SLOVENIA

Highlights

- **The economy returned to growth in 2014.** After contracting by 1.0 per cent in 2013, economic activity accelerated to 3.0 per cent in 2014, mainly on the back of net exports and higher use of EU funds for infrastructure investments. In the second quarter of 2015, year-on-year growth stood at 2.6 per cent, mainly driven by net exports and consumption.
- **Privatisation efforts progressed, albeit with delays and further challenges.** The long-awaited state asset management strategy, determining the course of management and privatisation for state-owned enterprises (SOEs) was approved by parliament in July 2015. Several privatisations from the 2013 list of 15 have been completed, but the privatisation of Telekom Slovenia failed.
- **Efforts to restructure the banking sector were intensified.** In line with the government's privatisation and restructuring agenda, efforts to reduce costs and streamline the business operations of NLB (the largest bank) are under way, but the course of privatisation remains to be seen. Meanwhile, the sale agreement of NKBM (Slovenia's second largest bank) was signed in June 2015, and consolidation of some smaller banks has taken place.

Key priorities for 2016

- **In the corporate sector, the restructuring and privatisation of enterprises is crucial.** Deleveraging of the non-financial corporations continued in 2014, yet despite ongoing privatisation efforts, there is still excessive leverage. Efforts to restructure corporations should facilitate unwinding a web of cross-shareholdings, ultimately under state ownership, and fostering efficiency enhancements. Implementation of the new asset management strategy is the key challenge.
- **Efforts to resolve non-performing loans (NPLs) should continue.** Although a large proportion of corporate NPLs have been transferred to the Bank Asset Management Company (BAMC), significant NPLs still remain in the banking sector. Although the sale of assets transferred to BAMC has progressed well, extending the asset sale deadline by five years to 2022 implies that the restructuring and divestment processes are more complex than initially expected. The dismissal of BAMC's key foreign managers in October 2015 has posed additional uncertainty regarding the future extent and pace of restructuring assets under BAMC's management.
- **Implementation of the new fiscal rule should be carried out to preserve macroeconomic stability.** The fiscal rule, envisaging a structurally balanced budget in the medium term, and the bill for its implementation were approved by the parliament in 2015. It is important to develop an operational roadmap for the implementation of the fiscal rule in order to have efficient budget planning and compliance with fiscal policy coordination in the European Union.

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Main macroeconomic indicators %

	2011	2012	2013	2014	2015 proj.
GDP growth	0.6	-2.7	-1.1	3.0	2.3
Inflation (average)	1.8	2.6	1.8	0.2	-0.5
Government balance/GDP	-6.6	-4.1	-15.0	-5.0	-3.7
Current account balance/GDP	0.2	2.6	5.6	7.0	6.7
Net FDI/GDP (neg. sign = inflows)	-1.7	-1.3	-0.1	-1.6	-3.0
External debt/GDP	107.0	121.6	119.7	115.2	n.a.
Gross reserves/GDP	2.0	2.0	1.9	2.1	n.a.
Credit to private sector/GDP	82.3	79.8	65.9	55.0	n.a.

Macroeconomic performance

Economic activity accelerated to 3.0 per cent in 2014. Growth has been driven by strong export performance, boosted by increased competitiveness through slower wage growth and euro weakening, as well as gains in non-price factors, as reflected in the higher market share in export destinations. Higher utilisation of EU funds for infrastructure investments pushed up public investments, while private investments remained subdued, given high corporate indebtedness. A gradual rebound in real wages and declining unemployment increased disposable income and helped the revival of private consumption, leading to a year-on-year growth of 3.0 per cent in 2014. In the second quarter of 2015, year-on-year growth stood at 2.6 per cent, on the back of net exports and household consumption. Meanwhile, average inflation stood at an historically low annual level of 0.2 per cent in 2014, reflecting lower global oil prices and lower food prices. Consumer price inflation remained in negative territory in the first nine months of 2015, with deflation of 0.6 per cent in September 2015.

The gradual consolidation of government finances continued, although one-off recapitalisations of the banking sector continued to weigh on them. As a follow-up to the large-scale bank recapitalisation in 2013, with a cost of around 10.3 per cent of GDP, the cost of further recapitalisation declined significantly to 1.6 per cent of GDP in 2014, pulling the general government budget deficit down to around 5.0 per cent of GDP. While expenditure growth remained limited, revenue growth accelerated due to improving labour market conditions and higher tax collection, as well as one-off, non-tax factors, such as proceeds from the sale of the mobile frequency range in April 2014. Public debt reached around 81 per cent of GDP in 2014, while the declining country risk premium, following credible bank recapitalisation, eased the government's access to borrowing in international markets and reduced the cost of the debt. While external debt moderated to 115.2 per cent of GDP in 2014, the current account surplus widened to 7.0 per cent of GDP, reflecting improved competitiveness in tradeable sectors, as well as gains in services trade.

Growth is expected to be 2.3 per cent in 2015 and moderate slightly to 2.0 per cent in 2016. Fiscal consolidation and deceleration of EU-funded investments will likely limit public investments and growth over this period. Meanwhile, private consumption is expected to increase on the back of low inflation, an easier monetary stance, and the revival of delayed purchases of durable goods, along with an increase in private investments amid a low interest rate environment. Limited but somewhat stronger growth in the eurozone, Slovenia's main trading partner, and continued gains in competitiveness, will result in a continuing positive contribution of net exports to growth. Inflation is expected to remain in negative territory in 2015, due to low commodity prices and still slowly recovering economic activity.

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Major structural reform developments

Business environment has improved over the past year, but efforts to further improve it should continue. Slovenia ranked 29th among 189 countries in the World Bank's *Doing Business 2016* report, an improvement of six places over the previous year, but still slightly below the OECD high-income regional average. The most significant improvement was in the area of resolving insolvency, while the country continues to score poorly in areas of contract enforcement, getting credit and dealing with construction permits. In February 2015, the government, trade unions and employers signed a social contract for 2015-16, following five years of failures, which sets goals for finance, development, investments and the labour market. The agreement between social partners will likely provide a more stable investment environment, while providing space for further structural reforms.

Much-needed reforms have revived after elections in 2014, but may be under threat again. Economic reforms lost steam in the wake of snap elections in July 2014 and were slowly revived after the new coalition government was formed in September. While the new government has indicated it will continue reforms and privatisation of the 15 companies from the parliament-approved list, as well as in the area of long-term sustainability of public finances, it remains to be seen how further reforms and privatisations will proceed.

Progress is being made in reinforcing budgetary strategy. In December 2014 the government proposed the specifics of the fiscal rule to comply with the European Union's requests. The fiscal rule, which was later approved by the parliament in February 2015, envisages a structurally balanced budget in the medium term, except during crises. The bill to implement the fiscal rule was approved by the parliament in July 2015 and foresees a structural deficit adjustment of 0.5 per cent each year after correcting the excessive deficit, and achieving zero structural balance by 2020. However, a fiscal council, which would monitor fiscal accounts and make recommendations for necessary adjustments, is yet to be established.

Efforts to privatise SOEs are on track, albeit with some delays. Several privatisations, such as Ljubljana Airport, Helios and Fotona have been completed, while the signing of share sale and transfer agreements took place for NKBM, Elan (sports goods manufacturer) and Žito (food producer) in 2015. However, efforts to privatise Telekom Slovenia failed. In July 2015 parliament approved the long-awaited state asset management strategy, determining the course of privatisation for companies which were not part of the initial list of 15, but its implementation remains to be seen.

Corporate restructuring and improving corporate governance continue to be challenging. In line with the European Commission's recommendations, the government approved a taskforce in January 2015 to create an action plan for corporate restructuring and deleveraging and identify measures to enhance the efficiency of the process. Additional authority was given to the Bank Asset Management Company (BAMC) for taking part in the corporate restructuring process. Despite ongoing privatisation efforts, state ownership in the economy still remains high and corporate governance is relatively poor relative to the best practices in the European Union, according to the IMF's Article IV Report from February 2015. To address the problem, the Slovenian Sovereign Holding (SSH) issued a corporate governance code in December 2014, determining corporate governance and supervision standards in However, the effects of implementation are yet to be seen.

Improvements in the banking sector have occurred. A government-approved taskforce has been assigned to draw up proposals for reviving lending activity in the country, but a roadmap has not yet been prepared. In line with the government's privatisation and restructuring agenda, efforts to reduce costs and streamline business operations of NLB (the largest bank) are under way, but the course of its privatisation is as-yet unknown. Meanwhile, the share sale and transfer agreement of NKBM, the second largest bank in the country, was signed with Apollo, a US-based private equity fund, and the EBRD in June 2015. Efforts towards bank consolidation continue, with the merger of A-banka and Banka Celje cleared by the Bank of Slovenia, and plans to privatise the new bank in 2017.

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A large proportion of corporate NPLs have been transferred to BAMC, but significant NPLs still remain in the banking sector. The transfer of NPLs from eligible banks to the BAMC was completed in 2014 and early 2015. Nevertheless, a significant number of NPLs (11.4 per cent in March 2015) still remain on the banks' balance sheets, and the central bank is actively identifying ways to deal with these. In an effort to clean-up claims, BAMC sold a part of the NPL portfolio to Bank of America Merrill Lynch in March 2015 for €123 million, representing the first sale of total claims worth €670 million. However, in July 2015, the government extended BAMC's operations and asset sale deadline by five years to 2022, implying that the restructuring and divesting processes are complex and require more time to preserve the value. The dismissal of BAMC's key foreign managers in October 2015 has posed additional uncertainty regarding the future extent and pace of restructuring assets under BAMC's management.

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