

May 14, 2021

**Statement by Mr. Palotai and Mr. Pucnik on Republic of Slovenia  
Executive Board Meeting  
May 19, 2021**

On behalf of our Slovenian authorities, we would like to thank staff for the constructive dialogue during the 2021 Article IV Consultation with Slovenia, and for their comprehensive and candid analysis. The Slovenian authorities broadly agree with staff's assessment of the economic developments and outlook in Slovenia, as well as with the policy challenges.

**Economic performance and outlook**

Slovenia had been experiencing solid economic growth and a strong fiscal position in the years prior to the COVID-19 pandemic. The gap in economic development with the EU average had been gradually narrowing and employment reached record highs. This was reflected in higher household income, favorable labor market developments, and a significant movement in the state of public finances after a deterioration during the economic and financial crisis.

The COVID-19 pandemic and the accompanying containment measures strongly impacted the Slovenian economy. The annual decline in economic activity amounted to 5.5 percent in 2020, which was less than expected and better than the euro average. Household consumption, due to limited spending possibilities and increased precautionary as well as forced saving, significantly contributed to the fall in GDP in 2020. Despite a worsening of epidemiological conditions in the wake of the pandemic's second wave at the end of 2020, real GDP declined only by 1.0 percent in the final quarter of last year, mainly reflecting the economy's effective adaptation to operating in the adverse situation. The macroeconomic risks remains high, although they have begun to decline due to the accelerating vaccination progress.

The authorities acted swiftly to deal with the adverse effects of the COVID-19 crisis. They adopted numerous emergency measures that supported enterprises and employees, preventing a higher drop in GDP and employment. The measures were defined in several COVID-19-related legislation packages, most notably the Emergency Fiscal Measures Act, Wages and Social Security Contributions Act, and the Deferral of Borrowers' Liabilities Act. The impact of the emergency measures and investments originating from the EU Recovery and

Resilience Fund (RRF) are expected to improve the much worse outlook that could have otherwise prevailed in their absence. The emergency measures will continue to mitigate COVID-19's negative impact, particularly in the first half of 2021, and will be lifted only gradually.

The COVID-19 crisis had an uneven impact on the economy. The implementation of emergency measures prevented a collapse of some particularly exposed sectors. The most affected sectors were in the non-tradeable part of the economy, which is mainly due to the nature of containment measures (physical distancing and wearing masks). The sharpest drops were in accommodation and food service activities, entertainment, sports, recreational and personal services, and a large part of trade. In 2020, only high-technology sectors such as pharmaceutical and ICT equipment manufacturing increased production.

The authorities are more optimistic about the growth outlook than Fund staff. They are striving for strong and sustainable growth above 4 percent in 2021, driven by bolstered investment and higher household consumption. The current account surplus continues to strengthen during the COVID-19 pandemic. The increase occurred through a widening of the savings-investment gap (surplus of gross savings over investment), and has been strongly influenced by the narrowing of the general government deficit and stronger household savings.

The outlook remains highly uncertain. The prolongation of support measures depends on the pandemic's evolution, vaccine availability and vaccination, related health restriction measures, and the evolution of demand in main trading partners. In the remaining part of the year, it will be crucial to carefully replace emergency measures with recovery measures in order to ensure a sustainable recovery and long-term growth. The premature removal of measures could lead to reduced economic activities and higher unemployment. In this regard, the authorities appreciate staff's advice that fiscal support should continue until the recovery is entrenched. The authorities acknowledge the importance of continuing the assessment of anti-crisis measures in order to execute their gradual and well-planned lifting.

### **The COVID-19 response**

Slovenia has experienced three waves of the COVID-19 epidemic, with lockdowns of varying lengths imposed during each wave. The surge in cases during the last wave in April 2021 was attributed to the prevalence of new, more potent strains of the virus, which temporarily resulted in a deterioration of the epidemiological situation.

The authorities reacted quickly and decisively to the COVID-19 pandemic. They implemented a number of strict social distancing measures to limit and contain the spread of the pandemic, while providing support measures to help alleviate the epidemic's impact on businesses and households.

With the partial lifting of restrictions in Spring 2021, the economic circumstances began to improve, although there are still considerable uncertainties surrounding the pandemic's

evolution. Given the current epidemiological and economic situation, some key measures will be extended to preserve lives and livelihoods.

The vaccination campaign started at the end of December 2020 with vaccines approved by the European Medicines Agency. The interest in vaccination among people exceeds the quantity of available vaccines, which might hamper reaching the set objective of at least 60 percent vaccination of the country's population before Summer 2021 in order to attain herd immunity.

### **Fiscal policy**

The COVID-19 pandemic considerably impacted budgetary revenues and especially expenditure in 2020. General government revenues were down 4.6 percent in 2020, driven primarily by falls in direct and indirect taxes. Expenditure increased by 14.8 percent, largely in connection with supporting measures to alleviate the pandemic's impact. Public debt had reached 80.8 percent by the end of 2020, which is approximately a 15-percentage points increase from the previous year. The rise in debt was driven by the large deficit and major decline in economic activity. However, Slovenia is one of the less indebted EU Member States in terms of gross and net external debt. The escape clause allowing deviations from the fiscal rules was activated.

The authorities implemented a comprehensive package of supporting fiscal measures that significantly mitigated pandemic-related income losses of the economy and the population, and provided enterprises with liquidity and support to cope with the negative consequences. The total value of these measures is estimated at EUR 3 billion. By February 2021, EUR 2.5 billion in expenditures were realized from supporting measures on the central budget. The largest expenditure was made on the furlough scheme (wages and social contributions), additional payments to employees working during the crisis, basic income to different vulnerable groups of population, tourist vouchers, and others. In order to achieve a sustainable recovery, the impact of the supporting measures will also be crucial in 2021.

The recovery will be a long-term process and will largely depend on how the pandemic evolves. The fiscal policy will support the recovery, which will remain differentiated across sectors. The authorities are mindful of the fiscal risks in this respect and have made all efforts to contain them.

In May 2021, the Slovenian government adopted amendments to three tax laws in a bid to reduce labor taxation, and help businesses and individuals in the post-COVID recovery, including by increasing the general personal income allowance and reducing tax on capital. The amendments will enter into force on January 1, 2022.

### **Financial sector policy**

The banking sector entered the pandemic well-capitalized, liquid, and profitable. As a result of the COVID-19 pandemic and the accompanying measures, credit growth slowed sharply, and the trend of weak corporate lending was further amplified. Credit risk is rising, also in

view of the anticipated gradual withdrawal of supporting measures to businesses and households. The prolonged low interest rate environment further decreased bank profitability. Nevertheless, the banking system continues to be liquid and profitable. Performance on regulatory ratios has remained strong to date, with the banking system's total capital ratio of 18.3 percent on a consolidated basis at the end of 2020, well above the statutory requirements. The banking system also remains highly resilient as a whole. There are, however, considerable variations in the levels of resilience at individual banks, given the differences in the structure and quality of their credit portfolios and capital surpluses.

The authorities have implemented several measures to cushion the pandemic's impact on the financial position of corporates and households, most notably the loan moratoria and government loan guarantees. The loan moratoria are in line with the European Banking Authority (EBA) guidelines<sup>1</sup> and allow payments deriving from liabilities to be deferred for up to 12 months. As a result, interest income temporarily declined to some extent, but will eventually be higher as borrowers will have to pay interest for the period of moratoria.

Macroprudential policy shifted from predominantly restrictive to easing, noticeably in releasing existing and adopting additional instruments to maintain stable financing conditions. With this background, the authorities adjusted the macroprudential restrictions on consumer and mortgage lending so that a temporary decline in a consumer's income during the course of the pandemic can be excluded from the calculation of their creditworthiness. Additionally, the authorities introduced, and later adjusted and extended, a temporary restriction on profit distribution for banks and leasing enterprises. The purpose of the measure is to ensure the retention of capital at banks and leasing enterprises so that the Slovenian banking system would be better able to withstand potential losses, and further supply credit to business and households. With a view of providing timely and in-depth information, the Bank of Slovenia regularly communicates with stakeholders regarding implemented measures. Gradual adjustments in the macroprudential policy will be performed alongside changes in the risks to financial stability. The 2017 Strategic Framework for Macroprudential Policy for the banking sector was updated in January 2020.

The measures taken have cushioned the pandemic's impact on the financial positions of businesses and households. However, some sectors, as well as households, have been more affected, and their financial positions have been weakened to a greater extent. With the gradual termination of supporting measures, the quality of the credit portfolio may deteriorate. Non-performing exposures can increase, particularly in sectors that were hit the hardest by COVID-19. Credit risks elevated by the pandemic might be evident after a lag of several months. Despite growing real estate prices even in 2020, there are no major imbalances in the real estate market per se.

Increased banks' capital and liquidity positions are the legacy of financial sector reforms following the 2013 banking crisis. In this regard, the authorities appreciate staff's analysis and advice during that time. The authorities are, however, aware that the banking sector faces further structural challenges. A particularly pronounced one originates from the banks' shift

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<sup>1</sup> More information available at: <https://eba.europa.eu/eba-publishes-guidelines-treatment-public-and-private-moratoria-light-covid-19-measures>.

from corporate to household lending. As a result, banks are faced with transformed asset portfolios and increased reliance on customer deposit funding. Subsequently, banks will have to rethink their business models.

The European Central Bank (ECB) responded to the downturn caused by the COVID-19 pandemic with supportive monetary policy. Providing sufficient liquidity at favorable terms is important for the euro area and Slovenia, as banks continue to play a key role in financial intermediation. In addition to a sharp expansion in securities purchases, the ECB introduced extra refinancing operations and changes in the collateral terms.

### **Structural policy**

The authorities are focused on promoting inclusive and sustainable economic growth, as well as employment. Measures designed to help the economy to recover from the COVID-19 pandemic will be combined with structural reforms to make the economy and society more resilient to future shocks.

Slovenia faced the COVID-19 pandemic with some unresolved development challenges that only deepened with the pandemic. Slovenia's identified key long-term development challenges eligible for investment are enhancing productivity growth; inclusive social development and inter-generational solidarity; a faster transition to a low-carbon circular economy; and strengthening the state and its agencies' development role. In this regard, the authorities appreciate staff's advice regarding the importance of implementing the strategy for a low-carbon economy.

The EU's recovery funds, such as the Next Generation EU instrument, present an opportunity to play a key role in ensuring the recovery from the pandemic crisis, while at the same time addressing key developing challenges. These funds will be used efficiently with respect to the limited fiscal space as a result of the increase in public debt. Their utilization will improve economic sentiment in Slovenia, foster investment in digital and green technologies, growth in production, and final consumption.

In April 2021, the authorities submitted to the European Commission a Recovery and Resilience Plan, which specifies reforms and public investment projects that Slovenia intends to implement with the support of the EU Recovery and Resilience mechanism.

The plan addresses structural reforms and is structured around four priority pillars: The green transition; digital transformation; smart, sustainable, and inclusive growth; and health and welfare, including investments and reforms in long-term care and social housing. The plan envisages the use of all EUR 1.8 billion in grants, and EUR 666 million out of EUR 3.6 billion in available loans. Out of the EUR 2.5 billion requested under Slovenia's plan, 43 percent or more than EUR 1 billion is intended for green goals, and 20 percent or more than EUR 330 million for digital objectives. The remaining two segments are smart, sustainable, and inclusive growth, for which almost EUR 750 million is planned to be invested; and healthcare and social security, which is to receive EUR 364 million<sup>2</sup>.

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<sup>2</sup> More information available at: <https://www.eu-skladi.si/en/post-2020-1/recovery-and-resilience-plan>.

As a result of the fiscal policy measures to alleviate the impact of the COVID-19 pandemic, the labor market has remained stable. Job preservation measures were related to the partial coverage of wage compensation during temporary lay-offs, the crisis bonus, monthly basic income, and relief from the payment of social security contributions for eligible workers. These measures helped maintain household purchasing power, and enabled further growth in households' disposable income. The fall in employment was not significant as a result of these job preservation measures. With improvements in the epidemiological conditions, employment growth will continue to strengthen amid further economic recovery, while unemployment will remain higher than in 2019. Going forward, reallocation measures such as supplementary training, education, job search services, and lowering costs for enterprises to employ new workers, will be used to assist workers in the transition between economic sectors in light of economic transformation in the post COVID-19 world.