IMF Country Reports 23/120

Republic of Slovenia: 2024 Article IV Consultation-Press Release; Staff Report; and Statement by the Executive Director for the Republic of Slovenia

INTERNATIONAL MONETARY FUND

IMF Country Report No. 24/120

REPUBLIC OF SLOVENIA

May 2024

2024 ARTICLE IV CONSULTATION—PRESS RELEASE; STAFF REPORT; AND STATEMENT BY THE EXECUTIVE DIRECTOR FOR THE REPUBLIC OF SLOVENIA

Under Article IV of the IMF's Articles of Agreement, the IMF holds bilateral discussions with members, usually every year. In the context of the 2024 Article IV consultation with the Republic of Slovenia the following documents have been released and are included in this package:

- A **Press Release** summarizing the views of the Executive Board as expressed during its May 3, 2024, consideration of the staff report that concluded the Article IV consultation with the Republic of Slovenia.
- The **Staff Report** prepared by a staff team of the IMF for the Executive Board's consideration on May 3, 2024, following discussions that ended on January 30, 2024, with the officials of the Republic of Slovenia on economic developments and policies. Based on information available at the time of these discussions, the staff report was completed on April 10, 2024.
- An **Informational Annex** prepared by the IMF staff.
- A **Statement by the Executive Director** for the Republic of Slovenia.

The documents listed below have been or will be separately released.

Selected Issues

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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PRESS RELEASE

PR 24/158

IMF Executive Board Concludes 2024 Article IV Consultation with Slovenia

FOR IMMEDIATE RELEASE

Washington, DC – May 14, 2024: The Executive Board of the International Monetary Fund (IMF) concluded the Article IV consultation[1] with the Republic of Slovenia on Friday, May 3, 2024.

Slovenia's economy recovered well from the pandemic, only to be hit by spillovers from the war in Ukraine, followed by severe flooding in 2023. After a strong recovery in 2021, growth slowed in 2022 because of adverse energy price spillovers from the war in Ukraine and supply chain disruptions. Severe floods in August 2023 posed new challenges, with direct damages estimated by the authorities at almost 5 percent of GDP, and the cost of upgrading infrastructure to be more climate resilient estimated to be much higher. Inflation has fallen from earlier highs as pressures from commodity prices abated, and as tighter monetary policy fed through to prices.

Growth is expected to recover and inflation to fall further this year, although uncertainty remains high and risks appear on the downside. Growth is expected to increase to about 2 percent in 2024, led by domestic demand, including because of higher flood-related investment, and higher consumption as real wages recover. Inflation is projected to decline to below 3 percent by end-year and to 2 percent in 2025. External risks include an intensification of regional conflicts, renewed commodity price volatility, and lower external demand. Supply chain disruptions pose additional risks but also may create opportunities for Slovenia in the event of nearshoring. Labor shortages and broader capacity constraints could affect post-flood reconstruction or undermine disinflation. Severe weather events also remain a risk.

Executive Board Assessment[2]

Executive Directors agreed with the thrust of the staff appraisal. They commended the authorities for Slovenia's economic resilience and their timely and effective policy response to shocks, including the recent devastating floods. Directors looked forward to the envisaged recovery, while recognizing that the outlook is subject to uncertainty and downside risks. They underscored the need to maintain prudent fiscal and macroprudential policies and advance structural reforms to boost growth, accelerate income convergence with the EU, and strengthen climate resilience.

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

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

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Directors agreed that stronger medium-term fiscal consolidation and fiscal reforms are important to rebuild fiscal space and underpin debt sustainability, especially given the expected increase in age-related spending. Noting the increase in core public spending and the high tax wedge, Directors called for expenditure-driven consolidation, accompanied by pension, health, tax, and public sector wage reforms. Eliminating remaining pandemic and energy-related measures would also support consolidation. Directors welcomed the authorities' transparent handling of flood-related spending and underscored the need for careful prioritization and phasing. They recognized the potential negative effects of the new bank asset tax and agreed that it should be allowed to lapse after the allotted 5-year period. Noting the expected increase in public investment, Directors recommended enhancing the efficiency of capital spending by implementing recommendations from the recent Public Investment Management Assessment.

Directors agreed that the banking system appears sound, with strong profitability, capital, and liquidity, and with low non-performing loans. High interest rates have, however, increased repayment and rollover risks, warranting continued close monitoring of bank assets. Directors concurred that the Bank of Slovenia's macroprudential stance is appropriate and that the planned increase in the neutral countercyclical capital buffer will help to strengthen the banking system's capacity to respond to adverse shocks. They also welcomed progress on strengthening the AML/CFT framework.

Directors called for structural reforms to boost productivity growth, supported by the EU-backed National Recovery and Resilience Plan. They underscored the need to address skill mismatches, improve regulatory quality, and deepen capital markets. Reducing the tax wedge on labor would help to support a higher labor supply. Directors welcomed the authorities' emphasis on investment in the digital and green transitions. They also stressed the need to continue to adapt to climate change and for timely preparation of a national climate adaptation strategy.

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

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Slovenia: Selected Economic Indicators, 2020–25

(Annual percentage change, unless noted otherwise)

	2020	2021	2022	2023	2024	2025
				Prel.	Projections	
Real economy						
Real GDP	-4.2	8.2	2.5	1.6	2.0	2.5
Domestic demand (contribution to growth)	-3.9	9.2	3.5	-1.2	3.7	3.0
Private consumption	-6.5	10.3	3.6	1.3	1.3	2.6
Public consumption	4.2	6.1	-0.5	2.4	5.4	2.6
Gross capital formation	-6.3	13.9	7.9	-9.8	12.2	5.0
Gross fixed capital formation	-7.2	12.6	3.5	9.5	5.9	3.1
Net exports (contribution to growth)	-0.3	-1.0	-1.0	2.8	-1.7	-0.5
Exports of goods and services	-8.5	14.5	7.2	-2.0	2.9	4.3
Imports of goods and services	-9.1	17.8	9.0	-5.1	5.2	5.1
Output gap (in percent of potential GDP)	-2.2	2.3	1.9	0.7	0.2	0.0
Unemployment rate (in percent, ILO definition)	5.0	4.7	4.0	3.7	3.7	3.8
Prices						
Consumer prices (national def., period average)	-0.1	1.9	8.8	7.4	2.7	2.0
Core inflation (period average) 1/	1.0	1.0	6.8	7.8	2.9	2.0
Public finance (percent of GDP)						
General government balance	-7.6	-4.6	-3.0	-2.5	-3.0	-2.7
Cyclically-adjusted general government balance	-6.6	-5.6	-3.8	-2.8	-3.1	-2.7
Structural balance 2/	-6.6	-5.6	-3.8	-2.7	-2.4	-2.2
Structural primary balance 2/	-5.2	-4.4	-2.9	-2.0	-1.4	-1.0
General government gross debt	79.6	74.4	72.5	69.2	68.1	67.4
Monetary and financial indicators						
Credit to the private sector	-1.0	5.0	9.5	-0.6	2.0	3.7
Lending rates 3/	1.8	1.6	2.0	4.9	5.5	...
Deposit rates 4/	0.1	0.1	0.1	0.8	1.4	...
Government bond yield (10-year)	0.1	0.1	1.9	3.4	...	...
Balance of payments (percent of GDP)						
Current account balance	7.2	3.3	-1.0	4.5	2.7	2.1
Trade balance (goods and services)	0.8	-2.1	-3.1	2.8	0.3	0.0
Gross external debt (percent of GDP, end-period)	102.1	97.4	90.9	91.8	87.0	83.7
Nominal effective exchange rate (2010=100)	106.8	107.7	106.7	109.6	...	...
Real effective exch. rate (2010=100, CPI-based)	98.0	97.6	96.5	99.4	...	...
Memorandum items						
Population (millions)	2.1	2.1	2.1	2.1	2.1	2.1
Nominal GDP (EUR millions)	47,045	52,279	57,038	63,090	66,900	69,995
GDP per capita (EUR)	22,447	24,789	27,068	29,802	31,572	33,023

Sources: Slovenia authorities and IMF staff estimates and projections.

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

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

3/ Floating or up-to-one-year fixed rate for new loans to NFCs over €1 million. 2024 value shows an average for the first two months.

4/ For household time deposits with maturity up to one year. 2024 value shows an average for the first two months.

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INTERNATIONAL MONETARY FUND

REPUBLIC OF SLOVENIA

STAFF REPORT FOR THE 2024 ARTICLE IV CONSULTATION

April 10, 2024

KEY ISSUES

Context: Slovenia has weathered the pandemic and the energy price shocks well, but long-term challenges remain. Ageing of Slovenia's population is a challenge, and private investment has softened over the past decade. The 2023 floods caused significant damage.

Outlook and risks: Growth is expected to accelerate, driven by a recovery in domestic demand. Inflation is projected to continue to decline, reflecting tight ECB monetary policy and global food and energy prices declines. The outlook remains subject to high uncertainty, with risks stemming from an intensification of regional conflicts, renewed commodity price volatility, and lower trading partners' demand on the external side and labor shortages and broader capacity constraints on the domestic side. Severe weather events also remain a risk.

Key policy recommendations: Policies should focus on maintaining prudent fiscal and macroprudential stances and on advancing structural reforms.

- *Fiscal policy:* Given underlying increase in core public spending in recent years, age-related spending pressures, and relatively high public debt, sustained fiscal consolidation and fiscal reforms, including in taxation, the pension, public wage and health systems, are needed to underpin long-term public debt sustainability. Post-flood reconstruction should aim to boost resilience and be based on a well-prepared and prioritized plan.
- *Financial policies:* Uncertainty and macroeconomic risks warrant continued close monitoring of bank asset quality and the increase in the countercyclical capital buffer to one percent would strengthen the capacity of the banking system to respond to future shocks. The macroprudential stance is appropriate.
- *Structural policies:* Deeper structural reforms would help boost growth and foster income convergence. Longer-term limits on employment growth call for reforms enhancing productivity growth, including improving regulatory quality, building human capital, and deepening the financial sector. 2023 floods underscore the importance of continuing to adapt to climate change.

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Approved By
Laura Papi (EUR) and Fabian Bornhorst (SPR)

Discussions took place in Ljubljana during January 18–30, 2024. The staff team comprised D. McGettigan (mission head), S. Armendariz, D. Kovtun, M. Pinat, and R. Rozenov (all EUR). K. Kirabaeva, J. Mochizuki, and J. Ren (FAD), and A. Kahn (LEG) joined some meetings from headquarters. The mission was assisted by I. Alasal, M. Quin, N. Kumar, B. Plein and V. Timonova (EUR). Staff met with the Bank of Slovenia Governor Boštjan Vasle, Minister of Finance Klemen Boštjančič, members of the parliamentary committee on finance and monetary policy, other senior officials, representatives of the private sector, and labor unions.

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TABLES

ANNEXES

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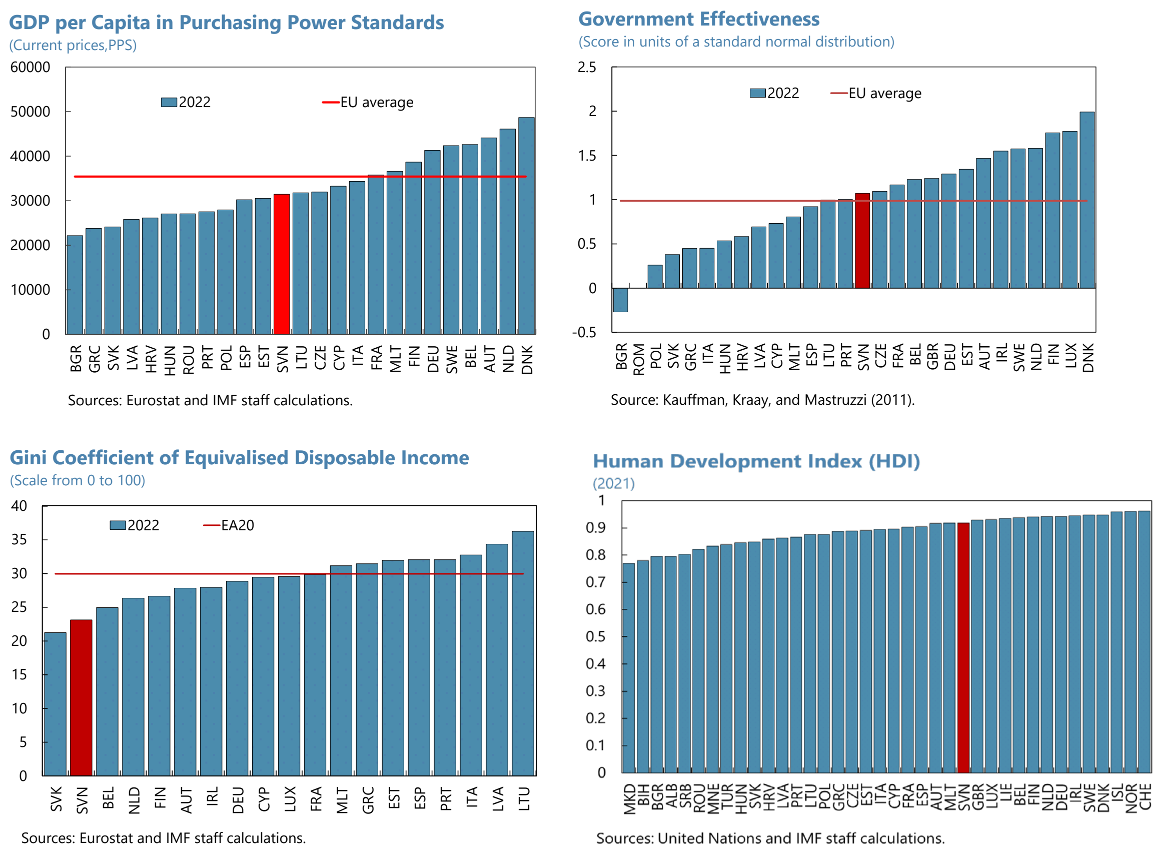
CONTEXT

1. **Slovenia is a high-income Eurozone member with strong human development and governance indicators.** Slovenia has high per capita income and one of the lowest inequality rates in Europe. The country also scores highly on human development indicators and has effective institutions.

Figure 1. Slovenia: Human Development and Governance Indicators



2. **The economy has weathered the pandemic and recent energy price shocks well, but long-term challenges remain.** Although growth fell sharply in the wake of the pandemic, growth rebounded in 2021, only to be dragged down in 2022 by the adverse impact of Russia's invasion of Ukraine. Government policies, which have been broadly in line with past IMF advice (Annex I), have played an important role in supporting economic activity despite the shocks. Slovenia's ageing population remains a challenge, however, and private investment has softened over the last decade, posing challenges to deeper income convergence with the EU.

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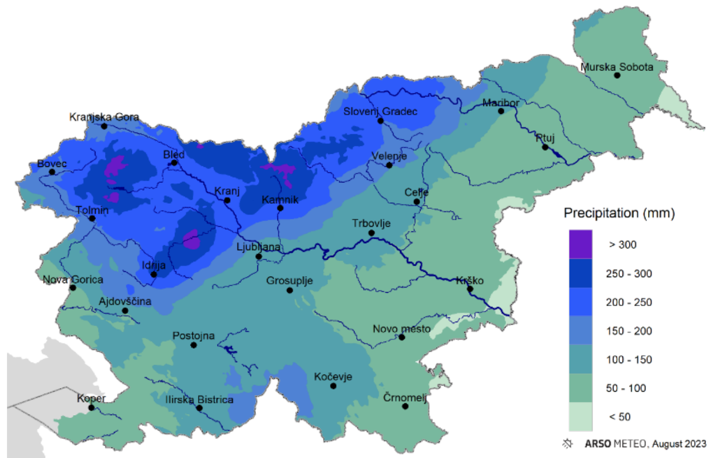
3. Slovenia was hit by severe floods in August 2023, which caused significant damage. About two-thirds of the country was affected, and the government has estimated direct damages to infrastructure and other assets at €3 billion (5 percent of GDP), with the total cost, including upgrading infrastructural climate resilience, assessed at €10 billion (Box 1). Soon after the floods, the government adopted emergency flood relief legislation aimed at assisting affected households and businesses, repairing infrastructure, and strengthening flood prevention. Legislation on the post-flood reconstruction and its financing was approved by the government in November, and included a temporary tax on bank assets.

Impact of the Floods

Rainfall accumulation over August 1–6 (mm)



Sources: The Ministry of Environment, Climate and Energy and ARSO Meteo. The image is reproduced from August 2023 Hydrometeorological Report.

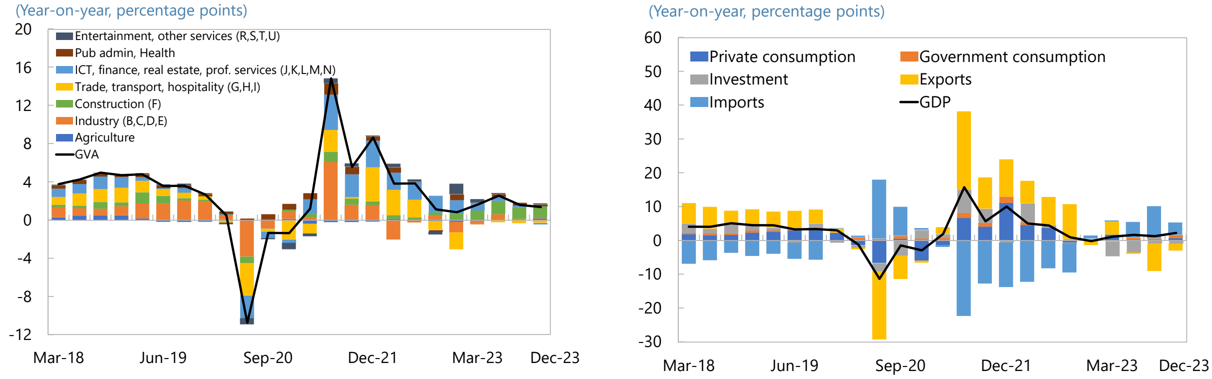
RECENT DEVELOPMENTS

4. Growth softened in 2023 as domestic demand fell. Real GDP growth fell by about 1 ppt to 1.6 percent in 2023. Private consumption growth slowed as the effects of reopening after the pandemic faded and investment fell sharply, mainly because of the unwinding of stocks accumulated previously. Although exports declined due to weaker demand in Slovenia's trading partners, imports fell by even more, reflecting lackluster consumption and falling inventories, with net exports contributing positively to growth as a result. Strong construction activity was a key driver of growth on the supply side. While the floods caused significant damage to the capital stock, their impact on GDP growth was contained.

Figure 2. Slovenia: GDP and Gross Value Added

Contributions to GVA Growth (Year-on-year, percentage points)

Contributions to GDP Growth (Year-on-year, percentage points)



Sources: Haver Analytics and IMF staff calculations.

Sources: Haver Analytics and IMF staff calculations.

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Box 1. Slovenia: August 2023 Floods: Damages and the Authorities' Response

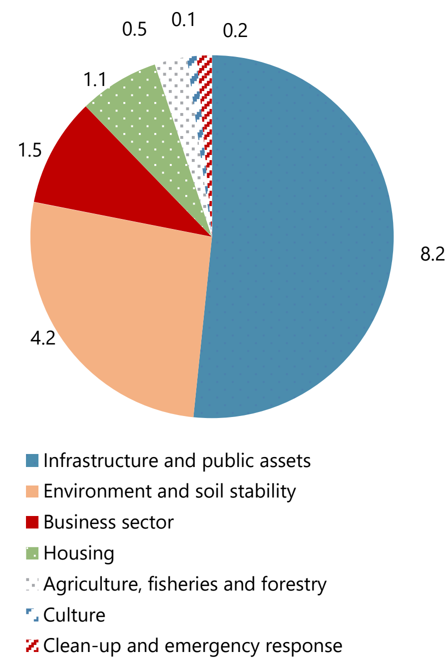
The floods in August 2023 inflicted significant infrastructural and broader damage. The authorities' swift and decisive response was instrumental in alleviating the consequences.

The Post-Disaster Needs Assessment (PDNA), conducted shortly after the floods, estimated total costs, including upgrading climate resilience, at about 16 percent of GDP (€10 billion), most of which (€8 billion) is in the public sector. The estimate of direct damages at replacement costs in the national methodology was lower, at about €3 billion (5 percent of GDP).

The authorities promptly passed special legislation providing a range of support measures. In 2023, immediate financial assistance and reconstruction spending on a cash basis amounted to 0.9 percent of GDP (estimated accrual-based spending of 0.6 percent of GDP). About 1.6 percent of GDP in expenditure is budgeted for this year, which will be allocated to reconstruction projects as they become ready. The government will also provide firms affected by floods with loan guarantees and with interest subsidies of up to 30 percent of estimated damage costs, up to €500 million (0.7 percent of GDP).[1] Beyond spending, concessional loans will be granted to affected firms and individuals and will be managed by the state development bank (SID Bank).

The fiscal financing strategy for flood-related spending combines revenue measures, outside financing, and drawing on existing fiscal buffers. Revenue measures include an increase (3 ppts) in the corporate income tax for 2024–28, non-adjustment of PIT brackets in 2024, and a temporary tax on bank assets for 2024–28. The authorities received an initial transfer of €100 million (0.2 percent of GDP) from the EU Solidarity Fund in late November 2023 and €300 million is expected this year. Profits of the state asset manager Slovenian Sovereign Holding (SSH), state budget funds, and donations are expected to supplement available resources.

Post-Disaster Needs Assessment: Total Costs of Floods
(Percent of GDP)



Source: The Slovenian authorities.

Fiscal Policy Response to the Floods
(Percent of GDP)

	Estimated impact		
	2023	2024	2025
Revenue measures and grants	**0.2**	**1.0**	**0.4**
Increase in corporate income tax	0.1	0.2	0.2
Non-adjustment of PIT brackets	...	0.1	...
Tax on bank assets	...	0.1	0.2
EU funds	0.2	0.4	...
Expenditure measures 1/	**0.6**	**1.6**	**0.9**
Reconstruction of public infrastructure		0.7	0.9
Reimbursement for lost income		0.5	...
Immediate financial assistance for reconstruction		0.4	...
Net impact on the budget	**0.4**	**0.6**	**0.5**
Below the line support	**0.2**	**0.2**	**0.2**
Support to the state development bank	0.2	0.2	0.2
Total fiscal support 2/	**0.8**	**1.8**	**1.1**

Sources: The Slovenian authorities and IMF staff estimates.
1/ 2023 value is an estimate on the accrual basis taking into account factual spending on the cash basis (€560 million) adjusted for prepayments to municipalities.
2/ Fiscal expenditure and support to the state development bank.

1/ The government will guarantee 100 percent of the principal amount of individual loans taken to repair flood-related damage up to €100,000 for each borrower and cover the entire interest costs of the loans, up to €200 million (0.3 percent of GDP).

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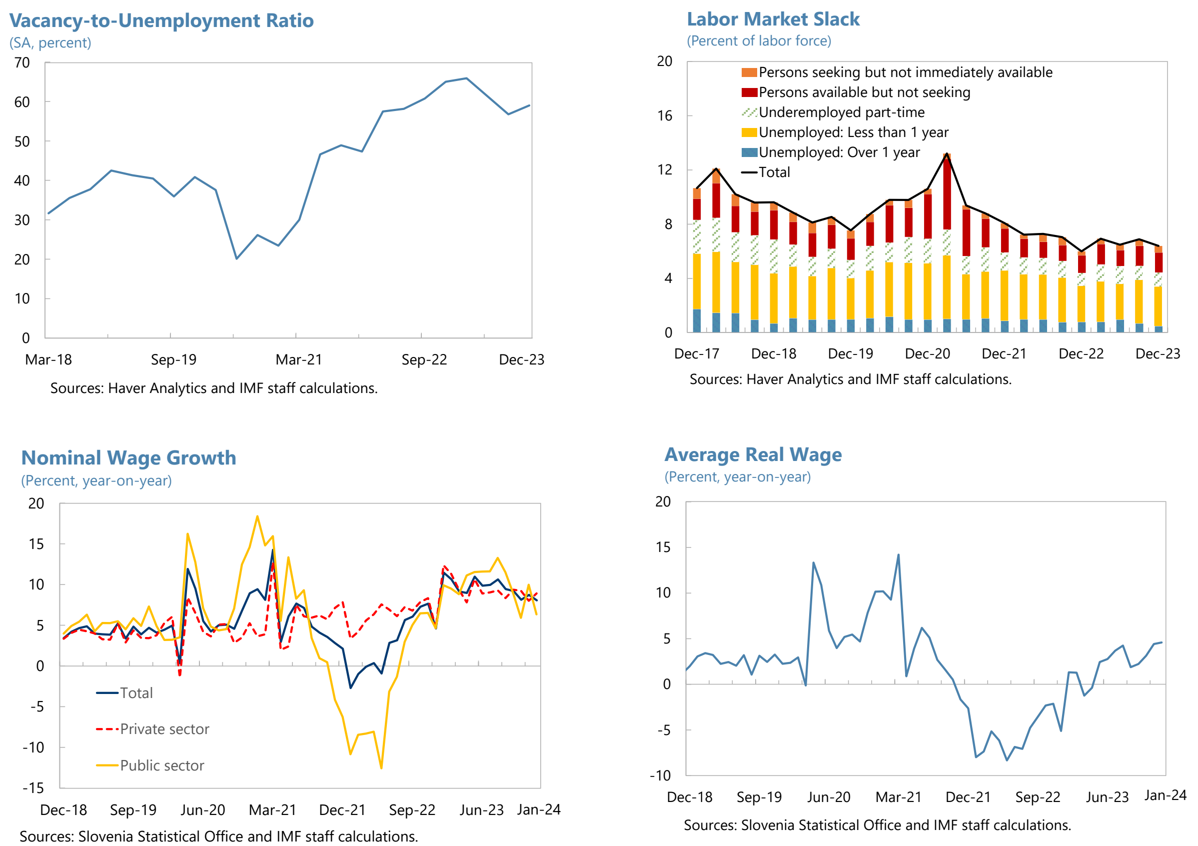
5. **Despite slower growth, the labor market remains tight.** The 4-quarter average unemployment rate fell to a historic low of 3.7 percent in 2023. The vacancy to unemployment ratio remains high, despite some decline, with several sectors experiencing staff shortages, in particular construction, hospitality, and administrative services. Also reflecting labor market tightness, and underlying ageing trends in Slovenia, a rising share of job vacancies has been filled with foreign workers, with these workers accounting for over 90 percent of the increase in employment in 2023 from a year earlier. Against this backdrop, nominal wages rose by close to 10 percent in 2023 and real wage growth turned positive following sharp declines in 2022.

Figure 3. Slovenia: Labor Market Indicators



6. **Inflation has eased.** External pressures from commodity prices and supply chain bottlenecks have largely dissipated, with headline CPI inflation falling from almost 10½ percent in March 2023 to about 3½ percent in March 2024. Core inflation also declined to below 4 percent in early 2024, more than halving from its peak in January 2023. The inflation slowdown is driven by tight monetary policy and softer economic growth, as well as by helpful base effects. Food and energy prices have contributed most to the decline, although the services sector has experienced higher inflation in a context of strong wage growth and a tight labor market. Falling inflation has in turn shrunk the positive inflation gap with the euro area. Inflation momentum—both headline and core—has also slowed in recent months, supported in turn by falling inflation expectations.

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Figure 4. Slovenia: Inflation Developments

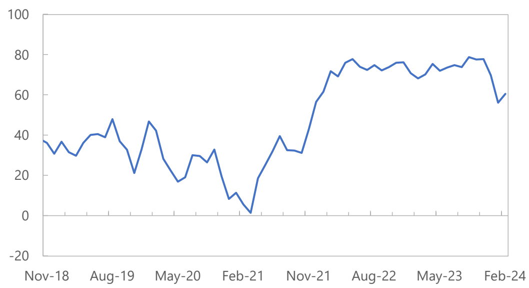
(Year-on-year growth unless indicated otherwise)

	2023					2024		
	Jan.	Mar.	Jun.	Sep.	Dec.	Jan.	Feb.	Mar.
Year-on-year growth								
Headline (CPI)	10.0	10.5	6.9	7.4	4.2	3.3	3.4	3.6
Headline (HICP)	9.9	10.4	6.6	7.1	3.8	3.4	3.4	3.4
Core (HICP)	9.5	9.4	8.5	7.3	4.6	3.7	3.8	…
Inflation momentum 1/								
Headline (CPI_SA)	11.5	6.4	5.1	7.1	-1.2	-2.4	2.1	4.0
Headline (HICP_SA)	10.3	5.7	4.6	7.2	-1.6	-2.4	2.0	4.0
Core (HICP_SA)	12.6	7.3	6.6	3.8	1.2	1.4	2.9	…

1/ 3-month moving average of annualized month-on-month changes of the corresponding seasonally adjusted index.

Inflation Diffusion Index[1]

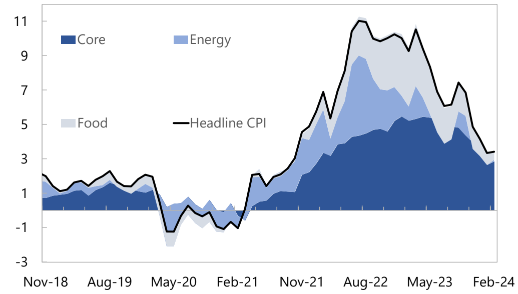
(Percent)



Sources: Haver Analytics and IMF staff calculations.
1/ Share of items with increasing prices minus share of items with decreasing prices.

Contributions to Inflation

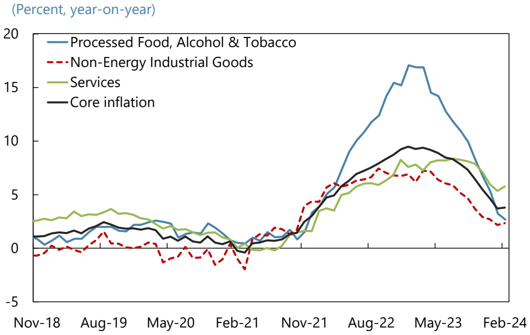
(Percentage points, year-on-year)



Sources: Haver Analytics and IMF staff calculations.

Core Inflation Composition

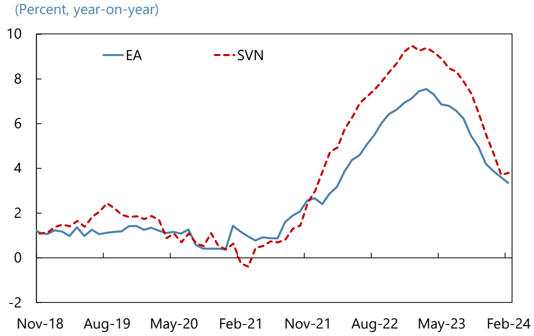
(Percent, year-on-year)



Sources: Haver Analytics, Eurostat and IMF staff calculations.

Core Inflation

(Percent, year-on-year)



Sources: Haver Analytics, Eurostat and IMF staff calculations.

7. **Staff's assessment suggests that the external position in 2023 is stronger than the level implied by fundamentals and desirable policies.** After a deficit of 1 percent of GDP in 2022 on the back of high import prices, especially in energy, the current account balance (CAB) moved to a surplus of 4.5 percent of GDP in 2023, driven by a decline in import volumes and a modest improvement in the terms of trade. The CAB is stronger than the norm suggested by the EBA-lite methodology (1.9 percent of GDP, Annex II), implying a 2.7 percent current account gap and a 4 percent real exchange rate undervaluation, although these model-based estimates are subject to uncertainty.

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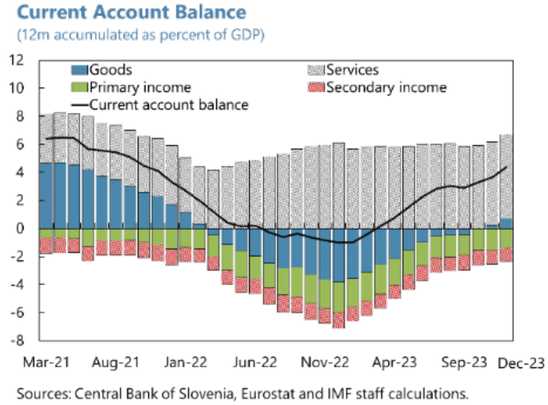
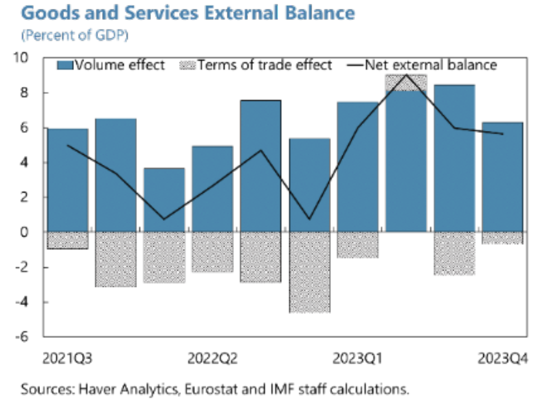
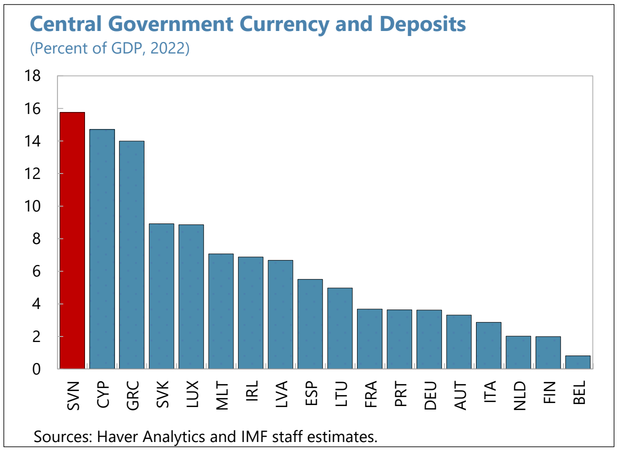
Figure 5. Slovenia: External Sector Developments





8. **Despite the floods, the fiscal deficit decreased to 2.5 percent of GDP in 2023 and public debt also declined and the government's liquidity position remained healthy.** Revenue increased by about 11 percent in 2023, helped by inflation and strong EU fund inflows, while expenditure rose by almost 10 percent, mainly driven by underlying ("core") and flood-related expenditure. Savings from energy measures, as energy prices fell, have been repurposed to finance emergency floods spending and complemented with additional expenditure, leading to a lower deficit (down by 0.5 percent of GDP to 2.5 percent of GDP in 2023). Reflecting high nominal GDP growth and a low interest burden, the public debt ratio continued to fall in 2023, to about 69 percent of GDP in gross terms (about 53 percent in net terms). Sizeable government deposits at the Bank of Slovenia accumulated during the period of low interest rates, which drive the large difference between gross and net debt, constitute a large buffer.



9. **The financial sector appears sound and profitable, while credit growth is slowing.** Banks are well-capitalized and liquid (Table 5). Non-performing exposures (NPEs) stand at around 1 percent of the total, a historic low. Stage 2 loans are relatively low, standing at 5 percent of the total. Profitability has improved significantly on the back of net interest income, which doubled in 2023 compared to the previous year. Higher interest rates and changing economic conditions have, however, reduced the demand for credit, resulting in a sharp deceleration of credit growth to non-financial corporates. While lending rates have adjusted in line with other EA countries, the pass-through to household deposit rates has been slower and weaker, reflecting ample liquidity in the banking system.

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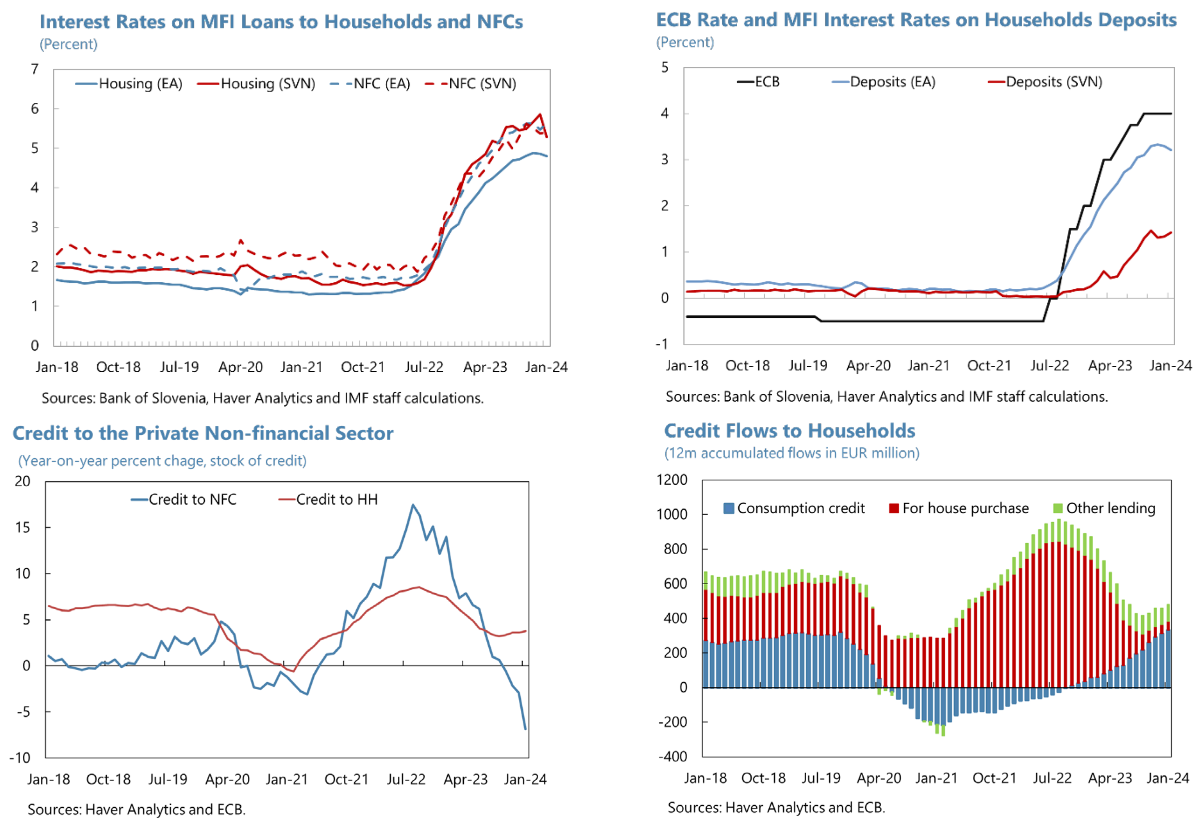
Figure 6. Slovenia: Interest Rates and Credit



OUTLOOK AND RISKS

10. Growth is projected to increase in 2024, followed by further recovery, to its potential, over the medium-term. Growth is expected to increase to 2 percent in 2024, led by domestic demand, including higher flood-related investment, and by higher consumption as real wages recover (Table 1). Growth should approach its estimated potential of about 2½–2¾ percent over the medium term as private consumption and euro area trading partners gather strength. Under the assumption of broadly stable commodity prices and interest rates on hold in the first half of 2024, inflation is projected to decline to below 3 percent by end-year and to 2 percent in 2025. Higher domestic demand, including stepped-up private investment, is expected to bring the current account surplus close to its norm over the medium term (Table 3).

11. Uncertainty remains high and risks to growth appear on the downside (Annex III). Economic spillovers from geopolitical conflicts could lead to trade disruptions and high and volatile energy prices. Geoeconomic fragmentation and reorganization of value chains pose risks to Slovenia's highly integrated economy but also create opportunities in the event of nearshoring. Lower external demand and higher real interest rates and risk premia could also affect credit and economic activity more than expected. Domestically, capacity constraints in the construction sector could affect flood-

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related reconstruction. Sustained high wage growth could lead to prolonged inflation and hurt Slovenia's competitiveness; a mitigating factor is the economy's openness and the strong role of import prices in determining domestic inflation. Delays in key investments and needed structural reforms would impact productivity growth and future convergence. Risks also include extreme weather events—the recent floods exposed the need for deeper climate adaptation.

Authorities' Views

12. The authorities agreed with staff's assessment. They expected growth this year to be broadly in line with, or slightly higher than, staff's baseline projection, also driven by stronger consumption and investment. Investment looked set to increase because of post-flood reconstruction expenditure and re-stocking after a significant decline in inventories in 2023. The authorities agreed with staff's external assessment and noted that while exports are expected to increase this year, imports would likely increase even more, and the current account surplus would decline over the medium term. Staff and the authorities shared similar views on inflation. The authorities saw wage growth as a concern as it may slow disinflation and hamper external competitiveness. The authorities agreed on the key risks to the outlook although they saw risks as more balanced and noted higher private consumption as an upside risk, along with attracting more foreign labor and more effective absorption of EU funds.

POLICY DISCUSSIONS

Against the backdrop of the floods, policy discussions focused on the appropriate policy mix, the near- and medium-term fiscal stance, key structural fiscal reforms, financial sector health and macro-financial linkages, prospects for growth and productivity, and building resilience to climate change.

A. Fiscal Policy

13. The overall fiscal deficit is expected to increase moderately in 2024 because of flood-related spending, with underlying core expenditure pressures also remainaing a problem. Strong economic and employment growth, robust corporate profitability, and additional EU funds are all expected to help revenues. Despite flood-related budgetary spending, staff expects the overall deficit to widen from an 2.5 percent of GDP in 2023 to 3.0 percent of GDP this year.[1] This corresponds to a moderate loosening of the cyclically adjusted overall balance (CAOB) by about 0.3 percent of GDP, which appears appropriate given the need for post-flood reconstruction. Underlying "core" expenditure is, however, expected to continue to rise as a share of GDP, driven by lagged inflation adjustments in social benefits, rising interest costs, and growing healthcare and social support amid demographic shifts. This is expected to lead in turn to a widening of the CAOB

[1] Staff's baseline projections incorporate policies from the authorities' 2024 budget. The 2024 budget was produced shortly after the August floods, when their impact was not yet fully assessed, and envisaged an overall general government deficit of 3.8 percent of GDP.

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net of all extraordinary fiscal measures by about one percent of GDP in 2024 on account of increased core spending (Table below).[2]

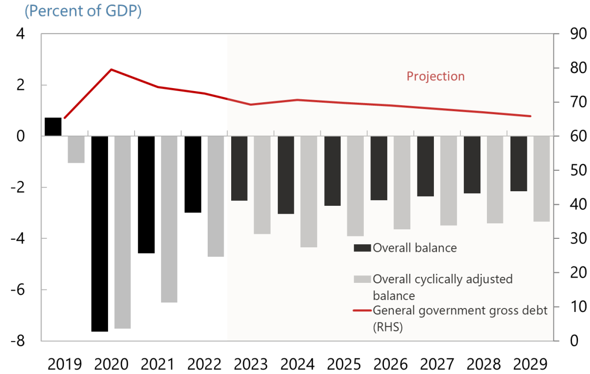
Indicators of Fiscal Performance
(Percent of GDP)

	2019	2020	2021	2022	2023	2024	2025
Overall balance (OB)	0.7	-7.6	-4.6	-3.0	-2.5	-3.0	-2.7
Cyclically adjusted overall balance (CAOB)	-0.9	-6.6	-5.6	-3.8	-2.8	-3.1	-2.7
Structural balance 1/	-1.1	-6.6	-5.6	-3.8	-2.4	-2.4	-2.2
Extraordinary fiscal measures since 2020	…	6.0	4.0	3.3	1.8	0.6	0.5
COVID-19 support	…	6.0	4.0	1.1	0.3	…	…
Energy price and cost of living	…	…	…	2.2	1.1	…	…
Floods (net)	…	…	…	…	0.4	0.6	0.5
OB net of extraordinary fiscal measures	0.7	-1.6	-0.6	0.3	-0.8	-2.4	-2.3
CAOB net of extraordinary fiscal measures	-0.9	-0.6	-1.6	-0.6	-1.1	-2.5	-2.3
Memorandum item							
Gross public debt	65.4	79.6	74.4	72.5	69.2	68.1	67.4

Sources: Slovenian authorities and IMF staff calculations.
1/ Excludes floods-related spending in 2023–2025 as agreed with the European Commission.

14. Stronger medium-term consolidation would help lower public debt further and add to fiscal space, including to prepare for longer-term spending pressures. Despite three large shocks in four years, Slovenia has some remaining fiscal space reflecting in part its strong debt management. This said, and despite the need to address flood-related damages, fiscal consolidation remains an important objective given longer-term ageing and climate change challenges. Staff recommends consolidation of close to 0.5 percent of GDP a year from 2026[3] until the overall deficit falls to zero. This would allow public debt to fall below 60 percent of GDP and stay there, reduce long terms risk of debt distress, which is currently assessed as moderate (Annex IV), and provide a cushion against adverse shocks. Such an approach would also be in compliance with the national fiscal rule, which calls for a gradual elimination of structural deficit

Baseline Fiscal Balances and Debt
(Percent of GDP)



Sources : Ministry of Finance and IMF staff calculations.

[2] Multiple shocks in recent years complicate the analysis of the fiscal stance. While the change in the CAOB remains a useful indicator of the impact of fiscal policy on demand, the deficit net of all extraordinary fiscal measures taken since 2020 (core deficit) shows how the underlying structural fiscal position has evolved over time.

[3] The timing is driven by the need to address the consequences of floods, assuming that the bulk of reconstruction efforts will take place through 2025. This period aligns with the agreement with the European Commission to consider flood-related expenditures as one-off items in 2023–25.

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of the general government.[4] Early indications suggest this path would be broadly in line with the new EU fiscal rules. Such consolidation could be achieved by implementing key structural reforms aiming at containing current expenses (¶18). On addressing the consequences of floods, urgent infrastructure repairs should take place without delay, but some upgrades could be spread over time or postponed until the labor market is less tight. Otherwise, there is a danger of flood-related spending fueling construction costs rather than providing for needed rebuilding. Should downside risks materialize, some of the available fiscal space could be used to provide temporary and targeted support to the vulnerable.

15. Post-flood reconstruction should aim to boost resilience and be based on a well-prepared and prioritized reconstruction plan. Given the scale of the reconstruction efforts, it is crucial for the authorities to establish a list of priority projects, have a thorough assessment of climate risks in the planned reconstruction areas, and to maintain proper checks and balances. The authorities' transparency in handling flood-related spending—including by publishing details of publicly-financed projects—is welcome given the extent of public spending. Reconstruction spending should aim to increase resilience and help adapt to growing climate risks.

16. Although the additional tax on banks helps secure revenues for flood-related spending, it could have negative effects. The government passed a 0.2 percent tax on bank assets covering 2024–28, which is expected to generate 0.15 percent of GDP annually towards flood-related spending. While other European countries have also instituted new bank taxes, taxing assets, independent of banks' financial results, is problematic as it may impact bank capital over time, cause reputational damage for Slovenia as an investment destination, and induce riskier bank behavior. The agreed cap of 30 percent of bank pre-tax profits will nevertheless serve as an important and necessary safeguard. Going forward, this tax should be allowed to lapse after its allotted five years.

17. Active debt management has helped lower financing needs and attenuate the impact of shocks and rising interest rates on public finances. Long-term financing obtained during favorable market conditions has contained debt service requirements in the face of higher global sovereign yields. Gross public debt is expected to continue to fall and converge to 60 percent of GDP over the medium term (appreciably lower in net terms). The overall risk of sovereign stress is assessed as low (Annex IV).

[4] In their assessment of budgetary documents for 2024 and 2025, the Fiscal Council indicated that quantitative assessments of compliance with national fiscal rule continue to be exposed to many uncertainties, but indicators point to non-compliance.

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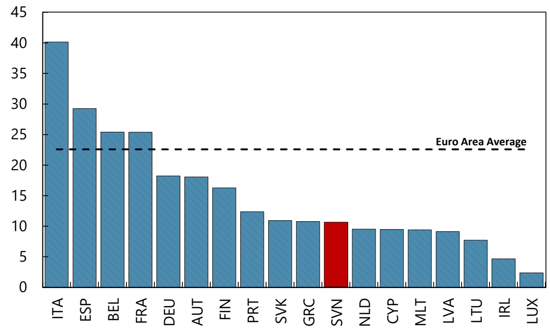
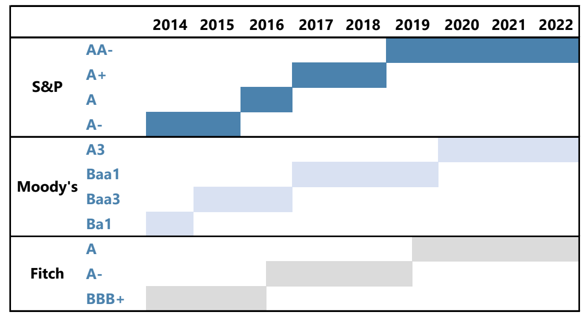
Figure 7. Slovenia: Debt Service and Credit Ratings

General Government: Debt Service due in 2 Years
(Percent of GDP as of Sep23)



Sources: Haver Analytics, ECB and IMF staff calculations

Credit Rating



Souces: S&P, Moody's and Fitch Rating.

18. Key structural fiscal reforms should be advanced without further delay to address longer-term pressures. Staff's past advice remains relevant. On the expenditure side, several important reforms, including in pensions and public sector wages, both milestones in the National Recovery and Resilience Plan (NRRP) in 2024, still need to be tackled, as do tax and health reforms.

- ***Pension reform:*** Even though the peak in expected pension-related spending has been revised down significantly, pension spending is still set to increase over time and reforming the pension system remains a priority.[5] Parametric changes, including raising the retirement age (linked to life expectancy), increasing the pension contribution period, and revising indexation rules, in particular, limiting ad hoc changes,[6] would help ensure the sustainability of the first pillar. Addressing what appear to be understated pension-related incomes among some self employed workers would also increase the solvency of the pension system. These reforms should also aim to further increase labor force participation of older workers, in particular in the age group 60–64, which remains significantly lower than the EU average. Building on first pillar reforms, stronger second and third pension pillars would help increase retirement savings and support capital market development.

- ***Public wage reform:*** A comprehensive public wage reform should introduce differentiated remuneration and allow for better wage bill management. It would also ease existing difficulties in hiring and retaining qualified staff despite the large public wage bill (Annex V).

- ***Tax reform:*** Slovenia's relatively high labor tax wedge (especially the social security contribution component) could be reduced, and loss of revenue could be offset, by raising property and environmental taxes and broadening VAT and income tax bases, along with improvement in

[5] Updated demographic projections suggest that the long-term annual aging cost peak would be about 2 percent of GDP lower than previous estimates.

[6] See OECD, "Reviews of Pension Systems: Slovenia" (2021) for a detailed analysis of policy options.

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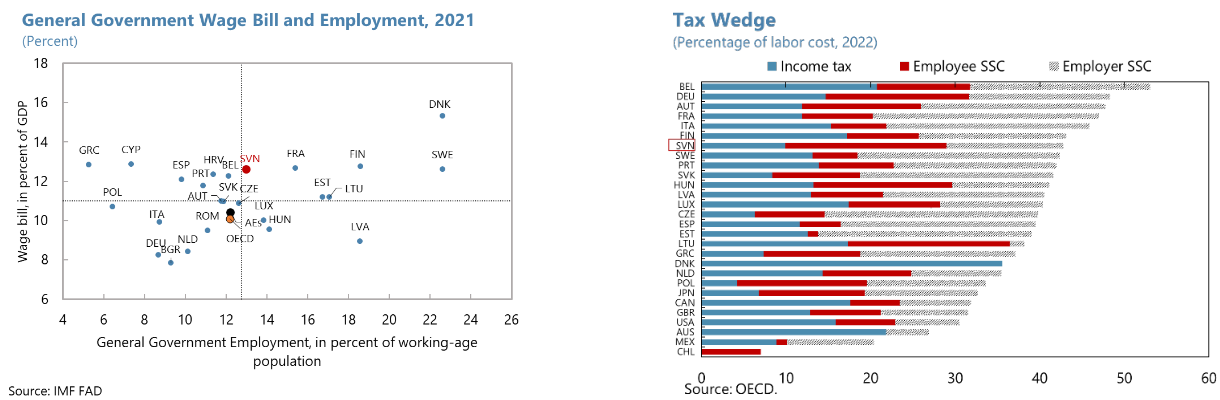
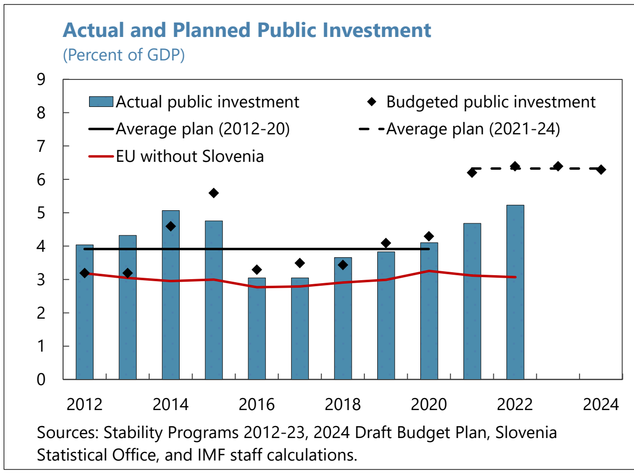
revenue administration, with a focus on large taxpayers. (Tax expenditures are estimated at about 5 percent of GDP in Slovenia.)

- ***Health reform:*** A comprehensive health reform is a major challenge and needs to address both rising healthcare costs and the need to improve access and quality of health services. Reforms could include optimizing healthcare delivery, strengthening the governance of the sector, promoting the use of digital health solutions, and encouraging a greater focus on preventive healthcare practices.

Figure 8. Slovenia: General Government Wage Bill, Employment and Tax Wedge



19. Acting on the recommendations of the Fund's recent Public Investment Management Assessment would help increase the efficiency of capital spending. Public investment is set to pick up noticeably in the coming years, underpinned by increased EU funds. Improving project preparation and the design capacity of implementing agencies, and reducing delays in spatial planning and permits, would help increase execution. More robust evaluation and selection processes are also needed.



Authorities' Views

20. The authorities broadly agreed with staff's advice. Despite flood-related public spending challenges, they remained committed to fiscal consolidation underpinned by a credible medium-term framework. The authorities have adopted measures to ensure the transparency of reconstruction spending, including by publishing relevant information online, and conducting reviews of the efficiency of public expenditure. The authorities acknowledged the underlying increase in core spending and expect that the upcoming public wage bill and health reforms will

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help lower the pressures in the medium term, although near-term costs may rise. All reforms will comply with the new EU economic governance framework and take into account available fiscal space. They continue to prioritize prudent debt management, which has contributed to keeping spreads low, and have taken further steps to diversify the investor base and debt instruments.

21. The authorities are working to advance structural fiscal reforms. They noted that, despite delays because of the floods, progress is being made on pensions, health and public wage reforms. The pension reform is set to be adopted by the end of 2024; ongoing discussions with stakeholders are focusing on modifications to the retirement age, the contribution period, the indexation rules, and enhancing the role of the second pillar. The public sector wage reform is also planned for this year with a view to becoming effective in January 2025. Reforms here could include introducing occupation-based pillars for wage negotiations, addressing Slovenia's public sector wage compression, expanding the role of performance bonuses, and enhancing managerial training. The authorities hope to increase the attractiveness of public sector jobs and fill numerous current vacancies, especially for highly skilled workers. Two advisory bodies have been established in the Prime Minister's office and the Ministry of Finance to conduct a thorough analysis of the tax system and propose changes to be discussed with stakeholders. Health reform remains a priority and consultations are ongoing. The Health Care, Labor and Social Care Intervention Measures Act, effective January 2024, introduced measures to improve access to healthcare, redesign health insurance, and address absenteeism. Finally, the authorities welcomed the PIMA and are working on implementing the recommendations.

B. Financial Sector Policies

22. The Slovenian banking sector appears in good health. Banks have ample capital buffers, with capital ratios increasing further in 2023 on the back of reduced credit exposures and increased regulatory capital. And banks are assessed as maintaining healthy capital levels even under adverse scenarios as indicated by Bank of Slovenia stress tests, although differences exist across banks. Liquidity coverage is among the highest in the euro area, standing at about 340 percent, and the net stable funding ratio also significantly exceeds regulatory requirements. Asset quality improved further in 2023. Risks to financial stability have abated overall on account of lower credit and income risks especially with bank profitability at historic highs.

23. However, uncertainty and macroeconomic risks warrant continued close monitoring of bank asset quality. High interest rates increase household and non-financial corporate (NFC) repayment and rollover risks, especially for corporates where loans are of shorter maturity and the share of variable interest rates is higher. This calls for continued close monitoring of the quality of bank portfolios and conducting stress tests to identify vulnerabilities across institutions. House price growth has fallen, with outright price declines precluded by housing supply constraints, and indicators of overvaluation have declined. Overall, risks from the real estate market appear contained, with still a low share of housing loans in banks' balance sheets (15 percent of bank assets), and more than 70 percent of these at fixed interest rates.

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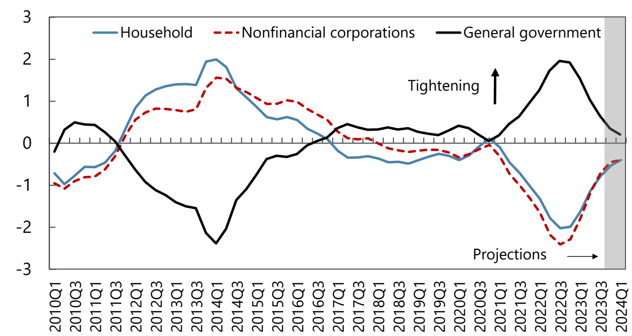
24. **The Bank of Slovenia's macroprudential stance is appropriate despite tightening of financial conditions.** After increasing the countercyclical capital buffer (CCyB) from 0 to 0.5 percent effective end-2023, the Bank of Slovenia (BoS) introduced additional changes to its macroprudential toolkit. These include increasing access to credit for lower income borrowers, while tightening the Debt Service To Income (DSTI) cap to maintain the overall stance. The Bank of Slovenia has reduced the sectoral risk buffer on retail exposures secured by residential real estate from 1 percent to 0.5 percent effective from 2025 as real estate risks have eased. At the same time, the authorities see merit in a positive neutral CCyB and have announced its increase to 1 percent effective from 2025. In staff's view, and despite tightening of financial conditions that led to significant slowdown of credit, this is appropriate from a broader perspective as it would strengthen the capacity of the banking system to respond to future adverse shocks. In view of high bank profitability, the increase in net capital requirements and the tax on bank assets should not have a significant impact on bank balance sheets or financial intermediation. Combining the CCyB increase with the relaxation of the sectoral systemic risk buffer for real estate backed loans announced in 2023 would achieve a good balance between financial stability and maintaining the flow of credit to the economy. Should risks to the outlook materialize, consideration could be given to lowering the buffers.

Financial Conditions Index by Sectors
(Index)



Sources: Borraccia et al., 2023, Financial Conditions in Europe: Dynamics, Drivers, and Macroeconomic Implications, IMF Working Paper WP/23/209, and IMF staff calculations.
Note: The latest available factual values are as of 2023:Q3. Values for 2023:Q4 and 2024:Q1 are forecasts.

25. **The authorities are continuing to strengthen the anti-money laundering and combating the financing of terrorism (AML/CFT) framework.** They expect a soon-to-be published MONEYVAL report to note that, with recent Criminal Code amendments, Slovenia achieved satisfactory ratings on all FATF recommendations, and no longer needs to report back under the current evaluation cycle. The new Prevention of Money Laundering and Terrorist Financing Act reinforced preventive measures for financial institutions and updated the definition of virtual asset service providers (VASPs) to bring it in line with the FATF standards. The legal and regulatory frameworks for VASPs will need to be further adjusted, including to introduce "travel rule" requirements under FATF Recommendation 15.[7] The authorities should also continue to raise awareness of virtual asset-related money laundering and terrorism financing risks. Progress was made in reinforcing ML investigations and prosecutions and in the recovery of criminal assets, notably through amendments to the Criminal Procedure Act, though the conviction rate remains low. The authorities have continued to allow public access to the beneficial ownership register and should further pursue their efforts to ensure that the information provided in the register is complete and accurate, and to sanction non-compliant entities.

[7] VASPs are currently subject to a dual supervisory regime of the Bank of Slovenia and the Financial Intelligence Unit.

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Authorities' Views

26. The authorities concurred with staff's assessment and recommendations. They noted that efforts to build a resilient financial system after the 2013 crisis have paid off and Slovenian banks have withstood a series of recent adverse shocks without a major negative impact on their performance. The authorities highlighted that bank capital and liquidity positions are robust, profitability is at record highs, and risks have diminished overall. Risks from real estate are now lower as house price growth has slowed. Asset quality remains strong and the 2023 floods did not have a material effect on bank balance sheets. The authorities are nevertheless monitoring closely portfolio developments to identify potential problems early and take supervisory actions. They also explained the rationale behind the recent changes to the macroprudential regulations and confirmed that the increase in the CCyB will not have a significant impact on credit supply, given banks' ample capital buffers.

27. The authorities welcomed the opportunity to discuss the recent changes to their AML/CFT framework. They noted that the Bank of Slovenia has issued updated guidance to financial institutions to reflect the requirements under the new law. Regarding enforcement, ML convictions have increased but remain limited, in part due to strict evidentiary standards. Work continues to improve the supervision of VASPs but challenges remain, including because not all providers are registered in Slovenia. The authorities remain committed to transparency and have continued to collect and publish information on the beneficial owners of companies operating in the country.

C. Structural Policies

28. Structural reforms will be key to sustaining growth and income convergence in the long run.[8] Over the past decade, GDP per capita convergence to the EU average has slowed (Figure 9). The growth contribution of capital has fallen as business investment has softened. On the labor side, and similar to peers, population ageing is a major challenge, although this has been helped in recent years by net inward migration. Total factor productivity growth will, however, be the key to determining future growth performance and raise living standards. Raising productivity will in turn depend on continued structural reforms. Slovenia performs well in areas such as innovation and human capital, that help support productivity growth. At the same time, there is room for improvement in certain areas, including:

- ***Regulatory quality:*** The authorities have adopted a number of initiatives aimed at easing the administrative burden, summarized in the National Reform Program. Further improvements could, however, be made in streamlining procedures in areas such as building permits, ensuring the stability of contracts, and digitalization of public services.

[8] See Republic of Slovenia: Selected Issues.

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- ***Labor regulations:*** The 2013 Employment Relations Act made significant progress in easing labor regulations. As a result, Slovenia scores close to the average on OECD's overall employment protection regulations but with relatively wide variation across individual indicators. Further progress, including, for example, on severance costs and broader employer burdens could also help the economy grow and remain competitive.

- ***Education and skills mismatch:*** Slovenia has achieved good results in education but there is a gap between available skills and the rapidly evolving market demand. This calls for measures to increase the adaptability of the education system to market needs, which could be done in consultation with relevant stakeholders, including employers. The authorities' initiative to launch a labor market platform that assesses the gaps in competences and predicts labor market needs is welcome, especially if results are used as feedback to education policies.

- ***Taxation:*** Slovenia's high labor tax and social security contribution rates are seen as a major obstacle by many employers, especially foreign investors who have difficulties attracting highly skilled employees and managers from abroad. Lowering the tax wedge on labor could increase labor supply with a non-negligible effect for growth.[9]

- ***Capital market:*** Similar to many peers, Slovenia's capital markets are fairly shallow. Although there are no quick fixes, deepening capital markets over time would help support private investment and growth.

[9] IMF (2015) estimates that a revenue-neutral reform that reduces the tax wedge by 5 percent would increase long-run growth by 0.2–0.3 percent.

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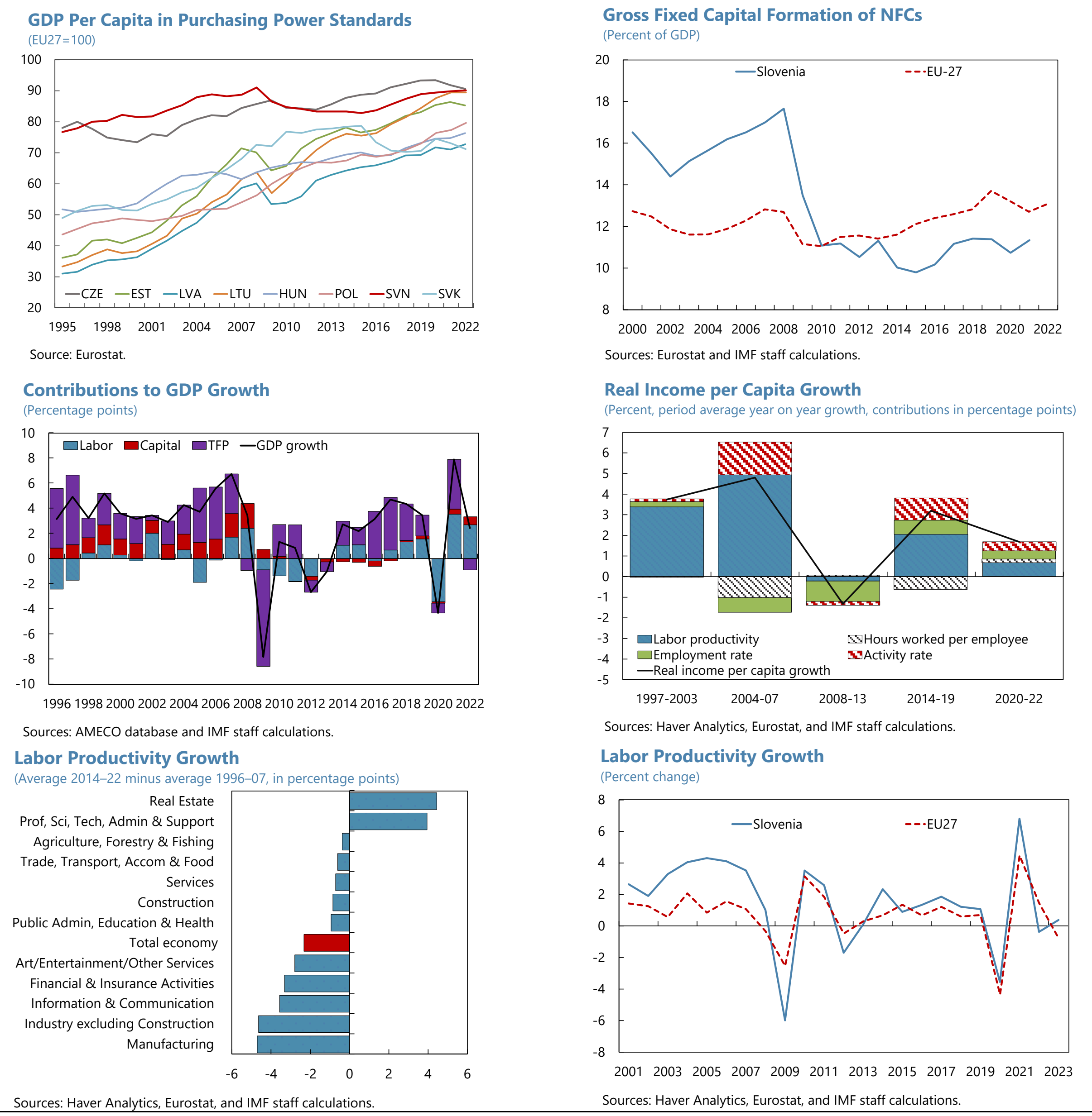
Figure 9. Slovenia: Growth and Productivity



29. The authorities are committed to strengthening Slovenia's resilience to climate change and meeting its emission reduction objectives (Annex VI). The new Climate Law will create a legal framework for implementing climate policy in both adaptation and mitigation areas and set out governance structures for better implementation.

- ***Adaptation:*** The August 2023 floods underscore the importance of adapting to climate change. While the frequency of natural disasters in Slovenia is lower than peers, losses owing to extreme climate-related events in Slovenia are estimated as the highest among EU countries. In the aftermath of the floods, the authorities' intent to build back better (with an objective to withstand future floods) is welcome. Adherence to strong prevention policies, including spatial planning, strong enforcement of building codes, flood protection investments, and promoting

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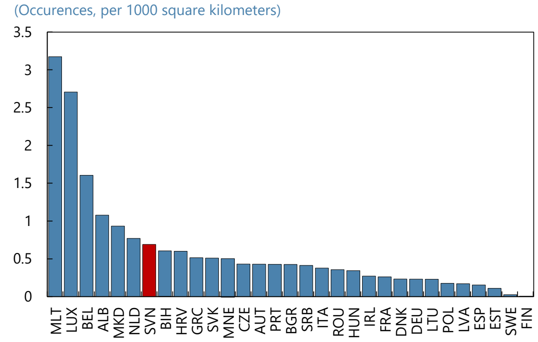
public awareness of flood risks, would minimize damages from future extreme weather events. Timely preparation of a national climate change adaptation strategy, including vulnerability assessments and guidelines for key sectors, followed by regional and urban adaptation plans, would also help boost climate resilience.

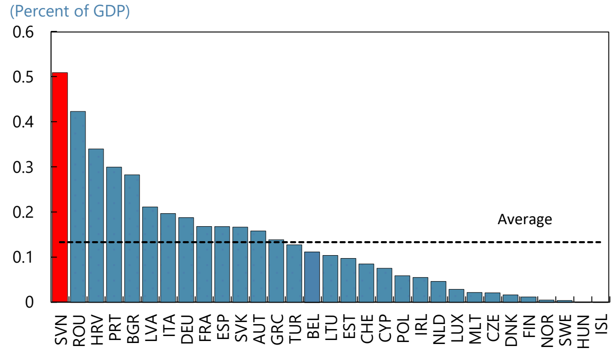
Figure 10. Slovenia: Natural Disasters and Losses due to Extreme Weather Events

Natural Disasters, 1992–2023
(Occurences, per 1000 square kilometers)



Sources: EM-DAT database and IMF staff estimates.

Average Annual Losses due to Extreme Weather Events[1],1995–2022
(Percent of GDP)

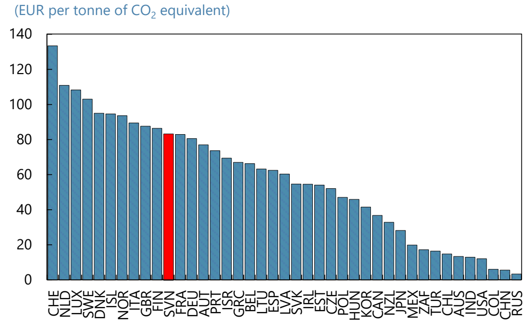


Sources: European Environment Agency, ECDATA, and IMF staff calculations.
1/ Defined as meteorological events (storms), hydrological events (floods, mass movements), and climatological events (heatwaves, cold waves, droughts, forest fires).

- ***Mitigation:*** The authorities should continue making steady progress on achieving emission reduction objectives, supported by promoting investment in renewable energy sources and increasing carbon prices, including by raising net effective carbon rates in sectors where they are relatively low. The draft update of the National Energy and Climate Plan (NECP), currently under discussion, envisages raising the share of renewable energy from 29 percent in 2023 to 30–35 percent by 2030, and is welcome.

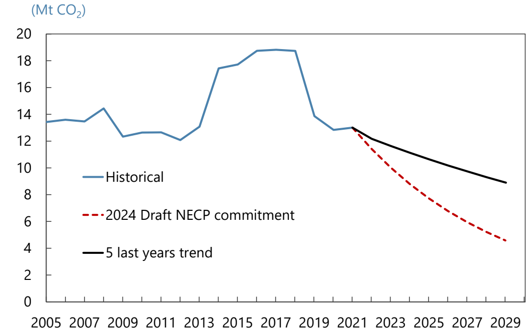
Figure 11. Slovenia: Net Effective Carbon Rates and Emissions from Energy Use

Net Effective Carbon Rates, 2021
(EUR per tonne of CO_2 equivalent)



Source: OECD.

GhC Emissions from Energy Use
(Mt CO_2)



Sources: Eurostat and IMF staff calculations.

Authorities' Views

30. The authorities shared staff's views on the importance of productivity enhancement for long-term growth. They emphasized the importance of accelerated investment toward digital and green transitions. Slovenia's Recovery and Resilience Plan contains multiple measures to

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address structural challenges related not only to the digital and green transitions, but also to health and long-term care and the labor market, thus contributing to sustained productivity growth. The authorities recognized the importance of the regulatory environment and are taking steps to reduce the administrative burden and to increase the efficiency of the public administration; digitalization is expected to contribute significantly to these efforts. They also emphasized the role of deeper capital markets for investment and have designed a capital market development strategy through 2030 to help achieve this.

31. Climate policies are high on the authorities' priority list. The Climate Law is expected to be passed this year, and vulnerability assessments and guidelines for 11 priority areas are expected to be completed in 2025–26. The authorities are fully committed to strengthening the prevention pillar of the adaptation strategy, including relocation of infrastructure as needed. On the mitigation side, the draft NECP remains a living document and will be shaped by multi-stakeholder dialogue. The draft envisages a decrease in overall emissions by 55 percent by 2033. A special focus is given to the phase-out of coal by 2033 at the latest, improving security of energy supply, increasing the share of renewable energy and improving energy efficiency. The authorities are planning to prepare a comprehensive strategy for the transport sector by 2025 to address the challenges of reducing emissions in that sector.

STAFF APPRAISAL

32. Following recent shocks, including the August 2023 floods, growth is expected to recover and inflation to fall further this year, although uncertainty remains high. Growth is expected to increase to about 2 percent in 2024, led by domestic demand, including because of higher flood-related investment, and higher consumption as real wages recover. Inflation is projected to decline to below 3 percent by end-year and to 2 percent in 2025. The external position in 2023 is stronger than implied by fundamentals and desirable policies. Stronger domestic demand is projected to bring the current account closer to the norm over time.

33. The growth outlook is subject to downside risks. External risks include an intensification of regional conflicts, renewed commodity price volatility, and lower external demand. Supply chain disruptions pose additional risks but also may create opportunities for Slovenia in the event of nearshoring. Labor shortages and broader capacity constraints could affect post-flood reconstruction or undermine disinflation. Finally, new severe weather events also remain a risk.

34. Stronger fiscal consolidation over the medium term would help reduce debt further, rebuild fiscal space, and address pressures from aging. Given underlying increases in core public spending in recent years, age-related spending pressures, and relatively high public debt, sustained fiscal consolidation and fiscal structural reforms are needed to underpin long-term public debt sustainability. The elimination of remaining pandemic and energy measures will help such consolidation, despite additional flood-related spending. Given the high tax wedge, consolidation should be mainly expenditure-based and could be achieved by containing current expenditure through implementing pension, health, and wage bill reforms. The bank tax is not ideal and should

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be allowed to lapse after its allotted 5-year period. The authorities should also continue with their active debt management, which has helped to lower debt servicing costs, improve the debt profile, and allowed the buildup of ample public cash buffers.

35. A phased and transparent approach to flood-related spending is critical. Lower-priority needs should only be addressed as labor market conditions ease. Otherwise, there is a danger of flood-related spending fueling construction cost increases rather than providing for needed rebuilding. The authorities' transparent handling of flood-related spending—including by publishing details of publicly financed projects—is welcome given the extent of public spending.

36. Key structural fiscal reforms should be accelerated. Reforming the pension system remains a priority given the higher expected pension spending over the medium and longer term. Reforms to the retirement age (linked to life expectancy), years of contributions, and indexation would help contain pension costs. Stronger second and third pension pillars would help increase retirement savings and support capital market development. Public wage reforms—linking pay more closely to skills and performance—are also important given the high public wage bill alongside difficulties in hiring and retaining qualified staff. Reducing labor taxes while broadening tax bases and increasing property tax would also be helpful. Planned comprehensive reforms of the health sector should continue. Finally, building on the recommendations of the IMF's recent Public Investment Management Assessment (PIMA), improved project preparation, evaluation, selection, and permit times would help increase public investment efficiency, which is important given the scale of public investment.

37. Banks appear in good health, but ongoing uncertainties warrant continued close monitoring of asset quality. Bank profitability and capital adequacy are strong and liquidity is among the highest in the euro area. Non-performing loans are at historic lows, but high interest rates increase repayment and rollover risks, particularly for firms where loans are of shorter maturity or at variable rates.

38. The Bank of Slovenia's macroprudential stance is appropriate. The positive neutral countercyclical capital buffer of one percent will help further strengthen the capacity of the banking system to respond to adverse shocks. The impact on financial intermediation of this measure is expected to be limited. Increased access to credit for lower income borrowers is welcome. Finally, the reduction of the sectoral risk buffer on real estate exposures is appropriate given reduced risks in the housing market as valuation measures have softened. The progress on AML/CFT is welcome.

39. Deeper structural reforms are needed to boost growth and foster greater income convergence. Although labor contributions to growth have been strong in recent years—reflecting increased labor force participation, lower unemployment, and positive net inward migration—the limits to future such gains call for a shift to a focus on productivity growth, a key priority. Productivity would be helped by higher overall investment and by further structural reforms, supported by the EU-backed National Recovery and Resilience Plan and Cohesion policy funding. Addressing skill shortages and mismatches, improving regulatory quality, and deepening the financial sector would also help boost productivity growth.

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40. The recent floods underscore the importance of continuing to adapt to climate change. As floods pose the highest risk, efforts should be focused on flood risk management, including on zoning. Timely preparation of a national climate adaptation strategy, including vulnerability assessments and guidelines for key sectors, followed by regional and urban adaptation plans, would help boost climate resilience. On mitigation, continuing to promote investment in renewables and reducing carbon price exemptions in polluting industries would help Slovenia achieve its climate goals.

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

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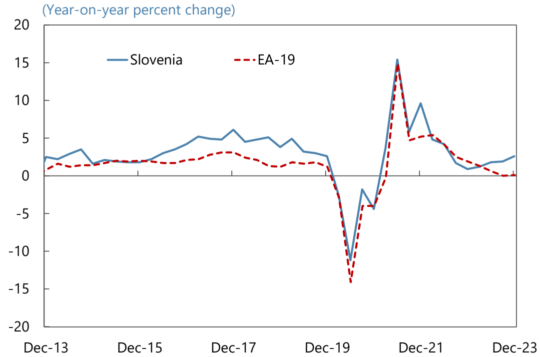
Figure 12. Slovenia: Macroeconomic Developments

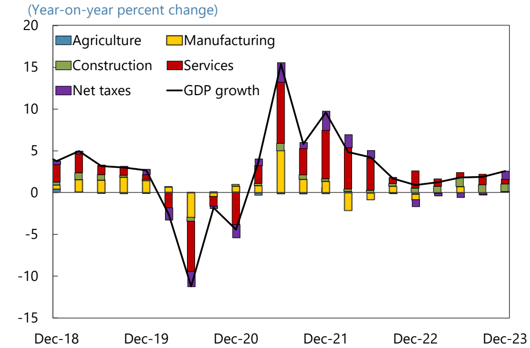
Growth is lower…

Real GDP Growth
(Year-on-year percent change)



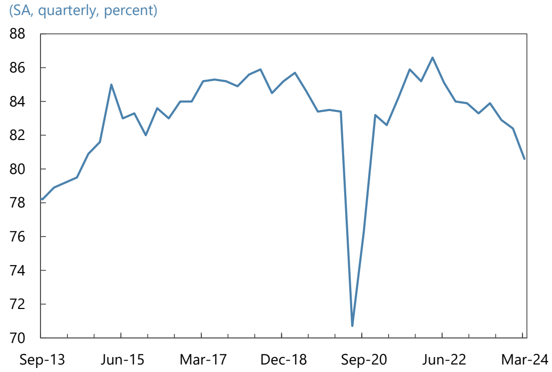
…across most sectors.

Contribution to Real GDP Growth, Gross Value Added
(Year-on-year percent change)



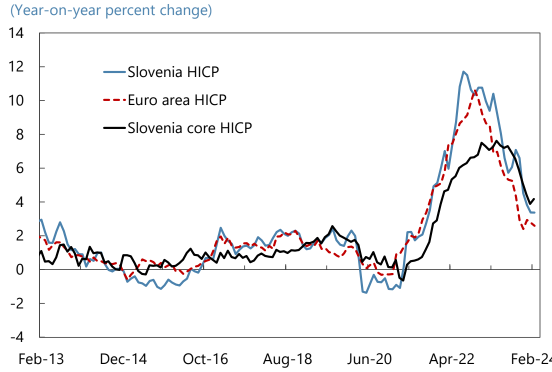
Capacity utilization is falling…

Capacity Utilization in Manufacturing
(SA, quarterly, percent)



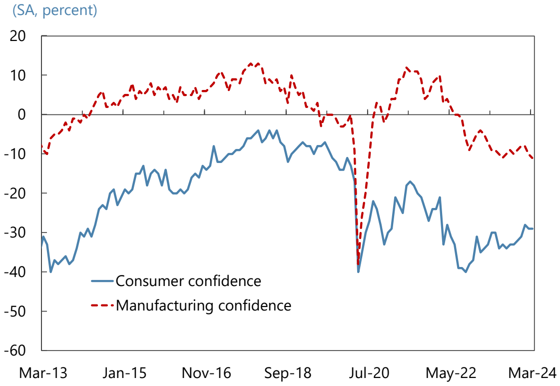
…as is inflation.

Consumer Price Index
(Year-on-year percent change)



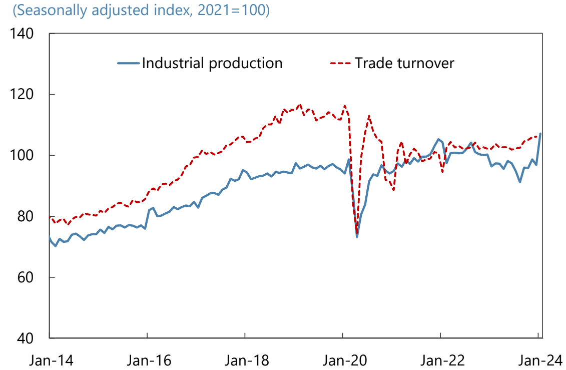
Consumer confidence is gradually improving, albeit from low levels.

Sentiment Indicators
(SA, percent)



After a period of decline, industrial production shows signs of recovery.

Industrial Production and Trade Turnover
(Seasonally adjusted index, 2021=100)



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

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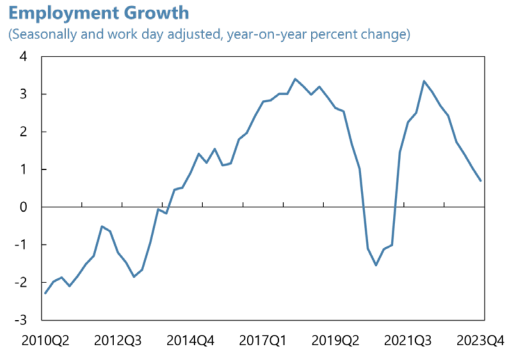
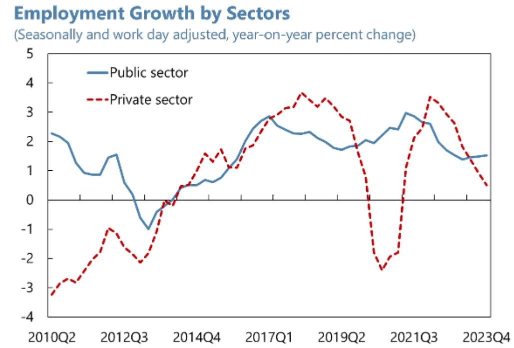
Figure 13. Slovenia: Labor Market Developments

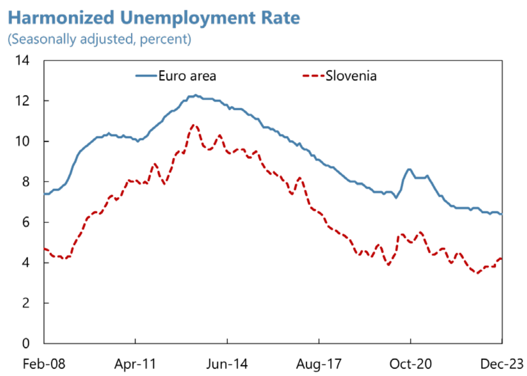
Employment growth has slowed...



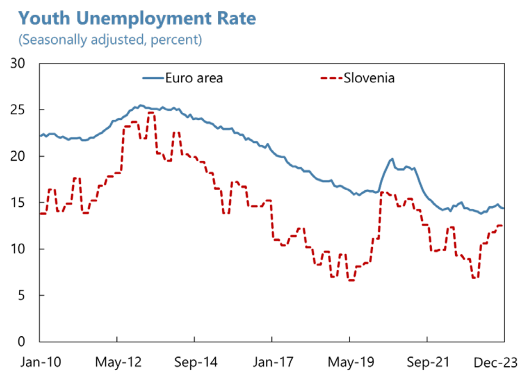
...largely because of private sector jobs.



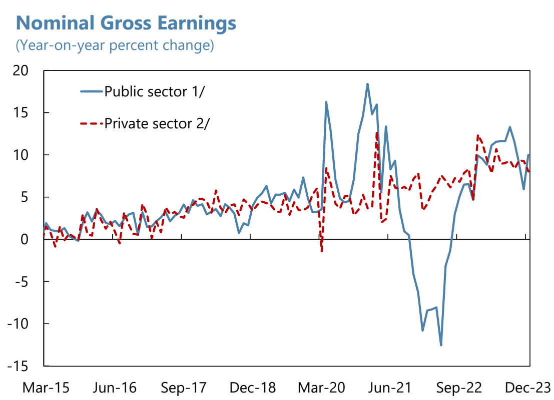
The overall unemployment rate is low...



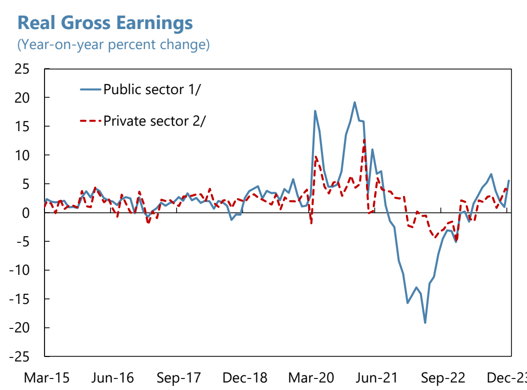
...but youth unemployment remains high.



Nominal wage growth has picked up...



...and real wages are increasing.



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

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

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

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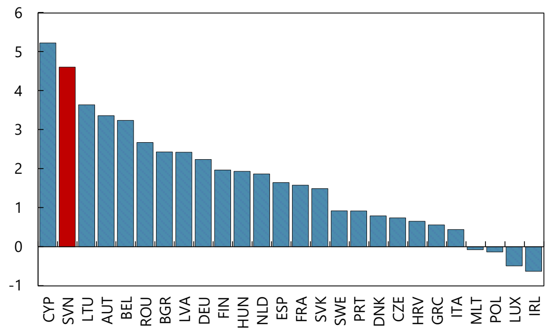
Figure 14. Slovenia: General Government Financing

The maturity of public debt has doubled since 2015...

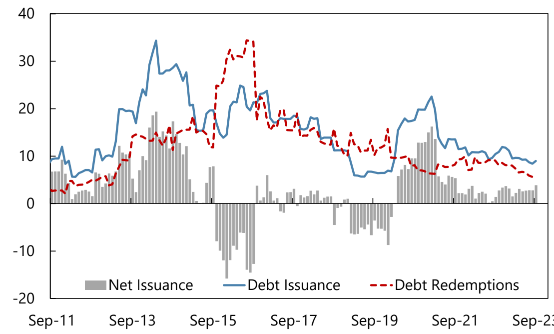
Government Debt Securities: Weighted Average Maturity
(Years, Sept. 2023 – Mar. 2015 change)



Sources: Haver Analytics, ECB and IMF staff calculations

...lowering short term financing needs.

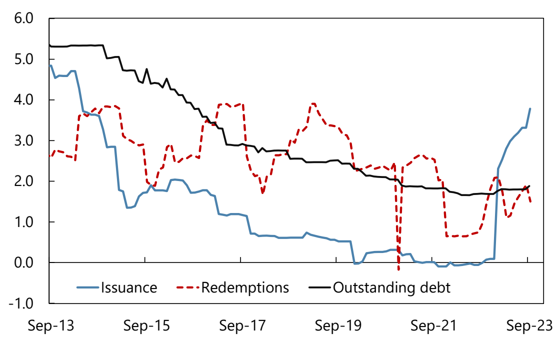
Government Debt Securities
(Percent of GDP, 12m accumulated)



Sources: Haver Analytics, ECB and IMF staff

Despite rising government bond yields...

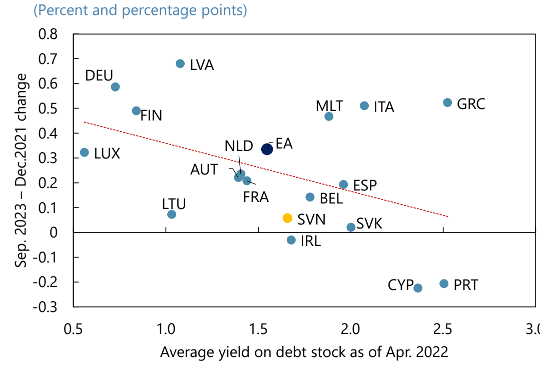
Average Nominal Yield on Government Debt
(Percent)



Sources: Haver Analytics, ECB and IMF staff

...debt servicing costs have not increased much.

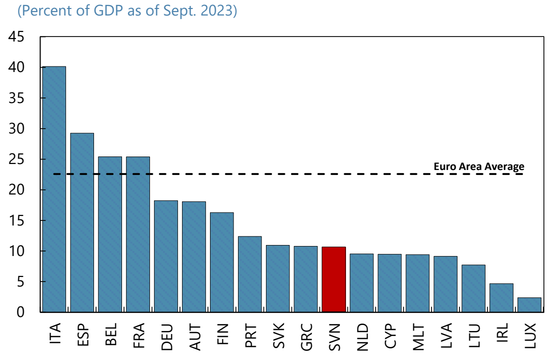
Average Nominal Yield Outstanding Stock of Debt
(Percent and percentage points)



Sources: Haver Analytics, ECB and IMF staff

Debt service is comparatively low in the short term...

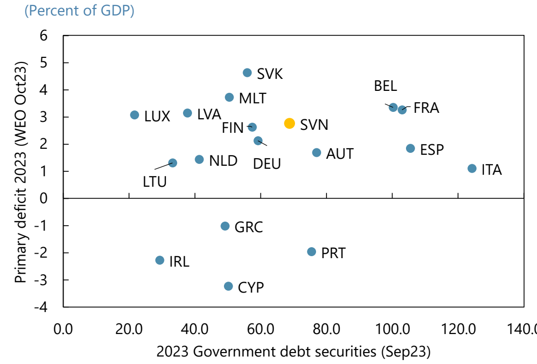
General Government: Debt Service due in 2 Years
(Percent of GDP as of Sept. 2023)



Sources: Haver Analytics, ECB and IMF staff calculations

...but the primary deficit continues adding to financing needs.

Primary Deficit And Debt
(Percent of GDP)



Sources: Haver Analytics, ECB and IMF staff

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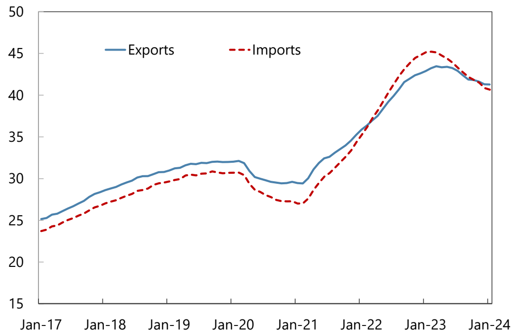
Figure 15. Slovenia: External Sector Developments

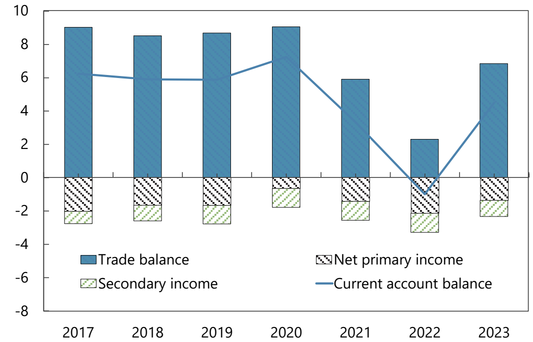
Imports are declining, including because of lower prices…

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



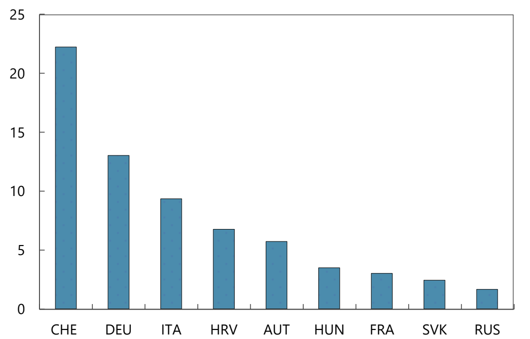
…and the current account has again moved to surplus.

Current Account Balance
(Percent of GDP)



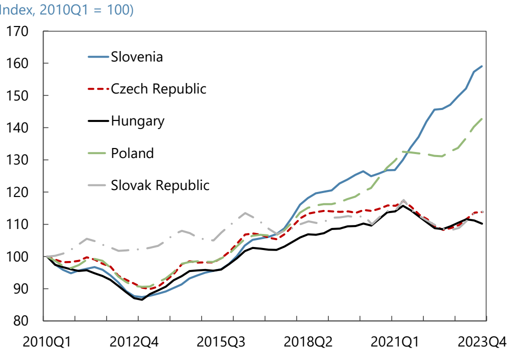
Exports are strongly linked to global value chains…

Slovenia Exports by Destination, 2023
(Percent)



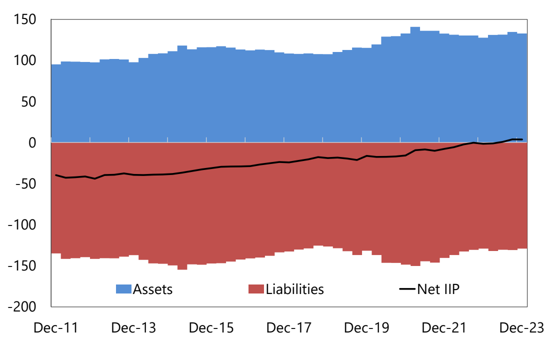
…and Slovenia has gained market share over time.

Market Share in World Trade
(Index, 2010Q1 = 100)



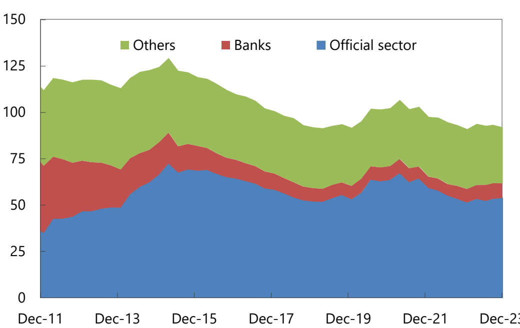
The net IIP position turned positive…

International Investment Position
(Percent of moving 4-quarter sum of GDP)



…as external debt has declined slightly.

External Debt
(Percent of moving 4-quarter sum of GDP)



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

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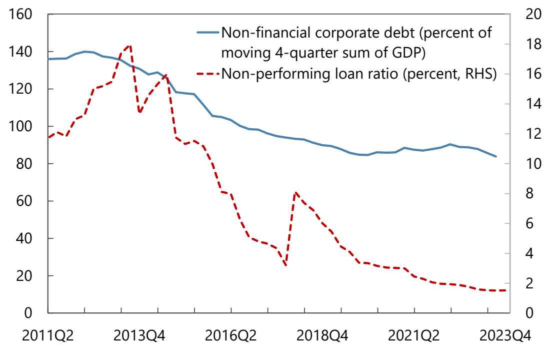
Figure 16. Slovenia: Financial Sector Developments

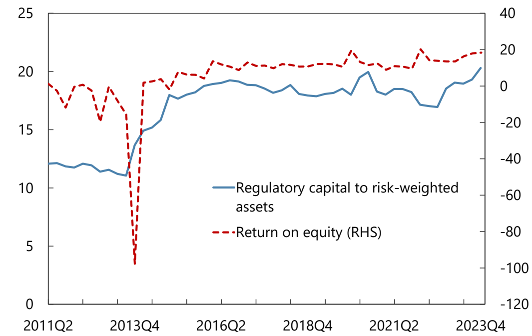
NPLs remain low.

Corporate Debt and Non-Performing Loans
(Percent)



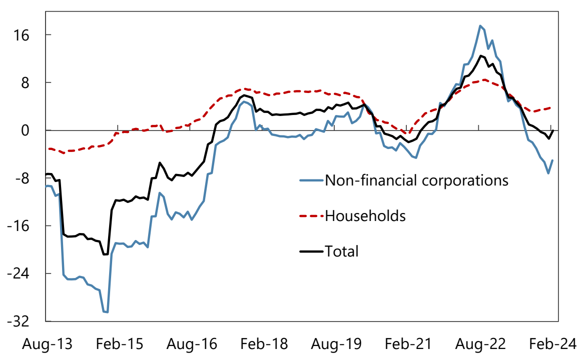
Slovenian banks are well-capitalized and profitable.

Bank Capital Adequacy and Profitability
(Percent)



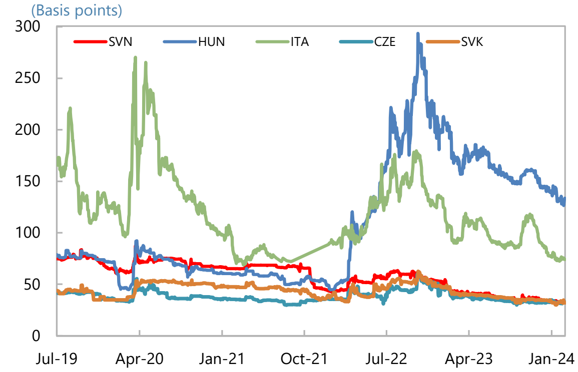
Private sector credit growth fell.

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



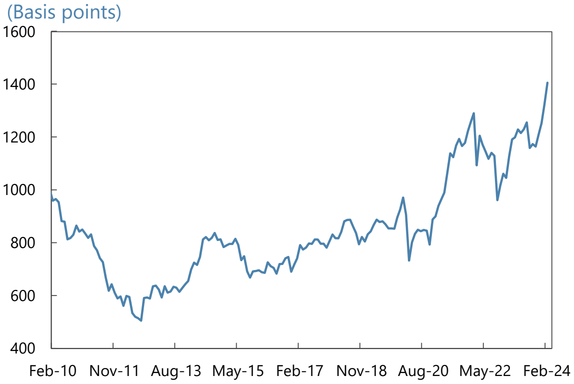
Slovenia's sovereign spreads remain low.

5-year Sovereign CDS Spreads
(Basis points)



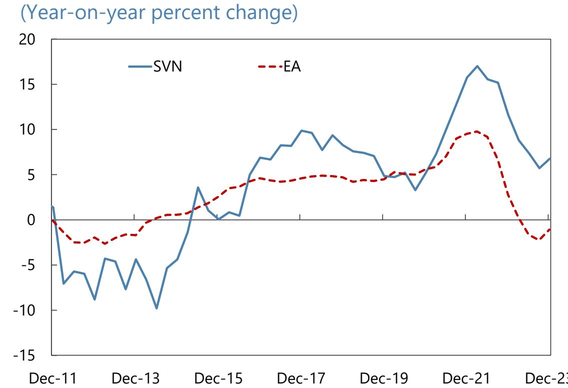
The stock market has recovered.

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



House price growth has moderated.

Housing Prices
(Year-on-year percent change)



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

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Table 1. Slovenia: Selected Economic Indicators, 2019–29
(Annual percentage change, unless indicated otherwise)

	2019	2020	2021	2022	2023	2024	2025	2026	2027	2028	2029
					Prel.			Proj.			
Real sector											
Real GDP	3.5	-4.2	8.2	2.5	1.6	2.0	2.5	2.7	2.7	2.7	2.7
Domestic demand (contribution to growth) 1/	3.3	-3.9	9.2	3.5	-1.2	3.7	3.0	2.5	2.5	2.6	2.6
Private consumption	5.5	-6.5	10.3	3.6	1.3	1.3	2.6	2.7	2.7	2.7	2.7
Public consumption	1.8	4.2	6.1	-0.5	2.4	5.4	2.6	2.2	2.2	2.3	2.3
Gross capital formation	0.5	-6.3	13.9	7.9	-9.8	12.2	5.0	3.0	2.9	3.2	3.1
Gross fixed capital formation	5.0	-7.2	12.6	3.5	9.5	5.9	3.1	3.1	2.9	3.2	3.2
Net exports (contribution to growth)	0.2	-0.3	-1.0	-1.0	2.8	-1.7	-0.5	0.2	0.2	0.1	0.1
Exports of goods and services	4.5	-8.5	14.5	7.2	-2.0	2.9	4.3	4.3	4.5	4.4	4.4
Imports of goods and services	4.7	-9.1	17.8	9.0	-5.1	5.2	5.1	4.3	4.6	4.5	4.5
Potential output growth	2.5	1.8	3.4	2.9	2.8	2.6	2.7	2.7	2.7	2.7	2.7
Output gap (in percent of potential GDP)	3.9	-2.2	2.3	1.9	0.7	0.2	0.0	0.0	0.0	0.0	0.0
Prices											
GDP deflator	2.3	1.1	2.7	6.5	8.9	3.9	2.1	2.0	2.0	2.0	2.0
Consumer prices (national definition, period average)	1.6	-0.1	1.9	8.8	7.4	2.7	2.0	2.0	2.0	2.0	2.0
Consumer prices (national definition, end of period)	1.8	-1.1	4.9	10.3	4.2	2.2	2.0	2.0	2.0	2.0	2.0
Core inflation (period average)	1.8	1.0	1.0	6.8	7.8	2.9	2.0	2.0	2.0	2.0	2.0
Employment and wages											
Unemployment rate (in percent, ILO definition)	4.5	5.0	4.7	4.0	3.7	3.7	3.8	3.9	3.9	3.9	4.0
Real wages (all sectors)	2.6	6.0	4.0	-5.6	2.1	1.8	1.2	1.2	1.3	1.4	1.6
Public finance (percent of GDP)											
General government balance 2/	0.7	-7.6	-4.6	-3.0	-2.5	-3.0	-2.7	-2.5	-2.3	-2.2	-2.1
Cyclically-adjusted general government balance	-0.9	-6.6	-5.6	-3.8	-2.8	-3.1	-2.7	-2.5	-2.3	-2.2	-2.1
Structural balance 3/	-1.1	-6.6	-5.6	-3.8	-2.7	-2.4	-2.2	-2.5	-2.3	-2.2	-2.1
Structural primary balance 3/	0.3	-5.2	-4.4	-2.9	-2.0	-1.4	-1.0	-1.4	-1.3	-1.1	-0.8
General government gross debt	65.4	79.6	74.4	72.5	69.2	68.1	67.4	66.6	65.8	64.9	64.0
General government net debt	49.5	56.7	55.8	55.4	52.9	52.0	51.5	50.9	50.3	49.6	48.9
Monetary and financial indicators											
Credit to the private sector	3.5	-1.0	5.0	9.5	-0.6	2.0	3.7	4.3	4.8	4.8	4.9
Lending rates 4/	1.6	1.8	1.6	2.0	4.9	5.5	...	...	...	...	...
Deposit rates 5/	0.2	0.1	0.1	0.1	0.8	1.4	...	...	...	...	...
Balance of payments (percent of GDP)											
Current account balance	5.9	7.2	3.3	-1.0	4.5	2.7	2.1	2.1	2.1	2.0	2.0
Trade balance (goods and services)	8.7	9.0	5.9	2.3	6.8	5.3	4.7	4.7	4.7	4.7	4.7
Terms of trade (goods and services)	0.6	0.8	-2.1	-3.1	2.8	0.3	0.0	0.0	0.0	0.0	0.0
Gross external debt (percent of GDP, end-period)	91.6	102.1	97.4	90.9	91.8	87.0	83.7	80.2	77.2	74.7	72.6
Nominal effective exchange rate (2010=100)	104.9	106.8	107.7	106.7	109.6	...	...	...	...	...	...
Real effective exchange rate (2010=100, CPI-based)	97.5	98.0	97.6	96.5	99.4	...	...	...	...	...	...
Memorandum items											
Nominal GDP (millions of euros)	48,582	47,045	52,279	57,038	63,090	66,900	69,995	73,332	76,822	80,497	84,355
Population (millions)	2.1	2.1	2.1	2.1	2.1	2.1	2.1	2.1	2.1	2.1	2.1
GDP per capita (euros)	23,347	22,447	24,789	27,068	29,802	31,572	33,023	34,596	36,248	37,992	39,828

Sources: The Slovenian authorities; and IMF staff estimates and projections.

1/ Historical data include the statistical discrepancy.

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. 2024 value shows an average for the first two months.

5/ For household time deposits with maturity up to one year. 2024 value shows an average for the first two months.

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Table 2. Slovenia: General Government Operations, 2019–29
(Percent of GDP, unless indicated otherwise)

	2019	2020	2021	2022	2023	2024	2025	2026	2027	2028	2029
						Proj.					
Revenue	**44.1**	**43.7**	**44.9**	**44.2**	**44.2**	**44.2**	**43.5**	**43.5**	**43.5**	**43.5**	**43.5**
Taxes	22.0	20.9	21.9	21.4	21.0	20.9	21.0	21.0	21.0	21.0	20.9
Taxes on income, profits, and capital gains	7.8	7.8	8.4	8.0	7.9	8.1	8.2	8.2	8.2	8.2	8.1
Payable by individuals	5.2	5.2	5.4	5.2	5.1	5.3	5.1	5.1	5.1	5.1	5.1
Payable by corporations and other enterprises	2.0	2.0	2.5	2.3	2.3	2.5	2.5	2.5	2.5	2.5	2.3
Taxes on goods & services	14.2	13.0	13.5	13.3	13.1	12.8	12.8	12.8	12.8	12.8	12.8
VAT	8.2	7.6	8.2	8.2	8.2	8.0	8.0	8.0	8.0	8.0	8.0
Taxes on products (except VAT and imp. taxes)	4.8	4.3	4.1	3.9	3.6	3.5	3.5	3.5	3.5	3.5	3.5
Social contributions	15.9	17.2	16.7	16.3	16.1	17.0	17.0	17.0	17.0	17.0	17.2
Social security contributions 1/	15.6	16.8	16.4	16.0	15.8	16.7	16.7	16.7	16.7	16.7	16.9
Grants	1.6	1.5	2.0	1.8	2.3	2.5	1.8	1.7	1.7	1.7	1.8
Other revenue 1/	4.6	4.2	4.3	4.7	4.8	3.8	3.8	3.8	3.8	3.8	3.8
Interest income	0.2	0.2	0.1	0.2	0.6	0.3	0.3	0.3	0.2	0.3	0.2
Expenditure	**43.4**	**51.4**	**49.5**	**47.2**	**46.7**	**47.3**	**46.3**	**46.0**	**45.8**	**45.7**	**45.7**
Expense	39.4	47.1	44.8	41.6	41.3	41.3	40.8	40.6	40.4	40.5	40.6
Compensation of employees	11.3	12.9	12.7	11.4	11.4	11.4	11.5	11.5	11.5	11.5	11.5
Purchases/use of goods & services	6.0	6.1	6.5	6.6	6.5	6.6	6.6	6.6	6.5	6.5	6.5
Interest	1.7	1.6	1.2	1.1	1.2	1.3	1.4	1.4	1.3	1.4	1.5
Social benefits	17.3	19.4	18.4	18.5	17.5	18.2	18.2	18.2	18.2	18.2	18.2
Subsidies	0.9	4.0	2.4	1.2	1.9	1.2	1.0	1.0	0.9	0.9	0.9
Other transfers and grants	1.8	2.7	3.1	2.4	2.1	2.0	1.7	1.7	1.7	1.7	1.7
Other current expense	0.4	0.4	0.5	0.4	0.6	0.6	0.4	0.3	0.3	0.3	0.3
Net acquisition of non-financial assets	4.0	4.3	4.7	5.6	5.4	5.9	5.5	5.4	5.4	5.2	5.1
Net lending/borrowing	**0.7**	**-7.6**	**-4.6**	**-3.0**	**-2.5**	**-3.0**	**-2.7**	**-2.5**	**-2.3**	**-2.2**	**-2.1**
Memorandum items											
General government balance (ESA 2010)	0.7	-7.6	-4.6	-3.0	-2.5	-3.0	-2.7	-2.5	-2.3	-2.2	-2.1
Primary balance	2.2	-6.2	-3.5	-2.1	-1.9	-2.1	-1.6	-1.4	-1.3	-1.1	-0.8
Gross operating balance	4.7	-3.4	0.2	2.6	2.9	2.9	2.8	2.9	3.1	3.0	3.0
Cyclically-adjusted balance	-0.9	-6.6	-5.6	-3.8	-2.8	-3.1	-2.7	-2.5	-2.3	-2.2	-2.1
Structural balance	-1.1	-6.6	-5.6	-3.8	-2.7	-2.4	-2.2	-2.5	-2.3	-2.2	-2.1
Structural primary balance	0.3	-5.2	-4.4	-2.9	-2.0	-1.4	-1.0	-1.4	-1.3	-1.1	-0.8
General government gross debt	65.4	79.6	74.4	72.5	69.2	68.1	67.4	66.6	65.8	64.9	64.0
General government net debt	49.5	56.7	55.8	55.4	52.9	52.0	51.5	50.9	50.3	49.6	48.9

Sources: Ministry of Finance; and IMF staff estimates.

1/ In 2024, voluntary health insurance becomes compulsory for all beneficiaries, implying a reclassification of the expenditure from “Other revenues” to “Social security contributions.”

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Table 3. Slovenia: Balance of Payments, 2019–29
(Percent of GDP, unless indicated otherwise)

	2019	2020	2021	2022	2023	2024	2025	2026	2027	2028	2029
					Prel.	Proj.					
Current account	**5.9**	**7.2**	**3.3**	**-1.0**	**4.5**	**2.7**	**2.1**	**2.1**	**2.1**	**2.0**	**2.0**
Trade balance, goods and services	8.7	9.0	5.9	2.3	6.8	5.3	4.7	4.7	4.7	4.7	4.7
Goods	2.7	5.0	1.7	-3.8	0.7	-0.7	-1.3	-1.4	-1.4	-1.5	-1.5
Exports f.o.b.	65.9	63.0	67.4	74.7	65.5	65.3	66.3	66.9	67.6	68.5	69.5
Imports f.o.b.	63.2	58.0	65.7	78.5	64.8	66.0	67.7	68.2	69.0	69.9	70.9
Services	6.0	4.1	4.2	6.1	6.1	6.0	6.1	6.1	6.1	6.1	6.1
Exports	17.8	14.8	16.2	19.5	18.8	18.7	19.0	19.3	19.5	19.5	19.6
Imports	11.8	10.8	12.0	13.4	12.7	12.7	12.9	13.2	13.4	13.4	13.5
Primary Income, net	-1.7	-0.7	-1.4	-2.2	-1.4	-1.6	-1.5	-1.5	-1.6	-1.6	-1.6
Secondary Income, net	-1.1	-1.1	-1.1	-1.1	-1.0	-1.1	-1.1	-1.1	-1.1	-1.1	-1.1
Capital account	**-0.5**	**-0.5**	**0.3**	**-0.4**	**-0.3**	**-0.4**	**-0.5**	**-0.5**	**-0.6**	**-0.6**	**-0.6**
Financial account, excl. reserves	**4.1**	**7.4**	**1.8**	**-3.2**	**4.1**	**2.2**	**1.6**	**1.5**	**1.4**	**1.3**	**1.3**
Direct investment, net	-1.6	0.6	-0.8	-2.3	-0.8	-1.1	-1.4	-1.4	-1.4	-1.3	-1.3
In Slovenia	4.0	0.9	3.6	3.6	1.7	2.1	2.4	2.4	2.5	2.5	2.5
Abroad	2.4	1.5	2.8	1.3	0.9	1.0	1.0	1.0	1.1	1.2	1.2
Portfolio investment, net	1.5	-2.4	5.3	0.0	-0.4	0.7	0.8	1.3	1.2	1.1	1.1
Equity	-0.2	1.0	1.6	0.0	0.7	0.6	0.9	1.0	1.2	1.2	1.2
Debt	1.7	-3.4	3.7	0.0	-1.1	0.0	-0.1	0.3	0.0	-0.1	-0.1
Financial derivatives	-0.3	0.1	0.1	-0.3	-0.1	-0.2	-0.2	-0.2	-0.2	-0.2	-0.2
Other investment, net	4.5	9.2	-2.8	-0.6	5.4	2.9	2.4	1.8	1.8	1.7	1.7
Loans	1.1	1.6	0.6	-0.9	-1.4	0.6	0.5	0.5	0.3	0.3	0.2
Currency and deposits	3.7	8.4	-1.8	0.4	6.1	4.2	3.9	3.7	3.4	3.2	3.2
Trade credits	-0.1	-0.2	-0.5	0.1	1.0	0.7	0.7	0.7	0.7	0.7	0.7
Other	-0.3	-0.6	-1.1	-0.3	-0.4	-2.6	-2.7	-3.0	-2.7	-2.5	-2.4
Net errors and omissions	**-1.3**	**1.1**	**-0.2**	**-1.5**	**-0.1**	**0.0**	**0.0**	**0.0**	**0.0**	**0.0**	**0.0**
Overall balance	**0.1**	**0.4**	**1.6**	**0.3**	**0.0**	**0.1**	**0.1**	**0.1**	**0.1**	**0.1**	**0.1**
Change in official reserves (+: increase)	0.1	0.4	1.6	0.3	0.0	0.1	0.1	0.1	0.1	0.1	0.1
Memorandum items											
Export of goods (percent change in value)	3.9	-7.4	19.0	20.9	-3.1	5.9	6.2	5.6	5.9	6.1	6.3
Import of goods (percent change in value)	3.9	-11.1	26.0	30.3	-8.9	8.2	7.3	5.6	5.9	6.2	6.3
Terms of trade, goods (percent change)	0.4	0.8	-2.3	-2.9	2.6	0.1	0.0	-0.1	0.0	0.0	0.0
Gross external debt (billions of euros)	44.5	48.0	50.9	51.8	57.9	58.2	58.6	58.8	59.3	60.1	61.3
(percent of GDP)	91.6	102.1	97.4	90.9	91.8	87.0	83.7	80.2	77.2	74.7	72.6
Net international investment position	-16.3	-15.7	-7.7	-1.5	3.7	5.8	7.2	8.5	9.6	10.6	11.5
Nominal GDP (million euros)	48,582	47,045	52,279	57,038	63,090	66,900	69,995	73,332	76,822	80,497	84,355

Sources: The Slovenian authorities and IMF staff estimates and projections.

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Table 4. Slovenia: Vulnerability Indicators, 2017–23
(Percent of GDP, unless indicated otherwise)

	2017	2018	2019	2020	2021	2022	2023
External Indicators							
Current account balance	6.2	5.9	5.9	7.2	3.3	-1.0	4.5
Capital and financial account balance	4.2	5.1	3.7	7.3	3.7	-3.3	3.8
Of which							
Inward portfolio investment (debt securities, etc.)	-0.3	-0.5	-0.1	4.3	-3.7	2.5	3.3
Inward foreign direct investment	2.5	2.8	4.0	0.9	3.6	3.6	1.7
Other investment (net)	-0.7	6.0	4.5	9.2	-2.8	-0.6	5.4
Euros per U.S. dollar (period average)	0.89	0.85	0.89	0.88	0.84	0.95	0.92
Market Indicators							
Financial Markets							
Public sector debt	74.2	70.3	65.4	79.6	74.4	72.5	69.2
Stock market index (period average, 2010=100)	88.4	94.7	97.5	96.1	124.2	127.3	134.3
Real estate prices (index, 2010=100, period average)	95.4	103.7	110.7	115.7	129.1	148.2	158.7
Credit markets (end-of-period 12-month growth rates)							
Bank credit to households	6.4	6.5	5.9	0.2	5.1	7.6	3.6
Of which housing loans	4.6	4.4	5.6	4.2	9.0	9.8	0.7
Bank credit to nonfinancial enterprises	0.2	-0.1	1.2	-0.7	6.7	12.2	-2.9
Sectoral risk indicators							
Household sector							
Household savings ratio (percent)	13.1	13.8	13.5	22.9	18.8	9.4	…
Gross disposable income	60.2	60.0	60.1	64.4	62.5	62.4	…
Personal income	49.4	49.7	50.6	53.6	52.7	52.0	53.2
Corporate sector							
Business investment	11.5	11.8	11.9	11.1	11.6	12.1	…
Investment rate NFCs (percent)	21.2	21.5	21.3	20.3	21.2	21.9	…
Gross profit share NFCs (percent)	35.7	35.1	34.4	36.4	34.9	31.8	…
Net return after taxes NFCs (percent)	11.7	11.5	11.6	10.7	9.9	7.3	…
Banking sector (percent)							
Share of housing loans in bank credit to the private sector	51.0	52.6	53.8	54.0	53.6	52.6	54.2
Share of nonperforming loans in total loans	3.2	6.0	3.4	3.0	2.1	1.8	1.5
Ratio of nonperforming loans net of provisions to capital	5.9	12.6	5.2	4.1	1.8	1.1	-0.1
Liquid assets to total short-term liabilities	51.9	32.5	34.0	36.1	31.4	31.0	35.8
Return on assets	1.2	1.5	1.5	1.5	1.2	1.5	2.1
Return on equity	9.8	10.8	10.6	12.4	9.6	13.5	18.4
Regulatory capital to risk-weighted assets	18.2	17.9	18.5	18.3	18.2	18.5	20.3

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

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Table 5. Slovenia: Core Financial Soundness Indicators, 2017–23
(Percent unless indicated otherwise)

	2017	2018	2019	2020	2021	2022	2023
Capital							
Regulatory capital to risk-weighted assets	18.2	17.9	18.5	18.3	18.2	18.5	20.3
Regulatory Tier 1 capital to risk-weighted assets	17.8	17.6	17.8	16.7	16.8	16.2	17.9
Profitability							
Return on assets	1.2	1.5	1.5	1.5	1.2	1.5	2.1
Return on equity	9.8	10.8	10.6	12.4	9.6	13.5	18.4
Interest margin to gross income	55.3	52.2	52.3	43.1	51.9	50.0	69.6
Noninterest expenses to gross income	87.1	65.9	64.1	53.7	67.5	58.7	51.0
Liquidity							
Liquid assets to total assets	30.5	24.1	26.0	27.9	28.1	27.7	31.7
Liquid assets to short-term liabilities	51.9	32.5	34.0	36.1	31.4	31.0	35.8
Sensitivity to market risk							
Net open position in foreign exchange to capital	10.8	12.0	10.7	21.7	21.8	22.4	21.5
Asset quality							
Non-performing loans to total gross loans	3.2	6.0	3.4	3.0	2.1	1.8	1.5
Non-performing loans net of provisions to capital	5.9	12.6	5.2	4.1	1.8	1.1	-0.1

Sources: Bank of Slovenia and IMF Financial Soundness Indicators.

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Table 6. Slovenia: Summary of Monetary Accounts, 2019–24
(Billions of Euros unless indicated otherwise)

	2019	2020	2021	2022	2023	2024 Jan.
Central Bank Survey						
Net foreign assets	10.2	13.5	14.9	15.0	20.8	21.1
Foreign assets	10.6	13.8	16.6	16.6	22.4	22.5
Foreign liabilities	0.4	0.3	1.7	1.6	1.6	1.5
Net domestic assets	0.4	0.5	2.7	1.9	-1.5	-2.6
Claims on banks	1.0	1.5	2.5	0.9	0.2	0.2
Net claims on central government	4.6	6.4	8.5	7.1	7.1	5.6
Other items, net	-5.2	-7.4	-8.4	-6.2	-8.8	-8.5
Reserve money	10.6	14.1	17.5	16.9	19.3	18.4
Currency in circulation	5.8	6.5	7.0	7.1	7.0	7.2
Liabilities to other depository corporations	4.3	7.1	9.9	8.9	11.1	10.1
Liabilities to other sectors	0.4	0.5	0.7	0.9	1.2	1.1
Banking Survey						
Net foreign assets	15.3	20.1	22.4	23.1	29.9	30.5
Central bank	10.2	13.5	14.9	15.0	20.8	21.1
Banks	5.2	6.5	7.5	8.1	9.2	9.4
Net domestic assets	18.5	17.8	18.7	21.1	16.2	15.4
Net claims on central government	8.4	10.2	11.2	9.0	9.4	8.1
Claims on state and local government	0.6	0.6	0.7	0.8	0.9	0.8
Claims on NBFIs	1.7	1.7	1.7	2.2	1.6	1.6
Claims on private sector	20.6	20.4	21.4	23.4	23.3	23.3
Corporates	9.6	9.4	9.8	11.0	10.4	10.4
Households	11.0	11.0	11.6	12.4	12.9	12.9
Other items, net	-12.9	-15.1	-16.2	-14.4	-18.9	-18.4
Broad money	33.8	37.8	41.1	44.2	46.1	45.9
Currency in circulation	5.4	6.0	6.5	6.7	6.6	6.8
Transferable deposits	22.1	26.1	30.2	33.2	32.8	32.2
Other deposits	6.3	5.7	4.4	4.4	6.8	6.9
Securities	0.0	0.0	0.0	0.0	0.0	0.0
Memorandum items	(Annual percentage change unless indicated otherwise)					
Monetary base	15.0	32.7	24.7	-3.7	14.2	11.5
Broad money	7.1	11.9	8.7	7.6	4.3	4.4
Claims on private sector	3.5	-1.0	5.0	9.5	-0.6	-1.5
Corporates	1.0	-2.3	4.9	11.8	-5.4	-7.3
Households	5.9	0.1	5.1	7.6	3.6	3.8
Broad money velocity (GDP/Broad money)	1.4	1.2	1.3	1.3	1.4	1.4

Sources: IMF International Financial Statistics and IMF staff estimates.

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Annex I. Implementation of Previous Article IV Recommendations

Policy Advice	Progress
Fiscal Policies	
Tighten the fiscal stance in 2023 to contain demand pressures, support disinflation efforts and lower public debt over time.	The estimated 2023 overall deficit is much lower than originally budgeted despite August 2023 floods and the cyclically adjusted overall balance is estimated to have mariginally tightened relative to 2022.
Ensure that support to alleviate the impact of high energy and food prices is temporary and more targeted.	Fiscal measures to cushion the impact of higher energy and food prices were phased out in the 2024 budget.
Allow automatic stabiliziers to operate fully in case of shocks.	Automatic stabilizers were positive in 2023, driven by social security and family benefits. This was partially driven by measures to alleviate a sharp increase of the energy prices.
Make progress with structural fiscal reforms, including in the pension, health and long-term care system areas.	The implementation of several reforms were postponed due to the floods but are expected to be presented to Parliament in 2024 and implemented in 2025.
Financial Sector Policices	
Continue close monitoring of asset quality and war-related spillover vulnerabilities to safeguard financial stability.	The Bank of Slovenia monitors closely asset quality and conducts stress tests to identify vulnerabilities.
Maintain flexible macroprudential policies to ensure the right balance between financial stability and credit supply to the economy.	Macroprudential policies have been recalibrated to improve access to credit of lower income househlds while at the same time increasing the capital buffers.
Adopt efficient restructuring mechanisms.	Amendments to the Insolvency Act that transpose the EU Directive on Restructuring and Insolvency provide a judicial procedure for restructuring.
Continue efforts to strengthen the AML/CFT framework.	Slovenia made significant progress in AML/CFT and is expected to achieve satisfactory ratings on all FATF recommendations.
Structural Policies	
Continue efforts to ensure alternative gas supplies, encourage energy savings and prepare contingency plans.	Slovenia has reduced its dependence on Russian gas by imports from Algeria and is working to further improve interconnectedness and promote renewable energy. Energy efficiency measures are an important component of the National Recovery and Resilience Plan.
Implement policies to address disincentives to labor market participation.	Tax and pension reforms to reduce the labor tax wedge and address disincentives for early exit from the labor market are still in progress.
Improve the business climate and reduce the administrative burden.	The authorities have adopted a number of initiatives aimed at deregulation and easing of the administrative burden, summarized in the National Reform Program.

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Policy Advice	Progress
Use active labor market policies (ALMPs) to increase employability and reduce skill mismatches.	ALMPs have been used to increase employment of underemployed groups; their effectiveness is being evaluated. A new platform is being prepared to assess gaps in competences and predict labor market needs.
Ease the access of migrant workers to the labor market.	The authorities have made amendments to the Employment Act to ease the hiring of foreign nationals and ensure adequate working conditions.

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Annex II. External Sector Assessment

Overall Assessment: *Staff's assessment is that the external position of Slovenia in 2023 was stronger than the level implied by fundamentals and desirable policies.*

Potential Policy Responses: *Over the medium term, Slovenia's current account balance (CAB) is expected to record small surpluses. Higher domestic demand, including stepped-up private investment, would help bring the CAB close to its norm.*

Foreign Assets and Liabilities: Position and Trajectory

Background. At end-2023, Slovenia's Net International Investment Position (NIIP) was modestly positive at 3.7 percent of GDP. It increased by 5.2 percent of GDP relative to end-2022, continuing the positive trend since the global financial crisis, supported by CAB surpluses. Gross external debt has fallen from a peak of 102 percent of GDP in 2020 to about 92 percent of GDP in 2023.

Assessment. The NIIP has improved steadily since the global financial crisis. CAB surpluses (with the notable exception of 2022, when the current account recorded a negative balance because of worsening of the terms-of-trade) continue to increase the NIIP over time.

2023 (% GDP)	NIIP: 3.7	Gross assets: 132.8	Debt assets: 98.1	Gross liab.: 129	Debt liab.: 91.8

Current Account

Background. The CAB increased from a deficit in 2022 to a surplus of 4.5 percent of GDP in 2023. The decline in import volumes and terms of trade improvement are the main factors behind the reversal. The CAB is expected to decline to about 2 percent of GDP over the medium term. Slovenia's CAB remains susceptible to external shocks, however, including to slowdown in Europe and geo-economic fragmentation, because of its strong integration into European value chain.

Assessment. The EBA-lite current account model suggests that the current account gap is 2.7 percent of GDP. Under the EBA-Lite Current Account approach, the multilaterally consistent cyclically adjusted CA norm is estimated at 1.9 percent of GDP in 2023 while the cyclically adjusted CAB is estimated at 4.7 percent. The difference with the norm is driven by a variety of factors including subdued credit growth, although these estimates are subject to significant margin of error.

Slovenia: Model Estimates for 2023
(In percent of GDP)

	CA model 1/	**REER model** 1/
	(in percent of GDP)	
CA-Actual	**4.5**	
Cyclical contributions (from model) (-)	-0.2	
Additional temporary/statistical factors (-) 2/	0.0	
Adjusted CA	**4.7**	
CA Norm (from model) 2/	**1.9**	
Adjusted CA Norm	**1.9**	
CA Gap	**2.7**	**-4.1**
o/w Relative policy gap	1.6	
Elasticity	-0.6	
REER Gap (in percent)	**-4.7**	**7.0**

1/ Based on the EBA-lite 3.0 methodology
2/ Cyclically adjusted, including multilateral consistency adjustments.

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Real Exchange Rate
Background. The real effective exchange rate has remained relatively stable in recent years, because of Slovenia's high level of integration in the EA economy. However, the CPI-based real effective exchange rate (REER) appreciated by 3.5 percent in 2023 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 4.7 percent REER undervaluation. Separately, the REER model suggests an overvaluation of 7 percent. Given the poor fit of the REER model for Slovenia, the overall assessment relies on the current account model.
Capital and Financial Accounts: Flows and Policy Measures
Background. Current account surpluses have predominated since the 2013 banking crisis as the banking and corporate sectors accumulated assets and reduced investment liabilities. Inward FDI flows averaged close to 3 percent of GDP over 2015–23. Government external debt, which reached a peak of 64½ percent of GDP in 2015, fell to 36 percent of GDP in 2023. **Assessment.** Slovenia has reduced its net external liabilities, particularly through deleveraging by banks and NFCs, and the acquisition of portfolio assets abroad.
FX Intervention and Reserves Level
Background. The euro has the status of a global reserve currency. **Assessment.** Reserves held by the euro area are typically low relative to standard metrics. The currency floats freely.

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Annex III. Risk Assessment Matrix[1]

Source of Risks, Likelihood, and Time Horizon	Impact on Slovenia if Realized	Recommended Policy Response
External Risks		
High (short to medium-term) **Intensification of regional conflicts.** Escalation or spread of the conflict in Gaza and Israel, Russia's war in Ukraine, and/or other regional conflicts or terrorism disrupt trade (e.g., energy, food, tourism, supply chains), remittances, FDI and financial flows, payment systems, and increase refugee flows	**High** An escalation of the existing conflicts or the outbreak of new conflicts could lead to loss of exports, supply chain disruptions and rising prices. Consumer and investor confidence would decrease further and an 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 volatility.** A succession of supply disruptions (e.g., due to conflicts, export restrictions, and OPEC+ decisions) and demand fluctuations causes recurrent commodity price volatility, external and fiscal pressures in EMDEs, cross-border spillovers, and social and economic instability.	**High** As a commodity importer, a surge in price volatility, especially of energy, would affect adversely consumption and investment through increased uncertainty and potentially higher inflation.	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.
Medium (medium-term) **Abrupt global slowdown.** Global and idiosyncratic risk factors cause a synchronized sharp growth downturn, with recessions in some countries, adverse spillovers through trade and financial channels, and market fragmentation triggering sudden stops in EMDEs. • **Europe:** Intensifying fallout from Russia's war in Ukraine, supply disruptions, tight financial conditions, and real estate market corrections exacerbate economic downturn.	**High** A synchronized sharp global slowdown and recession in Europe would impact significantly Slovenia's exports and lead to a contraction of domestic demand and rise in unemployment, with possible consequences for the financial sector, especially in the event of real estate market corrections.	Allow automatic stabilizers to operate fully and provide additional targeted support to vulnerable households. Monitor closely the quality of banks' assets and perform stress tests to identify vulnerabilities. Adjust the CCyB if warranted.
Medium (medium-term) **Monetary policy miscalibration.** Amid high economic uncertainty, major central banks loosen policy stance prematurely, hindering disinflation, or keep it tight for longer than warranted, causing abrupt adjustments in financial markets and weakening the credibility of central banks.	**Medium** A premature loosening of monetary policy (MP) in response to the slowing of growth could de-anchor inflationary expectations and induce a wage price spiral, especially in a situation of tight labor markets. Keeping MP tight for longer than warranted could slow growth.	In case of premature MP loosening, tighten fiscal and macroprudential policies to and support the disinflation efforts. Ease the access of foreign workers to reduce labor market pressures. If tight MP is kept for longer than needed, loosen fiscal policy and consider loosening the macroprudential stance to support credit and demand.
Medium (short to medium-term) **Systemic financial instability.** High interest rates and risk premia and asset repricing amid economic slowdowns and political uncertainty (e.g., from elections) trigger market dislocations, with cross-border spillovers and an adverse macro-financial feedback loop affecting weak banks and NBFIs.	**Medium** Although Slovenia's banking system is well capitalized and liquid, a sharp tightening of financial conditions and instability could lead to sharp asset price corrections. Higher real interest rates and risk premia would affect negatively economic activity.	Intensify the monitoring of liquidity and capital positions and asset quality to identify vulnerabilities and intervene where necessary to prevent a deeper crisis. Recalibrate macroprudential regulations to maintain credit to the economy.

[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.

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Source of Risks, Likelihood, and Time Horizon	Impact on Slovenia	Recommended Policy Response
High (short to medium-term) **Deepening geoeconomic fragmentation.** Broader conflicts, inward-oriented policies, and weakened international cooperation result in a less efficient configuration of trade and FDI, supply disruptions, protectionism, policy uncertainty, technological and payments systems fragmentation, rising shipping and input costs, financial instability, a fracturing of international monetary system, and lower growth.	**High** As a small open economy, Slovenia is highly vulnerable to rapid shifts in trade and FDI flows and supply chain disruptions.	Furter strengthen external competitiveness and diversify suppliers and markets. Accelerate reforms to improve the business environment and promote investment in R&D and product development.
Medium (short to medium-term) **Cyberthreats.** Cyberattacks on physical or digital infrastructure and service providers (including digital currency and crypto assets) or misuse of AI technologies trigger financial and economic instability.	**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. Further strengthen the cyber security framework, including resilience testing and business continuity plans.
Domestic Risks		
Medium (short to medium-term) **Extreme climate events.** Extreme climate events driven by rising temperatures cause loss of human lives, severe damage to infrastructure, supply disruptions, lower growth, and financial instability.	**High** As demostrated by the recent events, climate-related natural disasters can have devastating effects on the economy by destroying capital stock and disrupting economic activity.	Reallocate fiscal spending to support affected people/firms and rebuild needed 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 gaps in the labor market increase the pressure on wages and trigger a wage-price spiral.	**Medium** A continuing pressure on wages would fuel inflation and worsen Slovenia's international competitive position.	Tighten fiscal policy further to counteract short-term, demand pressures, deploy active labor market policies 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 and reprioritization 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 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.

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Annex IV. Public Sector Debt Sustainability Analysis

Figure 1. Slovenia: Risk of Sovereign Stress

Horizon	Mechanical signal	Final assessment	Comments
Overall	...	**Low**	The overall risk of sovereign stress is low. This reflects the individual mechanical ratings, thelong maturity of debt, the low proportion of foreign debt in total public debt, the high liquidity buffer at the disposal of the Ministry of Finance, net debt being far lower than gross debt, a highly liquid domestic banking sector (providing a ready investor base), as well as the projected decline in debt over the medium term.
Near term 1/	...	...	
Medium term	**Low**	**Low**	Medium-term risks are moderate based on the Fanchart but low based on the GFN Financiability Module. Risks are limited by Slovenia's stable investor base, relatively long average debt maturity, and predominantly euro-denominated debt.
Fanchart	**Moderate**	...	
GFN	**Low**	...	
Stress test		...	
Long term	...	**Moderate**	Long-term risks are moderate as aging-related expenditures on health and social security are expected to increase and feed into debt dynamics. The European Commission estimate the total cost of ageing for Slovenia to reach 29.5 percent of GDP in 2070, 8.9pp higher than in 2019. 3/
Debt stabilization in the baseline 2/			Yes

DSA Summary Assessment

Commentary: Slovenia is at a low overall risk of sovereign stress and public debt is sustainable. After increasing at the onset of the pandemic, Slovenia's public debt-to-GDP ratio declined sharply to below 73 percent in 2022, as the economy recovered strongly and inflation surprised on the upside. The floods that impacted the country in August 2023 are expected to slow the reduction in public debt, but the ratio is still expected to be close to 60 percent in the medium-term, conditional on staying the course with fiscal consolidation. Medium-term risks are assessed as low, in line with the mechanical result provided by the GFN Financiability Module. Over the long term, Slovenia will face substantial challenges linked to population ageing.

Source: Fund staff.

Note: The risk of sovereign stress is a broader concept than debt sustainability. Unsustainable debt can only be resolved through exceptional measures (such as debt restructuring). In contrast, a sovereign can face stress without its debt necessarily being unsustainable, and there can be various measures—that do not involve a debt restructuring—to remedy such a situation, such as fiscal adjustment and new financing.

1/ The near-term assessment is not applicable in cases where there is a disbursing IMF arrangement. In surveillance-only cases or in cases with precautionary IMF arrangements, the near-term assessment is performed but not published.

2/ A debt sustainability assessment is optional for surveillance-only cases and mandatory in cases where there is a Fund arrangement. The mechanical signal of the debt sustainability assessment is deleted before publication. In surveillance-only cases or cases with IMF arrangements with normal access, the qualifier indicating probability of sustainable debt ("with high probability" or "but not with high probability") is deleted before publication.

3/ European Commission (2021). "The Ageing Report: Economic & Budgetary Projections for the EU Member States (2019–2070)." Institutional Paper 148.

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Figure 2. Slovenia: Debt Coverage and Disclosures

						Comments
1. Debt coverage in the DSA: 1/	CG	GG	NFPS	CPS	Other	
1a. If central government, are non-central government entities insignificant?					n.a.	
2. Subsectors included in the chosen coverage in (1) above:						

				No.	Subsectors captured in the baseline	Inclusion	Comments
CPS	NFPS	GG: expected	CG	1	Budgetary central government	Yes	
				2	Extra budgetary funds (EBFs)	No	Not applicable
				3	Social security funds (SSFs)	Yes	
				4	State governments	Yes	
				5	Local governments	Yes	
				6	Public nonfinancial corporations	No	
				7	Central bank	No	
				8	Other public financial corporations	No	

3. Instrument coverage:	Currency & deposits	Loans	Debt securities	Oth acct. payable 2/	IPSGSs 3/

4. Accounting principles:	Basis of recording		Valuation of debt stock		
	Non-cash basis 4/	Cash basis	Nominal value 5/	Face value 6/	Market value 7/

5. Debt consolidation across sectors:	Consolidated	Non-consolidated

Color code: chosen coverage | Missing from recommended coverage | Not applicable

Reporting on Intra-Government Debt Holdings

				No.	Issuer \ Holder	Budget. central govt	Extra-budget. funds (EBFs)	Social security funds (SSFs)	State govt.	Local govt.	Nonfin. pub. corp.	Central bank	Oth. pub. fin corp	Total
CPS	NFPS	GG: expected	CG	1	Budget. central govt									0
				2	Extra-budget. funds									0
				3	Social security funds									0
				4	State govt.									0
				5	Local govt.									0
				6	Nonfin pub. corp.									0
				7	Central bank									0
				8	Oth. pub. fin. corp									0
					Total	0	0	0	0	0	0	0	0	0

1/ CG=Central government; GG=General government; NFPS=Nonfinancial public sector; PS=Public sector.
2/ Stock of arrears could be used as a proxy in the absence of accrual data on other accounts payable.
3/ Insurance, Pension, and Standardized Guarantee Schemes, typically including government employee pension liabilities.
4/ Includes accrual recording, commitment basis, due for payment, etc.
5/ Nominal value at any moment in time is the amount the debtor owes to the creditor. It reflects the value of the instrument at creation and subsequent economic flows (such as transactions, exchange rate, and other valuation changes other than market price changes, and other volume changes).
6/ The face value of a debt instrument is the undiscounted amount of principal to be paid at (or before) maturity.
7/ Market value of debt instruments is the value as if they were acquired in market transactions on the balance sheet reporting date (reference date). Only traded debt securities have observed market values.

Commentary: The debt coverage remains unchanged from the last Article IV consultation. Slovenia's debt coverage and disclosure are consistent with standard recommendations.

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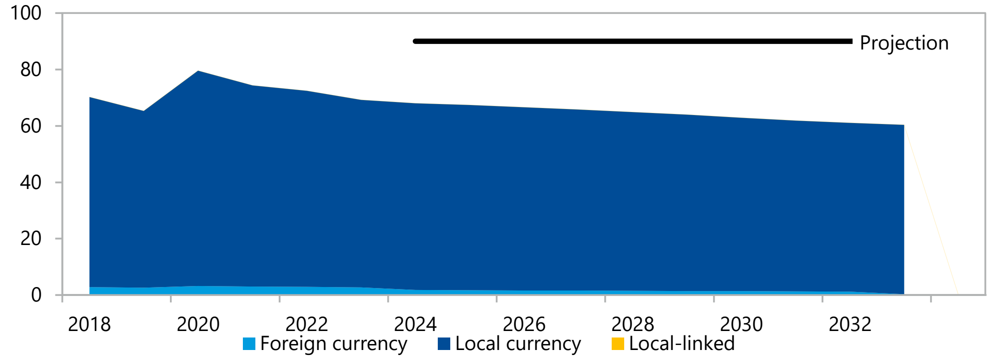
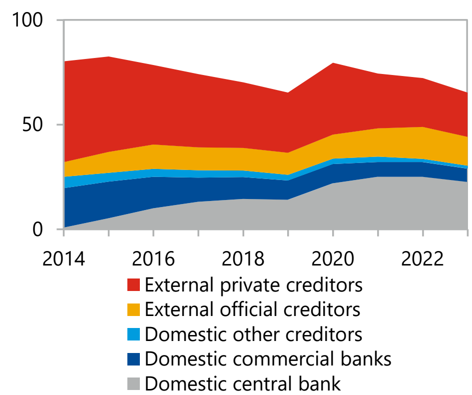
Figure 3. Slovenia: Public Debt Structure Indicators

Debt by Currency (Percent of GDP)



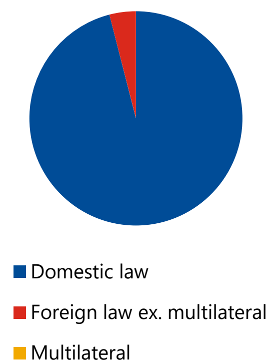
Note: The perimeter shown is general government.

Public Debt by Holder (Percent of GDP)



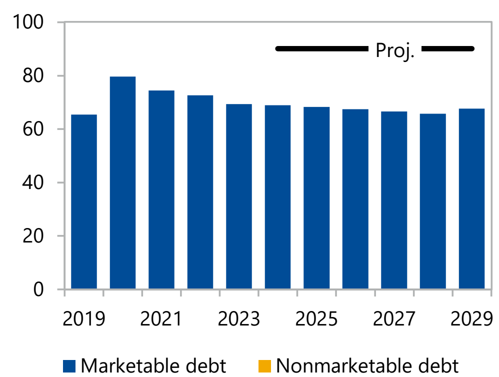
Note: The perimeter shown is general government.

Public Debt by Governing Law, 2023 (Percent)



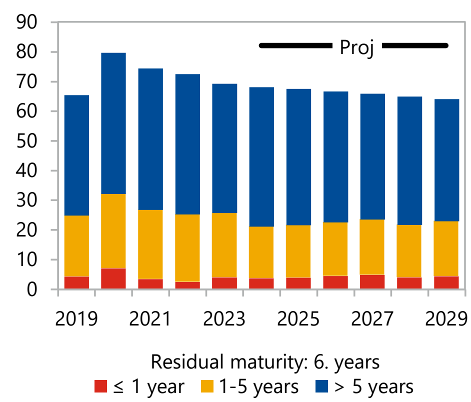
Note: The perimeter shown is general government.

Debt by Instruments (Percent of GDP)



Note: The perimeter shown is general government.

Public Debt by Maturity (Percent of GDP)



Note: The perimeter shown is general government.

Commentary: Public debt is almost entirely in local currency and marketable. The share held by the central bank has risen from zero in 2014 to 25 percent in 2022 while the share of external private creditors declined from 55 percent in 2014 to 39 percent in 2022. Over 39 percent of the central government debt has residual maturity of more than 5 years and 99 percent is at fixed interest rates. In addition, the government has sizeable cash holdings which can be used to cushion adverse market developments.

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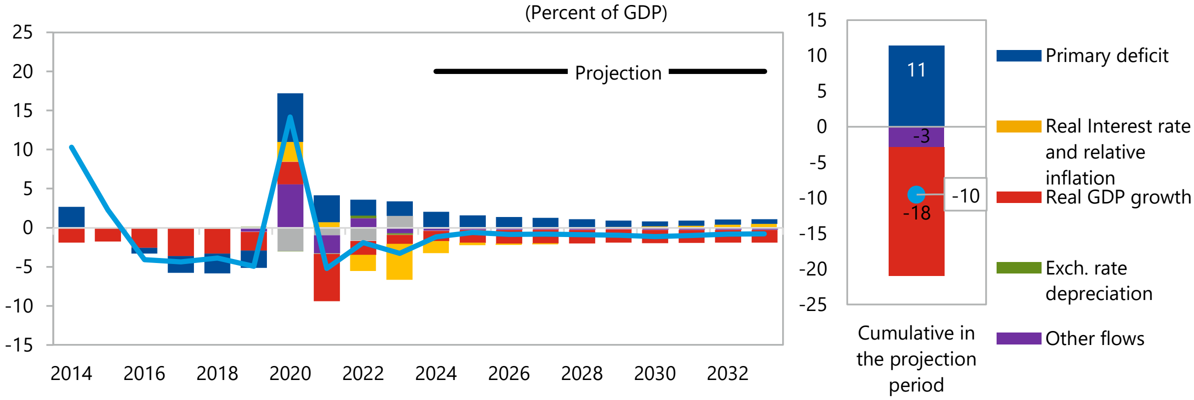
Figure 4. Slovenia: Baseline Scenario
(Percent of GDP unless indicated otherwise)

	Actual	Medium-term projection						Extended projection			
	2023	2024	2025	2026	2027	2028	2029	2030	2031	2032	2033
Public debt	69.2	68.1	67.4	66.6	65.8	64.9	64.0	62.9	61.9	61.1	60.3
Change in public debt	-3.3	-1.2	-0.6	-0.8	-0.8	-0.9	-0.9	-1.1	-1.0	-0.8	-0.8
Contribution of identified flows	-4.8	-1.2	-0.6	-0.8	-0.8	-0.9	-0.9	-1.1	-1.0	-0.8	-0.8
Primary deficit	1.9	2.1	1.6	1.4	1.3	1.1	0.8	0.6	0.7	0.7	0.6
Noninterest revenues	43.6	43.9	43.3	43.3	43.3	43.2	43.4	43.3	43.3	43.3	43.3
Noninterest expenditures	45.5	45.9	44.9	44.6	44.6	44.3	44.2	43.9	43.9	44.0	43.9
Automatic debt dynamics	-6.0	-2.9	-2.0	-1.9	-1.9	-1.7	-1.6	-1.5	-1.4	-1.2	-1.1
Real interest rate and relative inflation	-4.6	-1.5	-0.3	-0.2	-0.1	0.0	0.1	0.2	0.3	0.4	0.5
Real interest rate	-4.8	-1.6	-0.3	-0.2	-0.1	0.0	0.1	0.2	0.3	0.4	0.5
Relative inflation	0.1	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Real growth rate	-1.1	-1.4	-1.7	-1.8	-1.8	-1.7	-1.7	-1.7	-1.7	-1.6	-1.6
Real exchange rate	-0.2	…	…	…	…	…	…	…	…	…	…
Other identified flows	-0.7	-0.3	-0.3	-0.3	-0.2	-0.3	-0.2	-0.3	-0.3	-0.3	-0.3
Contingent liabilities	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
(minus) Interest Revenues	-0.6	-0.3	-0.3	-0.3	-0.2	-0.3	-0.2	-0.3	-0.3	-0.3	-0.3
Other transactions	-0.1	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Contribution of residual	1.5	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Gross financing needs	5.1	6.4	6.0	5.9	6.4	6.6	5.8	6.0	6.7	7.3	5.6
of which: debt service	3.8	4.6	4.6	4.8	5.3	5.8	5.1	5.7	6.3	6.9	5.2
Local currency	2.6	3.8	4.6	4.7	5.3	5.8	5.1	5.7	6.3	6.9	4.3
Foreign currency	0.2	0.9	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.9
Memo:											
Real GDP growth (percent)	1.6	2.0	2.5	2.7	2.7	2.7	2.7	2.7	2.7	2.7	2.7
Inflation (GDP deflator; percent)	8.9	3.9	2.1	2.0	2.0	2.0	2.0	2.0	2.0	2.0	2.0
Nominal GDP growth (percent)	10.6	6.0	4.6	4.8	4.8	4.8	4.8	4.8	4.8	4.8	4.8
Effective interest rate (percent)	0.0	1.6	1.6	1.7	1.8	2.0	2.2	2.3	2.5	2.7	2.9

Contribution to Change in Public Debt
(Percent of GDP)



Staff commentary: Public debt decreased to 69.2 percent of GDP in 2023 and is expected to continue to decline in both the near and medium terms as energy-relief measures and flood-related spending are phased out, while GDP growth starts to strengthen.

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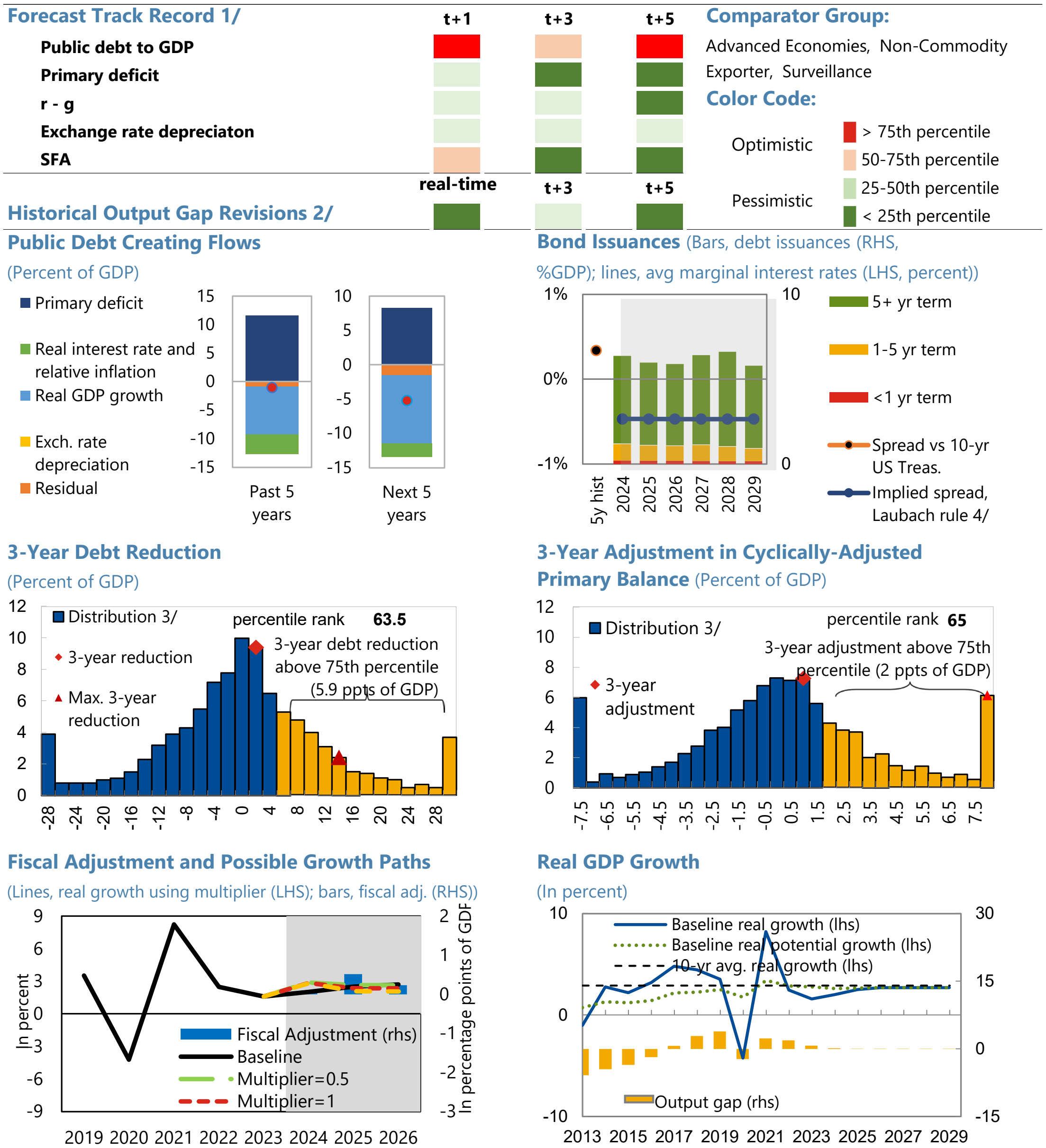
Figure 5. Slovenia: Realism of Baseline Assumptions



Commentary: The forecast track record figure generally does not show systemic realism issues as there is a mix of red and green cells throughout the table. The projected change in public debt is similar to the past 5 years, and the pattern of contributions is broadly similar between the baseline and the recent past. There is a stable pattern in the implied spreads and the maturity structure stays similar. Realism analysis point to large projected 3-year reduction in the debt-to-GDP ratio in comparison to other countries (in the yellow region) but modest compared to its own history (left of the red triangle). The baseline fiscal consolidation (red diamond) does not appear as ambitious by either cross-country or own history (in the blue region and left of the red triangle). Growth and fiscal adjustment paths are consistent with reasonable multiplier estimates.

Source: IMF staff.

1/ Projections made in the October and April WEO vintage.

2/ Calculated as the percentile rank of the country's output gap revisions (defined as the difference between real time/period ahead estimates.

3/ Data cover annual obervations from 1990 to 2019 for MAC advanced and emerging economies. Percent of sample on vertical axis.

4/ The Laubach (2009) rule is a linear rule assuming bond spreads increase by about 4 bps in response to a 1 ppt increase in the projected debt-to-GDP ratio.

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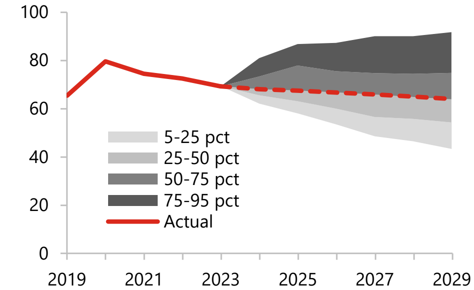
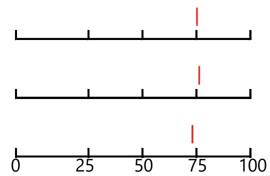
Figure 6. Slovenia: Medium-Term Risk Assessment

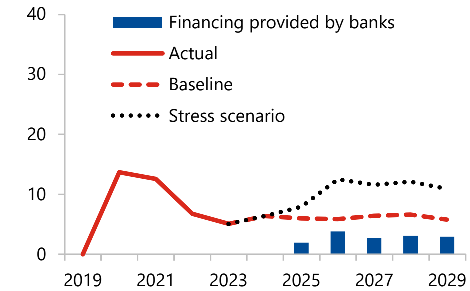
Final Fanchart (Percent of GDP)



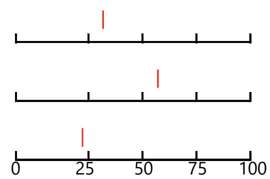
	Value	Contrib 1/	Percentile in peer group 2/
Debt fanchart module			
Fanchart width *(percent of GDP)*	48.3	0.7	
Probability of debt non-stabilizaiton *(percent)*	27.5	0.2	
Terminal debt-to-GDP x institutions index	21.0	0.5	
Debt fanchart index (DFI)		1.4	
Risk signal: 3/		**Moderate**	



Gross Financing Needs (Percent of GDP)



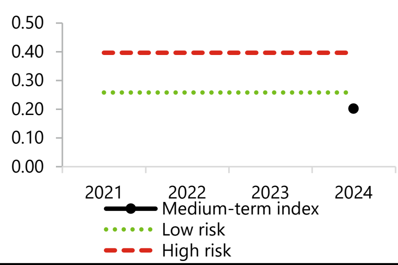
	Value	Contrib 1/	Percentile in peer group 2/
Gross financing needs (GFN) module			
Average baseline GFN *(percent of GDP)*	6.2	2.1	
Initial Banks' claims on the gen. govt *(pct bank assets)*	7.0	2.3	
Chg. In banks' claims in stress *(pct banks' assets)*	1.6	0.5	
GFN financeability index (GFI)		4.9	
Risk signal: 4/		**Low**	



Triggered stress tests (stress tests not activated in gray)

Banking crisis | Commodity prices | Exchange rate | Contingent liab. | Natural disaster

Medium-Term Index (Index Number)



Medium-term risk analysis

	Value	Value (normalized)	Weight	Contribution
Debt fanchart index	1.4	0.3	0.5	0.2
GFN finaceability index	4.9	0.1	0.5	0.0
Medium-term index		0.2		
Risk signal: 5/		**Low**		
Final assessment:		**Low**		

Prob. of missed crisis, 2024-2029, if stress not predicted: 9.1 pct.
Prob. of false alarms, 2024-2029, if stress predicted: 53.4 pct.

Commentary: Of the two medium-term tools, the Debt Fanchart Module is pointing to moderate level of risk, while the GFN Financeability Module suggests low level of risk. Adjusted fanchart is presented reflecting the optimism of staff baseline compared to historical debt reduction in Slovenia. Public guarantees are estimated at 7.9 percent of GDP in 2022.

Source: IMF staff estimates and projections.
1/ See Annex IV of IMF, 2022, Staff Guidance Note on the Sovereign Risk and Debt Sustainability Framework for details on index calculation.
2/ The comparison group is advanced economies, non-commodity exporter, surveillance.
3/ The signal is low risk if the DFI is below 1.13; high risk if the DFI is above 2.08; and otherwise, it is moderate risk.
4/ The signal is low risk if the GFI is below 7.6; high risk if the DFI is above 17.9; and otherwise, it is moderate risk.
5/ The signal is low risk if the GFI is below 0.26; high risk if the DFI is above 0.40; and otherwise, it is moderate risk.

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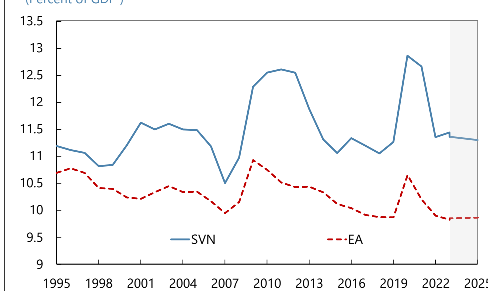
Annex V. Reform Options to Improve the Efficiency of the Wage Bill[1]

This annex examines characteristics of the public sector wage bill in Slovenia, given its weight in public expenditure and the difficulties of hiring high-skilled workers. Demographic shifts, marked by an ageing population and emigration of highly educated and younger workers, creates difficulties in replenishing the public sector workforce, which are exacerbated by the current compensation policy. Addressing these challenges requires targeted public wage reforms designed to attract and retain talent while ensuring that expenditure remains on a sustainable trajectory.

General Government Compensation of Employees

(Percent of GDP)



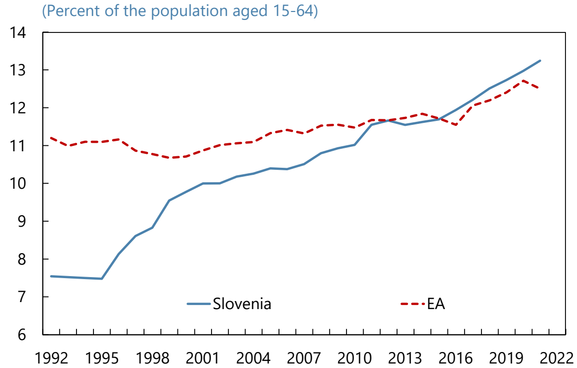
Source: European Commission.

1. **Slovenia's public wage bill is high.** Peaking at almost 13 percent of GDP in 2020 due to pandemic-related support, the wage bill has since decreased to 11.3 percent of GDP in 2022, although still remaining about 1 percent of GDP higher than the Euro Area average. The wage bill is projected to remain at similar levels in the medium term in a no-reform scenario. Public sector employment has steadily risen to 13.3 percent of the working-age population.

Figure 1. Slovenia: Public Wage Bill

General Government Employment

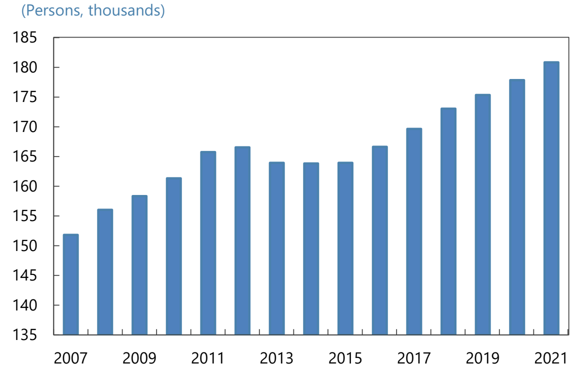
(Percent of the population aged 15-64)



Source: IMF Expenditure Policy division.

General Government Employment

(Persons, thousands)



Source: OECD.

2. **Unfavorable demographic conditions put upward pressure on the wage bill.** The ageing of civil servants reflects broader demographic trends in Slovenia. From 2000 to 2022, the share of the 55–59 cohort in the labor force more than tripled, while the cohort under 35 years old halved (Figure 2). This shift is reflected in government employment, where the share of staff over 55 aligns with the OECD average but is on an upward trend. The ageing of civil servants places a burden on the wage bill because of a system of automatic salary adjustments for years of accrued experience. Moreover, the share of central employees under the age of 34 is significantly lower than the OECD

[1] Prepared by Jiemin Ren (FAD) and Magali Pinat (EUR).

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average and is declining, a trend influenced by a decrease in the young population and, to some extent, by an increasing emigration trend among younger Slovenians.

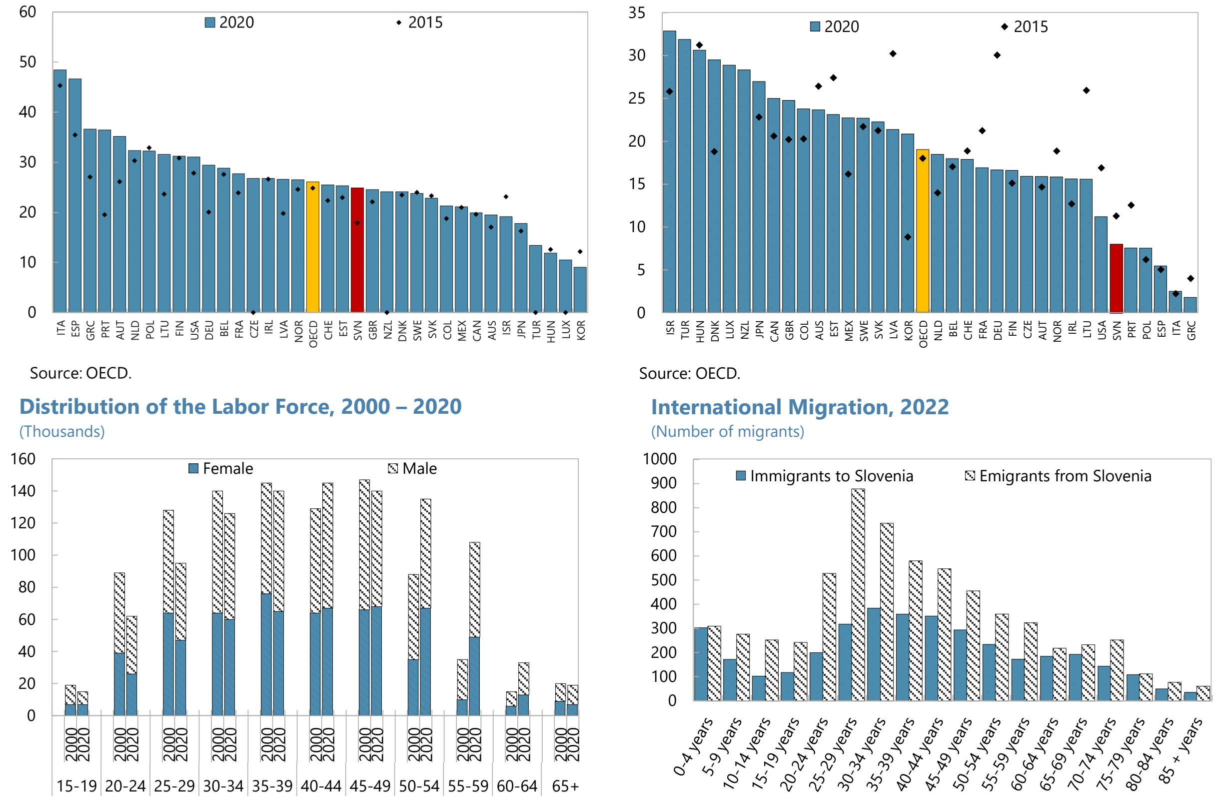
Figure 2. Slovenia: Government Employment

Central Government Employees Over 55 Years Old
(Percent of total central government employees)

Central Government Employees Between 18–34 Years Old
(Percent of total central government employees)

Distribution of the Labor Force, 2000 – 2020
(Thousands)

International Migration, 2022
(Number of migrants)



Source: OECD.

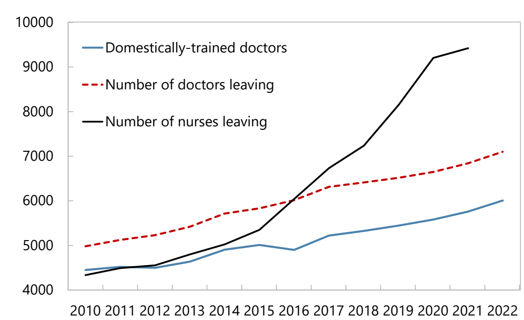
Source: OECD.

Source: Statistical Office of the Republic of Slovenia.

Source: Statistical Office of the Republic of Slovenia.

3. **Despite a substantial wage bill, the authorities encounter challenges in filling certain high-skilled positions.** The Council of Officials reported that in 2021 more than 40 percent of top civil service positions received only a single application.[2] The overall number of applications for these positions has, moreover, been falling, decreasing from an average of 4.7 applicants for each position in 2015 to just 2.6 in 2019. The health sector faces particularly severe shortages, exacerbated by the COVID-19 pandemic. At Slovenia's largest hospital, the University Clinical Centre Ljubljana (UKC),

Health Workforce Emigration



Source: OECD.

[2] Civil Servants' Council, 2021 Annual Report.

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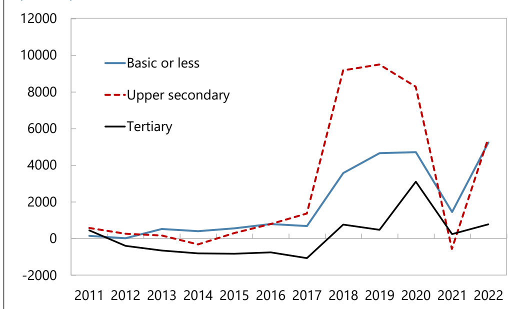
nurse vacancies reached 10 percent of all positions.[3] More doctors and nurses have emigrated over the past decade, and approaching retirement of a large cohort is expected to aggravate staff shortages.

4. The emigration of highly educated and young workers from Slovenia presents a significant challenge for the government and the private sector. In 2022, over one third of emigrants from Slovenia were aged between 20–34 years. Concurrently, the proportion of individuals aged 25–34 with tertiary education rose by 29 percentage points, from 19 percent in 2000 to 48 percent in 2021. This increase has resulted in the net emigration of Slovenians with tertiary education becoming positive in recent years.

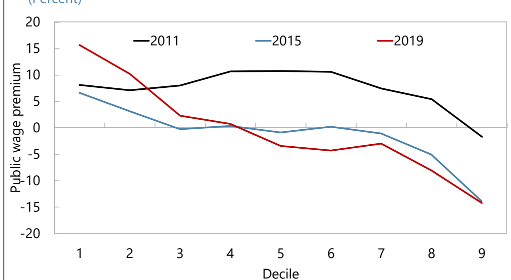
Net Migration by Education
(Persons)



Source: Statistical Office of the Republic of Slovenia.

5. Public sector compensation appears uncompetitive at higher levels. While an unconditional regression indicates that public sector wage is 23 percent higher than the private sector on average, the estimated wage premium (after controlling for education, gender, age, hours worked, part-time, and occupation) falls to just 7 percent. Moreover, results from separate quantile regressions suggest that there is a statistically significant negative public wage premium for those on higher salaries, and a positive premium for those on lower salaries, suggestive of public sector wage compression.[4] This trend towards higher public sector wage compression has deepened in the recent years, decreasing from 6.8 to 1 in 2015 to 3.9 to 1 in 2019.[5]

Public Wage Premium
(Percent)



Sources: IMF staff estimates based on EU SILC.
Note: The chart reports the coefficients associated to public sector from a quantile regression explaning gross wage with gender, age, occupation, and education.

6. Moreover, the high labor tax wedge affects Slovenia's performance in attracting and retaining talent. The relatively high labor tax wedge contributes to the low earnings potential for high-skilled workers, thereby making Slovenia a less attractive place to work. In 2022, Slovenia's labor tax wedge—the gap between the total labor costs to the employer and the workers' after-tax income—was higher than the EU average across various income levels.

[3] See Vah Jevšnik, M., 2021. Welfare Considerations Underpinning Healthcare Workers' Decision About Migration: The Case of Slovenia. Migration to and from Welfare States: Lived Experiences of the Welfare–Migration Nexus in a Globalised World, pp.123–141.

[4] IMAD (2018, 2024) estimates a similar negative premium between the public and the private sector for medium- and high-skilled occupational groups, ranging between 5 percent and 10 percent on average, and a positive for less qualified occupations, at around 10 percent.

[5] The wage compression is defined as the ratio between the 95th percentile of hourly wage in the public sector and the 5th percentile.

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7. The authorities are reforming the public sector wage system. As one of the NRRP milestones, the reform is scheduled to be presented to Parliament in June 2024 and to be implemented by January 2025. Originally planned for an earlier date, the implementation was postponed by one year because of the floods. The anticipated measures to reduce the wage bill and enhance the attractiveness of certain positions in the public sector include: (i) increasing wages to ensure no employee is paid below the minimum wage and reducing wage compression at the upper levels, (ii) reducing automaticity in step increases, (iii) reforming the bonus system to a performance-based system, and (iv) introducing a four-pillar framework to group professions for wage negotiations.

8. A comprehensive reform of the public sector compensation is critical for retaining talent while ensuring the sustainability of public finances. Guided by a clear target that would make the wage bill sustainable and agreeable for taxpayers, areas of reforms could include reducing wage compression through increasing wages of high-skilled workers to increase attractiveness of top-tier public sector positions, introducing a mandatory retirement age for civil servants, and conducting a comprehensive review of benefits and a functional review of the composition of public service.

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Annex VI. Climate Change Risks and Adaptation in Slovenia

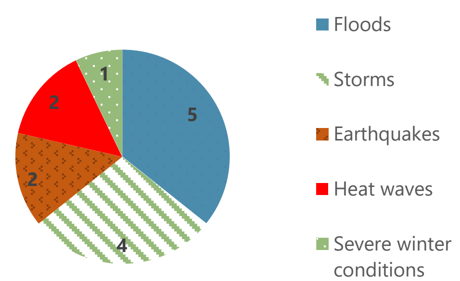
The unprecedented floods in August 2023 underscore the importance of building resilience to climate change and to extreme climate events. Adapting to hazards that exert a more gradual impact on the economy and human health is also important. The Slovenian authorities are developing a comprehensive adaptation framework to improve the economy's resilience climate change. Given the significant costs involved, including of flood-related rebuilding, prioritization is key.

A. Context

1. In August 2023, Slovenia was hit by its worst floods on record. Already in July, rainfall was up to three times higher than the long-term average, waterlogging the ground and raising water levels. Extreme rainfall on August 3–4, with an estimated return period of at least 250 years, led to widespread flooding and numerous landslides, aggravated by destructive debris flows. The floods caused significant environmental and economic impacts. The post-disaster needs assessment, promptly conducted by authorities after the floods, estimated total costs at 16 percent of GDP, including needed upgrades, although the assessment of damages at replacement (depreciated) cost is lower, at 5 percent of GDP.

2. While the frequency of natural disasters in Slovenia is lower than in peers, damages from extreme weather events are the highest among EU countries. The combination of Alpine, Continental and Mediterranean climates in a small area poses risks of severe weather events. Most of Slovenia's natural disasters during 1992–2023 reported in EM-DAT database were extreme weather events, namely five floods, four storms, two heatwaves, and one occurrence of severe winter conditions. The average annual losses from extreme weather events amounts to about 0.5 percent of GDP, significantly higher than the regional average.

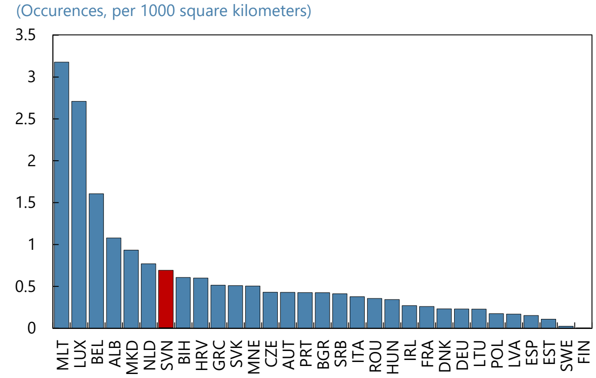
Ocurrence of Natural Disasters in Slovenia, 1992-2023



Source: EM-DAT database.

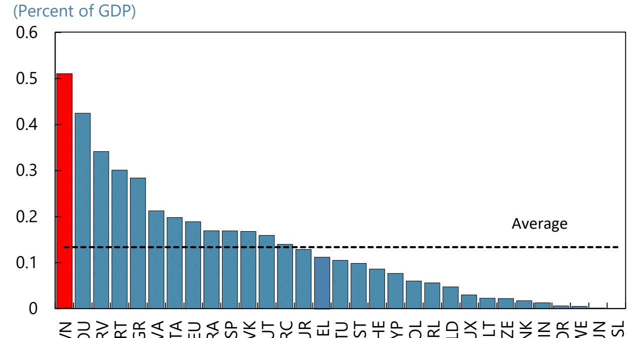
Figure 1. Slovenia: Natural Disasters and Average Annual Losses

Natural Disasters, 1992–2023
(Occurences, per 1000 square kilometers)



Sources: EM-DAT database and IMF staff estimates.

Average Annual Losses due to Extreme Weather Events[1],1995–2022
(Percent of GDP)



Sources: European Environment Agency, ECDATA, and IMF staff calculations.
1/ Defined as meteorological events (storms), hydrological events (floods, mass movements), and climatological events (heatwaves, cold waves, droughts, forest fires).

B. Climate Change-Related Hazards and Risks for the Economy

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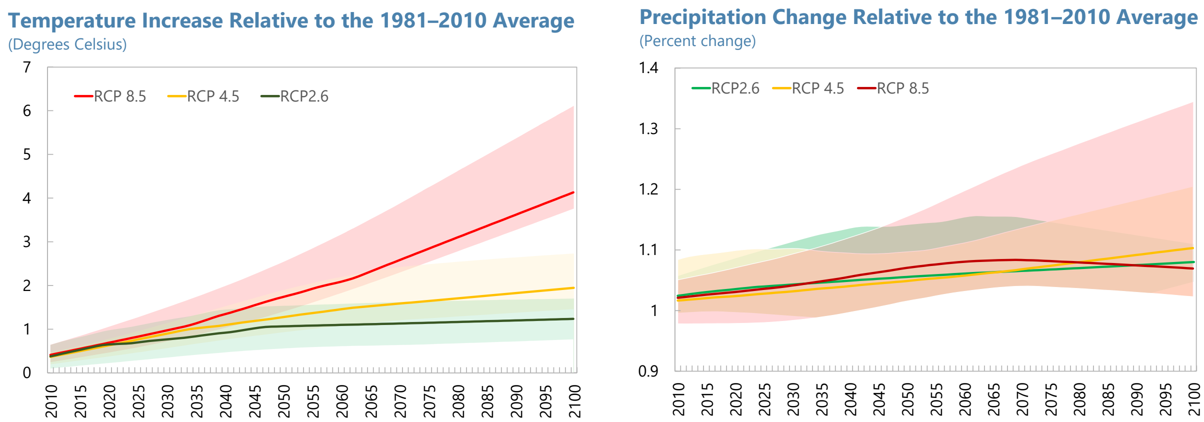
3. Global climate change is expected to increase average temperature and precipitation in Slovenia and the risk of extreme rainfall. The authorities' Climate Change Assessment (2018) considers three Representative Concentration Pathway (RCP) scenarios, ranging from relatively stringent (RPC2.6) to "business as usual" (RPC8.5) where emissions keep rising. In these scenarios, average temperature would increase by 1–4 °C.[1] In all scenarios, precipitation increases compared to the 1981–2010 average. Climate change is likely to increase the intensity and frequency of extreme rainfall and risk of flash floods.

Figure 2. Slovenia: Climate Change Scenarios



Source: The Environmental Agency of the Republic of Slovenia.
Note: The temperature chart shows an absolute change (in degrees Celsius) from the 1981–2010 average. The precipitation chart shows a relative change from the 1981–2010 average value. The shared areas represent minimum and maximum values of model projections under each scenario.

4. Climate change will affect Slovenia through two main channels. First, climate change could increase the intensity of **natural disasters** such as floods, landslides, droughts, wildfires, spells of extreme temperature (acute hazards in Table 1). The second channel constitutes slower changes (**chronic hazards**) arising from higher temperature and gradual shifts in precipitation patterns. These slow-moving changes can have significant cumulative effect over the longer term, such as changes in biodiversity and in human health due, for example, to hotter urban areas.

5. According to the National Disaster Risk Assessment, floods constitute the highest risk for Slovenia.[2] Estimates of flood damages, including to crops, soil, and infrastructure, are expected to increase from 0.2 percent of GDP per year in 2010 to almost ½ percent of GDP in 2050 under the "business as usual" scenario (AQUEDUCT), albeit with significant heterogeneity in regional and sectoral exposure to flood risks.

[1] The Slovenian Environmental Agency's website published the full assessment in Slovene and its summary in English.

[2] The assessment is available from the European Climate Adaptation Platform.

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Table 1. Slovenia: Climate Hazards with Significantly Increasing Trends

Acute/Chronic	Hazard type	Climate hazards with increasing trend
Acute	Water	Droughts
		Floods
		Heavy precipitation
		Snow and ice load
	Temperature	Cold waves and frost
		Heat waves
		Wildfires
	Wind	Storm
	Solid Mass	Landslides
Chronic	Water	Changing precipitation patterns and types
		Precipitation hydrological variability
		Sea level rise
		Water scarcity
	Temperature	Changing temperature

Source: Climate Adapt Portal. The assessment can be downoaded from here: https://climate-adapt.eea.europa.eu/en/countries-regions/countries/slovenia

C. Climate Adaptation Policies in Slovenia

6. **Slovenia's adaptive capacity to handle climate shocks is broadly comparable with its peers.** The country has been integrating climate adaptation policies across sectors, including agriculture, water management, and infrastructure. Slovenia's adaptive capacity is higher than the EU average, although it is behind Northern European countries that are often seen as benchmarks in climate adaptation within the EU (Figure 3). Slovenia should continue scaling up its initiatives and ensuring that adaptation measures are robust and inclusive.

7. **The authorities are developing their climate adaptation framework and action plans.** In 2016, Slovenia adopted the Strategic Framework for Climate Change Adaptation (SFCCA) laying out a broad approach to climate change adaptation. The authorities are also developing a new Climate Law to create a legal framework for implementing climate mitigation and adaptation policies. The law passed public consultation and is expected to be adopted later this year. The Law foresees the preparation of a Climate Change Adaptation Strategy, to include vulnerability assessments and guidelines for 11 priority sectors and expected to be completed in 2025–26. Given Slovenia's diverse landscape, the adaptation strategy will be complemented by regional and municipal adaptation action plans.

Figure 3. Slovenia: IMF-Adjusted ND-GAIN Readiness and Vulnerability Index (2021)

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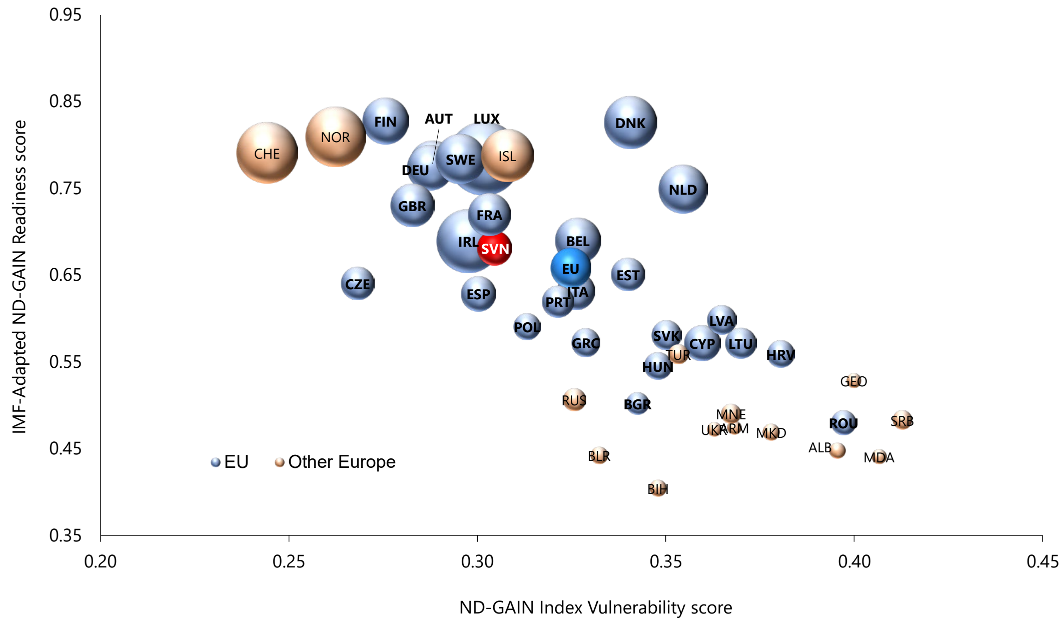

Sources: ND-GAIN, IMF Adapted ND-GAIN, and IMF staff calculations.

Notes: Blue bubble size corresponds to country's nominal GDP per capita in US dollars.
ND-GAIN Vulnerability index measures a country's exposure, sensitivity and adaptive capacity in six life-supporting sectors: food, water, health, ecosystem services, human habitat, and infrastructure.
IMF-Adjusted ND-GAIN Readiness index is measured using three components: Economic, Governance and Social. Higher values correspond to higher adaptive capacity.

8. **The authorities have mainstreamed adaptation in strategic planning and increased funds for adaptation, but vulnerability assessments are still in the planning stage.** The report on the implementation of the SFCCA in 2016–20 highlights key achievements (e.g., mainstreaming of climate change adaptation in strategic planning, European and international activities, increase in funds earmarked for adaptation purposes) and areas that need further attention (preparing vulnerability indicators and assessments). The authorities are planning to conduct vulnerability assessments in key sectors (urban, agriculture, forestry, health, economy) by end-2025/early 2026. These assessments will be used for developing adaptation guidelines for priority sectors.

9. **A well-designed adaptation framework should integrate three pillars—prevention, alleviation, and macro-fiscal resilience.**[3] The prevention pillar encompasses risk information, early warning systems, and risk prevention. The alleviation pillar includes disaster contingency plans and social safety nets. The macro-fiscal resilience pillar would typically seek to ensure adequate fiscal resources for adaptation and alleviation.

[3] See IMF Staff Climate Note 2022/003.

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Prevention Pillar

10. The authorities strengthened spatial planning and building codes in 2021 and upgraded their flood risk reduction plans last year. The 2021 amendment of the Spatial Planning and Building Acts streamlined procedures, including environmental impact assessments and building rehabilitation following disasters. The Act adopted risk-informed land use planning, where land use zoning is informed by the estimated flood levels of a 100-year return period. Just prior to the 2023 floods, the authorities updated their Flood Risk Reduction Plan, which identified green, gray, and non-structural flood risk reduction investments for 86 priority areas with an estimated cost of €678 million. The 2023 floods, however, demonstrated the need to reconsider previous technical assessments. The authorities, working with experts, are currently updating spatial zoning data and risk maps.

11. A significant opportunity exists for cost-effective flood risk reduction options. A recent study for alternative green, gray and non-structural flood investments in a sample of EU countries (Dottori et al. (2023)) suggested that investing in river protection and in dykes would have a small annual cost and high benefit to cost ratios (Figure 4). Cost-effective opportunities also exist, albeit at a smaller scale, in dry and wet flood proofing of buildings (e.g., such as the use of waterproof veneers, backflow valves, flood openings) and relocation.

12. Increasing risk awareness is an important element of prevention. The authorities maintain an online water cadaster, which includes spatial information of flood risk throughout the country. Slovenia has also conducted community-based flood risk-communication projects. Provision of risk information, however, is not mandatory for common transactions such as property sales, limiting its effectiveness to inform the public.

Alleviation Pillar

13. The disaster management framework in Slovenia is strong. Slovenia has strong civil protection under the Department of Defense and a strong flood early warning system under the Slovenian Environmental Agency. The issuance of red alerts, together with the activation of national flood emergency response plan and subsequent recovery efforts are deemed timely and appropriate, as evidenced by low casualty rates following the August floods. The authorities also collaborated well with the EU mechanism of emergency response support.

14. Assistance provided in response to the August 2023 floods also illustrates the strength of the alleviation pillar. Shortly after the floods, the authorities launched public assistance programs to foster private sector disaster response and recovery. The Act Determining Intervention Measures for Recovery from the Floods and Landslides of August 2023 activated numerous measures to help affected households such as increased social protection, market rent subsidies, provision of crisis accommodation for the vulnerable, and co-financing of psychosocial and family support programs. Affected businesses and the self-employed were likewise eligible for a assistance options such as preferential tax treatment, reimbursement of flood recovery costs, and lowering of requirements for bank guarantees. Municipalities' borrowing limits and the use of reserve fund were also temporarily relaxed. Together with simplification of administrative procedures including public procurement, these measures facilitated swift disaster response and recovery efforts.

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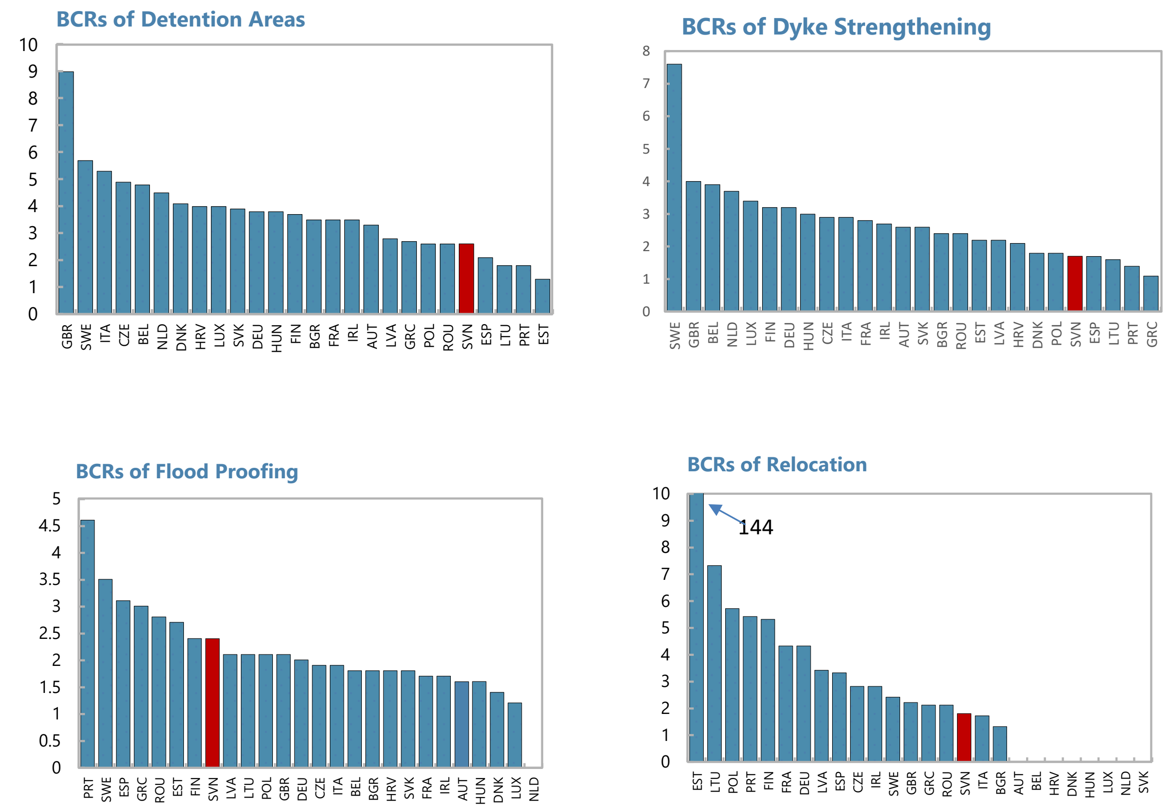
Figure 4. Slovenia: Benefit-Cost Ratios of Flood Adaptation Strategies for the 3°C Warming Scenario by 2100



Source: F. Dottori, L. Mentaschi, A. Bianchi, L. Alfieri and Luc Feyen. "Cost-effective adaptation strategies to rising river flood risk in Europe." Available electronically from here.

Macro-Fiscal Resilience Pillar

15. **Despite multiple shocks in recent years, Slovenia has fiscal space for addressing the consequences of the floods and building resilience to climate change.** It also has access to the financial markets allowing mobilization of resources as necessary. Slovenia does, however, face labor market constraints and needs to prioritize projects accordingly. And these constraints are stronger in smaller municipalities that were hit hardest by the floods. Also, challenges in public procurement could undermine timely and efficient infrastructure recovery.

16. **While government plays the key role in climate adaptation development, it could further encourage stronger participation from the private sector.** While about the same proportion of Slovenia firms have developed or invested in measures to build resilience to climate risks, similar to the EU average, more could be done to raise climate change awareness and private investment in climate adaptation. Government could support insurability of flood risk through effective land-use planning and flood protection investments as well as efforts to improve understanding of flood risks and the need for financial protection. For example, in countries where flood risks are automatically included in standard building and contents insurance for households

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and businesses, insurance penetration rates are generally higher (OECD Report on Financial Flood Risk).

17. There is also room to expand the role of climate-related insurance. Higher levels of insurance typically reduce fiscal costs in the event of disaster and incentivize more investment in protection of individual properties (e.g., elevation, reinforcement of foundations). Insurance payments also tend to be larger and more quickly disbursed than government assistance (OECD Report on Financial Flood Risk). But the penetration of flood insurance in Slovenia remains limited (e.g., no public sector assets had insurance) and could be expanded, including by offering premium discounts for risk-reduction behaviors.

D. Conclusions

18. The August 2023 floods highlighted the growing risks of climate change and the need to build resilience to shocks. The authorities had begun to strengthen their flood management framework before the floods, but the exceptional nature of the recent floods calls for further action. Promoting public awareness of the flood risks and implementing flood protection investments would encourage better adaptation efforts from the population and the broader private sector. Vulnerability assessment of climate change-related risks—that could go beyond the risk of floods—would be key for developing a comprehensive adaptation strategy. And effective coordination across government levels and agencies will be critical for establishing an integrated approach to climate adaptation and for more efficient allocation of public resources.

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INTERNATIONAL MONETARY FUND

REPUBLIC OF SLOVENIA

April 4, 2024

STAFF REPORT FOR THE 2024 ARTICLE IV CONSULTATION—INFORMATIONAL ANNEX

Prepared By

European Department
(In Consultation with Other Departments)

CONTENTS

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FUND RELATIONS

(As of February 29, 2024)

Membership Status: Joined December 14,1992; Article VIII

General Resources Account:

	SDR Million	Percent of Quota
Quota	586.50	100
Fund holdings of currency	429.80	73.28
Reserve position	156.72	26.72
Lending to the Fund	0	0

SDR Department:

	SDR Million	Percent of Allocation
Net cumulative allocation	778.02	100.00
Holdings	791.93	101.79

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				
	2024	**2025**	**2026**	**2027**	**2028**
Principal					
Charges/Interest	0.01	0.01	0.01	0.01	0.01
Total	0.01	0.01	0.01	0.01	0.01

Exchange Rate Arrangement:

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 19 other members of the EU and has no separate legal tender. Slovenia accepted the obligations under Article VIII, Section 2(a), 3, and 4 of the IMF's Articles of Agreement, and maintains an exchange system free of multiple currency practices and restrictions on payments and transfers for current international transactions, except those notified to the Fund in accordance with Decision No. 144-(52/51).

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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.

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Table 1. Republic of Slovenia: Technical Assistance, 2012–24

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	April 2023	Public Investment Management Assessment (PIMA)
	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	Under preparation	Macroeconomic Frameworks
	January 2022	Macroeconomic Modeling

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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. In September 2023, SORS revised 2022 national accounts data reducing GDP growth by 2.9 ppts relative to the initial estimate.

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 are 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.

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Republic of Slovenia: Table of Common Indicators Required for Surveillance
(As of April 4, 2024)

	Date of Latest Observation	Date Received or Posted	Frequency of Data[6]	Frequency of Reporting[6]	Frequency of Publication[6]
Exchange Rates	03/2024	03/2024	D	D	D
International Reserve Assets and Reserve Liabilities of the Monetary Authorities[1]	02/2024	03/2024	M	M	M
Reserve/Base Money	01/2024	02/2024	M	M	M
Broad Money	01/2024	02/2024	M	M	M
Central Bank Balance Sheet	01/2024	02/2024	M	M	M
Consolidated Balance Sheet of the Banking System	01/2024	02/2024	M	M	M
Interest Rates[2]	03/2024	03/2024	D	D	D
Consumer Price Index	02/2024	03/2024	M	M	M
Revenue, Expenditure, Balance and Composition of Financing[3] – General Government[4]	12/2023	03/2024	M	M	M
Revenue, Expenditure, Balance and Composition of Financing[3]– Central Government	12/2023	03/2024	M	M	M
Stocks of Central Government and Central Government-Guaranteed Debt[5]	12/2023	03/2024	M	M	M
External Current Account Balance	01/2024	03/2024	M	M	M
Merchandise Trade	01/2024	03/2024	M	M	M
GDP/GNP	Q4/2023	02/2024	Q	Q	Q
Gross External Debt	01/2024	03/2024	M	M	M
International Investment Position	Q4/2023	03/2024	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).

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Statement by Mr. Palotai and Mr. Pucnik on Republic of Slovenia
May 3, 2024

On behalf of the Slovenian authorities, we would like to thank Mr. Donal McGettigan and his team for the insightful policy discussions, and the thorough analysis presented in the Staff Report. The Slovenian authorities broadly agree with the thrust of the Report, which offers a candid overview and assessment of recent economic developments in Slovenia. They highly value the Fund's advice, which is beneficial in guiding their policies and further reform endeavors. The authorities also welcome the Selected Issues Paper's focus on boosting productivity in Slovenia, which ranks high among their development priorities.

Recent economic developments and outlook: A continuation of solid developments

A small open economy deeply embedded within global supply chains, Slovenia has effectively preserved fiscal, external, and financial stability, despite uncertainties stemming from geopolitical developments, high inflation, and extreme weather events. This achievement underscores the authorities' effective implementation of robust macroeconomic policies and institutional frameworks, which have bolstered the Slovenian economy's resilience.

Demographic shifts remain a key structural challenge, prompting the government to prepare and execute structural reforms for the healthcare, long-term care, and pension systems, as well as the labor market. Systemic adjustments to social protection systems aimed at achieving greater long-term sustainability will positively impact the medium-term fiscal space of public financial policy.

In 2023, Slovenia experienced a slowdown in economic activity to 1.6 percent, a figure lower than expected in the October 2023 World Economic Outlook, and the growth experienced in 2022, due to stronger cost pressures on businesses and households, and a more pronounced deceleration in external demand. The decline was particularly noticeable in the export sector, reflecting the economic cooling in Slovenia's most important trading partners, and reduced activity in energy-intensive industries. Furthermore, lower private consumption growth following the reopening effect after the pandemic in 2022, affected activity in the retail and services sectors. However, a more pronounced cooling of GDP growth was partly offset by government investment, supported by EU funding, robust housing investments, and a positive contribution from the trade surplus. **Despite the slowdown in economic activity, Slovenia's labor market remained tight**, with the unemployment rate reaching historic lows, and the number of employed reaching historic highs. The tight labor market led to significant wage growth, reaching 10.7 percent in the third quarter 2023, among the highest in the euro area. **Inflation, measured as CPI, gradually declined** from 10 percent at the beginning of 2023, to 4.2 percent by December 2023, primarily driven by lower energy prices, although it was still 1 percentage point above the euro area average. Without any new structural shocks, the inflation gap between Slovenia and the euro area is expected to diminish by 2025. **In early August 2023, Slovenia was hit**

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by floods and adverse weather conditions, resulting in far-reaching and devastating consequences, albeit with relatively limited effects on economic growth.

A rebound is anticipated in 2024, with GDP growth projected to exceed 2 percent, surpassing the eurozone average, with the projections for 2025 improving even further. Private consumption, international trade activity, and government consumption are expected to be key drivers of growth, although investment growth may remain subdued due to factors such as transitioning to a new EU financial perspective and the lingering effects of past interest rate hikes. Despite the expectations for a gradual recovery in domestic and foreign demand, challenges persist in the manufacturing sector owing to higher energy prices, labor shortages, less favorable financing conditions, and ongoing uncertainty. Going forward, it is essential that further wage policies and bargaining remain closely aligned with productivity growth. The authorities are committed to prudent fiscal and macroeconomic policies. In this regard, they appreciate staff's thorough analyses, particularly their assessment that crucial structural fiscal reforms should be promptly advanced to tackle longer-term pressures.

Upside risks to economic growth could stem from a faster decline in inflation, successful workforce attraction, and improved EU fund absorption, alongside reform efforts. A quicker drop in inflation, if driven by lower energy prices, would boost household purchasing power and domestic demand. Recruiting foreign labor and implementing additional measures could alleviate shortages, bolstering economic activity. Enhanced EU fund absorption and effective reforms, both domestically and among key trading partners, would further boost Slovenia's growth potential. This presents opportunities to prioritize research, innovation, and digital transformation for productivity gains; pursue green initiatives for sustainable development; and address demographic challenges through systemic social protection adjustments, ultimately enhancing medium-term fiscal space.

Downside risks to economic growth could arise from the escalation of the war in Ukraine and conflicts in the Middle East, the pace of China's economic growth, the impacts of climate change, and cyberattacks. Some of these factors may result in higher energy and food prices, necessitating a prolonged tightening of monetary policy to anchor inflationary expectations. Other factors could limit fiscal capacity, as efforts to mitigate the effects of reduced external demand growth, supply chain disruptions, climate change, and cyberattacks may constrain resources.

The flood response: The Government reacted quickly and adopted measures to manage the consequences.

In August 2023, Slovenia experienced devastating floods and adverse weather conditions that impacted two-thirds of the country's territory. Heavy rainfall led to widespread flooding, landslides, and infrastructural damage. Considered the largest catastrophic weather event in the nation's history, its economic effects were profound, affecting various sectors such as agriculture, tourism, and transportation. The natural disaster has impacted less developed regions of the country, underscoring the urgency of swift post-flood reconstruction efforts. The Slovenian authorities assessed the damage and its consequences using the PDNA (Post-Disaster Needs Assessment) methodology, which considers not only the immediate damage caused, but also the costs of restoring the affected

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areas to enhance resilience against future climate shocks. The estimate for direct damage and the cost of mitigating the consequences of the floods stands at EUR 10 billion (currently around 16 percent of GDP).

The Slovenian authorities mobilized both domestic and international resources for relief and recovery efforts. They adopted emergency flood relief legislation to provide immediate assistance domestically and applied for EU Solidarity Fund assistance, resulting in the European Commission's approval of a EUR 100 million advance payment, and potential additional financial support of up to EUR 300 million in 2024.

The primary challenge in reconstructing public infrastructure is navigating the risk of delays in completing construction works due to labor shortages, a common issue across European countries including Slovenia. This shortage leads to limited resources on construction sites, necessitating a balancing act between ongoing projects, and the reconstruction and restoration of flood-damaged infrastructure. The increased demand for construction services may also lead to price hikes in the construction sector, crowding out of other investment projects, inflationary pressures, and a reduction in the purchasing power of available funds. As staff correctly points out, the careful prioritization of investments and a phased approach to flood-related spending are essential for effective resource management.

Fiscal policy: Toward the consolidation of public finances

At 2.5 percent of GDP, the 2023 deficit was lower than anticipated, despite the implementation of support measures following the major floods in August, and ongoing efforts to mitigate high energy prices. General government revenues grew by 10.6 percent, surpassing the previous year's rate. Indirect taxes, including VAT and excise duties, grew faster than the tax base. Personal income tax and social security contributions saw increased growth as a result of the favorable labor market situation. Corporate income tax (CIT) increased by 9.3 percent, also higher than the previous year, while interest rates brought a sharp rise in interest income. On the expenditure side, at 9.5 percent, growth was slower compared to revenues. Wages, buoyed by agreed wage increases, constituted the largest factor in the nominal increase. Subsidies and intermediate consumption also contributed significantly, influenced by support measures to address high energy prices and floods. Interest payments increased due to past rises in borrowing costs.

The floods' direct negative impact on economic activity will be temporary and, although significant at the local level, will not have a major effect at the macroeconomic level. Expenditure side measures for flood reconstruction are estimated at 0.9 percent of GDP in 2023, increasing to 1.6 percent of GDP in 2024, and with additional expenditure expected in the following years. These will be funded through increased revenues facilitated by the implementation of the Act on Reconstruction, Development, and Provision of Financial Resources, outlined as follows: i) A temporary three-percentage-point increase in the CIT tax to 22 percent, effective from 2024 to 2028; ii) A temporary imposition of a tax on the total assets of banks and savings banks for the calendar years 2024 to 2028; iii) A temporary utilization of the net balance sheet profit of the Slovenian State Holding. Flood reconstruction, driven by increased government investment, is expected to boost the economy

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by 0.7 percent of GDP.

In 2024, fiscal policy will continue at a gradual pace of medium-term fiscal consolidation, emphasizing enhanced revenue mobilization and the reprioritization of expenditures to further reduce general government debt, and bolster growth and development prospects. While the Act on Reconstruction, Development, and Provision of Financial Resources covers new revenue measures, on the expenditure side, the authorities will prioritize eliminating measures aimed at mitigating the effects of the COVID-19 epidemic, as well as allocating fewer resources to address the energy crisis and high cost of living. The process of reducing the general government debt from 69.2 percent of GDP in 2023 will primarily rely on nominal GDP growth and the gradual reduction of state budget liquidity reserves. The projected developments in Slovenia's general government debt aligns with both the national fiscal rule and the new EU fiscal rules. Overall, Slovenia remains one of the lesser indebted EU Member States, both in terms of gross and net external debt.

Financial sector policy: A resilient financial sector with strong buffers

The Slovenian financial sector maintains a robust financial position, with the additional improvements in the performance of Slovenian banks in 2023 attributed to moderate economic growth and high interest rates. The banking system's high liquidity has improved further, and banks continue to be well-capitalized and profitable. While extreme weather events may not significantly affect banks' asset quality, insurers might experience a larger – albeit still moderate – impact on their performance. Nevertheless, uncertainties remain relatively high due to the combination of high inflation and the simultaneous cooling of the global economy.

With the flood reconstruction efforts, banks and savings banks will bear an additional tax on their balance sheets for a limited five-year period, taking into account their recent performance. The tax base will be the total value of assets in the statements of financial positions of banks' balance sheets, with a rate of 0.2 percent. We should emphasize that i) the additional CIT, which also aids in financing state restoration, will reduce the tax on the balance sheet; and ii) there will be a cap on the balance sheet tax set at 30 percent of the taxpayer's operating profit. The Bank of Slovenia will perform an annual analysis of the tax's impact on the Slovenian banking sector's stability.

Macroprudential policy aims to enhance the resilience of the banking system in light of recent pronounced cyclical developments and the high-earnings environment. The shift from a period characterized by low interest rates and low variability across economic categories to one marked by elevated inflation, higher nominal interest rates, and increased variability in nominal and real economic and financial indicators, underscored the need for adjusted macroprudential measures. **In December 2023, the Bank of Slovenia implemented a Countercyclical Capital Buffer (CCyB) set at 0.5 percent of the total risk exposure amount, due to increasing cyclical systemic risks.** Subsequently, the CCyB will be raised to 1.0 percent of the total risk exposure amount effective from January 1, 2025. The motivation for the introduction of a positive neutral CCyB includes building up the banking

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system's resilience to shocks that do not necessarily originate in the domestic financial system, nor are the result of excessive credit growth, and the inherent uncertainty in assessing cyclical risks, along with delays in both risk assessments and the building of CCyB. **The Bank of Slovenia reduced the sectoral systemic risk buffer for residential real estate-secured exposures from 1.0 percent to 0.5 percent**, reflecting the decrease in cyclical risks within the real estate market. The current slowdown in residential real estate prices and decrease in sales volume are seen as a corrective phase, rather than a manifestation of financial stability risks. **The Bank of Slovenia has also adopted new regulations concerning consumer lending**, aimed at enhancing access to credit for lower-income borrowers. The changes include adjusting the minimum creditworthiness amount for consumers (from 76 percent of the minimum gross wage to EUR 745), implementing a standardized cap on the debt-servicing-to-income (DSTI) ratio (with a maximum allowed DSTI of 50 percent, regardless of income level), modifications to the calculation of annual income, and reducing allowable deviations from the DSTI cap.

Slovenia made significant regulatory advancements in AML/CFT in 2022 and 2023. The new AML/CFT law was adopted in April 2022, introducing measures to enhance the effectiveness of managing AML/CFT risks by obliged entities and improving risk-based supervision. Additionally, the new AML/CFT law included revisions to the scope and definition of Crypto Assets Service Providers (CASPs), along with strengthened obligations regarding crypto assets and CASPs.

Structural policy: Continued commitment to long-term reforms

To ensure sustained growth and speed up the convergence process with the EU, Slovenia relies heavily on reforms and investments strategically tailored to technological advancements, and the transition to a green and smart economy. In the past decade, Slovenia's progress in closing the GDP-per-capita gap with the EU has been modest and slower than peer countries. The convergence process was mainly driven by the rising employment rate, while catching up in terms of productivity was slow. Building on the National Reform Program 2023, Slovenia is committed to renewing the knowledge, technologies, and processes necessary to leverage economic conditions to accelerate productivity gains and maintain export orientation, particularly towards high-tech exports. Further investments in the green and digital transition will be increased, including through the support of a more active and developed capital market. The Recovery and Resilience Plan will further support these efforts. The amended version from October 2023 has been supplemented with a REPowerEU chapter, and additional loans aimed at mitigating the risk of flooding and other climate-related disasters, the sustainable renovation of buildings, and enhancing railway infrastructure capacity. The plan is now valued at almost EUR 2.7 billion, comprising EUR 1.6 billion in non-repayable support and EUR 1.07 billion in loans.

Healthcare reform remains a primary focus for the Government, with policy objectives for 2024 and 2025 directed at bolstering stability within the healthcare system. Significant strides have already been made in healthcare reform, with several initiatives already in effect that concentrate on expanding access to services, enhancing health outcomes through knowledge-sharing among providers, and optimizing organizational structures to mitigate

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inequalities at both the national and regional levels. One of the key reforms implemented since August 2023 is the Long-Term Care Act, a landmark initiative that regulates the gradual establishment of rights and sets up a sustainable financing system for this essential service.

Pension reform is also among the central priorities. Demographic challenges, exemplified by the decreased ratio of insured persons to pensioners from 1.8 in 2000 to 1.57 in 2022, pose a significant economic strain on public finances. One of the primary goals of the upcoming amendments to the pension legislation is to further increase the effective retirement age. Slovenia aims to enact changes to its pension and disability insurance system by the end of 2024.

The Government is focusing on implementing efficient labor market policies to tackle the growing problem of labor shortages. The sectors with the highest demand for workers in 2023 were manufacturing and construction, followed by education, social services, and health services. Several retraining programs have been initiated to address labor market skill mismatches; alongside legislative changes aimed at facilitating foreigners' access to employment. The employment of foreign workers has become increasingly crucial for the growth in labor force participation.

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