Research Update:

Outlook On Slovenia Revised To Stable On Improved Economic Growth Prospects; Ratings Affirmed At 'A-/A-2'

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Overview

• Slovenia's policies have become more predictable following the election of a new government that has a sizable parliamentary majority and mandate to stabilize its public finances and financial system.
• We have revised our 2014-2016 average annual real GDP growth projections for Slovenia to 1.5% from 0.9% and are therefore revising our outlook on Slovenia to stable.
• We are also affirming our 'A-/A-2' long- and short-term sovereign credit ratings on Slovenia.
• The stable outlook reflects our expectation that the new government will progress with fiscal consolidation, banking system restructuring, and implementation of structural reforms, including the privatization of state assets.

Rating Action

On Dec. 19, 2014, Standard & Poor's Ratings Services revised its outlook on the Republic of Slovenia to stable. At the same time, we affirmed our 'A-/A-2' long- and short-term foreign and local currency sovereign credit ratings on Slovenia.

Rationale

The outlook revision reflects our opinion that the election of the new coalition government has improved growth prospects and reduced policy uncertainty.

The ratings on Slovenia reflect our view of its open and relatively wealthy economy. Although Slovenia tends to record weaker growth than its eurozone peers, it has outperformed our January and revised June economic forecasts, and its external performance remains strong. These strengths are moderated, in our opinion, by the sharp increase in Slovenia's debt burden associated with the government rescue of its banks, and some residual political uncertainty regarding the new government's ability to implement structural reforms, strengthen the banking system, boost public finances, and enhance economic growth.

We consider that policy risks in Slovenia have receded since the Party of Miro Cerar (Stranka Mira Cerarja; SMC) won the July 13 election and formed a
center-left coalition with the Democratic Party of Slovenian Pensioners (DeSUS) and the center-left Social Democrats (SD). The coalition has a comfortable parliamentary majority: it holds 52 out of 90 parliamentary seats. In our view, entrenched political patronage and weak institutional and corporate governance, as well as nonparliamentary opposition such as from trade unions, could still restrict the pace and scope of budgetary, health care, labor, and state administration reforms, and hamper banking system resolution and the ongoing privatization process.

The new government has stated that its key priority is to prepare and adopt measures to balance public finances by 2019. It has introduced legislation that will embed a new balanced budget rule in the constitution. The National Reform Program 2013-2014 and Stability Program 2014 will remain policy anchors.

Slovenia has passed several of the milestones required to strengthen the stability of its banking system under the National Reform Program 2013-2014. These include establishing the Bank Asset Management Company (BAMC), transferring the bulk of the nonperforming claims to the BAMC, and injecting capital increases into distressed state-owned banks. It has also progressed toward its goal of selling 15 state-owned companies and has completed four sales (including FOTONA d.d., Helios d.d., and Aerodrom Ljubljana d.d.).

We estimate Slovenia's GDP per capita in 2014 at $23,700, and have revised our 2014-2016 average annual real GDP growth projections for Slovenia to 1.5% from 0.9%. This revision reflects the stronger performance of net exports (particularly of information and communications technology and electrical equipment) and rising civil engineering construction (mainly EU-funded municipal infrastructure projects). Rising retail and wholesale trade, and professional and technical services (such as architectural and engineering services), also contributed to the improved growth outlook.

Despite Slovenia's recovery becoming broader, we consider that prospects for economic growth remain weak without further structural reforms. Given the high indebtedness of the corporate sector and the government's gradually reducing fiscal flexibility, we anticipate that economic prospects may remain subdued unless Slovenia further reduces its involvement in the economy.

We also consider that regulatory and judicial reforms could improve the investment environment--investing in Slovenia is currently slow and costly--and are also likely to improve Slovenia's growth prospects. This could lead to higher foreign or domestic direct investments, which Slovenia needs to reduce its external borrowings and support the economy's growth potential. Although the economy benefits from its trade openness, in our view, significant administrative barriers still inhibit foreign direct investment (FDI). At the same time, we see the sustainability of economic recovery in its main trading partners as a key risk for Slovenia's growth prospects.

We expect a headline general government deficit of 6.8% of GDP in 2014 (3.4% of GDP without one-off expenditure to recapitalize banks and fund loan
carve-out expenses associated with transferring nonperforming claims to the BAMC). The government's target is a fiscal deficit of 2.8% of GDP in 2015. It intends to achieve this by limiting public sector wage rises, rationalizing general government transfers, and improved targeting of investment. It plans only minor revenue initiatives, such as raising taxes on financial services and insurance services, and increasing the efficiency of tax collection.

Reflecting the bank support costs, fiscal deficits, and significant prefunding of 2015 financing needs, we project the net general government debt to rise by about 23% of GDP over 2012–2014 to 71.9%. From 2015, we expect the pace of debt accumulation will slow markedly, reflecting lower fiscal deficits and an end to government support of banks. We expect the pace of debt accumulation to fall to 0.7% of GDP by 2017, after further fiscal consolidation.

We forecast gross general government debt (excluding the guarantees related to the European Financial Stability Facility) to rise by 13% to 83.4% in 2014 (partly reflecting a fiscal deficit of 6.8%). We forecast that it will peak at 83.7% of GDP in 2015 and decline to about 80% by 2017. As with the debt of all asset management companies ("bad banks"), our estimates of Slovenia's gross and net general government debt include BAMC-related obligations issued to purchase loans and other distressed assets from participating Slovenian banks at a discount to market value. These obligations amount to about €1.6 billion (4.6% of GDP). Although we consolidate this debt into general government debt, we do not consider BAMC's assets to be liquid, apart from cash and cash equivalents (currently negligible).

Should BAMC convert its loan assets into cash through foreclosure or sale more quickly than we expect, Slovenia's general government debt net of liquid assets could decline faster than we project. We do not include any future privatization proceeds in our forecasts. If these materialized, net general government debt could stabilize or decline.

A loss in competitiveness associated with a fall in labor productivity (by 2% since 2008), a strong rise in nominal unit labor costs (11% since 2008), a real effective exchange rate appreciation (2% since 2008), and a mild deterioration in Slovenia's terms of trade, have so far not undermined Slovenia's external performance. The current account surplus rose to an estimated 5.5% of GDP in 2014 after a decade of deficits before 2010. We project that Slovenia's current account surpluses will average about 5.5% of GDP through 2017, due to improved export performance. Offsetting these flows, the income deficit continues to rise, reflecting higher dividend and interest payments on Slovenia's high external liabilities.

Slovenian banks and companies have been reducing their external borrowings in recent years. We anticipate that Slovenia's reliance on external savings to fund its growth could fall further as a result of increased FDI, including from the scheduled privatizations. Increased FDI would also likely strengthen Slovenia's competitive position. We anticipate narrow net external debt (the ratio of gross external debt less official reserves and financial sector external assets to current account receipts [CARs]) will average 59.5% over

Although Slovenian banks and companies borrow at higher rates than comparable entities in northern eurozone states, we view Slovenian banks' access to the European Central Bank (ECB) as an important ratings factor. Although Slovenian banks' low rollover rate of external debt has seen them move into small external creditor positions in 2014, from net external debt of 30% of CARs in 2009, we understand that Slovenian banks have ample unencumbered collateral (including recent government injections of recap bonds) to access ECB facilities if needed.

Recapitalization costs remain broadly consistent with the estimates in our base-case scenario of the provisioning the banking system will need to maintain an adequate level of capital at the end of 2015. Any further asset quality deterioration in domestic, and particularly government-owned, banks increases the likelihood of further support from the Slovenian government, as well as contingent liabilities crystallizing on the sovereign balance sheet (see "Banking Industry Country Risk Assessment: Slovenia," published March 27, 2014).

Outlook

The stable outlook reflects our expectation that the new government will progress with fiscal consolidation, banking system restructuring, and implementation of structural reforms, including the privatization of state assets.

Our outlook also assumes that Slovenia's coalition government will stabilize net general government debt at about 70% of GDP in 2015.

We may lower the ratings if:

• Economic growth prospects weaken significantly, damaging the policy cohesiveness of the government coalition and reversing the budgetary consolidation;
• Policymaking becomes less predictable, for example due to economic policy deviations from the government's own program; or
• Net government debt rises to above 80% of GDP, either because of fiscal loosening or additional government support for the banking sector.

On the other hand, we may raise our ratings if the implementation of the government reform program results in substantially better growth and fiscal outturns than we currently project, such that net general government debt falls below 60% of GDP and net external debt continues to decline.
## Key Statistics

### Table 1

**Republic of Slovenia - Selected Indicators**

<table>
<thead>
<tr>
<th>Year</th>
<th>Nominal GDP (bil. US$)</th>
<th>GDP per capita (US$)</th>
<th>Real GDP growth (%)</th>
<th>Real GDP per capita growth (%)</th>
<th>Change in general government debt/GDP (%)</th>
<th>General government balance/GDP (%)</th>
<th>General government debt/GDP (%)</th>
<th>Net general government debt/GDP (%)</th>
<th>General government interest expenditure/revenues (%)</th>
<th>Other dc claims on resident nongovernment sector/GDP (%)</th>
<th>CPI growth (%)</th>
<th>Gross external financing needs/CARs plus usable reserves (%)</th>
<th>Current account balance/GDP (%)</th>
<th>Current account balance/CARs (%)</th>
<th>Narrow net external debt/CARs (%)</th>
<th>Net external liabilities/CARs (%)</th>
</tr>
</thead>
<tbody>
<tr>
<td>2007</td>
<td>48</td>
<td>23,964</td>
<td>6.9</td>
<td>6.6</td>
<td>(0.7)</td>
<td>(0.1)</td>
<td>22.7</td>
<td>20.7</td>
<td>3.0</td>
<td>77.5</td>
<td>3.8</td>
<td>117.1</td>
<td>(4.1)</td>
<td>(5.4)</td>
<td>62.6</td>
<td>31.0</td>
</tr>
<tr>
<td>2008</td>
<td>56</td>
<td>27,767</td>
<td>3.3</td>
<td>3.3</td>
<td>0.7</td>
<td>(1.8)</td>
<td>21.6</td>
<td>20.2</td>
<td>2.6</td>
<td>83.8</td>
<td>5.5</td>
<td>158.2</td>
<td>(5.3)</td>
<td>(7.2)</td>
<td>67.6</td>
<td>45.8</td>
</tr>
<tr>
<td>2009</td>
<td>50</td>
<td>24,821</td>
<td>1.2</td>
<td>3.7</td>
<td>11.8</td>
<td>(6.1)</td>
<td>34.5</td>
<td>33.1</td>
<td>3.1</td>
<td>90.7</td>
<td>0.9</td>
<td>168.6</td>
<td>(0.5)</td>
<td>(0.8)</td>
<td>99.2</td>
<td>64.6</td>
</tr>
<tr>
<td>2010</td>
<td>48</td>
<td>23,457</td>
<td>(7.8)</td>
<td>4.3</td>
<td>3.5</td>
<td>(5.7)</td>
<td>37.9</td>
<td>36.5</td>
<td>3.7</td>
<td>92.3</td>
<td>2.1</td>
<td>165.5</td>
<td>(0.2)</td>
<td>(0.2)</td>
<td>93.4</td>
<td>61.4</td>
</tr>
<tr>
<td>2011</td>
<td>51</td>
<td>25,032</td>
<td>1.2</td>
<td>4.3</td>
<td>8.9</td>
<td>(6.2)</td>
<td>46.2</td>
<td>43.1</td>
<td>4.5</td>
<td>88.3</td>
<td>2.1</td>
<td>146.1</td>
<td>0.4</td>
<td>0.6</td>
<td>71.9</td>
<td>49.0</td>
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<tr>
<td>2012</td>
<td>46</td>
<td>22,506</td>
<td>0.6</td>
<td>4.5</td>
<td>6.1</td>
<td>(3.7)</td>
<td>53.4</td>
<td>49.2</td>
<td>5.6</td>
<td>85.7</td>
<td>2.8</td>
<td>142.3</td>
<td>2.8</td>
<td>0.6</td>
<td>85.5</td>
<td>60.5</td>
</tr>
<tr>
<td>2013</td>
<td>48</td>
<td>23,316</td>
<td>(2.6)</td>
<td>5.6</td>
<td>17.2</td>
<td>(14.7)</td>
<td>70.4</td>
<td>62.7</td>
<td>6.5</td>
<td>70.8</td>
<td>1.9</td>
<td>139.5</td>
<td>5.8</td>
<td>3.5</td>
<td>82.5</td>
<td>52.3</td>
</tr>
<tr>
<td>2014</td>
<td>49</td>
<td>23,775</td>
<td>(1.0)</td>
<td>6.5</td>
<td>14.3</td>
<td>(6.8)</td>
<td>83.4</td>
<td>71.9</td>
<td>7.8</td>
<td>70.4</td>
<td>0.5</td>
<td>127.6</td>
<td>1.0</td>
<td>7.1</td>
<td>68.2</td>
<td>42.9</td>
</tr>
<tr>
<td>2015</td>
<td>47</td>
<td>22,636</td>
<td>1.4</td>
<td>6.5</td>
<td>2.8</td>
<td>(2.8)</td>
<td>83.7</td>
<td>72.5</td>
<td>7.9</td>
<td>69.7</td>
<td>1.0</td>
<td>124.4</td>
<td>1.7</td>
<td>6.3</td>
<td>64.3</td>
<td>37.1</td>
</tr>
<tr>
<td>2016</td>
<td>48</td>
<td>23,001</td>
<td>1.4</td>
<td>7.9</td>
<td>1.8</td>
<td>(1.5)</td>
<td>82.7</td>
<td>71.6</td>
<td>1.7</td>
<td>68.7</td>
<td>1.7</td>
<td>120.7</td>
<td>1.7</td>
<td>6.3</td>
<td>55.8</td>
<td>30.0</td>
</tr>
<tr>
<td>2017</td>
<td>49</td>
<td>23,822</td>
<td>1.8</td>
<td>8.0</td>
<td>0.4</td>
<td>(0.7)</td>
<td>80.1</td>
<td>69.7</td>
<td>8.0</td>
<td>67.6</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

Other depository corporations (dc) are financial corporations (other than the central bank) whose liabilities are included in the national definition of broad money. Gross external financing needs are defined as current account payments plus short-term external debt at the end of the prior year plus nonresident deposits at the end of the prior year plus long-term external debt maturing within the year. Narrow net external debt is defined as the stock of foreign and local currency public- and private-sector borrowings from nonresidents minus official reserves minus public-sector liquid assets held by nonresidents minus financial-sector loans to, deposits with, or investments in nonresident entities. A negative number indicates net external lending. CARs--Current account receipts. The data and ratios above result from Standard & Poor's own calculations, drawing on national as well as international sources, reflecting Standard & Poor's independent view on the timeliness, coverage, accuracy, credibility, and usability of available information.

## Ratings Score Snapshot

### Table 2

**Republic of Slovenia - Ratings Score Snapshot**

<table>
<thead>
<tr>
<th>Key rating factors</th>
<th>Neutral</th>
</tr>
</thead>
<tbody>
<tr>
<td>Institutional and governance effectiveness</td>
<td>Neutral</td>
</tr>
</tbody>
</table>

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[WWW.STANDARDANDPOORS.COM/RATINGSDIRECT](http://WWW.STANDARDANDPOORS.COM/RATINGSDIRECT)
Standard & Poor’s analysis of sovereign creditworthiness rests on its assessment and scoring of five key rating factors: (i) institutional and governance effectiveness; (ii) economic structure and growth prospects; (iii) external liquidity and international investment position; (iv) the average of government debt burden and fiscal flexibility and fiscal performance; and (v) monetary flexibility. Each of the factors is assessed on a continuum spanning from 1 (strongest) to 6 (weakest). Section VB of Standard & Poor's "Sovereign Government Rating Methodology And Assumptions," published on June 24, 2013, summarizes how the various factors are combined to derive the sovereign foreign currency rating, while section VC details how the scores are derived. The ratings score snapshot summarizes whether we consider that the individual rating factors listed in our methodology constitute a strength or a weakness to the sovereign credit profile, or whether we consider them to be neutral. The concepts of "strength", "neutral", or "weakness" are absolute, rather than in relation to sovereigns in a given rating category. Therefore, highly rated sovereigns will typically display more strengths, and lower rated sovereigns more weaknesses. In accordance with Standard & Poor’s sovereign ratings methodology, a change in assessment of the aforementioned factors does not in all cases lead to a change in the rating, nor is a change in the rating necessarily predicated on changes in one or more of the assessments.

### Table 2

<table>
<thead>
<tr>
<th>Economic structure and growth</th>
<th>Neutral</th>
</tr>
</thead>
<tbody>
<tr>
<td>External liquidity and international investment position</td>
<td>Strength</td>
</tr>
<tr>
<td>Fiscal flexibility and performance</td>
<td>Neutral</td>
</tr>
<tr>
<td>Debt burden</td>
<td>Neutral</td>
</tr>
<tr>
<td>Monetary flexibility</td>
<td>Strength</td>
</tr>
</tbody>
</table>

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### Related Criteria And Research

#### Related Criteria

- Sovereign Government Rating Methodology And Assumptions, June 24, 2013
- Methodology For Linking Short-Term And Long-Term Ratings For Corporate, Insurance, And Sovereign Issuers, May 7, 2013
- Criteria For Determining Transfer And Convertibility Assessments, May 18, 2009

#### Related Research

- Sovereign Risk Indicators, Dec. 15, 2014
- Sovereign Ratings Score Snapshot, Dec. 15, 2014
- Sovereign Rating And Country T&C Assessment Histories, Dec. 4, 2014
- Sovereign Ratings And Country T&C Assessments, Nov. 21, 2014
- Why The Move To A Single Supervisor Isn't Likely To Affect Eurozone Bank Ratings, At Least For Now, Nov. 4, 2014
- The Eurozone Crisis Is Still Not Over Yet, Oct. 23, 2014
- A Parting Of The Ways In The Global Economy, Oct. 1, 2014
- Sovereign Defaults And Rating Transition Data, 2013 Update, Sept. 17, 2014
- Banking Industry Country Risk Assessment: Slovenia, March 27, 2014

In accordance with our relevant policies and procedures, the Rating Committee was composed of analysts that are qualified to vote in the committee, with sufficient experience to convey the appropriate level of knowledge and
understanding of the methodology applicable (see 'Related Criteria And Research'). At the onset of the committee, the chair confirmed that the information provided to the Rating Committee by the primary analyst had been distributed in a timely manner and was sufficient for Committee members to make an informed decision.

After the primary analyst gave opening remarks and explained the recommendation, the Committee discussed key rating factors and critical issues in accordance with the relevant criteria. Qualitative and quantitative risk factors were considered and discussed, looking at track-record and forecasts.

The committee agreed that all key rating factors were unchanged.

The chair ensured every voting member was given the opportunity to articulate his/her opinion. The chair or designee reviewed the draft report to ensure consistency with the Committee decision. The views and the decision of the rating committee are summarized in the above rationale and outlook. The weighting of all rating factors is described in the methodology used in this rating action (see 'Related Criteria And Research').

**Ratings List**

Ratings Affirmed; CreditWatch/Outlook Action

<table>
<thead>
<tr>
<th>To</th>
<th>From</th>
</tr>
</thead>
<tbody>
<tr>
<td>Slovenia (Republic of)</td>
<td>Sovereign Credit Rating A-/Stable/A-2 A-/Negative/A-2</td>
</tr>
<tr>
<td>Senior Unsecured</td>
<td>A-</td>
</tr>
<tr>
<td>Transfer &amp; Convertibility Assessment</td>
<td>AAA</td>
</tr>
</tbody>
</table>

Dezelna Banka Slovenije

Senior Unsecured* A-

*Guaranteed by Republic of Slovenia.

**Additional Contact:**

SovereignEurope; SovereignEurope@standardandpoors.com

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