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Assessment of the 2018 Stability Programme for

Slovenia

(Note prepared by DG ECFIN staff)

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1. INTRODUCTION

On 26 April 2018, Slovenia submitted its 2018 Stability Programme (hereafter called Stability Programme), covering the period 2018-2021. The programme provides a no-policy-change scenario as it is presented by the outgoing government, ahead of the elections foreseen on 3 June 2018. In the Stability Programme the authorities recognise the need to take further measures in order to ensure compliance with the applicable fiscal rules.

Slovenia is currently subject to the preventive arm of the the Stability and Growth Pact (SGP) and should ensure sufficient progress towards its Medium-Term Budgetary Objective (MTO) of a surplus of 0.25%. As the debt ratio was 82.6% of GDP in 2015 (the year in which Slovenia corrected its excessive deficit), exceeding the 60% of GDP reference value, Slovenia is also subject to transitional arrangements as regards compliance with the debt reduction benchmark during the three years following the correction of the excessive deficit (transitional debt rule). In this period it should ensure sufficient progress towards compliance with the debt reduction benchmark. After the transition period, as of 2019, Slovenia is expected to comply with the debt reduction benchmark.

This document complements the Country Report published on 7 March 2018 and updates it with the information included in the Stability Programme.

Section 2 presents the macroeconomic outlook underlying the Stability Programme and provides an assessment based on the Commission 2018 spring forecast. The following section presents the recent and planned budgetary developments, according to the Stability Programme. In particular, it includes an overview on the medium term budgetary plans, an assessment of the measures underpinning the Stability Programme and a risk analysis of the budgetary plans based on the Commission spring forecast. Section 4 assesses compliance with the rules of the SGP, including on the basis of the Commission forecast. Section 5 provides an overview on long term sustainability risks and Section 6 on recent developments and plans regarding the fiscal framework. Section 7 provides a summary.

2. MACROECONOMIC DEVELOPMENTS

Slovenia's real GDP grew by 5.0% in 2017, up from 3.1% in 2016. Growth was broad-based. Domestic demand expanded robustly, driven by a 10.3% increase in investment, despite a slight fall in public investment. Private consumption also increased by 3.2% helped by growing disposable income. Net exports contributed positively to growth (1.3 percentage points), with exports growth (10.6%) outpacing imports growth (10.1%). Employment grew by 2.8%, bringing the unemployment rate down to 6.6% from 8.0% in 2016.

In 2018, the Stability Programme projects real GDP growth to reach 5.1%, with a stronger contribution from domestic demand than in 2017. Investment is expected to continue to grow strongly at 10%, helped by a recovery in public investment (25.7%), driven by the increased absorption of EU funds. Exports and imports are forecast to grow, at 9.2% and 9.3% respectively, still implying a significantly positive contribution to growth from net exports (0.9 percentage points) due to the higher level of exports. In 2019, growth is expected to slow down to 3.8% as investment growth decelerates somewhat (8.5%) and the positive contribution of net exports declines to 0.3 percentage points.

In the Stability Programme, the labour market is expected to tighten over the forecast horizon with the unemployment rate falling to 4.0% in 2021, below the historical low of 4.4% recorded in 2008. Compensation per employee is expected to increase at around 5% per year over the period with inflation gradually increasing from 1.6% in 2017 to 2.3% in 2020 and 2021.

The growth forecast has been revised upwards compared to the previous forecast. The 2017 Stability Programme forecasted real GDP growth in 2018 at 3.2%. The forecast was already increased to 3.9% in the Draft Budgetary Plan. The upward revision is based on the better than expected outcome for 2017, and in particular, the strong last quarter of the year, entailing a strong carry over for 2018 (6.2% y-o-y). In particular, investment and net exports are expected to contribute more than forecast in the Stability programme 2017.

The Stability Programme macroeconomic outlook for 2018-2019 is slightly more dynamic than the Commission 2018 spring forecast. For 2018, the Commission expects growth at 4.7%, i.e. 0.4 percentage points lower than in the Stability Programme. For 2019, the difference between the two forecasts is reduced to 0.2pp, with the Commission expecting real GDP growth at 3.6% compared with 3.8% in the Stability Programme. The composition of growth is slightly different, since the Commission 2018 spring forecast expects a stronger contribution from domestic demand in both years on the back of stronger growth of private consumption, while the contribution of net exports is expected to be lower. The forecasts for employment growth are very close for both 2018 and 2019. Compensation per employee is expected to grow significantly less in the Commission spring forecast than in the Stability Programme in 2018 (3.9% vs. 5.2%) and slightly less in 2019 (4.8% vs. 5.1%). The GDP deflator is instead expected to grow somewhat faster in the Commission forecast in both 2018 (2.6% vs. 2.4% in the Stability Programme) and 2019 (2.7% vs. 2.6% in the Stability Programme).

The output gap, as recalculated by the Commission based on the information in the programme following the commonly agreed methodology[1], is estimated to be positive already

[1] The output gap estimates in the Stability Programme are not taken at face value; instead they are recalculated using the commonly agreed production function methodology on the basis of the Stability Programme forecast.

in 2017, at 1.3% of potential GDP, and is projected to increase to 3.2% in 2018 and thereafter decline to 3.5% in 2019. As calculated by the national authorities in the Stability Programme, the output gap is estimated to have been negative at 0.3% of potential GDP in 2017 and is expected to turn positive in 2018 (2%) and further increasing to 2.7% in 2019.

The plausibility tool developed by the Commission in consultation with the Member States points to a high degree of uncertainty surrounding the output gap estimates for Slovenia provided by the commonly agreed methodology. The analysis based on the constrained judgement approach can be found in Box 2 in section 4.

Overall, the Stability Programme is based on plausible macroeconomic assumptions.

Table 1: Comparison of macroeconomic developments and forecasts

	2017		2018		2019		2020	2021
	COM	SP	COM	SP	COM	SP	SP	SP
Real GDP (% change)	5.0	5.0	4.7	5.1	3.6	3.8	3.2	3.0
Private consumption (% change)	3.2	3.2	4.1	3.6	4.1	3.0	2.0	2.0
Gross fixed capital formation (% change)	10.3	10.3	10.1	10.0	9.3	8.5	7.5	7.5
Exports of goods and services (% change)	10.6	10.6	8.1	9.2	6.5	7.5	6.8	5.9
Imports of goods and services (% change)	10.1	10.1	8.9	9.3	8.4	8.1	6.9	6.4
Contributions to real GDP growth:								
- Final domestic demand	3.9	3.9	4.5	4.2	4.4	3.5	2.7	2.8
- Change in inventories	-0.2	-0.2	0.0	0.1	0.0	0.0	0.0	0.0
- Net exports	1.3	1.3	0.2	0.9	-0.8	0.3	0.5	0.2
Output gap[1]	1.4	1.3	3.4	3.2	4.1	3.5	2.6	1.4
Employment (% change)	2.8	2.8	2.3	2.4	1.5	1.5	0.8	0.5
Unemployment rate (%)	6.6	6.6	5.6	5.3	5.4	4.6	4.2	4.0
Labour productivity (% change)	2.2	2.2	2.4	2.7	2.1	2.2	2.4	2.5
HICP inflation (%)	1.6	1.6	1.9	1.5	2.0	1.9	2.3	2.3
GDP deflator (% change)	2.0	2.0	2.6	2.4	2.7	2.6	2.3	2.2
Comp. of employees (per head, % change)	2.8	2.8	3.9	5.2	4.8	5.1	4.7	4.9
Net lending/borrowing vis-à-vis the rest of the world (% of GDP)	6.1	6.1	7.1		6.1			

Note:

[1]In % of potential GDP, with potential GDP growth recalculated by Commission services on the basis of the programme scenario using the commonly agreed methodology.

Source:

Commission 2018 spring forecast (COM); Stability Programme (SP).

3. RECENT AND PLANNED BUDGETARY DEVELOPMENTS

3.1. DEFICIT DEVELOPMENTS IN 2017 AND 2018

In 2017, the Slovenian general government finances were balanced, a significant improvement compared to the headline deficit of -1.9% of GDP in 2016. The deficit reduction was faster than expected in the 2018 Draft Budgetary Plan and the 2017 Stability Programme – in both documents a deficit of 0.8% of GDP was planned for 2017. Broadly two thirds of the difference arises from improved revenues and one third from lower expenditure.

The macroeconomic developments were more favourable in 2017 than expected in the 2017 Stability Programme and in the 2018 Draft Budgetary Plan. This resulted in somewhat higher tax revenues and social contributions than previously foreseen. The largest revision on the revenue outturn compared with the most recent projections arose from the sales and other current revenues (including property income, mainly dividends from the state-owned enterprises, including banks). On the expenditure side, intermediate consumption, interest expenditure, subsidies and investments were lower than expected – in nominal terms and even more as a share of GDP, due to a much stronger than expected growth (i.e. the denominator effect). Social transfers somewhat exceeded expectations.

In 2018, a headline surplus of 0.4% of GDP is projected. This is in line with the Draft Budgetary Plan, while a deficit of 0.2% of GDP was planned in the previous Stability Programme. The projected improvement in the headline balance is however smaller than the change in the cyclical position would imply and therefore the fiscal stance is projected to be looser in 2018. Compared to the Draft Budgetary Plan, revenues as a share of GDP are revised downward, mainly due to lower social contributions and other revenues. The latter are now expected to decline (an increase was projected in the DBP) mainly because of significantly lower property income intakes as dividends from state-owned companies are set to fall. At the same time, expenditure is expected to nominally increase, while falling as a share of GDP compared to the DBP projection. The most important changes concern compensation of employees, social transfers and other current expenditure. The increase in expenditure is connected to the government's non-application of the consolidation measures as foreseen in the Draft Budgetary Plan and more cautious expenditure forecast. In particular, the Draft Budgetary Plan expected that certain temporary measures to contain public sector wages and social allowances (restrictive payments of the bonuses for work performance and the lagged payments related to work promotion, parental leave compensation cap, restriction of the employment incentive for elderly employees, restrictive income eligibility criteria for social scholarships) would be fully or partly extended into 2018. These measures were expected to lower expenditure by 0.4% of GDP but were not implemented before the government resigned.

3.2. MEDIUM-TERM STRATEGY AND TARGETS

The Stability Programme plans an an improvement of the headline surplus, from 0.0% of GDP in 2017 to 0.9% of GDP in 2021.

By 2021, the planned structural deficit (face value in the programme) is expected to be 0.2% of GDP. However, the recalculated[2] structural balance is expected to reach a surplus of 0.2%

[2] Recalculated by the Commission on the basis of the information in the programme according to the commonly agreed methodology.

of GDP. The difference in the recalculation arises from the higher contribution of total factor productivity to potential growth in the final years covered in the Stability Programme.

Table 2: Composition of the budgetary adjustment

(% of GDP)	2017	2018		2019		2020	2021	Change: 2017-2021
	COM	COM	SP	COM	SP	SP	SP	SP
Revenue	**43.1**	**42.3**	**42.3**	**41.8**	**41.7**	**40.8**	**39.8**	**-3.4**
of which:								
- Taxes on production and imports	14.2	13.9	13.9	13.6	13.4	13.1	12.8	-1.4
- Current taxes on income, wealth, etc.	7.4	7.5	7.6	7.5	7.6	7.5	7.5	0.1
- Social contributions	14.7	14.6	14.5	14.6	14.4	14.4	14.4	-0.4
- Other (residual)	6.8	6.3	6.4	6.1	6.3	5.9	5.2	-1.6
Expenditure	**43.1**	**41.8**	**41.9**	**41.5**	**41.5**	**40.2**	**38.9**	**-4.2**
of which:								
- Primary expenditure	40.6	39.8	39.9	39.8	39.8	38.6	37.4	-3.2
of which:								
Compensation of employees	11.1	11.0	11.0	10.9	10.9	10.5	10.2	-0.9
Intermediate consumption	6.3	6.1	5.9	5.9	5.7	5.5	5.4	-1.0
Social payments	16.9	16.3	16.3	16.1	16.1	15.8	15.7	-1.2
Subsidies	0.7	0.7	0.7	0.7	0.7	0.6	0.5	-0.2
Gross fixed capital formation	2.9	3.1	3.4	3.5	3.9	3.7	3.4	0.4
Other (residual)	2.7	2.6	2.6	2.7	2.6	2.5	2.4	-0.3
- Interest expenditure	2.5	2.0	2.0	1.7	1.7	1.6	1.5	-1.0
General government balance (GGB)	**0.0**	**0.5**	**0.4**	**0.4**	**0.2**	**0.6**	**0.9**	**0.9**
Primary balance	**2.5**	**2.5**	**2.4**	**2.0**	**1.9**	**2.2**	**2.3**	**-0.2**
One-off and other temporary	-0.1	-0.1	-0.1	0.0	-0.1	0.0	0.0	0.1
GGB excl. one-offs	**0.1**	**0.6**	**0.4**	**0.4**	**0.2**	**0.6**	**0.9**	**0.8**
Output gap[1]	1.4	3.4	3.2	4.1	3.5	2.6	1.4	0.1
Cyclically-adjusted balance[1]	-0.6	-1.1	-1.2	-1.6	-1.5	-0.7	0.2	0.8
Structural balance[2]	**-0.6**	**-1.1**	**-1.1**	**-1.5**	**-1.4**	**-0.7**	**0.2**	**0.7**
Structural primary balance[2]	1.9	1.0	0.9	0.1	0.3	0.9	1.6	-0.3

Notes:

[1]Output gap (in % of potential GDP) and cyclically-adjusted balance according to the programme as recalculated by Commission on the basis of the programme scenario using the commonly agreed methodology.

[2]Structural (primary) balance = cyclically-adjusted (primary) balance excluding one-off and other temporary measures.

Source:

Stability Programme (SP); Commission 2018 spring forecasts (COM); Commission calculations.

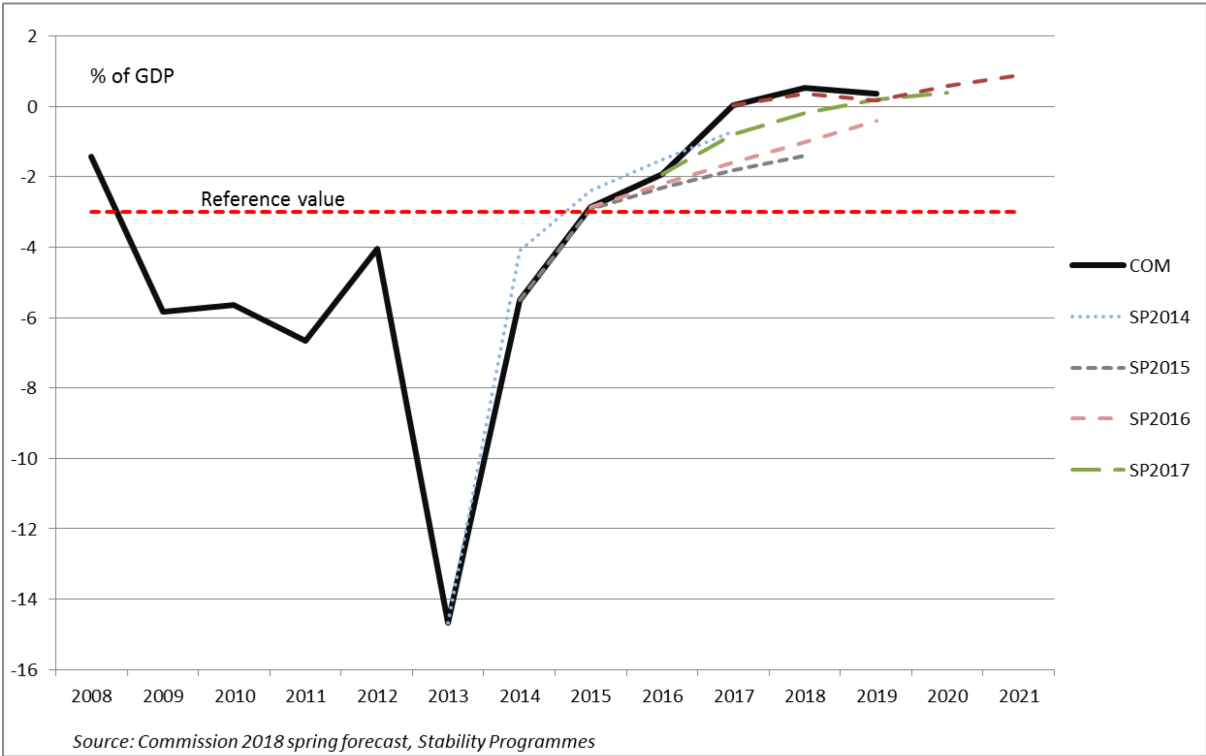
The medium-term objective (MTO) chosen in the Stability Programme is a structural surplus of 0.25% of potential GDP. The MTO reflects the objectives of the Pact. However, the planned adjustment path shows that if no measures are taken, Slovenia will move further away from the MTO in 2018 and 2019 and will start to move towards the MTO in 2020 and 2021. By 2021, Slovenia would be close to the MTO based on the recalculated structural balance. There would be a significant fiscal expansion in 2018, slight expansion in 2019 and

thereafter a rather strong tightening. Therefore the adjustment would be back-loaded to the outer years of the Stability Programme.

The adjustment path in the no-policy change Stability Programme is significantly different from that in the Draft Budgetary Plan, which was aiming at a 0.5 percentage points of GDP structural balance improvement in 2018, compared to the 0.5 percentage points deterioration now projected. While assessing the Draft Budgetary Plan based on the Commission 2017 autumn forecast, the Commission's opinion was that the fiscal adjustment projected for 2018 was not adequate in light of the sustainability challenges that Slovenia faces. The Commission invited the authorities to take the necessary measures within the national budgetary process to ensure that the 2018 budget is compliant with the SGP. However, as the consolidation measures included in the Draft Budgetary Plan were not implemented and revenues have been revised downwards, Slovenia moved in the opposite direction.

Based on Figure 1, the successive programmes have improved the forecast of general government balance since 2016. This is mainly due to the better-than-expected economic growth in recent years.

Figure 1: Government balance projections in successive programmes (% of GDP)



3.3. MEASURES UNDERPINNING THE PROGRAMME

The no-policy-change Stability Programme does not provide measures for budgetary adjustment. However, the authorities recognize the need for such measures, which will have to be undertaken by the forthcoming government.

The programme discusses possible reforms in pension system, health and long-term care. All these topics are covered in the Country Report.

3.4. DEBT DEVELOPMENTS

After an almost fourfold increase over the period 2008-2015 (from 21.8% of GDP in 2008 to 82.6% of GDP in 2015), the public debt ratio started to decrease in 2016 and reached 73.6% of GDP in 2017. The 4.9 percentage points. of GDP decrease in the debt ratio in 2017 was more than the 3.3 percentage points of GDP decrease projected in the 2018 Draft Budgetary Plan, due to higher than expected nominal GDP growth and improvement in the general government primary balance.

The Stability Programme projects public debt to decline further to 69.3% and 65.2% of GDP in 2018 and 2019 respectively. These projections are below the ones in the 2018 Draft Budgetary Plan and in the previous Stability Programme, partly due to a better starting position in 2017. However, the debt-increasing impact of the stock-flow adjustment has been revised upwards (to 1.2% of GDP) in 2018, reflecting the updated liquidity management strategy. For both years, the Commission 2018 spring forecast projections for the public debt ratio are very close to those in the Stability Programme.

Table 3: Debt developments

(% of GDP)	Average 2012-2016	2017	2018		2019		2020	2021
			COM	SP	COM	SP	SP	SP
Gross debt ratio[1]	**73.1**	**73.6**	**69.3**	**69.3**	**65.1**	**65.2**	**61.5**	**58.3**
Change in the ratio	6.4	-4.9	-4.3	-4.3	-4.2	-4.1	-3.7	-3.2
Contributions[2] :								
1. Primary balance	**3.0**	**-2.5**	**-2.5**	**-2.4**	**-2.0**	**-1.9**	**-2.2**	**-2.3**
2. "Snow-ball" effect	**1.3**	**-2.6**	**-3.0**	**-3.1**	**-2.4**	**-2.5**	**-1.8**	**-1.6**
Of which:								
Interest expenditure	2.8	2.5	2.0	2.0	1.7	1.7	1.6	1.4
Growth effect	-0.9	-3.7	-3.2	-3.5	-2.4	-2.5	-2.0	-1.8
Inflation effect	-0.6	-1.4	-1.8	-1.6	-1.7	-1.7	-1.4	-1.3
3. Stock-flow adjustment	**2.1**	**0.3**	**1.3**	**1.2**	**0.3**	**0.3**	**0.3**	**0.8**
Of which:								
Cash/accruals diff.								
Acc. financial assets								
Privatisation								
Val. effect & residual								

Notes:

[1] End of period.

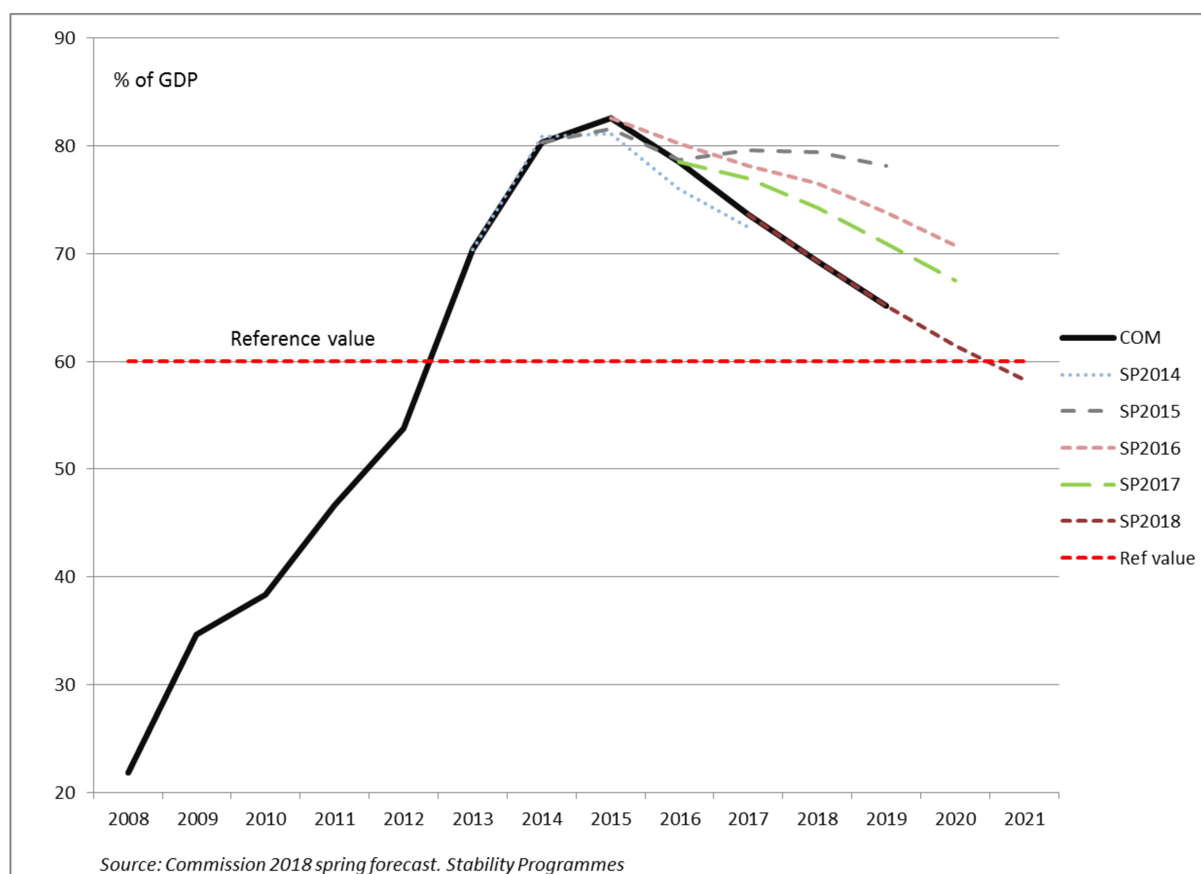
[2] The snow-ball effect captures the impact of interest expenditure on accumulated debt, as well as the impact of real GDP growth and inflation on the debt ratio (through the denominator). The stock-flow adjustment includes differences in cash and accrual accounting, accumulation of financial assets and valuation and other residual effects.

Source :

Commission 2018 spring forecast (COM); Stability Programme (SP), Commission calculations.

As shown in Figure 2, the successive programmes have improved the forecast of the general government gross debt ratio since 2016 and especially for 2017. This is again mainly due to the better-than-expected economic growth in recent years, which has increased the denominator and helped increase the primary surplus.

Figure 2: Government debt projections in successive programmes (% of GDP)



Source: Commission 2018 spring forecast. Stability Programmes

3.5. RISK ASSESSMENT

After the elections of June 2018, the new government is expected to take measures that would change the medium-term budgetary projections.

The risks underlying the deficit projections in the Stability Programme are primarily on the expenditure side, particularly on public wages and social transfers. On the revenue side, the main risks are related to external factors affecting economic growth as internal macroeconomic imbalances have unwound. The projections of tax revenue growth in the programme are conservative and broadly in line with the Commission spring forecast.

Based on the Commission forecast, government investment is expected to grow less than in the Stability Programme projections in 2018 and 2019. While this is positive from the perspective of the budgetary balance, it would be negative from the point of view of long-term economic growth.

Proceeds from the ongoing privatisation processes (14 assets mentioned in the Stability Programme) represent a positive risk to the projected debt levels.

4. COMPLIANCE WITH THE PROVISIONS OF THE STABILITY AND GROWTH PACT

Box 1. Council Recommendations addressed to Slovenia

On 11 July 2017, the Council addressed recommendations[3] *to Slovenia in the context of the European Semester. In particular, in the area of public finances the Council recommended to Slovenia to "pursue a substantial fiscal effort in 2018 in line with the requirements of the preventive arm of the Stability and Growth Pact, taking into account the need to strengthen the ongoing recovery and to ensure the sustainability of Slovenia's public finances."*

The Council noted that in 2018, in the light of its fiscal situation and in particular of its debt level, Slovenia is expected to further adjust towards an appropriate medium-term budgetary objective. According to the commonly agreed adjustment matrix under the Stability and Growth Pact, that adjustment translates into a requirement of a nominal growth rate of net primary government expenditure which does not exceed 0.6%. It would correspond to a structural adjustment of 1% of GDP. As recalled in the Commission Communication on the 2017 European Semester accompanying these country-specific recommendations, the assessment of the 2018 Draft Budgetary Plan and subsequent assessment of 2018 budget outcomes will need to take due account of the goal to achieve a fiscal stance that contributes to both strengthening the ongoing recovery and ensuring the sustainability of Slovenia's public finances.

4.1. Compliance with the debt criterion

As Slovenia was under the excessive deficit procedure (EDP) on 8 November 2011, it is subject to the transitional debt rule during the three years following the EDP abrogation, 2016 to 2018 included. Transitional debt rule implies compliance with the Minimum Linear Structural Adjustment (MLSA).

In 2018, according to the Stability Programme, Slovenia is projected to be compliant with the transitional debt rule. Specifically, the recalculated structural effort of -0.6% of GDP in 2018 is considerably above the required MLSA of -7.7% of GDP. This is confirmed based on the Commission spring forecast.

In 2019, as its public debt still exceeds the 60% of GDP reference rate of the Treaty, Slovenia has to comply with the debt reduction benchmark. Based on the Stability Programme, as well as the Commission spring forecast, Slovenia is expected to comply as the debt-to-GDP ratio is forecast to be below the debt reduction benchmark with a gap of more than 7% of GDP. Slovenia is expected to comply with the debt reduction benchmark in 2019, with a gap above 7%, based on the Stability Programme as well as based on the Commission spring forecast.

[3] Council Recommendation of 11 July 2017 on the 2017 National Reform Programme of Slovenia and delivering a Council opinion on the 2017 Stability Programme of Slovenia (*OJ C 261, 9.8.2017, p. 105–109)*

Table 4. Compliance with the debt criterion

	2017	2018		2019	
		SP	COM	SP	COM
Gross debt ratio	**73.6**	**69.3**	**69.3**	**65.2**	**65.1**
Gap to the debt benchmark [1,2]				-7.1	-7.2
Structural adjustment [3]	0.6	-0.6	-0.5	-0.4	-0.5
To be compared to:					
Required adjustment [4]	2.5	-7.6	-7.5		

Notes:

[1] Not relevant for Member Sates that were subject to an EDP procedure in November 2011 and for a period of three years following the correction of the excessive deficit.

[2] Shows the difference between the debt-to-GDP ratio and the debt benchmark. If positive, projected gross debt-to-GDP ratio does not comply with the debt reduction benchmark.

[3] Applicable only during the transition period of three years from the correction of the excessive deficit for EDP that were ongoing in November 2011.

[4] Defines the remaining annual structural adjustment over the transition period which ensures that - if followed – Member State will comply with the debt reduction benchmark at the end of the transition period, assuming that COM (S/CP) budgetary projections for the previous years are achieved.

Source :
Commission 2018 spring forecast (COM); Stability Programme (SP), Commission calculations.

4.2. Compliance with the MTO or the required adjustment path towards the MTO

Assessment of requests for deviating from SGP requirements

In the 2017 Stability Programme, the Slovenian authorities indicated that the expenditure related to the exceptional inflow of refugees was projected to be 0.07% of GDP in 2017, of which the Commission only considers the incremental impact compared to the previous year, amounting to 0.01% of GDP. However, outturn data from 2017 showed that there was no incremental budgetary impact. Therefore, no temporary deviation from the adjustment path towards the MTO is granted concerning the additional expenditure for refugee-related costs in 2017.

Adjustment towards the MTO

Slovenia was recommended to achieve a structural adjustment of 0.6 percentage points in 2017. Compared to 2016, the structural balance improved by the required amount in 2017 and

therefore points to compliance. The expenditure benchmark[4] points to a significant deviation, as the growth of government expenditure, net of discretionary revenue measures and one-offs, exceeded the applicable benchmark of -0.7% in 2017.The structural balance is negatively affected by revenue shortfalls (-0.5% of GDP). At the same time it benefits from falling interest expenditure (partly attributable to active debt management policies) and lower government investments (overall 0.5% of GDP). The most important difference between the results arises from the different potential growth estimates used: the medium-term potential GDP growth rate used for the expenditure benchmark (0.7%) is considerably lower than the potential growth rate arising from the spring forecast (2.1%) used for the structural balance. The rate used in expenditure benchmark is based on the Commission 2016 spring forecast and appears to be outdated. The recovery of potential growth has in fact been much faster than expected in 2016. It is therefore more appropriate to consider as a benchmark for growth of net primary expenditure the medium-term potential GDP growth rate of 1.5% arising from the Commission 2018 spring forecast for the same reference period (2011-2020). When adjusting the expenditure benchmark for this effect, the deviation would be less than -0.5% of GDP over one year while over 2016 and 2017 taken together the deviation would be -0.2%. Therefore, the overall assessment concludes that there was some deviation from the required adjustment path in 2017.

In 2018, the annual structural adjustment required according to the matrix under the Stability and Growth Pact would be 1.0 % of GDP. Based on the Stability Programme, the recalculated structural balance is expected to worsen by 0.6% of GDP, leading to a deviation from the required adjustment of -1.6% of GDP. In addition, the expenditure benchmark points to significant deviation, as the growth of government expenditure, net of discretionary revenue measures and one-offs, is expected to exceed the applicable benchmark by 1.0% of GDP in 2018 and by 0.9% over 2017 and 2018 taken together. This strongly suggests a planned risk of significant deviation and the overall assessment confirms this to be the case. Although the structural balance is negatively affected by the expected significant revenue shortfalls (-1.4% of GDP), it is expected to continue benefiting from falling interest expenditures and lower government investments. Another factor relevant for the difference between the two indicators arises from the potential growth estimates used therein. The rate used in expenditure benchmark is based on the spring 2017 forecast and appears to be outdated. It is therefore more appropriate to consider as a benchmark for growth of net primary expenditure the medium-term potential GDP growth rate of 1.9% arising from the spring 2018 forecast for the same reference period (2012-2021). Even when adjusting the expenditure benchmark for this effect, an overall assessment confirms the risk of a significant deviation from the requirements in 2018 and over 2017 and 2018 taken together.

In 2018, based on the Commission spring 2018 forecast both pillars point to a risk of a significant deviation (-1.5% based on the structural balance and -1.3% based on the expenditure benchmark). The overall assessment reaches the same conclusion as the overall assessment based on the Stability Programme.

The country-specific recommendation adopted by the Council on 11 July 2017 mentioned that the assessment of the 2018 Draft Budgetary Plan and subsequent assessment of 2018 budget

[4] As part of the agreement on the EFC Opinion on "*Improving the predictability and transparency the SGP: a stronger focus on the expenditure benchmark in the preventive arm*", which was adopted by the Economic and Financial Committee on 29 November 2016, the expenditure benchmark, that is the maximum allowable growth rate of expenditure net of discretionary revenue measures, is expressed in nominal terms as from 2018.

outcomes will need to take due account of the goal of achieving a fiscal stance that contributes to both strengthening the ongoing recovery and ensuring the sustainability of public finances.

Following the Commission's assessment of the strength of the recovery in Slovenia while giving due consideration to its sustainability challenges, carried out in the context of its opinion on Slovenia's Draft Budgetary Plan, a fiscal structural effort of at least 0.6% of GDP is required for 2018, without any additional margin of deviation over one year. Taking that into account in the overall assessment, Slovenia is still at risk of significant deviation in 2018.

Table 5: Compliance with the requirements under the preventive arm

(% of GDP)	2017	2018		2019	
Initial position[1]					
Medium-term objective (MTO)	0.3	0.3		0.3	
Structural balance[2] (COM)	-0.6	-1.1		-1.5	
Structural balance based on freezing (COM)	-1.6	-1.1		-	
Position vis-a -vis the MTO[3]	Not at MTO	Not at MTO		Not at MTO	
(% of GDP)	**2017**	**2018**		**2019**	
	COM	**SP**	**COM**	**SP**	**COM**
Structural balance pillar					
Required adjustment[4]	0.6	1.0		0.7	
Required adjustment corrected[5]	0.6	1.0		0.7	
Change in structural balance[6]	0.6	-0.6	-0.5	-0.4	-0.5
One-year deviation from the required adjustment [7]	0.0	-1.6	-1.5	-1.0	-1.1
Two-year average deviation from the required adjustment [7]	-0.1	-0.8	-0.8	-1.3	-1.3
Expenditure benchmark pillar					
Applicable reference rate[8]	-0.7	0.6		3.1	
One-year deviation adjusted for one-offs[9]	-0.7	-1.0	-1.3	-0.7	-0.8
Two-year deviation adjusted for one-offs[9]	-0.4	-0.9	-1.0	-0.9	-1.1
PER MEMORIAM: One-year deviation [10]	-0.7	-1.0	-1.3	-0.7	-0.8
PER MEMORIAM: Two-year average deviation [10]	-0.3	-0.9	-1.0	-0.9	-1.1

Notes

[1] The most favourable level of the structural balance, measured as a percentage of GDP reached at the end of year t-1, between spring forecast (t-1) and the latest forecast, determines whether there is a need to adjust towards the MTO or not in year t. A margin of 0.25 percentage points (p.p.) is allowed in order to be evaluated as having reached the MTO.

[2] Structural balance = cyclically-adjusted government balance excluding one-off measures.

[3] Based on the relevant structural balance at year t-1.

[4] Based on the position vis-à-vis the MTO, the cyclical position and the debt level (See European Commission: Vade mecum on the Stability and Growth Pact, page 38.).

[5] Required adjustment corrected for the clauses, the possible margin to the MTO and the allowed deviation in case of overachievers.

[6] Change in the structural balance compared to year t-1. Ex post assessment (for 2017) is carried out on the basis of Commission 2018 spring forecast.

[7] The difference of the change in the structural balance and the corrected required adjustment.

[8] Reference medium-term rate of potential GDP growth. The (standard) reference rate applies from year t+1, if the country has reached its MTO in year t. A corrected rate applies as long as the country is adjusting towards its MTO, including in year t.

[9] Deviation of the growth rate of public expenditure net of discretionary revenue measures, revenue increases mandated by law and one-offs from the applicable reference rate in terms of the effect on the structural balance. The expenditure aggregate used for the expenditure benchmark is obtained following the commonly agreed methodology. A negative sign implies that expenditure growth exceeds the applicable reference rate.

[10] Deviation of the growth rate of public expenditure net of discretionary revenue measures and revenue increases mandated by law from the applicable reference rate in terms of the effect on the structural balance. The expenditure aggregate used for the expenditure benchmark is obtained following the commonly agreed methodology. A negative sign implies that expenditure growth exceeds the applicable reference rate.

Source :

Stability Programme (SP); Commission 2018 spring forecast (COM); Commission calculations.

In view of the uncertainty surrounding the output gap estimates for Slovenia (see assessment in Box 2), the Commission has decided that an annual structural adjustment of 0.65% of GDP in 2019, corresponding to a maximum growth rate of net primary government expenditure of 3.1%, appears appropriate.

Based on the Stability Programme, the recalculated structural balance is expected to worsen by 0.4% of GDP, leading to a deviation from the required adjustment of -1% of GDP in 2019

and -1.3% of GDP over 2018 and 2019 taken together. The expenditure benchmark also points to a risk of significant deviation, as the growth of government expenditure, net of discretionary revenue measures and one-offs, is projected to exceed the applicable benchmark in 2019 and over 2018 and 2019 taken together. The negative deviations based on both pillars indicate a strong presumption of the risk of significant deviation. The overall assessment shows that the structural balance is expected to continue to be negatively affected by revenue shortfalls (-0.7% of GDP), while it benefits from a higher potential growth than the expenditure benchmark. An overall assessment confirms the conclusion of a risk of significant deviation.

The Commission 2018 spring forecast, reaches the same conclusion as the overall assessment based on the Stability Programme.

Box 2. Assessment of uncertainty surrounding the output gap estimate for 2019

Using the production function method as endorsed by the ECOFIN Council on 12 July 2002 (known as the commonly agreed methodology), Slovenia is projected to reach a positive output gap of 4.1% of potential GDP in 2019. This would correspond to ‘good economic times’, according to the matrix of requirements under the Stability and Growth Pact.

An assessment of uncertainty surrounding the output gap estimate based on the production function approach has been performed, taking into account a broader range of economic indicators.

First, the output gap estimate for 2017 based on the common methodology is flagged by the plausibility tool[5] as subject to particularly high uncertainty. In particular, the central estimate of the tool indicates that the output gap would be 0.1% of potential GDP, rather than 1.4% as resulting from the common methodology.

Second, while the unemployment rate (5.8% in Q4 2017) is close to the non-accelerating wage rate of unemployment (NAWRU), the number of discouraged persons and involuntary part-time workers are still well above the pre-crisis level. This could indicate that labour market slack is larger than what indicated by the standard measures. The still low immigration, well below the pre-crisis level, and the rather subdued dynamics of real and nominal unit labour costs provide additional indications of labour market slack. Inflation was 1.6% in 2017 and is expected to remain below 2% also in 2018 and 2019, with core inflation forecast at 1.6% in 2019.

Third, investment, as share of GDP, is expected to remain below the euro area average, and more so the average of peer countries in the region, over the whole forecast horizon, including in 2019.

The above-mentioned factors confirm that the output gap estimate based on the common methodology is subject to a degree of uncertainty.

[5] The ‘plausibility tool’ is a transparent and economically grounded tool to statistically test the plausibility of the output gap estimates for individual Member States estimated on the basis of the common method. It is based on a set of cyclically relevant indicators as well as thresholds/ranges - to signal cases when the outcomes of the commonly agreed methodology could be interpreted as being subject to a large degree of uncertainty and therefore deserving of further investigation on the part of the Commission.

5. FISCAL SUSTAINABILITY

Slovenia does not appear to face fiscal sustainability risks in the short run[6].

Based on the Commission 2018 spring forecast and a no-fiscal policy change scenario beyond the forecast horizon, government debt, at 73.6% in 2017, is expected to decrease to 61.0% by 2028, thus remaining above the 60% of GDP Treaty threshold but not surpassing the 2017 level. Sensitivity analysis confirms the risk that the debt ratio would not decrease below 60% of GDP before 2028[7]. Overall, this highlights medium risks for the country from debt sustainability analysis in the medium term. Under the Stability Programme no-policy change assumptions, debt would be on a lower, more quicly decreasing path by 2028, with debt expected to stand below the 60% of GDP reference value in 2028.

The medium-term fiscal sustainability risk indicator S1[8] is at 1.0 percentage points of GDP. This result is primarily related to the projected ageing costs and the high level of government debt contributing 1.1 percentage points and 0.4 percentage points of GDP respectively, thus indicating medium risks in the medium term. Under the no-policy change Stability Programme assumptions the sustainability risk indicator S1 would be at -1.1 percentage points of GDP, leading to lower medium-term risks. Overall, risks to fiscal sustainability over the medium term are, therefore, medium[9].

The long-term fiscal sustainability risk indicator S2[10]is at 6.1 percentage points of GDP. In the long term, Slovenia therefore appears to face high fiscal sustainability risks, primarily related to the projected ageing costs contributing 5.3 percentage points of GDP. Under the Stability Programme assumptions, the S2 indicator would be 4.6 percentage points of GDP, leading to medium risk in the long term[11].

Recent policy measures have so far improved fiscal sustainability only to a limited extent. Political consensus, including with social partners, regarding the path towards pension reform has been reached, but it is still unclear how and by when the proposed measures would be implemented. Effective since October 2017, the Pension and Disability Insurance Act, increases the minimum old-age and disability pension for those fulfilling full retirement conditions. Some laws to reform the healthcare sector have been adopted while the key legislation (Health care and health insurance Act) has not been adopted yet. A proposal for reforming the long-term care has been publicly consulted but not yet put forward.

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[6] This conclusion is based on the short-term fiscal sustainability risk indicator S0. See the note to Table 5 for a definition of the indicator.

[7] Sensitivity analysis includes several deterministic debt projections, as well as stochastic projections (see Debt Sustainability Monitor 2017 for more details).

[8] See the note to Table 5 for a definition of the indicator.

[9] For detailed information on the analysis and conclusions see Annex A8 "Assessment of fiscal sustainability challenges: criteria used": European Commission, Debt Sustainability Monitor 2016, available at https://ec.europa.eu/info/publications/debt-sustainability-monitor-2016_en

[10] See the note to Table 4 for a definition of the indicator.

[11] The projected costs of ageing used to compute the debt projections and the fiscal sustainability indicators S1 and S2 are based on the updated projections, endorsed by the EPC on 30 January 2018, and to be published in the forthcoming Ageing Report 2018.

Table 6: Sustainability indicators

Time horizon				Commission Scenario		Stability / Convergence Programme Scenario	
Short Term				**LOW risk**			
S0 indicator [1]				0.1			
	Fiscal subindex			0.1	LOW risk		
	Financial & competitiveness subindex			0.2	LOW risk		
Medium Term				**MEDIUM risk**			
DSA [2]				MEDIUM risk			
S1 indicator [3]				1.0	MEDIUM risk	-1.1	LOW risk
	of which						
		Initial Budgetary Position		-0.5		-2.1	
		Debt Requirement		0.4		-0.2	
		Cost of Ageing		1.1		1.1	
		of which					
			Pensions	0.6		0.6	
			Health-care	0.3		0.3	
			Long-term care	0.1		0.1	
			Other	0.1		0.1	
Long Term				**HIGH risk**		**MEDIUM risk**	
S2 indicator [4]				6.1		4.6	
	of which						
		Initial Budgetary Position		0.8		-0.8	
		Cost of Ageing		5.3		5.4	
		of which					
			Pensions	3.4		3.5	
			Health-care	0.8		0.8	
			Long-term care	0.7		0.7	
			Other	0.4		0.4	

Source: Commission services; 2018 stability/convergence programme.

Note: the 'Commission' scenario depicts the sustainability gap under the assumption that the structural primary balance position evolves according to the Commissions' spring 2018 forecast covering until 2019 included. The 'stability/convergence programme' scenario depicts the sustainability gap under the assumption that the budgetary plans in the programme are fully implemented over the period covered by the programme. Age-related expenditure as given in the 2018 Ageing Report.

[1] The S0 indicator of short term fiscal challenges informs the early detection of fiscal stress associated to fiscal risks within a one-year horizon. To estimate these risks S0 uses a set of fiscal, financial and competitiveness indicators selected and weighted according to their signalling power. S0 is therefore a composite indicator whose methodology is fundamentally different from the S1 and S2 indicators, which quantify fiscal adjustment efforts. The critical threshold for the overall S0 indicator is 0.46. For the fiscal and the financial-competitiveness sub-indexes, thresholds are respectively at 0.36 and 0.49*.

[2] Debt Sustainability Analysis (DSA) is performed around the no fiscal policy change scenario in a manner that tests the response of this scenario to different shocks presented as sensitivity tests and stochastic projections*.

[3] The S1 indicator is a medium-term sustainability gap; it measures the upfront fiscal adjustment effort required to bring the debt-to-GDP ratio to 60 % by 2032. This adjustment effort corresponds to a cumulated improvement in the structural primary balance over the 5 years following the forecast horizon (i.e. from 2020 for Commission scenario and from last available year for the SCP scenario); it must be then sustained, including financing for any additional expenditure until the target date, arising from an ageing population. The critical thresholds for S1 are 0 and 2.5, between which S1 indicates medium risk. If S1 is below 0 or above 2.5, it indicates low or high risk, respectively*.

[4] The S2 indicator is a long-term sustainability gap; it shows the upfront and permanent fiscal adjustment required to stabilise the debt-to-GDP ratio over the infinite horizon, including the costs of ageing. The critical thresholds for S2 are 2 and 6, between which S2 indicates medium risk. If S2 is below 2 or above 6, it indicates low or high risk, respectively*.

* For more information see Fiscal Sustainability Report 2015 and Debt Sustainability Monitor 2017.

6. FISCAL FRAMEWORK

The Slovenian Fiscal Rules Act (FRA) includes a numerical fiscal rule, which sets limits for general government expenditure dependent on the position of the economy in the cycle (positive or negative output gap) to ensure that the general government budget is in balance or in surplus over the medium term. However, this rule is only applicable once the country has reached its medium-term objective (MTO). Since Slovenia is currently converging towards its medium-term fiscal objective, according to the FRA, the compliance with the adjustment path should be assessed against the requirements of the Stability and Growth Pact. Therefore on the basis of the assessment of compliance with the MTO or the required adjustment path towards the MTO provided in Section 4.2, the fiscal performance in Slovenia appears not to comply with the requirements of the applicable numerical fiscal rule.

Slovenia has a Fiscal Council, an independent state authority that - among other things – monitors the respect of the above-mentioned rule. The Fiscal Council has reviewed the 2018 Stability Programme and concluded that the projected fiscal trends are not compliant with the national numerical fiscal rules. Morover, it highlighted that the MTO will not be achieved over the period covered by the Stability Programme, as no further fiscal consolidation measures are foreseen. In addition, the deterioration of the structural balance projected in 2018 and 2019 represents in its view a deviation from the convergence towards the medium-term fiscal objective. Finally, the Fiscal Council called the caretaker government to adopt measures reducing the growth in general government expenditure in 2018.

The Stability Programme indicates that it constitutes the national medium-term fiscal plan (NMTFPs), as required by Art. 4.1 of Regulation No 473/2013. However, neither the Stability Programme nor the National Reform Programme includes specific indications on the expected economic returns on non-defence public investment projects that have a significant budgetary impact.

The macroeconomic scenario underpinning the Stability Programme is the Spring 2018 Forecast of Economic Trends produced by the Institute of Macroeconomic Analysis and Development (IMAD). The independent status and tasks of IMAD arise from legislation. IMAD produces economic forecasts twice a year (in March and October) to underpin the Stability Programme in April and the Draft Budgetary Plan in autumn.

7. SUMMARY

In 2017, Slovenia improved its structural balance by 0.6% of GDP, which is in line with the required adjustment towards the MTO. On the other hand, the growth rate of government expenditure, net of discretionary revenue measures, exceeded the applicable expenditure benchmark rate by -0.7% of GDP. An overall assessment indicates that there was some deviation from the recommended adjustment path towards the MTO in 2017.

Slovenia has presented a no-policy change Stability Programme, as it will hold general elections on 3 June 2018. Therefore, the Stability Programme reflects the trends Slovenia would face at no policy change and provides the future government with guidance on the scope of policy action to be taken in order to meet the requirements of the Stability and Growth Pact.

Under the no policy change scenario presented in the programme, the growth rate of government expenditure as well as the changes in structural balance will not be compliant with the requirements of the Stability and Growth Pact in 2018 and 2019. Slovenia is thus at risk of a significant deviation from the recommended adjustment path towards the MTO in 2018 and 2019. This is confirmed also based on the Commission 2018 spring forecast.

Based on the Stability Programme, compliance with the transitional debt rule is ensured in 2017 and 2018, as well as with the debt reduction benchmark in 2019. This is confirmed by the Commission 2018 spring forecast.

8. ANNEXES

Table I. Macroeconomic indicators

	2000-2004	2005-2009	2010-2014	2015	2016	2017	2018	2019
Core indicators								
GDP growth rate	3.6	2.4	0.2	2.3	3.1	5.0	4.7	3.6
Output gap [1]	0.6	3.2	-4.2	-3.1	-1.4	1.4	3.4	4.1
HICP (annual % change)	6.9	3.0	1.8	-0.8	-0.2	1.6	1.9	2.0
Domestic demand (annual % change) [2]	3.0	1.8	-1.5	1.8	2.9	4.1	5.0	4.9
Unemployment rate (% of labour force) [3]	6.4	5.5	8.8	9.0	8.0	6.6	5.6	5.4
Gross fixed capital formation (% of GDP)	26.0	27.4	20.0	18.9	17.6	18.5	19.4	20.6
Gross national saving (% of GDP)	25.0	26.5	22.2	23.9	24.0	26.0	26.8	26.6
General Government (% of GDP)								
Net lending (+) or net borrowing (-)	**-2.9**	**-2.0**	**-7.3**	**-2.9**	**-1.9**	**0.0**	**0.5**	**0.4**
Gross debt	**26.5**	**26.3**	**57.9**	**82.6**	**78.6**	**73.6**	**69.3**	**65.1**
Net financial assets	**8.6**	**7.4**	**-11.4**	**-27.3**	**-30.6**	**n.a**	**n.a**	**n.a**
Total revenue	43.1	42.7	44.1	44.9	43.3	43.1	42.3	41.8
Total expenditure	46.0	44.7	51.4	47.7	45.3	43.1	41.8	41.5
of which: Interest	2.1	1.3	2.3	3.2	3.0	2.5	2.0	1.7
Corporations (% of GDP)								
Net lending (+) or net borrowing (-)	**-2.5**	**-5.5**	**5.3**	**4.0**	**2.0**	**2.0**	**2.6**	**1.9**
Net financial assets; non-financial corporations	**-91.4**	**-110.5**	**-114.0**	**-95.3**	**-88.9**	**n.a**	**n.a**	**n.a**
Net financial assets; financial corporations	**7.1**	**3.7**	**8.2**	**9.7**	**8.4**	**n.a**	**n.a**	**n.a**
Gross capital formation	17.6	19.0	12.0	11.0	12.1	12.8	13.9	14.8
Gross operating surplus	17.5	19.5	18.6	19.8	19.5	20.5	21.5	21.6
Households and NPISH (% of GDP)								
Net lending (+) or net borrowing (-)	**3.2**	**4.7**	**4.4**	**4.5**	**4.3**	**4.1**	**3.9**	**3.7**
Net financial assets	**70.2**	**71.1**	**67.3**	**69.8**	**70.7**	**n.a**	**n.a**	**n.a**
Gross wages and salaries	43.6	42.9	43.7	42.1	42.6	41.9	41.6	41.9
Net property income	1.6	1.4	1.3	1.2	1.2	1.1	1.1	0.9
Current transfers received	20.0	18.8	20.9	19.5	19.2	18.7	18.0	17.5
Gross saving	8.6	9.6	7.7	7.8	7.9	7.3	6.7	6.3
Rest of the world (% of GDP)								
Net lending (+) or net borrowing (-)	**-2.2**	**-2.8**	**2.4**	**5.6**	**4.5**	**6.1**	**7.1**	**6.1**
Net financial assets	**5.5**	**28.3**	**49.9**	**43.0**	**40.4**	**n.a**	**n.a**	**n.a**
Net exports of goods and services	-1.1	-0.4	4.1	8.6	9.2	9.7	9.7	8.6
Net primary income from the rest of the world	-0.7	-1.8	-1.3	-3.0	-2.8	-2.2	-2.2	-2.1
Net capital transactions	-0.2	0.2	0.5	1.1	-0.8	-0.6	0.5	0.8
Tradable sector	47.3	46.0	45.2	46.5	46.5	47.1	n.a	n.a
Non tradable sector	40.3	41.7	41.6	40.0	40.1	39.9	n.a	n.a
of which: Building and construction sector	5.4	6.6	5.0	4.7	4.5	4.8	n.a	n.a
Real effective exchange rate (index, 2000=100)	91.2	94.9	97.8	94.3	95.0	95.1	95.7	96.7
Terms of trade goods and services (index, 2000=100)	103.3	101.9	98.8	100.7	101.6	101.1	101.7	101.8
Market performance of exports (index, 2000=100)	83.2	98.7	103.1	104.8	107.1	112.0	114.5	116.1

Notes:

[1] The output gap constitutes the gap between the actual and potential gross domestic product at 2005 market prices.

[2] The indicator on domestic demand includes stocks.

[3] Unemployed persons are all persons who were not employed, had actively sought work and were ready to begin working immediately or within two weeks. The labour force is the total number of people employed and unemployed. The unemployment rate covers the age group 15-74.

Source :
AMECO data, Commission 2018 spring forecast