Creditreform Sovereign Rating

Creditreform Rating

Rating Object	Rating Information	
REPUBLIC OF SLOVENIA	Assigned Ratings/Outlook: **AA- /stable**	Type: Monitoring, Unsolicited with participation
Long-term sovereign rating Foreign currency senior unsecured long-term debt Local currency senior unsecured long-term debt	Initial Rating Publication Date: Rating Renewal: Rating Methodologies:	03-03-2017 15-12-2023 "Sovereign Ratings" "Rating Criteria and Definitions"

Rating Action

Neuss, 15 December 2023

Creditreform Rating has affirmed the unsolicited long-term sovereign rating of "AA-" for the Republic of Slovenia. Creditreform Rating has also affirmed Slovenia's unsolicited ratings for foreign and local currency senior unsecured long-term debt of "AA-". The outlook remains stable.

Contents

Key Rating Drivers

1. Supported by favorable labor market conditions and its diversified structure, Slovenia's economy has weathered the recent succession of crises relatively well; high—albeit receding—inflation still poses downside risks in the short term, adding to adverse effects of tighter monetary policy and a challenging geopolitical environment; however, we expect these factors to ease in 2024, giving way to a moderate acceleration in growth

2. Medium-term growth perspectives remain constructive against the backdrop of recent progress in the implementation of the national Recovery and Resilience Plan (RRP) and its envisaged further roll-out, firming expectations of strengthening potential growth; maintaining competitiveness from a cost perspective and retaining and/or attracting talent in the face of persistent skill shortages may become more challenging at some point

3. Generally strong institutional governance, as largely underscored by the World Bank's Worldwide Governance Indicators (WGIs), buttressed by access to substantial funding associated with EU/EMU membership; the government's parliamentary majority should generally be conducive to progress on structural reforms, although the need to tackle flood damage has partly led to some further delays; the AML/CFT framework and the quality of the justice system have seen further improvement

4. Government support to address the cost-of-living crisis and to facilitate recovery from the devastating floods this August should temporarily lead to higher deficits compared to 2022; nevertheless, we expect the public debt ratio to continue to decrease on the back of robust nominal GDP; Slovenia's favorable debt profile, and a sizeable liquidity buffer remain mitigating factors for fiscal sustainability risks; fiscal pressures linked to age-related expenditure may be addressed by an imminent pension reform, while contingent liability risks related to public guarantees have declined significantly in recent years

5. We continue to view external risks as manageable, and Slovenia is well on track to become a net international creditor; last year's sharp deterioration in the current account balance should prove temporary as energy prices decline

Reasons for the Rating Decision and Latest Developments[1]

Macroeconomic Performance

Slovenia's credit ratings remain backed by its very strong macroeconomic profile. Key characteristics include the country's diversified economy and relatively high level of wealth. Moreover, the labor market remains supportive, having proved resilient during the cost-of-living crisis, although shortages in skilled labor pose challenges. In light of Slovenia's high energy intensity, downside risks to growth in the short term continue to relate to possible economic repercussions from the war in Ukraine and the conflict in the Middle East. At the same time, authorities remain committed to mitigating the adverse impact of the energy crisis. Over the medium term, growth perspectives seem somewhat constrained by labor input in the face of a declining working-age population, while wage and productivity developments remain to be monitored. We continue to view the overall growth outlook as constructive, thanks to the expected further disbursement of EU funds under NextGenerationEU (NGEU) and the Multiannual Financial Frameworks (MFF). Corroborating this view, the implementation of respective reforms and investments under the RRP has progressed significantly since our last review. Medium-term risks to growth prospects are further mitigated by the sovereign's moderate level of private indebtedness.

After rebounding strongly from the pandemic-related slump, Slovenia's economic growth slowed down last year. The Statistical Office of the Republic of Slovenia revised growth figures sharply downwards to 2.5% for 2022, from an initially reported 5.4% expansion. The revision was based on better data quality and more reliable data sources. In addition, we gather that a more extensive data revision will take place next year. Last year's real GDP growth was driven by private consumption, gross fixed capital formation, and stockbuilding. On the other hand, net exports acted as a drag on real economic activity, reflecting more costly imports related to rising energy prices.

Despite the headwinds of the polycrisis, the convergence of Slovenia's GDP per capita towards the European Union (EU) did not experience a major setback and remained above the pre-pandemic reading. Slovenia's per capita GDP grew by 9.7% to an estimated level of USD 48,757 in 2022 (IMF data, PPP terms), corresponding to 89% of the weighted EU average and the highest reading among the CEE economies, underscoring Slovenia's credit strength.

On a q-o-q basis, real GDP growth held up relatively well in the first half of the current year, thanks to a positive contribution from net external trade. In the three months from July to September, however, real GDP shrunk by 0.2%, reflecting a sharp decline in exports alongside a contraction in private consumption. At the same time, the positive impact of public consumption and fixed investment on real economic growth was smaller than in the previous quarter. The

[1] This rating update takes into account information available until 08 December 2023.

slight contraction in economic activity is likely to have been influenced by the severe floods in August, which caused considerable damage to Slovenian infrastructure.

At the start of Q4, sentiment indicators paint a mixed picture of economic developments. While industrial and consumer confidence remained relatively pessimistic in November, the indicator for the services sectors was more upbeat. The recovery in tourism is likely to have contributed to a more positive sentiment in the services sector. Total tourist arrivals increased by 5.2% in the first ten months of 2023 compared to the same period of the previous year (SiStat data) and were on par with the corresponding 2019 levels.

Likewise, we note ongoing progress in diversifying away from Russia as an energy supplier. While natural gas accounted for a moderate share in Slovenia's energy mix in 2021, Slovenia was sourcing a significant share of its gas from Russia at that time, either directly or indirectly via Austria. Featuring a high energy intensity, Slovenia's industry has been particularly vulnerable to sudden energy shortages and related price shocks, which became more tangible in the advent of the geopolitical crisis. In response to these risks, Slovenia now imports a substantial share of its gas from Algeria.

With regard to the downbeat consumer sentiment and relatively high, albeit decreasing, inflation rates, household spending may take some time to accelerate, and is likely to post very weak expansion in 2023. Slovenian headline inflation stood at 6.6%, well above the corresponding euro area (EA) reading of 2.9% (Eurostat data). In a similar vein, core inflation (excluding energy, food, alcohol and tobacco) was above the euro area level at 5.9% (EA: 4.2%). According to more recent SURS data, inflation continued to fall (4.9% in Nov-23). At the same time, household purchasing power is supported by fiscal measures and a resilient labor market. Among other energy measures, allowances to vulnerable groups and families were included, along with a reduction in VAT for electric energy and natural gas, which expired this May. The price cap on natural gas was extended until the end of the heating season (April 2024), the cap on electricity until the end of 2024.

Moreover, following a pandemic-related interruption, the Slovenian labor market has shown solid employment growth, which, however, fell short of the euro area in Q3-23, posting at 1.0% y-o-y (EA: 1.3%). With a view to the unemployment situation, Slovenia's unemployment rate stood at 4.1% y-o-y in Oct-23, continuing to compare favorably with the euro area as a whole (6.5%, Eurostat data). Slovenia's labor participation remains above the ratio observed for the euro area, and ranges among the better-performing CEE economies on the European Commission's (EC's) Social Scoreboard, with good results in 'Social protection and inclusion', further corroborating sound labor market conditions.

That said, structural challenges related to the tightness of the labor market persist. We understand that the government is preparing two laws to address the shortage of workers with specialized skills, in a bid to maintain the competitiveness of Slovenian companies. Despite edging down from 3.0% in Q3-22 to 2.7% in Q3-23 (Eurostat data), the job vacancy rate remains high. The tight labor market may well add to existing wage pressures, which are also visible in the agreement between unions and the government to increase the lion's share of public sector wages by roughly 4.0% from 1 April 2023, and in the 12.0% rise in the minimum wage from the beginning of the year.

In our view, gross fixed capital formation will constitute a supportive factor for real economic growth this year and next, partly due to the implementation of projects under NGEU. To be sure, fixed investment faces headwinds, including heightened uncertainty stemming from geopolitical tensions, the sharp rise in interest rates against the backdrop of monetary policy tightening, and subdued foreign demand, which in turn has led to a decline in investment in machinery and equipment in the last four quarters. Labor shortages could also weigh on investment prospects. According to the EC's survey data for the industry sector, the percentage of businesses citing labor as a factor limiting production declined slightly from its interim peak in the three months from April to June, but still stands at a high 42.5% in this year's final quarter.

On the other hand, construction investment should benefit from the reconstruction of buildings and infrastructure following the devastating floods in August, while the implementation of reforms and investments under the RRP is progressing. Focusing on the latter, the EC disbursed the first tranche of grants under the RRF this March, following the fulfillment of 12 milestones. Another payment request was endorsed in November, covering 41 milestones and 3 targets related to investments in digitalization of businesses and infrastructure. Moreover, the EC has approved Slovenia's request to modify its RRP in October. The amended version includes part of the Brexit Adjustment Reserve, and has been complemented by a REPowerEU chapter with a greater emphasis on the green transition, making the plan now worth almost EUR 2.7bn.

As a small and open economy, Slovenia's net external trade is strongly influenced by the international economic environment. Although export expectations for Q4-23 were more upbeat after the pessimistic outlook in the previous two quarters, we expect exports to be lower in 2023 as a whole, given the slowdown in economic activity in Slovenia's main trading partners. At the same time, import growth should decrease more strongly due to weakened domestic demand, resulting in a positive contribution of net exports to real GDP growth. As we expect the economic situation in key trading partners to improve in 2024, we believe that foreign demand for Slovenian goods and services should pick up again, which would be supportive for net exports next year, although likely not sufficient to have net foreign demand add to economic growth, given the higher import growth induced by domestic demand.

At this stage, we forecast real GDP growth to decelerate to 1.4% in 2023 on the back of weaker domestic and external demand, before climbing to 2.1% in 2024, thanks to fading inflationary pressures and improved investment, as well as export prospects. However, we highlight that the unpredictable nature of the geopolitical crises renders these projections highly uncertain.

Constructive medium-term growth prospects are underpinned by the envisaged growth-enhancing impact of the effective implementation of the RRP, with recent progress strengthening confidence in the timely disbursement of outstanding funds. Ultimately, EU financing should help to push underlying growth to even higher levels. After averaging 2.3% over the period 2020-2022, Slovenia's potential growth is estimated to rise further to 2.9% this year and next, which would be more than twice as high as the EC estimates for the euro area as a whole and would compare favorably with most of the CEE economies (AMECO data).

According to the recently published Digital Decade Country Report 2023, Slovenia displays mixed performance as regards the degree of digitalization. While the digitalization of public services and businesses is well advanced, there is room for improvement in terms of the level of basic digital skills and the utilization of some advanced technologies such as big data. We note that the government has recognized these challenges and is taking action to reduce digital gaps. As a case in point, the Promotion of Digital Inclusion Act was passed in March 2023.

Having achieved rank 42 out of 64 participating economies, Slovenia's performance in the 2023 vintage of the IMD World Competitiveness Yearbook also indicates scope for improvement. At the same time, Slovenia is placed within the group of best performers in the UN's Global Innovation Index 2023, ranking 33rd out of 132 countries, based on good performance in a wide range of innovation pillars, including, e.g., infrastructure, human capital and research, and business sophistication. In the European Innovation Scoreboard 2023, Slovenia is classified as a moderate innovator, albeit displaying a better result than the average moderate innovator.

Looking more closely at the situation of SMEs, the start-up ecosystem enjoys substantial support from the Slovenian Enterprise Fund. While the fund provides financial assistance to businesses in their early stages, access to finance remains a key challenge. The Slovenian government addressed this issue by adopting the Capital Market Development Strategy for 2023-2030 in March this year, geared towards providing SMEs with equity and debt financing that meets the standards of modern European capital markets.

Risks pertaining to private sector debt are relatively low, adding to the positive medium-term growth outlook. Measured against disposable income, household debt counted as one of the lowest among EU countries in the second quarter of 2023. Similarly, non-financial-corporate debt as a percentage of GDP exhibited one of the lowest levels in the EU. Nevertheless, we will continue to keep an eye on housing market developments in combination with the tight monetary policy and high bank lending rates, which could have a more adverse impact on household spending in the event of a more severe house price correction.

We will also monitor developments related to Slovenia's cost competitiveness position. With the decline in real compensation per employee outweighing the decrease in real labor productivity per person, real unit labor costs fell slightly between 2021 and 2022. We note, however, that the results are likely to be distorted by the recent succession of crises. Over the past decade, excessive wage growth has outpaced productivity gains.

On the positive side, Slovenia outperforms most CEE peers in terms of nominal labor productivity per person and per hour worked, respectively (PPS, 2022: 82.4% and 82.3%). From a more general perspective, grants under the RRF should prove conducive to the implementation of productivity-enhancing reforms, balancing risks to eroding competitive advantages to some extent. Judging by its share of global exports of goods and services, Slovenia does not appear to have suffered a significant loss of competitiveness. The worldwide share of respective exports edged down from 0.19% in 2021 to 0.18% in 2022, which is in line with its pre-pandemic level. The share of global services exports ticked up from 0.16% to 0.17% over the same period.

Institutional Structure

We continue to assess Slovenia's institutional set-up as generally strong, reflecting the significant advantages related to its EU/EMU membership, including EU funding via NGEU and the MFF, as well as access to the large single market. We believe that the parliamentary majority of the current government will be conducive to the further implementation of the RRP, with recent progress demonstrating effective policy-making. Advancements of key structural reforms, including reforms of long-term care, health care, and the pension system, remain to be monitored. While progress has been made with regard to anti-money laundering (AML), countering the financing of terrorism (CFT), and the quality of the judiciary, there remains some room for improvement in terms of the length of court proceedings.

Slovenia's favorable institutional framework is also reflected in the latest set of the WGIs, our preferred metrics when assessing the institutional quality of a sovereign. Referring to 2022 as the base year, the relative ranks of the four indicators on which we put the highest emphasis are broadly in line with the respective median rank of the euro area members, with the 'voice and accountability' indicator falling slightly short thereof, despite an improvement. There remains some gap with our other AA-rated sovereigns across all the four dimensions we consider the most relevant.

More specifically, Slovenia's relative rank in terms of 'voice and accountability' and 'control of corruption' improved by three and six places to 47, respectively, compared to respective median ranks of 33 and 49 as regards the euro area. Concerning the perceived quality of policy formulation and implementation ('government effectiveness'), Slovenia recorded a deterioration by seven places to relative rank 42 (out of 213, EA median: 43). At the same time, the relative rank of the perceived quality of the judiciary ('rule of law') remained unchanged at 38 (out of 213, EA median: 36).

Picking up on the latter, the EC's most recent rule of law report (Jul-23) attests to further improvements of the justice system, inter alia thanks to the intensified use of electronic communication tools. We are also aware of progress as regards the protection of whistleblowers, with the respective act becoming effective this February transposing the EU Whistleblower Directive. That said, there remain some concerns over the indictments and judgements regarding high-level corruption cases. Judging by the EU Justice Scoreboard 2023, Slovenia exhibited the longest average duration of corruption offenses in the EU in 2021.

When it comes to strengthening the combat of money laundering and financing of terrorism, we note that Slovenia has been advancing its AML/CFT framework, as underscored by Moneyval in its fifth Enhanced Follow-up Report (May-23). Customs authorities have been vested with extended competencies, and measures within the VASP sector have been stepped up. Accordingly, Moneyval re-rated Slovenia on two recommendations from 'partially compliant' to 'largely compliant'.

Despite the government reshuffle in the wake of criticism of the management of the flood disaster, we expect that the coalition's parliamentary majority will prove conducive to continued coherent policy formulation and provide for a more stable political backdrop than in the past. Recent successes in terms of the absorption of RRP-related funds support our view that the government remains committed to implementing reforms and investments in an effective manner.

Progress on major structural reforms has been somewhat mixed lately. In July 2023, the National Assembly adopted the new Long-Term Care Act, which will be phased in between 2024 and 2025. The Act establishes rules regarding the implementation and funding of social security. Aspects of a wider health reform were withdrawn in summer due to concerns over data protection. Concerning the pension reform, starting points were communicated to the social partners. Among other measures, the labor ministry envisages an increase of the retirement age and a change to the indexation mechanism for pensions to align them more closely with inflation. The government proposed to postpone the reform of the public sector salary system from 2024 to 2025due to the floods this summer. We will monitor developments on these issues closely.

Turning to environmental aspects, Slovenia occupies a middle-range position among the EU members with regard to the EC's Eco Innovation Index (reference year 2022), marking a considerable improvement in its score compared to the previous issue. In terms of greenhouse gas emissions per head, Slovenia is close to the EU average. As a means of creating a legal framework for implementing climate policy, including, e.g., the regulations for the reduction of greenhouse gas emissions, the government is preparing the Climate Change Act, with the aim of becoming a carbon-neutral economy by 2050. Related to climate matters, the new Flood Risk Reduction Plan (2023-2027) aims to accelerate the planning and implementation of measures to prevent and mitigate the harmful impact of floods.

Slovenia's overall share of energy from renewable sources moves in the upper half among the EU countries. In a bid to foster the utilization of renewable energy in the electricity sector, the Act on the introduction of installations for the production of electricity from renewable sources was adopted this July. More recently, the government passed an action plan targeting an increase in energy efficiency and a more widespread use of renewables.

Fiscal Sustainability

Support measures related to the cost-of-living crisis and the flood disaster continue to weigh on public finances in the near term, while the fiscal burden linked to the fight against the Covid-19 pandemic is diminishing. Although we expect the general government deficit to be higher this year and next compared to 2022, the debt-to-GDP ratio should decline on the back of nominal GDP growth. The sovereign's track record of fiscal consolidation, alongside a benign debt profile and considerable liquidity buffer, serve as risk-mitigating factors to fiscal sustainability. Despite rising interest expenditure, debt affordability should remain high. While risks to financial stability appear contained, given the resilience of the banking sector and moderate levels of private debt, we will pay attention to banks' asset quality in the context of the floods. Contingent liabilities have declined persistently over recent years, contributing to the assessment of overall sustainable public finances, although high age-related costs pose a challenge to the medium- to long-term fiscal outlook. The progress of reforms in the pensions, health, long-term care and public wage systems, and respective implications for public finances, will thus have to be monitored closely.

Affected by the revision of the national accounts data and main aggregates of the general government sector, which was based on updated data sources and covered the years 2019-2022, Slovenia's net lending ultimately amounted to 3.0% of GDP in 2022. While the headline deficit thus narrowed relative to the levels recorded during the Covid-19 pandemic, there is still a gap to the 2015-19 average (-0.7% of GDP). Compared to 2021, the most notable expenditure increases in 2022 concerned public investment and intermediate consumption, whereas a substantial reduction in subsidies (-46.3%) and a decline in the public wage bill slowed the rise in total general government expenditure (+4.0%). Notable increases were also in social benefits in 2022 compared to 2021. Total general government revenue (+7.4%) was boosted by tax receipts, in particular taxes on production and imports, as well as by net social contributions.

State budget revenue grew by 1.8% y-o-y in the first ten months of the current year. Personal income tax revenue continued to benefit from wage growth and the resilience of the labor market. On the expenditure side, a higher wage bill reflects the agreement between unions and the government to raise public sector wages. Investment activity (+40.0%) and subsidies (+55.4%) were significantly higher than a year before. Overall, state budget expenditure rose by 9.8%

y-o-y over the first ten months 2023, and flood-related expenditure is likely to add to this in the remaining months.

Looking ahead, government revenue looks set to benefit from higher tax income and social security contributions next year. In addition, other current transfers will play a more meaningful role than in 2023, due to disbursements from the EU Solidarity Fund. At the end of November, the EC approved the payment of grants worth EUR 100mn under the EU Solidarity Fund, providing financial assistance following the floods in August. The remaining EUR 300mn will be disbursed in 2024, subject to a positive assessment by the EC.

In the context of the floods, a request over additional borrowing under the RRF loan program has been approved by the EC and the Council of the EU, increasing the loan component to EUR 1.07bn. As a result of the floods, the public wage reform has been proposed by the government to be postponed to 2025, but this remains to be formally agreed. The flood disaster will also be reflected in higher public investment, whilst social security benefits and employee compensation will add to government spending.

With regard to the fiscal impact of government interventions until November 2023, according to the Fiscal Council, EUR 255mn were related to Covid-19 measures, EUR 445mn were used to address the cost-of-living crisis, and EUR 438mn were spent to cope with the flood disaster, which together amount to 1.8% of our estimated 2023 GDP. Focusing on flood-related expenditure, the Ministry of Finance expects the expenditure to total EUR 535mn and EUR 1.062bn in 2023 and 2024, respectively.

Given these spending blocks, we expect the headline deficit to widen to 4.2% of GDP in 2023. Assuming a full phase-out of energy-related measures by the end of next year, the general government deficit should come down to 3.6% of GDP in 2024. Apart from the unpredictable evolution of the wars in Ukraine and the Middle East, and related implications for our fiscal projections, the public sector wage reform adds to uncertainty in this respect beyond 2024.

Slovenia's debt-to-GDP ratio fell to 72.3% of GDP in 2022, a relatively moderate level compared to the euro area as a whole (90.9% of GDP). Tying in with the abovementioned data revision, the outcome for 2022 was significantly higher than initially reported. The decline in the public debt ratio came on the back of strong nominal GDP growth. More recent data show that the debt-to-GDP ratio remained on a downward path, posting at 70.5% as of Q2-23 (Eurostat data). On the basis of our assumptions regarding the general government balance and nominal GDP growth, we project the debt-to-GDP ratio to edge down to 69.2% in 2023 and 68.2% in 2024.

Contingent liability risks have declined since our last review. Public guarantees are estimated to amount to 6.7% of GDP in 2023, down from 7.9% of GDP in 2022, and further to 6.1% of GDP in 2024 (Ministry of Finance data). More than half of the maximum amount of contingent liabilities was linked to the Covid-19 crisis, with the take-up estimated to have been relatively moderate.

The banking sector seems well placed to absorb economic shocks. Asset quality continued to improve, with the non-performing exposure (NPE) ratio declining to 1.0% in Q2-23 (BoS data, EU: 1.6%, EBA data). NPEs may increase following the flood catastrophe, but according to Banka Slovenije this is unlikely to have a significant impact on asset quality. In addition, banks have increased their capitalization, as illustrated by an increase of the CET-1 ratio to 16.3% as of Q2-23 (Q2-22: 15.6%, BoS data), slightly above the EU average (Q2-23: 16.0%, EBA data).

While financial stability risks emanating from the housing market may have diminished amid slowing house price dynamics and lower demand for mortgages, we will nevertheless follow developments closely. Drawing on Eurostat data, annual house price growth fell to 7.4% as of Q2-23, whereas the 3-year rate of change stabilized at a high level (Q2-23: 36.6%). At the same time, the volume of outstanding mortgage loans increased by only 1.0% y-o-y compared to 11.6% a year before (BoS data). Banka Slovenije previously decided to raise the countercyclical capital buffer from zero to 0.5%, entering into effect by the end of this year. Overall, the relatively moderate level of private sector debt mitigates interest rate risks arising from higher bank lending rates. Moreover, the overwhelming share of new housing loans to households and new loans for commercial real estate to NFCs is subject to fixed rates.

Following the hike by 25bp of its key policy rates in September, the ECB decided to keep interest rates unchanged at its October monetary policy meeting, emphasizing that interest rates could remain at their current high level for a protracted period and stressing the data-dependency of future decisions. We believe that the tightening cycle has peaked, and that a rate cut is unlikely to be implemented before the second half of 2024. Meanwhile, the winding down of the APP portfolio proceeds according to plan, and maturing government bonds under the PEPP will be reinvested until at least the end of 2024.

The yield on 10-year Slovenian bonds seems to have plateaued, coming down to 3.12% as of 08-Dec-23 (weekly quote). After peaking at 142bp in Nov-22, the bund spread has been moving around 90bp over recent weeks. It is worth noting that Slovenia returned to the USD market for the first time since 2014 on 12-Sep-23, issuing a 10-year US dollar bond in the amount of USD 1bn and with a coupon of 5.0%.

We regard fiscal risks as further mitigated by the sovereign's track record of fiscal discipline and sound debt management, as well as by its substantial liquidity buffer. In addition, Slovenia exhibits a benign debt profile, underscored by one of the EU's highest weighted average maturities (Oct-23: 9.6 years, ECB data) and the fact that more than half of public debt was held by the official sector in Q4-22. We also believe that debt will remain affordable, despite becoming more costly. As of Q2-23, the interest-to-revenue ratio stood at 2.7%.

While awaiting updated forecasts for age-related costs contained in the EU Aging Report 2024, we reiterate that, based on the projections of the 2021 edition, Slovenia will be among those EU economies experiencing the most substantial rise in age-related costs in the long run, potentially weighing on the medium- to long-term sustainability of public finances. Against this backdrop, the abovementioned potential elements of the pension reform could entail both upside and downside risks, but more detail will be required on this. Similarly, net effects of the (envisaged) health and long-term care reforms are difficult to gauge at this stage.

Foreign Exposure

We continue to consider external risks as manageable, notwithstanding last year's sharp deterioration in the current account balance. Energy price developments have partly reversed since then, reinforcing our view that the observed movements in the current account are likely to be temporary. Acknowledging downside risks pertaining to potential renewed energy price spikes, we expect the current account balance to display a surplus in 2023 and to remain positive in the medium term. Following years of improvement, Slovenia's NIIP has recently turned positive, with the size and composition of the position contributing to an overall solid picture of the external sector at this stage.

Having exhibited an average surplus of 5.7% of GDP over 2017-2021, Slovenia's current account balance deteriorated markedly in 2022, concluding the year with a deficit of -1.0% of GDP. The swing was largely driven by the goods balance, which turned negative on the back of rising import prices, in particular for energy. The services surplus widened by 1.9 p.p. in 2022, partly supported by recovering tourism and offsetting the negative impact of the goods deficit to some extent.

More recent data up to Q2-23 suggest that the current account balance should be back in surplus in 2023. Drawing on the four-quarter average, the net positive position amounted to 2.5% of GDP, mainly due to an improving goods balance as energy prices recede. We expect the current account balance to post surpluses over the medium term, although investments will potentially keep these surpluses more moderate as compared to the pre-pandemic period.

The sovereign's negative NIIP improved to -1.5% of GDP in 2022, and further into positive territory more recently (Q2-23: 0.6% of GDP), continuing the favorable trend observed since 2012. Last year's favorable development was driven by a higher net positive position regarding portfolio investment, financial derivatives, and employee stock options. Slovenia's NIIP should continue on its upward trajectory, given prospective current account surpluses going forward.

Rating Outlook and Sensitivity

Our rating outlook on the Republic of Slovenia is stable. This reflects our view that downside risks to macroeconomic performance, fiscal sustainability, and foreign exposure in the near term remain balanced by constructive medium-term growth prospects, a moderate private debt level, as well as fiscal and external buffers to meet challenging circumstances presented by the recent successive crises.

We could raise the sovereign's credit ratings or outlook if the economy grows at a considerably faster pace than we expect, possibly due to a swift implementation of structural reforms under NGEU and the MFF 2021-2027, which would likely be accompanied by tangible progress in the convergence process towards EU income levels. A positive rating action could also be triggered by a sustained reduction in the public debt ratio and/or implementation of well-designed reforms expected to ease the fiscal burden of an aging society whilst addressing shortcomings of the social security system.

Conversely, we could lower the sovereign's credit ratings or outlook if the medium-term growth outlook deteriorates significantly, possibly induced by a failure to absorb EU funds in a timely manner, leading to a significant slowdown or even reversal in the convergence process. A negative rating action could also be prompted by a rise in the debt-to-GDP ratio over a protracted period, potentially related to weak economic performance or shifting fiscal priorities, implying failure to address pressure on age-related costs.

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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

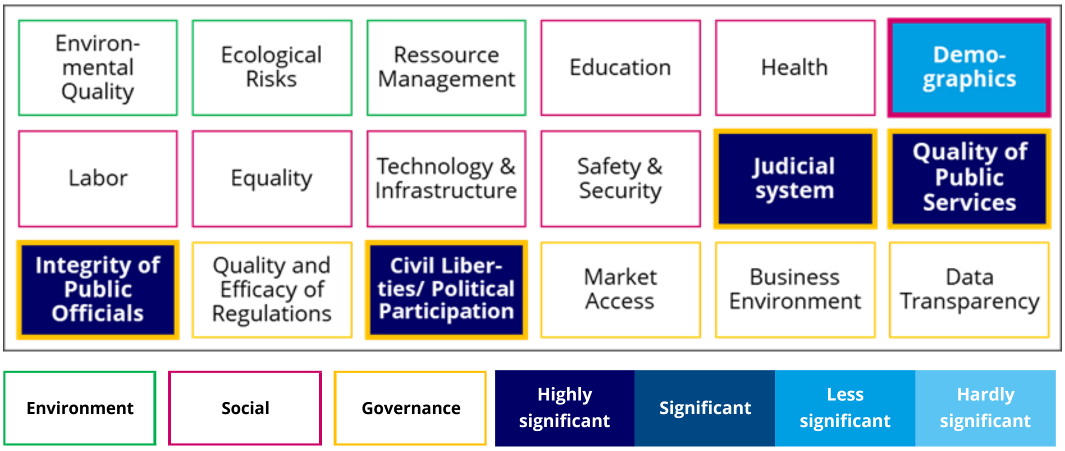
ESG Factors

Creditreform Rating has signed the ESG in credit risk and ratings statement formulated within the framework of the UN Principles for Responsible Investment (UN PRI). The rating agency is thus committed to taking environmental and social factors as well as aspects of corporate governance into account in a targeted manner when assessing creditworthiness.

While there is no universal and commonly agreed typology or definition of environment, social, and governance (ESG) criteria, Creditreform Rating views ESG factors as an essential yardstick for assessing the sustainability of a state. Creditreform Rating thus takes account of ESG factors in its decision-making process before arriving at a sovereign credit rating. In the following, we explain how and to what degree any of the key drivers behind the credit rating or the related outlook is associated with what we understand to be an ESG factor, and outline why these ESG factors were material to the credit rating or rating outlook.

For further information on the conceptual approach pertaining to ESG factors in public finance and the relevance of ESG factors to sovereign credit ratings and to Creditreform Rating credit ratings more generally, we refer to the basic documentation, which lays down [key principles of the impact of ESG factors on credit ratings.]()

ESG Factor Box



The governance dimension plays a pivotal role in forming our opinion on the creditworthiness of the sovereign. As the World Bank's Worldwide Governance Indicators Rule of Law, Government Effectiveness, Voice and Accountability, and Control of corruption have a material impact on Creditreform Rating's assessment of the sovereign's institutional set-up, which we regard as a key rating driver, we consider the ESG factors 'Judicial System and Property Rights', 'Quality of Public Services and Policies', 'Civil Liberties and Political Participation', and 'Integrity of Public Officials' as highly significant to the credit rating.

The social dimension plays an important role in forming our opinion on the creditworthiness of the sovereign. Indicators or projections providing insight into likely demographic developments and related cost represent a social component affecting our rating or adjustments thereof. Hence, we regard the ESG factor 'Demographics' as less significant in our ESG framework.

While Covid-19 may exert adverse effects on several components in our ESG factor framework in the medium to long term, it has not been visible in the relevant metrics we consider in the context of ESG factors – though it has a significant bearing on public finances. To be sure, we will follow ESG dynamics closely in this regard.

Economic Data

[in %, otherwise noted]	2017	2018	2019	2020	2021	2022	2023e	2024e
Macroeconomic Performance								
Real GDP growth	4.8	4.5	3.5	-4.2	8.2	2.5	1.4	2.1
GDP per capita (PPP, USD)	36,680	39,216	41,047	39,536	44,433	48,757	51,407	53,698
Credit to the private sector/GDP	47.6	45.5	44.7	45.7	43.4	43.9	n/a	n/a
Unemployment rate	6.6	5.1	4.5	5.0	4.7	4.0	n/a	n/a
Real unit labor costs (index 2015=100)	100.6	101.1	102.7	108.9	107.3	106.2	106.5	107.5
World Competitiveness Ranking (rank)	43	37	37	35	40	38	42	n/a
Life expectancy at birth (years)	81.2	81.5	81.6	80.6	80.7	81.3	n/a	n/a
Institutional Structure								
WGI Rule of Law (score)	1.0	1.0	1.1	1.0	1.0	1.0	n/a	n/a
WGI Control of Corruption (score)	0.8	0.8	0.9	0.8	0.7	0.8	n/a	n/a
WGI Voice and Accountability (score)	1.0	1.0	1.0	0.9	0.9	1.0	n/a	n/a
WGI Government Effectiveness (score)	1.1	1.1	1.0	1.1	1.1	1.1	n/a	n/a
HICP inflation rate, y-o-y change	1.6	1.9	1.7	-0.3	2.0	9.3	7.5	4.3
GHG emissions (tons of CO2 equivalent p.c.)	8.7	8.6	8.3	7.6	7.7	n/a	n/a	n/a
Default history (years since default)	n/a	n/a	n/a	n/a	n/a	n/a	n/a	n/a
Fiscal Sustainability								
Fiscal balance/GDP	-0.1	0.7	0.7	-7.6	-4.6	-3.0	-4.2	-3.6
General government gross debt/GDP	74.2	70.3	65.4	79.6	74.4	72.3	69.2	68.2
Interest/revenue	5.7	4.6	3.9	3.6	2.8	2.5	n/a	n/a
Debt/revenue	168.5	159.0	148.2	182.0	165.8	163.8	n/a	n/a
Total residual maturity of debt securities (years)	9.1	9.0	8.9	8.8	9.7	10.1	n/a	n/a
Foreign exposure								
Current account balance/GDP	6.2	5.9	5.9	7.2	3.3	-1.0	n/a	n/a
International reserves/imports	2.5	2.2	2.3	3.1	3.9	3.3	n/a	n/a
NIIP/GDP	-24.2	-19.0	-16.3	-15.7	-7.7	-1.5	n/a	n/a
External debt/GDP	100.5	91.8	91.6	102.1	97.4	90.9	n/a	n/a

Sources: IMF, World Bank, Eurostat, AMECO, ECB, SiStat, 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
Monitoring	22.01.2021	AA- /stable
Monitoring	14.01.2022	AA- /stable
Monitoring	16.12.2022	AA- /stable
Monitoring	15.12.2023	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. The rating was not endorsed by Creditreform Rating AG from a third country as defined in Article 4 (3) of the CRA-Regulation.

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

Unsolicited Credit Rating	
With Rated Entity or Related Third Party Participation	YES
With Access to Internal Documents	NO
With Access to Management	NO

The rating was conducted on the basis of CRAG's "Sovereign Ratings" methodology (v1.2, July 2016) in conjunction with its basic document "Rating Criteria and Definitions" (v1.3, January 2018). 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 our website.

To prepare this credit rating, CRAG has 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, World Intellectual Property Organization (WIPO), IMD Business School, Bank of Slovenia, Ministry of Finance, Fiscal Council, Statistical Office of the Republic of Slovenia (SiStat), Institute for Macroeconomic Analysis and Development (IMAD).

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.

No ancillary services in the regulatory sense were carried out for this rating object. Creditreform Rating AG ensures that the provision of ancillary services does not present conflicts of interest with its credit rating activities and discloses ancillary services provided for the rated entity or any related third party, if any, in its rating reports. For the complete list of provided rating and credit service ancillaries please refer to https://www.creditreform-rating.de/en/about-us/regulatory-requirements.html#non-core-busi-ness-activities.

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”.

In accordance with Article 11 (2) EU-Regulation (EC) No 1060/2009 registered or certified credit rating agency shall make available in a central repository established by ESMA information on its historical performance data, including the ratings transition frequency, and information about credit ratings issued in the past and on their changes. Requested data are available on the ESMA website: https://cerep.esma.europa.eu/cerep-web/statistics/defaults.xhtml.

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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