SLOVENIA

Highlights

- **The economy is recovering strongly in 2021.** After a 4.2 per cent fall in 2020, gross domestic product (GDP) recovered by 8.8 per cent year-on-year in the first half of 2021, supported by domestic demand.
- **Digitalisation has accelerated since the start of the Covid-19 pandemic.** The authorities have prioritised enhancing online public services in light of containment measures, while new structures in the government were created to coordinate and enhance the delivery of the digital transformation.
- **The National Recovery and Resilience Plan (NRRP) has been approved.** Following the plan's approval in July 2021, Slovenia received the first tranche of €231 million from the European Union (EU) in September, part of its total allocation of €2.5 billion.

Key priorities for 2022

- **EU funds should be targeted towards productivity growth.** The authorities will need to prepare operational programmes for absorbing the funds from the next EU budget, which should complement the areas covered by the NRRP, namely, green, digital and smart growth.
- **A renewed commitment to fiscal consolidation is needed.** In line with the conclusions of the Fiscal Council and international partners, fiscal consolidation will need to accelerate after a year of Covid-19-induced delay.
- **Governance-related structural reforms should continue.** Further improvements are needed to the governance of state-owned enterprises and in the overall business environment, such as strengthening the public procurement system and further reducing administrative barriers.

Main macroeconomic indicators %

	2017	2018	2019	2020	2021 proj.
GDP growth	4.8	4.4	3.3	-4.2	6.0
Inflation (average)	1.4	1.7	1.6	0.0	1.4
Government balance/GDP	-0.1	0.7	0.4	-7.7	-7.0
Current account balance/GDP	6.2	6.0	6.0	7.4	6.4
Net FDI/GDP [neg. sign = inflows]	-1.2	-2.0	-1.6	0.6	0.9
External debt/GDP	101.9	91.8	90.5	101.9	n.a.
Gross reserves/GDP	n.a.	n.a.	n.a.	n.a.	n.a.
Credit to private sector/GDP	44.4	43.0	42.3	43.5	n.a.

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Covid-19: macroeconomic implications

Growth has exceeded expectations in the first half of 2021. Following the -4.2 per cent recession in 2020, the economy expanded by 8.8 per cent year-on-year in the first half of 2021, almost reaching pre-Covid-19 pandemic levels. Domestic demand was behind the strong rebound, with private consumption growing by 8.9 per cent year-on-year and investment recovering by 13.4 per cent year-on-year in the first half of 2021 after a steep fall in 2020. Consumption has been supported by employment preservation schemes, with the unemployment rate falling to 4.3 per cent in the second quarter of 2021, a level comparable with the pre-pandemic situation. Exports have also reached 2019 volumes, but higher import growth, accelerated by domestic demand, resulted in a slightly negative contribution of net exports to growth.

Fiscal expansion is aiding the recovery but also increasing fiscal risks. The government deployed a comprehensive support package of 6.5 per cent of GDP in 2020, which, in combination with decreasing revenues, led to a fiscal deficit of 8.3 per cent of GDP. In 2021 the authorities initially projected a deficit of 5.7 per cent of GDP, but another wave of Covid-19 infections in the spring forced the government to adopt additional support measures. The resulting budget revision from September targets a deficit of 7.9 per cent of GDP. The deficit is then expected to fall to 5.4 per cent of GDP in 2022 and 3.3 per cent in 2023. As a result, public debt will remain at current elevated levels in the short term and will gradually fall to a projected 70 per cent of GDP at the end of 2024.

The short-term outlook is positive. We forecast GDP to grow by 6.0 per cent in 2021, moderating slightly to 4.5 per cent in 2022. Domestic demand will remain the key growth driver in the short and medium term. Risks to the current forecast are on the upside if consumption and investment continue the robust expansion seen in the first half of 2021. EU funds will also make a notable contribution to investment from 2022. The key downside risk remains the Covid-19 pandemic and the possibility of further containment measures amid new infection waves.

Policy response to Covid-19

The authorities have continued fiscal support for businesses and workers in 2021. In 2020 the key support measures were the furlough and short-time work schemes, a credit guarantee scheme, help to cover fixed expenses for affected firms, and financial support to the self-employed and part-time workers. Most of these measures were extended until at least mid-2021. Nevertheless, only half of the initially announced support has been used since the start of the Covid-19 pandemic; credit guarantees have not been used much by firms due to the relatively stable level of liquidity. In May 2021 the authorities approved an eighth support package, worth €320 million, which extended the furlough scheme and provided subsidies to firms to compensate for the higher minimum wage, which entered into force in 2021.

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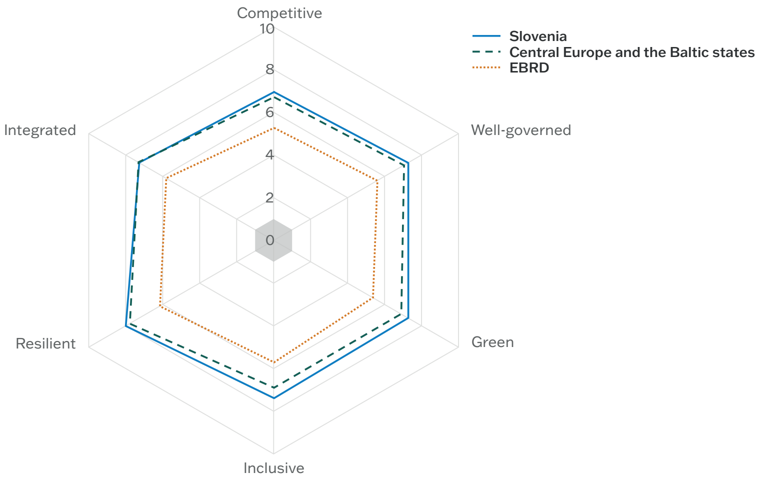
Assessment of transition qualities (1-10)



Structural reform developments

The NRRP prioritises the green and digital transitions. The approved plan allocates 42 per cent of the budget to green measures, such as addressing flood risk, mobility and improving the power network and energy efficiency of buildings. The digitalisation component of the NRRP focuses on modernising existing e-governance systems, digital education, enhancing civil servants' skills and boosting cybersecurity. The plan also includes reforms to improve long-term care, the pension system and social housing, and to modernise the healthcare system.

An omnibus bill targeting the reduction of red tape has been passed. The bill, passed by the government in March 2021, covers multiple areas, including: increased use of digitalisation in administrative services, changes to official registries and payment rules, increased powers to state secretaries and a cap on social security contributions of €6,000 per month. The latter measure sparked controversy, as it is not directly related to red tape and reduces fiscal space.

The digitalisation of public services has advanced. The Electronic Identification and Trust Services Act, adopted in April 2021, will enable the use of new biometric identity cards as electronic identification. In July 2021 the government created the Government Office for Digital Transformation and appointed a new minister for digital transformation to coordinate all digitalisation initiatives in the government.

A framework bill on long-term care is in place. The new bill, passed in June 2021, connects long-term care to the health, social care and pension systems under a more comprehensive system. Both institutional and community-based facilities will be developed to allow everyone to receive the required services, regardless of income or social status. The new system will be financed through a special mandatory contribution for long-term care, which will be implemented by mid-2024. Until the new financing mechanism is in place, existing resources and the national budget will cover the costs of developing relevant services.

OTP Group has agreed to acquire Nova KBM to become the largest bank in Slovenia. Nova KBM, the second-largest bank in Slovenia, has agreed to an acquisition by Hungarian OTP Bank, resulting in a market share for OTP Bank of about 30 per cent. The deal follows the completed merger between Nova KBM and state-owned Abanka in September 2020. The deal is still pending regulatory approval and is expected to be finalised in the second quarter of 2022, marking an end to the restructuring of the banking sector following the crisis in 2013.

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Planned tax cuts will put additional pressure on fiscal neutrality in the medium term. The key measures include an increase in personal income tax breaks, a reduction in capital gains tax from 27.5 per cent to 25 per cent, a rental income tax cut from 27.5 per cent to 15 per cent, and a reduction in the rate of personal income tax in the top bracket from 50 per cent to 45 per cent. Most of these tax breaks have not been included in the 2021-24 fiscal framework and will require an update of the current fiscal plan. A modelling exercise conducted by the Fiscal Council shows mixed effects on GDP, while the impact on public finances is likely to be negative, with a total estimated cost of 5.3 to 6.3 per cent of 2019 GDP between 2022 and 2025.

The government has committed to phase out coal in the coming decade. In line with EU targets, coal-powered plants will be closed by 2033. To support a "just transition", €235 million will be allocated to the Savinjsko-Šaleška region, where the only coal-fired plant is still operating, to support the creation of 5,000 jobs. However, some local stakeholders have put the cost of the plan at significantly higher levels, while increasing carbon costs could force an earlier shutdown and bring forward most expenses to earlier than currently planned.