SLOVENIA

STRONG CAPACITY TO REBOUND

Slovenia's economy is in a relatively favourable position to face the Covid-19 crisis. The past three years were marked by robust growth, fiscal surpluses and the gradual clean-up of bank balance sheets. Yet as a small, open economy closely tied to the European Union, Slovenia could be significantly impacted by the crisis. European fiscal and monetary support as well as healthy public finances should soften the impact of the crisis on public finances and growth prospects.

ECONOMIC ACTIVITY PLUMMETS

Like in the other Eurozone member countries, the economic consequences of the Covid-19 pandemic are bound to trigger a severe recession in Slovenia in 2020. So far, the pandemic's health impact has been relatively mild compared to the rest of the region, with 54 deaths per 1 million inhabitants (vs. a Eurozone average of more than 360 deaths), but the spread of the pandemic is still uncertain. A second, smaller wave of the virus has emerged since mid-June.

The pandemic is having severe economic consequences due to strict lockdown measures and Slovenia's high economic integration within the European Union (EU). Our 2020 outlook calls for real GDP to contract by 9% in the Eurozone and by 7% in Slovenia. GDP contracted 4.5% q/q in Q1 2020 (vs. -3.6% in the Eurozone) due to the downturn in household consumption (-16%) and investment (-10%). Slovenian exports to the EU have plummeted by 30% since March, especially automotive and capital goods exports to Italy, France and Germany. The industrial output index seems to have bottomed out in April before picking up slightly in May, but that was an automatic effect linked to the lifting of certain lockdown measures. All in all, the Q2 downturn in GDP will be more pronounced due to tighter lockdown measures in Slovenia and in the EU as a whole.

Economic growth has averaged 3.3% since 2015. Over the past two years, the economy was buoyed in particular by consumption (53% of GDP) and investment (20% of GDP), which gradually replaced exports as the main growth engine. The unemployment rate hit a low of 3.8% at the end of 2019. For the moment, the rise in unemployment is still under control (4.8% in May according to Eurostat), thanks notably to government support measures. The domestic components of growth should pick up a little earlier than in the rest of the Eurozone because Slovenia was the first country in the region to declare the end of the pandemic (15 May), even though some restrictions are still in place. For the moment, the loss of purchasing power has been buffered by wage compensation schemes that allow employees without work to maintain part of their income. Yet job statistics could deteriorate in H2 with the ending of government support measures.

SIGNIFICANT SUPPORT MEASURES SHOULD BOLSTER THE RECOVERY FROM 2021

In 2021, the economic recovery will depend notably on government support measures and the European recovery. The European Union absorbs 74% of Slovenia's exports. The automobile and capital goods sectors are major export sectors, accounting for 38% of total exports. Fiscal support measures come from the Slovenian government as well as the EU budget. A series of measures were launched to help households and companies, with direct support measures totalling the equivalent of 4.2% of GDP in 2020. In 2021, we expect GDP to rebound by 6%.

FORECASTS

	2018	2019	2020e	2021e
Real GDP growth (%)	4.1	2.4	-7.0	6.0
Inflation (HICP, year average, %)	1.9	1.7	0.5	1.2
Gen. Gov. balance / GDP (%)	0.7	0.5	-7.2	-2.1
Gen. Gov. debt / GDP (%)	70.0	66.0	84.0	80.0
Current account balance / GDP (%)	6.3	6.8	4.0	6.0

TABLE 1 e: ESTIMATES AND FORECAST
SOURCE: BNP PARIBAS GROUP ECONOMIC RESEARCH

INDUSTRIAL PRODUCTION INDEX, 2015=100

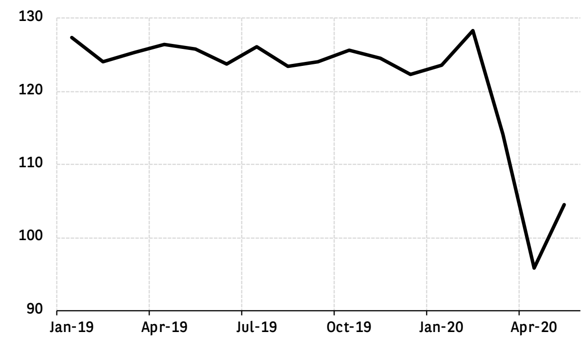

CHART 1 SOURCE: EUROSTAT

Thereafter, the European Union has set up the EU Next Generation recovery plan to support public finances, the private sector and priority sectors for member countries during the period 2021-2027. Slovenia's share of the programme could be equivalent to about EUR 5 bn, or 10% of 2019 GDP. Moreover, further liquidity injections by the ECB should enable Slovenian banks to respond to corporate needs.

LARGE EXPECTED FISCAL DEFICITS

Slovenia has reported fiscal surpluses since 2017 (+0.4% of GDP on average) thanks notably to buoyant economic growth. In 2020, the expected decline in fiscal revenues (-9.2% y/y in the first 5 months of the year) coupled with economic stimulus measures (spending was increased by 11.4% over the same period) should widen the fiscal deficit, which could exceed 7% of GDP. The deficit is then expected to fall back to more moderate levels in 2021 (2.1% of GDP).

In the medium term, there is no particular risk associated with Slovenia's fiscal situation. Yet demographic trends at work over the past decade are not favourable and could have a negative impact on economic prospects and public finances. The active population is shrinking by about 10,000 people a year, and problems addressing the shortage of skilled labour could reduce the potential growth rate. Currently, more than 35% of companies in the manufacturing sector and 45% of construction companies are experiencing shortages of skilled labour. The pension system is also a potential long-term source of fiscal imbalance given the rapid increase in spending on pensions (the highest in Europe). Pension system reform has been underway since 2013, but progress is slow.

RISING BUT SUSTAINABLE PUBLIC DEBT

Government debt has declined since 2015, to 66% of GDP in 2019. With the drop-off in activity and a record fiscal deficit, public debt should swell to 84% of GDP in 2020, before narrowing to 80% of GDP in 2021. Despite this big increase, debt dynamics should still be favourable in the medium term. Debt servicing as a percentage of total fiscal revenues has declined regularly since 2014 to 3.8% in 2019, from 7.1% in 2014. In recent years, the apparent interest rate on public debt has fallen to 2.6% in 2019 from 4.4% in 2014, while the average maturity has increased to 8.9 years in 2019 (from 5.7 years in 2014). About 95% of total debt is denominated in euros. The government's buyback operations have significantly reduced the share of debt denominated in USD. Not only has the debt profile improved, the government has also accumulated significant liquid assets, primarily from the proceeds of privatisation. This liquidity allocated to reducing the debt stock is equivalent to about 8% of GDP.

A HEALTHIER BANKING SECTOR TO FACE THE CRISIS

Slovenia's banking sector was hard hit by the financial crisis and required massive government support, but it has come through stronger since 2015. Asset quality and profitability have improved and the sector is less dependent on market financing (which accounted for 12% of funding in 2019, down from 33% in 2013) and more so on customer deposits.

The non-performing exposure ratio (using the European Banking Authority's definition) dropped to 2.2% in March 2020, from 3.6% the previous year, according to the central bank. Although this favourable trend will probably be reversed in 2020, Slovenian banks are likely to be resilient due to their high level of capitalisation and comfortable liquidity reserves.

Since mid-2019, the growth of domestic credit has slowed (1% y/y in May 2020 vs. 3.1% the previous year) due to the slowdown in household lending. After years of debt reduction, corporate lending has begun to rise again for the past year (+2.5% in May 2020). The debt to assets ratio has declined at less than 90%, from 137% in 2012. After a period of buoyant growth (consumer lending rose at an average annual rate of more than 10% between 2017 and 2019), household lending has slowed since year-end 2019 under the new standards imposed by the central bank to limit household debt. In May 2020, consumer lending was still trending slightly downwards (-0.1% y/y), while household lending continued to rise at a rate of 2.5%. So far, household debt as a percentage of disposable income has remained relatively stable at less than 16%, but it could rise in 2020 due to the economic contraction.

DOMESTIC CREDIT

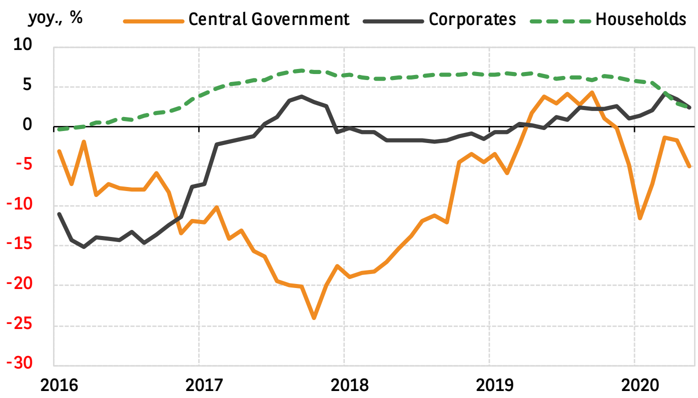

CHART 2

SOURCE: BANK OF SLOVENIA

The banks' exposure to the household segment rose from 30% of total domestic lending in 2012 to 53% in May 2020.

Real estate loans are fairly resilient and have continued to increase since the beginning of the year (+4.7% y/y in May 2020). The strong rise in real estate prices observed in 2017 and 2018 (up 10% and 9.1%, respectively) slowed to 5.2% in 2019, in keeping with the slowdown in growth. According to the central bank, higher real estate prices reflect the convergence towards European standards, and residential real estate prices have not yet reached levels signalling overvaluation

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