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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 16-12-2022 "Sovereign Ratings" "Rating Criteria and Definitions"

Rating Action

Neuss, 16 December 2022

Creditreform Rating has affirmed the unsolicited long-term sovereign rating of "AA-" for the Republic of Slovenia. Creditreform Rating has also affirmed Slovenia's unsolicited ratings for foreign and local currency senior unsecured long-term debt of "AA-". The outlook remains stable.

Key Rating Drivers

1. Comparatively wealthy economy featuring a good degree of diversification; a strong post-pandemic recovery including positive labor market development enabled uninterrupted convergence towards EU-levels in terms of GDP per capita over the pandemic phase, pointing to increasing economic resilience
2. While direct trade exposure to Russia is relatively low, pressure via high commodity prices and a weaker external environment is likely to weigh on economic performance in the near-term; despite the notion of some delays, positive medium-term prospects should remain supported by envisaged implementation of EU-funded measures as set out in the Recovery and Resilience Plan (RRP), expected to further lift potential growth
3. Generally high institutional quality including benefits linked to EU/EMU membership, such as ample EU-level funding associated with NextGenerationEU (NGEU) and the respective Multiannual Financing Frameworks (MFF); after a more challenging phase in terms of government stability, the parliamentary majority of the new government may facilitate implementation of envisaged RRP initiatives, although the speed may have to be monitored
4. The recent succession of crises and respective fiscal countermeasures, in combination with a slow start to picking up Recovery and Resilience Facility (RRF) funds, should pose some challenges to significantly reducing the public debt ratio over the medium term; while public guarantees continue to add somewhat to fiscal risks, sound debt management, a considerable liquidity buffer, and still high debt affordability constitute mitigating factors; demographic developments and related spending could add significant pressure in a medium-to-longer-term view, but may be reined in by a planned pension reform
5. External risks continue to appear manageable; previously high current account surplus positions have contributed to a further improvement of the net international investment position; given high energy prices and a more challenging environment for external demand, we expect the current account balance to temporarily post a small deficit

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Reasons for the Rating Decision and Latest Developments¹

Macroeconomic Performance

Slovenia's very strong macroeconomic profile is buttressed by the sovereign's relatively wealthy, diversified and competitive economy. The relatively flexible labor market adds to these strengths, as does a moderate level of private sector indebtedness. High energy prices, as well as intensifying shortages of skilled labor, pose downside risks to industrial activities, a key sector thus, while the service sector adds some stability in the current phase, alongside reinforced government support to alleviate adverse economic effects from the war in Ukraine. Notwithstanding some delays in the implementation of RRP initiatives, and thus in disbursement of related EU funds, we continue to view the medium-term growth outlook as constructive, mainly due to substantial EU funding available via NGEU and the respective MFFs 2014-20 and 2021-27. In addition to the evolution of Slovenia's competitive stance against the backdrop of its relatively high energy intensity and recent energy price developments, we will follow closely wage and productivity dynamics going forward.

Following its pandemic-induced decline by 4.3% in the first year of the corona crisis (2020), Slovenia's real GDP bounced back sharply, expanding by 8.2% in 2021, boosted by private consumption on the back of lifted containment measures, as well as by recovering investment and further increasing government consumption. Household expenditure contributed the most to last year's GDP growth, accounting for 5.0 p.p. of the overall outcome (Eurostat, 2015 chain-linked). Against the backdrop of the strong rebound in domestic demand, imports posted an even stronger increase than recovering exports, ultimately causing net trade to take 1.0 p.p. off GDP growth in 2021.

Given the somewhat milder pandemic recession in comparison to the euro area, partly due to lower exposure to service industries particularly affected by the containment measures, and given the more forceful recovery, Slovenia's GDP per capita experienced an uninterrupted convergence process towards the EU level. In 2021, GDP per capita rose by 12.0%, to an estimated level of USD 44,162 (IMF data, PPP terms), which corresponds to roughly 90% of the EU-level and compares as high against most CEE peers, adding to Slovenia's credit strengths when assessing its macroeconomic profile.

Due to the war in Ukraine, related price spikes of various commodities, and required re-routing of trade flows, the economic outlook has clouded, both for the Slovenian economy and for its key trading partners. Slovenia's direct trade exposure to Russia appears small, and its diversified energy mix points to mitigating effects against risks related to energy imports. Gas accounted for only 11.4% of Slovenia's energy mix in 2020 (Eurostat), whereas oil and petroleum products made up 33.0% in that year. While Russia was the origin of 8.7% of all gas imports in 2020 and supplied 12.9% of the imported oil and petroleum products, the European Commission (EC) highlights that e.g. indirect gas imports from Russia via Austria were markedly higher. Among the EU members, Slovenia also counts as an economy featuring a somewhat higher energy intensity, thus exhibiting some vulnerability via this channel.

Latest quarterly data on real GDP suggest that, after a very strong second half of 2021, economic activity lost steam in the first half of 2022, with the GDP recording a small decline in the first

¹ This rating update takes into account information available until 09 December 2022.

quarter (-0.1% q-o-q) and a small increase in Q2-22 (+0.2% q-o-q). In the three months to June, private consumption, gross capital formation and government consumption all decreased. However, while according to current Eurostat information real GDP posted a pronounced decline in this year's third quarter (-1.4% q-o-q), we note that this seems to have been entirely due to the inventory component. Nevertheless, the burden placed on consumers and businesses by high commodity prices and the deteriorating external environment are set to weigh on economic activity over the winter season, with partly worsening business indicators and consumer sentiment at the beginning of the final quarter of 2022 likely representing harbingers thereof.

To be sure, the picture is somewhat mixed, as sentiment in the service sector has been holding up well compared to clouding sentiment in industrial sector, where high commodity prices weigh heavier and are compounded by ongoing difficulties in sourcing certain materials and finding skilled workers. Sentiment in the construction sector has held up better as well, despite headwinds from shortages of labor and high costs of materials. The greater significance of the manufacturing sector in terms of the gross value added (GVA) share vis-à-vis the euro area overall (Q2-22: 21.1% of total GVA vs. EA 16.5%, Eurostat), which in the pandemic phase acted as a stabilizer, could become a drag at the current juncture. However, high-tech industries, such as the manufacturing of pharmaceutical and computer/electronic/optical products, may hold up better.

It also seems worth mentioning that recovering (foreign) tourism currently adds to a more favorable picture in the service sector. January to October 2022 saw an increase of about 54% in total tourist arrivals compared to the same period in 2021 (SiStat data), boosted by foreign tourists, the number of which has not yet fully caught up with 2019 levels. Total overnight stays rose by roughly 46% over the same period. According to BoP data, travel exports exceeded their 2019 level at the end of summer 2022.

Meanwhile, consumer sentiment has deteriorated sharply over recent months, matching the low levels reached at the time of the coronavirus outbreak and boding ill for private consumption. Slovenia's inflation rate has been in double-digit territory since June, posting at 10.8% in Nov-22, and real monthly retail sales (excluding motor vehicles) in October recorded a second consecutive decline.

While we think that household expenditure will see markedly slower growth next year after relatively vivid expansion in 2022 due to a substantial carry-over from the preceding year, fiscal support to cushion the adverse effects from higher energy prices, as well as a still well-performing labor market, should act as stabilizers. Apart from one-off vouchers for private households earlier this year, as well as subsidies to their utility bills, cushioning measures also include a cap on electricity and gas prices, introduced from Sep-22 and intended to remain in place for one year.

On the labor market, Slovenia's job vacancy rate peaked at 3.1% as of Q2-22 (Eurostat, s.a.), remaining among the higher rates in the EU. The unemployment rate averaged 4.8% in 2021 (euro area: 7.7%, Eurostat data), having gone up at the height of the pandemic, and recently stabilizing at 4.1% as of Oct-22, a rate slightly below levels prior to the Covid-19 crisis. With this, Slovenia's unemployment rate remains well below the rate recorded for the euro area (EA) as a whole (EA Oct-22: 6.5%).

After a phase of relatively strong annual increases in employment and a comparatively mild decline in 2020, Slovenian total employment has seen uninterrupted quarterly growth since Q3-

20, exceeding its pre-pandemic level by 2.9% as of Q2-22 (EA vs. Q4-19: +1.7%). Contrary to the euro area, Slovenia also posted positive employment growth in the industrial sector in 2021, further illustrating the sovereign's relative resilience during the pandemic phase. Slovenia's overall labor participation continues to exceed the respective euro area ratio, and judging by the European Commission's Social Scoreboard, the sovereign counts among the outperformers among the CEE countries. The strong labor market may well add to wage pressure already noticeable in the public sector, where the wage agreement between the government and respective trade unions will see most public employees' wages lifted markedly again in Apr-23, after an initial leap in Oct-22.

While gross fixed capital formation will likely see relatively robust expansion in 2022, the near-term outlook for investment has deteriorated against the backdrop of a worsening business climate, weakening prospects for foreign demand, less favorable financing conditions on financial markets on the back of monetary policy tightening, and challenges to finding skilled labor. In fact, investment in machinery and equipment recorded two consecutive quarter-on-quarter declines in this year's second and third quarters. Moreover, drawing on the Q4-22 quarterly industry survey by the European Commission, the percentage of businesses indicating labor as a factor limiting production has reached its highest level in ten years. In the construction sector, there are only few signs of relaxation in this respect. However, with the implementation of RRP initiatives assumed to see more progress following some delays, we expect investment to be generally supported over the coming few years.

With regard to net trade, we expect a pronounced drag on GDP growth for 2022, owing to a prospective stronger increase in imports than in exports. Slovenia, as a very open economy, is likely to feel the pinch of weakening external demand given the current geopolitical and associated economic challenges. For 2023, we assume both slower growth in exports and in imports, ultimately leading to a slightly negative contribution to GDP growth next year.

On the back of likely significantly slowing growth in domestic demand, we expect GDP growth overall to slow to about 0.4% in 2023, from a strong 5.0% in 2022, which was assisted by a carry-over effect from the preceding year and amounting to 5.4 p.p.

The overall constructive medium-term growth outlook remains supported by the expected positive impact linked to effective implementation of the RRP plan, which should be conducive to further lifting potential growth. The latter is estimated to have averaged 2.6% over the years 2019-2021, already remarkably higher than in the preceding five-year period 2014-2018 (1.3%). By 2024, potential growth could be pushed to around 3.0%, according to EC estimates (AMECO data).

With its 11th rank among the EU members in the EC's Digital Economy and Society Index (DESI, 2022), improving two places compared to 2021, the sovereign demonstrates noticeable advancements pertaining to its digital transformation. Apart from efforts underway to further enhance e.g. digital skills and digital infrastructure, and in addition to a large number of digital transformation projects in the SME space, the sovereign remains committed to drive investment in its social security system and (green) transport infrastructure in 2023.

According to the Draft Budgetary Plan 2023 (DBP23), public investment is to amount to about 7% of GDP in 2023, which would constitute a considerable leap from the 4.7% of GDP recorded in 2021. In this context, we are aware that no RRF funds were drawn in 2022 (see also below),

and that monthly state budget data hint at under-execution of previous public investment targets for 2022. State budget data merely show a revenue of EUR 117.8mn in January 2022 which are part of EUR 231mn of pre-financing related to RRF funds.

We assume a meaningful acceleration in light of the new government's commitment to focusing on RRP implementation and submittal of the first payment request this October. Moreover, confidence over a timely absorption of available funds is partly underpinned by a relatively high share of European Structural and Investment Funds already spent under the MFF 2014-2020 by European comparison.

Further supporting the constructive medium-term outlook, private sector indebtedness moves at moderate levels from a European perspective, both in terms of household debt-to-disposable-income and with a view to NFC debt-to-GDP, thus suggesting some buffer against economic shocks. That said, developments on the housing market show signs of overheating, calling for closer monitoring going forward, also in connection with monetary policy becoming tighter and driving up bank lending rates, as a correction on the housing market could have negative effects on private consumption.

We would also pay attention to Slovenia's competitive stance with regard to less favorable developments of its unit labor costs by European comparison over the last few years, bearing in mind that there are most likely also some pandemic-related distortions at play, and with regard to potentially longer-lasting pressure on its industrial sector from energy prices. At least for the EU market, the export market share of energy-intensive products in the EU market appeared stable in the first half of 2022. In light of the tight labor market and recent harsh consumer price increases combined with the apparently more severe shortages of skilled labor, wage pressure could intensify, potentially eroding competitive advantages in case of a protracted phase of moving well above productivity gains.

Measured by its overall stable global export market share in 2021 (0.19%), Slovenia has not seen any competitive losses of late. While its market share in global goods exports has edged down, a somewhat higher share in global services exports has more or less made up for this. In fact, Slovenia made significant progress during the pandemic period as far as exports of other business services are concerned and became a net exporter in this regard (Eurostat BoP data), a feature not observed before.

Institutional Structure

The sovereign's generally strong institutional framework is underpinned by significant benefits associated with EU/EMU membership, with substantial – partly contingent – EU funding in the form of NGEU and the MFF cases in point, adding to the advantages coming with access to the large single market, as well as to deep and broad capital markets. The recent election and resulting coalition, which commands a majority in parliament, may give rise to a somewhat more stable political phase, possibly enabling faster progress in the roll-out of RRP measures and thus disbursement of related funding. Major envisaged reforms concern long-term care and a pension reform, advancements of which we will be monitoring. Some progress was made with regard to improvements in the justice system and concerning anti-money laundering (AML), as well as countering the financing of terrorism (CFT), while some challenges remain.

Drawing on the latest set of the World Bank's Worldwide Governance Indicators (WGIs), which assesses developments in the year 2021, we observe a slight deterioration across all four dimensions on which we place high emphasis in our assessment of the sovereign's institutional set-up. Generally though, Slovenia is by and large in line with the euro area average with regard to three of these four pillars, lagging somewhat in terms of voice and accountability (relative rank of 48 out of 208 economies considered, EA median: 26). When it comes to government effectiveness and rule of law, Slovenia occupies relative ranks of 33 (out of 209, EA median: 36) and of 36 (out of 209, EA median: 32), edging down by two ranks, respectively, compared to the preceding set of WGIs. A somewhat more pronounced deterioration is apparent concerning control of corruption, with regard to which the sovereign has slipped by 6 places to a relative rank of 51 out of 209 economies (EA median: 42). Compared to our AA-rated sovereigns, Slovenia has some more scope to improve in terms of the mentioned four dimensions.

That said, and also highlighted in the EC's 2022 Rule of Law report, there have been advancements in strengthening the justice system and in terms of working on a new national anti-corruption strategy. As part of such efforts, the Commission for the Prevention of Corruption adopted a code of governance for companies, which will enter into force from 1 January 2023.

As to further key aspects of the institutional framework, we also note that, according to the 4th Enhanced Follow-up report by Moneyval (May-22), Slovenia has made some progress in complying with the standards applied by the Financial Action Task Force when it comes to AML and CFT measures. The actions led to an upgrade of Slovenia from 'partially compliant' to 'largely compliant' in these areas. At the same time, we note that the report stresses persistent technical compliance deficiencies, e.g. legislative shortcomings concerning the criminalization of terrorism financing.

Turning to domestic politics, we recall that over recent years a higher degree of political fragmentation entailed some challenges to coherent policy-making, apparently causing some delays in terms of RRP implementation, in addition to the pandemic. With a new government coalition in place and commanding over a parliamentary majority following April's general election, chances of a somewhat more stable backdrop for the legislature seem improved. This should facilitate the roll-out of RRP measures and the related disbursement of funding, if agreed targets and milestones are deemed to be met after no RRF funds were drawn in the year 2022 (Ministry of Finance, MoF, intelligence). Led by the recently established Freedom Movement under new prime minister Golob, which obtained 41 of the 90 seats in parliament, the government coalition includes the Social Democrats (7 seats) and the Left Party (5 seats).

Apart from the abovementioned envisaged reforms to long-term care and the pension system, the government aims to enhance the public procurement system and reduce the administrative burden, as also set out in the national RRP, thus potentially further improving the quality of the public administration alongside investment to foster the digitalization in the sector.

Concerning the green transition, RRP initiatives include investment in flood control and protection, and railway infrastructure. Looking at relevant environmental indicators, Slovenia continues to move among the middle-range of EU members when it comes to the EC's Eco Innovation Index (2022), showing a marked improvement compared to the preceding edition. With an overall share of renewable energy sources of 25.0% as of 2020 (Eurostat), it is slightly ahead of the EU level as a whole (2020: 22.1%), given that its use of renewables is well above the respective share of the EU as concerns heating/cooling. The emission of greenhouse gas per capita was roughly in line with the EU average in 2020.

Fiscal Sustainability

The recent succession of crises and concomitant mitigating fiscal support weighs on fiscal metrics and, possibly combined with increases of public wages and social benefits, is likely to pose some obstacles to decisively bringing down the public debt ratio over the medium term. Whilst this does not obstruct our confidence in the sustainability of Slovenia's public finances and our positive perception of Slovenia's fiscal consolidation track record in the recent past, the expected development, alongside still somewhat elevated contingent liabilities, balances to some extent the positive elements underlying our credit assessment concerning fiscal sustainability. We continue to regard sound debt management, still high debt affordability and a substantial liquidity buffer as significant factors mitigating fiscal risks. In view of still pending reforms to the social security system, in particular the pension reform, unfavorable projections for age-related costs cloud the longer-term fiscal outlook.

Following the acute phase of the global pandemic, which drove Slovenia's general government balance deep into deficit in 2020 (-7.7% of GDP, EA: -7.0% of GDP), the subsequent economic recovery and reduction of Covid-19 support measures enabled an improvement in public finances. Nevertheless, the sovereign concluded 2021 with a headline deficit of 4.7% of GDP (EA: -5.1% of GDP), revised from an initially reported larger negative turnout of -5.2% of GDP.

Following its strong increase in the first year of the corona crisis (2020: 14.8%), total general government expenditure continued to mount in 2021, albeit to a slower extent, rising by 7.0%, driven by further sizeable increases in social benefits (6.3%) and public wages (9.4%). Total general revenue, after having dropped in 2020, rebounded strongly, rising by 14.1%, mainly boosted by substantially higher tax income, but also by higher net social contributions.

Looking at the current year, public finances seem to be on course for a markedly smaller deficit than last year. Monthly budget execution data (state budget) covering Jan-Nov-22 exhibit a decline in expenditure by 6.1% y-o-y, amid reduced transfers to individuals and households, and lower subsidies as Covid-19 support is withdrawn further, whereas financial support to alleviate the effects from higher energy prices is beginning to kick in. As regards the revenue side, the monthly state budget data show a rise by 12.0% from Jan-Nov-22 versus the corresponding period in 2021, chiefly on the back of higher VAT revenue and corporate income tax receipts.

According to the Fiscal Council, state-level expenditure for Covid-19-related measures amounted to about EUR 716mn in Jan-Nov-22. Since March 2020, about EUR 5,509mn has been dedicated to this cause. Financial support to mitigate high commodity prices came to roughly EUR 700mn in the period Jan-Nov-22, although not the whole amount will have an impact on the budget balance. The Fiscal Council reckons with an impact on the general government balance of EUR 528mn. At the current juncture, we expect a headline deficit of about 2.8% of GDP for 2022, acknowledging a still pronounced degree of uncertainty around this.

As underscored by the latest fiscal package in support of businesses announced by the government in December 2022 and estimated to amount to a maximum of EUR 1.2bn, there is more substantial uncertainty over the ultimate turnout for 2023, not least as this package is contingent on the actual development of energy prices. Not the whole amount is likely to have an impact on budget balance; the package includes also EUR 250mn for liquidity purposes.

In addition, the public wage bill will likely continue to rise next year, given the wage agreement with public sector unions. Uncertainty also persists over economic performance, especially throughout the approaching winter season, and possible further measures to support the economy, in addition to lacking detail on a broader tax reform envisaged for 2023 with the aim to

shift some tax burden from labor towards capital. We currently assume the headline deficit to come in higher in 2023, amounting to about 5.4% of GDP.

The outlook for public finances over the medium-term remains subject to risks related to an envisaged overhaul of the public sector pay system in 2023, potentially adding to fiscal pressure, and only very vague prospects with a view to effects of the intended pension reform. That said, we note that the government has committed itself to fiscal prudence and plans, and currently targets a deficit below 3% of GDP with regard to 2024.

Slovenia's public debt ratio, which, following a peak in 2015 had been on a firm downward trend until the pandemic hit, fell to 74.5% of GDP last year (2020: 79.6% of GDP), continuing to post well below the level recorded for the euro area as a whole (2021: 95.4% of GDP). As of Q2-22, the ratio stood at 73.5% of GDP. In light of our estimates for the general government balance and our expectations for nominal GDP growth in the near term, we expect debt-to-GDP to dwindle to 69.7% of GDP this year and to broadly stabilize at that level in 2023 (69.8% of GDP).

Having decreased markedly since a peak in 2013, contingent liability risks in the form of public guarantees remain somewhat elevated and are estimated to increase slightly in 2022 (9.8% of GDP, 2021: 9.0% of GDP) and shrink to roughly 9.0% of GDP in 2023 (DBP23). The amount of maximum guarantees to support state-owned companies operating on international energy markets and recapitalizations was increased to EUR 2.8bn. In this context, it is worth mentioning that, reportedly, power utility HSE is to receive a capital injection adding up to about EUR 492mn by the middle of December 2022.

Contingent liabilities relating to the banking sector seem relatively moderate at the current stage, given increased resilience of the sector over recent years, above all in terms of improving asset quality. While the sector seems relatively well capitalized, we note that the CET1 ratio has trended downward since the most acute phase of the pandemic, dropping slightly below the EU level as of Q2-22 (SI: 14.9%, EU: 15.2%, EBA data) and continuing to show a larger gap towards CEE peers. The NPE ratio has stabilized at 1.7% in Q2-22, remaining broadly on par with the EU level, while bank profitability in terms of RoA was ahead of fellow EU members in the present year's first half. In light of the strengthened situation of Slovenia's banking sector over recent years, we note that the Bank Asset Management Company (BAMC) will cease its operations at the end of 2022, as it will be merged with SSH, which will acquire all of BAMC's assets, as well as all its rights and obligations.

To be sure, we will closely monitor asset quality in the banking sector against the backdrop of a worsening near-term economic outlook in combination with tighter monetary policy, strong increases in outstanding credit to the private sector and signs of overvaluation on Slovenia's housing market. The stock of bank loans to NFCs increased by 16.9% y-o-y in Sep-22 (ECB data), while outstanding loans to households for house purchases exceeded their level in the respective month of the prior year by 11.6%.

The share of mortgages in total bank credit outstanding to the private sector has continuously climbed over recent years, reaching slightly more than a third as of Sep-22 (35.6%, BSI). The vast majority of new loans to households in the first half of 2022 were subject to fixed interest rates (91%, BSI Financial Stability Review), potentially shielding borrowers from running into difficulties servicing their debt if the cycle of monetary policy tightening continues, but potentially weighing on banks' profitability. While new loans to NFCs have been increasingly subject to fixed rates as well, the majority of the stock of loans to enterprises is based on variable rates.

After some moderation already prior to the pandemic, Slovenian house price growth has accelerated more recently. As of Q2-22, the annual increase stood at 15.6%, while the 3-year rate of change (i.e. compared to Q2-19) mounted to 33.9% (Eurostat data). Affordability indicators such as the loan-to-income ratio (OECD data), which has risen above its long-term average, back the impression of some price misalignments. In order to counter emerging risks in this regard, Bank of Slovenia adjusted macro-prudential levers in April 2022, entering into force from July 2022, and has introduced two sectoral systemic risk buffers which will apply from January 2023. In a more recent decision (Dec-22), the countercyclical capital buffer was raised from zero to 0.50% for the banking sector with effect from December 2023.

We continue to view sound public debt management, the relatively high average weighted maturity of the debt portfolio (2022e: 10.2y, MoF data) and a sizeable liquidity buffer as risk-mitigating factors to some extent. Debt affordability should remain high, although gradually becoming less favorable further out. In 2021, interest payments dropped by 13.4% and are on course to post another decline in 2022, having fallen by 10.0% y-o-y in the first eleven months of this year, according to the monthly state budget execution data by the Fiscal Council.

While for now the ECB keeps reinvesting principal payments of maturing government bonds purchased under the PSPP and the PEPP, this policy may begin to be wound down in 2023. As of Nov-22, cumulative Slovenian government bond purchases under both programs amounted to about EUR 17.8bn, corresponding to about 43.3% of Slovenia's gross general government debt as of Q2-22 (ECB and Eurostat data). We expect the ECB to raise its policy rates by 50bp this December and to continue hiking rates at an overall slower pace in 2023.

With tangible progress on pension reform still pending, we highlight longer-term fiscal risks stemming from projected demographic developments and age-related costs, as e.g. reflected by the EU-Ageing Report 2021. We gather that the pension system is to see a greater overhaul in 2024 (Stability Program 2022), having been postponed somewhat in light of the recent succession of crises and a more volatile domestic political backdrop. According to the RRP, adoption of proposals for amendments to pension legislation by the parliament is envisaged for Q4 2024.

Foreign Exposure

As regards the external sector, we continue to view Slovenia's situation as generally solid. A persistent current account surplus has contributed to improving the sovereign's net international investment position (NIIP) through the years. Under the impression of commodity price and trade developments linked to the war in Ukraine, the current account is more likely to record a small deficit in the near term. Whilst we consider such a development to be temporary at this stage, anticipating at least a moderation of energy prices in 2023, a more protracted phase of high energy prices than currently assumed may carry a risk of hampering Slovenia's export competitiveness.

Owing to pandemic-related distortions to trade flows in 2020, Slovenia's current account surplus marked a peak at 7.6% of GDP in that year, before being pulled back by a shrinking surplus in goods trade amid the economic recovery following the global health crisis. Last year, the surplus thus decreased to 3.8% of GDP, a level more in line with the average balance recorded over the ten years to 2019 (3.5% of GDP).

More recently, and as measured by the four-quarter moving sum, the positive current account position narrowed significantly (Q2-22: 0.6% of GDP), with the trade in goods balance moving into deficit and developments in the service balance unable to compensate for this. For 2022 as

a whole, we expect the current account to post a small deficit, which could start to reverse in the course of next year if, as we assume, commodity prices and supply bottlenecks moderate and the European economy can avoid a deep or prolonged recession.

Slovenia's negative NIIP, meanwhile, has improved further, amounting to -4.0% of GDP as of Q2-22 (Q2-21: -7.4% of GDP), outperforming from a CEE perspective. With a medium-term view and despite current downside risks, the sovereign might eventually assume a role as net external creditor.

Rating Outlook and Sensitivity

Our rating outlook on the Republic of Slovenia is stable, as we view downside risks to macroeconomic performance, fiscal consolidation and foreign exposure primarily associated with the war in Ukraine as largely mitigated by ultimately still constructive medium-term growth perspectives, as well as sufficient fiscal and external buffers to address the current challenges.

We could raise the sovereign's credit rating or outlook if economic growth continues to exceed expectations, accelerating the convergence towards EU income levels. Likewise, we could consider a positive rating action if the public debt ratio rapidly embarks on a firm and sustained downward path. Decisive steps in terms of reforms to the social security system, which would markedly improve prospects for longer-term fiscal sustainability, could also prompt us to lift our credit ratings or the outlook.

By contrast, we could contemplate a negative rating action if economic growth performance weakens substantially and for a prolonged phase, halting or even reversing the convergence process, possibly on the back of more persistent pressure via high energy prices, which could weigh on Slovenia's industrial performance and export competitiveness, and/or via slower or less-effective-than-expected implementation of RRP initiatives. Downward pressure on the rating or the outlook could also result from persistently deteriorating fiscal metrics, possibly as a consequence of economic weakness and/or failure to adjust relevant levers to prospectively rein in fiscal pressures such as age-related costs.

Analysts

Primary Analyst
Fabienne Riefer
Sovereign Credit Analyst
f.riefer@creditreform-rating.de
+49 2131 109 1462

Chairperson
Dr Benjamin Mohr
Head of Sovereign Ratings
b.mohr@creditreform-rating.de
+49 2131 109 5172

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

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 the following, we explain how and to what degree any of the key drivers behind the credit rating or the related outlook is associated with what we understand to be an ESG factor, and outline why these ESG factors were material to the credit rating or rating outlook.

For further information on the conceptual approach pertaining to ESG factors in public finance and the relevance of ESG factors to sovereign credit ratings and to Creditreform Rating credit ratings more generally, we refer to the basic documentation, which lays down [key principles of the impact of ESG factors on credit ratings](#).

ESG Factor Box



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]	2017	2018	2019	2020	2021	2022e	2023e
Macroeconomic Performance							
Real GDP growth	4.8	4.5	3.5	-4.3	8.2	5.0	0.4
GDP per capita (PPP, USD)	36,680	39,211	41,011	39,428	44,162	49,968	52,518
Credit to the private sector/GDP	47.6	45.5	44.8	45.7	43.4	n/a	n/a
Unemployment rate	6.6	5.1	4.4	5.0	4.8	n/a	n/a
Real unit labor costs (index 2015=100)	100.6	101.1	102.8	109.0	107.4	99.7	99.2
World Competitiveness Ranking (rank)	43	37	37	35	40	38	n/a
Life expectancy at birth (years)	81.2	81.5	81.6	80.6	80.9	n/a	n/a
Institutional Structure							
WGI Rule of Law (score)	1.0	1.1	1.1	1.1	1.0	n/a	n/a
WGI Control of Corruption (score)	0.8	0.9	0.9	0.8	0.7	n/a	n/a
WGI Voice and Accountability (score)	1.0	1.0	1.0	0.9	0.9	n/a	n/a
WGI Government Effectiveness (score)	1.2	1.1	1.1	1.2	1.2	n/a	n/a
HICP inflation rate, y-o-y change	1.6	1.9	1.7	-0.3	2.0	9.2	6.9
GHG emissions (tons of CO2 equivalent p.c.)	8.6	8.5	8.2	7.6	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	-0.1	0.7	0.6	-7.7	-4.7	-2.8	-5.4
General government gross debt/GDP	74.2	70.3	65.4	79.6	74.5	69.7	69.8
Interest/revenue	5.7	4.6	3.9	3.7	2.8	n/a	n/a
Debt/revenue	168.5	159.0	149.5	183.2	166.9	n/a	n/a
Total residual maturity of debt securities (years)	8.5	9.1	9.1	8.8	9.7	n/a	n/a
Foreign exposure							
Current account balance/GDP	6.2	6.0	5.9	7.6	3.8	n/a	n/a
International reserves/imports	0.0	0.0	0.0	0.0	0.0	n/a	n/a
NIIP/GDP	-24.2	-18.9	-16.2	-15.6	-6.8	n/a	n/a
External debt/GDP	100.5	91.9	91.6	102.1	97.3	n/a	n/a

Sources: IMF, World Bank, Eurostat, AMECO, ECB, SiStat, 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
Monitoring	16.12.2022	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, IMD Business School, European Center for Disease Prevention and Con-

trol (ECDC), Blavatnik School of Government, 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).

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".

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An explanatory statement of the meaning of each rating category and the definition of default are available in the credit rating methodologies disclosed on the website.

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Creditreform Rating AG

Creditreform Rating AG

Europadam 2-6
D - 41460 Neuss

Phone +49 (0) 2131 / 109-626
Fax +49 (0) 2131 / 109-627
E-Mail info@creditreform-rating.de
Internet www.creditreform-rating.de

CEO: Dr. Michael Munsch
Chairman of the Board: Michael Bruns
HRB 10522, Amtsgericht Neuss