Euler Hermes Economic Research

Country Risk Analysis

# Slovenia

# Next candidate for a bailout ?

## General Information

| | |
|---|---|
| **GDP** | USD49.5bn (World ranking 76, World Bank 2011) |
| **Population** | 2.05 million (World ranking 145, World Bank 2011) |
| **Form of state** | Parliamentary Republic |
| **Head of government** | Alenka BRATUSEK |
| **Next elections** | 2015, legislative |

## Strengths

- Stable democracy and fairly good regional and international relations; EU membership
- Adequate inflation
- Current account surplus in 2012, also forecast for 2013-2014
- Strong business environment

## Weaknesses

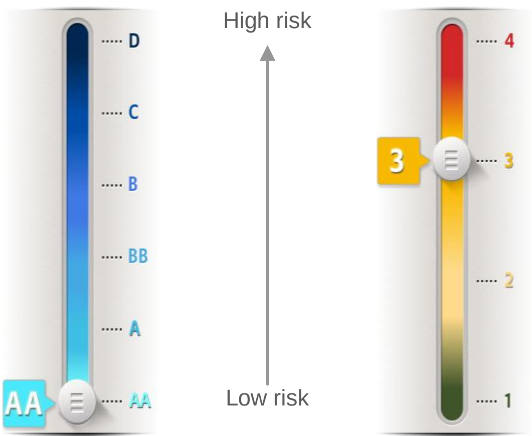
- Government instability and policy ineffectiveness at a critical time as global and domestic economic environments require effective policymaking
- Very weak domestic demand and subdued external demand have led to renewed recession
- Rapidly deteriorated fiscal position since 2009
- Banking sector needs substantial recapitalisation
- Negative loop between protracted recession, weak corporate balance sheets, banking sector distress and fiscal consolidation have taken Slovenia on the brink of financial crisis
- High gross external debt

## Country Rating

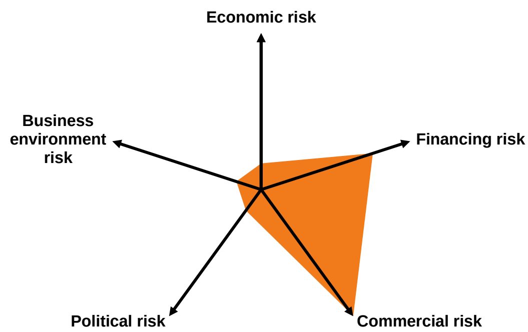
AA3

### Country Grade

### Country Risk Level

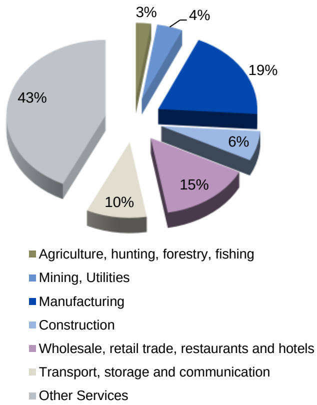



## Risk Dimensions



## Economic Structure

### GDP breakdown (% of total, 2010)




Sources: Chelem, IHS Global Insight, Euler Hermes

### Trade structure (% of total, 2010)

By destination/origin

| Exports | | Rank | | Imports |
|---|---|---|---|---|
| Germany | 21% | 1 | 18% | Germany |
| Italy | 12% | 2 | 17% | Italy |
| France | 8% | 3 | 11% | Austria |
| Austria | 7% | 4 | 5% | France |
| Croatia | 6% | 5 | 5% | China |

By product

| Exports | | Rank | | Imports |
|---|---|---|---|---|
| Cars And Cycles | 9% | 1 | 7% | Refined Petroleum Products |
| Pharmaceuticals | 9% | 2 | 5% | Cars And Cycles |
| Miscellaneous Hardware | 5% | 3 | 4% | Plastic Articles |
| Domestic Electrical Appliance: | 5% | 4 | 4% | Iron Steel |
| Electrical Apparatus | 5% | 5 | 4% | Vehicles Components |

## Economic Forecasts

| | Average 2000-08 | 2009 | 2010 | 2011 | 2012 | 2013f | 2014f |
|---|---|---|---|---|---|---|---|
| GDP growth (% change) | 4.4 | -7.8 | 1.2 | 0.6 | -2.3 | -3.0 | -0.5 |
| Inflation (%, end-year) | 4.9 | 1.8 | 1.8 | 2.1 | 2.7 | 2.8 | 1.6 |
| | | | | | | | |
| Fiscal balance (% of GDP) | -0.9 | -5.5 | -5.3 | -5.6 | -4.0 | -5.3 | -4.9 |
| Public debt (% of GDP) | 26.7 | 35.0 | 38.6 | 46.9 | 54.1 | 61.0 | 66.5 |
| | | | | | | | |
| Current account (% of GDP) | -2.3 | -0.7 | -0.6 | 0.0 | 2.5 | 1.5 | 1.0 |
| External debt (% of GDP) | 70.5 | 117.5 | 115.3 | 107.0 | 114.6 | 111.5 | 114.5 |

Sources: IHS Global Insight, national sources, Euler Hermes

## Economic Growth

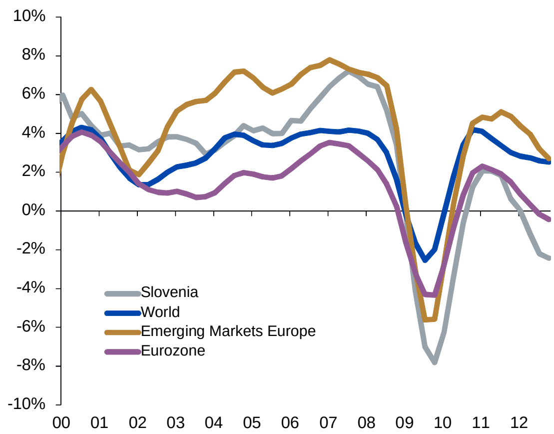
### The economy is firmly back into recession

Following the deep recession that saw real GDP contracting by -7.8% in 2009, the economy grew by just +1.2% in 2010 and +0.6% in 2011, and shifted back to a -2.3% contraction in 2012. Domestic demand was particularly weak in 2012, with private consumption falling by -2.9%, public consumption -1.6% and fixed investment -9.3%. Moreover, inventories subtracted -1.9pps from overall growth. Imports were also dragged down by domestic demand, falling -4.3%, while exports increased by a meagre +0.3%, such that net exports (+3.3pps) prevented an even deeper contraction. We expect the economy to remain in recession until at least mid-2014, declining by about -3% in full year 2013 and -0.5% in 2014. However, the balance of risks to this forecast is more to the downside, as a financial crisis and a potential EU/IMF bailout are looming, with potential adverse effects on public finances and growth potential.

### Most sectors declined in 2012

Value added declined in agriculture (-5.8%), manufacturing (-0.9%), construction (-11.6%) and in all major service sectors. Within the manufacturing sector, only computer & optical products (+7.2%), machinery & equipment (+2.8%) and basic metals (+2.4%) recorded noteworthy real turnover growth, while foodstuff (-5%), wood and paper (-4%), chemicals (-6.6%), rubber & plastic (-7%), furniture (-13%), automotive (-9.8%) and other transport equipment (-24.1%) contracted sharply.

### GDP growth (% y/y, 4 qtrs cumulated)



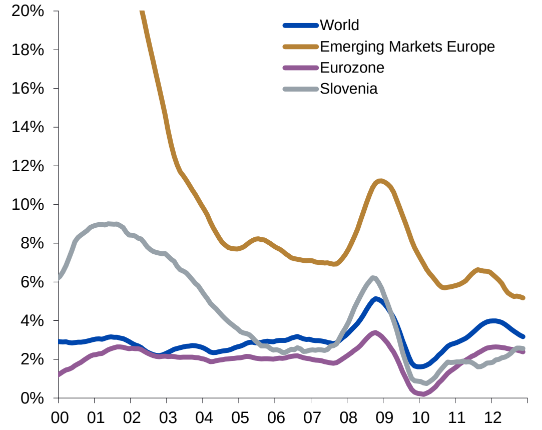

Sources: IHS Global Insight, national sources, Euler Hermes

# Economic Policies

## Inflation is adequate

Upward inflationary pressures stemming from higher international energy and food prices and tax rises are largely compensated for by depressed domestic demand and tight credit conditions. Headline inflation picked up to a temporary peak of 3.3% y/y in September 2012, owing to the introduction of some new excise taxes in mid-2012, but has since fallen to 2% y/y in March 2013. The 12-month average price growth picked up from 1.8% in 2011 to 2.6% in 2012 and is forecast to remain below 3% until end-2013.

Inflation rate (%)

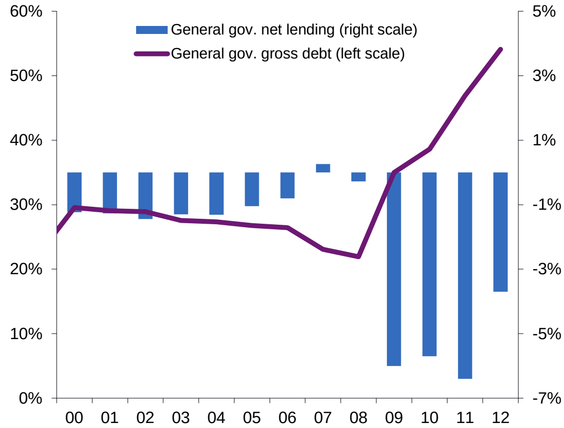



Sources: IHS Global Insight, national sources, Euler Hermes

## The fiscal position has rapidly deteriorated

Budgetary policy was reasonably sound in the past, reflected in annual fiscal deficits of less than 3% of GDP (ESA-95 standard) in 2002-2008. Public debt had fallen to 22% of GDP in 2008. As a result of recession-related lower revenues and several crisis-related supplementary budgets, however, the annual fiscal deficit rose sharply to around 6% of GDP in 2009-2011. The deficit narrowed to 4% in 2012 as some austerity measures were implemented. Slovenia is subject to the EU's Excessive Deficit Procedure. Total public debt has increased rapidly to 54.1% of GDP in 2012. For 2013, a fiscal deficit of 5.3% of GDP and public debt of 61% of GDP are projected, with both figures including capital injections into banks in Q1 2013 equivalent to 1.2% of GDP.

Fiscal balance and public debt (% of GDP)




Sources: IHS Global Insight, national sources, Euler Hermes

## Rising risk that an EU/IMF bailout is needed

The fiscal position looks even more worrisome with regard to the rising risk that a government bailout of the increasingly vulnerable banking sector will be required at some point, which itself may trigger an EU/IMF bailout of the sovereign. A recapitalisation of major banks (see below for details on the banking sector) by the government is likely to impair fiscal sustainability further. Sovereign funding costs have already risen, not least because international credit rating agencies have downgraded Slovenia's sovereign risk rating several times over the past one and a half years. In view of the increased funding costs and the contingent liabilities from the banking sector, public debt is likely to increase more rapidly than anticipated so far, probably exceeding 70% of GDP in 2013. All of this indicates a growing likelihood that Slovenia may require a bailout by the EU/IMF at some point.

## The banking sector needs substantial recapitalisation

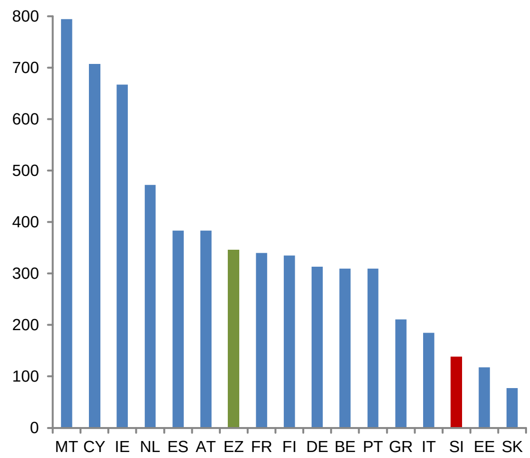
Initially Slovenian banks withstood the impact of the 2008-2009 global financial crisis relatively well, thanks to limited exposure to structured financial products and other toxic assets, the modest level of household debt (about 30% of GDP) and financial stability measures adopted by the authorities at that time. Private sector credit growth decelerated from a relatively high 33% in H2 2007 to 17% at end-2008 and just 3% at end-2009, and shifted into negative in H2 2011. However, the persistent economic downturn since 2009 (the lack of recovery from the deep recession in 2009) has led to a rapid accumulation of non-performing loans (NPLs) in the Slovenian banking sector as a growing number of companies has been unable to repay or roll-over credits, especially in the badly affected and highly leveraged construction and real estate sectors. According to the IMF, the share of NPLs in total gross loans has increased rapidly from 5.8% at end-2009 to 8.2% at end-2010, 11.8% at end-2011 and 15.2% (about EUR6bn) at end-2012. Banks' profitability and capital adequacy have continued to decline consequently.

## Economic Policies (continued)

The three largest banks saw their NPLs ratio increase from 16% in 2011 to 21% in 2012, with about one third of their corporate loans non-performing. Meanwhile a recapitalisation of major banks appears inevitable, with the required capital support estimated at EUR1bn (3% of GDP) in 2013. If economic conditions deteriorate further, the need for capital could rise by further EUR2bn beyond 2013. The burden of this will largely fall on the government which still owns a majority in each of the three largest banks which together control about half of total banking assets. As a result, the balance of risks to the above mentioned forecast ratios of fiscal deficit (5.3%) and public debt (61%) to GDP in 2013 is firmly to the downside.

It should be noted, however, that the Slovenian banking sector is comparatively small. Banks' total assets as a percentage of GDP stood at 138% at end-2011, as compared to 346% for the eurozone average and 707% for Cyprus (latest figures).

**Total banking sector assets (% of GDP)**




Sources: ECB, Eurostat, Euler Hermes

## External Sector

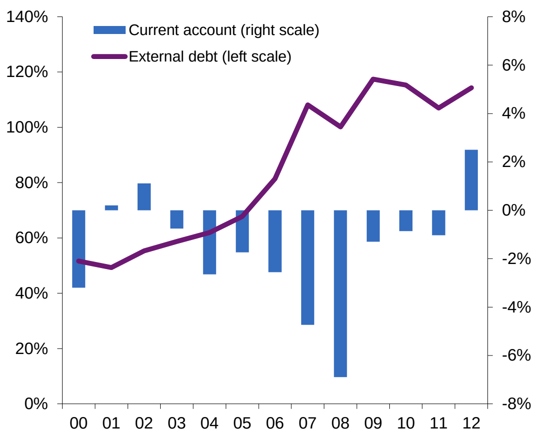
### Current account will remain in surplus

The current account balance shifted from small annual deficits during 2009-2011 to a surplus of 2.5% of GDP in 2012 as imports were suppressed by weak domestic demand. We expect continued, albeit smaller surpluses in 2013-2014. Net foreign direct investment inflows remained positive in 2012, but narrowed to 0.6% of GDP from 1.8% in 2011. Moreover, large net portfolio investment inflows during 2009-2011 were discontinued in 2012 which saw a small net outflow (0.2% of GDP).

### External debt burden is high

Gross external debt stood at EUR40.6bn at end-2012, equivalent to about 115% of GDP and 153% of annual export earnings. Short-term external debt accounted for about 26% of gross debt (EUR10.4bn at end-2012). As around 65% of gross external liabilities were balanced by gross external assets, net external debt stood at an estimated 40% of GDP (EUR14.3bn) at end-2012. While this ratio appears more favourable, it should be noted that it has picked up from 37% (EUR13.3bn) at end-2011. Moreover, in 2004 Slovenia was still a net external creditor.

**Current account and external debt (% of GDP)**




Sources: IHS Global Insight, national sources, Euler Hermes





Contact Euler Hermes Economic Research Team
research@eulerhermes.com

Latest review: 2013-04-08
Country Risk Analyst:
Manfred Stamer
manfred.stamer@eulerhermes.com