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 22-01-2021 "Sovereign Ratings" "Rating Criteria and Definitions"

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Rating Action

Neuss, 22 January 2021

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 is stable.

Key Rating Drivers

1. The sovereign boasts a wealthy economy as well as strong and stable pre-pandemic economic growth, with a good degree of diversification adding to resilience and supporting expectations of a timely economic rebound following the Covid-induced recession; whilst labor market flexibility and low private sector indebtedness would prove supportive to such a scenario, we have to highlight persistent demographic challenges which continue to present risks to underlying growth further out
2. Generally strong institutional set-up which is backed by evident benefits from EU/euro area membership for the small open economy, especially regarding sizeable support for a recovery from the pandemic in the shape of EU funding; higher political fragmentation and challenges to forming stable governments over the last few years represent a balancing factor to some extent
3. Covid-19 pandemic to temporarily reverse improving trend in public finances, with the public debt ratio leaping to an elevated level; a remarkable track record in fiscal consolidation, sound debt management, favorable debt affordability, and a sizeable cash buffer are factors supporting our expectations of improving fiscal metrics alongside a growth rebound once the acute pandemic phase has been overcome; further fiscal risks relate to public guarantees and estimates of a strong increase in age-related spending
4. Risks pertaining to Slovenia's external position seem manageable and have further receded thanks to persistently large current account surpluses, which are set to further reduce external risks in our baseline scenario

Reasons for the Rating Decision and Latest Developments

Creditreform Rating has affirmed the Republic of Slovenia's credit ratings, which rest on a strong macroeconomic performance profile, solid though transitorily weakening public finances, and limited and receding external risks. The robust institutional framework continues to leave some room for improvement.

Macroeconomic Performance

As a small, open economy, Slovenia appears generally sensitive to international trade dynamics. Notwithstanding the negative effects on tourism and transport from the corona crisis, its diversified and competitive economy and relatively high wealth level make for an overall strong macroeconomic performance profile. In our view, relatively flexible labor markets and the low level of private indebtedness add to the sovereign's resilience. In the current context, these factors would help to limit any macro-financial destabilization tendencies should a higher number of insolvencies start to take a toll on the economy in the course of the year as crisis measures are gradually phased out. In the medium to long term, we still see challenges arising from a declining working-age population which, if unaddressed, would weigh on the economy's underlying growth.

Slovenia enjoyed high levels of economic growth before the outbreak of the novel coronavirus. Following average real GDP growth of 3.6% in 2015-19 (euro area (EA): 1.9%), Slovenia's economic expansion slowed to 3.2% in 2019 (2018: 4.4%) amid decelerating growth of gross fixed capital formation (5.8%, 2018: 9.6%) due to a more challenging international trade environment as well as a moderation of government consumption (1.7%, 2018: 3.0%). Private consumption, on the other hand, had accelerated markedly in 2019 (4.8%, 2018: 3.6%), driven by robust labor market development including a strong increase in average monthly gross earnings (4.3%, 2018: 3.4%).

The Slovenian economy thus continued to converge towards EU-levels as measured by GDP per capita, estimated to have reached USD 40,717 in 2019 (IMF data, PPP, current prices), corresponding to an increase of 4.2% against its 2018 level and amounting to 87.3% of the EU level (2018: 86.6%). Among the CEE countries, Slovenia is surpassed only by the Czech Republic in this respect. In light of the economic fallout caused by the coronavirus and the measures taken against it, GDP per capita will see a notable setback in 2020 before presumably resuming its upward path as the pandemic is reined in by effective and widespread vaccines, and thanks to decisive policy action to mitigate the economic fallout from the crisis.

When the pandemic struck with the first confirmed infection on 4 March, the Slovenian economy entered a recession amid lockdown measures to suppress the spread of the virus. Judging by the stringency index provided by Blavatnik School of Government, the restrictions imposed on the public were introduced somewhat later than in a number of other European countries, but were widely seen to be rather strict. Ultimately, real GDP posted a stronger decline in Q1-20 than the euro area overall (-4.7% q-o-q vs. EA -3.7%), as private consumption saw a steeper fall than in the euro area and as net exports acted as a heavy drag. With the full effect of the shutdown felt in last year's second quarter, real GDP plunged by 9.8% q-o-q (EA: -11.7%), but made a robust recovery by 12.4% in Q3-20 (EA: 12.4%) as restrictions were gradually lifted.

Apart from private consumption being subdued, one key source of disruption was the decline of tourism, as travel exports had accounted for about a third (32.2%) of total services exports in 2019 (BOP data). Travel services plunged by 82.2% in Q2-20 compared to the same quarter one year earlier. According to OECD, tourism accounted for approx. 5.3% of total GDP in 2017, or 8.4% of GDP considering direct and indirect impacts. Similarly, tourism stood for about 7.7% of total employment (2018). The number of foreign tourists from Jan-Nov-20 was down to about

27% of the level in the same period of the previous year. Domestic tourism developed markedly better, as it benefited from spending vouchers issued by the government in the second half of the year. Services exports have also been disrupted by the transport sector, accounting for 29.3% of all services exports in 2019 and contracting by 20.0% in Q2-20 against Q2-19. Trade in goods, on the other hand, was less gravely affected. By November, merchandise exports already exceeded their previous year's level.

While tourism is set to remain severely hampered until broad-based vaccination is achieved, the volume of industrial production experienced a rapid rebound following the plunge in April, broadly on par with pre-crisis levels, although developments were heterogeneous. While production levels in machinery, electrical equipment and chemicals stood above previous year's levels in Nov-20, the same cannot be said for the Slovenian car production, for instance. Since the country boasts one of the highest gross value added (GVA) shares of the industrial sector among the EU-27 (Q3-20: 27.0%), this should shield the economy to some extent from deeper scarring in the present crisis. We note, however, a comparatively low - though rising - GVA share of the ICT sector (4.3% in Q3-20, EA: 5.2%), as well as of business services (9.5% vs. 11.2%).

In light of the new lockdown, which has become increasingly strict towards the end of last year due to very high infection rates, currently also including a curfew during the night hours while most non-essential shops remain closed and gatherings are prohibited, we assume that GDP will have declined in Q4, with private consumption again bearing the brunt. Following a recovery after the first lockdown, the volume of retail trade has been shrinking since August, falling more dramatically again in November. Unsurprisingly, retail and services sentiment as well as consumer confidence have markedly clouded in the last two months of 2020, whereas sentiment in the industry and in construction held up better. Overall, we expect Slovenia's economic output to have registered a decrease by 6.1% in 2020, with domestic demand exhibiting strong contractions including negative contribution from inventories, whereas net trade may have contributed positively, as imports may have posted a stronger decline than exports for the year as a whole.

Looking ahead, the quarterly GDP profile this year will be shaped by the subdued start of 2021, with another contraction in Q1-21 becoming increasingly likely as the current restrictions to public life become longer and more intense. We gather that the present containment measures, which compared to the first wave still seem less stringent, are to be in place until at least 22 January. We think it is reasonable to assume that adverse effects will be less severe than in spring, as many businesses and consumers have adapted their behavior. Moreover, a rebound in German manufacturing seems underway, construction appears to be less impacted by the second wave, and foreign demand should be bolstered by more robust economic activity in third countries such as China. To be sure, private consumption will suffer heavily from the muting of public life, although it should recover quickly once limitations are lifted, also cushioned by the furlough scheme, which enables companies to retain qualified staff, and by the statutory increase of the minimum wage from January 2020. To our understanding, an eighth anti-corona package is being prepared, also foreseeing an extension of the furlough scheme.

At this stage, we would expect a rebound from Q2-21, as immunization should slowly increase and restrictions are likely to be relaxed as spring kicks in, allowing more activity in consumer-facing services to take place outside. Vaccination began on 27 December 2020 and seems to have progressed well, judging by 2.02 doses administered per 100 people as of 17 January. While we expect vaccination to gain traction as more vaccine becomes available and procedures become smoother, any delays in this process would lead to a weaker economic outcome and increase the risk of a deeper scarring of the economy.

Gross fixed capital formation could see a more cautious recovery until there is widespread conviction that the pandemic is by and large under control, although EU funding coming on the back of Next Generation EU (NGEU, see below) will to some extent likely be used to foster private investment, too, along with public investment. Slovenia's very high degree of trade integration in the EU puts strong emphasis on a timely and sustainable recovery of this area. Thanks to NGEU, the post-Brexit deal clinched with the UK, and prospects of a more constructive trade dialogue with the US under a new president, the likelihood for this to happen has increased. Moreover, a high degree of export dependence on the German economy, and to a lesser degree the Austrian economy, which were both seemingly less adversely affected by the fallout from the health crisis, should prove supportive to the rebound of the Slovenian economy. Tourism will certainly remain subdued for as long as confidence is low as to the reining in of Covid-19.

Slovenia's labor market has performed relatively robustly so far, entering the global health crisis from a position of strength, bearing in mind an unemployment rate well below the euro area level (4.5% in 2019, EA: 7.5%), although not necessarily below the rate of all CEE peers (PL: 3.3%, EE: 4.4%). Employment reached a new record high in 2019, posting a broad-based increase of 2.5% compared to the preceding year. The construction sector recorded the largest increase in jobs (+9.1%). Before the Covid-19 crisis struck, Slovenia's labor participation rate (15-64y) had mounted to 75.2% in 2019, up from 75.0% in 2018, continuing its upward trend over the last few years and moving above the euro area level (73.7%), although still exceeded by CEE peers such as the Czech Republic, Latvia, and Lithuania.

Contrary to the euro area overall, Q1-20 still saw a slight increase in job creation before the full blow of the pandemic and the lockdown took its toll in the second quarter. In the face of resuming activity in Q3, Slovenian employment started to climb again (+0.2% q-o-q). The LFS-adjusted unemployment rate went up to 5.1% in Q3-20 (4.2% in Q4-19), thus rising to a lesser extent than in the Baltic countries for instance, and roughly in line with the euro area as a whole (Q3-20: 8.3%).

Structurally, labor market segmentation appears to remain a challenge, mirrored by a comparatively low participation rate of older people (55-64y, sa), coming to just 52.2% against 63.9% in the euro area in Q3-20, and given that a relatively high share of young people (15-24y, LFS adjusted series) have only temporary employment contracts (61.2% in 2019, vs. 52.1% in the EA).

Meanwhile, risk-bearing capacities of the private sector appear ample, with household and non-financial corporations' (NFC) debt among the lowest in the EU-27. Measured against disposable income, household debt has remained relatively stable at a comparatively low level so far, amounting to 44.7% in Q3-20 (vs. 44.5% in Q3-19). By the same token, a comparatively low debt-to-GDP level in the NFC sector offers some buffers should a higher number of insolvencies affect the economy once payment deferral rules and other temporarily more benign regulations are phased out. NFCs thus have continued to deleverage until recently, with debt declining from 45.6% to 41.9% of GDP in 2018-19, although we observe a slight increase to 42.9% as of Q3-20 (in non-consolidated terms).

All in all, we would tentatively pencil in GDP growth of a magnitude of about 4.3% for 2021, aided by the now seven support packages adopted by the Slovenian parliament which are dedicated to propping up the health sector, maintaining employment and income of workers, providing liquidity to enterprises, and supporting the particularly hard-hit businesses such as restaurants and accommodation. Our forecast also includes a positive effect from the substantial support on the EU-level in the form of NGEU, especially the Recovery and Resilience Facility (RRF) from which Slovenia expects to receive about EUR 1.6bn in grants and about EUR 3.6bn in loans. Means from the Multiannual Financial Framework 2021-27 would add to that, resulting in the overall sum of approx. EUR 10.2bn by 2029.

According to the draft National Recovery and Resilience Plan approved by the Slovenian government on 8 October 2020, the lion's share of RRF grants (roughly 42%) is to be dedicated to sustainability and the green transition, followed by about 20% that should be directed towards enhancing the degree of digitalization, and 19% that will be allocated to education. The largest chunk of RRF loans will also go towards sustainability and greening the economy, followed by a sizeable amount dedicated to enhancing a supportive environment for enterprises. In this vein, the government's commitment to further improve the use of EU funds is a welcome sign, as the recent track record in ESIF absorption suggests there is some room to catch up with a number of CEE peers. Slovenia has decided on roughly 88% and spent 50% of the ESIF 2014-20 funds (EU average: 93% and 47%).

The intended structural shifts would kick in at a time during which the pace of reform is widely perceived to have slowed with a view to tackling Slovenia's demographic challenges affecting its pension, health care, and long-term care systems in the medium-to-longer term. We also note that gross fixed capital formation has lagged behind the EU average over the last few years, which may have contributed to moderating productivity growth. Growth in real labor productivity per employee slowed to 0.7% in 2019 vs. 2018, although still posting at a higher rate than the euro area overall and its main European trading partners in that year. Taking into account a longer time horizon, the same remains by and large true.

While Slovenia's cost competitiveness still compares relatively well against the euro area overall and main European trading partners over a longer term horizon, real unit labor costs have risen by 1.9% in 2018-19, suggesting that, against the backdrop of rising real compensation per employee, they could start to eat into Slovenia's cost competitiveness. Having said that, stronger wage growth would also be conducive to maintaining and attracting skilled labor. Moreover, although the country's global export market share stalled in 2019 against the preceding year, the slight upward trend both with regard to goods and services over the last few years remains in place. While the World Bank's Ease of Doing Business report was not updated in 2020, we recall that Slovenia improved by three ranks in the latest ranking, from 40 to 37 out of 190, thus moving into the middle range among the EU-27.

More sustainable GDP growth would presumably also entail more inclusive growth that would find ways to capitalize on skills and experience from older generations currently underrepresented with regard to Slovenia's labor participation, or pursue to re-train at least part of this group. When aiming for a higher degree of economic sustainability, authorities may also have in mind that a relatively high share of jobs in Slovenia could be subject to the risk of automation, according to a perception expressed in the recent special edition of the World Economic Forum's Global Competitiveness Report. Enhancing skills and fostering investment in R&D seems to be of the essence, along with the necessary institutional and political clout to swiftly implement this and monitor progress on these fronts. Slovenia improved slightly with regard to the EU's 2020 Digital Economy and Society Index (DESI), where it ranks 16 among the former 28 EU members.

As far as gross expenditure on R&D is concerned, we observe that the country posted at 2.04% of GDP in 2019, moving somewhere in the middle-range among EU countries.

Institutional Structure

Slovenia's credit rating continues to be backed by a generally strong institutional set up. As a small open economy, Slovenia draws significant benefits from EU and euro area membership, which among other things offers access to the large single market. As part of the euro area, the sovereign also enjoys favorable financial market conditions, in place not least thanks to the ECB's accommodative stance and swift emergency response to the Covid-19 crisis. The substantial crisis and recovery funds that Slovenia is able to tap on the European level constitute another example of the benefits that come with EU membership at this stage. This positive assessment is partly balanced by a fragmented domestic political environment that seems to have complicated formation of stable governments over the last few years. If this becomes more entrenched, we see some risks to the quality of governance as well as slowing structural reform momentum, which could ultimately hamper potential growth.

Having said this, the latest set of the World Bank's Worldwide Governance Indicators (WGI) continues to suggest that the sovereign's performance is perceived as better than that of CEE peers, and generally better than the median of our A-rated sovereigns. We would highlight favorably that with respect to voice and accountability as well as to rule of law, the sovereign's ranking has improved to relative ranks 40 and 34 out of 209 economies (from 43 and 37 respectively), although there remains room to catch up with our AA-rated universe. Looking at control of corruption (42 after 41) and government effectiveness (38 after 36), we observe that Slovenia has slipped one or two ranks. In terms of the WGI political stability, we would point out that the sovereign has slipped 13 ranks to 56/211, its lowest rank since inception of the WGIs. The latter seems to tie in with the impression of relatively frequent changes in government or (snap) elections over the years since 2013, which we would continue to flag as a factor potentially slowing down progress on reforms. The latest EBRD transition report presented in November echoes such concerns.

In this vein, the shaky four-party government formed in March under PM Janša following the resignation of his predecessor Sarec in January 2020, who had led a minority government, has been difficult in the making and lost the support of the Pensioners' Party (DeSUS) party in December 2020. This leaves three parties (SDS, SMC, NSi) that currently occupy 41 of the 90 seats in the national assembly. We are monitoring developments around the motion of no-confidence in the government, as announced by the leader of DeSUS, Erjavec, who aims to form a more left-leaning government and may become the designated prime minister if the incumbent decides to withdraw should he lose parliament's confidence. As things currently stand, a snap election ahead of the scheduled parliamentary election in 2022 cannot be ruled out. This being said, Slovenia has so far made remarkable progress when it comes to vaccinations administered, as mentioned further above, which points to authorities' sound crisis management.

We are aware that the latest EU Rule of Law Report mentions the lack of media-specific rules to prevent conflicts of interest in the sector, which according to the Report hampers media pluralism in Slovenia. Apart from pointing to lengthy processes when it comes to gaining access to public information for the public and journalists, the Rule of Law Report also highlights lawsuits with an intimidating effect, online harassment of and threats against journalists as issues of concern, along with perceived lack of response of the criminal justice system thereon. Apparently, there also remain some challenges in effectively prosecuting economic and financial crime including money laundering, as the well-recognized work of the Commission for the Prevention of Corruption would benefit from additional staff and financial resources, which might ultimately also contribute to enhancing implementation of the Integrity and Prevention of Corruption Act.

Fiscal Sustainability

The pandemic and the measures taken to bring it under control will at least transitorily reverse the improving trend in Slovenia's fiscal metrics. Thanks to a favorable starting position, although less benign than in other CEE peers, there is plenty of fiscal headroom to cushion the negative effects from the crisis. Despite the imminent significant leap of the public debt ratio back to an elevated level, we thus view Slovenia's remarkable track record in fiscal consolidation - following the global financial crisis and its banking crisis - sound debt management, favorable debt affordability, and sizeable cash buffers as factors mitigating fiscal risks. Besides risks related to a somewhat elevated level of public guarantees, a projected strong increase in age-related spending continues to pose challenges in the medium-to-longer term.

Following the exemplary consolidation of its general government balance, which has resulted in a second consecutive small surplus in 2019 (0.5% of GDP, 2018: 0.7%), the corona crisis will cause Slovenia's headline balance to turn into a pronounced deficit. According to the Ministry of Finance (consolidated public finance budgetary accounts), total revenue dropped by 3.0% over the first eleven months of 2020, with tax revenue falling by 3.9%, while total expenditure soared by 14.1% over this period, amidst steep increases in current transfers (+23.7%) and another strong increase in public wages (10.6%).

In order to alleviate the fallout from the Covid-19 pandemic, Slovenian authorities have put in place a wide range of measures since March 2020, including the now seventh anti-corona package which was adopted by parliament on 29 December. As a consequence of a plunging GDP along with the substantial increase in government spending in order to safeguard lives, ring-fence jobs, and minimize disruption to business operations, we assume a general government deficit of about 8.5% of GDP for 2020.

For the current year, amid expected resuming GDP growth and a partial phase-out of some of the above measures, we cautiously forecast the deficit to shrink to about 7.0% of GDP. Included in our estimate is a positive effect from the RRF, which the government envisages to come to roughly 0.6% of GDP in 2021, with 0.2 p.p. thereof in the form of investments and subsidies in the public sector and 0.4 p.p. as support to the private sector via grants and subsidies. We gather that the Slovenian government assumes it will be able to draw on a total EUR 5.2bn in RRF funds.

There is considerable uncertainty linked to both the revenue and expenditure side in 2021 as the evolution of the pandemic, also given virus mutations, remains highly unpredictable. At present, we understand that envisaged new measures on the expenditure side to assist the recovery in 2021 would total about 1.0% of GDP (DBP21). Additional fiscal measures with a deficit-increasing effect, for instance, include a reduction of tax on motor vehicles. Moreover, public investment expenditure is foreseen to be at 6.2% of GDP. In this context, we take note of the Slovenian Fiscal Council's cautioning over perceived bottlenecks in management, making this an ambitious aim. This being said, we are aware of the government's expectation to increase absorption of ESI funds. The planned expansion of public investment is rather diversified, including investment in health capacities, energy efficiency of buildings, rail and road transportation, as well as in the modernization of the armed forces, among others.

In light of the expected headline deficit and slumping GDP, we expect the public debt ratio to leap to 81.7% in 2020, thus temporarily reversing the rapidly falling debt-to-GDP ratio that decreased to 65.6% in 2019 (2018: 70.3%), from its peak of 82.6% reached in 2015. For 2021, we tentatively forecast that the ratio will stay around the prior year's level before embarking on a downward trajectory. It has to be emphasized that the sovereign commands over considerable cash buffers, which were further ramped up throughout last year. Currency and deposits significantly increased from 16.9% of GDP in Q3-19 to 22.9% of GDP in Q3-20 (Eurostat, consolidated quarterly government financial accounts).

We flag moderate contingent liability risks due to public guarantees, which have been downward trending since 2014, but were still at a somewhat elevated level in 2019, standing at 11.2% of GDP (SP20 data). The government expects these to have risen to 12.7% of GDP in 2020 (DBP21). In the wake of the Covid-19 crisis, extensive guarantees have been offered. However, only EUR 66mn in loans were extended from the EUR 2bn quota for covering loan principal under the second anti-corona package, while EUR 61mn were taken up out of the EUR 200mn guarantees under the first anti corona package (Bank of Slovenia data). Given further progress in terms of bank privatization, the corona crisis thus to some extent replaces some of the contingent liabilities previously linked to the financial sector. For 2021, the government envisages guarantees to mount to 13.7% of GDP before edging down to 10.7% of GDP in 2022.

At this juncture, we assess potential risks stemming from the banking sector as limited, against the backdrop of significantly improved capitalization and increased asset quality prior to the outbreak of Covid-19, as well as further progress when it comes to privatization. Drawing on Bank of Slovenia (BoS) data, the CET1 ratio was at 18.2% in Q3-20 (Q3-19: 17.7%), pointing to available buffers. The banking sector's NPE ratio has pursued an ongoing downward trend, falling to 2.0% as per Q3-20 (Q3-19: 2.9%). Monthly BoS data points to slight NPE increases between September and November 2020, by 0.1 p.p. both in the segments NFC and other households. A particularly sharp rise by 1.6 p.p. against Dec-19 was registered among NFCs in accommodation and food services, where, however, total exposure in this category only made up for 3.8% of the total NFC loan portfolio in Nov-20. At the same time, the NPE ratio even slightly declined by 0.4 p.p. to 2.4% in the manufacturing sector, which at 27.9% of the total NFC loan portfolio accounted for the lion's share of total exposure in Nov-20. While these findings so far suggest limited fallout from the pandemic, we will continue to monitor developments, as difficulties in servicing debt and/or a higher number of insolvencies may yet follow once relaxed payment rules begin to expire.

In terms of profitability, we note that negative effects from the corona crisis do not seem to have come through yet as of Q3-20, when ROA stood at 1.3% (Q3-19: 1.8%). However, according to Bank of Slovenia, much of the relatively high profit over the first eleven months of 2020 were due to the merger of two banks (Abanka and NKBM), thus a one-off factor. In the absence of the one-off effect, pre-tax profit would have declined by 53.9% against the first eleven months of the previous year, against a decrease of less than a fifth including the one-off effect. In September 2020, the takeover of Abanka by NKBM was fully completed, which we assess as positive.

Turning to the housing market, we observe that the year-on-year increase in house prices slowed to 3.3% by Q3-20 (7.1% in Q3-19, Eurostat), with the 3-year growth rate down to a still vigorous 20.9% in Q3-20 (26.7% in Q3-19). Affordability indicators such as the price-to-income ratio provided by the OECD suggest that homes have continued to become less affordable over the last few years, but do not point to overstretched valuation at present. We would reiterate our view that, in the face of increasing urbanization amid Slovenia's ongoing convergence path, upward pressure on prices is likely here to stay, although the corona crisis may temporarily alleviate supply and demand imbalances somewhat.

Structural shortcomings that may weigh on debt sustainability in the medium-to-longer term relate to Slovenia's ageing population. We have to reiterate that age-related expenditure in percent of GDP is set to increase markedly in the medium term, thus increasing pressure to better integrate the older population into the labor market. Against this backdrop the envisaged rise in expenditure on pensions by 5.5% in 2021, following regular and extraordinary adjustment in 2020, would add to concern. We also note that the Fiscal Council has expressed some caution over parts of the more recent anti-corona measures pertaining to pensions, as these might not sufficiently take the longer-term view into account.

We think that Slovenia's favorable debt profile and sound debt management, along with high affordability, constitute mitigating factors as far as fiscal sustainability risks over the medium term are concerned. Moreover, about a third of the outstanding public debt was held by the official sector in Q2-20 (33%, Q2-19: 37%, IMF). The average weighted maturity of the public debt portfolio stood at approximately 8.9y in Nov-20 (ECB data), thus suggesting limited refinancing risks. In light of the ECB's ongoing accommodative stance, given the increase of the PEPP envelope by EUR 500bn to EUR 1,850bn and the extension of the horizon for net purchases under the PEPP to at least the end of March 2022, financing conditions on the financial markets look set to remain benign. Slovenian 10-year bond yields have been moving in negative territory since the second half of 2020. On 5 Jan, the sovereign issued a new 10-year bond of EUR 1.75bn, for the first time in history with a negative yield of -0.096% and a coupon rate of 0%. In addition, Slovenia increased the existing issue of long-term 30-year euro bonds at an interest rate of 0.381% at EUR 250mn, and another EUR 200mn were raised by increased issuance of a 10-year bond, maturing in 2029.

Foreign Exposure

With a view to the external sector, we continue to assess Slovenia's situation as generally solid. Its economy has been running large current account surpluses, thus significantly improving the net international investment position (NIIP) since the year 2012, when the goods deficit started to swing towards a surplus amid private sector deleveraging and rising competitiveness.

Slovenia's current account surplus peaked at 6.2% of GDP in 2017, but still remained above its five year average at 5.6% in 2019, one of the highest readings in the EU, thanks to the surplus in services trade climbing to a high at 5.8% of GDP. In the wake of the pandemic, however, the services surplus shrank noticeably, while the surplus in goods trade was lifted through a stronger decline in imports than in exports. Overall, the current account surplus rose to 6.5% of GDP in Q3-20 (based on a rolling four-quarter sum).

For 2020 as a whole, we expect a somewhat larger current account surplus compared to the previous year. Going forward, amid a beginning normalization of services trade over the course of the year as immunization widens on the one hand, and a possible smaller surplus in goods trade as domestic demand should drive economic growth on the other hand, we would tentatively forecast the current account surplus to display a similar order of magnitude compared to 2020.

Bolstered by a persistently large current account surplus, Slovenia's NIIP narrowed further to -15.4% of GDP in 2019 (2018: -19.0%), maintaining the least negative stance among its CEE peers. Overall, a negative net FDI position and thus a less futile form of investment remains the dominating component of the NIIP. By Q3-20, the NIIP registered a somewhat more negative position, coming to -17.3% of GDP. Taking into account the NIIP excluding non-defaultable instruments (NENDI), we observe that in 2019 this position has turned positive (1.6% of GDP) for the first time since 2004, adding to the impression that risks pertaining to foreign exposure have further receded.

Rating Outlook and Sensitivity

Our rating outlook on the Republic of Slovenia is stable. We perceive current downside risks regarding the macroeconomic performance and the fiscal outlook, which could potentially be exacerbated by volatile political circumstances, as being offset by a good degree of economic resilience, substantial EU-level support to overcome the fallout from the pandemic and spur transition towards more sustainable economic growth, as well as by the above-mentioned factors mitigating fiscal risks. We would reiterate that the assessment and interpretation of economic developments in the near future is considerably more challenging than under normal circumstances, as is the case for other indicators, e.g. from the fiscal realm.

We could raise the sovereign's credit ratings or the outlook if the Slovenian economy sees a rapid recovery and medium-term economic growth significantly exceeds our expectations, resulting in an accelerated convergence towards EU-levels, or if public debt returns to a sustainable downward trend in a timely fashion. We could also consider a positive rating action if decisive implementation of reforms that address unfavorable demographic developments and related costs strongly point towards a more sustainable fiscal footing of the pension system and the long-term and healthcare systems. A higher degree of political stability than recently witnessed would seem beneficial in this respect.

Conversely, a negative rating action could be prompted if medium-term economic growth fails to meet our expectations, which might be the case in a scenario of delayed immunization against Covid-19 or lack of vaccine effectiveness, requiring renewed restrictions hampering economic developments. A downgrade of Slovenia's rating or the outlook could also be prompted if fiscal metrics develop a deteriorating trend, possibly against the backdrop of an unfavorable scenario as described above, or if protracted government fragility leads to 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]	2015	2016	2017	2018	2019	2020e	2021e
Real GDP growth	2.2	3.2	4.8	4.4	3.2	-6.1	4.3
GDP per capita (PPP, USD)	31,647	33,882	36,66	39,067	40,717	38,506	41,384
HICP inflation rate, y-o-y change	-0.8	-0.2	1.6	1.9	1.7	-0.3	0.9
Default history (years since default)	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
Life expectancy at birth (years)	80.9	81.2	81.2	81.5	n.a.	n.a.	n.a.
Fiscal balance/GDP	-2.8	-1.9	-0.1	0.7	0.5	-8.5	-7.0
Current account balance/GDP	3.8	4.8	6.2	5.8	5.6	n.a.	n.a.
External debt/GDP	118.8	109.6	100.5	91.9	90.5	n.a.	n.a.

Source: International Monetary Fund, Eurostat, own estimates

ESG Factors

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.]

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 have significant 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 concerning economic prospects and public finances. To be sure, we will follow ESG dynamics closely in this regard.

ESG Factor Box

Environmental Quality	Ecological Risks	Ressource Management	Education	Health	**Demographics**
Labor	Equality	Technology & Infrastructure	Safety & Security	**Judicial system**	**Quality of Public Services**
Integrity of Public Officials	Quality and Efficacy of Regulations	**Civil Liberties/ Political Participation**	Market Access	Business Environment	Data Transparency

Environment	Social	Governance	Highly significant	Significant	Less significant	Hardly significant

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

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 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.

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, ECDC, 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), Slovenian Tourist Board.

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".

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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