former has the biggest revenue potential (about €0.7 billion at current stock price), while the sale of the bank could prove much more difficult. The planned centralized management agency for state assets, overseen by an independent and professionally qualified board, should improve governance of public companies and further facilitate privatization, which would materially reduce the state control of the economy. Establishing arms-length relations between SOEs and the government (and public agencies) will also improve governance. Transparency of privatization is also important and renationalization through publicly-owned agencies should be avoided.²

² For instance, in 2011 NKBM sold its shares in the Warsaw stock market to enlarge and internationalize its investors' base. However, at the same time public enterprises and agencies, including the capital asset management company of Slovenia, the electricity company, the airport holding, a pension fund, and the postal office bought shares of NKBM, increasing public ownership in the bank.

STAFF APPRAISAL

37. **The AQR and ST together with the prompt bank recapitalization are key milestones along the path toward stability and growth.** The comprehensive and independent AQR and ST were crucial to remove the uncertainty about the strength of the banking system and restore confidence. The prompt bank recapitalization will reduce short-term deleveraging pressures in the banking system.

38. **Bank recapitalization, however, is not sufficient to lay the groundwork for a resumption of growth.** Only restructuring the corporate and financial sectors and reducing the role of the state in the economy can restore durable growth. Without these reforms, recapitalizing banks will be only an expensive stop-gap solution, as loss-making corporations will generate new NPLs that erode rebuilt bank buffers, and evergreened loans absorb credit growth.

39. **The BAMC is expected to facilitate bank and corporate restructuring.** A swift transfer of impaired assets to the BAMC, at prices that reflect realistic recovery values, will support corporate restructuring. The BAMC has the tools to achieve a quick resolution of impaired assets. A timely disposal of restructured assets and a strong cash protocol should ensure that bonds issued by the BAMC are quickly repaid. However, the effectiveness of the BAMC as a restructuring tool hinges on ensuring its operational independence and clear accountability, as well as transferring most NPLs and evergreened loans from the banks' balance sheets.

40. **Bank governance and risk management should be strengthened to address endemic connected lending and lax risk controls.** The role of the state in the financial system should be drastically reduced through privatization and independent management. Bank consolidation should be driven by private market considerations favoring strong and qualified candidates.

41. **Bankers should focus on banking.** State-owned banks have ended up owning shares in several corporates, including the main supermarket chain, breweries, sparkling water plants, hotels, and newspapers, creating the potential for directed and connected lending and political interference. A prudent enforcement of mark-to-market and existing limits on connected lending are necessary.

42. **Corporate restructuring requires a multi-pronged approach.** In addition to the BAMC, the new insolvency law will facilitate effective and speedy rehabilitation of viable corporates and deleveraging through debt-to-equity swaps while allowing nonviable firms to be wound down. State support of troubled non-financial enterprises should be avoided: it is an inefficient use of limited fiscal resources, and also undermines management incentives and governance, while distorting competition. FDI is an important potential source of fresh capital for corporates.

43. **The planned fiscal stance for 2014 is appropriate but the lack of credible measures raises concerns that the deficit target may not be achieved.** The introduction of a broad-

based property tax is welcome. However, most of the projected improvement in the 2014 budget hinges on large across-the-board expenditure cuts, not supported by specific reforms, and uncertain revenue yields from stronger tax enforcement. Therefore, additional measures of around 1 percent of GDP will be needed to meet the deficit target. These could include a more ambitious public employment reduction, better targeting of social transfers, and reductions of specific subsidies. The transfer of seed money to the development bank, SID for a new lending program, which increases public debt and contingent liabilities, should be reconsidered.

44. **Further gradual fiscal consolidation is in order.** Sizeable public guarantees and the costs of an aging population will substantially increase public debt, necessitating gradual fiscal consolidation. Consensus should be built around additional necessary reforms of the pension system to address the indexation mechanism, benefits eligibility, and the retirement age. Should future bank recapitalizations be needed due to an insufficient bank clean-up, faster adjustment would be called for.

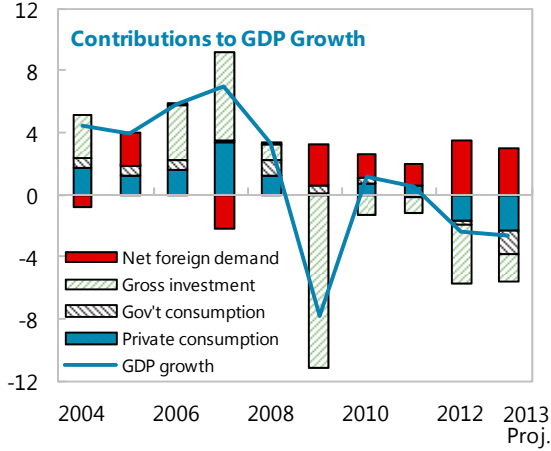
45. **Labor market flexibility is important to facilitate corporate restructuring.** Corporate restructuring will require a reallocation of labor among firms and industries. The brunt of this adjustment is likely to fall disproportionately on the young because older workers enjoy higher job protection. The recent reform reduces labor market duality and is a step in the right direction but its effectiveness needs to be closely monitored.

46. **The state should reduce its role in the economy.** Slovenia's attractiveness for foreign direct investment—a crucial conduit of job opportunities for young educated workers—remains hindered by excessive state control of the economy and pervasive red tape. The government's plan to privatize 15 companies is welcome (especially if promptly executed) but further privatization will be necessary. The decision to set up a centralized management agency for state assets is welcome.

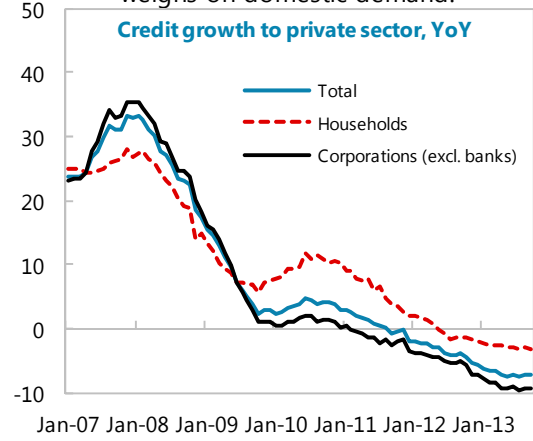
47. It is proposed that the next Article IV consultation be held on the 12-month cycle.

Figure 1. Slovenia: Macroeconomic Developments

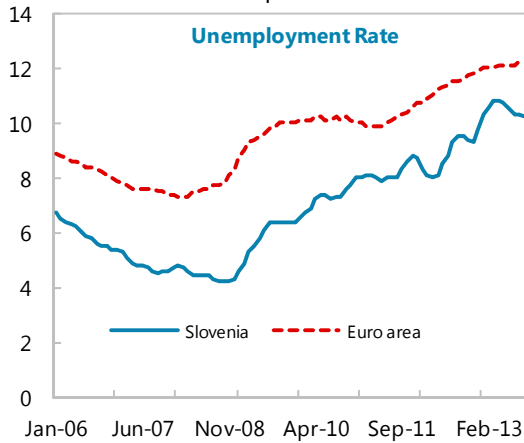
GDP has been contracting since 2011 despite positive net foreign demand...



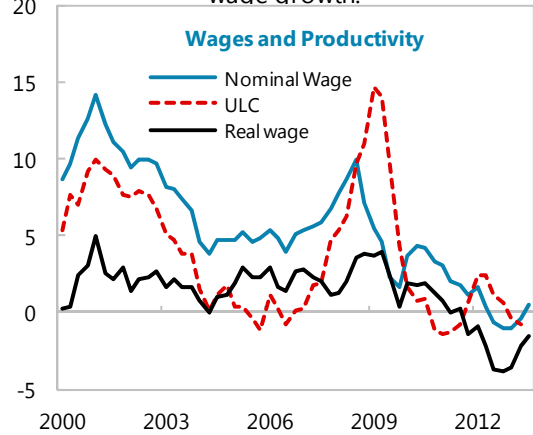
...as deleveraging in the banking sector weighs on domestic demand.



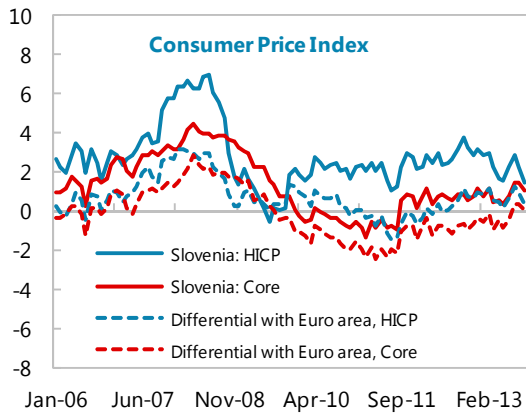
Unemployment is relatively contained given the scale of output losses...



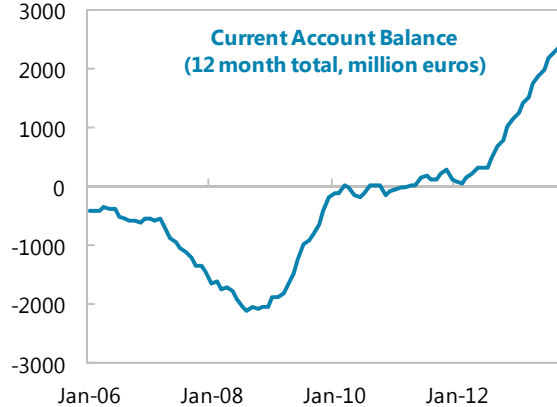
...but exerting downward pressure on the wage growth.



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



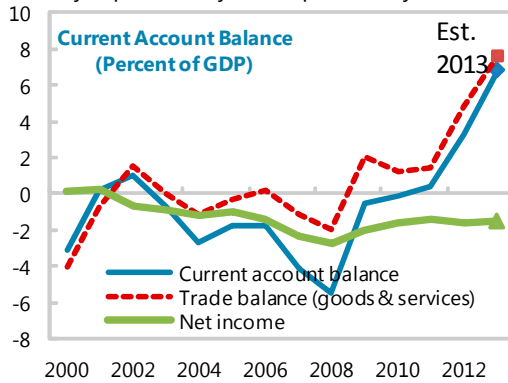
...and to a major turnaround in the current account balance.



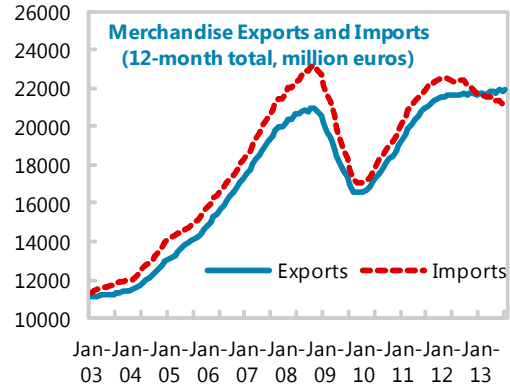
Sources: Bank of Slovenia; Eurostat; Ministry of Finance; Statistical Office of Slovenia; and IMF staff projections.

Figure 2. Slovenia: External Sector Developments

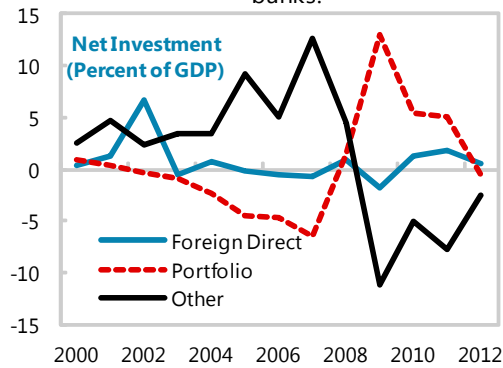
The current account improvement has been very rapid, mainly underpinned by trade...



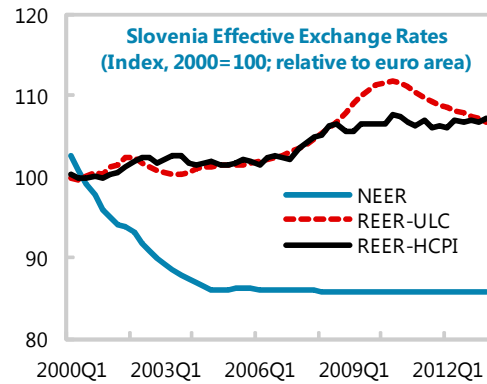
...which is mostly driven by imports compression.



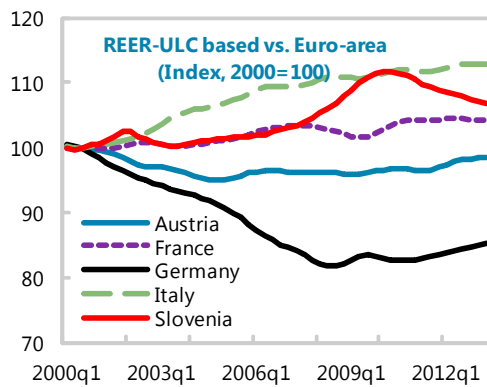
Portfolio inflows related to government issuance helped fund repayments by the banks.



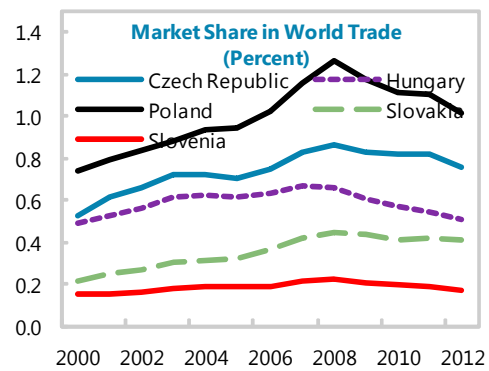
Despite some crisis-related improvement...



...Slovenia's cost competitiveness has more to go...



...as reflected in its global market share.



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

Figure 3. Slovenia: Financial Market Indicators

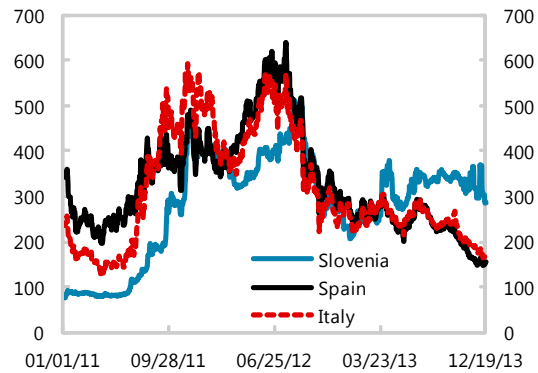
Slovenian bonds are trading significantly above core euro area rates...

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



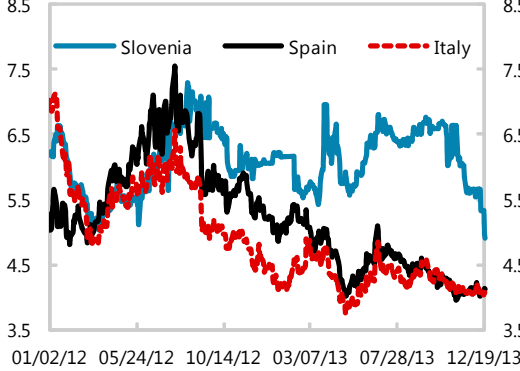
...reflecting higher perceived riskiness.

5-year Sovereign CDS Spreads
(Basis Points)



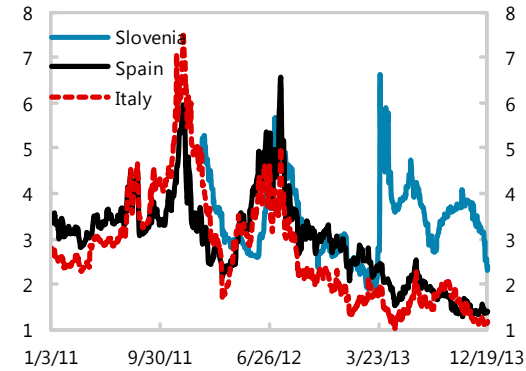
But after the recent AQR announcement, yields declined significantly...

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



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

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



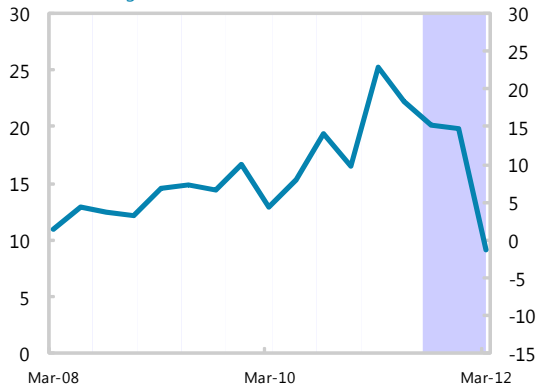
Equity prices stabilized at low levels...

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



...but property prices appear to be dipping again.

Prices of Existing Dwellings
(Percent change, YoY)



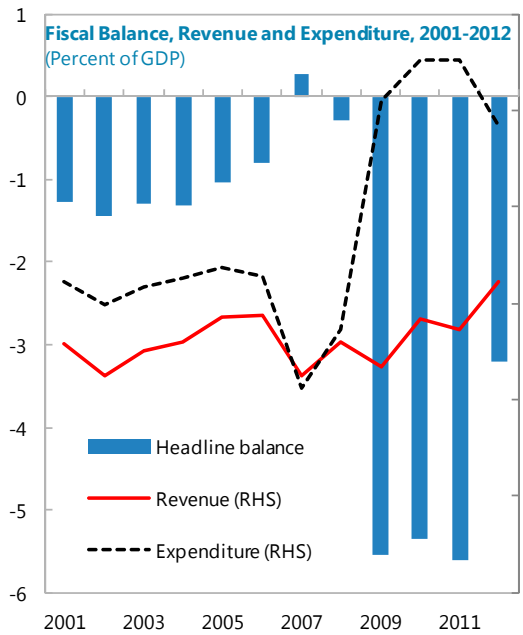
Source: Bloomberg; Statistical Office of Slovenia; and IMF staff calculations.

1/ SLOREP 4.625 09/09/24 used for Slovenia.

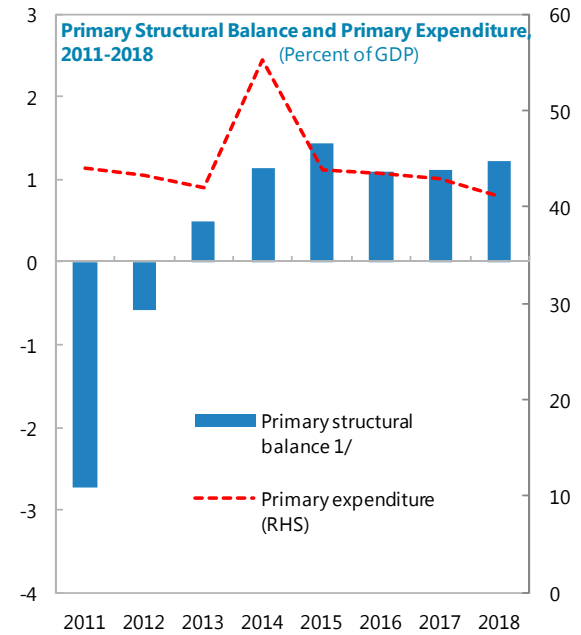
2/ Bloomberg 2-year generic bond yields.

Figure 4. Slovenia: Fiscal Developments

The fiscal balance has deteriorated substantially since 2008.

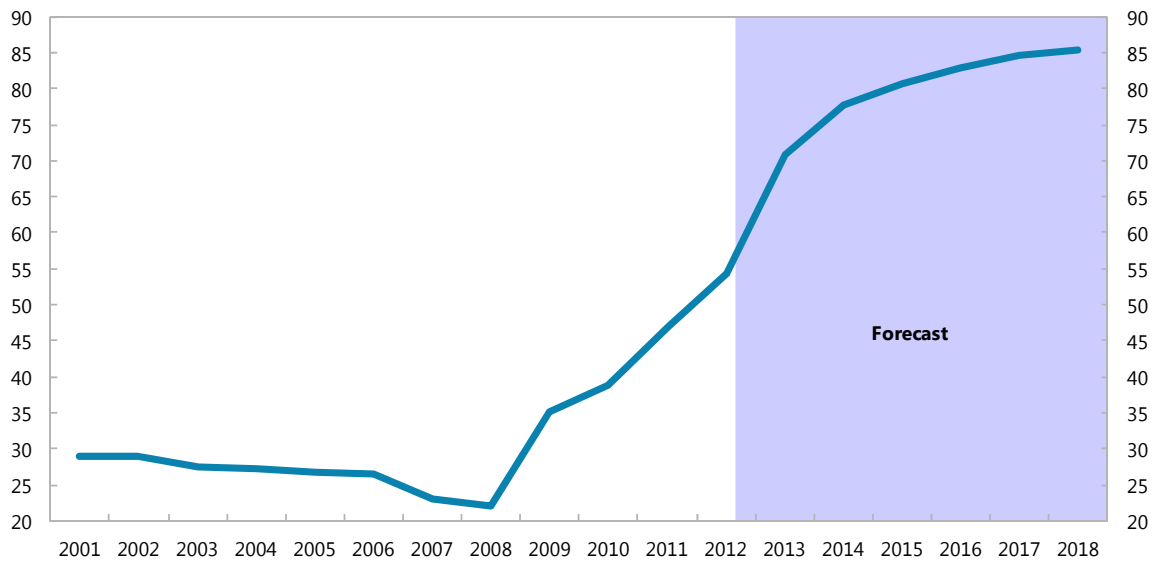


In spite of fiscal consolidation...



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

Debt-to-GDP Ratio, 2001-2018 2/
(Percent of GDP)



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

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

2/ Baseline, which includes the following assumptions about the effects of bank restructuring in 2013-14: (a) debt shock of EUR 1.7 billion (4.8 percent of GDP) from AMC bond issuance for bad loan carve-out ; (b) primary balance shock of EUR 3.6 billion (10.3 percent of GDP) from capital injections into banks ; (c) depositor redemptions of EUR 0.4 bn (1.1 percent of GDP).

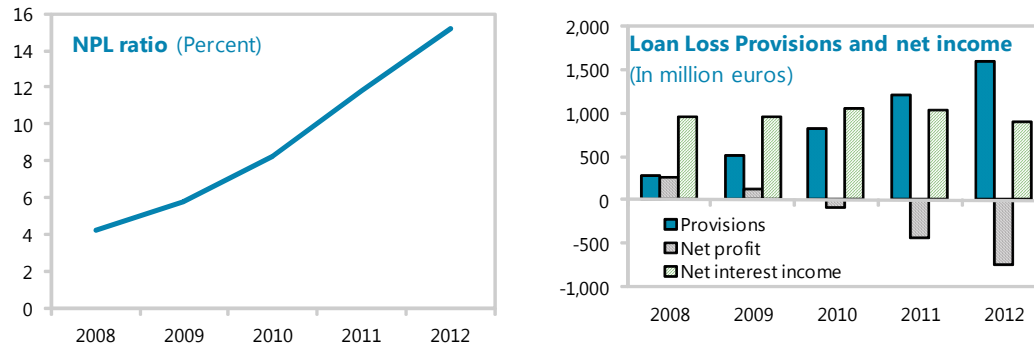
Figure 5. Slovenia: Financial Soundness Indicators, 2013 Q2



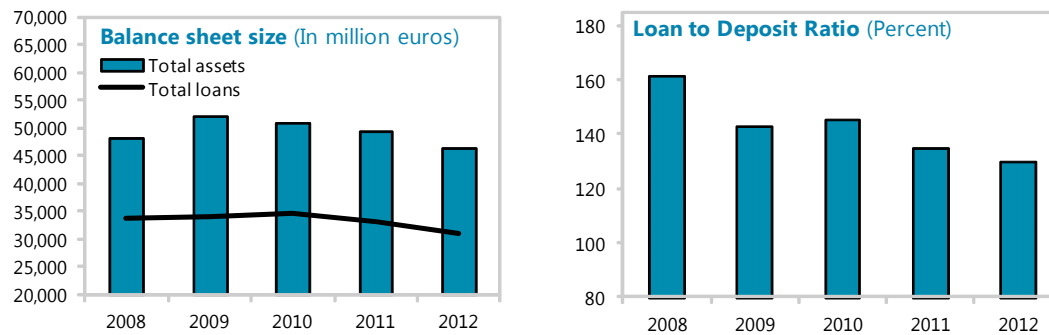
Source: IMF Financial Soundness Indicators.
1/ Data as of 2013 Q1.

Figure 6. Slovenia: Selected Banking Sector Indicators

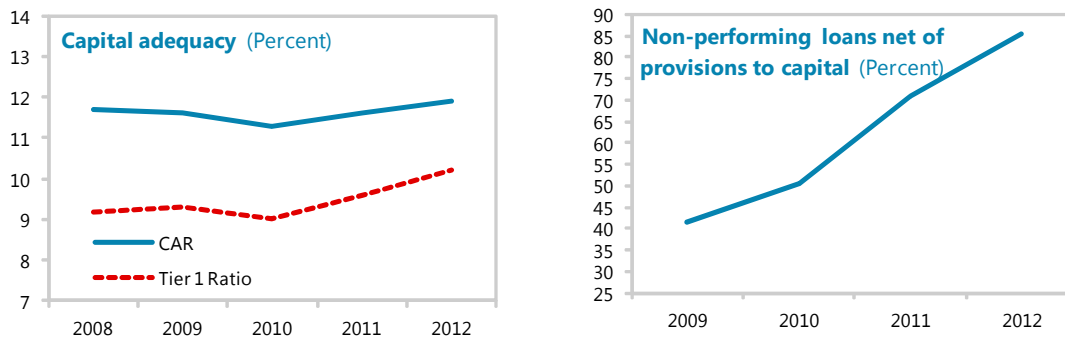
Banks continue to face a trend of deterioration in asset quality, which has led to increasingly large losses.



In response to the rising NPLs and continued funding strains, banks are trying to reduce the size of their balance sheets, leading to lesser credit provision.



Capitalization ratios are boosted by injections of public money, but are shadowed by the backlog of NPLs.



Source: Bank of Slovenia

Table 1. Slovenia: Selected Economic Indicators, 2008–15

(Annual percentage change, unless noted otherwise)

Key Export Markets: Germany, Italy, Countries of Former Yugoslavia, France, Austria
 Quota (as of August 31, 2013): SDR 275 million
 Main products/exports: Automotive, Machinery-Appliances, Tourism, Transportation

Population (2012): 2.1 million
 Literacy Rate (in percent): 99.5
 Poverty Rate (in percent, 2012): 13.5

	2008	2009	2010	2011	2012	Projections		
						2013	2014	2015
Nominal GDP (EUR millions)	37,244	35,420	35,485	36,150	35,319	35,006	34,966	35,827
GDP per Capita (EUR)	18,527	17,428	17,335	17,633	17,183	16,986	16,923	17,295
Real economy								
Real GDP	3.4	-7.9	1.3	0.7	-2.5	-1.7	-1.1	1.0
Domestic demand	3.2	-10.3	-0.5	-0.3	-6.4	-4.8	-3.0	0.8
Private consumption	2.3	-0.1	1.5	0.8	-4.8	-3.4	-2.8	1.0
Public consumption	5.9	2.5	1.3	-1.6	-1.3	-3.0	-2.5	-1.1
Gross capital formation	3.1	-34.3	-7.3	-2.3	-16.5	-9.0	-4.2	2.4
Net exports (contribution to growth)	0.1	2.9	1.9	1.1	4.0	2.5	1.5	0.2
Exports of goods and services	4.0	-16.1	10.2	7.0	0.6	4.1	3.7	3.7
Imports of goods and services	3.7	-19.2	7.4	5.6	-4.7	1.1	2.1	3.9
Output gap (in percent of potential GDP)	7.2	-2.2	-1.2	-0.5	-2.7	-3.8	-4.8	-4.0
Prices								
Consumer prices (national definition, period average)	5.7	0.9	1.8	1.8	2.6	1.8	1.4	1.7
Core inflation (period average)	3.8	1.7	-0.4	-0.4	0.7	...	...	...
Employment and wages								
Unemployment rate (in percent, ILO definition)	4.4	5.9	7.3	8.2	8.9	10.5	10.8	10.3
Employment (Full time basis, national accounts)	2.6	-1.8	-2.2	-1.6	-0.8	-2.0	-0.3	0.5
Nominal wages (all sectors)	8.3	3.5	3.9	2.0	0.1	0.0	-0.3	1.2
Real wages (all sectors)	2.5	2.6	2.0	0.2	-2.5	-2.2	-1.7	-0.4
Unit labor cost (all sectors)	7.5	10.3	0.4	-0.4	1.8	-0.3	0.6	0.7
Public finance (percent of GDP)								
General government balance 1/	-0.3	-5.5	-5.4	-5.6	-3.2	-5.7	-15.3	-4.4
Structural balance 2/	-3.2	-4.6	-4.9	-4.1	-2.3	-2.0	-2.3	-2.4
Primary balance 1/	0.5	-4.7	-4.1	-4.3	-1.5	-3.1	-11.9	-0.5
Structural primary balance 2/	-2.4	-3.5	-3.1	-2.3	-0.4	0.8	1.2	1.4
General government debt 3/	22.0	35.1	38.7	46.9	54.3	70.9	77.7	80.8
Monetary and financial indicators								
Credit to the private sector	16.7	3.2	1.9	-2.6	-3.2	...	...	...
Lending rates 4/	6.2	5.3	4.9	5.0	4.7	...	...	...
Deposit rates 5/	4.3	2.5	1.8	2.2	2.3	...	...	...
Government bond yield (10-year, average) 6/	4.6	4.4	3.8	5.0	5.8	...	...	...
Balance of payments (percent of GDP)								
Trade balance (goods)	-5.8	-1.2	-2.3	-2.6	-0.3	1.3	2.2	2.0
Current account balance	-5.4	-0.5	-0.1	0.4	3.3	6.8	7.5	7.2
Gross external debt (percent of GDP, end-period)	105.3	113.8	114.8	110.9	115.7	120.6	125.1	125.5
Nominal effective exchange rate (2000=100)	101.4	104.0	100.6	101.1	99.9	...	...	...
Real effective exchange rate (2000=100, CPI-based)	104.0	106.7	103.1	102.5	101.2	...	...	...

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

1/ Includes capital injections into banks and repayments to depositors of two failed banks. These amount to 0.3 billion euros in 2013 projections, 3.8 billion in 2014, and 0.1 billion in 2015.

2/ Excludes capital injections into banks and repayments to depositors of two failed banks. These amount to 0.3 billion euros in 2013 projections, 3.8 billion in 2014, and 0.1 billion in 2015.

3/ Includes a debt shock of EUR 1.7 billion (4.8 percent of GDP) in 2013 due to assumed debt issuance of the new Asset Management Company for loan carve-outs.

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

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

6/ 12-month average. Eurostat Data

Table 2. Slovenia: Balance of Payments, 2008–19

	(Percent of GDP, unless otherwise noted)											
	2008	2009	2010	2011	2012	Projections						
						2013	2014	2015	2016	2017	2018	2019
Current account	-5.4	-0.5	-0.1	0.4	3.3	6.8	7.5	7.2	6.5	5.4	4.3	3.6
Trade balance, goods and services	-1.9	2.0	1.3	1.4	4.8	7.6	8.9	8.9	8.5	7.7	6.8	5.8
Goods	-5.8	-1.2	-2.3	-2.6	-0.3	1.3	2.2	2.0	1.8	1.2	0.6	0.0
Exports f.o.b.	55.1	46.8	53.5	59.3	61.2	63.5	66.9	69.0	71.0	72.8	75.1	77.3
Imports f.o.b.	-60.9	-48.1	-55.8	-62.0	-61.6	-62.2	-64.7	-66.9	-69.2	-71.6	-74.4	-77.3
Services	3.8	3.3	3.6	4.1	5.1	6.3	6.7	6.8	6.7	6.5	6.1	5.8
Exports	13.3	12.2	12.9	13.4	14.6	16.0	16.7	17.1	17.3	17.5	17.7	17.9
Imports	-9.5	-8.9	-9.3	-9.3	-9.5	-9.7	-10.0	-10.2	-10.6	-11.1	-11.6	-12.2
Income, net	-2.8	-2.0	-1.7	-1.4	-1.6	-0.8	-1.5	-1.7	-2.1	-2.3	-2.5	-2.2
Current transfers, net	-0.8	-0.5	0.2	0.4	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.1
Capital account	-0.1	0.0	0.2	-0.2	-0.3	-0.3	-0.3	-0.3	-0.2	-0.2	-0.2	-0.2
Financial account, excl. reserves	7.0	0.0	1.3	-1.3	-3.2	-4.1	-7.3	-7.1	-6.4	-5.4	-4.3	-4.1
Direct investment, net	0.9	-1.9	1.2	1.8	0.5	1.0	0.3	1.2	1.2	1.2	1.3	1.3
In Slovenia	3.6	-1.3	0.8	2.0	-0.1	1.5	1.5	2.4	2.4	2.4	2.4	2.4
Abroad	-2.7	-0.5	0.4	-0.2	0.6	-0.5	-1.2	-1.2	-1.2	-1.2	-1.1	-1.1
Portfolio investment, net	1.5	13.1	5.5	5.1	-0.6	5.1	11.9	-0.4	1.9	0.0	0.1	0.8
Financial derivatives	0.1	0.0	-0.3	-0.4	-0.3	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Other investment, net	4.4	-11.2	-5.1	-7.7	-2.5	-10.2	-19.5	-8.0	-9.5	-6.6	-5.7	-5.5
Government	-0.1	-0.1	0.0	0.2	1.7	-0.1	-0.1	-0.1	-0.1	-0.1	-0.1	-0.1
Bank of Slovenia	0.0	0.0	0.3	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.3
Commercial banks	4.0	-11.2	-2.6	-4.2	0.1	-2.7	-10.1	-2.4	-4.5	-1.7	-1.1	-0.7
Nonbank private sector	-0.5	-2.0	2.5	-3.9	-3.0	-7.3	-9.1	-5.4	-5.0	-4.7	-4.5	-3.2
Loans	-0.3	0.0	0.1	-0.4	0.3	-0.5	-0.9	-0.4	-0.3	-0.3	-0.3	0.0
Currency and deposits	-1.6	-2.8	-2.5	-2.8	-3.9	-6.3	-7.7	-4.6	-4.3	-4.0	-3.8	-2.8
Trade credits	-0.6	-0.1	0.5	0.2	0.9	-0.2	-0.2	-0.2	-0.2	-0.2	-0.2	-0.2
Other	1.9	0.9	4.4	-0.8	-0.3	-0.3	-0.3	-0.2	-0.2	-0.2	-0.2	-0.1
Net errors and omissions	-1.5	0.0	-1.4	0.5	0.1	-2.4	0.1	0.2	0.2	0.2	0.2	0.2
Overall balance	-0.1	-0.5	-0.1	-0.6	-0.1	0.0	0.0	0.0	0.0	0.0	0.0	-0.6
Change in official reserves (-: increase)	0.1	0.5	0.1	0.2	0.1	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Memorandum items:												
Nominal GDP (million euros)	37,244	35,420	35,485	36,150	35,319	35,006	34,966	35,827	37,020	38,344	39,781	41,278
Export of goods (percent change in value)	2.5	-18.3	14.4	13.1	0.8	2.8	5.2	5.6	6.3	6.3	6.9	6.9
Import of goods (percent change in value)	5.6	-24.9	16.3	13.1	-3.0	0.0	3.9	6.0	6.8	7.3	7.8	7.8
Terms of trade (percent change)	-1.8	4.0	-4.8	-1.6	-1.2	0.3	-0.2	-0.1	0.2	0.1	0.2	0.0
Gross external debt (million euros)	39,234	40,318	40,723	40,100	40,849	42,205	43,734	44,963	46,276	47,281	48,810	50,264
(percent of GDP)	105.3	113.8	114.8	110.9	115.7	120.6	125.1	125.5	125.0	123.3	122.7	121.8

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

Table 3. Slovenia: Financial Soundness Indicators, 2008–13

(in percent unless indicated otherwise)

	2008	2009	2010	2011	2012	Jun-13
Capital						
Regulatory capital to risk-weighted assets	11.7	11.7	11.3	11.9	11.4	11.2
Regulatory Tier 1 capital to risk-weighted assets	9.0	9.3	8.6	9.3	9.8	9.7
Profitability						
Return on assets	0.5	0.2	-0.2	-0.9	-1.5	-0.6
Return on equity	7.1	2.0	-3.2	-11.8	-19.6	-8.1
Interest margin to gross income	65.7	61.3	63.6	65.3	58.0	57.1
Noninterest expenses to gross income	62.5	60.2	57.9	63.0	63.9	71.0
Liquidity						
Liquid assets to total assets	13.9	13.8	14.2	13.4	14.7	16.5
Liquid assets to short-term liabilities	34.8	36.2	42.9	40.3	43.5	44.9
Customer deposits to total (noninterbank) loans	161.2	142.9	145.3	134.9	129.8	...
Sensitivity to market risk						
Net open position in foreign exchange to capital	-2.2	-0.9	-1.2	-1.8	-2.7	-0.9
Asset quality						
Nonperforming loans to total gross loans	4.2	5.8	8.2	11.8	15.2	17.4
Non-performing loans net of provisions to capital	30.2	41.7	50.5	71.0	85.8	103.5
Sectoral distribution of loans						
Central Bank	0.0	0.0	0.7	0.9	2.2	3.5
General Government	3.0	3.7	4.7	6.7	8.6	7.7
Financial corporations	11.1	12.5	13.5	13.0	12.1	11.4
Nonfinancial Corporations	51.5	49.0	48.5	47.0	44.8	44.3
Other Domestic Sectors	19.2	19.3	20.7	21.1	21.0	21.0
Nonresidents	15.2	15.4	11.9	11.3	11.2	12.1

Source: Financial Soundness Indicators; Financial Stability Review.

Table 4. Slovenia: General Government Operations (cash basis), 2008–19

(In percent of GDP, unless indicated otherwise)

	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019
						Projections						
Revenue	40.7	40.2	40.9	41.1	42.1	41.7	43.5	43.4	43.4	43.4	43.4	43.4
Taxes	23.7	22.0	21.5	22.0	22.3	21.5	23.0	23.0	23.1	23.1	23.2	23.2
Taxes on income, profit, payroll	9.9	8.0	7.1	7.6	7.6	6.5	7.0	7.0	7.0	7.0	7.1	7.1
Taxes on goods and services	13.2	13.4	13.7	13.7	14.0	14.4	14.6	14.7	14.7	14.7	14.7	14.7
Other taxes	0.6	0.6	0.6	0.6	0.7	0.7	1.4	1.4	1.4	1.4	1.4	1.4
Social contributions	13.7	14.6	14.8	14.6	14.8	14.5	14.6	14.5	14.5	14.4	14.4	14.4
Other revenue	3.3	3.6	4.6	4.5	5.0	5.6	5.9	5.9	5.9	5.9	5.9	5.9
Expenditure	41.0	45.7	46.2	46.7	45.3	47.4	58.8	47.8	47.6	47.2	46.7	46.5
Expense	38.1	42.6	43.3	44.2	43.1	45.2	56.0	44.8	44.5	44.2	43.9	43.7
Compensation of employees	9.6	11.0	11.0	10.7	10.6	10.4	10.0	9.8	9.5	9.3	9.0	8.9
Purchases of goods and services	6.8	7.1	7.1	6.8	6.7	6.4	6.7	6.6	6.4	6.3	6.1	6.0
Interest	0.9	0.9	1.4	1.5	1.8	2.6	3.5	3.9	4.1	4.4	4.5	4.5
Transfers to individuals and households	15.1	17.0	17.7	18.1	18.1	18.0	18.7	18.5	18.5	18.6	18.7	18.8
of which: pensions	9.9	10.9	11.3	11.4	11.7	12.1	12.4	12.3	12.4	12.6	12.8	13.0
Subsidies	1.3	1.7	1.6	1.4	1.4	1.4	1.4	1.0	1.0	1.0	0.9	0.9
Other current transfers	4.4	4.8	4.5	5.8	4.5	6.3	15.8	5.1	4.8	4.7	4.6	4.6
of which: capital transfers	1.2	1.4	1.1	2.3	0.9	1.5	11.4	1.0	1.0	1.0	1.0	1.0
of which: capitalizations	0.3	0.5	0.0	1.3	0.0	0.6	10.4	0.0	0.0	0.0	0.0	0.0
transfers to EU budget	1.1	1.2	1.1	1.1	1.1	1.2	1.1	1.1	1.1	1.1	1.1	1.1
depositor redemptions	...	...	...	...	...	0.9	0.4	0.1	...	...	...	...
Net acquisition of non-financial assets	2.9	3.2	2.9	2.5	2.2	2.2	2.8	3.0	3.1	3.0	2.8	2.8
Gross operating balance 1/	2.6	-2.4	-2.5	-3.1	-1.0	-3.5	-12.6	-1.4	-1.1	-0.9	-0.5	-0.3
Net lending / Net borrowing 1/	-0.3	-5.5	-5.4	-5.6	-3.2	-5.7	-15.3	-4.4	-4.2	-3.8	-3.4	-3.1
Memorandum item:												
General government balance (ESA 95)	-1.9	-6.3	-6.0	-6.4	-4.1	-4.5	-1.8	-0.4	-0.3	-0.3	-0.3	0.0
Primary balance 1/	0.5	-4.7	-4.1	-4.3	-1.5	-3.1	-11.9	-0.5	-0.1	0.4	1.0	1.3
Structural budget balance 2/	-3.2	-4.6	-4.9	-4.1	-2.3	-2.0	-2.3	-2.4	-3.0	-3.2	-3.2	-3.1
Structural primary balance 2/	-2.4	-3.7	-3.6	-2.7	-0.6	0.5	1.1	1.4	1.1	1.1	1.2	1.3
General government debt 3/	22.0	35.1	38.7	46.9	54.3	70.9	77.7	80.8	83.0	84.5	85.4	86.0
Nominal GDP (millions of euro)	37244	35420	35485	36150	35319	35006	34966	35827	37020	38344	39781	41278

Sources: Ministry of Finance; and IMF staff calculations.

1/ Includes capital injections into banks and repayments to depositors of two failed banks. These amount to 0.3 billion euros in 2013 projections, 3.8 billion in 2014, and 0.1 billion in 2015.

2/ Excludes capital injections into banks and repayments to depositors of two failed banks. These amount to 0.3 billion euros in 2013 projections, 3.8 billion in 2014, and 0.1 billion in 2015.

3/ Includes a debt shock of EUR 1.7 billion (4.8 percent of GDP) in 2013 due to assumed debt issuance of the new Asset Management Company for loan carve-outs. The increase in debt is moderated by the projected use of cash balances in the bank recapitalization.

Table 5. Slovenia: Macroeconomic Framework, 2008–19

	2008	2009	2010	2011	2012	Projections						
						2013	2014	2015	2016	2017	2018	2019
Real GDP (percent change)	3.4	-7.9	1.3	0.7	-2.5	-1.7	-1.1	1.0	1.5	1.7	1.8	1.8
Contributions to growth												
Domestic demand	3.3	-10.5	-0.5	-0.3	-6.2	-4.5	-2.7	0.7	1.6	2.4	2.5	2.6
Private consumption	1.2	-0.1	0.8	0.5	-2.7	-1.9	-1.5	0.5	0.9	1.0	1.1	1.1
Government consumption	1.0	0.4	0.3	-0.3	-0.2	-0.6	-0.5	-0.2	-0.2	-0.1	-0.1	-0.1
Gross capital formation	1.0	-11.3	-1.7	-0.5	-3.5	-1.6	-0.7	0.4	0.9	1.5	1.5	1.6
Net exports	0.1	2.9	1.9	1.1	4.0	2.5	1.5	0.2	-0.1	-0.7	-0.7	-0.8
Exports of goods and services	3.0	-12.0	6.9	5.1	0.5	3.3	3.1	3.3	3.8	3.9	4.4	4.5
Imports of goods and services	2.8	-14.8	5.1	4.0	-3.5	0.8	1.6	3.1	3.9	4.5	5.0	5.2
Growth rates												
Domestic demand	3.2	-10.3	-0.5	-0.3	-6.4	-4.8	-3.0	0.8	1.8	2.7	2.8	2.9
Consumption	3.2	0.5	1.4	0.2	-3.8	-3.3	-2.7	0.5	1.0	1.3	1.3	1.4
Private	2.3	-0.1	1.5	0.8	-4.8	-4.8	-2.8	1.0	1.7	1.9	2.0	2.0
Public	5.9	2.5	1.3	-1.6	-1.3	-3.0	-2.5	-1.1	-0.9	-0.6	-0.7	-0.7
Gross capital formation	3.1	-34.3	-7.3	-2.3	-16.5	-9.0	-4.2	2.4	5.4	8.6	8.5	8.5
Fixed investment	7.1	-23.8	-15.2	-5.5	-8.2	-3.6	-3.9	2.3	5.0	8.0	8.0	8.0
Change in stocks (contribution to GDP growth)	-1.0	-4.3	2.0	0.6	-1.9	-0.9	0.0	0.0	0.0	0.0	0.0	0.0
Exports of goods and services	4.0	-16.1	10.2	7.0	0.6	4.1	3.7	3.7	4.1	4.1	4.5	4.5
Imports of goods and services	3.7	-19.2	7.4	5.6	-4.7	1.1	2.1	3.9	4.9	5.4	5.8	5.8
Output gap (in percent of potential)	7.2	-2.2	-1.2	-0.5	-2.7	-3.8	-4.8	-4.0	-2.7	-1.5	-0.4	0.0
Potential growth	2.7	0.9	0.2	0.1	-0.3	-0.6	-0.1	0.1	0.2	0.5	0.7	1.3
Savings and investment (percent of GDP)												
National saving	26.3	21.6	20.5	20.5	20.8	22.9	23.2	23.2	23.1	23.2	23.4	23.9
Government	4.3	-0.5	-0.5	-0.5	0.3	-1.4	-0.3	0.4	0.7	1.0	1.3	1.6
Non-government	22.0	22.1	21.0	21.0	20.5	24.4	23.5	22.8	22.4	22.3	22.1	22.3
Gross capital formation	31.8	22.1	20.6	20.1	17.5	16.1	15.7	16.0	16.7	17.8	19.0	20.3
Government	3.4	3.7	3.7	2.8	2.6	2.6	2.7	2.8	2.9	3.0	3.0	3.0
Non-government	28.4	18.4	16.9	17.3	14.9	13.5	13.0	13.2	13.8	14.8	16.0	17.3
Foreign saving	5.4	0.5	0.1	-0.4	-3.3	-6.8	-7.5	-7.2	-6.5	-5.4	-4.3	-3.6
Prices												
Consumer price inflation	5.7	0.9	1.8	1.8	2.6	1.8	1.4	1.7	1.9	1.9	2.0	2.0
GDP deflator	4.1	3.3	-1.1	1.2	0.2	0.8	1.0	1.5	1.8	1.8	2.1	2.1
Employment (percent change)	2.6	-1.8	-2.2	-1.6	-0.8	-2.0	-0.3	0.5	0.6	0.6	0.6	0.6
Unemployment rate (ILO, percent)	4.4	5.9	7.3	8.2	8.9	10.5	10.8	10.3	9.8	9.3	8.7	8.2
Real wages (percent change)	2.5	2.6	2.0	0.2	-2.5	-2.2	-1.7	-0.4	0.0	0.2	0.3	0.3
Government budget (percent of GDP)												
Revenue	40.7	40.2	40.9	41.1	42.1	41.7	43.5	43.4	43.4	43.4	43.4	43.4
Expenditure 1/	41.0	45.7	46.2	46.7	45.3	47.4	58.8	47.8	47.6	47.2	46.7	46.5
General government balance 1/	-0.3	-5.5	-5.4	-5.6	-3.2	-5.7	-15.3	-4.4	-4.2	-3.8	-3.4	-3.1
Primary balance 1/	9.6	-4.7	-4.1	-4.3	-1.5	-3.1	-11.9	-0.5	-0.1	0.4	1.0	1.3
Structural government balance 2/	-3.2	-4.6	-4.9	-4.1	-2.3	-2.0	-2.3	-2.4	-3.0	-3.2	-3.2	-3.1
General government debt 3/	22.0	35.1	38.7	46.9	54.3	70.9	77.7	80.8	83.0	84.5	85.4	86.0
Merchandise trade (percent change)												
Export volume	1.8	-16.6	12.0	8.2	-0.1	3.7	3.8	3.9	4.3	4.3	4.8	4.8
Import volume	3.0	-20.2	8.3	6.6	-5.1	1.2	2.3	4.1	5.0	5.4	5.8	5.8
Export value	2.5	-18.3	14.4	13.1	0.8	2.8	5.2	5.6	6.3	6.3	6.9	6.9
Import value	5.6	-24.9	16.3	13.1	-3.0	0.0	3.9	6.0	6.8	7.3	7.8	7.8
External balances (in billions of euros)												
Trade balance (merchandise)	-2.1	-0.4	-0.8	-1.0	-0.1	0.5	0.8	0.7	0.7	0.5	0.3	0.0
In percent of GDP	-5.8	-1.2	-2.3	-2.6	-0.3	1.3	2.2	2.0	1.8	1.2	0.6	0.0
Exports of goods	20.5	16.6	19.0	21.4	21.6	22.2	23.4	24.7	26.3	27.9	29.9	31.9
Imports of goods	22.7	17.0	19.8	22.4	21.7	21.8	22.6	24.0	25.6	27.5	29.6	31.9
Current account	-2.0	-0.2	0.0	0.1	1.2	2.4	2.6	2.6	2.4	2.1	1.7	1.5
In percent of GDP	-5.4	-0.5	-0.1	0.4	3.3	6.8	7.5	7.2	6.5	5.4	4.3	3.6

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

1/ Includes capital injections into banks and repayments to depositors of two failed banks. These amount to 0.3 billion euros in 2013 projections, 3.8 billion in 2014, and 0.1 billion in 2015.

2/ Excludes capital injections into banks and repayments to depositors of two failed banks. These amount to 0.3 billion euros in 2013 projections, 3.8 billion in 2014, and 0.1 billion in 2015.

3/ Includes a debt shock of EUR 1.7 billion (4.8 percent of GDP) in 2013 due to assumed debt issuance of the new Asset Management Company for loan carve-outs.

Appendix I. Slovenia: Risk Assessment Matrix 1/

Nature/Sources of Main Risks	Overall Level of Concern	
	Relative Likelihood (high, medium, or low)	Impact if Realized (high, medium, or low)
1. Bank balance sheet clean-up insufficient	<p>Medium</p> <ul style="list-style-type: none"> Ongoing deterioration in asset quality results in NPLs above that assumed in the bank recapitalization. Insufficient transfer to BAMC of restructured bank NPLs. 	<p>Medium</p> <ul style="list-style-type: none"> Permanent weakening of bank profitability raises concern about bank soundness, deepening deleveraging and weakening growth.
2a. Fiscal slippage raises budget deficit	<p>Medium</p> <ul style="list-style-type: none"> Amounts from revenue and expenditure measures fall short of targets owing to lack of specificity or political consensus. 	<p>High</p> <ul style="list-style-type: none"> Larger deficit pushes up debt and undermines credibility of fiscal policy. Remedial measures slow recovery.
2b. Public debt rises more than expected	<p>Low</p> <ul style="list-style-type: none"> Debt increased by materialization of contingent liabilities and more prolonged recession raises debt/GDP ratio substantially. 	<p>High</p> <ul style="list-style-type: none"> Debt ratio rises sharply to levels where sustainability is a greater concern, limiting market access.
3. Structural reforms slippage	<p>High</p> <ul style="list-style-type: none"> Reform stalls on lack of political consensus. Corporate deleveraging and restructuring insufficient due to slow implementation of insolvency process and transfers to BAMC. Pervasive state interference in economy not curtailed and privatization initiatives stall. 	<p>High</p> <ul style="list-style-type: none"> Reform slippage prolongs recession, undermining fiscal consolidation. Corporate access to credit not restored while FDI fails to provide new capital. The deleveraging cycle is prolonged, weighing on growth.
4. Financial stress in the euro area re-emerges	<p>Medium</p> <ul style="list-style-type: none"> Stalled or incomplete delivery of national and Euro area policy commitments undermines confidence across the region. A negative assessment from the euro area AQR combined with insufficient backstops and remedial measures undermines confidence. 	<p>Medium</p> <ul style="list-style-type: none"> Reduced availability of credit from foreign banks but reliance of on Euro area financing is already limited as local banks have lost market access and sovereign issues on dollar debt market.
5. Protracted period of slower European growth	<p>High</p> <ul style="list-style-type: none"> Larger than expected European deleveraging and/or a negative surprise to potential growth impedes the recovery in European growth over the medium term. 	<p>Medium</p> <ul style="list-style-type: none"> Growth in Slovenia lower on weaker exports to Europe but impact muted by solid growth in other export markets. Lower growth worsens debt dynamics, requiring a larger fiscal consolidation.

1/ The RAM shows events that could materially alter the baseline path discussed in this report (which is the scenario most likely to materialize in the view of the staff). The relative likelihood of risks listed is the staff's subjective assessment of the risks surrounding this baseline. The RAM reflects staff's views on the source of risks and overall level of concerns as of the time of discussions with the authorities



REPUBLIC OF SLOVENIA

STAFF REPORT FOR THE 2013 ARTICLE IV CONSULTATION—INFORMATIONAL ANNEX

December 27, 2013

Prepared By

European Department

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FUND RELATIONS

(As of October 31, 2013)

Membership Status: Joined 12/14/1992; Article VIII

General Resources Account:

	SDR Million	Percent of Quota
Quota	275.0	100
Fund holdings of currency	177.37	64.50
Reserve position	97.65	35.51
Lending to the Fund	33.38	

SDR Department:

	SDR Million	Percent of Allocation
Net cumulative allocation	215.88	100
Holdings	193.55	89.65

Outstanding Purchases and Loans: None

Financial Arrangements: None

Projected Payments to Fund:

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

	Forthcoming				
	2013	2014	2015	2016	2017
Principal					
Charges/Interest	0.00	0.02	0.02	0.02	0.02
Total	0.00	0.02	0.02	0.02	0.02

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).

Article IV Consultation:

Slovenia is on the 12-month Article IV consultation cycle. The 2013 mission visited Ljubljana during October 17–29, 2013 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. Repansek (Adviser to the Executive Director) attended the meetings. Mr. Prader (Alternate Executive Director) attended the concluding meeting.

The mission comprised: Mr. Spilimbergo (Head), Ms. Zakharova, Mr. Dalgic, Mr. Halikias (all EUR), Mr. Jaramillo-Vallejo (MCM), Mr. Tapsoba (FAD), and Mr. Craig (SPR). The mission held a press conference on the concluding statement. The authorities have agreed to the publication of the staff report.

FSAP Participation and ROSCs:

An FSAP mission took place in November 2000. The FSSA was published on September 2001 (Country Report No. 01/161). An FSAP update mission visited Ljubljana during November 10–21, 2003. The FSSA Update was published May 2004. The latest FSAP update mission took place in April 2012. The FSSA Update was published in December 2012 (Country Report No. 12/325). The fiscal transparency module of the fiscal ROSC was published in June 2002.

Technical Assistance: See the attached table.

Resident Representative Post: None.

Table 1. Republic of Slovenia: Technical Assistance, 2001–13

Department	Timing	Purpose
MCM	December 2009	Financial Supervisory Architecture
	October 2012	Bank Resolution
	December 2012	Bank Asset Management Company
	November 2013	Stress testing Workshop
	December 2013	Peripatetic expert, Financial Stability
LEG	October 2013	Insolvency Law
FAD	August 2001	VAT
	November 2001	Direct Tax Reform
	November 2003	Expenditure Rationalization
	April – May 2004	Performance Information to Support Better Budgeting
STA	November 2004	Recording Transactions in International Trade in Services
	April 2006	Government Finance Statistics

STATISTICAL ISSUES

1. Data provision is adequate for surveillance purposes.
2. Special Data Dissemination Standard: Slovenia has subscribed to the Special Data Dissemination Standard (SDDS), meets SDDS specifications, and its metadata are posted on the Fund's Dissemination Standards Bulletin Board on the Internet, which can be reached at: <http://dsbb.imf.org/Applications/web/sddscountrycategorylist/?strcode=SVN>
3. Real Sector Statistics: The Statistical Office of the Republic of Slovenia (SORS) follows the European System of Accounts 1995 (ESA95). Quarterly GDP estimates by industry and expenditure categories are compiled in both current and constant prices, and are published within 80 days after the reference quarter. In September 2005, the SORS changed the base year for compiling constant prices GDP from 2000 to the previous year's prices and started using the chain-link index methodology. The SORS also compiles inflation statistics including the Harmonized Index of Consumer Prices (HICP). However, price collection is restricted to four cities and their surrounding rural areas. The weights are based on the three-year average of expenditure data for consumer goods from continuous Household Budget Surveys for 2002, 2003, and 2004. It also compiles a retail price index (RPI), which differs from the consumer price index in weights only.
4. Government Finance Statistics: Slovenian fiscal statistics are timely and of a high quality. The ministry of finance publishes a comprehensive monthly Bulletin of Government Finance, which presents monthly data on the operations of the "state budget" (Budgetary Central Government), local governments, social security (Pension and Health funds), and the consolidated general government. The coverage of general government excludes the operations of extra-budgetary funds and own revenues of general government agencies (zavods). However, these operations are small in size. Monthly fiscal indicators are reported for publication in IFS on a timely basis and annual statistics covering general government operations, including the operations of the extra-budgetary funds are reported for publication in the Government Finance Statistic Yearbook (GFS Yearbook).
5. The data published in the Bulletin of Government Finance are on a cash basis and broadly use the analytical framework and classification system of the IMF's 1986 government finance statistics methodology. The data reported for publication in the GFS Yearbook are also on a cash basis but are recast in the analytical framework and classifications of the Manual on Government Finance Statistics 2001(GFSM 2001).
6. The Slovenian authorities adopted the GFSM 2001 methodology, which is used as a building block for the compilation of the ESA 95-based data jointly by the Ministry of Finance and the SORS for reporting to the European Commission. To assist the Ministry of Finance resolve several classification issues and develop a migration path, a STA technical assistance mission visited Ljubljana in April 2006. The introduction in 2008 of a new chart of accounts for all public entities based on accrual principles greatly facilitated the adoption of the new methodology.
7. Money and Banking Statistics: Monetary statistics are timely and of good quality.

8. Balance of Payments Statistics: Balance of payments data are comprehensive and of high quality. The data have been published in the Balance of Payments Statistics Yearbook since 1993 (with estimates of the international investment position published since 1994).
9. External Debt Statistics: External debt statistics were revised and brought in line with the SDDS in August 2003. The main change comprised the inclusion of trade credits in the debt data.

Republic of Slovenia: Table of Common Indicators Required for Surveillance

As of November 22, 2013

	Date of latest observation	Date received or posted	Frequency of Data ⁶	Frequency of Reporting ⁶	Frequency of publication ⁶
Exchange Rates	11/21/13	11/21/13	D	D	D
International Reserve Assets and Reserve Liabilities of the Monetary Authorities ¹	9/13	10/13	M	M	M
Reserve/Base Money	9/13	10/13	M	M	M
Broad Money	9/13	10/13	M	M	M
Central Bank Balance Sheet	9/13	10/13	M	M	M
Consolidated Balance Sheet of the Banking System	9/13	10/13	M	M	M
Interest Rates ²	10/30/13	10/30/13	M	M	M
Consumer Price Index	10/31/13	11/6/13	M	M	M
Revenue, Expenditure, Balance and Composition of Financing ³ – General Government ⁴	8/31/13	9/30/13	M	M	M
Revenue, Expenditure, Balance and Composition of Financing ³ – Central Government	8/31/13	9/30/13	M	M	M
Stocks of Central Government and Central Government-Guaranteed Debt ⁵	9/30/13	11/12/13	M	M	M
External Current Account Balance	9/30/13	11/12/13	M	M	M
Exports and Imports of Goods and Services	9/30/13	11/12/13	M	M	M
GDP/GNP	Q2/13	9/2/2013	Q	Q	Q
Gross External Debt	9/30/13	11/12/13	M	M	M
International Investment Position	6/30/13	11/12/13	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).



REPUBLIC OF SLOVENIA

STAFF REPORT FOR THE 2013 ARTICLE IV CONSULTATION—DEBT SUSTAINABILITY ANALYSIS

December 27, 2013

Approved By
**Philip Gerson (EUR) and
Ranil Salgado (SPR)**

Prepared by the Staff of the International Monetary Fund

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PUBLIC DEBT SUSTAINABILITY ANALYSIS

Despite substantial fiscal consolidation, debt has been growing rapidly as a result of the deep recession, high interest costs, and bank support outlays. Under the baseline scenario, Slovenia's public debt continues to grow throughout the projection horizon. The debt path is particularly sensitive to adverse growth, fiscal, and interest rate shocks. The high debt level, large gross financing needs and a growing share of short-term debt represent key vulnerabilities. Contingent liabilities associated with the banking sector and state owned enterprises add serious risks to debt sustainability.

1. **Under the baseline scenario Slovenia's public debt ratio would grow throughout the projection horizon, with large gross financing needs and a growing share of short term debt representing key sources of vulnerability.** After a step-wise increase in the near term as a result of the need to recapitalize public banks (€3.7 billion, or 10 percent of GDP) and issue bonds to finance the carve-out of NPLs from domestic banks to the Bank Asset Management Company (BAMC) (€1.7 billion, or 4.9 percent of GDP), the debt ratio would continue to grow steadily as a result of the positive real interest/growth rate differential. The pace of increase would decline over the medium term as a moderate growth pick-up enables the gradual closing of the presently-large output gap. Nonetheless, by 2018 the debt ratio would reach 85.4 percent—against a pre-crisis level of 22 percent in 2008. Because of the above-mentioned banking sector clean-up costs, financing needs would be particularly high in the near term.
2. **The analysis is based on the following main assumptions:**
 - **Real GDP growth** will remain negative through 2014 (-1.7 percent in 2013 and -1.1 percent in 2014) as poor asset quality and funding problems in banks, deleveraging in the corporate sector, and fiscal consolidation weigh on economic activity. Growth would resume—albeit gradually—starting in 2015, as bank and corporate restructuring take hold and unlock new credit flows to viable borrowers, exports accelerate on the back of the recovery in main trading partners, and households release some of the precautionary savings accumulated during the crisis.
 - **Inflation** (as measured by the change in the GDP deflator), initially contained (1 percent in 2014) by the large output gap, gradually converges to the euro area average to reach about 1.8 percent in 2016.
 - **Fiscal consolidation** will continue at a moderate pace through 2015, measured in structural primary balance terms, after which the fiscal stance would stabilize. This frontloaded fiscal adjustment would be sizeable from a cross-country perspective, but the authorities have achieved a significant share of it in difficult economic conditions. Indeed, as the output gap closes over time, the headline deficit would continue to decline during the forecasting horizon, reaching 3.4 percent in 2018.
 - **Market access** is assumed to remain adequate to cover maturing debt and the flow of deficits, though interest rates will gradually increase over time reflecting the growing debt ratio.

3. **The analysis focuses on the consolidated general government, of which the central government represents the lion's share (e.g., as of end-2013 Q2, the central government accounted for about 97.5 percent of the consolidated general government debt).** An important fiscal risk arises from extensive government guarantees of the debt of state-owned enterprises (SOEs). As of end-June 2013 government guarantees to the SOEs amounted to some 20 percent of GDP, three quarters of which to the banking and transportation sectors combined. To assess this risk, a customized stress scenario has been considered, whereby contingent liabilities amounting to 10 percent of GDP are called in 2014.

4. **Sensitivity analysis shows that the debt path is particularly fragile with respect to adverse growth and fiscal policy shocks.** In particular:

- The debt ratio would enter an increasing path and reach 116.8 percent in 2018 if growth is temporarily (in 2014 and 2015) lower by one historical standard deviation (though the size of the shock is increased by the presence in the historical sample of the sharp output contraction in 2009).
- Similarly, a combined macro-fiscal shock would quickly propel the debt ratio beyond 100 percent and on a diverging path.
- The materialization of a debt shock from the large amount of state guarantees to non-financial SOEs, as captured by a one-off 10 percent increase in public debt in 2014, would result in a debt path qualitatively similar to that in the baseline scenario, but correspondingly higher, thus increasing further the gap between the assumed path for the primary balance and its debt-stabilizing value. The same is true for further recapitalization needs that were to be identified in the context of the SSM-driven AQR and stress tests later in 2014, as captured in the financial sector contingent liability shock.

5. **The fan charts reveal large vulnerabilities associated with the baseline scenario.** These show graphically the distribution of the debt ratio over time, under the assumed policies, considering the historical variance and covariance of the key macroeconomic variables (an asymmetric fan chart is also presented, which is based on the assumption that the future distribution of the shocks to the primary balance is truncated at zero, i.e. no positive primary balance surprises).

6. **Finally, the reliability of the assessment depends on the realism of assumptions/forecasts on the evolution of key economic variables.** From this perspective, past forecast errors in the projection of the primary balance for Slovenia have been small and in line with those experienced in other countries. The risk of optimistic forecasts, based on past experience, appears to be somewhat higher when it comes to growth and inflation (GDP deflator). It is worth noting, however, that the team's growth forecasts for the near-term are below consensus and that inflation is assumed to converge to the expected euro area average only very gradually over time. If growth and/or inflation fall significantly below forecasts, the path for the debt ratio would be correspondingly higher, everything else equal.

7. **A heat map underscores that the maturity structure of Slovenia's public debt is increasingly a source of vulnerability.** In addition to the steadily increasing debt ratio, Slovenia faces large financing needs, especially in the near term. Despite this, Slovenia issued a €1.5 billion 3-year Eurobond on

November 15th, 2013, although at a relatively high coupon of 4.7 percent. In the baseline scenario, the share of short-term debt is envisaged to increase steadily, underscoring once more the underlying refinancing risks. Indeed a key source of risk is the possibility that the cost of market funding becomes increasingly prohibitive and/or access to the funding becomes difficult, in which case Slovenia would need to reduce its financing needs faster than presently envisaged.

8. **The authorities broadly agree with staff's assessment that further consolidation is needed to lower the vulnerabilities associated with public debt dynamics.** They consider that the quantum and the pace will need to be reassessed in the context of bank and corporate restructuring. They also note that future privatizations would reduce funding costs and help lower the gross debt ratio. Such privatizations could also have a positive effect on potential growth by increasing the efficiency of the economy.

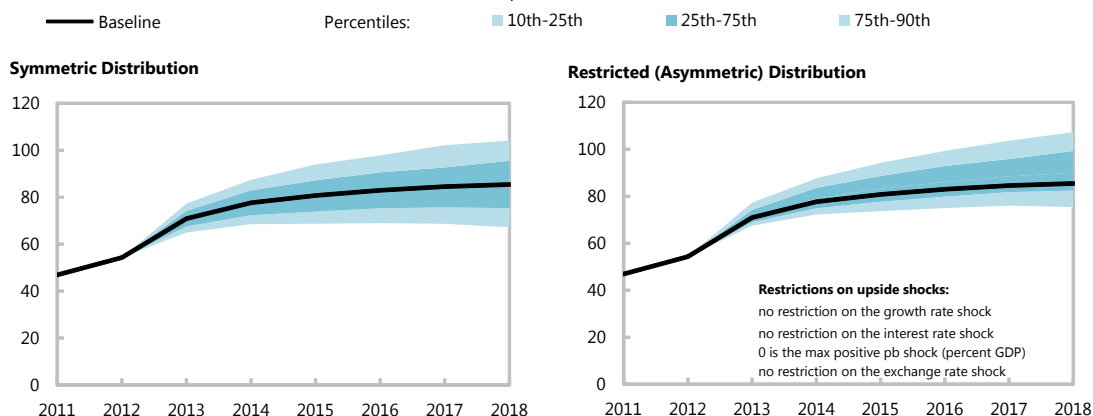
Slovenia: Public Sector Debt Sustainability Analysis (DSA) – Risk Assessment

Heat Map

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

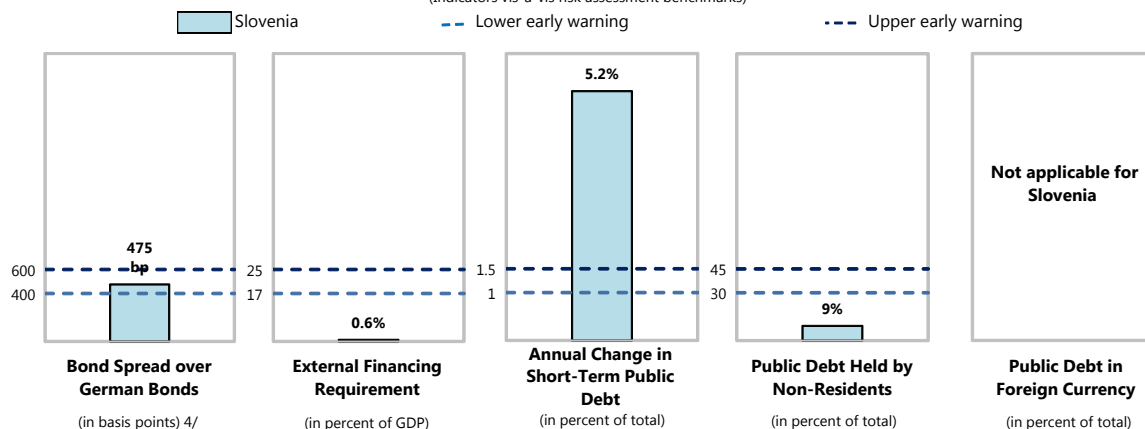
Evolution of Predictive Densities of Gross Nominal Public Debt

(in percent of GDP)



Debt Profile Vulnerabilities

(Indicators vis-à-vis risk assessment benchmarks)



Source: IMF staff.

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

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

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

Lower and upper risk-assessment benchmarks are:

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

4/ An average over the last 3 months, 13-Sep-13 through 12-Dec-13.

Slovenia: Public DSA – Realism of Baseline Assumptions

Real GDP Growth

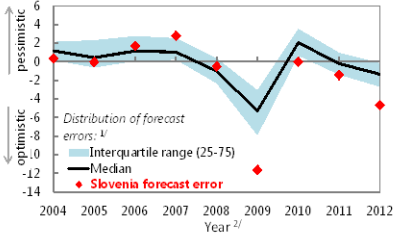
(in percent, actual-projection)

Slovenia median forecast error, 2004-2012:

-0.04

Has a percentile rank of:

40%



Forecast Track Record, versus all countries

Primary Balance

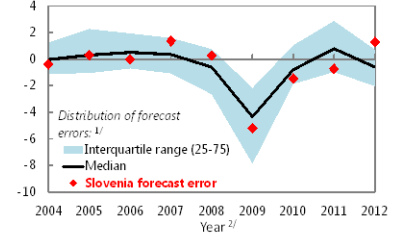
(in percent of GDP, actual-projection)

Slovenia median forecast error, 2004-2012:

-0.03

Has a percentile rank of:

51%



Inflation (Deflator)

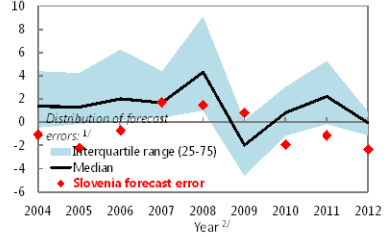
(in percent, actual-projection)

Slovenia median forecast error, 2004-2012:

-1.09

Has a percentile rank of:

2%

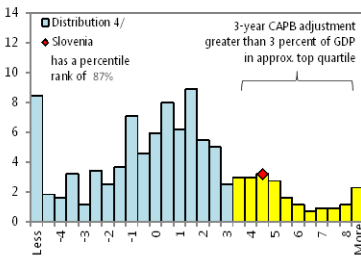


Assessing the Realism of Projected Fiscal Adjustment

3-Year Adjustment in Cyclically-Adjusted

Primary Balance (CAPB) %^{5/}

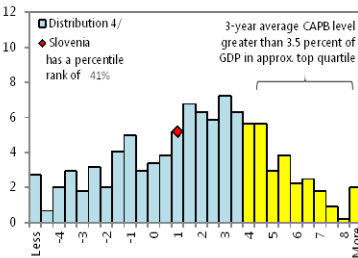
(Percent of GDP)



3-Year Average Level of Cyclically-Adjusted Primary

Balance (CAPB) %^{5/}

(Percent of GDP)

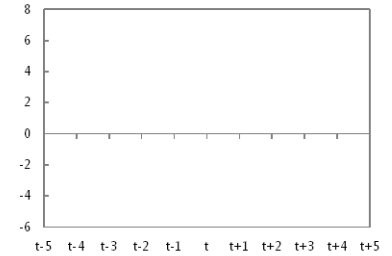


Boom-Bust Analysis^{3/}

Real GDP growth

(in percent)

— Slovenia



Source : IMF Staff.

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

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

3/ Not applicable for Slovenia.

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

5/ For Slovenia, the CAPB is excluding bank support outlays.

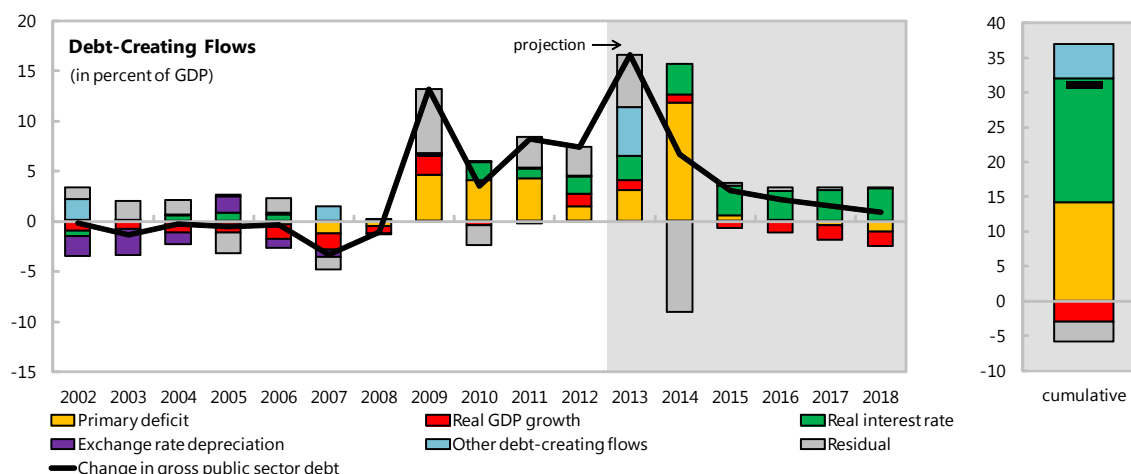
Slovenia: Public Sector Debt Sustainability Analysis (DSA) – Baseline Scenario

Debt, Economic and Market Indicators ^{1/}

	Actual			Projections						As of December 12, 2013		
	2002-2010 ^{2/}	2011	2012	2013	2014	2015	2016	2017	2018	Sovereign Spreads		
Nominal gross public debt	28.4	46.9	54.3	70.9	77.7	80.8	83.0	84.5	85.4	Spread (bp) ^{3/} 482		
Public gross financing needs	5.4	8.4	6.7	16.1	29.4	19.3	24.9	25.7	30.8	CDS (bp) 350		
Real GDP growth (in percent)	2.7	0.7	-2.5	-1.7	-1.1	1.0	1.5	1.7	1.8	Ratings	Foreign	Local
Inflation (GDP deflator, in percent)	3.4	1.2	0.2	0.8	1.0	1.5	1.8	1.8	1.9	Moody's	Ba1	Ba1
Nominal GDP growth (in percent)	6.3	1.9	-2.3	-0.9	-0.1	2.5	3.3	3.6	3.7	S&P's	A-	A-
Effective interest rate (in percent) ^{4/}	4.8	3.8	3.8	5.3	5.4	5.5	5.6	5.7	6.0	Fitch	BBB+	BBB+

Contribution to Changes in Public Debt

	Actual			Projections						cumulative	debt-stabilizing primary balance ^{10/}
	2002-2010	2011	2012	2013	2014	2015	2016	2017	2018		
Change in gross public sector debt	1.1	8.19	7.43	16.6	6.7	3.1	2.2	1.6	0.9	31.1	primary balance ^{10/} 1.7
Identified debt-creating flows	0.3	5.12	4.50	11.4	15.8	2.8	1.9	1.3	0.8	33.9	
Primary deficit	0.8	4.3	1.5	3.1	11.9	0.5	0.1	-0.4	-1.0	14.2	
Primary (noninterest) revenue and grants	41.0	41.3	42.4	42.2	44.2	44.1	44.1	44.1	44.1	262.8	
Primary (noninterest) expenditure	41.8	45.6	43.8	45.3	56.1	44.7	44.2	43.7	43.1	277.0	
Automatic debt dynamics ^{5/}	-1.0	0.7	2.9	3.4	3.9	2.3	1.8	1.7	1.8	14.8	
Interest rate/growth differential ^{6/}	-0.3	0.7	2.9	3.4	3.9	2.3	1.8	1.7	1.8	14.8	
Of which: real interest rate	0.4	1.0	1.7	2.5	3.1	3.0	2.9	3.1	3.3	17.9	
Of which: real GDP growth	-0.7	-0.3	1.2	0.9	0.8	-0.7	-1.2	-1.4	-1.5	-3.0	
Exchange rate depreciation ^{7/}	-0.6	0.0	0.0	...	...	...	...	...	...	...
Other identified debt-creating flows ^{8/}	0.5	0.1	0.1	4.9	0.0	0.0	0.0	0.0	0.0	4.9	
FIS: Privatization receipts (negative)	0.5	0.1	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	
Contingent liabilities	0.0	0.1	0.1	0.0	0.0	0.0	0.0	0.0	0.0	0.0	
FIS: Other (specify, e.g. bank recapitalization)	0.0	0.0	0.0	4.9	0.0	0.0	0.0	0.0	0.0	4.9	
Residual, including asset changes ^{9/}	0.8	3.1	2.9	5.2	-9.0	0.3	0.3	0.3	0.1	-2.8	



Source: IMF staff.

1/ Public sector is defined as general government.

2/ Based on available data.

3/ Bond Spread over German Bonds.

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

5/ Derived as $[(r - p(1+g) - g + ae(1+r))/(1+g+p+gp)]$ times previous period debt ratio, with r = interest rate; p = growth rate of GDP deflator; g = real GDP growth rate; a = share of foreign-currency denominated debt; and e = nominal exchange rate depreciation (measured by increase in local currency value of U.S. dollar).6/ The real interest rate contribution is derived from the denominator in footnote 4 as $r - \pi(1+g)$ and the real growth contribution as $-g$.7/ The exchange rate contribution is derived from the numerator in footnote 2/ as $ae(1+r)$.

8/ Assumes issuance of EUR 3bn of bonds by the Bad Assets Management Company (BAMCO). Recapitalization for EUR 1.2bn is included above the line.

9/ For projections, this line includes exchange rate changes during the projection period. The figures in 2013 and 2014 reflect accumulation and subsequent use of cash balances around the bank recapitalization

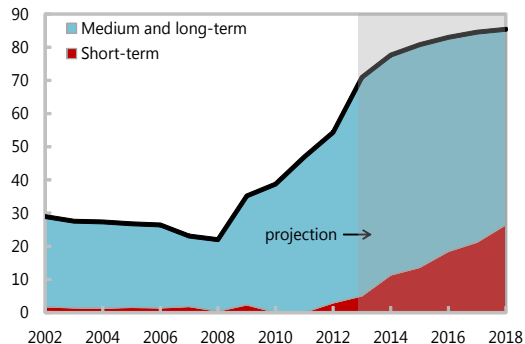
10/ Assumes that key variables (real GDP growth, real interest rate, and other identified debt-creating flows) remain at the level of the last projection year.

Slovenia: Public DSA – Composition of Public Debt and Alternative Scenarios

Composition of Public Debt

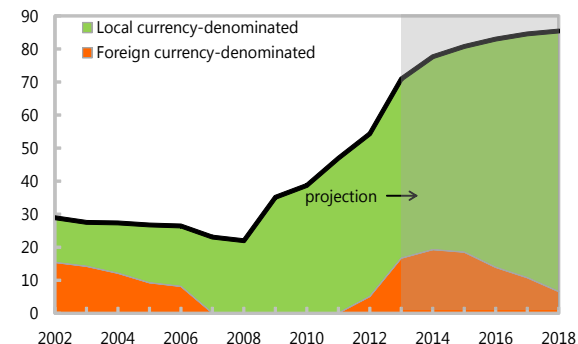
By Maturity

(in percent of GDP)



By Currency

(in percent of GDP)



Alternative Scenarios

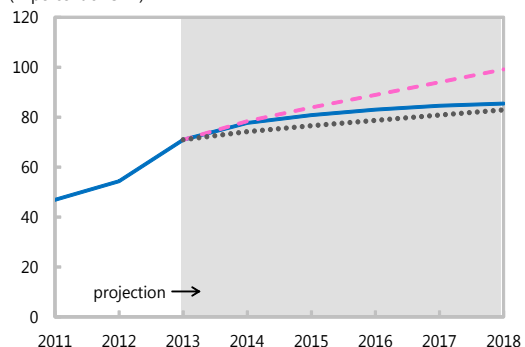
— Baseline

..... Historical

- - - Constant Primary Balance

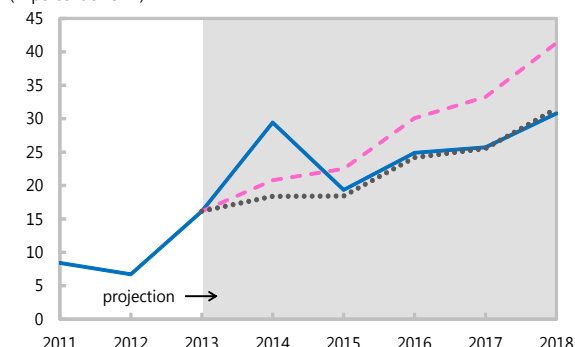
Gross Nominal Public Debt

(in percent of GDP)



Public Gross Financing Needs

(in percent of GDP)



Underlying Assumptions

(in percent)

Baseline Scenario

	2013	2014	2015	2016	2017	2018
Real GDP growth	-1.7	-1.1	1.0	1.5	1.7	1.8
Inflation	0.8	1.0	1.5	1.8	1.8	1.9
Primary Balance	-3.1	-11.9	-0.5	-0.1	0.4	1.0
Effective interest rate	5.3	5.4	5.5	5.6	5.7	6.0

Constant Primary Balance Scenario

	2013	2014	2015	2016	2017	2018
Real GDP growth	-1.7	-1.1	1.0	1.5	1.7	1.8
Inflation	0.8	1.0	1.5	1.8	1.8	1.9
Primary Balance	-3.1	-3.1	-3.1	-3.1	-3.1	-3.1
Effective interest rate	5.3	5.5	5.6	5.8	6.0	6.3

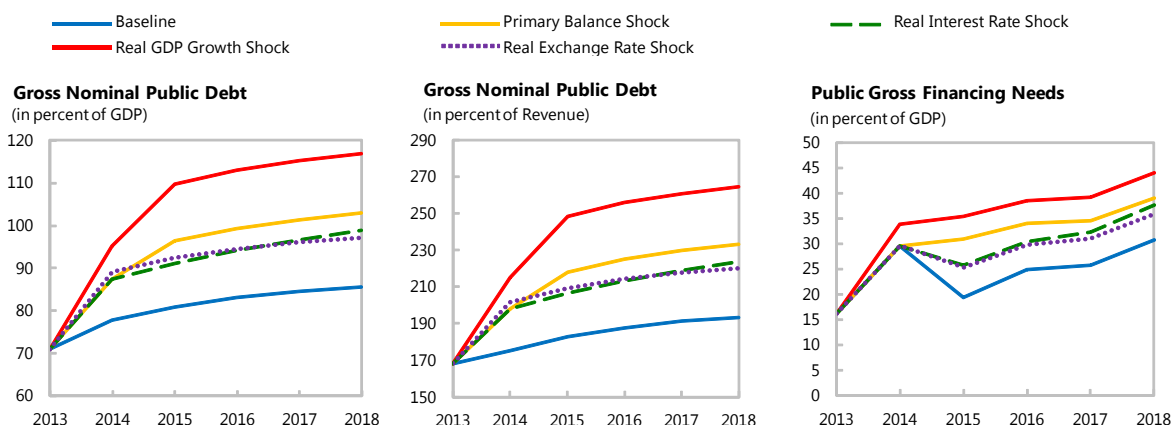
Historical Scenario

	2013	2014	2015	2016	2017	2018
Real GDP growth	-1.7	1.9	1.9	1.9	1.9	1.9
Inflation	0.8	1.0	1.5	1.8	1.8	1.9
Primary Balance	-3.1	-1.2	-1.2	-1.2	-1.2	-1.2
Effective interest rate	5.3	5.5	5.1	5.2	5.1	5.3

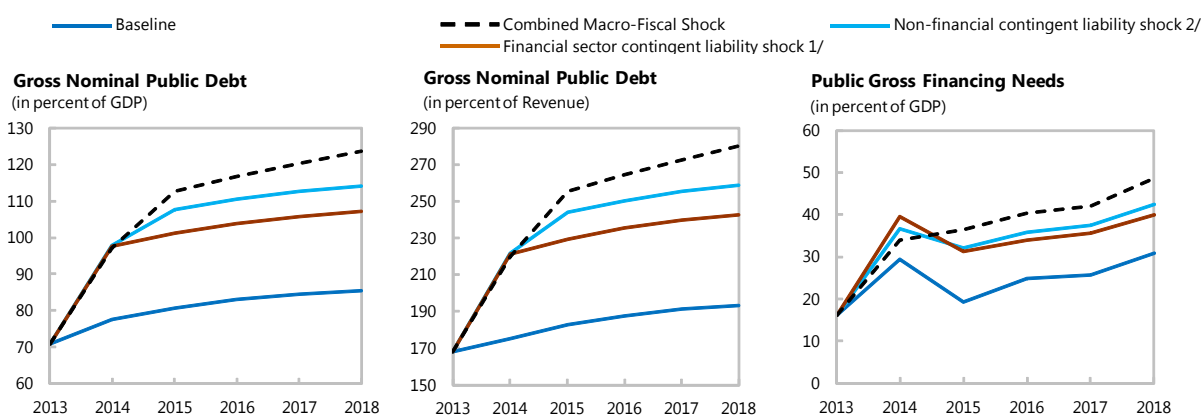
Source: IMF staff.

Slovenia: Public DSA – Stress Tests

Macro-Fiscal Stress Tests



Additional Stress Tests



Underlying Assumptions (in percent)

	2013	2014	2015	2016	2017	2018		2013	2014	2015	2016	2017	2018
Primary Balance Shock							Real GDP Growth Shock						
Real GDP growth	-1.7	-1.1	1.0	1.5	1.7	1.8	Real GDP growth	-1.7	-5.5	-3.4	1.5	1.7	1.8
Inflation	0.8	1.0	1.5	1.8	1.8	1.9	Inflation	0.8	-0.1	0.4	1.8	1.8	1.9
Primary balance	-3.1	-11.9	-6.2	-0.3	0.2	0.7	Primary balance	-3.1	-15.1	-5.8	-0.1	0.4	1.0
Effective interest rate	5.3	5.5	5.6	6.3	6.1	6.4	Effective interest rate	5.3	5.5	5.9	6.3	6.2	6.5
Real Interest Rate Shock							Real Exchange Rate Shock						
Real GDP growth	-1.7	-1.1	1.0	1.5	1.7	1.8	Real GDP growth	-1.7	-1.1	1.0	1.5	1.7	1.8
Inflation	0.8	1.0	1.5	1.8	1.8	1.9	Inflation	0.8	1.4	1.5	1.8	1.8	1.9
Primary balance	-3.1	-11.9	-0.5	-0.1	0.4	1.0	Primary balance	-3.1	-11.9	-0.5	-0.1	0.4	1.0
Effective interest rate	5.3	5.5	6.3	6.7	7.0	7.5	Effective interest rate	5.3	5.7	5.6	5.8	6.0	6.3
Combined Shock							Contingent Liability Shock						
Real GDP growth	-1.7	-5.5	-3.4	1.5	1.7	1.8	Real GDP growth	-1.7	-5.5	-3.4	1.5	1.7	1.8
Inflation	0.8	-0.1	0.4	1.8	1.8	1.9	Inflation	0.8	-0.1	0.4	1.8	1.8	1.9
Primary balance	-3.1	-15.1	-6.2	-0.3	0.2	0.7	Primary balance	-3.1	-17.6	-0.5	-0.1	0.4	1.0
Effective interest rate	5.3	5.7	6.3	6.8	7.1	7.5	Effective interest rate	5.3	5.9	6.1	6.0	6.1	6.4
Contingent liabilities shock													
Real GDP growth	-1.7	-1.1	1.0	1.5	1.7	1.8	Real GDP growth	-1.7	-1.1	1.0	1.5	1.7	1.8
Inflation	0.8	1.0	1.5	1.8	1.8	1.9	Inflation	0.8	1.0	1.5	1.8	1.8	1.9
Primary balance	-3.1	-11.9	-0.5	-0.1	0.4	1.0	Primary balance	-3.1	-11.9	-0.5	-0.1	0.4	1.0
Effective interest rate	5.3	5.5	5.6	5.9	6.0	6.4	Effective interest rate	5.3	5.5	5.6	5.9	6.0	6.4

Source: IMF staff.

1/ Assumes a further EUR 2 bn bank recapitalization need following the SSM AQR/ST in 2014

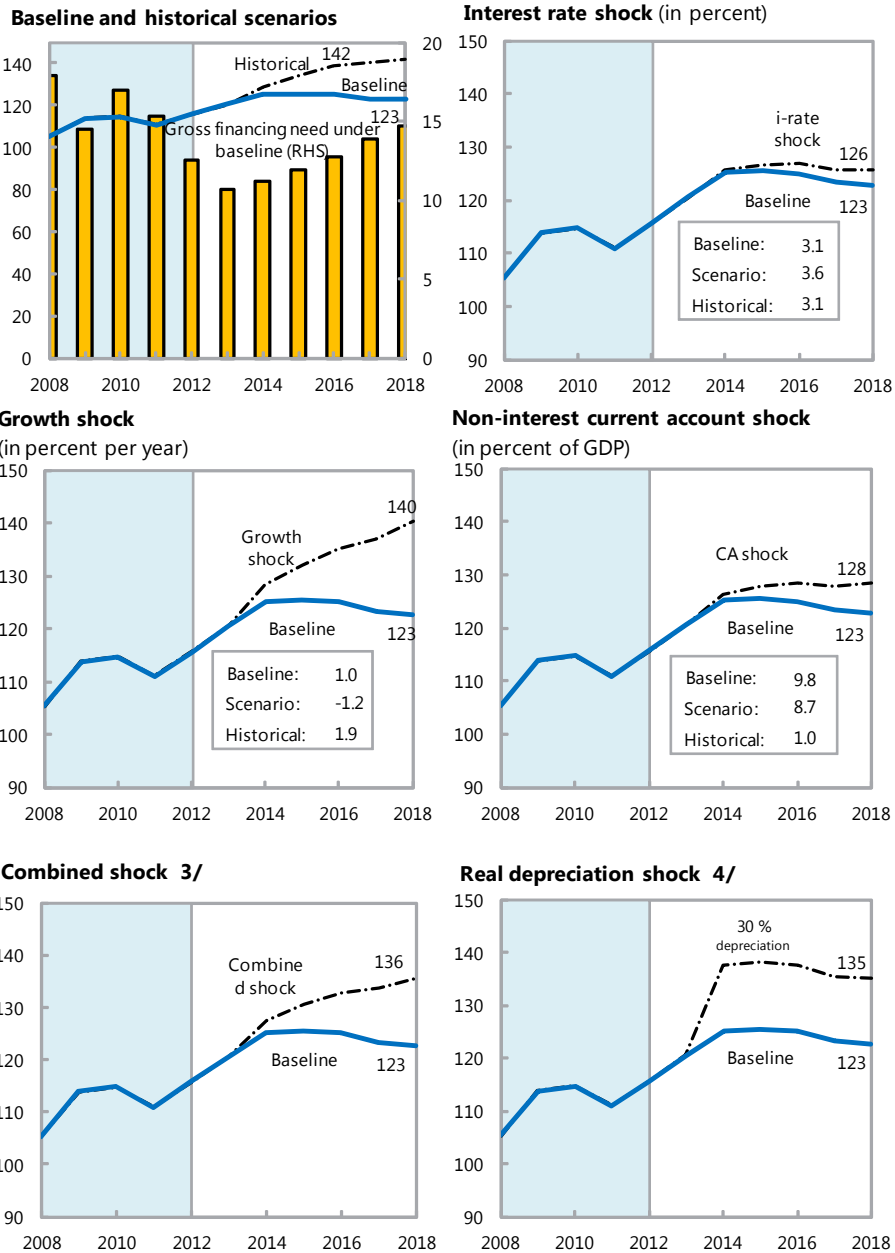
2/ Assumes contingent liabilities from guarantees to non-financial SOEs in the amount of 10% of GDP are called

EXTERNAL DEBT SUSTAINABILITY ANALYSIS

Slovenia had a high external debt-to-GDP ratio of 116 percent at end 2012 that has been growing as the deep recession reduced nominal GDP and the public sector raised financing abroad. This ratio is projected to peak in 2014 and starts to fall very gradually thereafter. Slovenia's external claims are substantial at 60 percent of GDP at end 2012 and projected to grow more rapidly, with the result that net external debt is at a relatively comfortable level and falling rapidly. The projected decline in gross debt is particularly sensitive to a negative growth shock given that it is driven by economic recovery.

1. **Under the baseline scenario Slovenia's external debt ratio starts to decline modestly in 2015 as its gross external financing needs are offset by the recovery in nominal GDP.** External debt increases between 2013 and 2014 as external debt purchases of debt issued to finance the bank recapitalization adds to external financing of the deficit. After 2014, however, external debt issuance is driven primarily by budget deficit financing needs that are not large enough to offset the effect on the ratio of the rebound in nominal GDP given the fiscal consolidation that has occurred and is projected to continue.
2. **The analysis is based on the macroeconomic assumptions outlined above in the public DSA.** There government is assumed to be the primary issuer of external debt as bank and non-financial private sector institutions are deleveraging abroad and have a limited need to borrow externally. External debt is distributed fairly evenly across the government, banks and the non-financial private sectors. Within the latter, debt is largely trade credit and loans to exporters, and unlikely to involve significant contingent liabilities for the government.
 - **Sensitivity analysis shows that the external debt path is particularly sensitive with respect to adverse growth shocks and a reversion to historical averages.** In particular, the external debt ratio continues to increase throughout the projections horizon in both scenarios. In contrast, the interest rate and depreciation shocks do not pose significant risks to external debt sustainability.

Slovenia: External Debt Sustainability: Bound Tests 1/2/ (External debt in percent of GDP)



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

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

2/ For historical scenarios, the historical averages are calculated over the ten-year period, and the information is used to project debt dynamics five years ahead.

3/ Permanent 1/4 standard deviation shocks applied to real interest rate, growth rate, and current account balance.

4/ One-time real depreciation of 30 percent occurs in 2014

Slovenia: External Debt Sustainability Framework, 2008–18

(In percent of GDP, unless otherwise indicated)

	Actual					Projections							Debt-stabilizing current account 6/ -3.5
	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018		
Baseline: External debt	105.3	113.8	114.8	110.9	115.7	120.6	125.1	125.5	125.0	123.3	122.7		
Change in external debt	4.8	8.5	0.9	-3.8	4.7	4.9	4.5	0.4	-0.5	-1.7	-0.6		
Identified external debt-creating flows (4+8+9)	-8.5	14.0	4.0	-9.4	8.2	-5.9	-6.4	-9.6	-9.5	-8.8	-7.8		
Current account deficit, excluding interest payments	1.8	-1.8	-2.1	-3.1	-5.7	-10.1	-11.1	-10.9	-10.2	-9.1	-8.0		
Deficit in balance of goods and services	-138.8	-116.1	-131.6	-144.0	-147.0	-151.4	-158.3	-163.2	-168.0	-173.1	-178.8		
Exports	68.4	59.1	66.4	72.7	75.9	79.5	83.6	86.0	88.3	90.4	92.8		
Imports	-70.3	-57.0	-65.1	-71.3	-71.1	-71.9	-74.7	-77.2	-79.7	-82.7	-86.0		
Net non-debt creating capital inflows (negative)	-0.4	1.8	-1.6	-1.7	-0.4	-1.0	-0.3	-1.3	-1.3	-1.3	-1.4		
Automatic debt dynamics 1/	-9.9	14.0	7.7	-4.6	14.4	5.2	5.0	2.5	1.9	1.6	1.5		
Contribution from nominal interest rate	3.7	2.3	2.2	2.7	2.5	3.3	3.6	3.7	3.7	3.7	3.6		
Contribution from real GDP growth	-2.9	9.3	-1.5	-0.8	3.1	1.9	1.3	-1.1	-1.8	-2.1	-2.1		
Contribution from price and exchange rate changes 2/	-10.6	2.4	6.9	-6.6	8.8	...	...	...	...	...	...
Residual, incl. change in gross foreign assets (2-3) 3/	13.3	-5.5	-3.1	5.6	-3.5	10.8	10.9	10.0	9.0	7.1	7.2		
External debt-to-exports ratio (in percent)	154.0	192.7	172.8	152.5	152.4	151.7	149.6	145.9	141.6	136.5	132.3		
Gross external financing need (in billions of US dollars) 4/	9.8	7.1	8.0	7.7	5.7	5.0	5.3	6.0	6.7	7.6	8.5		
in percent of GDP	17.9	14.5	17.0	15.3	12.6	10.6	11.1	11.9	12.8	13.9	14.7		
Scenario with key variables at their historical averages 5/						120.6	128.5	134.2	138.2	139.7	141.1	-6.8	
Key Macroeconomic Assumptions Underlying Baseline													
						Historical Average	Standard Deviation						
Real GDP growth (in percent)	3.4	-7.9	1.3	0.7	-2.5	1.9	4.4	-1.7	-1.1	1.0	1.5	1.8	
GDP deflator in US dollars (change in percent)	11.8	-2.2	-5.7	6.1	-7.3	6.1	10.4	4.5	4.0	3.2	3.2	2.9	
Nominal external interest rate (in percent)	4.2	1.9	1.9	2.5	2.0	3.1	1.0	2.9	3.1	3.1	3.1	3.1	
Growth of exports (US dollar terms, in percent)	13.2	-22.3	7.3	17.0	-5.8	11.5	15.1	7.6	8.2	7.2	7.4	7.1	
Growth of imports (US dollar terms, in percent)	14.5	-27.0	9.1	16.9	-10.0	11.5	17.6	3.9	6.8	7.6	8.2	8.5	
Current account balance, excluding interest payments	-1.8	1.8	2.1	3.1	5.7	1.0	2.3	10.1	11.1	10.9	10.2	9.1	
Net non-debt creating capital inflows	0.4	-1.8	1.6	1.7	0.4	0.2	1.0	1.0	0.3	1.3	1.3	1.4	

1/ Derived as $[r \cdot g - r(1+g) + ea(1+r)] / (1+g+r+gr)$ times previous period debt stock, with r = nominal effective interest rate on external debt; r = change in domestic GDP deflator in US dollar terms, g = real GDP growth rate,

e = nominal appreciation (increase in dollar value of domestic currency), and a = share of domestic-currency denominated debt in total external debt.

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

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

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

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

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



INTERNATIONAL MONETARY FUND



Press Release No. 14/13
FOR IMMEDIATE RELEASE
January 17, 2014

International Monetary Fund
Washington, D.C. 20431 USA

IMF Executive Board Concludes 2013 Article IV Consultation with the Republic of Slovenia

On January 13, 2014, the Executive Board of the International Monetary Fund (IMF) concluded the Article IV consultation¹ with the Republic of Slovenia.

After a brief stabilization in 2010, the recession resumed in 2011 and the economy now has contracted for eight consecutive quarters. While a sharp contraction in investment was the main driver of the downturn in the early stages, consumption—until then buffered by healthy household balance sheets—also started to decline from 2012, weighed down by deep fiscal cuts, stagnant wages, and growing uncertainty. The current account has moved into a substantial surplus. While competitiveness is on the mend, the bulk of the external adjustment has come from import compression. In all, through mid-2013, real GDP has fallen by 11 percent from its pre-crisis peak, the largest output loss among the euro area members after Greece.

The combination of an overly indebted corporate sector and weak banks has led to a vicious circle of deepening recession, mounting bankruptcies, rising nonperforming loans (NPLs), and further deleveraging. NPLs (inclusive of guarantees) increased from 11.2 percent at end-2011 to 20.9 percent by end-October 2013. NPLs are highly concentrated in large corporate debtors and in state banks. The deterioration in asset quality has led to an erosion of profitability and capitalization, forcing banks into deleveraging. At the same time, Slovenian corporates have one of the highest leverage ratios in the euro area, mainly because of a lack of equity. The average interest bill to earnings ratio has reached 90 percent, pushing into the red companies that might be viable with lower debt.

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.

On December 12, 2013, the Slovenian authorities announced the results of the comprehensive bank asset quality review and stress test exercise carried out by independent consultants. The exercise found that the banking system would need €4.8 billion in additional capital to withstand a severe adverse macroeconomic scenario. The authorities have since proceeded to address these capital needs by recapitalizing the three state-owned banks from budgetary resources, with the remaining five banks expected to raise private capital in the first half of 2014.

Public debt has been increasing rapidly. Before the global financial crisis public debt was low (22 percent of GDP) and the fiscal position close to balance. The prolonged recession and the burden of supporting the state-owned banks have put public finances under considerable strain. Public debt has more than doubled since 2008, reaching 55 percent of GDP by end-2012, and is set to increase sharply after bank restructuring. The deficit is slated to exceed 4 percent of GDP in 2013 (excluding bank support costs), despite a significant fiscal consolidation over the last three years. Reflecting in part concerns about the fiscal impact of bank restructuring, government bond yields averaged about 2 percentage points higher than in similarly-rated Spain and Italy in the second half of 2013, posing a challenge for debt sustainability, before moderating to about 1 percent following the announcement of the bank asset quality review results.

Executive Board Assessment²

Executive Directors noted that, with the economy still in recession, comprehensive bank and corporate restructuring is essential to achieve financial stability, fiscal and debt sustainability, and durable growth, and called on the Slovenian authorities to step up the current reform effort. Directors welcomed as key milestones the completion of the bank asset quality review and stress tests, recent bank recapitalization, ongoing transference of banks' problem loans to the Bank Asset Management Company (BAMC), and the adoption of new insolvency legislation.

Directors supported the authorities' 2014 fiscal deficit target, but raised concerns about the quality of the fiscal measures underpinning the budget. They advised more ambitious public employment reduction, better targeting of social transfers, and specific cuts in transfers and subsidies. Directors noted that further gradual consolidation would be necessary beyond 2014 to support debt sustainability in the face of sizeable government guarantees and bank restructuring costs, and highlighted the need for pension reform, given unfavorable demographic trends.

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

Directors underscored that durable financial stability hinges on reducing banks' vulnerabilities through improved bank governance, risk management, and profitability. In this regard, reducing the role of the state, including through privatization, is particularly important. Directors also recommended strengthening financial sector supervision and addressing shortcomings in the bank resolution framework. At the same time, Directors noted that public banks should focus on core activities, including through divestment of their corporate holdings, and that limiting connected lending is essential to contain moral hazard and excessive risk taking.

Directors emphasized that comprehensive non financial corporate restructuring that addresses the debt overhang is essential to break the negative feedback loop of recession, bank deleveraging, and corporate distress, which has been at the root of Slovenia's recent problems. They cautioned that budgetary support of distressed corporates would amplify fiscal risks, and should be avoided given limited fiscal space. Directors encouraged the authorities to utilize the tools provided by the BAMC and the new insolvency law for restructuring the sector, and welcomed the recent launching of the privatization program. They supported the authorities' plans to adopt a coherent state owned enterprise management strategy and a centralized management agency for state assets.

Directors welcomed the reduction in unit labor costs and labor market rigidities that have enhanced Slovenia's external competitiveness. They called for further regulatory and product market reforms to strengthen the business climate and better attract foreign direct investment.

Slovenia: Selected Economic Indicators, 2010–14

(Annual percentage change, unless noted otherwise)

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

Population (2012): 2.1 million

Quota (as of August 31, 2013): SDR 275 million

Literacy Rate (in percent): 99.5

Main products/exports: Automotive, Machinery-

Appliances, Tourism, Transportation

Poverty Rate (in percent, 2012): 13.5

	Projections				
	2010	2011	2012	2013	2014
Nominal GDP (EUR millions)	35,485	36,150	35,319	35,006	34,966
GDP per Capita (EUR)	17,335	17,633	17,183	16,986	16,923
Real economy					
Real GDP	1.3	0.7	-2.5	-1.7	-1.1
Domestic demand	-0.5	-0.3	-6.4	-4.8	-3.0
Private consumption	1.5	0.8	-4.8	-3.4	-2.8
Public consumption	1.3	-1.6	-1.3	-3.0	-2.5
Gross capital formation	-7.3	-2.3	-16.5	-9.0	-4.2
Net exports (contribution to growth)	1.9	1.1	4.0	2.5	1.5
Exports of goods and services	10.2	7.0	0.6	4.1	3.7
Imports of goods and services	7.4	5.6	-4.7	1.1	2.1
Output gap (in percent of potential GDP)	-1.2	-0.5	-2.7	-3.8	-4.8
Prices					
Consumer prices (national definition, period average)	1.8	1.8	2.6	1.8	1.4
Core inflation (period average)	-0.4	-0.4	0.7	...	...
Employment and wages					
Unemployment rate (in percent, ILO definition)	7.3	8.2	8.9	10.5	10.8
Employment (Full time basis, national accounts)	-2.2	-1.6	-0.8	-2.0	-0.3
Nominal wages (all sectors)	3.9	2.0	0.1	0.0	-0.3
Real wages (all sectors)	2.0	0.2	-2.5	-2.2	-1.7
Unit labor cost (all sectors)	0.4	-0.4	1.8	-0.3	0.6
Public finance (percent of GDP)					
General government balance 1/	-5.4	-5.6	-3.2	-5.7	-15.3
Structural balance 2/	-4.9	-4.1	-2.3	-2.0	-2.3
Primary balance 1/	-4.1	-4.3	-1.5	-3.1	-11.9
Structural primary balance 2/	-3.1	-2.3	-0.4	0.8	1.2
General government debt 3/	38.7	46.9	54.3	70.9	77.7
Monetary and financial indicators					
Credit to the private sector	1.9	-2.6	-3.2	...	...
Lending rates 4/	4.9	5.0	4.7	...	...
Deposit rates 5/	1.8	2.2	2.3	...	...
Government bond yield (10-year, average) 6/	3.8	5.0	5.8	...	...

Slovenia: Selected Economic Indicators, 2010–14 (continued)

	2010	2011	2012	Projections	
				2013	2014
Balance of payments (percent of GDP)					
Trade balance (goods)	-2.3	-2.6	-0.3	1.3	2.2
Current account balance	-0.1	0.4	3.3	6.8	7.5
Gross external debt (percent of GDP, end-period)	114.8	110.9	115.7	120.6	125.1
Nominal effective exchange rate (2000=100)	100.6	101.1	99.9	...	...
Real effective exchange rate (2000=100, CPI-based)	103.1	102.5	101.2	...	...

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

1/ Includes capital injections into banks and repayments to depositors of two failed banks. These amount to 0.3 billion euros in 2013 projections, 3.8 billion in 2014, and 0.1 billion in 2015.

2/ Excludes capital injections into banks and repayments to depositors of two failed banks. These amount to 0.3 billion euros in 2013 projections, 3.8 billion in 2014, and 0.1 billion in 2015.

3/ Includes a debt shock of EUR 1.7 billion (4.8 percent of GDP) in 2013 due to assumed debt issuance of the new Asset Management Company for loan carve-outs.

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

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

6/ 12-month average. Eurostat Data

**Statement by Johann Prader, Executive Director for the Republic of Slovenia and
Borut Repansek, Advisor do the Executive Director
January 13, 2014**

The Slovenian authorities thank staff for the valuable exchange of views during the meetings and their in-depth appraisal of the Slovenian economy. They broadly agree with the Fund's analysis and advice. The authorities also appreciate the Fund's technical assistance.

Economic Developments, Measures and Outlook

In the third quarter of 2013, Slovenia's current account balance reached 6.8 percent of GDP, growth was -0.6 percent and the unemployment rate stood at 9.4 percent. For the first three quarters of 2013, the general government deficit is estimated at 5.5 percent of GDP and its consolidated gross debt at the end of the third quarter is estimated at 62.6 percent of GDP. Inflation in December 2013 was 0.7 percent.

The authorities are more optimistic about the growth outlook than the Fund staff. The good performance of the export-oriented corporate sector, increased competitiveness and the recent bold actions taken in the banking sector are promising indicators.

Since the last Article IV Consultation, the Slovenian authorities have intensified their efforts to reduce macroeconomic imbalances which, combined with high economic uncertainty, required urgent policy responses and vigorous measures. Many remedial steps have been taken and the positive effects are becoming gradually visible.

- In January 2013, the pension reform entered into force, followed by a labor market reform in March, when the Bank Assets Management Company (BAMC) was also established.
- In March, the new government took over and was immediately faced with refinancing risks. The authorities swiftly responded to market speculations by preparing a bond issuance and raised USD 3.5 billion in early May. The Cyprus crisis challenged the trust of bank depositors also in Slovenia. Fortunately, no significant decrease in households' deposits occurred.
- In May, Slovenia submitted to the European Commission the comprehensive 2013 stability programme covering the period 2012-2016 and its 2013 national reform programme. At the end of May, the European Commission issued its policy recommendations to the Slovenian authorities. In parallel, the authorities had agreed with the social partners on an additional 1.25 percent reduction in basic gross wages in the public sector, on top of the 3 percent reduction that had been agreed upon in May 2012. Also, Parliament had approved a constitutional basis for establishing a general government budget balance/surplus rule in structural terms and tightened the constitutional rules to call and win a referendum. The latter should facilitate the introduction of fiscal and structural reforms.

- In autumn, Slovenia presented the Economic Partnership programme and Draft Budgetary Program to the European Commission. The measures outlined in these documents were evaluated by the Commission as adequate to address the macroeconomic challenges.
- The European Commission requested the execution of an independent Asset Quality Review (AQR) and stress tests for a representative portion of the banking system as a prerequisite for the transfer of claims to the BAMC and the approval of state aid. The Slovenian authorities embarked on the aforementioned actions in July 2013 by engaging foreign experts to ensure the complete independence and credibility of the review. The AQR and stress tests results were announced on December 12. A few days later, five banks were recapitalized and the first batch of bad assets was transferred to the BAMC. Markets clearly welcomed the transparency and the measures taken, and spreads declined considerably as a result. In addition to implementing the Fund's FSAP recommendations, the authorities will also take further measures, including privatizing now well-capitalized state-owned banks, strengthening banking supervision, implementing the banking sector consolidation, and establishing macro-prudential supervision, for which the necessary act has already been adopted. A new Banking Act that transposes the EU Capital Requirements Directive IV is expected to enter into force in the spring.

In addition to the external environment, the economic outlook depends on the implementation of technically complex reforms in the corporate, financial, and public sectors. The authorities are aware of the implementation risks, and policy measures will have to be carefully designed to ensure sufficient public support.

Banking sector, Asset Quality Review and Stress Tests

Banks dealt with bad assets before the stress tests were finalized in December 2013 by increasing write-offs and provisions, which in 2011, 2012 and in the first ten months of 2013 cumulatively amounted to EUR 4.2 billion.

The AQR, the stress tests and the bad assets transfer to BAMC exercises were designed and conducted in close cooperation with the European Commission and the ECB.

The adverse stress test scenario was based on very conservative assumptions, i.e. a cumulative 9.5 percent decline in the GDP growth rate in the period from 2013 to 2015. This is 1 percentage point higher than the realized decline in the period from 2009 to 2012, and quite different from the available projections. In addition, a conservative approach was applied through the valuation of collateral and a very stringent approach to client classifications by banks.

The estimate of a EUR 4.8 billion potential bank capital shortfall was the most conservative out of the four stress tests results, based on the two different methods and scenarios used.

The new insolvency law should work towards slowing down NPL accumulation in banks' balance sheets by accelerating resolution procedures.

Fiscal Policy

In spite of the ongoing recession, fiscal consolidation continues in Slovenia. The pace of fiscal consolidation should take into account its impact on employment and growth. Therefore, a gradual consolidation path towards structural balance by 2017 is underway. The authorities are mindful of the fiscal risks and have made all efforts to contain them, including a pension freeze, public sector wage reduction, improved tax collection, measures to limit the grey economy, and the introduction of a property tax. Also, the conservative stress tests results and the consequent bank recapitalization have likely ruled out the need for further state-owned bank recapitalization in the medium term. Further tax increases are not envisaged and the authorities are committed to pursue any additional consolidation on the expenditure side. In the authorities' view, staff's analysis of Slovenia's debt sustainability and respective policy option in the staff report should have put more emphasis on privatization. Privatizations, coupled with the debt reductions in the BAMC, can significantly reduce the debt level and the authorities intend to pursue this without delay. The authorities stand ready to promptly respond to fiscal deterioration if it emerges.

Structural Issues

Improving corporate sector governance and its deleveraging are key to achieve the much-needed increase in investment. Staff's proposal of a multi-pronged approach is well noted. Privatization of the first selected 15 companies has started, and will be upgraded by the adoption of a full-fledged strategy for managing SOEs in 2014, which will also designate further divestment paths. After the bad assets transfers and the recent recapitalization, BAMC can start coordinating creditors and facilitate corporate restructuring. The law to establish the Slovenian Sovereign Holding, whose mandate is to improve governance in state-owned companies, is in parliamentary procedure. Once the holding is functioning and the envisaged state-owned bank privatization implemented, the connected lending problem will be significantly reduced.

The March 2013 labor market reform will be complemented by a reform of the so-called "student employment" by April 2014. The "student employment" increases labor market flexibility, but is clearly a distortion rooted in years of economic development with negligible new job creation and labor shedding. Consequently, a part of the young population is formally enrolling in college to avoid unemployment and obtain short-term temporary jobs more easily. College graduates increasingly end up with temporary short-term employment, as permanent contracts are rarely offered. New job creation has become one of the policy priorities closely connected with all growth-enhancing policy measures.