Republic of Slovenia
Rating Report

A

STABLE OUTLOOK

Credit strengths

- Euro area membership
- Strong market access and debt profile
- Sound fiscal policy
- Fiscal and external buffers

Credit challenges

- Diversification of energy supply
- Moderately high public debt burden
- Labour market rigidities
- Ageing population

Rating rationale:

Euro area membership: Slovenia is a member of the euro area, benefitting from a highly credible monetary policy, and rigorous financial sector oversight through the ECB.

Strong market access and favorable debt profile: Slovenia benefits from a strong market access and debt management that mitigate risks resulting from higher interest rates and external shocks.

Effective fiscal policy management: Slovenia has demonstrated sound and effective fiscal policy making that should enable a gradual reduction of primary deficits conditional upon structural reforms.

Fiscal and external buffers: Slovenia has elevated cash reserves and comfortable current account surpluses until 2021 that reinforce its capacity to cope with market volatility and external shocks.

Rating challenges include: i) limited but growing diversification of energy supply amid geopolitical uncertainties that weigh on the economic outlook; ii) a moderately high public debt burden; iii) labour market rigidities curbing medium-term GDP growth; and iv) adverse demographic trends with a rapidly ageing population that places long-term structural pressures on fiscal sustainability through rising pension and healthcare expenditures.

Slovenia's sovereign rating drivers

Risk pillars		Quantitative		Reserve currency	Qualitative*	Final rating
		Weight	Indicative rating	Notches	Notches	
Domestic Economic Risk		35%	a+	EUR [+1]	-1/3	A
Public Finance Risk		20%	aa-		0	
External Economic Risk		10%	bbb-		-1/3	
Financial Stability Risk		10%	aaa		-1/3	
ESG Risk	Environmental factors	5%	a		-1/3	
	Social factors	7.5%	b+		0	
	Governance factors	12.5%	a		0	
Indicative outcome		**a+**			**-1**	
Additional considerations					**0**	

Note: *The qualitative scorecard adjustments, capped at one notch per rating pillar, are weighted equally with an aggregate adjustment rounded to the nearest integer. The reserve-currency adjustment applies to currencies in the IMF's SDR basket. For details, please see Scope's 'Sovereign Ratings' methodology. Source: Scope Ratings.

Outlook and rating triggers

The Stable Outlook reflects our view that risks to the ratings are balanced.

Positive rating-change drivers

- Medium-term growth prospects notably improve, supported by structural reforms
- Fiscal outlook improves; public debt on a firm downward trajectory

Negative rating-change drivers

- Medium-term growth prospects deteriorate
- Fiscal outlook weakens materially due to a protracted fiscal deterioration
- Political fragmentation and policy uncertainty curtail the implementation of needed reforms

Ratings and Outlook

Foreign currency

Long-term issuer rating	A/Stable
Senior unsecured debt	A/Stable
Short-term issuer rating	S-1/Stable

Local currency

Long-term issuer rating	A/Stable
Senior unsecured debt	A/Stable
Short-term issuer rating	S-1/Stable

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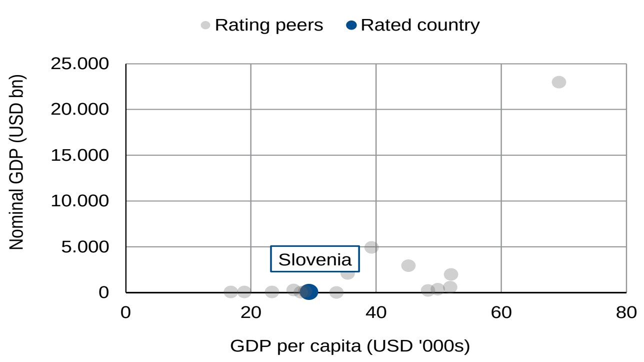
Domestic Economic Risks

- **Growth outlook:** Slovenia's GDP growth is forecasted at 1.0% in 2023, which is significantly below 2022 (5.4%) due to the decline in private consumption (50% of GDP) and investment (20% of GDP) amid challenging economic and financial conditions. Exports are expected to remain subdued because of the slowdown of main EU trading partners (Germany, Italy) but a stronger than expected activity in the euro area provides some upside. A diversified energy mix (with gas accounting for 15% of energy consumption) and alternative suppliers (Algeria, Croatia, Hungary) strengthen the country's energy security, although it remains a downside risk on the outlook. In 2024, GDP growth should pick up at 2.3% as internal and external demand recover gradually. In the long run, the country's GDP growth potential (3% according to the IMF) is driven by public investments funded by the EU Recovery and Resilience Plan, as well as structural reforms addressing bottlenecks related to a limited labour supply, productivity growth below the EU average, and a still large state-owned sector.
- **Inflation and monetary policy:** Inflation remains elevated at 10.0% in January 2023 but is expected to decline in 2023 to 5.8% on average thanks to the moderation of energy prices and ECB monetary policy tightening. Regulatory measures introduced on electricity and natural gas, such as the price cap until August 2023 and lower VAT rate until May 2023, should also help contain inflationary pressures. Still, the main risk on the inflation outlook relates to wage growth (5.0% in Q3 2022) given the rise in the minimum wage, hikes in public sector wages, and the structurally tight labour markets.
- **Labour markets:** Unemployment is at a record low of 4.0% in December 2022, compared to 6.5% in the euro area in November 2022, given labour shortages resulting from a strong demand and quickly ageing society shrinking labour supply. Although labour shortages could weigh on the country's GDP growth potential in the long run, recent reforms such as the Labour Relations Act introduced in 2022 improve labour market flexibility and address some of these challenges.

Overview of Scope's qualitative assessments for Slovenia's *Domestic Economic Risks*

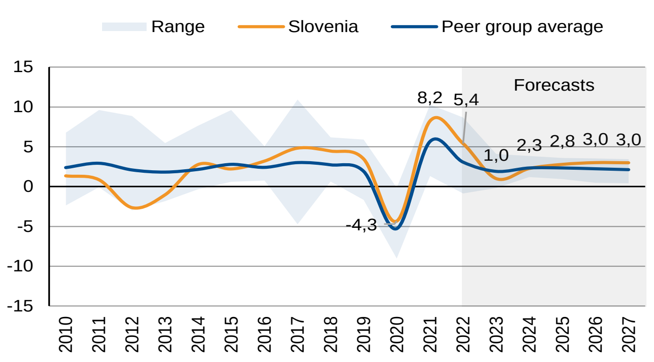
CVS indicative rating	Analytical component	Assessment	Notch adjustment	Rationale
a+	Growth potential of the economy	Neutral	0	Medium-run growth potential faces challenges from adverse demographic trends; sustained public investment
	Monetary policy framework	Neutral	0	ECB is a highly credible and effective central bank; effective policy framework and transmission over the cycle
	Macro-economic stability and sustainability	Weak	-1/3	Limited economic diversification; reliance on external markets

Nominal GDP and GDP per capita, USD



Source: IMF World Economic Outlook (WEO), Scope Ratings

Real GDP growth, %



Source: IMF WEO, Scope Ratings forecasts

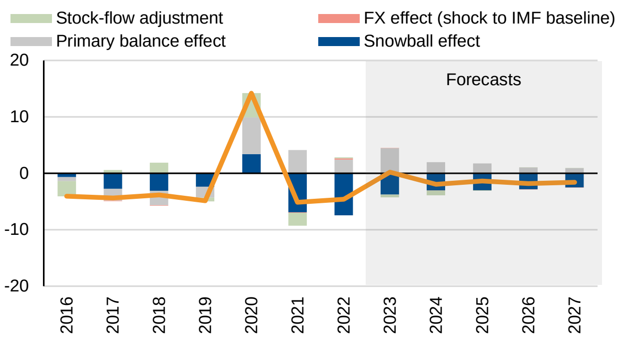
Public Finance Risks

- **Fiscal outlook:** We expect the public deficit to increase to 5.2% of GDP in 2023 from 3.2% in 2022 because of measures introduced to mitigate high energy prices. An equivalent of 2% of GDP (EUR 1.2bn) has been budgeted in 2023, including a price cap on electricity and natural gas, subsidies for corporates as well as energy allowance, liquidity loans for corporates, and recapitalisation of state-owned energy companies. A special tax on windfall profits has also been introduced to pay for those measures, but the impact is expected to be contained. Similarly, support from the European Resilience and Recovery Facility (EUR 2.2bn in total) is expected to be limited by the modest size of the 2023 draw down (EUR 0.5bn). Still, the Fiscal Council noted that the 2022 budget was close to balance excluding Covid and energy related measures, while stressing that spending tends to be excessive during exceptional circumstances. The phasing out of energy related measures should drive swift consolidation with the deficit declining to 2.8% of GDP in 2024 and 2.5% in 2025.
- **Debt trajectory:** We expect the debt-to-GDP ratio to progressively decline to around 63% of GDP in 2027 from 71.5% in 2022, broadly in line with pre-Covid levels (65.4% in 2019). Although persistent primary fiscal deficits should continue to weigh on the public debt trajectory, dynamic GDP growth amid still moderate interest rates should support lower ratios over the forecast horizon. Government guarantees (about 5% of GDP in 2021) could rise given support to energy firms (up to EUR 2.8bn in 2023). Longer-run, the main risk to the debt trajectory is rising age-related fiscal costs (pension), projected to reach 16% of GDP by 2070 from 10% in 2019.
- **Debt profile and market access:** Financing conditions are tightening with 10-year yields trading around 3.4% (+260 bps YoY). Even so, rates remain well-anchored thanks to strong public financial management, alongside a favourable debt profile, with low rollover needs (about EUR 2bn of repayment in 2023 and in 2024). Slovenia issued its second Sustainability Bond in January 2023 (EUR 1.25bn, 10 year). Large liquidity buffers, estimated at EUR 9bn or 15% of GDP, constitute a key strength to navigate higher interest rates and potential downside risks. A long average maturity (10 years), no FX exposure, fixed interest rates, a declining share of non-resident holdings amid significant holdings by the Bank of Slovenia (36% as of Q2 2022) are also strong mitigants.

Overview of Scope's qualitative assessments for Slovenia's *Public Finance Risks*

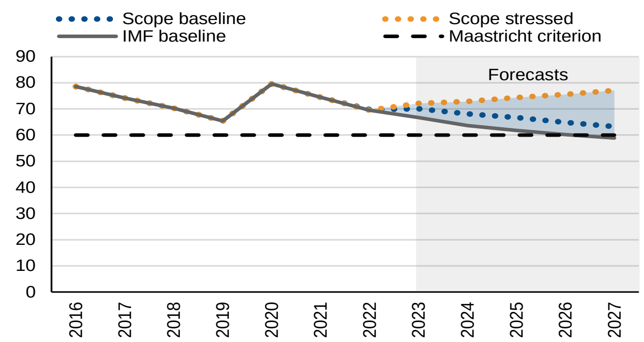
CVS indicative rating	Analytical component	Assessment	Notch adjustment	Rationale
aa-	Fiscal policy framework	Neutral	0	Credible fiscal policy framework; some fiscal space for policy stimulus
	Debt sustainability	Neutral	0	Declining debt trajectory in a baseline scenario; elevated pension and healthcare liabilities over the medium-run
	Debt profile and market access	Neutral	0	Low interest-payment burden; substantial public sector liquid assets

Contributions to changes in debt levels, pps of GDP



Source: IMF WEO, Scope Ratings forecasts

Debt-to-GDP forecasts, % of GDP



Source: IMF WEO, Scope Ratings forecasts

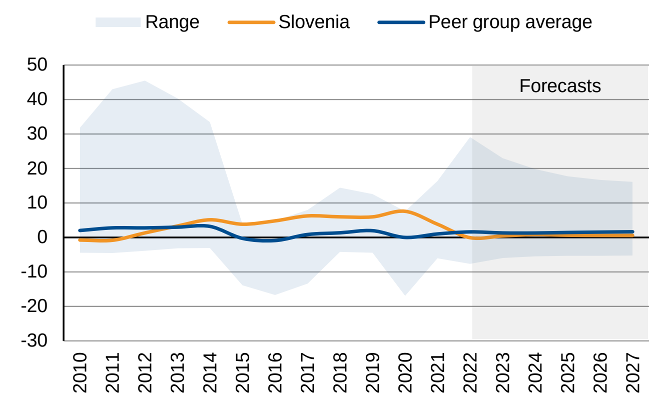
External Economic Risks

- **Current account:** The deficit of EUR 0.2bn recorded between January and November 2022 results from a more pronounced trade deficit (EUR -3.8bn). Imports from Russia have moderated but remain above pre-crisis level (1.8% of the total in November 2022) in the absence of gas storage facilities. The current account deficit is expected to persist in 2023 (up to -0.5% of GDP) but to turn into a small surplus in 2024 (around 1% of GDP), in line with the country's pre-Covid performance. This reversal should be driven by the gradual recovery of Slovenia's main trading partners, lower supply chain disruptions, and reduced tensions on energy prices. Still, external accounts could be penalised by a deterioration in price competitiveness, should the country's structural tight labour market and elevated minimum wage compared to peers drive a persistent wage-price spiral.
- **External position:** The Net International Investment Position (NIIP) is balanced, in line with peers, and reached a modest surplus in Q3 2022 (EUR 0.1bn) for the first time since the early 2000s. This trend is expected to persist based on moderate but sustained current account surpluses post-crisis. Contained net external liabilities and a relatively high share of FDI compared to portfolio investments, strengthen Slovenia's external position. However, gross external debt continues to follow a rising trend, with liabilities amounting to EUR 52bn (87% of GDP) in November 2022 (EUR 43bn in May 2019), mainly because of higher liabilities from the central bank and the private sector.
- **Resilience to shocks:** Slovenia's small open economy is highly reliant on external demand and well-integrated in the European supply chains. The EU accounts for more than three quarters of goods exports, among which the main trading partners are Germany (18% of the total between January and November 2022), Italy (13%), Croatia (11%), Austria (8%) and France (4%). Nonetheless, euro area membership constitutes a strength to accommodate external shocks.

Overview of Scope's qualitative assessments for Slovenia's *External Economic Risks*

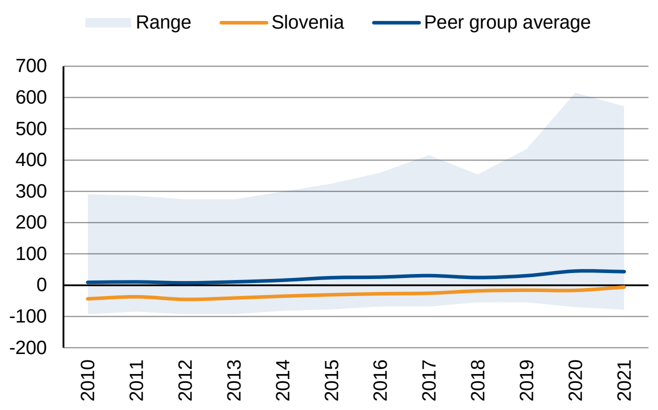
CVS indicative rating	Analytical component	Assessment	Notch adjustment	Rationale
bbb-	Current account resilience	Neutral	0	Competitive industrial base; strong manufacturing industry
	External debt structure	Neutral	0	Rising external debt stock; significant external assets
	Resilience to short-term external shocks	Weak	-1/3	Small, open economy; strong reliance on external demand and foreign direct investment

Current account balance, % of GDP



Source: IMF WEO, Scope Ratings

Net international investment position (NIIP), % of GDP



Source: IMF, Scope Ratings

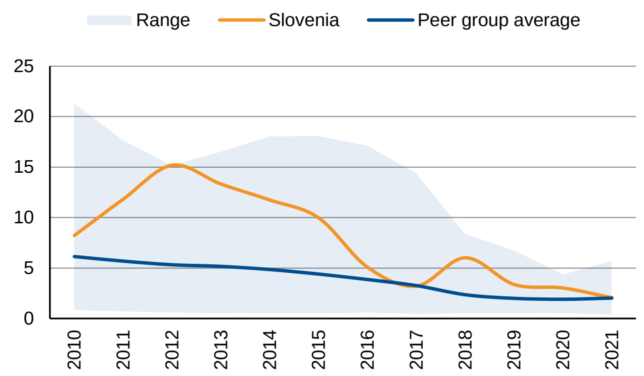
Financial Stability Risks

- **Banking sector:** Strong capitalisation (CET-1 ratio at 15.6% of as Q2 2022) and adequate profitability (pre-tax return on equity of 10.5% over January-November 2022) provide buffers against downside risks, while ample liquidity should enable banks to repay TLTRO-III loans. Non-performing exposures are low (1.9% of loans) allowing banks to weather the expected deterioration in credit quality driven by lower debt servicing capacity of corporates and households, amid higher rates and inflation. Still, provisions for impairment could weigh on banks' performance, although a high share of fixed rate mortgage loans (60% of total in Q3 2022) mitigates risks. The Bank Asset Management Company stopped its activities in 2022, reflecting a proven record to enhance the resilience of the banking system, including through the privatisation of State-owned banks. The stress test conducted by the Bank of Slovenia confirmed the stability of the banking system, while pointing out elevated risks to financial stability resulting from the Russia–Ukraine conflict.
- **Private debt:** Consolidated households and corporates' indebtedness is low (around 26% and 40% of GDP, respectively, as of 2021) and significantly below regional peers such as Slovakia (around 48% and 47%) and the Czech Republic (34% and 44%). However, highly indebted corporates experiencing higher refinancing costs and producer prices (energy, raw materials) could face temporary difficulties, despite the government's energy allowance, but with manageable implications for local banks.
- **Financial imbalances:** Overvaluation of real estate market prices is the main risk lingering on financial stability. Eurostat's house price index reached a record high in Q3 2022 (+15% compared to Q3 2021 and +35% vs Q3 2019), although the rise has been lower than regional peers such as Hungary and the Czech Republic. Mortgage loans to households continue to grow (10.4% YoY in November 2022), but low private debt and strengthening of capital requirements, among which the rise in the countercyclical capital buffer to 0.5%, mitigate risks.

Overview of Scope's qualitative assessments for Slovenia's *Financial Stability Risks*

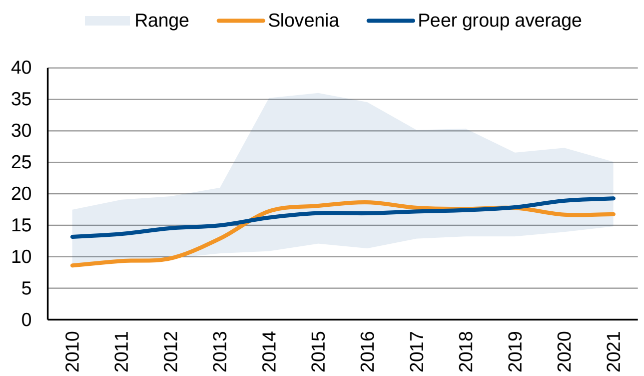
CVS indicative rating	Analytical component	Assessment	Notch adjustment	Rationale
aaa	Banking sector performance	Neutral	0	High capitalisation levels; emerging contingent risks
	Banking sector oversight	Neutral	0	Rigorous oversight under the ECB as part of the Single Supervision Mechanism
	Financial imbalances	Weak	-1/3	Imbalances in the real estate sector due to rising house prices and real estate market overvaluation; large maturity gap on banks' balance sheets

Non-performing loans, % of total loans



Source: IMF, Scope Ratings

Tier 1 ratio, % of risk-weighted assets



Source: IMF, Scope Ratings

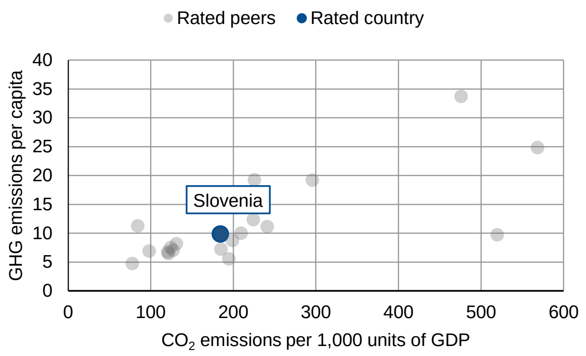
ESG Risks

- **Environment:** Slovenia's greenhouse gas emissions per capita (7.6 tonnes of CO2 equivalent in 2020) are in line with those of the EU (7.5). Its energy mix, with the highest share represented by oil (31%), followed by nuclear (23%) and coal (15%), is likely to become increasingly diversified. Still, the extension of the operating life of Krsko NPP nuclear power plant, the introduction of a windfall tax on energy companies to promote renewable energy, and an investment plan of EUR 3.5bn on the power distribution system should lower GHG emissions in the long run. The implementation of the action plan to abandon the use of natural gas of Russian origin by 2025 could also boost the use of low-carbon energy and renewables (25% of final energy consumption). Slovenia's membership of the United Nations Economic and Social Council for the 2023–2025 period and sustainability bond framework released in January 2023 could serve its "Sustainability 2030" strategy and support the objective to reach net-zero by 2050.
- **Social:** Demographic dynamics are unfavourable with the old-age-dependency ratio set to reach 65% in 2050 from 35% in 2020 according to the OECD. Pension spending is projected to increase more than in almost any other European country, with the second biggest rise in the EU-27 (after Luxemburg) by 2070. Still, a pension reform is set to be introduced by mid-2023 and to be gradually implemented from 2024. Slovenia's skills mismatches constitute another long-term challenge, calling for strong spending in education (equivalent to 5.9% of GDP in the 2023 budget).
- **Governance:** In April 2022, Slovenia held its first regular vote after three snap elections, where Robert Golob and his newly formed party Freedom Movement won the election. Golob's party formed a three-way center left coalition ensuring an absolute majority with 53 out of 90 seats. Following October's 2022 presidential elections, Natasa Pirc Musar, an independent candidate, became Slovenia's first female president. The next parliamentary elections will be held in 2026 and the presidential elections in 2027, which should lead to a period of political stability supporting reforms amid disbursements of European funds. A referendum held in November 2022 further indicates strong support for the government's political stance.

Overview of Scope's qualitative assessments for Slovenia's *ESG Risks*

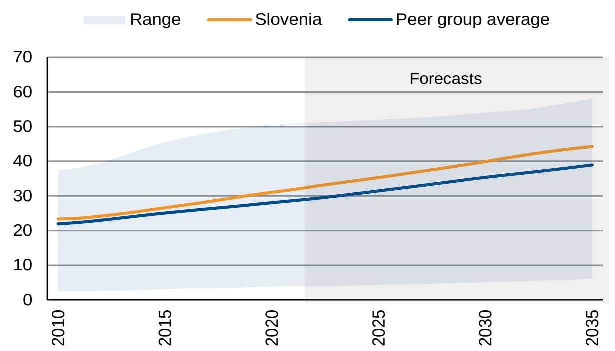
CVS indicative rating	Analytical component	Assessment	Notch adjustment	Rationale
bbb+	Environmental factors	Weak	-1/3	Energy mix represents transition risks; policy implementation could support gradual decarbonisation post energy crisis
	Social factors	Neutral	0	Well-educated labour force and low levels of income inequality, although rising old-age-dependency ratio
	Governance factors	Neutral	0	Strong mandate, but crisis mitigation and structural reforms agenda to test effective policy making and ruling coalition agreement

Emissions per GDP and per capita, $mtCO_2e$



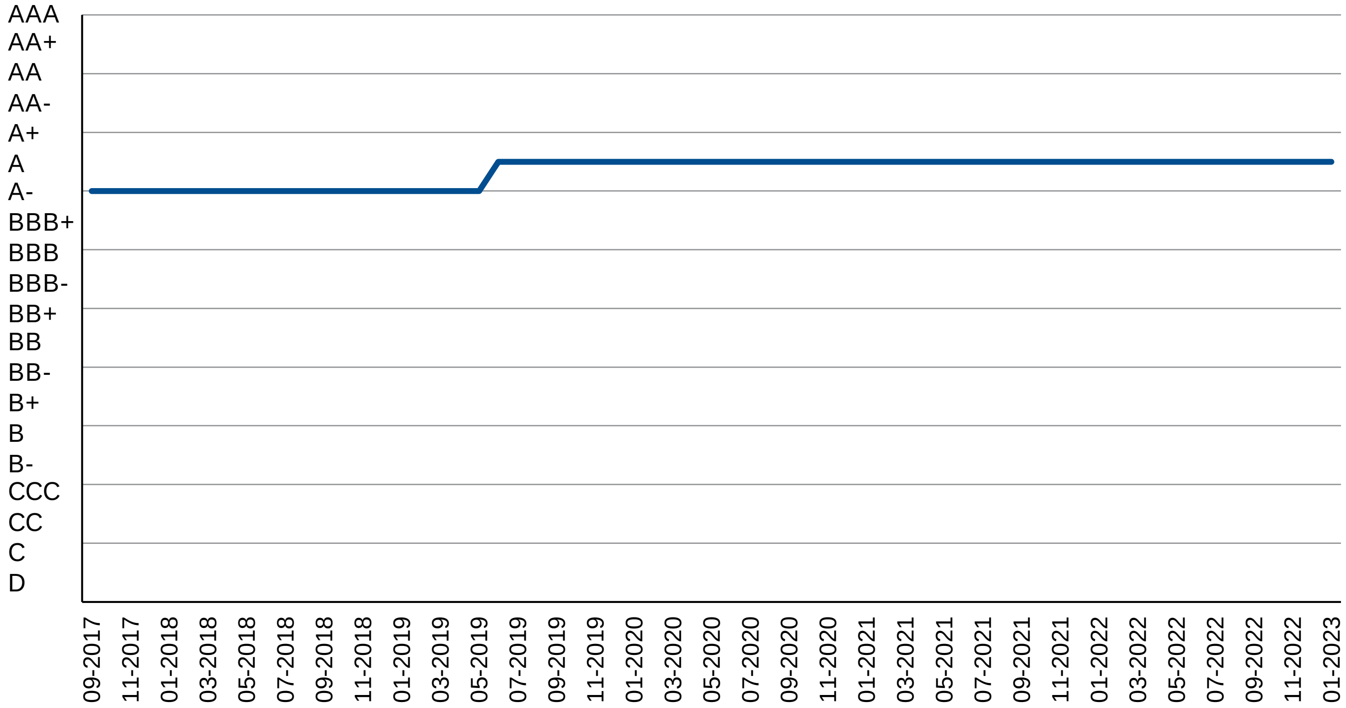
Source: European Commission, Scope Ratings

Old age dependency ratio, %



Source: United Nations, Scope Ratings

Appendix I. Rating history (foreign-currency long-term debt)



NB. Positive/Negative Outlooks are treated with a +/-0.33-notch adjustment. Credit Watch positive/negative with a +/-0.67-notch adjustment.

Appendix II. Rating peers

Rating peers are related to sovereigns with an indicative rating in the same rating category or in adjacent categories per Scope's Core Variable Scorecard, including a methodological reserve-currency adjustment.

Peer group*
Belgium
Croatia
Czech Republic
Estonia
France
Italy
Japan
Lithuania
Malta
United States

*Publicly rated sovereigns only; the full sample may be larger.

Appendix III. Statistical table for selected CVS indicators

This table presents a selection of the indicators (24 out of 30 – with the governance indicator reflecting a composite of six indicators) used in Scope's quantitative model, the Core Variable Scorecard, in line with Scope's Sovereign Rating Methodology. The metrics and sources for the data presented here ensure comparability across global peers and may therefore differ from national and other selective international statistics.

Pillar	Core variable	Source	2017	2018	2019	2020	2021
Domestic Economic	GDP per capita, USD '000s	IMF	23.511	26.224	26.112	25.605	29.298
	Nominal GDP, USD bn	IMF	48,6	54,2	54,3	53,7	61,8
	Real growth, %	IMF	4,8	4,5	3,5	-4,3	8,2
	CPI inflation, %	IMF	1,4	1,7	1,6	-0,1	1,9
	Unemployment rate, %	WB	6,6	5,1	4,5	5,0	4,4
Public Finance	Public debt, % of GDP	IMF	74,2	70,3	65,4	79,6	74,4
	Interest payment, % of revenue	IMF	4,9	4,1	3,4	3,2	2,4
	Primary balance, % of GDP	IMF	2,1	2,5	1,9	-6,5	-4,1
External Economic	Current account balance, % of GDP	IMF	6,2	6,0	5,9	7,6	3,8
	Total reserves, months of imports	IMF	0,3	0,3	0,3	0,4	0,5
	NIIP, % of GDP	IMF	-25,7	-18,4	-16,2	-16,8	-6,5
Financial Stability	NPL ratio, % of total loans	IMF	3,2	6,0	3,4	3,0	2,1
	Tier 1 ratio, % of risk-weighted assets	IMF	18,4	18,0	17,6	16,3	16,5
	Credit to private sector, % of GDP	WB	45,1	43,3	42,3	43,3	-
ESG	CO_2 per EUR 1,000 of GDP, $mtCO_2e$	EC	213,8	204,5	192,0	184,5	168,3
	Income share of bottom 50%, %	WID	22,9	23,1	23,1	23,1	23,1
	Labour-force participation rate, %	WB	74,2	75,1	75,1	-	-
	Old-age dependency ratio, %	UN	28,3	29,3	30,2	31,1	31,9
	Composite governance indicators*	WB	0,9	0,9	1,0	0,9	0,9

* Average of the six World Bank Worldwide Governance Indicators.

Appendix IV. Economic development and default indicators

IMF Development Classification	Advanced economy
5y USD CDS spread (bps) as of 6 February 2023	43.5

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