

Rating Object	Rating Information	
<b>REPUBLIC OF SLOVENIA</b>  Long-term sovereign rating Foreign currency senior unsecured long-term debt Local currency senior unsecured long-term debt	Assigned Ratings/Outlook: <b>AA- /stable</b>	Type: Monitoring, unsolicited with rated entity participation
	Initial Rating Publication Date: Rating Renewal: Rating Methodologies:	03-03-2017 21-02-2020 "Sovereign Ratings" "Rating Criteria and Definitions"

## Rating Action

Neuss, 21 February 2020

Creditreform Rating has raised its unsolicited long-term sovereign rating on the Republic of Slovenia to "AA-" from "A+". Creditreform Rating has also raised Slovenia's unsolicited ratings for foreign and local currency senior unsecured long-term debt to "AA-" from "A+". The outlook is "stable".

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## Key Rating Drivers

1. Very strong macroeconomic performance profile amid relatively high levels of wealth and high degree of diversification; sustained convergence towards EU-level in terms of GDP per capita; adverse demographic outlook and presumably less ESIF support pose challenges to long-term economic development
2. Economic expansion should remain robust, but come in at a reduced pace against the backdrop of a challenging international trading environment; tight labor markets are driving wage growth, which has to be monitored with regard to its potential impact on still high cost competitiveness
3. Sovereign benefits from generally high quality of institutional framework and EMU/EU membership; somewhat balanced by perception of relatively frequent government changes in the period since 2013, which may affect predictability and reform implementation
4. Solid economic growth and sound debt management along with falling interest expenses should keep debt-to-GDP on its downward path; fiscal risks stemming from unfavorable prospects regarding age-related spending and public guarantees, with the latter in decline
5. External position to continue to improve in light of sustained but slowly diminishing current account surpluses

### Reasons for the Rating Decision

Creditreform Rating has raised its ratings on the Republic of Slovenia to “AA-” from “A+”. The upgrade is underpinned by (i) Slovenia’s continuing economic expansion on the basis of a relatively wealthy, competitive and diversified economy, combined with positive labor market developments and robust wage growth; and (ii) the favorable debt trend and a lower level of the public debt ratio fueled by strong economic growth and lower interest outlays.

In general, our credit assessment of the Republic of Slovenia’s very high creditworthiness is reflected by the sovereign’s very strong macro performance, the strong public finance metrics, manageable external risks and the generally high quality of its institutional conditions.

### Macroeconomic Performance

Relatively high wealth levels as well as strong and stable economic growth, in addition to a well-diversified and competitive economy characterize the Republic of Slovenia’s favorable macroeconomic performance profile and support our positive assessment of the sovereign’s creditworthiness.

Over the years 2014-2018, Slovenia’s annual GDP growth rate averaged 3.4%, rendering the Republic one of the fastest growing euro area members during this period. We expect that Slovenia’s total output expansion slowed markedly, from 4.1 to 2.5% in 2018-19, amid a more mature economic cycle and challenging global economic environment, which would correspond to the lowest growth since 2015, but still significantly exceed euro area growth (flash estimate 1.2%). As in 2018, net trade presumably posed a drag to last year’s GDP expansion, as imports seem to have risen faster than exports. The annual quarterly growth rate of exports decreased to 3.8% in Q3-19, following 5.7% and 4.2% in Q1 and Q2-19, while imports grew at an annual rate of 6.0% in Q3-19, after 4.7% and 4.3% in the first two quarters of 2019. The country’s deep integration into the supply chains of other European countries such as Germany or Austria, which in turn are highly dependent on international trade, proved to be testing in the light of ongoing trade tensions, protectionist threats and a high level of uncertainty which caused the global trade volume to record the lowest increase since 2009. Germany, whose economic growth dwindled to a mere 0.6% in 2019, and whose automotive industry has been grappling with structural and regulatory challenges, is the destination for about 20% of Slovenian exports.

The demanding global environment also had a negative bearing on Slovenia’s gross fixed capital formation, which, next to private consumption, had been the main driver behind output expansion in 2018. Overall, GDP pursued a volatile path in the first three quarters of 2019. Expressed as annual quarterly rates, GDP growth decreased to 2.0% in Q3-19, from 3.5% in the first quarter of 2019. As mentioned, this slowdown can partly be attributed to weaker investment, which posted negative growth in Q2 and Q3-19 on a quarter-on-quarter basis, driving the yearly rate down to 1.4% in Q3-19. A slowing expansion rate of investment in construction (4.0% y-o-y in Q3-19, down from 13.5% in Q1) – although less so regarding residential construction – as well as in machinery and equipment (1.6% y-o-y in Q3-

19, down from 5.9% in Q1), were the main factors behind this. Moreover, industrial confidence has been falling since 2018, and only recently seemed to be stabilizing around levels last seen in 2013.

While government consumption also lost steam over the course of the year, slowing to an annual quarterly growth rate of 1.9% in Q3-19, down from 3.7% in Q1, private consumption growth accelerated to an annual quarterly rate of 4.3% (Household and NPISH final consumption expenditure) in Q3-19, buoyed by a strong labor market development, higher wage increases, and tame inflation rates. A double-digit increase of consumer loans probably added to this.

Notwithstanding the moderation in GDP growth, Slovenia continued its convergence towards EU levels in terms of GDP per capita in 2019, after having reached 85.1% of the EU total in 2018 (IMF data). Against this backdrop, we continue to think that Slovenia is at a more advanced stage than most of its Central and Eastern European (CEE) peers, as it is only surpassed by the Czech Republic with regard to income convergence. For 2019, the IMF estimates that Slovenia's output per capita will rise to 86.4% of the EU level.

Meanwhile, Slovenia's labor market continues to look tight. Thanks to an ongoing increase in economic activity and high labor demand, the unemployment rate (LFS Eurostat) fell from 5.1 to 4.6% in 2018-19, constituting the lowest reading since 2008. At this level, Slovenia's unemployment rate is similar to that of other CEE countries, while remaining well below the euro area's level (7.6%). Employment (national accounts data, domestic concept) saw another strong increase in 2018 (3.2% after 3.0%), with particularly strong gains in the construction sector (+6.5%) and real estate (6.2%).

However, we notice that over the first three quarters of 2019, employment dynamics have abated somewhat on a high level, with yearly employment growth decelerating to 2.4% in Q3-19. The slowdown is visible in most sectors apart from construction. In the same vein, the vacancy rate remains particularly high in the construction sector (6.1% vs. 2.2% in the economy as a whole in Q3-19, s.a.), but has come down from a recent peak, mirroring developments in the overall economy and a concurrent slowdown in labor demand.

Many businesses face a lack of (skilled) labor, which can be considered as one factor driving wages, although pressure in the industry and in the construction sector seems to have eased a little, judging by survey data from the European Commission (DG ECFIN quarterly industry survey and monthly construction survey) pertaining to the share of respective enterprises citing labor shortages as a factor limiting production. Accordingly, 33.6% of industry enterprises and 34.9% of construction companies mentioned difficulties in this regard in Q4-19, as opposed to well beyond 40% at the beginning of 2019.

A further increasing participation rate also points to ongoing labor market strength. According to Eurostat's LFS, the participation rate rose to 75.0% in 2018 (from 74.2%) and to 75.4% in Q3-19, thereby markedly exceeding the euro area level (73.6%) as well as the EU-level (74.0%). Among the CEE countries, only the Czech Republic and the Baltic states exhibit a higher rate of persons active on the labor market. We are aware, however, that there appear to remain challenges to integrating older people into the Slovenian labor market, in view of the fact that the participation rate of people aged 55-64 was significantly below

the rate recorded in the euro area (Q3-19: 51.2%, EA-19: 63.5%). Admittedly, the gap has been narrowing over the last few years, nevertheless it remains striking.

What is more, there seems to be room for improvement when looking at participation in activation measures. As for Slovenia, 6.1% of unemployed people seeking work took part in measures aimed at equipping them for a return to the labor market (2018, Eurostat Social Scoreboard), contrasting rather sharply with a share of 22.3% in the EU-28 (2016). Drawing on the same set of indicators and looking at individuals' digital skills levels in Slovenia, there seems to be some upward potential compared with the EU-28 (2018: 54% vs. 57% of individuals aged 16-74). While the 'student work' instrument may have some impact, a high level of temporary contracts for young people (15-24y, at 61.5% in 2018) compared to other European countries (euro area: 50.8%, 40.9% in EU-28) in 2018 seems to point to the need to strengthen labor market inclusiveness with regard to young people. On the other hand, we would stress that Slovenia compares favorably when it comes to gender equality on the labor market. Against the backdrop of efforts initiated by the authorities to enhance labor market inclusiveness such as encouraging longer work activity or improving education and training, it is worth keeping an eye on these aspects going forward.

Slovenia's strong labor market development buttresses vigorous wage dynamics: Total wages in industry, construction and services rose by 3.7% in Q3-19, up from a 2.5% annual rate in Q3-18 (Eurostat, Labor cost index). A rise in the minimum wage at the beginning of 2019 (+5.2% to a gross monthly minimum wage of EUR 886.63 versus 2018) also contributed to this, and will be followed by another hike (excluding all types of bonuses from the definition of minimum wages) of 6.1% in 2020. In December 2019, average monthly earnings totaled about EUR 1,748, 4.2% above the level seen a year before (SORS data). Going forward, against the backdrop of a softening growth picture which already shows some easing on the labor market in terms of employment growth, wage pressures could abate somewhat. However, we would highlight this as something we will be following closely, for continued or even accelerating wage growth may compromise Slovenia's cost competitiveness.

So far, repercussions from wage pressures on Slovenia's competitiveness seem limited, although real compensation per employee appeared to have outstripped productivity growth in 2019. Real unit labor costs have grown stronger than in the euro area as a whole (0.7 vs. 0.4% in 2019, AMECO data). The real effective exchange rate (ULC-based) remained broadly stable in 2019 (+0.3%), faring somewhat worse than its main trading partners. Ultimately, Slovenia was able to increase its global export market share from 0.18 to 0.19% in 2017-18, to which both goods and services contributed. With that, the export market share regarding services has matched its pre-crisis maximum.

Generally, Slovenia's high degree of trade openness (trade-to-GDP ratio of 162.5% of GDP in 2018) leaves it vulnerable to external risks. However, we assess that low and declining levels of private sector debt (72.8% in 2018, down from 76.3% in 2017, and among the lowest in the euro area) along with a still high degree of competitiveness have contributed to building resilience and to maintaining a high level of flexibility. Supporting this view is, among other things, a rather balanced relationship between services and industry, although we acknowledge that the currently challenging global context has a larger bearing

on goods trade than on services trade. In addition, we observe that business services came to 10.5% of total GVA in Q3-19, thus narrowing the gap to the EU-28 (11.6%) and paying further testament to the presence of a broad base of economic activities.

Looking ahead, economic growth should remain robust, and we expect Slovenia's economy to expand at a rate of 2.8% in 2020, thus remaining among the fastest growing countries in the euro area, with domestic demand as the driving force, while net external trade will likely drag on real GDP growth.

Ongoing favorable financing conditions, vivid housing activity, and a continued absorption of EU funds should prevent a further slowdown in investment growth. Adding to this is the still high capacity utilization in the industry sector (Q1-20: 83.0%), which has declined from a cycle peak of 86.0% in Q2-18, but still posts well above its long-term average (81.4% since Q1-2000). The outlook on external trade remains cautious, and net exports will likely produce a negative contribution to GDP growth in 2020, although there is the possibility of a slightly brightening picture in the light of recent signs of easing trade tensions on the global level. On the other hand, adverse effects on the global economy from the Coronavirus seem quite likely at the current stage.

Export expectations slumped to their lowest level since 2012 in the second half of 2019, but appeared to be stabilizing around the turn of the year. Along with industrial sentiment, overall economic sentiment has been declining since the beginning of 2018, but may be past its trough, following two consecutive increases in December 2019 and January 2020. Consumer confidence, which saw some improvement at the beginning of 2019, turned for the worse towards the end of 2019, possibly owing to political controversy culminating in the resignation of the prime minister in January (see below). If domestic political uncertainty turns out to be short-lived, it should not weigh on private consumption.

Against the backdrop of strong labor market developments and solid wage growth, private household spending should boost economic growth this year, while consumer loan growth may not be as supportive due to some macro-prudential modifications made by the Bank of Slovenia (BoS) in November 2019. We note that the BoS ultimately made binding changes to consumer lending, rather than sticking to recommendations. In October 2018, the BoS had extended macro-prudential recommendations for housing loans to consumer loans, intending to prevent excessive credit growth, as well as to set minimum credit standards.

In the medium-to-longer-term, challenges remain with regard to Slovenia's unfavorable demographic outlook. While in 2019 its population increased by 0.7% from 2018, a stronger increase than recorded in the EU-28 after virtually stagnating in 2018, the forecasts compare rather negatively. Slovenia's population is assumed to grow by 0.6% between 2018 and 2030, as opposed to 1.6% for the EU-28, with net migration flows only at a moderate level and probably insufficient to compensate for an increasingly ageing population (Eurostat data). The EU Ageing Report 2018 estimates that Slovenia's old-age dependency ratio (15-64) will increase to 41.3% by 2030, up from 30.5% in 2019, corresponding to one of the highest increases in the EU-28 and standing well above the EU average of then 39.5%. We understand that Slovenian authorities have envisaged various steps to mitigate risks related to these issues, such as establishing a demographic fund in order to put the pension

budget on a sustainable footing, as well as prolonging the work activity of the elderly, to name just two. Furthermore, we understand that a long-term spatial development strategy has been drafted that addresses, among other things, demographic changes.

Increasing Slovenia's productivity growth certainly becomes a pressing matter against this backdrop, and support from rising total factor productivity, not least by driving the digital transformation forward and strengthening investment in research and development, seems to be of the essence to enhance potential growth. In this context, we would also highlight that capital accumulation may become constrained further afield, mainly by a prospective reduction in ESI funding from 2021 onwards. Depending on the next multiannual EU budget framework (2021-2027), funding might not be as ample as before, not least since a net payer to the budget has left the Union with the United Kingdom's departure from the EU at the end of January. The European Commission has put forward plans to cut cohesion funding by 10% in 2021-2027 compared to the previous period (2014-2020).

With a view to the Slovenian business environment, we observe that the country climbed three positions, from rank 40 to rank 37 out of 190, in the World Bank's 2020 Ease of Doing Business compilation. Among the EU-28, this represents the middle-range. At the same time, some weaker rankings concerning sub-components, such as enforcing contracts (rank 112 after 110) or dealing with construction permits (119 after 120) underscore that there remain some obstacles left to remove when laying the ground for higher potential growth.

### Institutional Structure

The generally high quality of Slovenia's institutions remains an important pillar of our assessment of the country's creditworthiness. The sovereign benefits from EMU membership, especially trade integration and the adoption of common standards and rules, as well as access to broad and deep capital markets.

As regards our preferred measure of the institutional set-up, the World Bank's Worldwide Governance Indicators (WGIs), Slovenia displays a strong performance among CEE peers. The same holds true regarding the comparison with our A-rated countries. Slovenia's government effectiveness score, i.e. the quality of formulating and implementing policies, is broadly aligned with the euro area average (rank 36 versus euro area median of 35), in spite of a slight deterioration in this category in 2018 vs. 2017. As far as 'voice and accountability' is concerned, the sovereign exhibits a somewhat larger gap to the euro area median (rank 43 compared to the euro area median of 25), while lagging only slightly behind when it comes to 'rule of law' (37 versus euro area median of 32). As to control of corruption, Slovenia is seen on par with the euro area median (rank 41) and markedly above the median of our A-rated universe (rank 59).

Regarding the efficiency of the legal framework as per EU Justice Scoreboard 2019, one can state that Slovenia remains among those EU countries that manage to settle disputes in a relatively short period of time, adding to the impression of a sound institutional set-up. Moreover, the time needed to resolve civil, commercial, administrative and other cases has been reduced further, from 72 to 65 days in 2017. The number of pending cases declined



from 7.2 to 5.9 instances per 100 inhabitants in the same year. Somewhat less benign elements emerge when taking into account sub-factors compiled among the World Economic Forum's Global Competitiveness Indicators, namely judicial independence and efficiency of the legal framework in challenging regulations within the institutions pillar. With regard to both of these factors, Slovenia is ranked rather low (rank 82 and rank 109) among the 140 countries considered. However, as regards the institutions pillar as a whole, Slovenia posts at a decent rank 33.

In the recent past, we have flagged some concern over comparatively frequent (snap) elections or government changes in the period since 2013, as these tend to hamper policy-making and may delay the implementation of necessary structural reforms. Political fragmentation has increased, as demonstrated by the presence of nine parties in parliament after the 2018 election, and forming a government has thus become a lengthy process. Latest developments related to the resignation of PM Sarec (LMS) in January and the collapse of his five-party minority government only add to such reservations. In autumn 2019, the opposition Left Party withdrew its support for the minority government, which had only been in place since September 2018, over the 2020-2021 budget bill. While a budget was eventually approved with the help of the right-wing SNS and minority MPs, it is currently unclear whether there will be snap elections, possibly as early as April 2020, or whether some other coalition will be able and willing to govern the country until the regularly scheduled parliamentary election in 2022. Latest polls suggest another split parliament and difficult government formation in the case of a new election, since LMS and the conservative SDS would each only receive 15-20% of the votes, while other parties are polling below 10%. This may not bode well for political predictability more generally, and we will continue to monitor developments closely.

### Fiscal Sustainability

Slovenia's public finances have continued to improve since our last rating update. While the still elevated public debt ratio is rapidly falling, we view the active debt management, the decline in interest outlays, as well as the decreasing non-performing loan stock and the completion of the privatization of major financial institutions as somewhat balanced by the fiscal risks entailed by ageing costs and public guarantees. Expenditure pressure from public wages and social benefits represents a downside risk, in general.

According to preliminary data provided by the finance ministry, the 2019 general government surplus decreased compared to 2018, from EUR 525.6m to 264.2m – as measured by GDP, this should translate into a decline from 1.1 to 0.5% of GDP. Government expenditure rose by 5.0% (2018: 5.6%), with two drivers standing out: A strong increase in transfers to individuals and households (5.7%), such as social security transfers, and high public sector pay (7.0%) following agreements to increase wages and promotions. Total government revenue expanded by a more moderate 3.4% (2018: 10.7%), with personal income and corporate income tax revenues rising by 5.9% and 17.9% respectively (2018: 11.4% and 10.4%). Social security contributions grew by 7.2% (2018: 7.5%). The VAT intake increased by 3.1%, less than half the growth rate seen a year before (7.2%). The main reasons for revenue growth falling short of the 2018 outturn were two one-off factors in 2018, namely inflows

from dividend payments by Nova Ljubljanska Banka (NLB) and repayment of retained EU funds from the Cohesion Policy period 2007-2013, which explains the large difference in non-tax revenue between 2019 (-17.5%) and 2018 (24.0%).

Looking ahead, Slovenia should post another moderate surplus to the tune of about 0.6% of GDP in 2020, on the back of robust economic growth and a positive labor market development which will likely cater for solid tax revenues and social security contributions. Expenditure looks set to expand more slowly than in 2019, as social transfers should be lower, among other things due to stricter conditions for receiving unemployment benefits and amended provisions on the extraordinary pension adjustment. Furthermore, we gather that promotion-related payments will be restricted, thus tempering public employees' compensation growth somewhat, while public investment should grow at rate comparable to the previous year's. Some tax relief regarding the annual holiday allowance in 2019 (geared towards shrinking the tax wedge on labor) seems to be prolonged, thus extending a restraining effect on revenues. In addition to that, taxes on personal income will be cut in 2020 by lowering tax rates and by increasing tax brackets and general allowance. To compensate for the revenue loss from the measures aiming to reduce the tax burden on labor, taxes on capital gains, rental, and corporate income will be increased.

Against the backdrop of an expected moderate headline surplus, resilient economic growth and declining interest payments, we assume that the public debt ratio will continue to decrease in the coming years. In the wake of several years of strong GDP expansion and solid debt management, Slovenia's general government gross debt further declined to 70.4% of GDP in 2018 (2017: 74.1%), although still comparing rather unfavorably with other CEE countries. In our A-rated universe, Slovenia remains one of the highest-indebted countries. As per Q3-19, the ratio has continued to decline to 68.1%. Notwithstanding the positive debt trend, we flag that there is a discrepancy between general government gross debt in nominal and GDP terms, as the former has been stubbornly high.

Additionally, we would emphasize persistent risks to the fiscal outlook, stemming for one from age-related costs against the backdrop of unfavorable demographic developments. According to the EU's 2018 Ageing Report, age-related costs are expected to rise from 21.9% of GDP in 2016 to 22.1% in 2020 and to 23.9% in 2030, which would constitute one of the most unfavorable developments in the EU-28, mainly due to rising costs of public pensions. As discussed further above, the old-age dependency ratio is estimated to develop very unfavorably. To this end, the recent amendment to the pension and disability insurance act, approved by parliament in November 2019, should be viewed with caution. Legislative changes as regards compulsory pension and disability insurance include raising the replacement rate for both men and women to 63.5%, as well as upgrades to the existing system of payment – implying higher pensions for individuals staying longer in the labor market. While we acknowledge that these measures should enhance labor market inclusiveness and contribute to strengthening the social fabric of the country, since they aim at prolonging working life and offering some degree of income security in old age, they arguably cast further doubt over the long-term sustainability of the pension system. Furthermore, a draft bill on health care ensuring quality and accessibility and addressing fiscal sustainability is envisaged for mid-2020 (DBP). Meanwhile, a draft bill on long-term care



with similar goals, expected for early 2020, is reportedly dragging on, and such reforms could, in view of the currently uncertain political situation, experience further delay more generally.

Fiscal risks emanating from contingent liabilities are still sizeable though gradually subsiding. Public guarantees totaled 12.7% of GDP in 2018, and are estimated to have declined to 10.8% in 2019. We note that the Slovenian authorities expect a further reduction to 9.4% in 2020 (DBP 2020). Potentially adding to this, subscribed ESM-capital, which amounts to about EUR 2.99bn, accounts for about 6.5% of 2018 GDP.

As for the Slovenian banking sector, we would stress that the non-performing loans (NPL) ratio has continued its downward trend. The ratio has fallen by 11.7 percentage points within the three years to September 2019, when it stood at 4.7% (EBA data). Despite the pronounced decline, the NPL ratio was still noticeably above the EU-average (2.9%). Compared to other CEE countries, Slovenia is roughly in the middle of the range. Apart from that, we positively note that the privatization of NLB (65% in November 2018, 10% in June 2019) and of Abanka (February 2020) by the Slovenian Sovereign Holding has been completed successfully, thus further reducing contingent liabilities. Proceeds from the sale of Abanka totaled approximately EUR 444.2m, according to SSH. While the banking sector generally seems well-capitalized, with the CET 1 ratio at 18.6% in Q3-19, markedly above the EU-level (14.6%), concerns relate more to the persistently low interest rate environment, since the BoS has pointed to resulting challenges for the banking sector as far as generating interest income and maintaining profitability is concerned. BoS therefore qualifies income risk as elevated in its December 2019 review. Other than that, we gather that there could be further court cases (similar to Abanka's case in August 2019) following which the large banks may be forced to compensate (former) clients for the bail-in of bonds during the restructuring of the banks in the crisis 2013/2014, when subordinated debt of roughly EUR 600m was erased.

Looking at residential real estate, real house prices have partly begun to stabilize after having surged in the last few years. Bearing in mind, however, that in the wake of income convergence urbanization is likely to continue, upward pressure on prices should be here to stay. Drawing on OECD data, real house prices are back at pre-crisis levels, with the 3-year growth rate hovering around 20% lately (Q3-19: 20.7%). Judging by affordability measures such as the price-to-rent or price-to-income ratio, housing has become less affordable over the last few years, but the respective ratios remain close to the long-term average (measured since 2007) and thus do not signal immediate threats to financial stability. While annual mortgage loan growth has strengthened to its highest level since 2012 (5.6% in November 2019), it is far from being excessive. Moreover, from November 2019 the BoS made some of the macro-prudential measures targeted at housing loans binding, such as a cap on debt-servicing-to-income (DSTI). While the housing sector will require further monitoring, we consider risks to be largely contained. We would draw a similar conclusion with regard to consumer loans, which have been growing at double-digit annual rates for the last few years, and for which the BoS also enhanced macro-prudential measures last November.

Fiscal risks continue to be mitigated by improving debt affordability, as evidenced by a further receding ratio of interest expenditure to revenue, which was down to 4.5% in 2018, from 5.7% in 2017. As of Q3-19, this position has fallen to 3.8% (4-quarter moving sum). Furthermore, authorities pursue sound debt management, with the average weighted maturity at 9.2 years in 2019 (DBP 2020) and a diversified investor base. Usually long-term-oriented investors such as insurance companies or pension funds accounted for about two thirds. The share of non-resident investors was at approximately 60% in 2019 (Ministry of Finance). thereof. Thanks to the ECB's reinvigorated asset purchase program and firm investor confidence, 10-year bond yields are moving at a very low level, and are back in positive territory (24-01-20: 0.189%) after a brief phase of turning negative between August and October 2019, with a historical low reached at -0.235% in August. The spread to German 10-year government bonds is moving around 50bp.

### Foreign Exposure

Turning to the external sector, we continue to view Slovenia's situation as generally solid. The country's net international investment position (NIIP) has narrowed further to -18.9% of GDP in 2018, after -24.2% in the prior year. With that, Slovenia occupies a middle-range position among the EU countries and displays the least negative position among the CEE countries. In the course of 2019, the NIIP became even less negative, standing at -17.9% of GDP at the end of Q3-19. Moreover, net external debt in percent of GDP has declined markedly from 17.6% to 9.0% in 2017-18 and to 4.6% in Q3-19. Structurally, the negative NIIP is largely driven by negative net FDI, which in our view mitigates risks associated with a larger negative NIIP and arguably leaves Slovenia's external position somewhat stronger than meets the eye. The narrowing NIIP in 2018 was mainly due to a less negative balance of other investment, whereas net FDI became more negative on account of higher direct investment liabilities, or in other words, a stronger inflow of direct investment. As measured by GDP, net FDI decreased from -19% to -20.0% in 2018, while net other investment shrank from -6.8% to -0.7% of GDP.

Pronounced and rising current account surpluses over the last years supported the decrease of the NIIP. In 2018, Slovenia's surplus was at a still high 5.7% of GDP, after peaking at 6.1% in 2017. Looking at the composition of the current account balance, we note that the surplus resulting from trade in services accounted for the lion's share of the current account surplus, rising to 5.9% of GDP in 2018, thereby continuing its upward trend. The goods trade surplus, on the other hand, decreased to 2.5% in 2018, mirroring a more challenging international trade environment. Over the course of 2019, drawing on a 4-quarter-moving sum, the current account surplus has been more or less stable, posting 5.6% as of Q3-19. The dominating forces behind this were a further diminishing goods trade surplus, which was partly offset by the rising surplus in services trade, but also to a lesser extent by a lower deficit in the primary income balance. Going forward, we expect the current account surplus to decrease further to around 5% of GDP, as domestic demand looks set to be the main driver for growth, thus benefiting imports.

### Rating Outlook and Sensitivity

Our Rating outlook on the Republic of Slovenia's sovereign ratings is stable, as we assume that the risk situation underlying the key factors affecting sovereign credit risk – including macroeconomic performance, institutional structure, fiscal sustainability, and foreign exposure – is likely to remain unchanged over the next twelve months.

We could raise the sovereign's credit ratings or the outlook if Slovenia's medium-term economic growth exceeds our expectations significantly, thus accelerating the convergence process towards EU-levels, or if the debt trend improves further, resulting in a faster-than-expected decline in the debt-to-GDP ratio. Implementing decisive reforms that address unfavorable demographic developments and related costs, and hence put the pension system, long-term and health care on a sustainable fiscal footing, could also lead to upward pressure on our rating or the outlook. Timely clarity as regards a new government and a longer phase of stable political circumstances would seem beneficial in this context.

By contrast, we could downgrade Slovenia's credit ratings if medium-term economic growth is substantially behind expectations, which might be the case in a considerably deteriorating global economic environment, possibly exacerbated by adverse effects from the outbreak of the Corona virus. A negative rating action or outlook could also be considered if we observe substantial fiscal slippages and a subsequent reversal of the debt trend, or if prolonged political uncertainty results in a material deterioration in governance and policy predictability.

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### Ratings\*

Long-term sovereign rating	AA- /stable
Foreign currency senior unsecured long-term debt	AA- /stable
Local currency senior unsecured long-term debt	AA- /stable

\*) Unsolicited

## Economic Data

[in %, otherwise noted]	2014	2015	2016	2017	2018	2019e	2020e
Real GDP growth	2.8	2.2	3.1	4.8	4.1	2.5	2.8
GDP per capita (PPP, USD)	30,070	31,027	32,307	34,477	36,741	38,462	40,344
HICP inflation rate, y-o-y change	0.4	-0.8	-0.2	1.6	1.9	1.7	2.0
Default history (years since default)	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
Life expectancy at birth (years)	81.2	80.9	81.2	81.2	81.5	n.a.	n.a.
Fiscal balance/GDP	-5.5	-2.8	-1.9	0.0	1.1	0.5	0.6
Current account balance/GDP	5.1	3.8	4.8	6.1	5.7	n.a.	n.a.
External debt/GDP	124.3	118.8	109.7	100.5	92.0	n.a.	n.a.

Source: International Monetary Fund, Eurostat, Ministry of Finance Slovenia, own estimates

## Appendix

### Rating History

Event	Publication Date	Rating /Outlook
Initial Rating	03.03.2017	A- /stable
Monitoring	02.03.2018	A /positive
Monitoring	01.03.2019	A+ /stable
Monitoring	21.02.2020	AA- /stable

### Regulatory Requirements

In 2011 Creditreform Rating AG (CRAG) was registered within the European Union according to EU Regulation 1060/2009 (CRA-Regulation). Based on the registration Creditreform Rating AG is allowed to issue credit ratings within the EU and is bound to comply with the provisions of the CRA-Regulation.

This sovereign rating is an unsolicited credit rating. The Bank of Slovenia (BSI), the Institute of Macroeconomic Analysis and Development (IMAD), and the Ministry of Finance (MoF) participated in the credit rating process as BSI, IMAD, and MoF provided additional data and information, and commented on a draft version of the report. Thus, this report represents an updated version, which was augmented in response to the factual remarks of BSI, IMAD, and MoF during their review. However, the rating outcome as well as the related outlook remained unchanged.

The rating was conducted on the basis of CRAG's "Sovereign Ratings" methodology in conjunction with its basic document "Rating Criteria and Definitions". CRAG ensures that methodologies, models and key rating assumptions for determining sovereign credit ratings are properly maintained, up-to-date, and subject to a comprehensive review on a periodic basis. A complete description of CRAG's rating methodologies and basic document "Rating Criteria and Definitions" is published on the following internet page: [www.creditreform-rating.de/en/regulatory-requirements/](http://www.creditreform-rating.de/en/regulatory-requirements/).

To prepare this credit rating, CRAG used the following substantially material sources: International Monetary Fund, World Bank, Organization for Economic Co-operation and Development, Eurostat, European Commission, European Banking Authority, European Central Bank, World Economic Forum, Bank of Slovenia, Ministry of Finance, Fiscal Council, Statistical Office of the Republic of Slovenia (SORS), Slovenian Sovereign Holding (SSH), Bank Assets Management Company (BAMC).

A Rating Committee was called consisting of highly qualified analysts of CRAG. The quality and extent of information available on the rated entity was considered satisfactory. The analysts and committee members declared that the rules of the Code of Conduct were complied with. No conflicts of interest were identified during the rating process that might influence the analyses and judgements of the rating analysts involved or any other natural person whose services are placed at the disposal or under the control of Creditreform Rating AG and who are directly involved in credit rating activities or approving credit ratings and rating outlooks. The analysts presented the results of the quantitative and qualitative analyses and provided the Committee with a recommendation for the rating decision. After the discussion of the relevant quantitative and qualitative risk factors, the Rating Committee arrived at a unanimous rating decision. The weighting of all risk factors is described in CRAG's "Sovereign Ratings" methodology. The main arguments that were raised in the discussion are summarized in the "Reasons for the Rating Decision".

As regards the rating outlook, the time horizon is provided during which a change in the credit rating is expected. This information is available within the credit rating report. There are no other attributes and limitations of the credit rating or rating outlook other than displayed on the CRAG website. In case of providing ancillary services to the rated entity, CRAG will disclose all ancillary services in the credit rating report.

The date at which the credit rating was released for distribution for the first time and when it was last updated including any rating outlooks is indicated clearly and prominently in the rating report; the first release is indicated as "initial rating"; other updates are indicated as an "update", "upgrade or downgrade", "not rated", "affirmed", "selective default" or "default".

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An explanatory statement of the meaning of each rating category and the definition of default are available in the credit rating methodologies disclosed on the website.

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