IMF Country Reports 23/027

Republic of Slovenia: 2022 Article IV Consultation-Press Release; and Staff Report

INTERNATIONAL MONETARY FUND

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IMF Country Report No. 23/27

REPUBLIC OF SLOVENIA

2022 ARTICLE IV CONSULTATION—PRESS RELEASE; AND STAFF REPORT

January 2023

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 2022 Article IV consultation with Slovenia, the following documents have been released and are included in this package:

- A **Press Release**.
- The **Staff Report** prepared by a staff team of the IMF for the Executive Board's consideration on lapse-of-time basis, following discussions that ended on November 21, 2022, with the officials of Slovenia on economic developments and policies. Based on information available at the time of these discussions, the staff report was completed on December 13, 2022.
- An **Informational Annex** prepared by the IMF staff.

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

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International Monetary Fund
Washington, D.C.

IMF Executive Board Concludes 2022 Article IV Consultation with the Republic of Slovenia

FOR IMMEDIATE RELEASE

Washington, DC – January 18, 2023: The Executive Board of the International Monetary Fund (IMF) concluded the Article IV consultation[1] with the Republic of Slovenia on Wednesday, January 11, 2023, and endorsed the staff appraisal without a meeting.

Slovenia recovered quickly from the pandemic, with GDP increasing by more than 8 percent in 2021, largely driven by exports and private consumption. Strong economic performance has continued into 2022, but growth slowed significantly in the third quarter as spillovers from the war in Ukraine and rising prices weighed on economic activity. The labor market is tight, with unemployment at an historic low, but wage growth remains lower than inflation.

Growth is expected to slow further to 1.8 percent in 2023 from 5.4 percent in 2022, reflecting weaker external demand and subdued private consumption and investment, partly offset by an expected accommodative fiscal policy stance. Inflation is expected to decline but will likely remain elevated for some time before returning to target. The economic outlook is highly uncertain, and risks, mainly from war-related spillovers, are mostly on the downside. Over the medium term, growth is projected to rebound to its potential of around 3 percent, underpinned by investments and reforms, including those supported by EU funds.

Executive Board Assessment[2]

After an impressive post-pandemic recovery, Slovenia has continued to achieve strong economic growth, but the outlook has become more challenging. Real GDP increased by more than 8 percent in 2021, thus surpassing its pre-pandemic level, and economic activity remained strong in 2022. Staff's preliminary assessment suggests that the external position in 2022 is moderately stronger than the level implied by fundamentals and desirable policies. Russia's invasion of Ukraine poses considerable challenges, however, mainly through weaker external demand and high commodity prices, which are weighing on the economy. Growth is expected to slow in 2023 with downside risks stemming mainly from war-related spillovers. Inflation is expected to fall, but remain elevated, possibly triggering higher wage demands and higher inflation expectations.

A tighter fiscal stance is warranted in 2023 and energy price mitigation measures should be more targeted. Tight fiscal policy should support monetary policy in the effort to reduce inflation. With a positive output gap, tight labor market, and rising core inflation, it would be

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

[2]Management has determined that this Article IV Consultation meets the established criteria as set out in Board Decision No. 15207 (12/74); (i) there are no acute or significant risks, or general policy issues requiring a Board discussion; (ii) policies or circumstances are unlikely to have significant regional or global impact in the near term; and (iii) the use of Fund resources is not under discussion or anticipated.

prudent to save part of the large contingency fund and to reduce the fiscal deficit in cyclically adjusted terms relative to 2022. Public debt remains sustainable but is vulnerable to shocks. Temporary and targeted support should be deployed to protect the vulnerable against high energy prices and less targeted measures should be phased out. Should downside risks materialize, automatic stabilizers should be allowed to operate fully and in case of a large adverse demand shock consideration could be given to deploying discretionary fiscal stimulus.

A growth-friendly consolidation would help rebuild fiscal buffers. Improving the tax policy mix to reduce reliance on labor taxes, while increasing property taxes and broadening the tax base, could generate additional revenue and induce a positive labor supply response. Reforming the pensions, health, and long-term care systems is a priority. On pensions, which account for the bulk of age-related fiscal costs over the long term, options include gradual adjustments to the retirement age and to indexation rules. Modernizing the public sector wage system by better linking remuneration to performance would align incentives and allow for better wage bill management. Further strengthening public investment management is also critical given the envisaged scaling up of public investment.

Slovenia's macroprudential stance is appropriate but risks have increased. Given systemic risks, the recent increase in the countercyclical capital buffer from zero to 0.5 percent is welcome. Macroprudential policies should remain flexible to ensure the right balance between financial stability and credit supply to the economy. Continued close monitoring of asset quality and appropriate loan-loss provisioning remain important. Legacy Swiss franc loans should be handled on an individual basis and stability of contracts should be ensured.

Efforts should continue to be made to further strengthen the Anti-Money Laundering/Combating the Financing of Terrorism (AML/CFT) and restructuring frameworks. The focus should be on enhancing supervision to ensure that accurate and up-to-date beneficial ownership information of legal persons is available to competent authorities and reinforcing money laundering investigations and convictions. The transposition of the relevant EU legislation and its implementation is important for restructuring.

Measures to increase energy security should be compatible with Slovenia's green transition. The authorities should continue their efforts to ensure alternative gas supplies, encourage energy savings, and prepare contingency plans. While temporary reliance on more polluting energy sources may be needed in the short term, it is important to continue to keep a focus on long-term climate goals, including by further developing renewables to reduce dependence on fossil fuels. Carbon prices high enough to provide the right incentive for currently exempt polluting sectors should be put in place over time as the energy crisis abates.

Securing sustained and inclusive growth calls for further labor market reforms and digitalization to boost productivity. Policies to address disincentives to labor market participation should include reducing the relatively high labor tax wedge, reforming unemployment and pension policies to limit early exit from the labor market and tackling skill mismatches and inflexible work arrangements. Active labor market policies need to be well aligned with market needs, with education and training programs adapted to meet new demands from the green and digital transitions, and provided on a life-long basis. Closing remaining gaps in digital skills and the integration of digital technologies in businesses and public services would positively contribute to future productivity and growth.

It is recommended that the next Article IV consultation with Slovenia be held on the standard 12-month cycle.

Slovenia: Selected Economic Indicators

(Annual percentage change, unless noted otherwise)

	2019	2020	2021	2022	2023	2024
				Staff Projections		
Population (millions)	2.08	2.10	2.11	2.11	2.11	2.12
Nominal GDP (EUR millions)	48,533	47,021	52,208	58,762	63,404	67,612
GDP per Capita (EUR)	23,323	22,435	24,755	27,844	29,989	31,959
Real economy						
Real GDP	3.5	-4.3	8.2	5.4	1.8	2.4
Domestic demand (contribution to growth)	3.2	-4.3	9.0	6.9	1.7	2.9
Private consumption	5.3	-6.9	9.5	6.5	1.8	2.6
Public consumption	1.8	4.1	5.8	2.4	0.8	0.6
Gross capital formation	0.6	-7.1	15.1	12.3	3.8	6.2
Net exports (contribution to growth)	0.2	0.0	-0.8	-1.5	0.1	-0.5
Exports of goods and services	4.5	-8.6	14.5	6.2	3.9	4.2
Imports of goods and services	4.7	-9.6	17.6	8.0	4.1	5.0
Output gap (in percent of potential GDP)	0.9	-2.7	1.7	3.4	1.7	0.8
Unemployment rate (in percent, ILO definition)	4.5	5.0	4.7	4.3	4.6	4.5
Prices						
Consumer prices (national definition, period average)	1.6	-0.1	1.9	8.6	5.0	4.0
Core inflation (period average) 1/	1.8	1.0	1.0	6.6	5.6	5.3
Public finance (percent of GDP)						
General government balance	0.6	-7.7	-4.7	-3.1	-4.8	-2.5
Structural balance	0.0	-6.5	-5.4	-4.4	-5.2	-2.7
Structural primary balance	1.7	-4.9	-4.1	-3.2	-4.1	-1.4
General government gross debt	65.4	79.6	74.5	70.5	69.2	67.4
Monetary and financial indicators						
Credit to the private sector	3.4	-1.0	5.0	12.6	7.9	6.6
Lending rates 2/	1.6	1.8	1.6	…	…	…
Deposit rates 3/	0.2	0.1	0.1	…	…	…
Government bond yield (10-year)	0.1	0.1	0.2	…	…	…
Balance of payments (percent of GDP)						
Trade balance (goods and services)	8.7	9.3	6.4	3.0	3.6	3.7
Current account balance	5.9	7.6	3.8	0.5	1.1	1.2
Gross external debt (percent of GDP, end-period)	91.6	102.1	97.3	85.8	81.8	79.0
Nominal effective exchange rate (2010=100)	104.8	106.9	107.7	…	…	…
Real effective exchange rate (2010=100, CPI-based)	97.2	97.8	97.2	…	…	…

Sources: Slovenia authorities and IMF staff calculations and projections.

1/ Harmonized Index of Consumer Prices excluding energy and unprocessed food.

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

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

REPUBLIC OF SLOVENIA

STAFF REPORT FOR THE 2022 ARTICLE IV CONSULTATION

December 13, 2022

KEY ISSUES

Context: Slovenia recovered quickly from the pandemic but Russia's war in Ukraine is posing new challenges, especially the negative terms of trade shock. A center-left government took office in June, with a broad social and green reform agenda.

Outlook and risks: Growth is expected to slow as external demand declines, higher prices hurt consumption, and supply constraints persist. Inflation will likely remain elevated. The economic outlook is uncertain, with significant downside risks stemming from the escalation of the war, further supply disruptions, the tight labor market, and high inflation.

Key Policy Recommendations: Policies should focus on providing targeted support to those affected by high commodity prices, while maintaining prudent fiscal and macroprudential stances, and on the continuation of structural reforms.

- *Fiscal policy*: With rising core inflation and little slack in the labor market, a tighter fiscal policy in 2023 is warranted to curb demand pressures. Fiscal support to mitigate the impact of high commodity prices should be temporary and targeted to vulnerable households and to those companies that have been affected significantly by the high energy prices and that were in good financial standing before the crisis. With still-high public debt and ageing-related spending challenges, a growth-friendly fiscal consolidation would help rebuild fiscal buffers, guided by staff's past advice on pensions, public wage policy, and tax rebalancing.

- *Financial policy*: Continued close monitoring of asset quality and war-related spillover vulnerabilities is needed to safeguard financial stability. Given the recent rise in mortgage loans and real estate prices, the introduction of a sectoral systemic risk buffer is appropriate. Given systemic risks, the recent increase in the countercyclical capital buffer from zero to 0.5 percent is welcome. The macroprudential stance is appropriate and should continue to be adjusted, as needed, to ensure the right balance between financial stability and credit supply to the economy.

- *Structural policies:* Investment in energy security and green technologies will help foster a sustainable recovery and help achieve Slovenia's climate goals. The carbon tax base should be broadened to cover polluting industries once the pressures from energy prices subside. Labor market policies should aim to address ageing challenges, reduce skill mismatches, and facilitate labor reallocation. Further investment in digital transformation could help boost productivity and growth.

Approved By
Laura Papi (EUR) and Anna Ilyina (SPR)

Discussions took place in Ljubljana during November 10–21, 2022. The staff team comprised D. McGettigan (mission head), M. Hassine, R. Rozenov and W. Shi (all EUR), A. Kahn and N. Schwarz (LEG), and W.G. Choi (MCM), and was assisted at headquarters by I. Alasal and R. Dumo (EUR). Staff met with the Bank of Slovenia Governor Boštjan Vasle, Minister of Finance Klemen Boštjančič, members of the Parliamentary Committee on Finance, other senior officials, representatives of the private sector, and labor unions.

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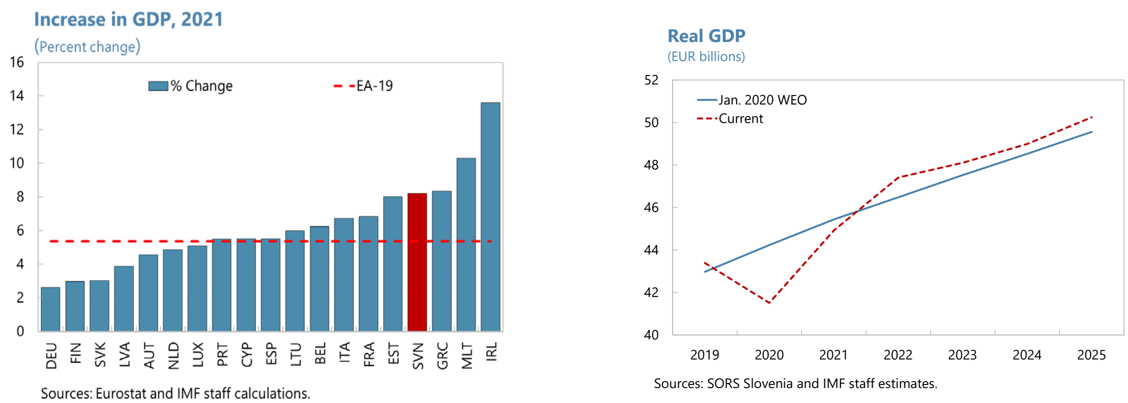
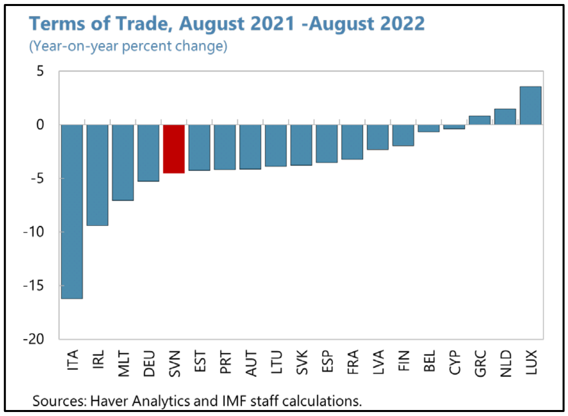
CONTEXT

1. **The Slovenian economy posted a strong, broad-based, post-pandemic recovery.** Following the phasing out of COVID-19 containment measures, GDP rebounded by more than 8 percent in 2021—above the euro area (EA) average, and surpassing its pre-pandemic level. Exports and private consumption were the main drivers of growth, the latter reflecting supportive policies, rising incomes, and lower household savings rates. Investment also picked up significantly, helped by higher public capital spending. On the supply side, activity recovered in most sectors apart from those services significantly affected by the epidemiological restrictions (travel, entertainment).

Figure 1. Slovenia: GDP Growth and Trend GDP



2. **Spillovers from Russia's war in Ukraine pose new challenges.**[1] Slovenia is affected mainly through commodity prices and external demand. Direct trade with Russia and Ukraine is small, although exposures are higher for specific industries (Annex I). The terms of trade deteriorated by about 4.5 percent YoY as of August 2022 and high energy and food prices are adding to inflation and reducing household real incomes. Dependence on Russian natural gas imports is high (about 80 percent) but the share of gas in the energy mix is just 12 percent. As of November, about 8 thousand refugees from Ukraine (0.4 percent of the population) had registered for temporary protection in Slovenia.



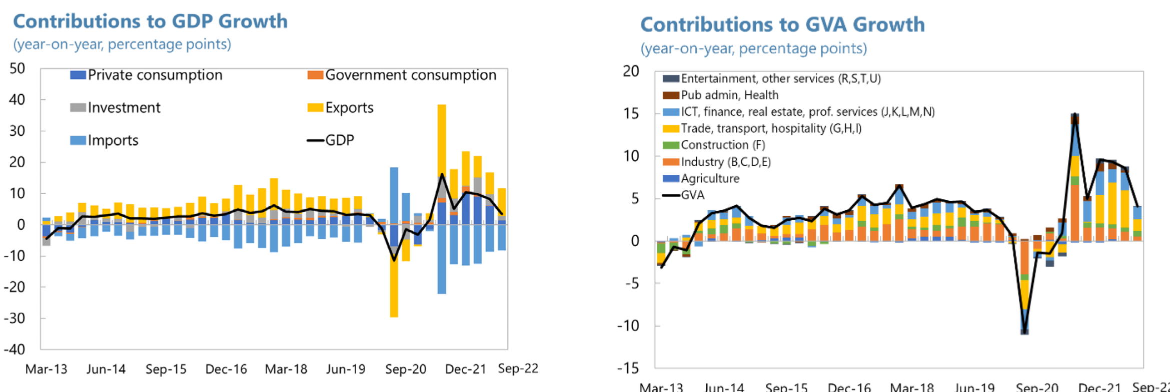
[1] In line with the EU-wide agreement, Slovenia has imposed sanctions on Russia and Belarus. An analysis of the global implications of the war in Ukraine and related sanctions can be found in the April 2022 World Economic Outlook.

3. A center left government came to power in June with an ambitious agenda. As an immediate priority, the government pledged to address rising energy and food prices. In the medium term, the focus would be on accelerating Slovenia's green transition, advancing the digital transformation, reforming healthcare, and pension systems to tackle challenges from ageing, increasing inclusiveness, and improving the social dialogue.

RECENT DEVELOPMENTS

4. Growth has continued into 2022, but has slowed noticeably. GDP increased by 9 percent year-on-year (YoY) in H1 on the back of robust domestic demand. The lifting of remaining COVID-19 restrictions boosted private demand. Growth was broad-based across sectors, and especially high in trade and services. However, preliminary estimates for Q3 suggest a significant slowdown, with GDP increasing by only 3.4 percent YoY, largely due to weakening of private consumption.

Figure 2. Slovenia: GDP and Gross Value Added



Source: Haver Analytics and IMF staff calculations

Source: Haver Analytics and IMF staff calculations.

5. Unemployment declined to historic lows and the labor market is tight. Policy support during the pandemic helped preserve jobs, and employment and hours worked recovered quickly. The registered unemployment rate fell to 5.3 percent in September, the lowest level recorded to date. Labor market conditions are tight, with shortages of workers especially acute in construction and in accommodation and food services where vacancy rates stood at 7 percent in Q3. This is despite the increased hiring of foreign nationals, which accounted for over half of the employment growth in January–September. The increase in the average gross wage was less than 6 percent in August YoY, but with private sector wage growth modestly higher. Still, real wage growth is negative across both the public and private sectors.

6. High commodity prices and supply bottlenecks amid strong demand have intensified inflationary pressures. Inflation stood at 10 percent in October, driven by external and domestic factors, largely because of energy but also because of intermediate goods price increases. Supply chain bottlenecks have led to high producer price inflation (21 percent in September) and, while the

balance has tilted towards supply shocks more recently, demand continues to contribute significantly to price dynamics (Annex II). Inflation has become broad-based and core CPI rose to 7 percent in October.

Figure 3. Slovenia: Labor Market Indicators

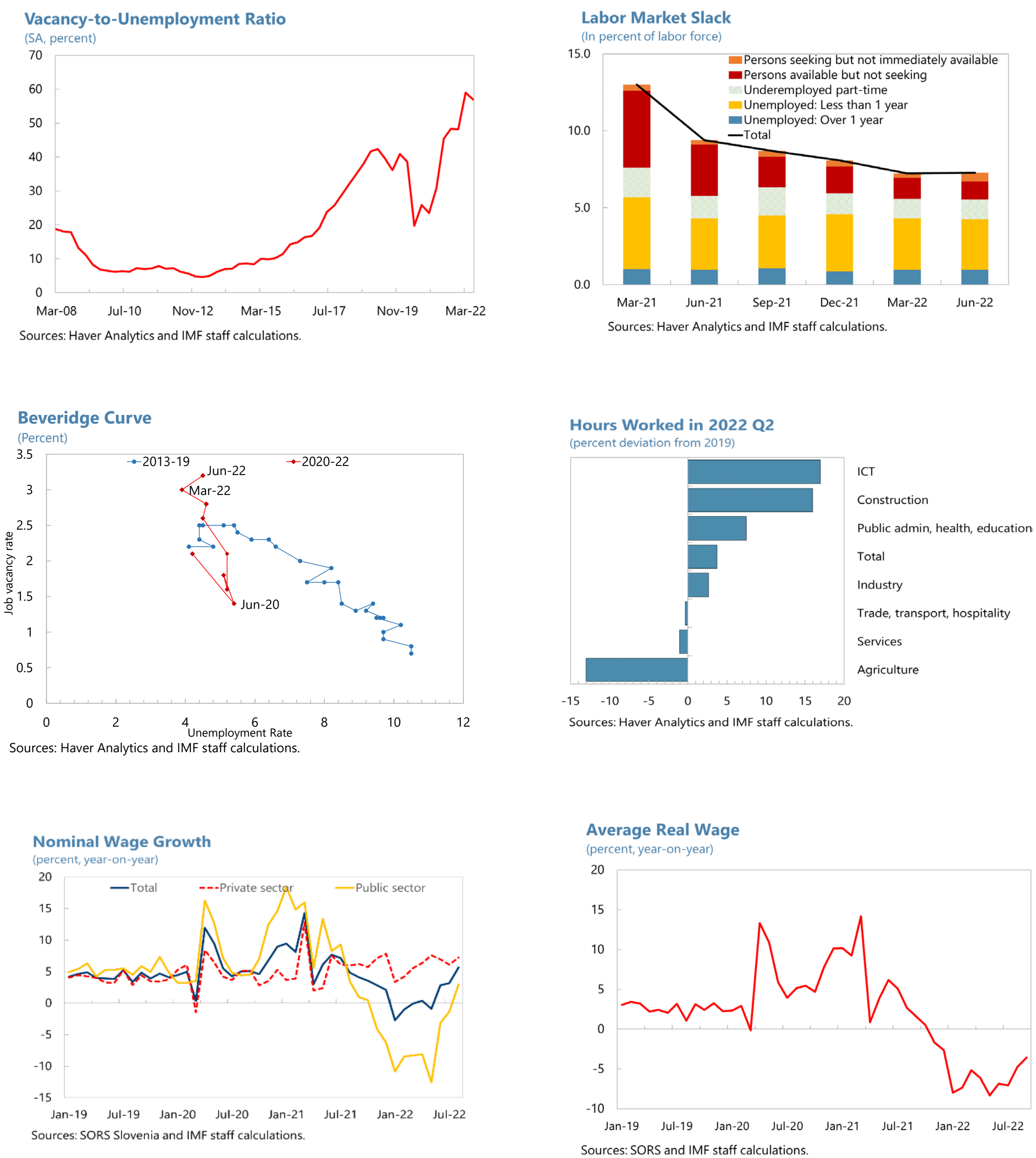
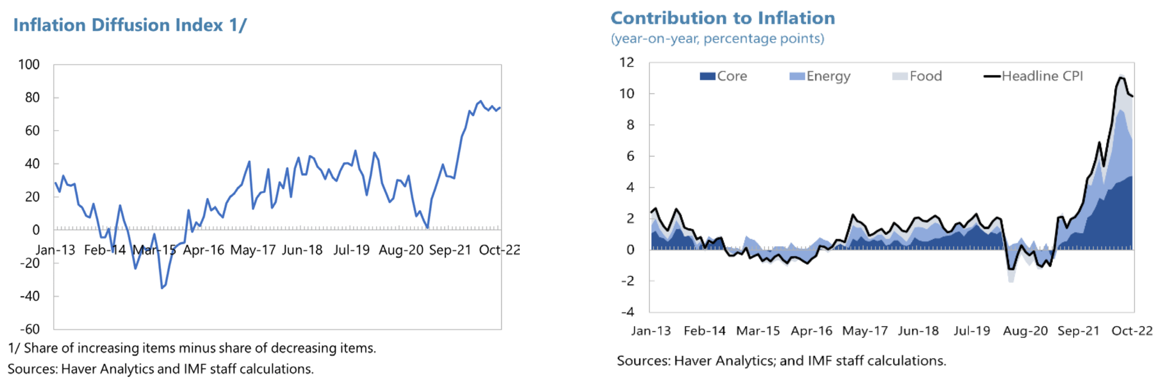
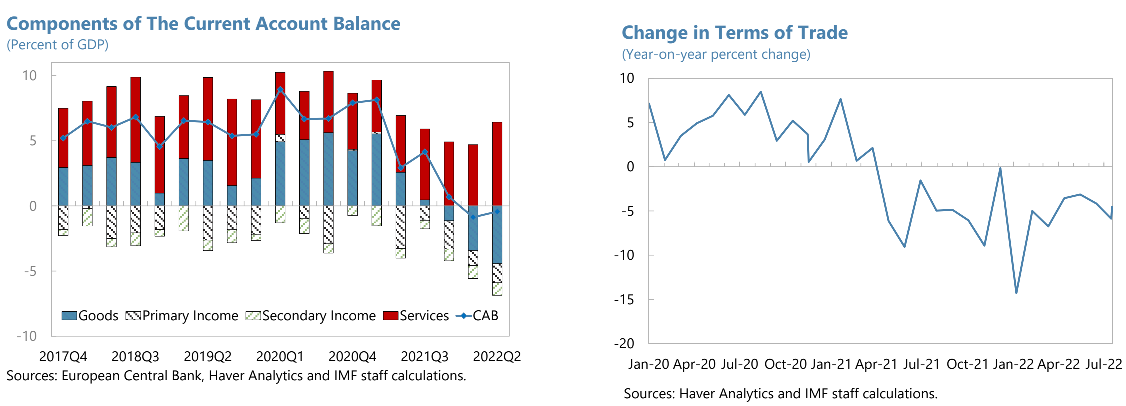


Figure 4. Slovenia: Inflation Developments



7. **Staff's preliminary assessment suggests that the external position in 2022 is moderately stronger than the level implied by fundamentals and desirable policies.** The current account surplus in 2021 stood at 3.8 percent of GDP—mainly driven by strong services performance, in particular travel and business services. However, a strong increase in energy prices and higher import volumes, backed by robust domestic demand, caused the current account balance to decline by 3.2 percent of GDP in the first nine months of 2022. The projected surplus for the year of 0.5 percent of GDP is higher than the norm suggested by the EBA-lite methodology (-0.4 percent of GDP, Annex III), implying a 1.1 percent current account gap and 1.8 percent REER undervaluation.

Figure 5. Slovenia: Current Account and Terms-of-Trade



8. **The fiscal balance improved in the first half of 2022 on the back of stronger revenue and the scaling down of COVID-19 support programs.** Revenue increased by 8 percent YoY, benefitting from strong indirect tax collections, while expenditure increased by less than 1 percent, reflecting the termination of most COVID-19 support measures. The deficit stood at about 1.6 percent of projected annual GDP, compared to 3.2 percent in 2021 H1. Starting from late

January, the government has put in place measures to mitigate the effect of high energy prices, with an estimated direct budgetary impact of 0.7 percent of GDP this year.

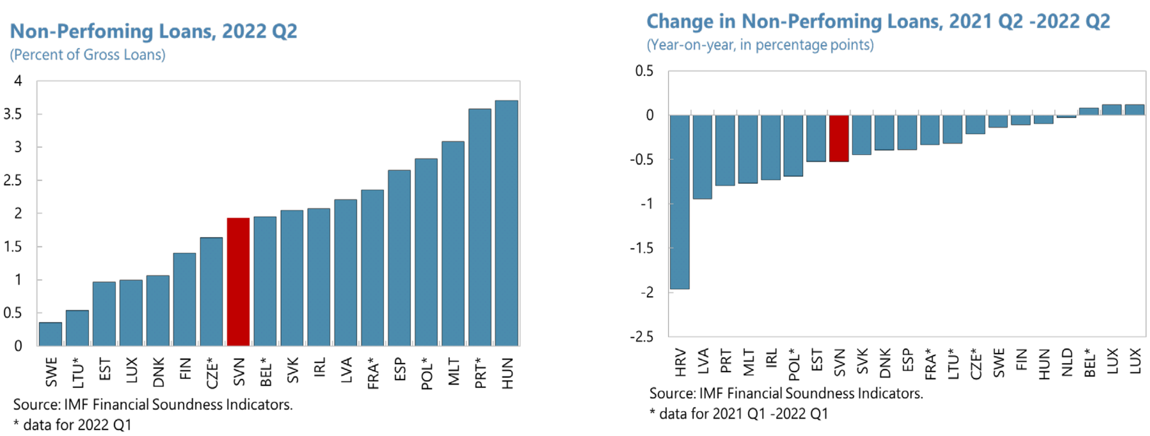
9. **The financial sector remains resilient, facilitating credit recovery.** Despite the withdrawal of COVID-19-related support measures, non-performing loans (NPLs) declined to less than 2 percent. Liquidity remains high, given ample domestic funding through deposits and the use of ECB's targeted longer-term refinancing operations (TLTRO). Credit growth increased to almost 13 percent in August, principally driven by loans to NFCs and housing loans. With the liquidation of Sberbank Europe in end-February, the shares of its Slovenian subsidiary were transferred to NLB, the largest domestic bank, resulting in an orderly transition.

COVID-19 Budget Measures

	2020	2021	2022	2023
Revenue measures	0.8	-0.6	-0.1	0.0
Expenditure measures	5.4	4.6	0.8	0.0
Labor market	2.7	1.0	0.1	0.0
Support to the economy	0.8	1.1	0.1	0.0
Healthcare	0.7	0.9	0.6	0.0
Social protection	0.4	0.2	0.0	0.0
Wages	0.7	1.4	0.0	0.0
Other	0.1	0.1	0.0	0.0
Total	6.2	4.0	0.7	0.0

Source: Slovenia Stability Program 2022

Figure 6. Slovenia: Financial Sector Performance



OUTLOOK AND RISKS

10. **Growth is expected to slow as external demand wanes and higher prices hurt consumption.** The Slovenian economy has demonstrated impressive resilience but the war in Ukraine is weighing on the outlook. The baseline assumes that the war continues but does not escalate, commodity price pressures ease, interest rates gradually increase in line with monetary policy normalization,[2] and fiscal policy is accommodative in 2023 and contractionary thereafter. Under the baseline, GDP growth in Slovenia is projected at 5.4 percent this year, slowing to 1.8 percent in 2023, mainly because of weaker demand, although supply constraints and labor shortages are expected to continue to affect output in certain sectors. Weaker demand in trading

[2] The forecast assumes that the ECB deposit rate increases to 3 percent by end-2023, in line with market expectations.

partners is expected to affect exports of goods and services, although in the baseline their growth remains positive, especially in tourism. Measures to mitigate the effect of high energy prices are helping to maintain purchasing power. Rising prices and uncertainty are, however, expected to curtail consumption growth going forward. The projected increase in investment reflects stepped-up public capital spending, including spending supported by EU funds (up by about 0.5 percent of GDP in 2023). With unemployment below trend and capacity utilization above the pre-pandemic average, the positive output gap is projected to widen to 3.4 percent in 2022, before closing by the end of the projection horizon. Growth in the medium term is projected at 3 percent (at around potential) and will be underpinned by investment and reforms, including in the National Recovery and Resilience Plan (NRRP). No scarring compared to the pre-pandemic trend is expected.

11. Inflation is expected to continue falling, but will likely remain elevated for some time. Staff's forecast for the average CPI increase is 8.4 percent this year, declining to 5 percent in 2023 as the pressure from energy and food prices is expected to abate, including because of administrative measures (tax cuts and price ceilings), and as higher interest rates take effect. With a tight labor market and stronger wage growth, second-round effects are becoming more likely. Core inflation is projected to decrease to 5 percent by end-2023.

12. Uncertainty is high and risks are mainly on the downside (Annex IV). The main risks stem from a possible escalation of the war in Ukraine and broadening of sanctions and countersanctions, which could lead to further commodity price increases, energy shortages, reduced external demand, and disruptions of supply chains. Rising commodity prices would fuel inflation and dampen growth, and may result in social discontent and spending pressures. Inflation could remain high for longer, possibly leading to higher inflation expectations. This could require a more aggressive tightening of monetary policy with implications for house prices and possibly for financial stability. Natural gas supply disruptions cannot be ruled out, but Slovenia's small size, its diverse energy mix, and its connectedness are mitigating factors. Domestic risks include possible intensification of wage pressures, especially if the expected minimum wage increase passes through to other wages, delays in public investments and other reforms, and a real estate market downturn. On the upside, continued energy price declines, a stronger-than-expected tourism rebound, and a possible acceleration of near-shoring would all benefit Slovenia.

Authorities' Views

13. The authorities agreed with staff's assessment. They noted that after an exceptionally strong recovery from COVID-19, activity is expected to remain robust in 2022, slowing in the second half of the year. Lower external demand, higher prices, and heightened uncertainty have affected the outlook and growth is expected to slow noticeably in 2023. Absent new shocks, the authorities agreed that headline inflation had passed its peak but that it would remain elevated in 2023. They also agreed that the labor market is tight, even though overall wage growth has lagged behind inflation. Spillovers from an escalation of the war in Ukraine are seen as the biggest risk, but risks have become more balanced as uncertainty around energy prices in the coming quarters has diminished from the peak at the end of the summer. Taking a longer-term perspective, they shared staff's view that the current account would remain broadly balanced.

POLICY DISCUSSIONS

Under the baseline, a tighter fiscal policy is warranted to help rein in inflation and to address Slovenia's relatively high debt burden. Should downside risks to the outlook materialize, however, timely, targeted, and temporary support should be provided to vulnerable households and companies that have been affected significantly by the high energy prices and that were in good financial standing before the crisis. Sustained fiscal consolidation based on high-quality measures is needed in the medium term to combat demographic-related spending pressures. Continued close monitoring and supervision of the financial sector is warranted, given the spillovers from the war; fast-growing house prices are worth watching closely and recent changes in macroprudential policies are welcome. Structural policies should remain focused on investment in energy security and green technologies, enhancing labor supply and advancing digitalization.

A. Fiscal Policy

14. The fiscal balance is projected to improve this year, largely because of the phasing out of COVID-19 support. Because of strong revenue performance and the winding down of most COVID-19 measures, staff projects that the overall deficit will improve to 3.1 percent of GDP this year compared with 4.1 percent in the April 2022 Stability Program. In structural terms, the improvement is estimated at 1 percent; without the phasing out of pandemic-related support, however, the structural deficit would have increased by more than 2 percent of GDP, mainly due to higher capital spending and energy support measures. Public debt is projected at 70.5 percent of GDP by end-2022, declining to 62 percent of GDP over the medium term; debt remains sustainable but is vulnerable to shocks (Annex V). Active debt management policy, including pre-financing during favorable market conditions and replacing high-interest debt with lower-interest debt, has helped accumulate a significant cash buffer and net debt is estimated at 53 percent of GDP in 2022.

Indicators of Fiscal Performance
(percent of GDP)

	2020	2021	2022	2023
Level				
Overall balance	-7.7	-4.7	-3.1	-4.8
Cyclically adjusted balance	-6.5	-5.4	-4.5	-5.5
Structural balance	-6.5	-5.4	-4.4	-5.2
Structural balance excl. COVID-19	-0.3	-1.4	-3.7	-5.2
Change				
Overall balance		3.1	1.6	-1.7
Cyclically adjusted balance		1.1	0.9	-1.0
Structural balance		1.1	1.0	-0.8
COVID-19 support		-2.2	-3.4	-0.6
Capital expenditure		0.5	1.1	0.8

Sources: Slovenian authorities and IMF staff calculations

15. A tighter fiscal stance is warranted in 2023 to help contain demand pressures, support disinflation efforts, and lower public debt over time. The authorities' budget plan envisages a fiscal deficit of 5 percent of GDP in 2023, largely due to a contingency fund (about 2 percent of GDP) to finance future energy support measures. However, against the background of tight labor market and rising core inflation, an increase in expenditure of such magnitude would be counterproductive as it would fuel domestic demand further and add to inflation pressures. A tighter fiscal position should be adopted while maintaining—if needed—targeted and temporary policy support to alleviate the impact of high energy and food prices on the vulnerable. It would be prudent to save part of the contingency fund and aim to reduce the fiscal deficit in cyclically

adjusted terms by ¼ to ½ percent of GDP relative to 2022. This would also reduce the government's gross financing needs, which are currently projected to increase by 3.5 percent of GDP next year.

16. Should downside risks materialize, automatic stabilizers should be allowed to operate fully, and flexibility should be maintained to respond to the changing conditions. The specific policy response should depend on the type and severity of the shock. In particular, high-quality discretionary spending could be deployed to offset the impact of a large adverse demand shock, but such measures should be temporary and targeted to avoid a weakening of the fiscal position in the future.

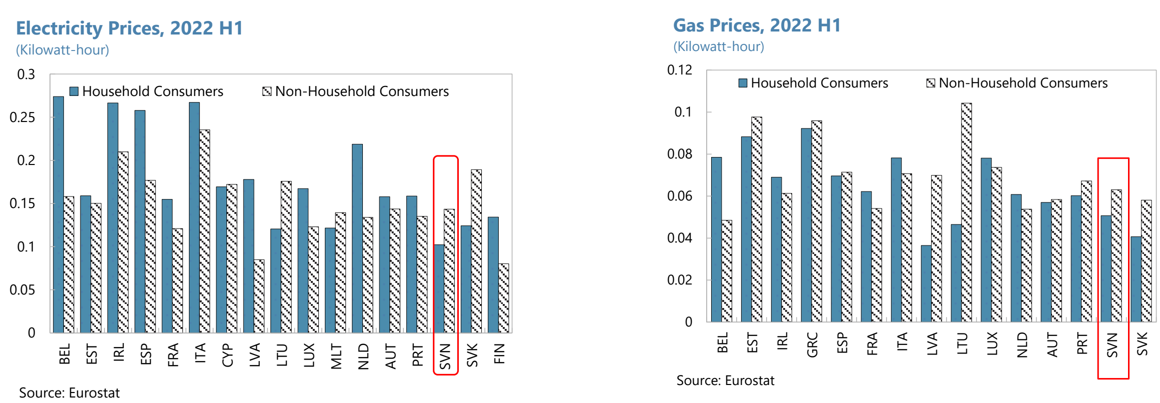
17. The authorities have taken a wide range of measures to help households and firms cope with rising energy prices. These include vouchers for vulnerable households, reduction of excise duties on energy, suspension of payments of network charges, reduction of environmental taxes and contributions, and price caps.[3] While some of the measures have been appropriately designed to support those in need, many involve across-the-board compensation mechanisms. Such untargeted support is inefficient, costly and delays the adjustment to higher prices by not providing sufficient incentives to save energy.

Policy Response to High Commodity Prices

Measure	Estimated impact (percent of GDP) 2022	2023
VAT rate reduction from 22 to 9.5 percent for electricity, gas, heating	0.1	0.1
Reduction of excise duties on gasoline, diesel, heating oil and natural gas.	0.2	0.0
Temporary decrease of CO2 duties and surcharges for RES and high-efficiency cogeneration	0.0	0.0
Cash vouchers to to people with disabilities, recepients of social assistance and pensioners with low pensions	0.2	0.0
One-off financial assistance to vulnerable households	0.0	0.0
Support to firms for high energy prices	0.1	0.0
Compensation to food producers	0.1	
Compensation to farmers	0.1	0.0
Reserve fund for wheat purchase	0.0	0.0
Recapitalization of energy companies 1/	0.0	1.2
Unspecified measures 1/	0.0	0.8
Measures with direct budgetary impact	**0.7**	**2.2**
Government guarantees for energy companies 2/	0.5	0.0
Grand total	**1.2**	**2.2**

Sources: Slovenian authorities and IMF staff calculations
1/ Contingency fund in the 2023 budget.
2/ Amount used out of EUR 1.6 billion (2.7 percent of GDP) available.

Figure 7. Slovenia: Electricity and Gas Prices

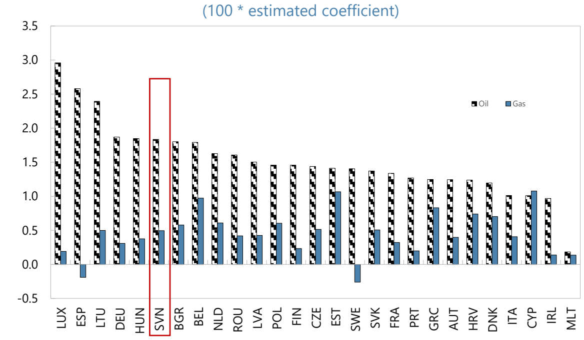


[3] In July, the government introduced maximum retail prices for electricity and natural gas for households and small commercial customers for one year from September 1. The price ceilings are set for each 1 kWh at levels 38 percent lower for electricity and 4 percent lower for gas than the prevailing prices in Q2.

18. Support to alleviate the impact of high energy and food prices should be temporary and more targeted. The untargeted measures currently in place should ideally be replaced with time-bound and well-targeted support to vulnerable households. Potential support to firms should be limited to companies that have been affected significantly by high energy prices and that were in good financial standing before the crisis and should include incentives to increase energy efficiency. Support to firms would also need to comply with the EU state aid framework. The current price caps on electricity and natural gas could be replaced with block tariffs applying to a basic consumption level, while allowing market prices to apply to the rest of the energy consumed to spur energy savings.[4] Policies to lower carbon taxation that could potentially undermine the commitment to green transition should be avoided where possible or reversed as soon as feasible.

19. A sustained, growth-friendly, fiscal consolidation would help rebuild fiscal buffers in the face of rising age-related spending pressures. Slovenia's relatively high debt and the long-term challenges from ageing call for fiscal consolidation and structural reforms to bolster the sustainability of public finances. Reducing the cyclically adjusted deficit by about ¾ percent of GDP per year on average from 2024 onwards would bring the budget to balance over the medium term. (Much of this adjustment would come in 2024 because of the planned unwinding of the energy measures.) Improving the tax policy mix, strengthening revenue administration, and pursuing expenditure reforms would create fiscal space; EU funds would help to partly offset the growth impact of consolidation. Staff's past advice remains largely relevant:

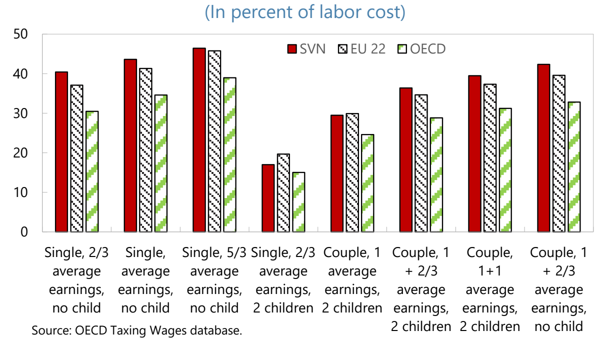
Oil and Gas Price Pass-Through to HICP
(100 * estimated coefficient)



Sources: ELSTAT; Eurostat; Haver Analytics; IMF, WEO database; and IMF staff calculations.
Note: Coefficients are estimated by regressing the log-difference of HICP on the log-differences of oil and natural gas prices. Monthly dummies are included.

- *Tax policy and revenue administration.* Slovenia's labor tax wedge could be reduced as it is higher than the OECD average. The associated loss of revenue would need to be offset by raising less distortive taxes and/or broadening the tax base. In particular, a strong case exists for increasing property taxation (currently among the lowest in the OECD), which would also help to cool the real estate market. Estimates suggest that adjusting property taxes and broadening the bases for VAT, PIT and CIT could generate 1.5 percent of GDP in additional revenue.[5] Efforts should continue to improve revenue administration, including

Average Tax Wedge, 2021
(In percent of labor cost)



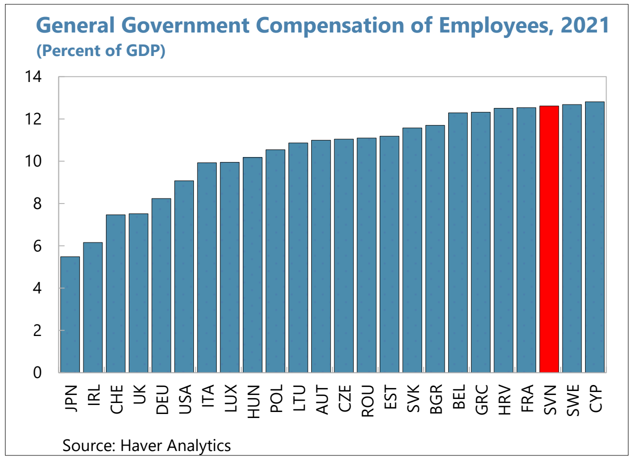
Source: OECD Taxing Wages database.

[4] For its part, the government has introduced measures to conserve electricity in public buildings by introducing recommended temperature ranges.

[5] See Republic of Slovenia: 2018 Article IV Consultation, IMF Country Report No. 19/58.,

compliance risk management with a focus on large taxpayers, drawing on recent IMF TA. Regular progress reports from the Financial Administration to the Ministry of Finance would be helpful.

- *Expenditure policy*. The fiscal cost of population ageing is a key long-term concern. Estimates suggest that, over the next fifty years, spending on pensions will increase by 6 percent of GDP, and healthcare and long-term care could add another 3 percent of GDP, absent policy changes.[6] Improving the adequacy and ensuring the sustainability of the pension system should, therefore, be a priority, and reform proposals should be prepared without delay (Q2 2023 NRRP milestone). Options could include adjustments to the minimum retirement age, which should in turn be linked to demographic trends, and new indexation rules.[7] Rationalizing current expenditure and making it more efficient would create additional fiscal space. In particular, the wage bill is relatively high by international standards. The reforms included in the NRRP to modernize the public sector wage system—by introducing differentiated remuneration and linking it to performance—would increase flexibility and allow for better wage bill management.



- *Public financial management*. The significant scaling up of public investment, supported by EU funds, comes with associated implementation risks, especially in the context of labor shortages, supply chain disruptions, and rising prices. Further improving public investment management is, therefore, critical. The authorities are encouraged to participate in the IMF's Public Investment Management Assessment (PIMA) program, possibly combined with a climate PIMA, to obtain a comprehensive assessment of current practices and specific advice on how to further strengthen governance and increase efficiency. Monitoring and management of fiscal risks (e.g., macro-fiscal and from contingent liabilities) has become increasingly important in a highly uncertain environment. Recent IMF TA recommendations on extending the authorities' analytical toolkit and capabilities provide a good basis for enhancing the risk assessment framework.

Authorities' Views

20. The authorities concurred with staff's views. They acknowledged that tight fiscal and monetary policies should work in tandem to reduce inflation and noted the need to mitigate the impact of high energy prices on vulnerable households and businesses. The authorities noted that policies in other EU countries have important competitiveness implications for Slovenia and underscored the importance of coordinated action. They motivated the substantial increase of the

[6] European Commission (2021), "The 2021 Ageing Report: Economic and Budgetary Projections for the EU Member States (2019–2070)".

[7] See OECD "Reviews of Pension Systems: Slovenia" for a detailed analysis of policy options.

contingency fund with the need to act quickly and flexibly to new energy price shocks; the amount actually spent and modalities of support would depend on economic and energy price developments, with the headline 5 percent deficit for 2023 envisaged as a ceiling, and not a target. The authorities are committed to improving the targeting of energy support measures.

21. The authorities recognized the importance of structural fiscal reforms for the long-term fiscal sustainability. A tax reform package will be prepared next year and will consider the tax burden on labor and property and will look at tax incentives. However, the existing framework imposes certain constraints, including that property taxes are currently determined at the municipal level. On spending, the authorities have prepared hypothetical pension reform scenarios, involving adjustments to the retirement age, accrual rates and pension indexation rules, and a complementary second pillar is being discussed; the options will be assessed carefully to design a comprehensive reform plan. Also, a review of the public sector wage system to better tie compensation to performance will be undertaken in line with the NRRP. The authorities stressed that for both tax and spending reforms, support from stakeholders will be key to ensure buy-in. Finally, the authorities reconfirmed their commitment to improving public financial management and expressed a strong interest in participating in the PIMA.

B. Financial Sector Policies

22. Slovenian banks are liquid and well-capitalized, but risks are increasing. The banking system has ample liquidity and capital buffers. Non-performing exposures (NPE) remain low at 1.2 percent overall (as of August), although in certain segments, notably accommodation and food services, and loans previously under moratoria, the ratio is higher. While direct cross-border exposure to Russia and Ukraine is limited, spillovers could indirectly affect banks' asset quality. Rapid house price growth has raised concerns over possible real estate overvaluation and associated credit risks, but housing debt remains low and mortgage loans are increasingly at fixed rates (Box 1). Nevertheless, rising interest rates also increase repayment and rollover risks, in particular for corporate loans, where the share of variable interest rates is high. In early October, and reflecting these factors, the Bank of Slovenia assessed risks to the financial system as elevated.[8] In the past ten years Slovenia implemented the key recommendations of the 2012 FSAP, introducing ECB rules and strengthening its legal framework on banking governance, crisis preparedness, and resolution.

23. Slovenian banks are profitable and their net interest margins (NIMs) are expected to improve. Profits increased in 2021 primarily due to a net release of impairments and provisions. The normalization of monetary policy is expected to strengthen NIMs. Looking ahead, it will be important to continue to keep costs under control and explore avenues for improving banking sector profitability in the medium term. Among other factors, these might include deepening intermediation, greater use of digital technologies, and expanding the range of products

[8] Press Release dated October 4, 2022, at https://www.bsi.si/en/media/1913/financial-system-in-slovenia-remains-stable-elevated-risks-amid-change-in-economic-situation

and services. Cyber risks should continue to be monitored closely, and contingency plans put in place to allow for an appropriate response.

24. The macroprudential stance is appropriate and the authorities should continue to monitor closely bank asset quality. Special attention is needed for loans under moratoria and sectors heavily affected by COVID-19 and by high energy prices. Consistent with staff's views, and given elevated risks to the financial system, the Bank of Slovenia increased the countercyclical capital buffer (CCyB), from zero to 0.5 percent of the total risk exposure amount. Macroprudential policies should remain flexible to ensure the right balance between financial stability and credit supply to the economy.

25. Real estate market developments have prompted a welcome regulatory response. To contain risks arising from steep real estate inflation, the Bank of Slovenia modified its macroprudential toolkit from July 1st. The recommended loan-to-value ratio (LTV) was reduced from 80 to 70 percent for non-primary residences. Using the provisions of Capital Requirements Directive V, the authorities have also adopted a sectoral systemic risk buffer from January 2023 with an estimated cost of 10 percent of banks' earnings to account for additional risks arising from the allowed deviation from macroprudential rules.

26. Efficient restructuring mechanisms and insolvency frameworks could facilitate capital reallocation. The authorities are reforming the insolvency framework under the EU Directive on Restructuring and Insolvency.[9] Staff welcomes these reforms as they seek to help companies in difficulty access restructuring measures at an early stage, to lay down minimum rules on the discharge of debt carried by insolvent entrepreneurs, and to increase the efficiency of preventive procedures.

27. Also on restructuring, legacy loans will need to be handled carefully and steps taken to prevent a recurrence. The entry into force of the Law on Mitigation and Allocation of Currency Risk Between Lenders and Borrowers in Swiss Francs would impact adversely the profitability (and capital) of some banks.[10] The authorities should encourage voluntary loan renegotiations based on the individual ability to repay, while avoiding changing past contracts for all borrowers. Looking ahead, lending in foreign currencies to unhedged borrowers, including households, should be discouraged through regulatory changes as needed.

28. Ongoing efforts to strengthen the anti-money laundering and combating the financing of terrorism (AML/CFT) framework should continue. After the MONEYVAL 2017 Mutual Evaluation Report (MER), the authorities made good progress in bolstering the AML/CFT regime by enhancing supervision of financial institutions and other covered entities and creating a Beneficial Ownership Register with a view to ensuring that accurate and up-to-date beneficial ownership information of legal persons is available to competent authorities. Based on the

[9] Directive 2019/1023 was adopted by the EU Parliament and the Council of the EU in June 2019.

[10] In January 2022, the parliament adopted a law aimed at protecting about six thousand borrowers in CHF from currency risk. The law is currently under review by the Constitutional Court.

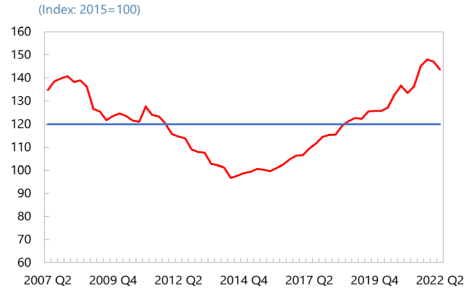
MONEYVAL 2022 follow-up report on Slovenia, the authorities have prepared legislative amendments to bring the terrorism financing offense and the definition of virtual asset service providers (VASPs) fully in line with Financial Action Task Force (FATF) Standards, and impose a declaration obligation on the cross-border physical transportation of cash and bearer negotiable instruments. Nevertheless, further moves would help bolster the effectiveness of the AML/CFT regime, including reinforcing ML investigations and convictions and bringing them in line with the country's risk profile.

Box 1. Housing Market Developments

House prices have increased sharply in Slovenia. Prices of residential real estate increased by 15½ percent YoY in 2022 Q2, above the EA average of almost 10 percent. Analysis by the Bank of Slovenia suggests that from Q4 of 2021, all relevant indicators point to overvaluation, with the composite indicator suggesting a maximum overvaluation of about 16 percent in 2022 Q2.[1] While housing loans increased last year, the stock of mortgages remains low compared to EU peers.

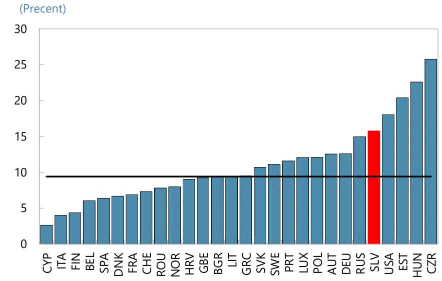
House prices are mainly explained by rising demand and a slow supply response. With low deposit rates and limited availability of alternative investment instruments, real estate is also seen by many as an opportunity to protect the value of savings. Limited new construction over past decades compounded these demand effects. The recent increase in construction costs, driven by supply chain issues and labor shortages is also adding to price pressures. Over the medium term, however, the recovery in the number of building permits and positive business tendencies in construction are expected to help counteract these factors.[2]

Real House Price Index
(Index: 2015=100)



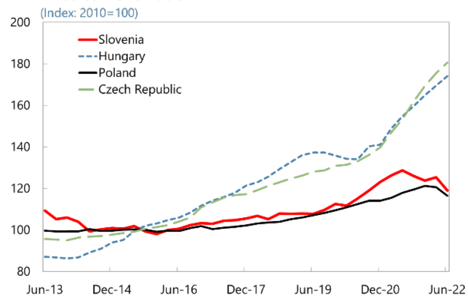
Sources: OECD and IMF staff calculations.

House Price Increases in 2021
(Precent)



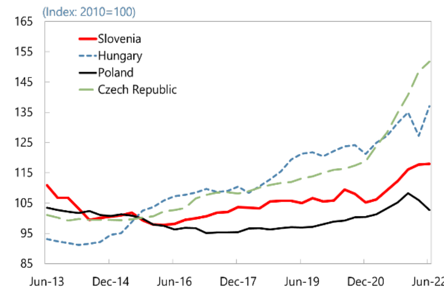
Source: BIS; and IMF staff calculations.

Price to Rent Ratio
(Index: 2010=100)



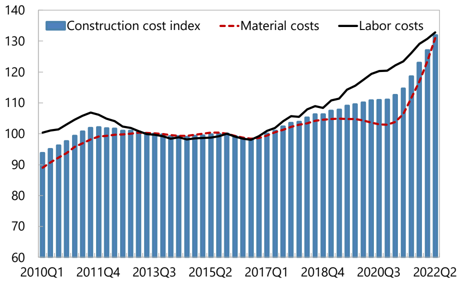
Source: OECD.

Price to Income Ratio
(Index: 2010=100)

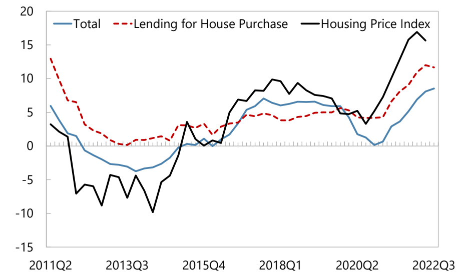


Source: OECD.

Box 1. Housing Market Developments (Concluded)



Source: SORS.



Sources: Haver Analytics and IMF staff calculations.

[1] The ratio of real estate prices to disposable income is less than 20 percent. See Bank of Slovenia Financial Stability Report, October 2022.
[2] The number of new dwellings on the market was up by 23 percent year-on year in 2022 H1.

Authorities' Views

29. The authorities agreed that the banking sector appeared resilient but that risks were increasing. The authorities remain vigilant to the possible impact of lower economic growth on credit quality. They monitor financial sector risks from many angles and employ an array of tools to assess risks, working closely with the SSM to monitor the risks of the largest banks. They have also intensified the surveillance of exposures to certain at-risk sectors and vulnerable borrowers. The Bank of Slovenia has also scheduled the EBA's comprehensive bottom-up stress test for 2023.

30. The authorities agreed that risks associated with residential real estate are elevated. They noted that the macroprudential measures, now including two sectoral systemic risk buffers on all retail exposures to natural persons that are secured by residential property and all other exposures of natural persons, which complement existing borrower-based measures, are adequate, without being overly intrusive.

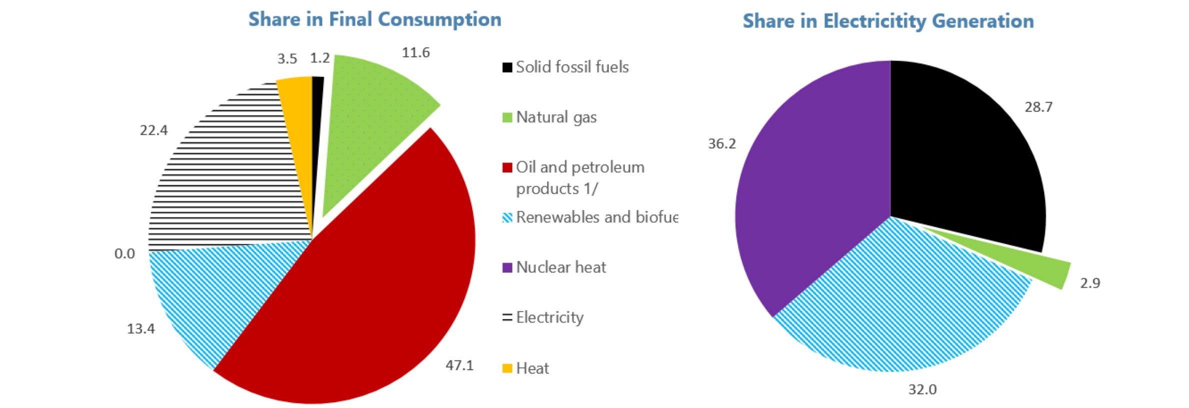
31. The authorities noted the progress made in strengthening the AML/CFT framework. They have updated the criminal code through a new draft law, soon to be approved by Parliament. Amendments include the criminalization of terrorism activities, while the regulation of cash couriers will apply uniformly to all concerned entities. The authorities have defined virtual asset service providers in line with the FATF glossary and have upgraded the registry of beneficial owners.

C. Structural Policies

32. Energy security has become a key policy priority, but the diverse energy structure mitigates the risk of gas supply disruptions. Slovenia depends heavily on oil and gas imports where Russia remains an important supplier. Slovenia is susceptible to high international energy prices and the associated cost-of-living pressures, and remains somewhat vulnerable to severe disruptions in supplies—such as those caused by a complete Russian gas shutoff. Risks are mitigated, however, by the relatively diversified domestic energy mix and the availability of alternative gas suppliers (Algeria, LNG through Croatia). In addition, the majority of electricity is

generated using solid fossil fuels, hydropower, and nuclear fuel (supplied from sources outside of Russia). Despite these risk mitigants, the authorities should make contingency plans and secure sufficient alternative supplies to avoid domestic consumption disruptions. Guided by EU initiatives,[11] the authorities should also identify additional measures that could increase energy savings and encourage a wider use of renewables. Over the longer term, it is important to continue to diversify energy supplies and further develop renewables to reduce dependence on fossil fuels, in line with the REPowerEU initiative.[12]

Figure 8. Slovenia: Role of Natural Gas in the Energy Mix



Sources: Eurostat and IMF staff calculation.
1/ excluding biofuel portion.

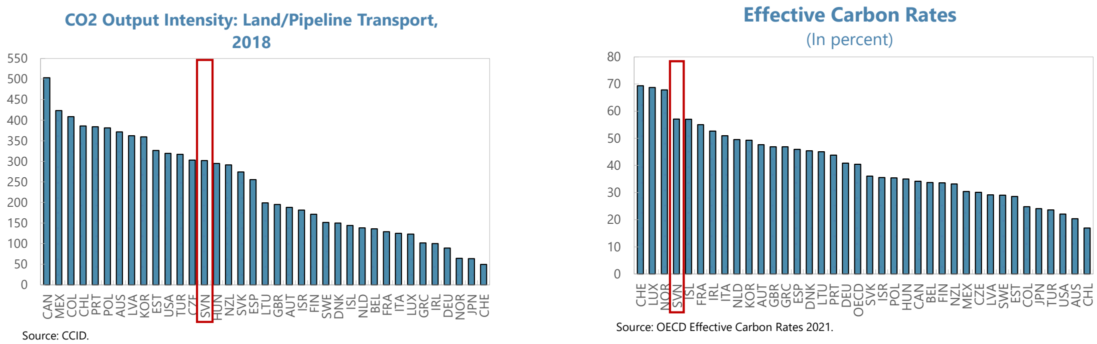
33. Measures to bolster the resilience of the energy sector should be compatible with the green transition goals. While in case of severe gas supply disruptions, it may be necessary to temporarily resort to more polluting energy sources to secure short-term energy supply,[13] the authorities' long-term goal remains anchored by carbon emission commitments in line with the EU climate objectives. Reforms and investments under the authorities' NRRP should continue to promote renewable energy sources and enhance the climate resilience of infrastructure and other assets, thus diversifying the energy mix and supporting climate adaptation over longer term. The authorities should also continue to step-up efforts to reduce the carbon footprint of the economy, including by taxing more heavily, and reforming, the most polluting industries. Slovenia already has relatively high effective carbon tax rates, mostly in the form of taxes on energy, but energy-reliant sectors such as transport and some industries continue to benefit from exemptions or low carbon tax rates. Carbon prices high enough to provide the right incentive for these sectors should be put in place over time as the energy crisis abates.

[11] See Press Release Save Gas for a Safe Winter and Emergency Measures to Reduce Energy Prices.

[12] See REPowerEU: Affordable, Secure and Sustainable Energy for Europe.

[13] The authorities have made legislative changes to grant temporary derogation to thermal power plants from emission limits, enabling them to switch from natural gas to heating oil or liquefied petroleum gas on short notice if necessary.

Figure 9. Slovenia: CO2 Intensity and Carbon Taxation

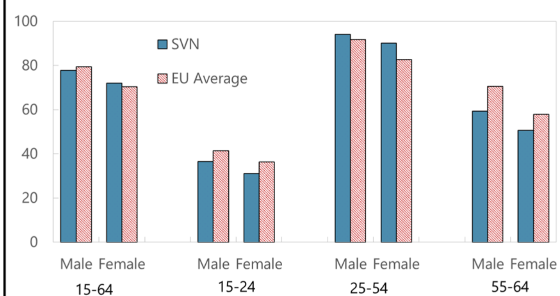


Source: CCID.

Source: OECD Effective Carbon Rates 2021.

34. The tight labor market calls for policies to stimulate labor supply. As ageing will continue to reduce the working-age population, sustained growth requires incentivizing less active groups to participate in the labor market, supplemented by continuing to attract foreign labor as needed. Slovenia's participation rate is currently on par with the EU average, reflecting an active prime-age (25–54) cohort, but participation of youth[14] and especially the older cohort (age 55 and above) underperforms. Disincentives include a high labor tax wedge (generally above peers), unemployment and pension policies that encourage early exit from the labor market, and other barriers (e.g., skill mismatches, inflexible work arrangements). Active labor market policies (ALMPs) need to be aligned with market needs and shift the focus from protecting existing jobs to assisting transitions between jobs or into jobs.[15] Complementary measures to improve the business climate should also be undertaken to enhance the efficiency of public administration and reduce the administrative burden on businesses, including the compliance burden on taxpayers by increasing efficiency, simplification, greater transparency, and tax certainty. Meanwhile, targeted measures should be deployed to increase the employability of less advantaged groups (youth, the elderly, low-skilled). The education and training agenda should be adapted to meet new demands from the ongoing green and digital transitions. Lastly, consideration could be given to easing the access of migrant workers to the Slovenian labor market, including, for example, by reducing administrative barriers and improving integration.

Participation Rate, 2021
(In percent of respective population)



Sources: Labor Force Survey; Haver Analytics; and IMF staff calculation.

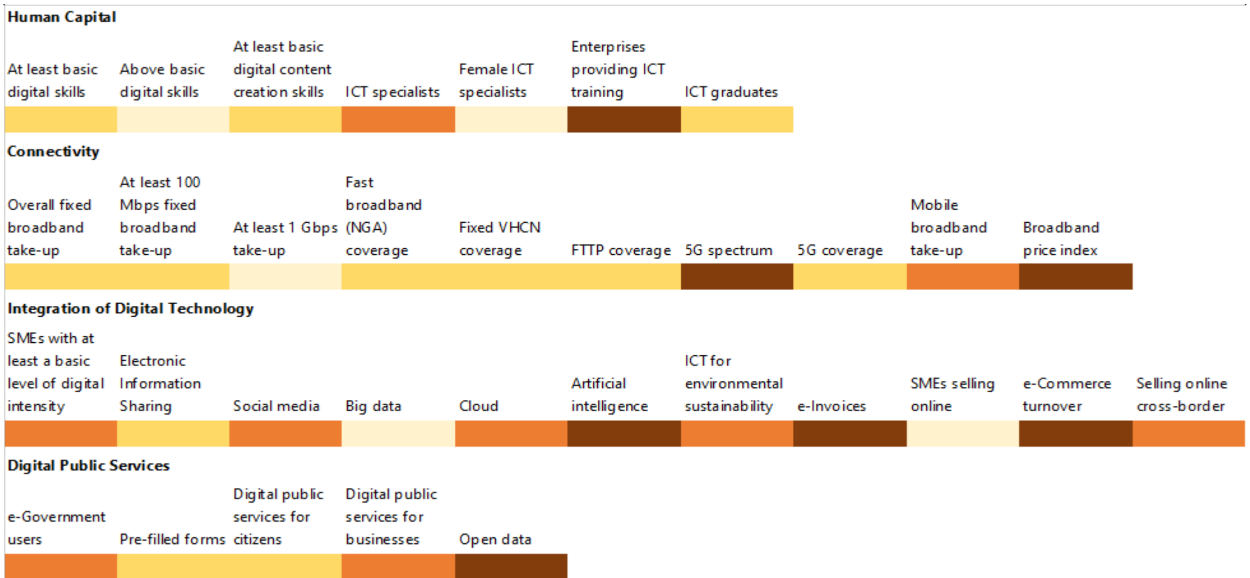
35. Further strengthening Slovenia's digital transformation would enhance productivity. Slovenia has made commendable progress and compares favorably with EU peers. Some gaps

[14] The relatively low youth participation rate mainly reflects low participation of people aged 15–19 who engage in other activities such as schooling and thus delay access to the labor market.

[15] The *OECD Economic Surveys Slovenia* finds that Slovenia features relatively low job-to-job transition and hiring from non-employment compared with the OECD peers.

remain, however, in digital skills, the use of internet, and the integration of digital technologies in businesses and public services. The NRRP is expected to play an important role in closing these gaps through reforms and capacity building projects, with a catalytic effect for private sector investments. If implemented well and without delay, the digital agenda would positively contribute to future productivity and output growth.

Figure 10. Slovenia: The Digital Economy and Society Index, 2022



Sources: European Commission, the Digital Economy and Society Index (DESI); and IMF staff calculation.
Note: Light yellow, orange, dartk orange and brown indicate, respectively, that Slovenia's value falls in the 1st (lowest), 2nd, 3rd, and 4th (highest) quartile among the EU members.

Authorities' Views

36. The authorities continue to address energy security and remain committed to their climate goals. In line with EU initiatives, the authorities have developed a comprehensive strategy to ensure energy security, with mandatory storage requirements for gas suppliers, contingency policies for switching to alternative fuels, and incentives for voluntary reduction of gas consumption. Slovenia's well-connected network allowing ready access to energy supply from neighbors minimizes the risk of severe disruptions of energy supply. The authorities remain committed to their long-term climate goals and continue to implement their National Energy and Climate Strategy to promote renewables, upgrade transmission and distribution networks, and improve energy efficiency and resilience.

37. The authorities agreed that structural reforms are key to enhancing economic resilience and sustaining growth. Training and ALMPs continue to be deployed to address barriers to participation, including targeted measures to youth (additional personal tax allowance, subsidized employment programs), long-term unemployed, low-skilled elderly people, and workers in sunset industries, with co-financing from EU sources in some cases. Given ageing-related challenges, emphasis has been put on lifelong learning to enhance the digital skills and tackle other gaps.

Recent policies to grant partial pensions to eligible pensioners remaining in employment have helped raise participation of the age 55-59 cohort substantially. [16] Efforts continue to be made in digitalizing public services, investment in digital infrastructure, and training and awareness. Further reforms are planned to promote the current open data framework and its use by the public.

STAFF APPRAISAL

38. After an impressive post-pandemic recovery, Slovenia has continued to achieve strong economic growth, but the outlook has become more challenging. Real GDP increased by more than 8 percent in 2021, thus surpassing its pre-pandemic level, and economic activity remained strong in 2022. Staff's preliminary assessment suggests that the external position in 2022 is moderately stronger than the level implied by fundamentals and desirable policies. The war in Ukraine poses considerable challenges, however, mainly through weaker external demand and high commodity prices, which are weighing on the economy. Growth is expected to slow in 2023 with downside risks stemming mainly from war-related spillovers. Inflation is expected to fall, but remain elevated, possibly triggering higher wage demands and higher inflation expectations.

39. A tighter fiscal stance is warranted in 2023 and energy price mitigation measures should be more targeted. Tight fiscal policy should support monetary policy in the effort to reduce inflation. With a positive output gap, tight labor market, and rising core inflation, it would be prudent to save part of the large contingency fund and to reduce the fiscal deficit in cyclically adjusted terms relative to 2022. Public debt remains sustainable but is vulnerable to shocks. Temporary and targeted support should be deployed to protect the vulnerable against high energy prices and less targeted measures should be phased out. Should downside risks materialize, automatic stabilizers should be allowed to operate fully and in case of a large adverse demand shock consideration could be given to deploying discretionary fiscal stimulus.

40. A growth-friendly consolidation would help rebuild fiscal buffers. Improving the tax policy mix to reduce reliance on labor taxes, while increasing property taxes and broadening the tax base, could generate additional revenue and induce a positive labor supply response. Reforming the pensions, health, and long-term care systems is a priority. On pensions, which account for the bulk of age-related fiscal costs over the long term, options include gradual adjustments to the retirement age and to indexation rules. Modernizing the public sector wage system by better linking remuneration to performance would align incentives and allow for better wage bill management. Further strengthening public investment management is also critical given the envisaged scaling up of public investment.

41. Slovenia's macroprudential stance is appropriate but risks have increased. Given systemic risks, the recent increase in the countercyclical capital buffer from zero to 0.5 percent is welcome. Macroprudential policies should remain flexible to ensure the right balance between

[16] People eligible to retire are allowed to receive 40 percent of their pensions over the first three years and 20 percent in subsequent years, in addition to their salary, if they decide to continue work. This policy has raised the active rate for the age 55–59 cohort to close to the EU average.

financial stability and credit supply to the economy. Continued close monitoring of asset quality and appropriate loan-loss provisioning remain important. Legacy Swiss franc loans should be handled on an individual basis and stability of contracts should be ensured.

42. **Efforts should continue to be made to further strengthen the AML/CFT and restructuring frameworks.** The focus should be on enhancing supervision to ensure that accurate and up-to-date beneficial ownership information of legal persons is available to competent authorities, and reinforcing ML investigations and convictions. The transposition of the relevant EU legislation and its implementation is important for restructuring.

43. **Measures to increase energy security should be compatible with Slovenia's green transition.** The authorities should continue their efforts to ensure alternative gas supplies, encourage energy savings, and prepare contingency plans. While temporary reliance on more polluting energy sources may be needed in the short term, it is important to continue to keep a focus on long-term climate goals, including by further developing renewables to reduce dependence on fossil fuels. Carbon prices high enough to provide the right incentive for currently exempt polluting sectors should be put in place over time as the energy crisis abates.

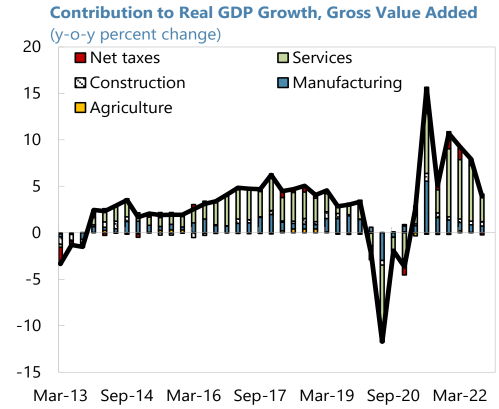
44. **Securing sustained and inclusive growth calls for further labor market reforms and digitalization to boost productivity.** Policies to address disincentives to labor market participation should include reducing the relatively high labor tax wedge, reforming unemployment and pension policies to limit early exit from the labor market, and tackling skill mismatches and inflexible work arrangements. Active labor market policies need to be well aligned with market needs, with education and training programs adapted to meet new demands from the green and digital transitions, and provided on a life-long basis. Closing remaining gaps in digital skills and the integration of digital technologies in businesses and public services would positively contribute to future productivity and growth.

45. **It is recommended that the next Article IV consultation with Slovenia be held on the standard 12-month cycle.**

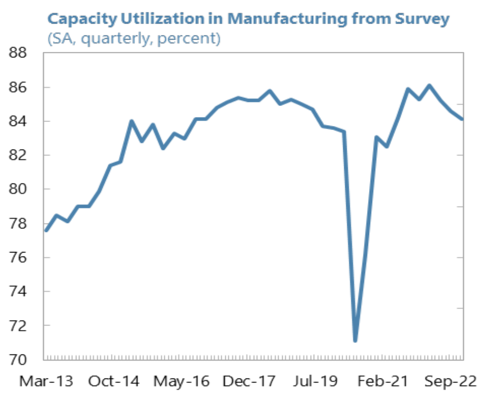
Figure 11. Slovenia: Macroeconomic Developments

Growth rebounded strongly after COVID-19 ...

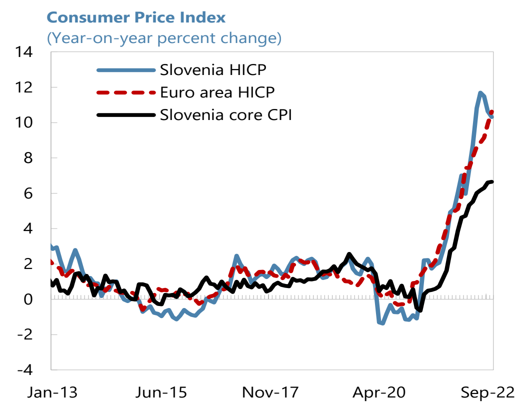
... and most sectors recovered to pre-pandemic levels.



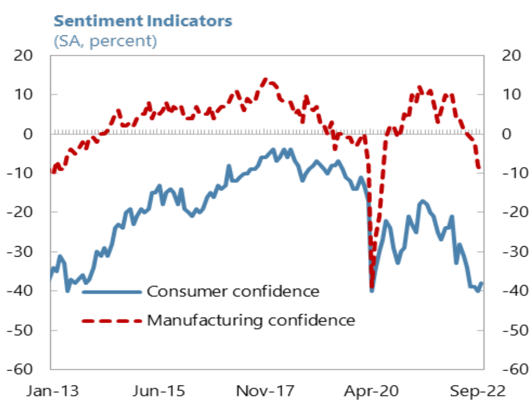
Capacity utilization is above its average level.



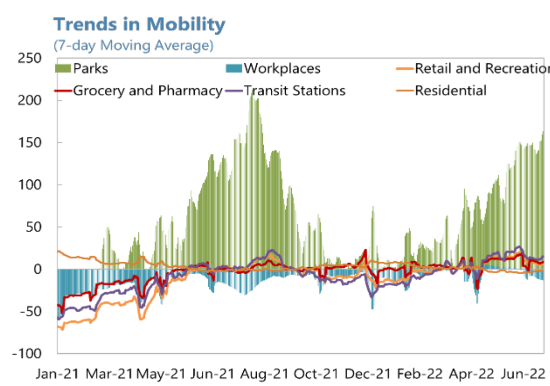
Core inflation is also rising.



The war in Ukraine and high inflation are affecting confidence ...



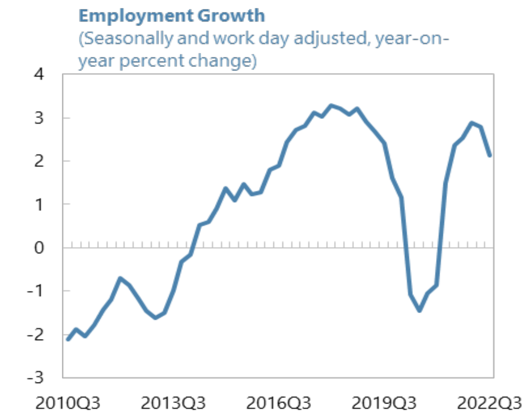
... but mobility trends remain positive.



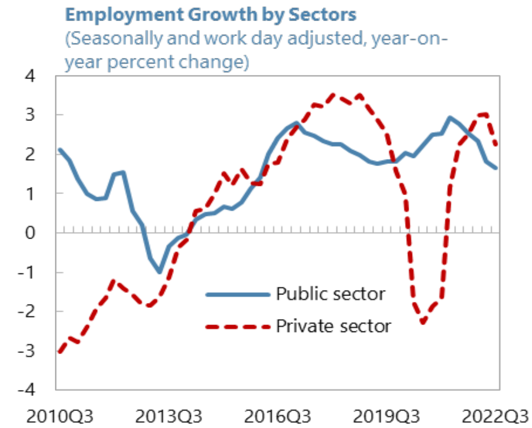
Sources: Bank of Slovenia; Eurostat; Haver Analytics and Google.

Figure 12. Slovenia: Labor Market

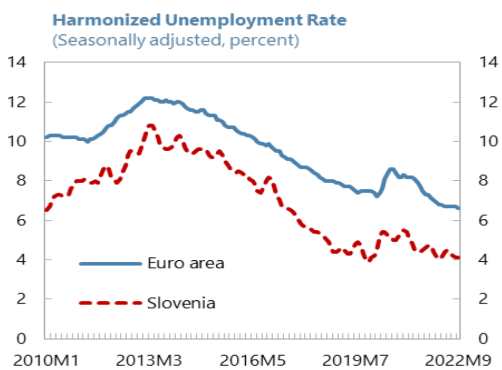
Employment growth is robust …



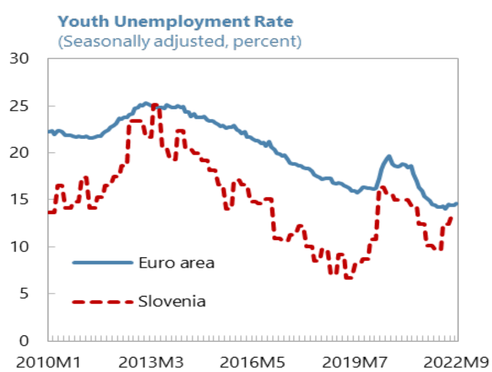
… due to a strong recovery of private sector jobs.



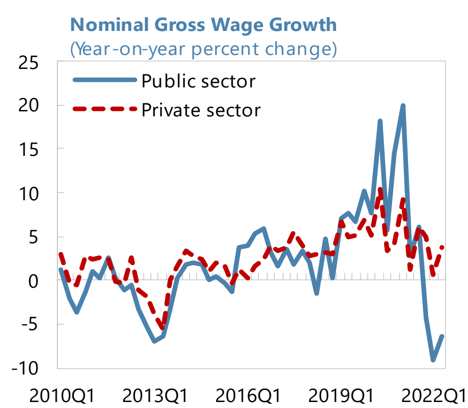
The overall unemployment rate is at an historic low …



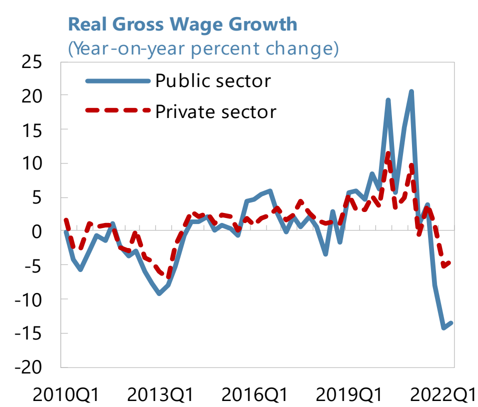
… but youth unemployment remains high.



Wage growth is modest, in part reflecting base effects from COVID-19 bonuses…



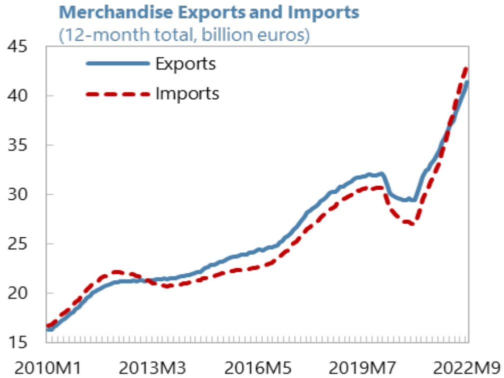
… and real wages fell both in the private and public sectors, reflecting high inflation.



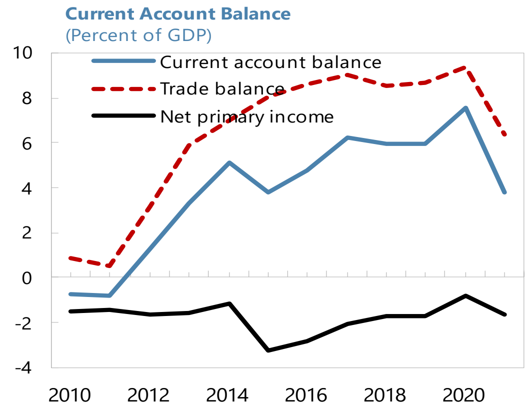
Sources: Bank of Slovenia; Eurostat; and Haver Analytics.

Figure 13. Slovenia: External Sector Developments

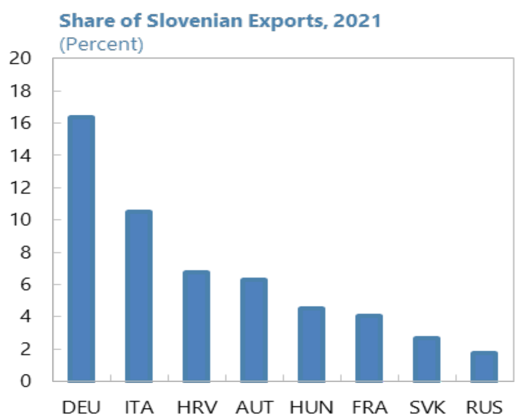
High export and import growth is largely driven by prices.



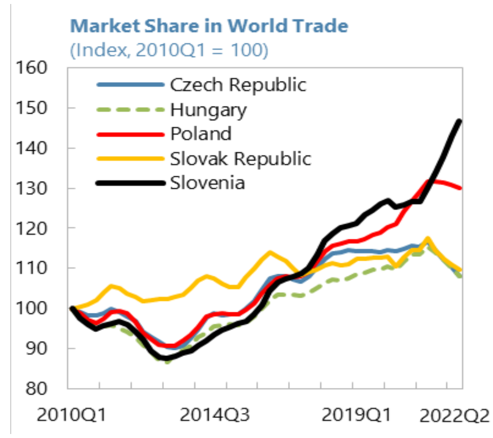
The current account surplus is declining reflecting higher import prices and volumes.



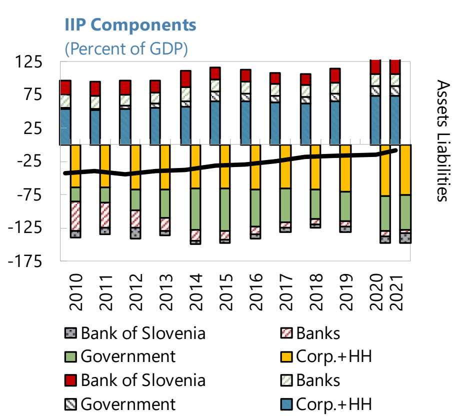
Exports are strongly linked to global value chains…



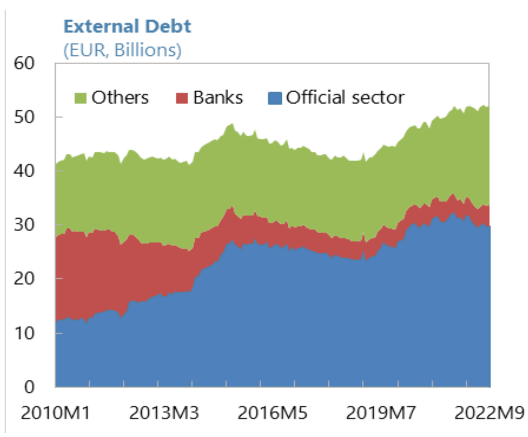
… and Slovenia has gained market share over time.



The net IIP position remains modestly negative…



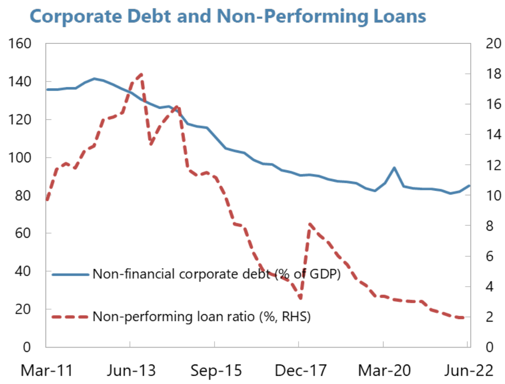
… and external debt has stabilized.



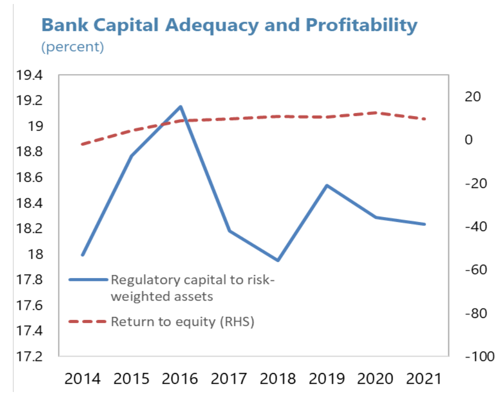
Sources: Bank of Slovenia; Direction of Trade Statistic; European Central Bank; Haver Analytics; Statistical Office of Slovenia; and IMF staff estimates.

Figure 14. Slovenia: Financial Sector Developments

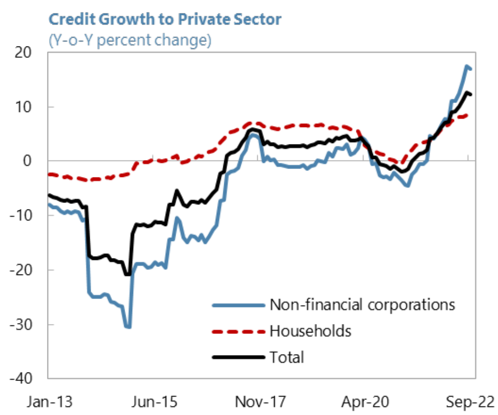
NPL ratios remain low.



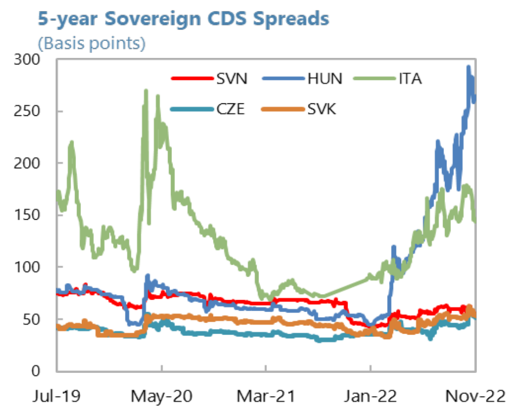
Slovenian banks are well-capitalized and profitable.



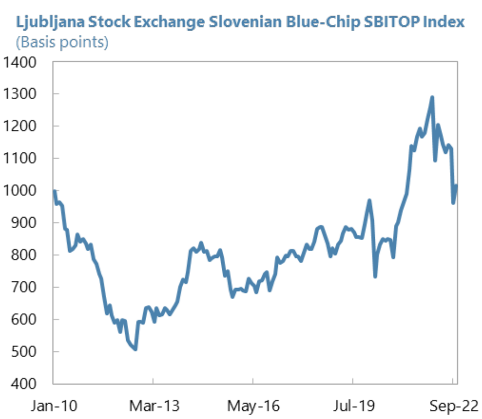
Credit to the private sector is strong.



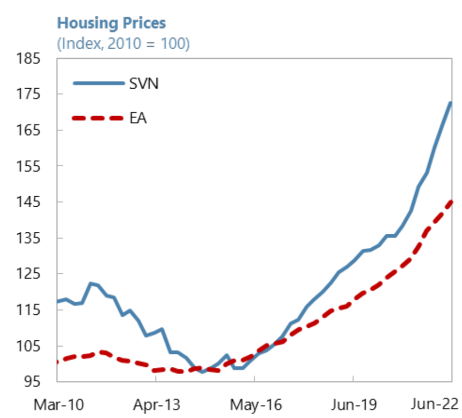
Slovenia's spreads remain low.



The stock market has fallen since the start of the war in Ukraine.



House prices, however, continue to increase.



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

Table 1. Slovenia: Selected Economic Indicators, 2018–27
(Annual percentage change, unless indicated otherwise)

	2018	2019	2020	2021	2022	2023	2024	2025	2026	2027
					Staff Projections					
Nominal GDP (EUR millions)	45,876	48,533	47,021	52,208	58,762	63,404	67,612	71,309	74,821	78,588
Population (millions)	2.1	2.1	2.1	2.1	2.1	2.1	2.1	2.1	2.1	2.1
GDP per Capita (EUR)	22,196	23,323	22,435	24,755	27,844	29,989	31,959	33,722	35,403	37,211
Real economy										
Real GDP	4.5	3.5	-4.3	8.2	5.4	1.8	2.4	2.8	2.9	3.0
Domestic demand (contribution to growth)	4.6	3.2	-4.3	9.0	6.9	1.7	2.9	3.0	2.9	3.0
Private consumption	3.5	5.3	-6.9	9.5	6.5	1.8	2.6	2.9	3.0	3.0
Public consumption	2.9	1.8	4.1	5.8	2.4	0.8	0.6	1.4	2.0	2.2
Gross capital formation	11.1	0.6	-7.1	15.1	12.3	3.8	6.2	5.0	4.0	4.2
Net exports (contribution to growth)	-0.1	0.2	0.0	-0.8	-1.5	0.1	-0.5	-0.2	-0.1	0.0
Exports of goods and services	6.2	4.5	-8.6	14.5	6.2	3.9	4.2	4.4	4.4	4.2
Imports of goods and services	7.1	4.7	-9.6	17.6	8.0	4.1	5.0	4.9	4.7	4.5
Potential output growth	4.1	2.8	-0.7	3.5	3.8	3.5	3.3	3.2	3.2	3.0
Output gap (in percent of potential GDP)	0.3	0.9	-2.7	1.7	3.4	1.7	0.8	0.4	0.0	0.0
Prices										
GDP deflator	2.1	2.3	1.3	2.6	6.7	6.0	4.1	2.6	2.0	2.0
Consumer prices (national definition, period averag	1.7	1.6	-0.1	1.9	8.6	5.0	4.0	3.1	2.4	2.1
Consumer prices (national definition, end of period	1.4	1.8	-1.1	4.9	8.9	3.9	3.2	2.4	2.0	1.9
Core inflation (period average) 1/	1.1	1.8	1.0	1.0	6.6	5.6	5.3	4.1	3.1	2.6
Employment and wages										
Unemployment rate (in percent, ILO definition)	5.1	4.5	5.0	4.7	4.3	4.6	4.5	4.5	4.4	4.4
Public finance (percent of GDP)										
General government balance 2/	0.7	0.6	-7.7	-4.7	-3.1	-4.8	-2.5	-1.9	-1.2	-1.0
Cyclically-adjusted government balance	0.6	0.2	-6.5	-5.4	-4.5	-5.5	-2.8	-2.1	-1.2	-1.1
Structural balance 3/	0.3	0.0	-6.5	-5.4	-4.4	-5.2	-2.7	-2.0	-1.1	-1.0
Structural primary balance 3/	2.3	1.7	-4.9	-4.1	-3.2	-4.1	-1.4	-0.7	0.2	0.4
General government gross debt	70.3	65.4	79.6	74.5	70.5	69.2	67.4	65.8	63.9	61.9
General government net debt	53.4	49.9	57.2	56.4	53.4	53.4	53.0	52.8	52.2	51.5
Monetary and financial indicators										
Credit to the private sector	2.5	3.4	-1.0	5.0	12.6	7.9	6.6	5.5	4.9	5.0
Lending rates 4/	2.1	1.6	1.8	1.6	…	…	…	…	…	…
Deposit rates 5/	0.2	0.2	0.1	0.1	…	…	…	…	…	…
Balance of payments (percent of GDP)										
Trade balance (goods and services)	8.5	8.7	9.3	6.4	3.0	3.6	3.7	3.5	3.4	3.3
Current account balance	6.0	5.9	7.6	3.8	0.5	1.1	1.2	0.8	0.8	0.6
Terms of trade	-0.1	0.5	0.7	-2.1	-2.7	0.2	0.0	0.0	0.0	0.0
Gross external debt (percent of GDP, end-period)	91.9	91.6	102.1	97.3	85.8	81.8	79.0	77.3	76.1	75.1
Nominal effective exchange rate (2010=100)	105.2	104.8	106.9	107.7	…	…	…	…	…	…
Real effective exchange rate (2010=100, CPI-based)	97.9	97.2	97.8	97.2	…	…	…	…	…	…

Sources: Slovenia authorities; and IMF staff calculations and projections.
1/ Harmonized Index of Consumer Prices excluding energy and unprocessed food.
2/ Accrual basis.
3/ Excludes one-offs and adjusted for calendar year shifts between receipts and expenditures of earmarked EU funds.
4/ Floating or up-to-one-year fixed rate for new loans to non-financial corporations over 1 million euros.
5/ For household time deposits with maturity up to one year.

Table 2. Slovenia: General Government Operations, 2018–27
(Percent of GDP, unless indicated otherwise)

	2018	2019	2020	2021	2022	2023	2024	2025	2026	2027
					Projections					
Revenue	44.2	43.8	43.4	44.6	43.5	42.9	42.4	42.3	42.2	42.1
Taxes	21.9	21.6	20.5	21.6	21.2	20.5	20.5	20.4	20.4	20.4
Taxes on income, profits, and capital gains	7.9	7.8	7.8	8.4	7.9	7.8	7.7	7.7	7.7	7.7
Payable by individuals	5.4	5.2	5.3	5.4	5.0	4.8	4.8	4.7	4.7	4.7
Payable by corporations and other enterprises	1.9	2.0	2.0	2.5	2.4	2.3	2.3	2.3	2.3	2.3
Taxes on goods & services	14.0	13.8	12.7	13.1	13.2	12.7	12.8	12.7	12.7	12.7
VAT	8.2	8.2	7.6	8.2	8.3	8.1	8.1	8.1	8.1	8.1
Taxes on products (except VAT and imp. taxes)	4.6	4.5	4.0	3.8	3.7	3.4	3.4	3.4	3.4	3.4
Taxes on international trade & transactions	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Taxes not elsewhere classified	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Social contributions	15.7	15.9	17.2	16.8	15.8	15.7	15.6	15.7	15.7	15.6
Social security contributions	15.4	15.6	16.8	16.4	15.5	15.4	15.3	15.3	15.3	15.3
Grants	1.6	1.6	1.5	2.0	2.2	2.5	2.0	1.9	1.8	1.8
Other revenue	5.0	4.6	4.2	4.3	4.3	4.2	4.3	4.3	4.3	4.3
Interest income	0.2	0.2	0.2	0.1	0.2	0.2	0.2	0.2	0.2	0.2
Expenditure	43.5	43.2	51.2	49.3	46.5	47.7	44.9	44.2	43.4	43.1
Expense	39.6	39.2	46.9	44.5	40.7	41.0	38.8	38.4	38.2	38.1
Compensation of employees	11.0	11.3	12.9	12.7	11.0	10.9	10.5	10.2	10.0	10.0
Purchases/use of goods & services	6.2	6.0	6.1	6.5	6.1	6.1	6.0	6.0	6.0	6.0
Interest	2.0	1.7	1.6	1.2	1.1	1.0	1.2	1.3	1.3	1.4
Social benefits	17.5	17.4	19.6	18.8	18.2	18.0	17.9	17.8	17.7	17.7
Subsidies	0.7	0.7	3.7	2.2	1.5	2.7	0.9	0.9	0.9	0.9
Other transfers and grants	1.7	1.7	2.6	2.7	2.2	1.8	1.7	1.7	1.7	1.7
Other current expense	0.4	0.4	0.5	0.5	0.5	0.5	0.5	0.5	0.5	0.5
Net acquisition of non-financial assets	3.8	4.0	4.3	4.8	5.9	6.7	6.1	5.8	5.3	5.0
Net lending/borrowing	0.7	0.6	-7.7	-4.7	-3.1	-4.8	-2.5	-1.9	-1.2	-1.0
Memorandum item:										
General government balance (ESA 2010)	0.7	0.6	-7.7	-4.7	-3.1	-4.8	-2.5	-1.9	-1.2	-1.0
Primary balance	2.5	2.1	-6.3	-3.5	-2.2	-3.9	-1.5	-0.9	-0.1	0.1
Gross operating balance	4.6	4.6	-3.4	0.1	2.8	1.9	3.6	3.8	4.1	4.0
Cyclically-adjusted balance	0.6	0.2	-6.5	-5.4	-4.5	-5.5	-2.8	-2.1	-1.2	-1.1
Structural balance	0.3	0.0	-6.5	-5.4	-4.4	-5.2	-2.7	-2.0	-1.1	-1.0
Structural primary balance	2.3	1.7	-4.9	-4.1	-3.2	-4.1	-1.4	-0.7	0.2	0.4
General government gross debt	70.3	65.4	79.6	74.5	70.5	69.2	67.4	65.8	63.9	61.9
General government net debt	53.4	49.9	57.2	56.4	53.4	53.4	53.0	52.8	52.2	51.5

Sources: Ministry of Finance; and IMF staff calculations.

Table 3. Slovenia: Balance of Payments, 2018–27
(Percent of GDP, unless indicated otherwise)

	2018	2019	2020	2021	2022	2023	2024	2025	2026	2027
					Projections					
Current account	6.0	5.9	7.6	3.8	0.5	1.1	1.2	0.8	0.8	0.6
Trade balance, goods and services	8.5	8.7	9.3	6.4	3.0	3.6	3.7	3.5	3.4	3.3
Goods	2.8	2.7	5.0	1.7	-2.6	-4.3	-4.6	-4.9	-5.0	-5.3
Exports f.o.b.	67.2	65.9	63.0	67.5	71.8	68.6	67.6	67.3	67.6	67.4
Imports f.o.b.	64.4	63.3	58.0	65.8	74.4	72.9	72.2	72.2	72.6	72.7
Services	5.7	6.0	4.4	4.7	5.6	7.9	8.3	8.4	8.4	8.6
Exports	17.7	17.8	14.8	16.2	17.8	19.1	19.4	19.5	19.6	19.7
Imports	12.0	11.9	10.4	11.5	12.2	11.2	11.1	11.1	11.1	11.1
Primary Income, net	-1.7	-1.7	-0.8	-1.7	-1.6	-1.5	-1.6	-1.7	-1.6	-1.7
Secondary Income, net	-0.9	-1.0	-1.0	-0.9	-0.9	-1.0	-1.0	-1.0	-1.0	-1.0
Capital account	-0.4	-0.5	-0.5	0.1	0.6	0.7	0.3	0.2	0.1	-0.1
Financial account, excl. reserves	5.4	4.2	5.6	1.6	0.9	1.7	1.3	0.9	0.8	0.4
Direct investment, net	-2.0	-1.6	0.1	-1.9	-1.5	-2.4	-2.2	-2.2	-2.3	-2.0
In Slovenia	2.8	4.0	1.4	4.6	3.5	3.2	3.2	3.2	3.2	3.1
Abroad	0.8	2.4	1.5	2.7	1.9	0.8	1.0	0.9	0.9	1.1
Portfolio investment, net	1.6	1.5	-3.9	6.1	2.1	1.1	1.1	0.6	0.5	0.2
Equity	-0.9	-0.2	1.0	1.6	1.2	0.2	0.5	0.0	0.1	0.1
Debt	2.6	1.7	-4.9	4.6	0.9	0.9	0.5	0.6	0.4	0.1
Financial derivatives	-0.2	-0.3	0.1	0.1	-0.6	-0.6	-0.3	-0.2	-0.2	-0.2
Other investment, net	6.0	4.6	9.2	-2.7	0.9	3.5	2.8	2.7	2.7	2.5
Loans	1.5	1.2	1.6	0.7	1.6	1.2	1.0	1.0	0.4	0.4
Currency and deposits	4.4	3.7	8.4	-1.8	3.8	5.6	4.0	4.4	4.4	4.2
Trade credits	-0.1	-0.1	-0.2	-0.5	-0.2	-0.2	-0.2	-0.2	-0.2	-0.2
Other	0.1	-0.3	-0.6	-1.1	-1.4	-1.2	-1.1	-1.1	-1.0	-1.0
Net errors and omissions	0.0	-1.2	-0.7	0.4	0.0	0.0	0.0	0.0	0.0	0.0
Overall balance	0.1	0.1	0.8	2.7	0.2	0.2	0.2	0.2	0.1	0.1
Change in official reserves (+: increase)	0.1	0.1	0.4	1.6	0.2	0.2	0.2	0.2	0.1	0.1
Memorandum items:										
Nominal GDP (million euros)	45,876	48,533	47,021	52,208	58,762	63,404	67,612	71,309	74,821	78,588
Current account balance	6.0	5.9	7.6	3.8	0.5	1.1	1.2	0.8	0.8	0.6
Export of goods (percent change in value)	8.6	3.9	-7.4	19.0	19.6	3.1	5.1	5.0	5.3	4.8
Import of goods (percent change in value)	10.4	3.9	-11.1	26.0	27.1	5.7	5.7	5.5	5.5	5.2
Terms of trade (percent change)	-0.1	0.5	0.7	-2.1	-2.7	0.2	0.0	0.0	0.0	0.0
Gross external debt (billions of euros)	42.1	43.8	48.2	49.2	50.4	51.9	53.4	55.1	56.9	59.0
(percent of GDP)	91.9	91.6	102.1	97.3	85.8	81.8	79.0	77.3	76.1	75.1
Net international investment position	-18.9	-16.2	-15.6	-6.8	-3.7	-1.9	-0.6	-0.2	-0.2	-0.9

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

Table 4. Slovenia: Vulnerability Indicators, 2013–21

(Percent of GDP, unless indicated otherwise

	2013	2014	2015	2016	2017	2018	2019	2020	2021
External Indicators									
Current account balance	3.3	5.1	3.8	4.8	6.2	6.0	6.0	7.4	3.3
Capital and financial account balance	4.9	6.3	5.6	2.2	4.2	5.1	3.9	5.8	2.2
Of which									
Inward portfolio investment (debt securities, etc.)	10.2	11.7	-2.4	-7.4	-0.3	-0.5	-0.1	5.8	-4.6
Inward foreign direct investment	0.2	2.0	4.0	3.2	2.5	2.9	4.0	0.9	3.0
Other investment (net)	15.7	18.0	0.6	-6.5	-0.7	6.0	4.6	9.4	-3.9
Euros per U.S. dollar (period average)	0.8	0.8	0.9	0.9	0.9	0.8	0.9	0.8	0.8
Market Indicators									
Financial Markets									
Public sector debt	70.0	80.3	82.6	78.5	74.2	70.3	65.6	79.8	74.7
Stock market index (period average, 2010=100)	70.2	86.5	83.8	79.5	88.4	94.7	97.5	96.1	124.2
Real estate prices (index, 2010=100, period average)	90.6	84.6	85.3	88.1	95.4	103.7	110.7	115.7	129.1
Credit markets (end-of-period 12-month growth rates)									
Credit to the private sector	-17.4	-13.4	-5.5	-2.7	3.3	3.3	3.7	-0.2	5.9
Bank credit to households	-3.8	-1.7	1.1	3.4	6.4	6.5	5.9	0.2	5.1
Housing Loans	0.9	0.8	3.3	3.5	4.6	4.4	5.6	4.2	9.0
Sectoral risk indicators									
Household sector									
Household savings ratio (percent)	11.2	11.3	11.8	11.8	13.1	13.8	13.5	22.9	18.8
Gross disposable income	63,161	61,829	60,948	61,103	60,187	60,005	60,314	64,600	62,762
Personal income	49,578	48,913	48,737	49,368	49,396	49,752	50,792	53,739	52,947
Corporate sector									
Business investment	11.8	10.5	10.3	10.7	11.5	11.8	11.9	11.1	11.8
Investment rate NFCs (percent)	22.4	19.5	19.0	19.6	21.2	21.5	21.3	20.3	21.4
Gross profit share NFCs (percent)	35.1	35.6	35.3	34.9	35.7	35.1	34.4	36.4	35.0
Net return after taxes NFCs (percent)	5.6	7.8	9.1	10.1	11.7	11.5	11.7	10.6	11.1
Banking sector (percent)									
Share of housing loans in bank credit to the private sector	38.5	43.6	46.7	49.5	51.0	52.6	53.8	54.0	53.6
Share of nonperforming loans in total loans	0.0	0.0	0.0	0.0	0.0	6.0	3.4	3.0	2.1
Ratio of nonperforming loans net of provisions to capital	55.3	36.7	25.0	10.8	6.3	12.6	5.2	4.1	1.8
Liquid assets to total short-term liabilities	45.6	62.9	54.8	53.5	51.9	32.5	34.0	36.1	31.4
Return on assets	-7.3	-0.2	0.5	1.1	1.2	1.5	1.5	1.5	1.2
Return on equity	-97.6	-1.9	4.2	8.8	9.8	10.8	10.6	12.4	9.6
Regulatory capital to risk-weighted assets	13.7	18.0	18.8	19.2	18.2	17.9	18.5	18.3	18.2

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

Table 5. Slovenia: Core Financial Soundness Indicators, 2013–21

(Percent unless indicated otherwise)

	2013	2014	2015	2016	2017	2018	2019	2020	2021
Capital									
Regulatory capital to risk-weighted assets	14.1	18.0	18.8	19.2	18.2	17.9	18.5	18.3	18.2
Regulatory Tier 1 capital to risk-weighted assets	13.3	17.3	18.1	18.7	17.8	17.6	17.8	16.7	16.8
Profitability									
Return on assets	-7.1	-0.2	0.5	1.1	1.2	1.5	1.5	1.5	1.2
Return on equity	-94.9	-1.9	4.2	8.8	9.8	10.8	10.6	12.4	9.6
Interest margin to gross income	53.9	55.4	57.4	54.2	55.3	52.2	52.3	43.1	51.9
Noninterest expenses to gross income	77.2	60.9	66.7	83.9	87.1	65.9	64.1	53.7	67.5
Liquidity									
Liquid assets to total assets	17.5	27.8	26.7	29.4	30.5	24.1	26.0	27.9	28.1
Liquid assets to short-term liabilities	45.6	62.9	54.8	53.5	51.9	32.5	34.0	36.1	31.4
Sensitivity to Market Risk									
Net open position in foreign exchange to capital	-4.0	-1.1	0.9	0.6	10.8	12.0	10.7	21.7	
Asset Quality									
Nonperforming loans to total gross loans	13.3	11.7	10.0	5.1	3.2	6.0	3.4	3.0	2.1
Non-performing loans net of provisions to capital	55.6	36.7	24.1	10.2	5.9	12.6	5.2	4.1	1.8

Sources: Bank of Slovenia and IMF Financial Soundness Indicators.

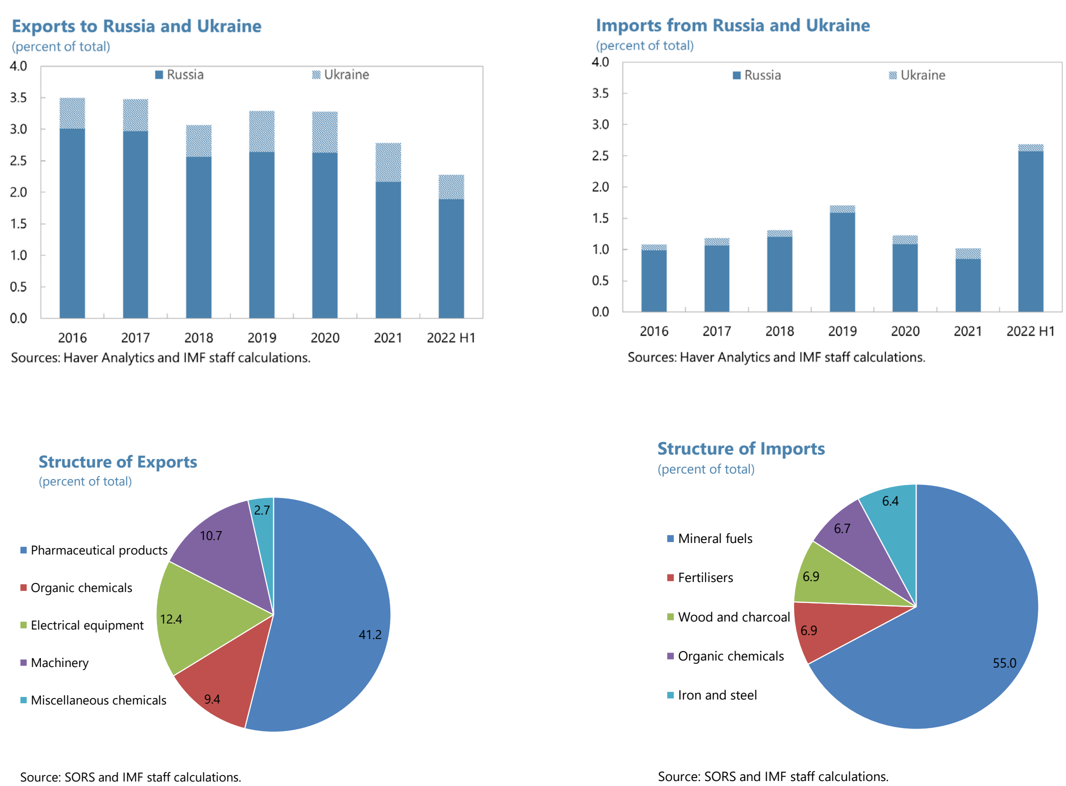
Annex I. Exposure to Spillovers from the War in Ukraine

While Slovenia's direct trade with Russia and Ukraine is low, some sectors are vulnerable to disruptions. An escalation of the war and further tightening of sanctions could impact significantly economic activity through reduced external demand, increased supply bottlenecks, higher commodity prices and an additional inflow of refugees.

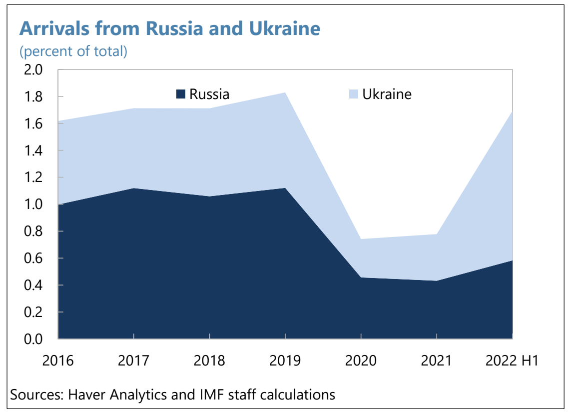
1. Slovenia's direct exposure to Russia and Ukraine is limited, apart from certain sectors such as energy.

- *Trade in goods.* Exports to Russia and Ukraine accounted for just 2.2 percent and 0.6 percent of total in 2021; shares have declined in 2022 after the start of the war. The largest exposures of Slovenian exporters are in pharmaceuticals, organic chemicals, and electrical appliances. Imports from the two countries were even smaller in 2021—just 1 percent of total, although they increased to 2.7 percent of total in January-June 2022, reflecting the higher price of energy goods imported from Russia. Mineral fuels account for over half of these imports, largely due to the imports of natural gas. Other items with more significant shares include fertilizers, wood and wood products and organic chemicals. Trade with Belarus is very small—less than 0.2 percent of exports and 0.05 percent of imports.

Figure AI.1. Slovenia's Trade with Russia and Ukraine



- *Trade in services.* Tourism, the main source of services export receipts prior to the pandemic, is not particularly vulnerable to an interruption of inflows from Russia and Ukraine as arrivals from both countries typically account for less than 2 percent of total. The composition changed in 2022, however, reflecting the influx of Ukrainian refugees. In value terms, total exports of services to Russia and Ukraine were less than EUR 80 million in 2021 (0.1 percent of GDP).



- *Investments.* Direct investments in Russia stood at EUR 425 million or 6.1 percent of the total Slovenian FDI stock at end-2020. Sixteen companies operating in Russia and controlled by Slovenian residents generated about EUR 600 million in revenue and employed 2.3 thousand workers.[1] The stock of direct investment in Ukraine at end-2020 was ten times smaller—just 0.6 percent of total. Portfolio investment in Russia was negligible as of June 2021 and no exposure to Ukraine was reported.[2]

- *Financial sector exposures.* Besides the Slovenian subsidiary of Sberbank Europe, the ownership of which was transferred in early March, Slovenia's financial sector is not significantly exposed to Russia and Ukraine. According to the Bank of Slovenia, banks' direct exposures to Russia, Ukraine and Belarus was only 0.2 percent of the total at end-2021. Indirect exposures through non-financial corporations with large receivables from trade credits is estimated at EUR 570 million (about 1 percent of banks' assets).[3]

2. The war in Ukraine is affecting the Slovenia economy through a number of channels:

- *Commodity prices.* Energy and food prices have already increased substantially and are major contributors to the overall CPI increase, undermining confidence, and denting consumption. An escalation of the war would strengthen these pressures and make them more persistent, which in turn could unlock a wage-price spiral if inflation expectations become de-anchored. The policy response will be key as to whether such a scenario unfolds. The effect on output would be exacerbated if imports of key inputs from Russia or Ukraine become unavailable. In particular, a potential shut-off of natural gas supplies would have a direct impact on Slovenia's manufacturing and power generation sectors, but also would affect the economy through a drop in external demand. Mitigating factors include the low

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[1] Bank of Slovenia, "Direct Investment 2020".

[2] Based on IMF's "Coordinated Portfolio Investment Survey".

[3] Bank of Slovenia, "Financial Stability Review", May 2022.

share of gas in the energy mix (just 12 percent of the total) and Slovenia's interconnectedness with other energy suppliers.

- *External demand*. The impact of the war has been moderate so far but in case of escalation and tightening of sanctions, a sharper reduction in exports could be seen, unless there is reorientation to alternative destinations. A more significant effect would come from a potential contraction of demand in Slovenia's EU trading partners, given the country's strong integration in the European supply chains. In such a scenario, the decline of exports would be broad-based and the options for reallocation would be more limited.

- *Supply disruptions*. Supply chain bottlenecks were already creating difficulties in manufacturing before the start of the war. An abrupt reduction in the imports of fertilizers would impact agriculture, and cuts in the supplies of metals and wood products would further increase construction costs. Activities that are indirectly linked to imports of raw materials from Russia and Ukraine, e.g., car manufacturing, would be hurt as well.

- *Refugees*. Shortly after the outbreak of the war, Slovenia offered temporary protection for Ukrainian refugees which grants the right to temporary residence, access to the labor market, accommodation, healthcare, and education. So far, about 8 thousand refugees from Ukraine have registered for temporary protection. This number is significantly below Slovenia's capacity (estimated at 20–30 thousand) but it could increase rapidly if the war intensifies. Current labor shortages are a mitigating factor but the impact on the labor market would depend to a large extent on the refugees' profile. In any event, a sharp increase in the inflow of refugees could strain institutional capacity and would increase fiscal costs (currently about 0.1 percent of GDP).

Annex II. Transmission of Shocks to Inflation in Slovenia

An historical decomposition of producer price inflation in Slovenia suggests that supply shocks have recently become an important driver of inflation, although the contribution of demand shocks continues to be significant. While the response of producer prices to shocks is quick and relatively strong, its pass-through to core consumer price inflation is more muted, likely reflecting a large share of services in core consumer prices and relatively sticky retail prices.

1. **A combination of demand and supply factors has led to a surge in inflation.** Following the relaxation of pandemic-related restrictions, domestic demand rebounded strongly, supported by improving labor market conditions and accommodative fiscal and monetary policies. At the same time, shortages of inputs (e.g., microchips in car manufacturing), delays in delivery and rising transportation costs constrained supply and pushed prices up. In 2022 H1, intermediate goods import prices in Slovenia increased by about 30 percent on average relative to the same period of the previous year. Energy import prices gained momentum as well, reaching a three-digit growth rate in late 2021 and sustaining it into 2022. In addition, imported food prices rose by 20 percent in 2022 Q2. The confluence of shocks has driven producer and consumer price inflation to the highest levels since mid-1990s.

2. **Identifying the nature of the shocks and their propagation could help inform policy decisions.** If inflationary pressures are primarily caused by demand factors, fiscal and financial policies could effectively be used as stabilization tools. Addressing supply shocks, on the other hand, is more challenging, especially if they are related to global value chain disruptions. To estimate the contribution of supply and demand shocks, a simple structural vector autoregression is used with industrial production (*IP*) and producer prices (*PPI*) as main variables, following the approach in Celasun et all (2022).[1] The identification strategy uses sign restrictions under the assumption that positive demand shocks increase both industrial production and producer prices, whereas positive supply shocks increase prices but reduce output.[2]

$$\begin{pmatrix} IP_t \\ PPI_t \end{pmatrix} = \begin{pmatrix} + & - \\ + & + \end{pmatrix} \begin{pmatrix} demand\ shock_t \\ supply\ shock_t \end{pmatrix}$$

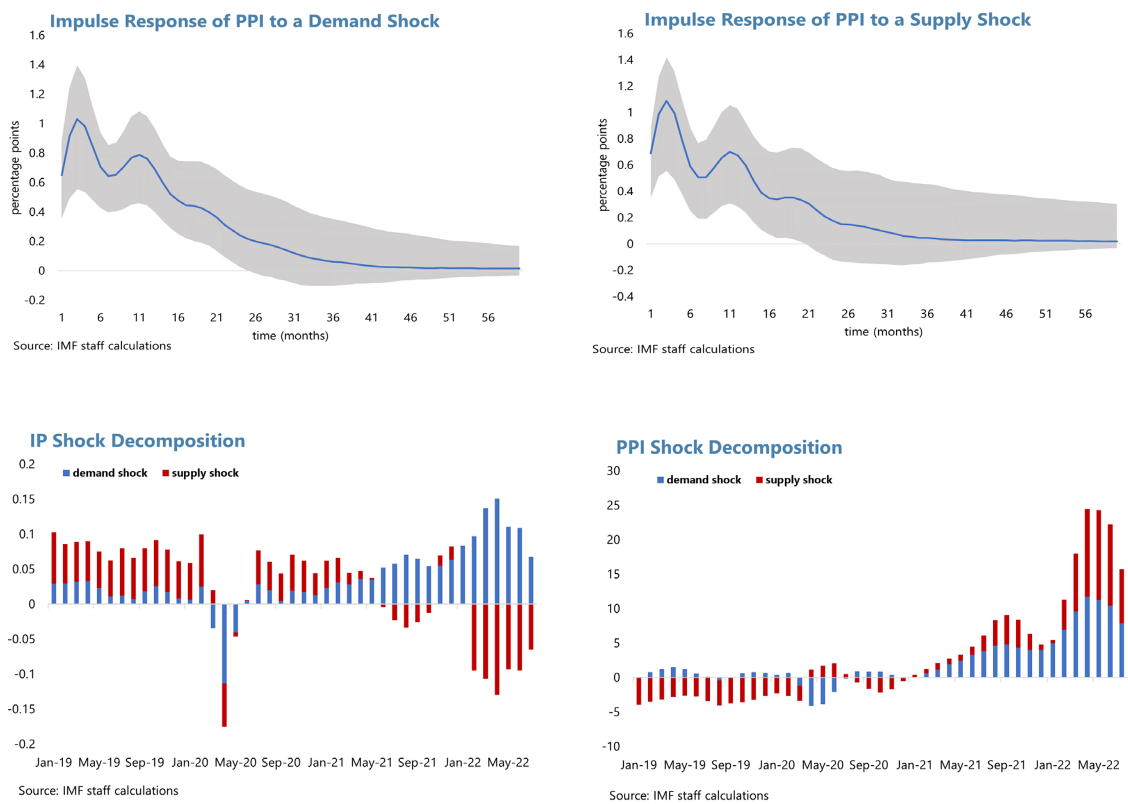
3. **The relative importance of supply shocks has increased in recent months, but demand remains an important contributor.** Producer prices respond strongly to both demand and supply shocks (Figure A1). Prior to the pandemic, negative supply shocks supported industrial production and kept prices in check. The sharp decline in output in the wake of COVID-19 is attributed to negative demand shocks, reflecting the strict lockdown at the time. Supply shocks turned positive

[1] Celasun, O., Hansen, N.J., Mineshima, A., Spector, M., and J. Zhou (2022), "Supply Bottlenecks: Where, Why How Much and What Next?", IMF Working Paper WP/22/31.

[2] For the estimation, the *IP* variable is calculated as the logarithmic difference of the industrial production index and a linear trend, and *PPI* is the annualized logarithmic difference of the average PPI index for the last 3 months and the previous non-overlapping 3-month period. The change in oil prices (defined in the same way as *PPI*) is included as an exogenous variable. Monthly data are used for the period January 2001–July 2022.

from 2021 and while initially they had a lower impact on production and prices, recently the balance has shifted and now they are playing a greater role in shaping producer price dynamics. Nevertheless, demand continues to contribute significantly to producer price inflation and explains over a third of the PPI increase.

Figure AII.1. PPI Impulse Responses and Contributions of Shocks

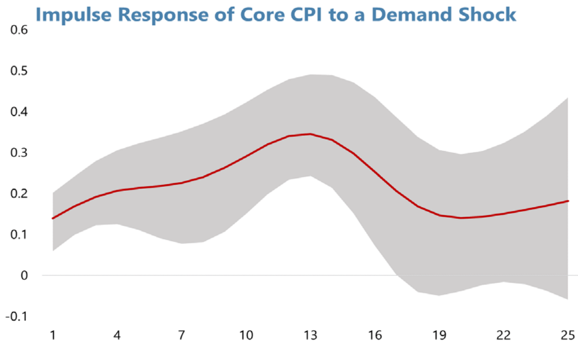


4. **The pass-through to core CPI is more limited and relatively slow.** To measure the impact of the estimated shocks on the core consumer price index (CPI excluding food, fuels, and energy), the smooth local projections method proposed by Barnichon and Brownlees (2019) is used.[3] While the peak response of PPI to one standard deviation demand and supply shock is about 1 percentage point (ppt), the effect on core CPI is about 0.3 ppt for demand and less than 0.2 ppt for supply (Figure A2). Moreover, it takes longer for consumer prices to react, and in the case of supply shocks, the response initially is insignificant. The lower pass-through to consumer prices could reflect the fact that services, which are usually less sensitive to supply-side factors, comprise a large share of the consumer basket. However, it could also be due to retailers being unable or reluctant to adjust

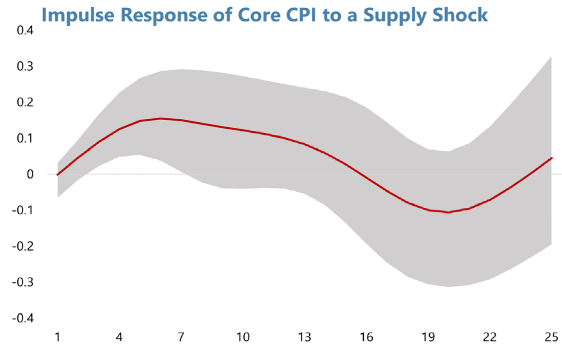
[3] Barnichon, R. and C. Brownlees (2019), "Impulse Response Estimation by Smooth Local Projections", The Review of Economics and Statistics, Vol. 101 (3), pp. 522–530.

prices immediately, given the uncertainty about the magnitude and the duration of supply disruptions.[4]

Figure AII.2. Core CPI Impulse Responses



Source: IMF staff calculations.



Source: IMF staff calculations.

[4] Cavallo et al. (2013), using supermarket data, find that prices do not increase significantly in the first few months after a natural disaster (see Cavallo, A., Cavallo, E. and R. Rigobon (2013), "Prices and Supply Disruptions During Natural Disasters", NBER Working paper 19474).

Annex III. External Sector Assessment

Foreign Assets and Liabilities	*Background:* At end-Q2 2022, Slovenia's Net International Investment Position (NIIP) stood at -3.8 percent of GDP, an improvement on the NIIP of -6.8 percent at end-2021 and -15.6 percent of GDP at end-2020. This continues the trend where the NIIP has gradually improved since the global financial crisis (GFC), supported by current account surpluses. Public external debt declined slightly from 2020 after increasing on the back of COVID-19-related measures and gross external debt is estimated at 89 percent of GDP in 2022 Q3. *Assessment:* The NIIP remains modestly negative, after having improved since the GFC. Current account surpluses continue to increase the NIIP over time.	**Overall Assessment:** Staff's preliminary assessment is that the external position of Slovenia in 2022 is moderately stronger than the level implied by medium term fundamentals and desirable policies. As the NIIP is still negative, the current account surplus is contributing to improving the negative NIIP. **Policy Responses:** Over the medium term, Slovenia's current account is expected to record small surpluses. Higher domestic demand, including stepped-up investment, would help bring the current account close to its norm.
Current Account	*Background:* Slovenia has run current account surpluses since 2012, averaging 5 percent of GDP, reflecting strong export growth and the decline in investment and consumption in the aftermath of the GFC. The strong increase in energy prices led to a sharp decline in the surplus in 2022, which is projected at 0.5 percent of GDP. *Assessment:* The EBA-lite current account model, adjusted for tourism (+1 percentage point of GDP) and substantially higher oil imports (+2 percentage points of GDP), finds that the current account surplus is 1.1 percentage points higher than implied by medium term fundamentals and desirable policies. Actual CA: 0.5 Cyclically adjusted CA: 0.7 CA Norm: -0.4 CA gap: 1.1 Policy Gap: 2.8	
Real Exchange Rate	*Background:* The real effective exchange rate has remained relatively stable in recent years, due to Slovenia's high level of integration in the euro zone. However, over the first eight months of 2022 the CPI-based REER appreciated by almost 3 percent because of modestly higher inflation in Slovenia compared to its trading partners. *Assessment:* Using standard elasticities of -0.57 of trade to the REER, the current account gap implies a 1.8 percent REER undervaluation. Separately, the REER model suggests an undervaluation of 7 percent. However, considering the poor fit of the REER model for Slovenia, the overall assessment relies on the current account model. Actual REER: 4.57 REER Norm: 4.64 REER gap: -0.07 Implied REER gap (from CA model): -1.8	
Capital and Financial Accounts	*Background:* Current account surpluses since 2012 occurred as the banking and corporate sectors accumulated assets and reduced investment liabilities. Inward FDI flows averaged 2.8 percent of GDP over 2016-20 and are estimated to have reached 4.6 percent of GDP in 2021. Government external debt, which reached a peak of 64.4 percent of GDP in 2015, gradually declined until 2019. In the COVID-19 context, the general government's external debt increased by 8 percentage points of GDP in 2020 but subsequently fell by 9.4 percentage points in 2021, to 42.8 percent of GDP. It is expected to decline gradually over the forecast horizon. *Assessment:* Slovenia has reduced its net external liabilities, particularly through deleveraging by banks and the acquisition of portfolio assets abroad.	
Foreign Exchange Intervention and Reserves	*Background and Assessment:* The euro is a global reserve currency. Reserves held by the euro area are typically low relative to standard metrics, but the currency is free floating.	

Annex IV. Risk Assessment Matrix[1]

Source of Risks, Likelihood, and Time Horizon	Impact on Slovenia	Recommended Policy Response
High (short to medium term) **Intensifying spillovers from Russia's war in Ukraine.** Further sanctions resulting from the war and related uncertainties exacerbate trade and financial disruptions and commodity price volatility, with Europe, LICs, and commodity-importing EMs among the worst hit.	**High** An escalation of the sanctions against Russia could lead to loss of exports to partners, further supply chain disruptions and rising prices. Consumer and investor confidence would decrease further and a sharp increase in the inflow of refugees would increase fiscal costs.	Provide additional targeted fiscal support to vulnerable households and viable firms. Allocate additional funds to accommodate refugees.
High (short term) **Commodity price shocks.** A combination of continuing supply disruptions (e.g., due to conflicts and export restrictions) and negative demand shocks causes recurrent commodity price volatility and social and economic instability.	**High** High and volatile energy and food prices are already a main driver of inflation in Slovenia. An intensification of the war in Ukraine war would increase commodity prices, adding to inflation pressures.	Allow price signals to operate more fully to encourage energy savings and efficiency. Provide temporary and targeted support and avoid the use of untargeted measures such as tax cuts or price controls. Continue to diversify energy imports.
Medium (medium term) **De-anchoring of inflation expectations and stagflation.** Supply shocks to food and energy prices sharply increase headline inflation and pass through to core inflation, de-anchoring inflation expectations and triggering a wage-price spiral in tight labor markets. Central banks tighten monetary policy more than envisaged leading to weaker global demand, currency depreciations in EMDEs, and sovereign defaults. Together, this could lead to the onset of stagflation.	**Medium** High and persistent inflation could de-anchor inflationary expectations and induce a wage price spiral.	Provide temporary fiscal support to protect low-income households, while cutting non-essential expenditure so that fiscal policy remains tight, in support of disinflation efforts. Ease the access of foreign workers to reduce labor market pressures.
Medium (short to medium term) **Abrupt global slowdown or recession.** Global and idiosyncratic risk factors combine to cause a synchronized sharp growth slowdown, with outright recessions in some countries, spillovers through trade and financial channels, and downward pressures on some commodity prices. **High** (short to medium term) • **Europe:** The fallout from the war in Ukraine is exacerbated by a gas shutoff by Russia, resulting in acute gas shortages and further supply disruptions, which triggers an EU recession.	**High** A sharp global slowdown and recession in Europe would impact significantly Slovenia's exports and lead to a rise in unemployment and contraction of consumption and investment, with implications for the financial sector health.	Allow automatic stabilizers to operate fully and provide additional targeted support to vulnerable households, especially if high energy and food prices persist. Monitor closely the quality of banks' assets and perform stress tests to identify vulnerabilities.
Medium (short to medium term) **Local Covid-19 outbreaks.** Outbreaks in slow-to-vaccinate countries or emergence of more contagious vaccine-resistant variants force new lockdowns or inhibit commerce. This results in extended supply chain disruptions, slower growth, capital outflows, and debt distress in some EMDEs.	A potential lockdown due to a new variant of COVID-19 would lead to a contraction in economic activity, especially in contact-intensive sectors, leading to higher unemployment.	Allocate additional resources to healthcare. Use available fiscal space to provide targeted support to vulnerable households and viable firms in affected sectors.

[1]Assessment Matrix (RAM) shows events that could materially alter the baseline path. The relative likelihood is the staff's subjective assessment of the risks surrounding the baseline ("low" is meant to indicate a probability below 10 percent, "medium" a probability between 10 and 30 percent, and "high" a probability between 30 and 50 percent). The RAM reflects staff views on the source of risks and overall level of concern as of the time of discussions with the authorities. Non-mutually exclusive risks may interact and materialize jointly. The conjunctural shocks and scenarios highlight risks that may materialize over a shorter horizon (between 12 to 18 months) given the current baseline. Structural risks are those that are likely to remain salient over a longer horizon.

Source of Risks, Likelihood, and Time Horizon	Impact on Slovenia	Recommended Policy Response
High (short to medium term) **Geopolitical tensions and de-globalization.** Intensified geopolitical tensions, security risks, conflicts, and wars cause economic and political disruptions, fragmentation of the international monetary system, production reshoring, a decline in global trade, and lower investor confidence.	High A protracted Russia-Ukraine war would weigh on activity in trading partners causing external demand to fall, keep inflation elevated, worsen supply chain disruptions, and weaken confidence.	Allow automatic stabilizers to operate fully. Accelerate reduction of energy dependence and seek alternative markets for exports.
Medium (short to medium term) **Cyberthreats**. Cyberattacks on critical physical or digital infrastructure (including digital currency platforms) trigger financial instability and disrupt economic activities.	Medium Cyber-attacks, if successful, could inflict significant damage to the financial sector and other critical infrastructure.	Increase the monitoring of cyber risks and the exchange of information with partners. Strengthen the cyber security framework, including resilience testing and business continuity plans.
Medium (short to medium term) **Natural disasters related to climate change.** More frequent natural disasters deal severe damage to infrastructure (especially in smaller vulnerable economies) and amplify supply chain disruptions and inflationary pressures, causing water and food shortages and reducing medium-term growth.	Medium Damage to physical infrastructure and further supply chain disruptions would impact adversely manufacturing and tourism.	Reallocate fiscal spending to rebuild damaged infrastructure. Provide support to affected households and businesses. Strengthen climate adaptation policies to build resilience.
Medium (short to medium term) **Further tightening of the labor market and wage pressures**. High demand for workers and widening skills mismatches in the labor market increase the pressure on wages and trigger a wage-price spiral.	Medium High and persistent inflation reduces households' purchasing power.	Tighten fiscal policy further to counteract demand pressures and allow for a larger inflow of migrant workers to alleviate supply side constraints.
Medium (short to medium term) **Delays in public investment and reforms.** Capacity constraints in combination with supply chain problems and labor shortages delay the implementation of key public investment projects and reforms.	Medium Delays in the execution of the public investment program and adoption of critical reforms would result in reduced EU grants and impede the digital and green transition.	Further prioritize improvements in public investment management to increase efficiency. Monitor closely project execution and assess and manage associated risks. Make greater efforts to build social consensus around key reforms.
Medium (short to medium term) **Real estate market downturn.** A sharp correction of house prices weakens banks' balance sheets.	Medium A large decline in real estate prices, after several years of strong growth, would affect the quality of banks' loan portfolio and reduce credit to the economy.	Continue the close monitoring of market developments and adjust macro prudential policies as needed.

Annex V. Public Sector Debt Sustainability Analysis

Slovenia's public debt-to-GDP ratio fell from almost 80 percent in 2020 to 74 percent in 2021; it is projected to decline further over the medium term to close to the 60-percent benchmark. Combined macro-fiscal shocks and shocks to contingent liabilities pose risks to the baseline scenario. They could push up public debt to over 80 percent of GDP and put it on a rising trajectory. This underscores the importance of growth-friendly fiscal consolidation and structural fiscal reforms to underpin long-term public debt sustainability in the face of substantial ageing challenges.

1. The public debt ratio has declined but remains above its pre-pandemic level. Gross public debt stood at 74 percent of GDP at end-2021, 5 percentage points lower than a year earlier. With the ongoing strong recovery, high inflation, and the lower fiscal deficit in 2022, it is expected to decline further to 70 percent of GDP by end-2022, still higher than in 2019. The authorities have taken advantage of favorable market conditions and engaged in active asset-liability management, replacing high-interest debt with lower-interest debt and accumulating a comfortable cash buffer of over 15 percent of GDP. In 2022, the government has secured financing of over EUR 3 billion by issuing euro bonds maturing in 2026 and 2062, tapping existing bonds, and issuing T-bills. The weighted average yield of long-term debt is 0.8 percent, with an average time to maturity of almost 15 years. The spread over the reference 10-year German bond was around 130 basis points in early November. In 2021, Slovenia issued an inaugural 10-year sustainability bond in the amount of EUR 1 billion with a coupon rate of 0.125 percent, which was very well-received (demand for EUR 8.4 billion by over 200 investors); it was tapped for additional EUR 50 million in 2022.

2. Staff's baseline scenario projects a gradual reduction in the debt ratio over the medium term. It is based on the following assumptions:

- Economic activity is expected to decline in the second half of 2022 as the impact of the rising inflation and spillovers from the war in Ukraine begin to weigh more heavily on consumption and exports. Growth is projected to slow significantly in 2023 to 1.8 percent as demand weakens further, before returning gradually to close to potential. Inflation is expected to remain above the ECB target and the monetary policy normalization will drive interest rates up, making new debt more expensive.

- With most of the COVID-19 containment measures expiring, and in the absence of additional measures to mitigate the impact of high commodity prices, the fiscal deficit is projected to fall to 3.1 percent of GDP this year and after a temporary increase in 2023, to decline in the medium term.

- The higher deficit in 2023 contributes to a significant increase of the government's gross financing needs, which is projected to increase from less than 6 percent of GDP in 2022 to 9 percent in 2023.

- The baseline projections are underpinned by realistic assumptions. Over 2013–21, staff projections of the main macroeconomic variables were close to, or more conservative than, the median, especially with regard to growth. In addition, the projected fiscal adjustments are close to the median of those achieved in comparator countries.

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

- **A shock to GDP growth would worsen the debt ratio significantly.** A negative one-standard deviation growth shock over two years would push the debt-to-GDP ratio to 80 percent by 2024, 13 percentage points above the ratio projected under the baseline. This illustrates the sensitivity of debt dynamics to the assumptions about the strength of the economy and underscores the need to carefully calibrate the fiscal policy actions.

- **Contingent fiscal liabilities are a potential source of vulnerability.** The total amount of government guarantees outstanding at the end of 2021 was EUR 4.7 billion (9 percent of GDP), of which EUR 0.7 billion are guarantees for liabilities of the financial sector. A standard contingent liability shock could create a rising trajectory of public debt, which would exceed 80 percent of GDP by 2027.

- **A combined macro-fiscal shock would result in high and persistent public debt.** The combination includes shocks to GDP growth, inflation, fiscal balance, exchange rate, and interest rate spread. In such an adverse scenario the debt ratio would rise to 81 percent of GDP and remain elevated throughout the projection period.

4. While the debt level remains relatively high and vulnerable to shocks, there are strong mitigating factors. The share of foreign currency debt is very small (less than 2.5 percent of total) and it is fully hedged. Over 30 percent of the central government debt has residual maturity of more than 10 years and 99 percent is at fixed interest rates. The investors base is large and diversified (asset managers, banks, pension funds and insurance companies). In addition, the government has sizeable cash holdings which can be used to cushion adverse market developments. Still, the DSA stress tests, including the sensitivity of the debt path to growth shocks, reinforce the case for a more front-loaded fiscal consolidation and structural fiscal reforms to ensure the long-term sustainability of public finances, given age-related spending pressures.

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

(in percent of GDP unless otherwise indicated)

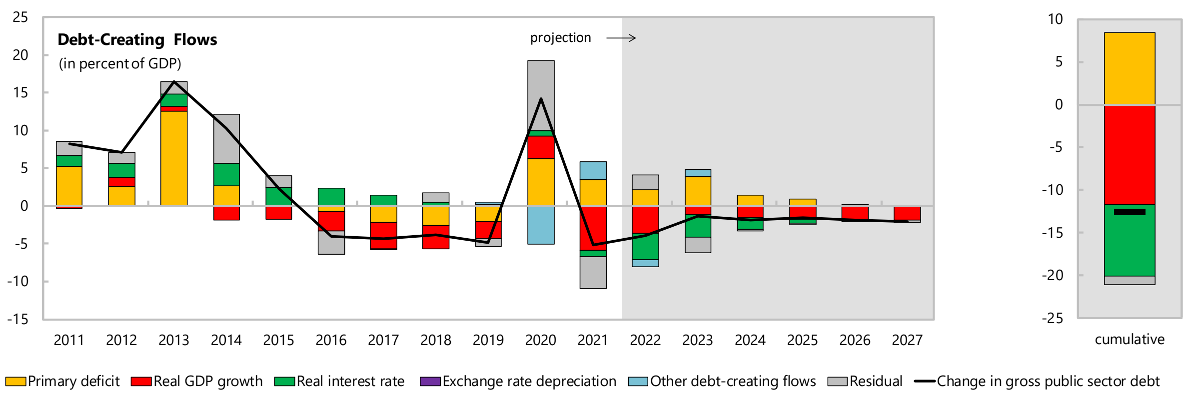
Debt, Economic and Market Indicators [1/]

	Actual			Projections					
	2011-2019 [2/]	2020	2021	2022	2023	2024	2025	2026	2027
Nominal gross public debt	69.0	79.6	74.5	70.5	69.2	67.4	65.8	63.9	61.9
Public gross financing needs	15.0	12.0	11.3	5.5	9.1	6.7	6.4	6.0	6.7
Real GDP growth (in percent)	2.0	-4.3	8.2	5.4	1.8	2.4	2.8	2.9	3.0
Inflation (GDP deflator, in percent)	1.3	1.3	2.6	6.7	6.0	4.1	2.6	2.0	2.0
Nominal GDP growth (in percent)	3.3	-3.1	11.0	12.6	7.9	6.6	5.5	4.9	5.0
Effective interest rate (in percent) [4/]	4.0	2.4	1.7	1.7	1.6	1.9	2.0	2.1	2.2

As of November 03, 2022		
Sovereign Spreads		
EMBIG (bp) 3/	134	
5Y CDS (bp)	55	
Ratings	Foreign	Local
Moody's	A3	A3
S&Ps	AA-	AA-
Fitch	A	A

Contribution to Changes in Public Debt

	Actual			Projections							
	2011-2019	2020	2021	2022	2023	2024	2025	2026	2027	cumulative	debt-stabilizing primary balance [9/]
Change in gross public sector debt	3.0	14.2	-5.1	-3.9	-1.3	-1.9	-1.6	-1.9	-2.0	-12.6	
Identified debt-creating flows	1.9	5.0	-0.8	-5.9	0.7	-1.6	-1.3	-1.7	-1.8	-11.6	
Primary deficit	1.7	6.3	3.5	2.2	3.9	1.5	0.9	0.1	-0.1	8.5	-1.7
Primary (noninterest) revenue and grants	44.3	43.2	44.5	43.2	42.7	42.2	42.0	42.0	41.9	254.0	
Primary (noninterest) expenditure	46.1	49.6	48.0	45.4	46.6	43.7	42.9	42.1	41.8	262.5	
Automatic debt dynamics [5/]	0.1	3.7	-6.7	-7.2	-4.1	-3.1	-2.2	-1.7	-1.7	-20.1	
Interest rate/growth differential [6/]	0.1	3.7	-6.7	-7.2	-4.1	-3.1	-2.2	-1.7	-1.7	-20.1	
Of which: real interest rate	1.6	0.8	-0.8	-3.6	-3.0	-1.5	-0.5	0.0	0.1	-8.4	
Of which: real GDP growth	-1.5	2.9	-5.9	-3.6	-1.2	-1.6	-1.8	-1.8	-1.8	-11.7	
Exchange rate depreciation [7/]	0.0	0.0	0.0	...	...	...	...	...	...	...	
Other identified debt-creating flows	0.0	-5.1	2.3	-0.9	0.9	0.0	0.0	0.0	0.0	0.0	
Privatization/Drawdown of Deposits (- reduces financing need) (negative)	0.0	-5.1	2.3	-0.9	0.9	0.0	0.0	0.0	0.0	0.0	
Contingent liabilities	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	
Other debt-creating flows (specify) (+ increases financing need)	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	
Residual, including asset changes [8/]	1.1	9.2	-4.3	2.0	-2.0	-0.2	-0.2	-0.2	-0.2	-1.0	



Source: IMF staff.

1/ Public sector is defined as general government.

2/ Based on available data.

3/ Long-term bond spread over German bonds.

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

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

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

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

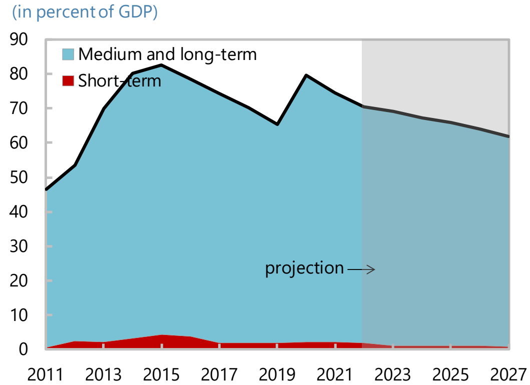
8/ Includes asset changes and interest revenues (if any). For projections, includes exchange rate changes during the projection period.

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

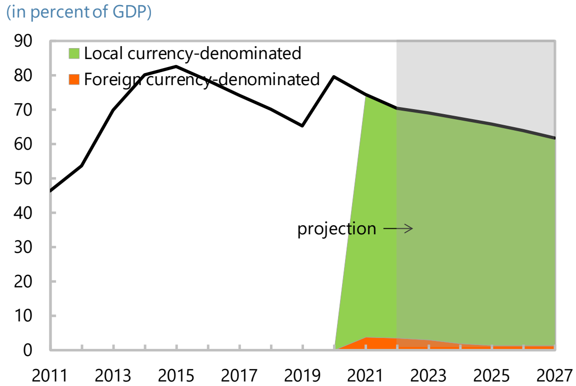
Figure AV. 2. Slovenia: Public Debt Sustainability Analysis—Composition of Public Debt and Alternative Scenarios

Composition of Public Debt

By Maturity
(in percent of GDP)



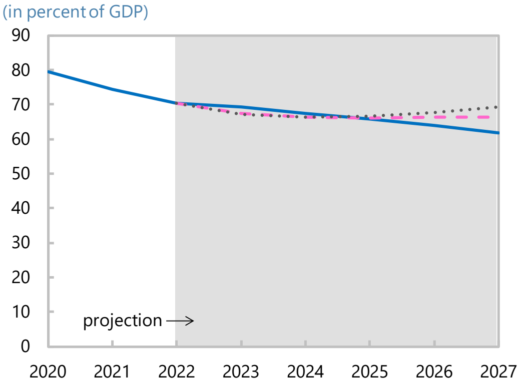
By Currency
(in percent of GDP)



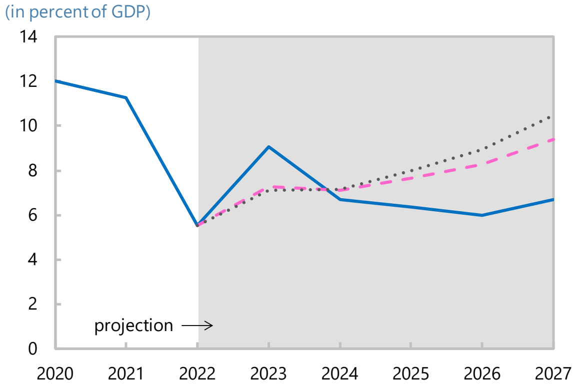
Alternative Scenarios

Baseline ········ Historical – – Constant Primary Balance

Gross Nominal Public Debt
(in percent of GDP)



Public Gross Financing Needs
(in percent of GDP)



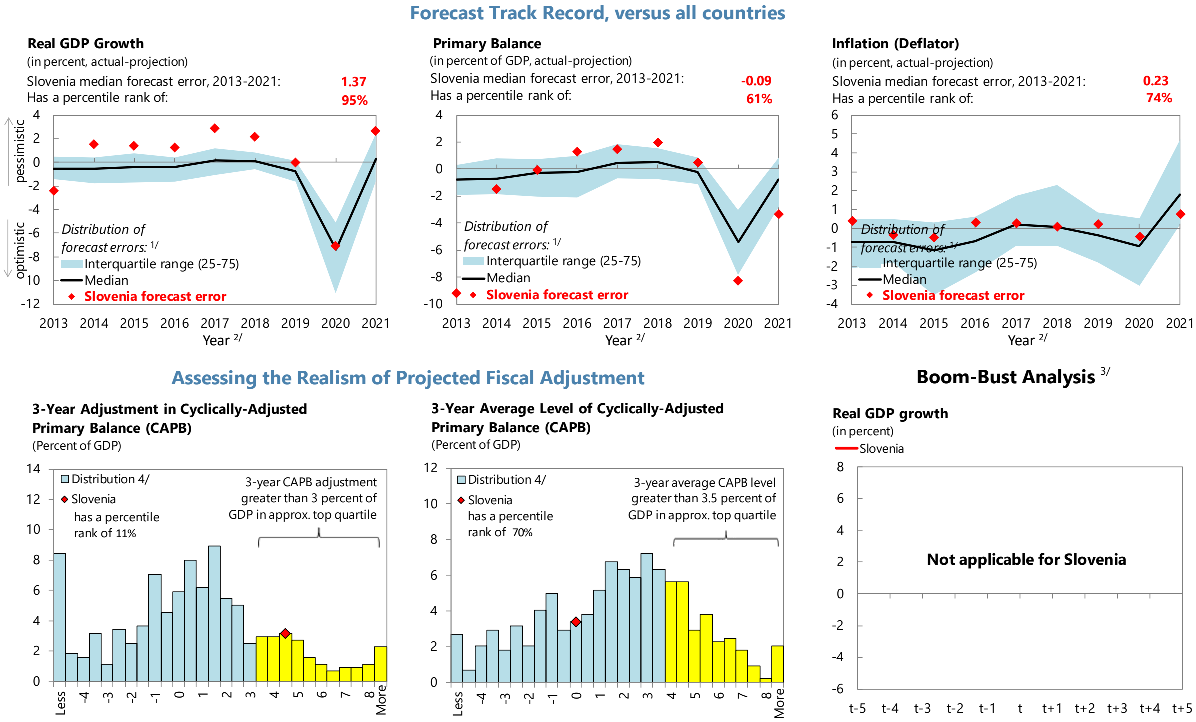
Underlying Assumptions
(in percent)

Baseline Scenario	2022	2023	2024	2025	2026	2027
Real GDP growth	5.4	1.8	2.4	2.8	2.9	3.0
Inflation	6.7	6.0	4.1	2.6	2.0	2.0
Primary Balance	-2.2	-3.9	-1.5	-0.9	-0.1	0.1
Effective interest rate	1.7	1.6	1.9	2.0	2.1	2.2
Constant Primary Balance Scenario						
Real GDP growth	5.4	1.8	2.4	2.8	2.9	3.0
Inflation	6.7	6.0	4.1	2.6	2.0	2.0
Primary Balance	-2.2	-2.2	-2.2	-2.2	-2.2	-2.2
Effective interest rate	1.7	1.6	1.8	1.9	2.1	2.3

Historical Scenario	2022	2023	2024	2025	2026	2027
Real GDP growth	5.4	2.1	2.1	2.1	2.1	2.1
Inflation	6.7	6.0	4.1	2.6	2.0	2.0
Primary Balance	-2.2	-2.0	-2.0	-2.0	-2.0	-2.0
Effective interest rate	1.7	1.6	2.2	2.6	3.2	3.7

Source: IMF staff.

Figure AV. 3. Slovenia: Public Debt Sustainability Analysis—Realism of Baseline Assumptions



Source : IMF Staff.

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

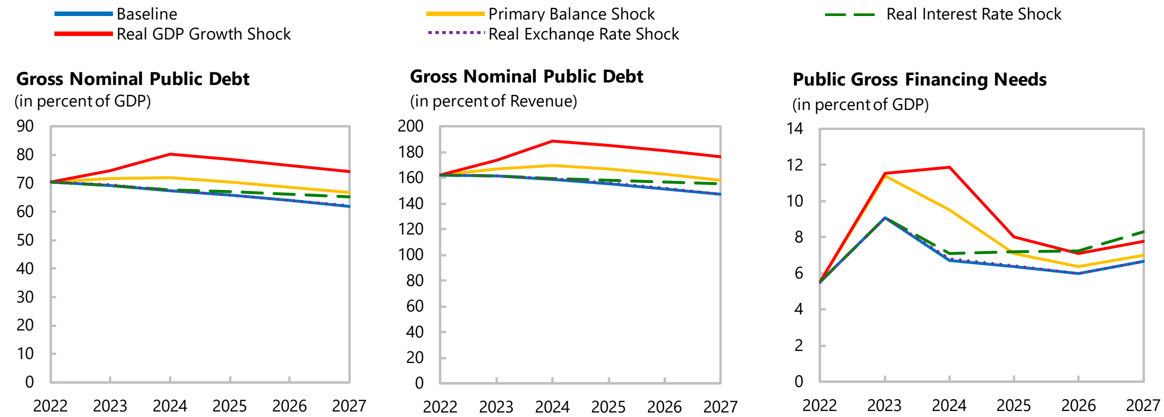
2/ Projections made in the spring WEO vintage of the preceding year.

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

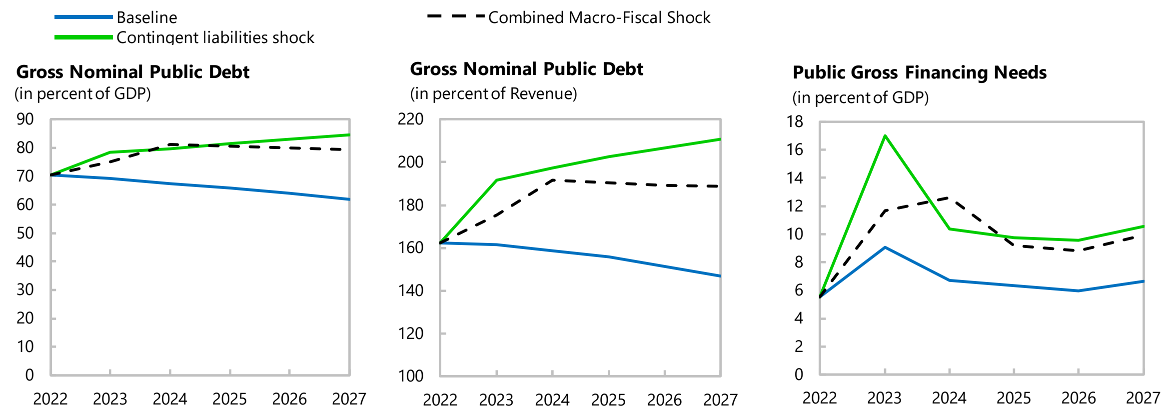
4/ Data cover annual obervations from 1990 to 2011 for advanced and emerging economies with debt greater than 60 percent of GDP. Percent of sample on vertical axis.

Figure AV. 4. Slovenia: Public Debt Sustainability Analysis—Stress Tests

Macro-Fiscal Stress Tests



Additional Stress Tests



Underlying Assumptions
(in percent)

Primary Balance Shock	2022	2023	2024	2025	2026	2027
Real GDP growth	5.4	1.8	2.4	2.8	2.9	3.0
Inflation	6.7	6.0	4.1	2.6	2.0	2.0
Primary balance	-2.2	-6.3	-3.8	-0.9	-0.1	0.1
Effective interest rate	1.7	1.6	2.0	2.2	2.4	2.5
Real Interest Rate Shock						
Real GDP growth	5.4	1.8	2.4	2.8	2.9	3.0
Inflation	6.7	6.0	4.1	2.6	2.0	2.0
Primary balance	-2.2	-3.9	-1.5	-0.9	-0.1	0.1
Effective interest rate	1.7	1.6	2.5	3.1	3.8	4.4
Combined Shock						
Real GDP growth	5.4	-2.0	-1.3	2.8	2.9	3.0
Inflation	6.7	5.1	3.2	2.6	2.0	2.0
Primary balance	-2.2	-6.3	-5.7	-0.9	-0.1	0.1
Effective interest rate	1.7	1.6	2.7	3.6	4.3	4.9

Real GDP Growth Shock	2022	2023	2024	2025	2026	2027
Real GDP growth	5.4	-2.0	-1.3	2.8	2.9	3.0
Inflation	6.7	5.1	3.2	2.6	2.0	2.0
Primary balance	-2.2	-6.2	-5.7	-0.9	-0.1	0.1
Effective interest rate	1.7	1.6	2.0	2.3	2.5	2.6
Real Exchange Rate Shock						
Real GDP growth	5.4	1.8	2.4	2.8	2.9	3.0
Inflation	6.7	6.4	4.1	2.6	2.0	2.0
Primary balance	-2.2	-3.9	-1.5	-0.9	-0.1	0.1
Effective interest rate	1.7	1.6	1.9	2.0	2.1	2.2

Source: IMF staff.

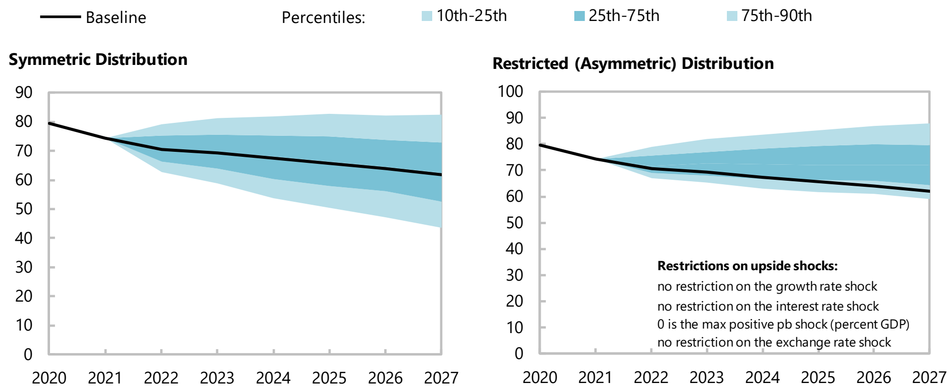
Figure AV. 5. Slovenia: Public Debt Sustainability Analysis—Risk Assessment

Heat Map

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

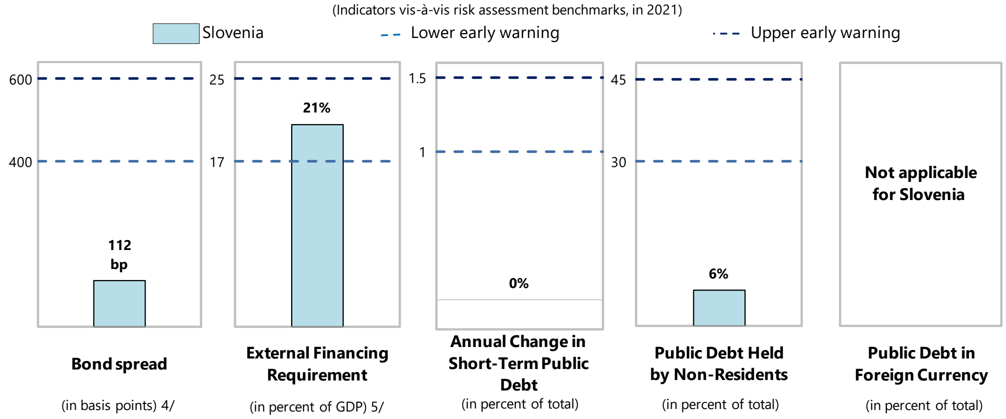
Evolution of Predictive Densities of Gross Nominal Public Debt

(in percent of GDP)



Debt Profile Vulnerabilities

(Indicators vis-à-vis risk assessment benchmarks, in 2021)



Source: IMF staff.

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

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

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

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

4/ Long-term bond spread over German bonds, an average over the last 3 months, 05-Aug-22 through 03-Nov-22.

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

INTERNATIONAL MONETARY FUND

REPUBLIC OF SLOVENIA

STAFF REPORT FOR THE 2022 ARTICLE IV CONSULTATION—INFORMATIONAL ANNEX

December 13, 2022

Prepared By

European Department
(In Consultation with Other Departments)

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FUND RELATIONS

(As of October 31, 2022)

Membership Status: Joined December 14,1992; Article VIII

General Resources Account:

	SDR Million	Percent of Quota
Quota	586.50	100
Fund holdings of currency	429.56	73.24
Reserve position	156.96	26.76
Lending to the Fund		
Borrowing Agreement		

SDR Department:

	SDR Million	Percent of Allocation
Net cumulative allocation	778.02	100.00
Holdings	794.65	102.14

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				
	2022	2023	2024	2025	2026
Principal					
Charges/Interest		0.01	0.01	0.01	0.01
Total		0.01	0.01	0.01	0.01

Exchange Rate Arrangement:

The currency of Slovenia is the euro. The exchange rate arrangement of the euro area is free floating. Slovenia participates in a currency union (EMU) with 18 other members of the EU and has no separate legal tender. Slovenia has accepted the obligations under Article VIII, Section 2(a), 3, and 4, and maintains an exchange system that is free of multiple currency practices and restrictions on the making of payments and transfers for current international transactions, except for those measures imposed for security reasons, in accordance with Regulations of the Council of the European Union, as notified to the Fund under Executive Board Decision No. 144-(52/51).

Article IV Consultation:

Slovenia is on the 12-month Article IV consultation cycle. Discussions were held in Ljubljana and by video conference during November 10–21, 2022 with the Bank of Slovenia Governor Boštjan Vasle, Minister of Finance Klemen Boštjančič, members of the Parliamentary Committee on Finance, other senior officials, representatives of the private sector and labor unions. The team also held a conference call with the Single Supervisory Mechanism. Mr. Pucnik (OED) attended the meetings and Mr. Palotai (OED) joined the concluding meeting.

The mission comprised Mr. McGettigan (Head), Ms. Hassine, Mr. Rozenov and Ms. Shi (all EUR), A. Kahn and N. Schwarz (LEG), and Mr. Choi (MCM).

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

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

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

Technical Assistance: See Table 1.

Resident Representative Post: None.

Table 1. Republic of Slovenia: Technical Assistance, 2012–22

Department	Timing	Purpose
MCM	April 2022	Cyber Risk Management
	February 2016	Bank Intervention and Resolution and Deposit Guaranty System - Follow Up
	November 2015	Macroprudential Framework - Follow-up
	July 2015	Bank Intervention and Resolution and Deposit Guaranty System
	June 2015	Macroprudential Framework Scoping Mission and Participation in Staff Visit
	December 2014	Bank Resolution and Deposit Insurance
	September 2014	Strengthening bank resolution framework and deposit guarantee scheme
	July 2014	Financial Stability
	May 2014	Financial Stability
	May 2014	Strengthen Supervision for Risk Assessment
	April 2014	Financial Stability
	January 2014	Financial Stability
	December 2013	Financial Stability
	November 2013	Stress Testing/AQR Workshop
	December 2013	Bank Resolution (participation in EUR staff visit)
	January 2013	Bank Resolution
	October 2012	Bank Resolution
	September 2012	Bank Resolution with Article IV
LEG	December 2021	Public Finance Law
	October 2013	Insolvency Law
FAD	January 2022	Fiscal modeling
	December 2021	Public Finance Law
	August 2021	Strengthening Tax Administration
	February 2021	Fiscal Risks
	December 2020	Estimating Fiscal Multipliers of Public Investment
	October 2015	Property Tax Act
	May 2015	Establishing a Spending Review Process
ICD	January 2022	Macroeconomic Modeling

STATISTICAL ISSUES

Data provision is adequate for surveillance purposes.

Special Data Dissemination Standard: Slovenia joined the Special Data Dissemination Standard Plus (SDDS Plus) — the highest tier of the Data Standards Initiatives — in February 2020, and posts its metadata on the Fund's Dissemination Standards Bulletin Board on the Internet: https://dsbb.imf.org/sddsplus/country/SVN/category

Real Sector Statistics: The Statistical Office of the Republic of Slovenia (SORS) follows the European System of Accounts 2010 (ESA10). Quarterly GDP estimates by industry and expenditure categories are compiled in both current and constant prices and published within 80 days after the reference quarter. In September 2005, the SORS changed the base year for compiling constant prices GDP from 2000 to the previous year's prices and started using the chain–link index methodology.

The Harmonized Index of Consumer Prices (HICP) is compiled for monitoring compliance with the Maastricht inflation criterion. However, price collection is restricted to four cities and their surrounding rural areas. The weights are based on expenditure data for consumer goods from Household Budget Surveys for 2019. It also compiles a consumer price index (CPI), which differs from the HICP in weights only and a house price index.

Government Finance Statistics: Slovenian fiscal statistics are timely and of a high quality. The ministry of finance publishes a comprehensive monthly *Bulletin of Government Finance*, which presents monthly data on the operations of the "state budget" (Budgetary Central Government), local governments, social security (Pension and Health funds), and the consolidated general government. The coverage of consolidated fiscal accounts in the national presentation excludes the operations of extra-budgetary funds and own revenues of general government agencies *(zavods)*. However, these operations are small in size.

Monthly fiscal indicators are reported for publication in *IFS* on a timely basis and annual statistics covering general government operations, including the operations of the extra-budgetary funds are reported to the IMF Annual and Quarterly Database and for publication in the *Government Finance Statistic Yearbook* (*GFS Yearbook*). Annual and high frequency fiscal data are compiled on ESA 2010 basis. Fiscal data in the *GFSM 2014* framework is reported through the Eurostat convergence project with the IMF.

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

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

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

Republic of Slovenia: Table of Common Indicators Required for Surveillance (As of November 2022)					
	Date of Latest Observation	Date Received or Posted	Frequency of Data[6]	Frequency of Reporting[6]	Frequency of Publication[6]
Exchange Rates	11/2022	11/2022	D	D	D
International Reserve Assets and Reserve Liabilities of the Monetary Authorities[1]	10/2022	11/2022	M	M	M
Reserve/Base Money	10/2022	11/2022	M	M	M
Broad Money	10/2022	11/2022	M	M	M
Central Bank Balance Sheet	10/2022	11/2022	M	M	M
Consolidated Balance Sheet of the Banking System	10/2022	11/2022	M	M	M
Interest Rates[2]	11/2022	11/2022	D	D	D
Consumer Price Index	10/2022	10/2022	M	M	M
Revenue, Expenditure, Balance and Composition of Financing[3] – General Government[4]	09/2022	11/2022	M	M	M
Revenue, Expenditure, Balance and Composition of Financing[3]– Central Government	09/2022	11/2022	M	M	M
Stocks of Central Government and Central Government-Guaranteed Debt[5]	09/2022	11/2022	M	M	M
External Current Account Balance	09/2022	11/2022	M	M	M
Merchandise Trade	09/2022	11/2022	M	M	M
GDP/GNP	Q3/2022	11/2022	Q	Q	Q
Gross External Debt	09/2022	11/2022	M	M	M
International Investment Position	Q2/2022	09/2022	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).