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 14-01-2022 “Sovereign Ratings” “Rating Criteria and Definitions”

Rating Action

Neuss, 14 January 2022

Creditreform Rating has affirmed its 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.

Contents

Key Rating Drivers

1. Well-diversified economy boasting a strong growth record and labor market development, and posting a forceful recovery following the pandemic-induced downturn, enabling ongoing convergence towards EU-levels in terms of GDP per capita; tourism remains affected by new infection waves in the near term, posing some downside risks to the growth outlook, with global supply bottlenecks adding to these
2. Constructive medium-term growth outlook in light of NGEU-backed reform and investment initiatives, although subject to the pace of fund absorption and quality of implementation; demographic challenges continue to weigh on the medium-to-longer-term outlook, as long as these are not addressed decisively; with convincing steps to put the pension system and the healthcare system on a more sustainable basis yet to be taken, there has been progress with regard to reforming the long-term care system
3. Generally strong institutional framework including advantages associated with EU/EMU membership, also underpinned by latest set of Worldwide Governance Indicators which point to persistent enhancement of ‘government effectiveness’ and some room to improve in terms of ‘voice and accountability’; polls with a view to the upcoming general election currently hint at an ongoing high degree of political fragmentation, maintaining some uncertainty over government stability and reform progress
4. Currently elevated public debt ratio likely to trend down over the next few years; sound debt management, a comfortable cash buffer, and high debt affordability continue to mitigate fiscal risks stemming from a higher debt level, public guarantees and, with a medium-to-longer-term view, from prospectively sizeable increases in age-related spending
5. External risks associated with a small open economy continue to appear manageable; supported by ongoing current account surpluses, the net international investment position has further improved, recently reaching single-digit territory in percent of GDP

Reasons for the Rating Decision and Latest Developments[1]

Macroeconomic Performance

The sovereign's wealthy, diversified, and competitive economy, in combination with a relatively flexible labor market and a moderate level of private indebtedness, underpins an overall strong macroeconomic profile. Slovenia's high degree of trade openness renders the economy sensitive to international trade dynamics, and the significance of its manufacturing sector highlights some vulnerabilities in the current context of ongoing supply chain bottlenecks. These are compounded by downside risks to the economic performance associated with the comparatively low Covid-19 vaccination rate of the population, which might require renewed containment measures with adverse effects on the economy in light of the current infection dynamics. The medium-term growth outlook seems favorable, with Slovenia's output expansion prospectively facilitated by substantial investment in digitalization, the green transition, and enhanced social inclusion, all financed through EU funds. We assume Slovenian GDP growth to continue to outperform euro area growth.

Slovenia featured a strong economic growth record prior to the outbreak of the coronavirus, with real GDP averaging 3.6% from 2015-19 (euro area: 2.0%). Revised data for 2020 show a decline of real economic output by 4.2%, hence less severe than the plunge in real GDP registered in the euro area as a whole (EA: -6.4%) and milder than previously reported (-5.5%). Slumping private consumption amid virus containment measures (-3.5 p.p.), and a steep fall in gross fixed capital formation as business sentiment deteriorated sharply, acted as heavy drags on GDP growth in the first year of the pandemic.

Notwithstanding the strong GDP contraction in 2020, Slovenia continues to display the second-highest GDP per capita among the main Central and Eastern European (CEE) peers after the Czech Republic, even though this metric dropped by 3.8% to an estimated USD 39,378 (IMF, current prices, PPP terms) in 2020. At 88.6% of the EU level in that year, Slovenia's convergence process towards EU GDP per head continued, as the EU posted a stronger fall in output per capita. With regard to 2021, the IMF reckons that Slovenia's GDP per capita increased by 9.7% to about USD 43,206, lifting it even closer to 90% of the EU level (89.4%).

With the outbreak of Covid-19, authorities acted swiftly in providing comprehensive support in order to maintain health and jobs, protect the vulnerable and enable ongoing business activity. So far, the government has presented ten support packages over the course of the pandemic. The latest package was adopted as recently as Dec-21 and, among others, aimed at supporting the most vulnerable persons and extending tourist vouchers in order to bolster one of the most heavily-affected sectors. According to the World Travel and Tourism Council, the total contribution of travel and tourism to GDP fell from 10.6% in 2019 to 6.5% in 2020.

On the back of fiscal and monetary policy support both nationally and on the global level, along with the vaccination campaigns, last year saw a continued recovery of Slovenian economic output. Quarter-on-quarter increases of real GDP in the first three quarters (Q3-21: 1.3%), largely driven by private consumption, pushed real GDP 1.2% above its pre-pandemic level (Q4-19) as of Q3-21 (EA: -0.3%). As far as the final quarter 2021 is concerned, there are indications for continued positive growth, irrespective of supply-chain bottlenecks that affected Slovenia and many

[1] This rating update takes into account information available until 07 January 2022.

other economies, and despite renewed restrictions to public life amid a resurging wave of coronavirus infections.

Monthly industrial production posted a third consecutive increase in Oct-21 (Eurostat, sa, ca). Traffic of electronically-tolled vehicles on Slovenian motorways was up by 8% y-o-y in Nov-21. While the massive leap in monthly retail sales in Oct-21 was exaggerated by higher automotive fuel sales, retail sales excluding this position still posted a third consecutive increase in October, thus pointing to ongoing growth impulses from private consumption in last year's fourth quarter. More or less in line with that, the European Commission's (EC) Economic Sentiment Indicator relating to December improved, but suggested a slowing pace of economic activity for the quarter as a whole.

This said, the Omicron strain of the virus which is about to make its way through continental Europe poses downside risks, as new restrictions to public life and contact-intensive services are looming. Sharply rising infection numbers in Slovenia, reaching a cumulative 14-day rate in excess of 2000 per 100 thousand persons in week 45-2021, have started to ease of late, falling to a still high 878.2 as of 7 January (ECDC). However, the vaccination rate lags strongly compared to the EU average, exposing the economy to risks as elaborated above. As of 07-Jan-22, only 56.8% of the total population were considered fully vaccinated, as compared to an EU average of 68.5%.

Adding to near-term risks are prolonged supply bottlenecks with regard to certain intermediate products and commodities, affecting both Slovenia and its main trading partners, especially in the automotive industry and its suppliers, but also the manufacturing industry more generally as well as the construction industry. In this context, we would also flag downside risks from more lasting price pressure to private consumption.

The latter, however, should generally remain supported by a tightening labor market and increasing wage growth. The government's support measures helped to stabilize employment in the pandemic, and employment already exceeded its pre-crisis level last year. At just under 906.5 thousand as of Sep-21 (Bank of Slovenia, BSI), the number of employed is seeing new record highs.

Overall, average monthly gross earnings rose by 4.6% y-o-y in 2020 (avg. 2015-19: 2.5%, SiStat), and by 6.8% y-o-y in the first ten months of 2021, although partly boosted by exceptional bonus payments in view of the corona crisis that drove wages especially in the public sector. Wages in the private sector benefited from the rise in the minimum wage by 8.9% last year (IMAD), but also increased amid the return of employees after job retention measures.

Going forward, wage pressure is likely to continue amid an ongoing lack of skilled workers. Unemployment, which is well below the rate of the euro area as a whole, dropped to 4.4% in the first half of last year, before edging up somewhat to 4.8% as of Oct-21 (Eurostat, sa, not ca). Thus, the rate stands only slightly above record-low levels seen shortly before the outbreak of Covid-19. Also, vacancy rates stand at record-high levels.

Investment activity looks set to be backed by favorable financing conditions for the time being, not least considering that the ECB's monetary policy will presumably remain accommodative despite the approaching end of the PEPP. Other than that, gross fixed capital formation will benefit from measures and investment as presented in the national Recovery and Resilience Plan (RRP), if these are implemented effectively and in a timely manner. As one caveat in this respect, we would flag possible delays, if bottlenecks continue to persist for longer with regard to delivery of certain materials and/or intermediate products. This could slow down construction activities. Shortages of skilled labor may add to this to some extent.

Slovenia is to receive EUR 1.8bn in grants via RRF and has asked for a loan amounting to about EUR 0.7bn, out of a maximum loan allocation of EUR 3.2bn from the RRF. Via the labor market instrument SURE, Slovenia receives loans in the amount of EUR 1.113bn. Regarding the Multiannual Financial Framework (MFF) 2021-27, the sovereign has access to roughly EUR 3.3bn in further EU funding (European Cohesion Policy), while remaining funds from the MFF 2014-20 amount to an estimated EUR 1.4bn (MoF data). We understand that a further loan request might follow at some point. A first tranche of grants for EUR 231mn was disbursed in Sep-21.

On the whole, NGEU could lift real GDP by about 1.1%-1.7% by 2026. EC simulations also suggest this could add about 6,000 jobs. In terms of fund absorption regarding the ESIF 2014-20, Slovenia moves above the EU average and close to those CEE peers most advanced in this respect, having spent 62% of those funds (EU average: 57%). Together with a previous commitment to further improve absorption and the related envisaged reform effort, we think this gives reason for an optimistic outlook on medium-term growth.

Given an expected ongoing international economic recovery, as defense against Covid-19 continues to advance despite setbacks by mutations, Slovenian exports should continue to benefit. At this stage, we expect net exports to have contributed negatively to GDP growth in 2021, notwithstanding expanding exports, as strong growth in domestic demand is likely to have driven import growth. We expect net external trade to remain a drag in 2022, albeit to a lesser extent than in 2021. The high degree of openness, reflected in a trade share of 146.6% of GDP (2020, Eurostat), continues to leave the sovereign exposed to the global and in particular the euro area's economic dynamics. Expectations for ongoing struggles in the automotive industry in Germany, Slovenia's most important trading partner, owing to the shortage of intermediate products, as well as a less upbeat outlook for the European economy in view of tightening containment measures against the spread of the Omicron variant, point at some downside risks here.

Overall, we expect real GDP to grow by 7.0% in 2021, while the expansion rate should moderate to about 3.9% in 2022. Protracted global supply chain bottlenecks and a shortage of skilled labor constrain the near-term economic outlook, and as far as semiconductors are concerned could last at least until the end of this year, according to industry experts (EC). As mentioned above, the low vaccination rate of the population highlights vulnerabilities to new infection waves.

Generally, Slovenia's diversified economy, and not least its high gross value added (GVA) share in manufacturing (Q3-21: 23.9%, EA: 16.4%) have contributed to resilience during this pandemic, recalling that the manufacturing sector already reached its pre-crisis output level as early as Apr-21. On the other hand, shortages of material and/or equipment are particularly felt in the important automotive sector, and, according to recent survey data (European Commission) reached a record high in Q4-21. This said, in November 2021 only two out of 21 manufacturing activities were down in y-o-y terms while 12 posted an increase in y-o-y output of more than 10%, as BSI points out. Aggregate production was up 10% as well.

Underscoring its competitive stance, Slovenia's global export market share edged up from 0.18% in 2019 to 0.19% in 2020, driven by a slightly rising market share in goods (2020: 0.20%) and matching a peak seen before the outbreak of the global financial crisis. While developments in the exceptional year 2020 may distort the picture, Slovenian real unit labor costs developed less favorably than those of most of the main European trading partners over the last few years amid stronger growth in real compensation per employee. If wage pressure continues, this may eventually bear down on the country's cost competitiveness. While to some extent a prerequisite to attract and maintain skilled staff, these findings seem to stress the importance of enhancing productivity growth.

Against this background, we note that GVA shares of typically high valued-added ICT and business services are below levels in the euro area as a whole (Q3-21: 4.2% vs. EA 5.3% and 9.7% vs. EA 11.4%, respectively). On the other hand, Slovenia ranges slightly above the EU level with regard to the EC's latest Digital Economy and Society Index 2021, ranking 13th among the 27 member states, with integration of digital technology as a particular strength relative to the EU level amid the four main dimensions considered for this compilation. Strengthening digital skills in the public sector, as well as in education and across businesses, is a key focus of the digitalization agenda in the RRP, with EUR 531mn earmarked for this purpose, and should be conducive to boosting productivity. In the same vein, foreseen initiatives for a faster entry of young people into the labor market, and to enhance training and set incentives for life-long learning should be beneficial to achieve this goal.

Notwithstanding the risks mentioned above, we assess Slovenia's medium-term growth outlook as positive, backed by its diversified economic structure and planned investment through NGEU means, although we would note that Slovenia's investment-to-GDP ratio was still well below the EU average in 2020 (18.9% vs. EU 21.9%). Recent estimates for Slovenia's potential growth suggest strong performance this year and next, with growth rates of 3.1% and 3.4% (AMECO), respectively, close to estimated growth rates of CEE top performers in this regard.

Apart from that, a comparatively low level of indebtedness of the private sector, as evidenced by a relatively low household debt-to-income ratio (Q2-21: 42.6%, ECB) and moderate NFC debt-to-GDP (Q2-21: 40.9%, ECB) hints at pronounced risk-bearing capacities. While outstanding loans to NFCs increased to 4.1% y-o-y in Nov-21 (Nov-20: -3.3%, ECB), the development seems somewhat exaggerated by base effects and large loans to two companies (BSI). It seems worth mentioning that bank lending increased most in the ICT sector, which seems to underscore ongoing investment in this area.

Institutional Structure

We continue to view the sovereign's institutional set-up as generally strong, aided by benefits Slovenia draws from its EU/EMU membership, which, apart from access to the single market as well as broad and deep capital markets, also includes comprehensive EU level funding. An ongoing fragmented political landscape as witnessed over the recent past may well continue to pose challenges to a stable political backdrop, which we would consider a balancing factor to the abovementioned strengths. This could potentially delay key reforms, inter alia related to pensions and healthcare. We will thus closely monitor developments around the upcoming parliamentary election in April.

With regard to the latest set of the World Bank's Worldwide Governance Indicators (WGIs), which we consider to be key gauges as far as the institutional framework is concerned, the sovereign's perceived performance is by and large in line with the median of the euro area members. That said, there is some underperformance when it comes to the indicator referring to freedom of expression and a free media (voice and accountability). We also note that the respective indicator has clouded somewhat since 2017 (rank 40/204, 2020: 46/208). Tying in with some perceived deterioration in voice and accountability, the EC's latest Rule of Law Report (Jul-21) expressed concern as regards the situation of media freedom and pluralism.

Moreover, we observe that the indicator pertaining to the perceived quality of policy formulation and implementation (government effectiveness) has continued its positive trend witnessed over the last few years, most recently climbing to relative rank 31 out of 209 economies in 2020, corresponding to the best result since inception of the series in 1996. While Slovenia slipped by one rank to 35/209 in 2020 as regards the WGI rule of law, we would stress an improving tendency over the last few years. When it comes to control of corruption, we highlight the impression of clear progress in this regard over a longer period, while the respective indicator points to some deterioration in the relative ranking as regards 2020.

The sovereign appears to have made some headway in terms of the prevention and combat of corruption, although displaying some scope for improvement relating to the enforcement of rules around this issue, as well as relating to limited human resources in this area. With regard to combating money laundering and terrorist financing, the latest Moneyval Report (Apr-21) confirms meaningful further advancements, attesting to improved compliance in a number of areas, including regulations concerning non-profit organizations, correspondent banking relationships and politically exposed persons. Still, dealing with virtual currencies remains a challenge, according to the report. The sovereign remains in the process of enhanced follow-up by Moneyval.

We also observe some positive developments regarding the Slovenian justice system, especially concerning judicial independence, while some challenges persist, including the timely appointment of state prosecutors and the timely nomination of European Delegated Prosecutors. In this context, we are aware that the EC has repeatedly expressed its concern over delays in finalizing national procedures for the nomination and delays in submitting the names of the selected persons to the European Public Prosecutor's Office last year.

Over the last decade, Slovenia's political environment has been characterized by a considerable and rising degree of fragmentation, as underscored by a second minority government, as well as by current polls ahead of the parliamentary election likely to be held in April. SDS, which runs the current minority government, remains in the lead, but with a share of the vote of only roughly 26% at the time of writing would have to try, and form a coalition. Given that apart from SD other parties poll at 12% or less currently, this may prove challenging. Uncertainty over government stability thus seems likely to persist for the time being. Several no-confidence motions, although unsuccessful, may serve as a case in point.

With regard to reforms and initiatives presented with the RRP, the government established the Recovery and Resilience Office in Jun-21, which will coordinate the implementation of the RRP, operating under the Ministry of Finance. The plan's main focus is on the environmental transition, given that about 42% of the allocated funds will be directed towards environmental objectives, including upgrades to and decarbonizing of railway infrastructure, as well as the financing of energy-efficient buildings. Roughly 21% of the funding is meant to boost the digital transformation including enhancing the corresponding skills.

To this end, the government also launched the Strategic Council for Digitalization (SCD) in April 2021. In June last year, the SCD presented an initial package of 40 measures to foster the digitization of the public administration, healthcare system, economy, and the education system. Related to this are proposals to improve cybersecurity, especially with regard to virtual currencies, which may address some of the concerns identified in the abovementioned Moneyval report.

Other main reforms which the government is working toward following some perceived, partly pandemic-related, slowdown in progress, include the recently adopted long-term care act, as well as a healthcare and a pension reform. While the long-term care act, which is to establish a respective care system as a new pillar of social security through the integration of social and health services, was adopted by the National Assembly in Dec-21, its implementation is to be finalized by the end of 2022, with all rights under this new framework to be gradually introduced by 2025. A pension reform aiming to ensure sustainability of the pension system is envisaged to be adopted by end of 2024, by which time the most important milestones for the healthcare system reform are to be in place as well.

We will continue to monitor developments as regards cutting red tape and easing the still heavy administrative burden. The first De-bureaucratization Act put forward by the government in Mar-21 and amended several times, was adopted by the National Assembly in Dec-21. Associated measures aim to facilitate access to public services and eliminate certain administrative obstacles, thus simplifying bureaucratic procedures. Among other things, this would concern official legal and personal registers, electronic delivery of official documents and the powers of state secretaries. Ultimately, this broad-based overhaul may also prove conducive to effectively implementing the RRP reforms. In this vein, progress made regarding improvement of administrative capacities in public investment management should have a positive effect as well, alongside efforts to simplify public procurement and increase transparency thereof, adopted by parliament in Jul-21. In the area of competition and regulation, the insolvency framework is being strengthened.

In terms of greening the economy, drawing on the EC's latest Eco-innovation index, Slovenia occupies a middle-range position among the fellow EU members. At 24.1% (2020, preliminary data, Eurostat), its overall share of energy from renewable sources has increased lately (2019: 22.0%), moving in the upper middle-range among EU countries in this respect (EU as a whole: 22.1%). By the same token, its level of greenhouse gas (GHG) emissions per head, which in 2019 came to 8.2 tons of CO2 equivalent, continues a gradual downward trend. As also set out in the National Energy and Climate Plan (NEPN, Feb-20), while aiming to become climate neutral by 2050, key objectives for 2030 include e.g. a reduction of total GHG emissions by 36% compared to 2005, and a 27% share of renewable energy sources in gross final energy use.

Fiscal Sustainability

While the Covid-19 pandemic has led to a significant deterioration of fiscal metrics, a convincing track record of fiscal consolidation following the global financial and the national banking crisis, as well as a comparatively favorable starting position when the corona crisis hit generally underpin our confidence in sustainable Slovenian public finances over the medium term. While we expect the public debt ratio to decrease over the next few years, there is some uncertainty about the extent to which authorities will be able to cut back on the currently elevated debt level. In any case, we continue to view sound debt management and high debt affordability alongside comfortable cash buffers, as material factors mitigating fiscal risks. Whilst respective reforms were envisaged in the RRP, projections for a strong increase of age-related cost highlight that demographic developments will put pressure on public finances, if not addressed decisively and in a timely manner.

Following a phase of progressing budget consolidation, with the general government balance showing a small surplus in the years 2018 and 2019, the pandemic caused Slovenia's headline balance to swing into a large deficit in 2020 (-7.7% of GDP, EA: -7.2%), exceeding that of most CEE peers, amid soaring expenditure (2020: +14.8%) and contracting revenue (2020: -3.4%).

Expenditure continued to increase strongly in 2021, as suggested by preliminary state-level data published by the Ministry of Finance (MoF, +13.6%), and to a great extent still driven by Covid-19 related investment and labor costs. At the same time, state-level revenue showed a strong positive rebound over last year (+23.1%), coming on the back of vivid economic recovery, which saw tax revenue and social contributions mount, and of the expiry of important crisis-mitigating measures. With regard to 2021 as a whole, provisional MoF figures suggest that the general government deficit narrowed to about 6.1% of GDP, which represents a markedly better result than assumed in the Draft Budgetary Plan 2022 (DBP22, -7.5% of GDP). The impact of Covid-19 expenditure measures on the state budget outturn came to about EUR 2.8bn (6.0% of 2020 GDP, Fiscal Council data), including higher public sector wage supplements and extensions of some support initiatives.

Turning to the current year, the headline balance remains affected by the fallout from the pandemic, with pronounced uncertainty in this regard still remaining. The estimated budgetary impact of crisis-related measures comes to roughly EUR 169mn (0.4% of 2020 GDP, DBP22). While the DBP22 does not include any new discretionary measures apart from the prolonged temporary Covid-19 measures for 2022, the most recent support package adopted by parliament in Dec-21, coming to about EUR 280mn in measures, will likely add to fiscal costs. Underscoring the aforementioned uncertainty, we would also flag the possibility of required further support amid the spread of new virus variants which could challenge vaccine efficacy.

In addition to this, we would continue to monitor developments around debated changes to the tax system (i.e. personal income tax, capital gains tax, rental income), which could potentially have a deficit-increasing impact going forward. Given our expectation of an ongoing economic recovery and the expiry of some of the Covid-19 measures, we expect the deficit to shrink further this year, reaching roughly 4.5% of GDP in 2022.

With a view to the medium term, the government expects the deficit to fall to below 3% of GDP from 2024 (DBP22), which we consider feasible, although uncertainty over the evolution of the coronavirus and the related vaccination efficacy could result in some delay in this respect. Apart from that, we are also aware of the Fiscal Council having expressed caution over the planned deficit reduction in 2023, pointing to the insufficient specification of measures to achieve an envisaged growth reduction of current expenditure. Looking at planned general government investment, the targeted level of approximately 7% of GDP in 2022 and an apparently intended investment ratio not too far below that over the coming few years might be characterized as ambitious.

From a comparatively moderate level compared to the euro area in 2019 (65.6%, EA: 83.6%), Slovenia's debt-to-GDP ratio leapt to 79.8% in 2020, still well below the level recorded in the EMU (97.3%) but remaining rather high in comparison with CEE peers. First MoF estimates suggest that the public debt ratio stood at 77.5% of GDP at the end of 2021, a level which the government had expected to reach only in 2022 at the time of presenting its DBP22. Against the backdrop of our expectations regarding an ongoing economic recovery and a smaller deficit, the debt level should continue to trend downward over the next few years. We would tentatively pencil in a debt-to-GDP ratio of 75.8% for 2022.

Contingent liability risks related to public guarantees seem to be on the retreat, as the latter are forecast to shrink to 8.3% of GDP in 2022, from an estimated 9.6% of GDP in 2021 (DBP22), and 11.0% in 2020 (SP21). Nevertheless, we would continue to monitor developments here, given the spread of the Omicron virus mutation and possibly required support measures for economic actors.

Having said this, we note that the asset quality of the Slovenian banking sector remains on an improving path, with the NPE ratio having decreased to 2.0% in Q2-21, matching the average EU level (EBA data). However, in light of stage 2 loans and advances with non-expired moratoria having accounted for a share of 57.4% as of Q2-21, more than tripling vis-à-vis Q2-20 (17.2%, EBA), we would keep an eye on developments here. BSI in December 2021 noted that the share of exposure with increased credit risk was again rising in certain sectors, most notably in services. We would also mention that according to BSI the NPE ratio for the whole Slovenian banking system dropped to 1.4% as of Jun-21.The banking sector's capitalization as measured by the CET1 ratio has trended down over recent years. At 15.7% in Q2-21 it is almost on par with the respective EU average (Q2-21: 15.8%, EBA). Drawing on IMF data, the CET1 ratio for the whole banking sector was at 17.0% as of Q2-21, comparing relatively low among CEE peers. Profitability as expressed by return on assets (Q2-21: 1.2%, EBA), on the other hand, compares by and large favorably against these peers, remaining well above the EU level as well.

As mentioned above, private indebtedness appears moderate, with the ratio of household debt to disposable income at 42.6% as of Q2-21 (ECB data). We would nevertheless highlight that outstanding mortgage loans to households have increased significantly, standing at +8.6% y-o-y as of Nov-21 (Nov-20: +4.1%). In this context, we also pay attention to increasing dynamics as regards house prices. Drawing on Eurostat data, the annual increase in house prices went up to 9.9% in Q2-21 (Q2-20: 3.3%). The price level is thus well exceeding peak levels of 2008 (Eurostat).

Having said this, affordability indicators such as the price-to-income ratio do not seem to hint at overly-stretched valuations (OECD data). Rather, we would once more point to likely persisting pressure on house prices amid continued income convergence towards EU levels, possibly paired with more lasting higher demand for more spacious accommodation, as working from home may be becoming more entrenched as a result of the corona crisis.

Potentially finalizing bank restructuring activities following the 2013 banking crisis, we understand that, subject to regulatory approval, the Hungarian OTP Group seeks to acquire Nova KBM, which would then become the largest bank in Slovenia, with the completion of the deal envisaged for Q2-22. A merger of Nova KBM and Abanka had been concluded in Sep-20.

We would reiterate a comfortable cash buffer (11.2% of GDP as of Q4-21, MoF), a smooth redemption profile, and a well-diversified investor base as a result of ongoing sound debt management as mitigating factors as far as fiscal risks are concerned. Moreover, a relatively long average weighted maturity of the general government debt portfolio, coming to 9.6y as of Nov-21 (ECB), reduces refinancing risks, while the ECB's accommodative monetary policy adds to favorable market conditions and continued high debt affordability. In 2021, interest payments declined by 5.8% y-o-y (preliminary, MoF), following a reduction by 9.1% to 1.6% of GDP in 2020 (3.7% of total general government revenue in 2020). In Dec-21, the ECB decided to temporarily increase its net purchases under the APP, following the intended termination of net purchases under the PEPP in Mar-22, in order to smooth the transition. An interest rate rise still seems unlikely for 2022, although developments will have to be monitored.

As of Nov-21, the ECB had bought Slovenian government bonds amounting to a cumulative EUR 6.1bn, or 13.1% of 2020 GDP under its PEPP. Adding to this, cumulative net purchases under the APP came to about EUR 10.3bn (22.1% of 2020 GDP) as of Dec-21. Together, ECB holdings account for a sizable 49.7% of Slovenian debt securities (2020 level) in volume terms. Taking advantage of the favorable financing costs, Slovenia issued a 4-year bond of EUR 1.25bn, achieving a historically low yield to maturity of -0.241%, and a 40-year bond of EUR 500mn, with a yield of 1.183%, on 5 January 2022. Both were very well-received and underscore forward-looking debt management.

Longer-term fiscal risks stemming from projected demographic developments and related costs continue to weigh on our assessment of the sovereign's creditworthiness, unless we observe tangible progress on the pension reform. Drawing on estimates included in the 2021 EU Ageing Report, Slovenian age-related costs could see a relatively strong increase by 2040, and even stronger beyond that horizon, which seems to highlight the necessity for making the pension system more sustainable, as pension costs are likely to be the major drivers. Any delays from implementing the abovementioned long-term-care act could potentially add to fiscal pressure here.

Foreign Exposure

Notwithstanding vulnerabilities associated with the high degree of openness of Slovenia's relatively small economy, we continue to assess Slovenia's external position as generally solid. Persistently high current account surpluses have contributed to a significant improvement of the negative net international investment position (NIIP) over the last ten years. Going forward, the surplus may narrow amid the domestic demand-induced strong import growth.

Slovenia's current account surplus, which averaged 5.4% of GDP over the period 2015-19, rose further to 7.4% of GDP in 2020 (2019: 6.0% of GDP), corresponding to one of the highest positive positions among the EU members. The increase was primarily driven by a higher goods surplus (+2.3 p.p. to 5.0% of GDP) amid collapsing imports, also due to falling oil imports, whereas exports contracted by a considerably smaller margin. Muted tourism had the surplus in the services balance shrink by 1.7 p.p. to 4.3% of GDP.

More recent data corroborate our assumption of a narrowing current account surplus in 2021. Measured as a four-quarter moving sum, the current account position amounted to 6.3% of GDP as of Q2-21. Looking further into the current year and slightly beyond, we expect the external surplus to narrow further in view of structurally strengthened domestic demand given presumably vivid investment activity. Nevertheless, export growth should still contribute to keeping the current account balance in surplus, especially when tourism numbers recover more sustainably, which would continue to foster improvement of Slovenia's negative NIIP. The latter has narrowed by 0.7 p.p. to -15.2% of GDP in 2020, coming from -44.0% of GDP in 2012, and further into single-digit territory as measured against GDP as of late (Q2-21: -7.5% of GDP) – for the first time since 2005.

Rating Outlook and Sensitivity

Our rating outlook on the Republic of Slovenia is stable. Downside risks to the macroeconomic performance in the short term are balanced by a favorable medium-term perspective, and we consider moderate risks to fiscal sustainability to be somewhat mitigated by the factors elaborated above. Nevertheless, we have to highlight that the assessment and forecast of economic development remains much more challenging due to the still high degree of Covid-19-related uncertainty, as is the case for other metrics.

We could raise the sovereign's credit ratings or the outlook, if the Slovenian economy continues to outperform our growth expectations, thus accelerating income convergence towards the EU-level, or if public debt clearly resumes a sustainable downward path. We could also consider a positive rating action if there is significant progress in addressing unfavorable demographic prospects and related costs, leading to a higher degree of conviction in the sustainability of the pension and healthcare systems. Political stability would continue to seem conducive to such a scenario materializing.

A negative rating action could be prompted if medium-term economic growth falls short of our expectations, which might be the case in a scenario of insufficient immunization against Covid-19 or lack of vaccine effectiveness, requiring renewed restrictions, thus hampering economic developments. We could also contemplate a downgrade of Slovenia's rating or of the outlook if fiscal metrics continue to deteriorate, possibly against the backdrop of a less favorable macroeconomic scenario as described above, imposing other policy priorities, or in case of slower or less-effective-than-expected implementation of envisaged NGEU-related investment and initiatives.

Analysts

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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

ESG Factor Box

Environ-mental Quality	Ecological Risks	Ressource Management	Education	Health	**Demo-graphics**
Labor	Equality	Technology & Infrastructure	Safety & Security	**Judicial system**	**Quality of Public Services**
Integrity of Public Officials	Quality and Efficacy of Regulations	**Civil Liber-ties/ Political Participation**	Market Access	Business Environment	Data Transparency

Environment	**Social**	**Governance**	**Highly significant**	**Significant**	**Less significant**	**Hardly significant**

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 what follows, we explain how and to which 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 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.

Economic Data

[in %, otherwise noted]	2016	2017	2018	2019	2020	2021e	2022e
Macroeconomic Performance							
Real GDP growth	3.2	4.8	4.4	3.3	-4.2	7.0	3.9
GDP per capita (PPP, USD)	33,947	36,680	39,199	40,919	39,378	43,206	46,281
Credit to the private sector/GDP	48.4	47.6	45.5	44.9	45.8	n/a	n/a
Unemployment rate	8.0	6.6	5.1	4.5	5.0	n/a	n/a
Real unit labor costs (index 2015=100)	100.9	100.6	101.2	103.1	109.4	n/a	n/a
Ease of doing business (score)	75.4	76.4	76.4	76.5	n/a	n/a	n/a
Life expectancy at birth (years)	81.2	81.2	81.5	81.6	80.6	n/a	n/a
Institutional Structure							
WGI Rule of Law (score)	1.1	1.0	1.1	1.1	1.1	n/a	n/a
WGI Control of Corruption (score)	0.8	0.8	0.9	0.9	0.8	n/a	n/a
WGI Voice and Accountability (score)	1.0	1.0	1.0	1.0	0.9	n/a	n/a
WGI Government Effectiveness (score)	1.1	1.2	1.1	1.1	1.2	n/a	n/a
HICP inflation rate, y-o-y change	-0.2	1.6	1.9	1.7	-0.3	2.0	3.5
GHG emissions (tons of CO2 equivalent p.c.)	8.6	8.6	8.5	8.2	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
Fiscal Sustainability							
Fiscal balance/GDP	-1.9	-0.1	0.7	0.4	-7.7	-6.1	-4.5
General government gross debt/GDP	78.5	74.2	70.3	65.6	79.8	77.5	75.8
Interest/revenue	6.9	5.7	4.6	3.9	3.7	n/a	n/a
Debt/revenue	177.5	168.5	158.9	149.9	182.9	n/a	n/a
Weighted average maturity of debt (years)	8.0	9.3	9.2	9.0	9.0	n/a	n/a
Foreign exposure							
Current account balance/GDP	4.8	6.2	6.0	6.0	7.4	n/a	n/a
International reserves/imports	0.0	0.0	0.0	0.0	0.0	n/a	n/a
NIIP/GDP	-28.8	-24.2	-18.9	-15.9	-15.2	n/a	n/a
External debt/GDP	109.6	100.5	91.9	91.5	101.9	n/a	n/a

Sources: IMF, World Bank, Eurostat, AMECO, ECB, SiStat, MoF, 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

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, European Investment Bank, Blavatnik School of Government, ECDC, Bank of Slovenia, Ministry of Finance, Fiscal Council, Statistical Office of the Republic of Slovenia (SiStat), Slovenian Sovereign Holding (SSH), Bank Assets Management Company (BAMC), World Travel and Tourism Council.

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.

Disclaimer

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