Republic of Slovenia
Rating Report

SCOPE A — STABLE OUTLOOK

Credit strengths

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

Credit challenges

- Moderately high public debt
- Fiscal cost of ageing population
- Labour market rigidities
- Weakening external competitiveness

Rating rationale:

Euro area membership: Slovenia's robust economic performance and resilience to external shocks is underpinned by a highly credible policy framework, based on ECB monetary policy and financial sector oversight, as well as European fiscal rules.

Strong market access and favourable debt profile: Sound debt management practices support Slovenia's debt affordability and mitigate risks stemming from higher interest rates and market volatility.

Prudent fiscal policy: Track record of effective and sound fiscal policy amid the likely deactivation of general escape clause starting in 2024 anchors the reduction of primary deficits. Achieving a gradual fiscal consolidation is conditional upon the implementation of structural reforms to sustain growth.

Fiscal and external buffers: Significant liquidity buffers strengthen shock-absorption capacity, while lower albeit still comfortable current account surpluses support the steady improvement of Slovenia's net external position.

Rating challenges include: i) the moderately high public debt; ii) a weak demographic outlook, with a rapidly ageing population pressuring long-term fiscal sustainability via rising pension and healthcare costs; iii) labour market rigidities that threaten to curb medium-term GDP growth potential; and iv) pressure on external competitiveness relative to regional peers.

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%	a+		0	
External Economic Risk		10%	bbb-		0	
Financial Stability Risk		10%	aaa		0	
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 Scope's view that risks to the ratings are balanced over the next 12-18 months.

Positive rating-change drivers

- Fiscal outlook improves; public debt on a firm downward trajectory and age-related pressures sustainably addressed
- Sustained growth raises income, supported by structural reforms

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 reform implementation

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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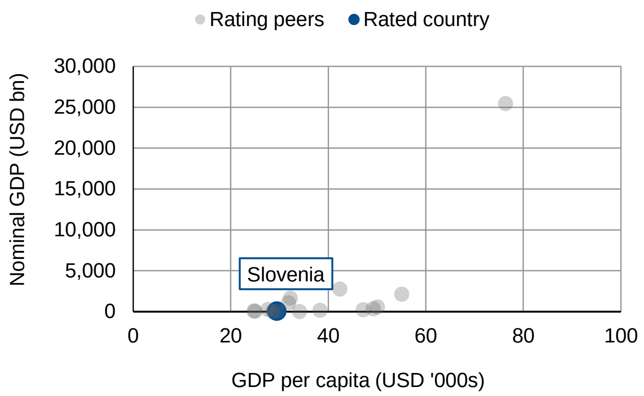
Domestic Economic Risks

- **Growth outlook:** GDP growth is projected to moderate to 1.3% in 2023 (0.7% YoY in Q1) once the economic rebound following the Covid crisis fades. Private consumption (50% of GDP) is being constrained by high inflation eroding real disposable incomes, although the effect is dampened by countercyclical measures as well as strong labour markets. Tighter funding conditions and uncertainty triggered by the Russia-Ukraine war across Europe are discouraging investment (20% of GDP), while the economic slowdowns of European trading partners such as Germany, Italy, and Austria are weighing on this year's growth forecast. In 2024, however, GDP growth is projected to rise to 2.4%, supported by higher public investment and the EU Recovery and Resilience Plan. Downside risks relate to tightening monetary policy in response to the higher-for-longer inflation and to tensions on energy markets. However, a declining inflation trajectory, a diversified energy mix (with natural gas accounting for just 12% of its energy supply in 2021) and energy supply agreements with other bilateral partners (Algeria, Croatia, and Hungary) mitigate risks.
- **Inflation and monetary policy:** The inflation rate declined to 6.9% YoY in June 2023, its lowest since April 2022, thanks to lower energy prices and large base effects. Over the year, inflation is forecasted to decrease to 7.0% from 9.0% in 2022. Yet, Slovenia's ability to gradually reduce inflation to 3.5% in 2024 is being hampered by labour supply tensions that are weighing on domestic prices through higher minimum wage – the level of which already exceed those of OECD regional peers. Gross monthly earnings averaged 10% YoY between January and May 2023, against 2.8% on average in 2022.
- **Labour markets:** The unemployment rate is close to historical lows at 3.6% in May 2023, reflecting a shrinking domestic labour force. The employment of foreign workers could ease near-term pressures, while a rapidly ageing population and associated decline in the working-age population will weigh on GDP growth potential. Skills mismatches constitute another long-term challenge. However, the authorities have initiated reforms around working conditions and lifelong learning (i.e., Labour Relations Act, amendment to the Employment Relationships Act) to address labour market challenges.

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

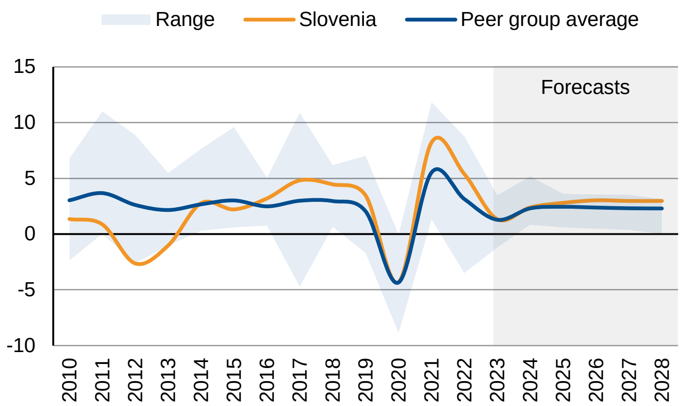
CVS indicative rating	Analytical component	Assessment	Notch adjustment	Rationale
a-	Growth potential of the economy	Neutral	0	Medium-run growth potential faces challenges from adverse demographic trends; sustained public investment
	Monetary policy framework	Neutral	0	ECB is a highly credible and effective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

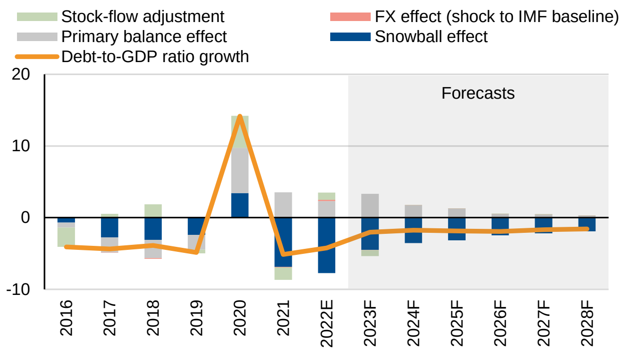
Public Finance Risks

- **Fiscal outlook:** The general government deficit is projected to widen to 4.1% of GDP in 2023 from 3.0% in 2022 (against 4.5% according to the government) due to a slowing economy and still accommodative fiscal stance. Revenues this year are being reduced by lower GDP growth, while countercyclical measures in response to the higher energy prices are costing an estimated 1.7% of GDP (against 2.2% in 2022). However, the gradual phase-out of fiscal measures amid the deactivation of the general escape clause – allowing for temporary derogation under exceptional circumstances – should enable the deficit to narrow to 2.6% of GDP in 2024 and around 1.8% of GDP on average by 2028. Slovenia's fiscal framework is expected to be instrumental in keeping the fiscal deficit in line with the Maastricht threshold in the near- to medium-term. Disbursements from the Recovery and Resilience Plan – EUR 391m this year according to the Fiscal Council – are expected to peak in 2025, supporting investment and medium-term flexibility, even though the authorities have proposed the postponement of certain milestones and targets.
- **Debt trajectory:** General government debt is set to decline to around 60% of GDP by 2028 from 70.2% in 2022, which is below the pre-Covid level of 65% and moderate relative to the euro-area average of 90%. Contingent liabilities in the form of government guarantees are low at 8% of GDP, which the authorities expect to drop to around 5% by end-2026. However, the steady rise expected in age-related expenditures will threaten long-term debt sustainability if existing policies are not changed. Planned reforms of pension, healthcare, and long-term care systems as part of the Recovery and Resilience Plan will be essential for the long-term debt trajectory.
- **Debt profile and market access:** The ample liquidity buffers (EUR 8.9bn at end-March 2023, or 13.7% of GDP) constitute a core credit strength, with the treasury single account system improving debt management flexibility. Liquidity buffers are larger than the principal to be repaid in 2024 and 2025 (EUR 4.6bn). Moreover, the interest burden is low, reflecting the solid investor base (non-residents hold around half of public debt), the lack of foreign-currency exposure, the fixed interest rates, and the long debt maturities. In addition, the Bank of Slovenia holds more than one-third of total public debt, reducing interest rate sensitivity.

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

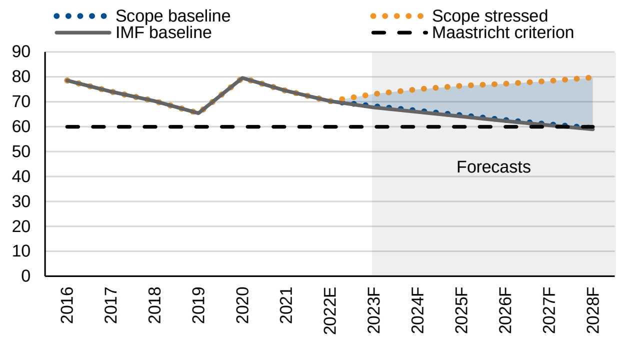
CVS indicative rating	Analytical component	Assessment	Notch adjustment	Rationale
a+	Fiscal policy framework	Neutral	0	Robust and credible fiscal policy framework in line with peers
	Debt sustainability	Neutral	0	Declining debt trajectory in a baseline scenario; elevated pension and healthcare liabilities over the medium- to long-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

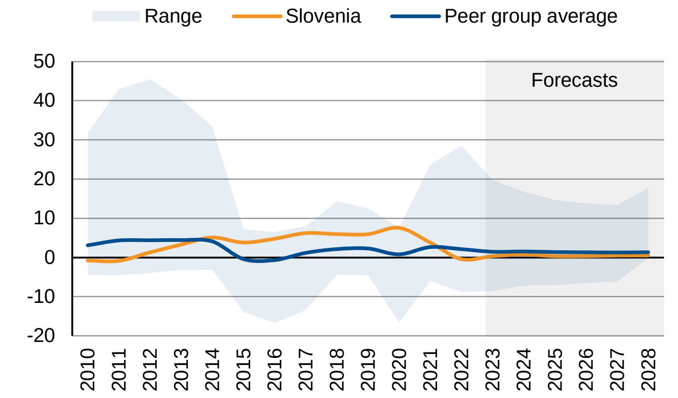
External Economic Risks

- **Current account:** Slovenia recorded a modest current account deficit of -0.4% of GDP in 2022 because of the deterioration in terms of trade due to the higher energy import bill. Imports from Russia declined to a marginal 0.2% of total imports in April 2023 (0.5% on average between January and April, after 2.2% in 2022) reflecting the diversification strategy initiated by the authorities. Slovenia is expected to run a current account surplus of about 2.0% of GDP thanks to the gradual normalisation of external trade conditions, including lower energy prices and robust exports (+21% YoY over January and May 2023 against 9% for imports). Even so, the current account surplus is expected to average 0.5% of GDP by 2028 according to the IMF, which is significantly lower than the 2010-2019 average of 3.5% of GDP. The medium-term risk on the current account relates to a sustained deterioration of price competitiveness relative to regional peers resulting from the tight labour market.
- **External position:** The Net International Investment Position (NIIP) recorded a modest deficit of -1.2% of GDP in Q1 2023, which is a material improvement since historical low in Q4 2012 (-44%). This reflects steady deleveraging of the public and private sectors, as well as sustained current account surpluses. Contained net external liabilities and a relatively high share of FDI compared to portfolio investment further strengthen Slovenia's external position. Nonetheless, gross external debt follows a modest rising trend, with liabilities amounting to EUR 54bn or 92% of GDP in May 2023, against EUR 43bn or 89% of GDP in May 2019.
- **Resilience to shocks:** Slovenia is a small open economy, well-integrated in European supply chains but highly reliant on external demand for chemical products, machinery and equipment, and manufactured goods, accounting for almost 80% of goods exports. In terms of geographic distribution, the EU accounts for more than three quarters of total goods exports, with Germany, Italy, Austria, and Croatia among the main trading partners. However, euro area membership constitutes a key credit strength to accommodate external shocks.

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

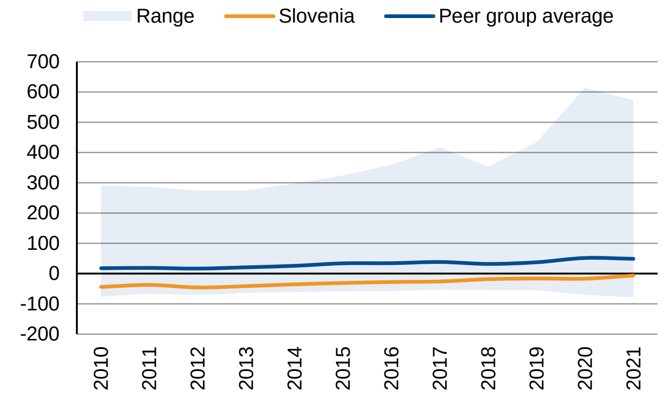
CVS indicative rating	Analytical component	Assessment	Notch adjustment	Rationale
bbb-	Current account resilience	Neutral	0	Competitive industrial base; strong manufacturing industry
	External debt structure	Neutral	0	Moderate rise in external debt stock; significant external assets
	Resilience to short-term external shocks	Neutral	0	Small, open economy; strong reliance on external demand and foreign direct investment; benefits from euro area membership

Current account balance, % of GDP



Source: IMF WEO, Scope Ratings

Net international investment position (NIIP), % of GDP



Source: IMF, Scope Ratings

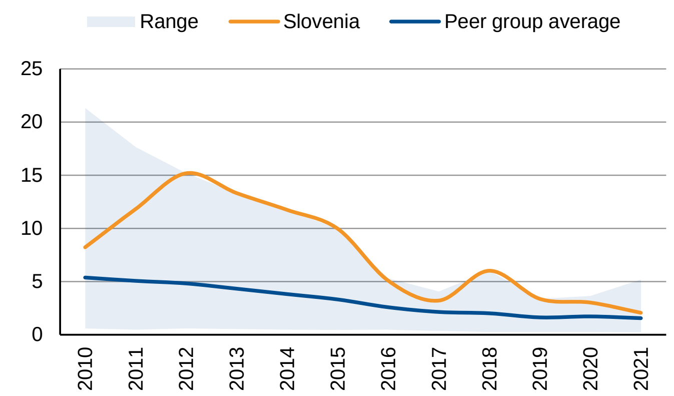
Financial Stability Risks

- **Banking sector:** Slovenian banks have a comfortable capital position with a CET1 ratio of 16.4% as of Q1 2023. Capitalisation is expected to be reinforced by retained earnings thanks to improved profitability (pre-tax return on equity of 14.1%) amid higher lending rates and strong asset quality. The rise in the countercyclical capital buffer to 0.5% by December 2023 should also support capitalisation. Non-performing exposures remain low (1.0% as of end-April 2023) and non-performing loans (around 1%) are in line with the euro-area average. Moreover, fixed-rate deposits are a robust source of funding for banks, which support comfortable liquidity. Finally, privatisation of State-owned banks initiated in 2013 strengthened Slovenia's banking sector, as reflected by the closure of the Bank Asset Management Company as of end-2022, replaced by the Slovenian Sovereign Holding in charge of managing the State's capital investments.
- **Private debt:** Consolidated households and corporates' indebtedness is low (around 26% and 40% of GDP, respectively) and significantly below regional peers such as Slovakia (around 48%, 46%) and the Czech Republic (34%, 44%). However, highly indebted corporates experiencing higher refinancing costs and producer prices could face temporary difficulties, but with manageable implications for the local banking sector.
- **Financial imbalances:** The evolution of real estate prices, as measured by the Eurostat house price index, is the main risk for financial stability, with an average rise of 14% between Q2 2021 and Q4 2022, among the highest in the European Union, albeit lower than peers such as Hungary and the Czech Republic. However, house price moderated to 8.8% YoY in Q1 2023 amid tighter credit conditions. Low private sector debt, strengthening capital requirements, and moderate share of mortgage in banks' risk-weighted exposure mitigate risks.

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

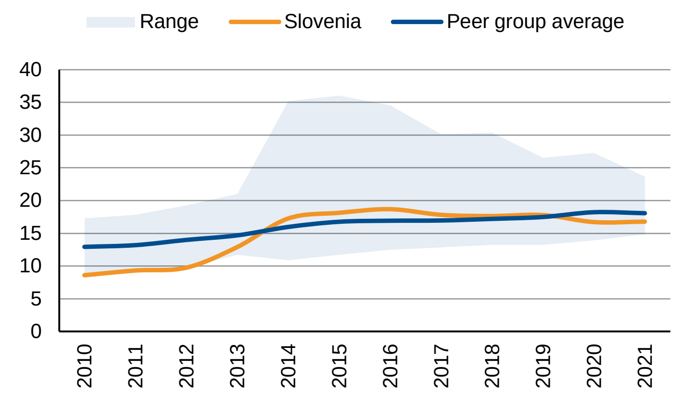
CVS indicative rating	Analytical component	Assessment	Notch adjustment	Rationale
aaa	Banking sector performance	Neutral	0	High capitalisation, robust profitability and liquidity, balanced by record of banking sector crisis
	Banking sector oversight	Neutral	0	Rigorous oversight under the ECB as part of the Single Supervision Mechanism
	Financial imbalances	Neutral	0	Continuous rise in real estate prices, but low private debt

Non-performing loans, % of total loans



Source: IMF, Scope Ratings

Tier 1 ratio, % of risk-weighted assets



Source: IMF, Scope Ratings

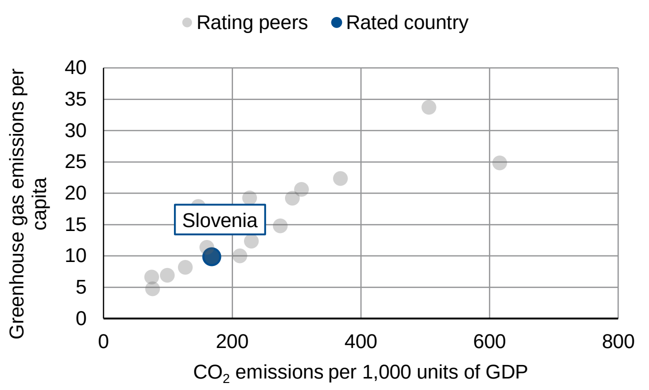
ESG Risks

- **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. The action plan to abandon the use of natural gas of Russian origin by 2025 could boost low-carbon energy and renewables. Similarly, the potential building of small modular reactors and the expansion of the existing Krško nuclear power plant would support Slovenia's green transition. The National Energy and Climate Plan was updated to better align domestic policy on more ambitious targets at the EU level. Slovenia raised the target for its minimum share of renewables in final energy consumption by 2030 from 27% to 30%-35%. The authorities also established a natural disaster reserve in the form of a budgetary fund as last year forest fires in the Karst of Gorica region illustrate vulnerability to climate change. Slovenia's 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 Slovenia's old age dependency ratio set to increase from 33% in 2022 to 59% in 2070 according to the European Commission. The share of people aged over 65 is projected to rise from 21% to 30% over that period. The projected rise in pension spending, to 16% of GDP by 2060 from 10% currently, outpaces that of almost all European countries and is the second highest of the 27 EU members.
- **Governance:** Following parliamentary elections in April 2022, the appointment of prime minister Robert Golob in June 2022, and the election of president Nataša Pirc Musar in November 2022, parliamentary (presidential) elections are scheduled for 2026 (2027). This electoral cycle may provide some space to tackle structural challenges, including those associated with the cost of an ageing population. However, political uncertainty increases execution risk on the reform agenda, as illustrated by the motion of no-confidence introduced in March 2023 against the centre-left ruling coalition, and by converging voting intentions between Robert Golob's Freedom Movement and Janez Jansa's Slovenia Democratic Party.

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

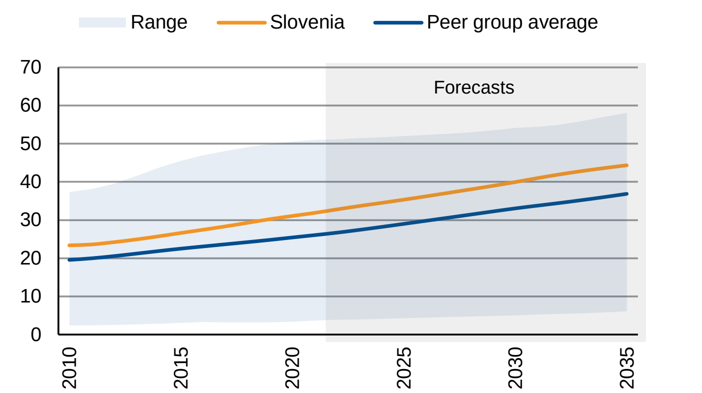
CVS indicative rating	Analytical component	Assessment	Notch adjustment	Rationale
bbb+	Environmental factors	Weak	-1/3	Energy mix represents transition risks; policy implementation could support gradual decarbonisation post energy crisis
	Social factors	Neutral	0	Well-educated labour force and low levels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

Emissions per GDP and per capita, $mtCO_2e$



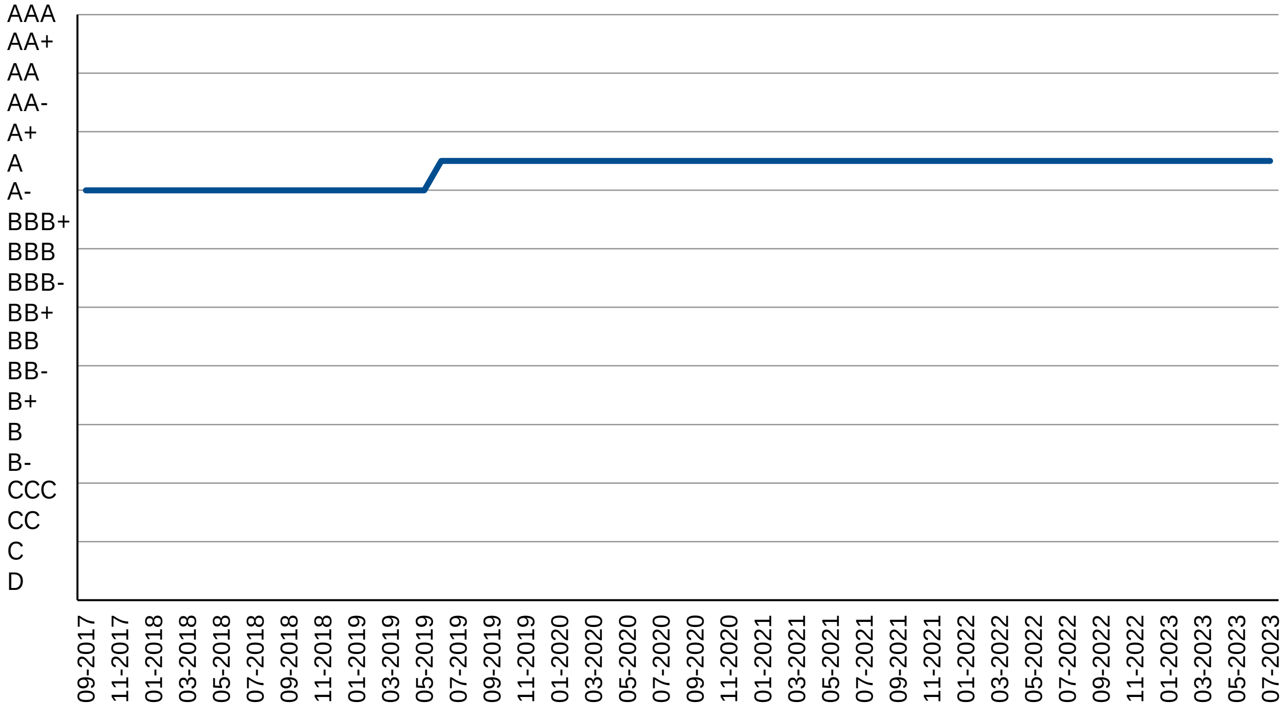
Source: European Commission, Scope Ratings

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
Cyprus
Czech Republic
Estonia
France
Japan
Lithuania
Malta
Portugal
United Kingdom
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	2018	2019	2020	2021	2022
Domestic Economic	GDP per capita, USD '000s	IMF	26.2	26.1	25.6	29.3	29.5
	Nominal GDP, USD bn	IMF	54.2	54.3	53.7	61.8	62.2
	Real growth, %	IMF	4.5	3.5	-4.3	8.2	5.4
	CPI inflation, %	IMF	1.7	1.6	-0.1	1.9	8.8
	Unemployment rate, %	WB	5.1	4.5	5.0	4.7	-
Public Finance	Public debt, % of GDP	IMF	70.3	65.4	79.6	74.5	70.2
	Interest payment, % of revenue	IMF	4.1	3.4	3.2	2.5	2.1
	Primary balance, % of GDP	IMF	2.5	2.1	-6.3	-3.5	-2.3
External Economic	Current account balance, % of GDP	IMF	6.0	5.9	7.6	3.8	-0.4
	Total reserves, months of imports	IMF	0.3	0.3	0.4	0.5	-
	NIIP, % of GDP	IMF	-18.4	-16.2	-16.8	-6.5	-0.6
Financial Stability	NPL ratio, % of total loans	IMF	6.0	3.4	3.0	2.1	1.8
	Tier 1 ratio, % of risk-weighted assets	IMF	18.0	17.6	16.3	16.5	15.7
	Credit to private sector, % of GDP	WB	43.3	42.3	43.3	-	-
ESG	CO_2 per EUR 1,000 of GDP, $mtCO_2e$	EC	204.5	192.0	184.5	168.3	-
	Income share of bottom 50%, %	WID	23.1	23.1	23.1	23.1	-
	Labour-force participation rate, %	WB	75.1	75.1	-	-	-
	Old-age dependency ratio, %	UN	29.3	30.2	31.1	31.9	32.8
	Composite governance indicators*	WB	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 21 July 2023	74.6

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