REPUBLIC OF SLOVENIA
FISCAL COUNCIL

Public finance and macroeconomic developments

July 2023

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Data available up to and including 10 July 2023 were used.

The present document contains an analysis of fiscal trends in the general government sector in accordance with the European System of Accounts methodology (ESA, 2010), also used for the monitoring of EU fiscal rules. These trends are published quarterly as national accounts statistics by SORS. It also monitors trends in the state budget, local government budgets, the pension insurance fund (ZPIZ) budget and the health insurance fund (ZZZS) budget in accordance with the International Monetary Fund methodology for monitoring government finance statistics (GFS) based on the cash flow principle, which are published on a monthly basis by the Ministry of Finance.

The comments on the state budget implementation (Section 2) refer to the daily data available at:
https://proracun.gov.si/# (Only in Slovene).

Summary

In the first half of this year, the fiscal situation deteriorated slightly, which is mostly related to high inflation. Its initial positive impact on revenue, which was noticeable last year, has gradually faded and with a delay the pressure on expenditure increased, as expected. The direct impact of intervention measures has been slightly less than in the same period last year, although it is still considerable. The negative effect of measures to alleviate the cost-of-living crisis, which are focused on the business sector this year, has been increasing. The relative indebtedness of the general government continues to gradually reduce, mostly due to high inflation, although it remains higher than before the epidemic. Considering the more adverse fiscal trends forecasted for this year compared to the EU average and the uncertainty regarding the effect of further measures, the risk of a more pronounced tightening of financing conditions is increasing, although, for now, it is also limited by a large liquidity reserve. Many adopted and announced discretionary measures are a continuation of the unsuitable past approach with exclusively negative consequences for fiscal sustainability.

* * *

According to the data available, the general government deficit was marginally higher in the first quarter of this year (at 3.6%) than in the same period last year and than the EU average. The cash flow data indicate similar trends in the second quarter, as the state budget deficit (of EUR 413 million) was roughly EUR 300 million larger than in the same period last year. The waning of economic activity dynamics after the period of acceleration following the end of the epidemic, the exhaustion of the initial positive impact of higher inflation and cost-of-living measures are the main factors slowing growth in the majority of tax revenues. The procurement of the considerable EU funds available also remains relatively ineffective. These negative factors are partly mitigated by the positive impact of the persistent favourable conditions in the labour market on the dynamics of the revenue from social contributions. Expenditure growth remains high, albeit with a slightly different structure. Growth in "core" current spending (i.e. without the effect of intervention measures) is mostly due to the higher growth in labour costs as a result of the wage increase agreement reached last autumn, which predominantly maintains the real purchasing power of public employees. The relatively high growth in transfers to individuals and households and in expenditure on goods and services is also partly related to high inflation. Investment dynamics remain strong, although they have slowed slightly compared to last year. According to budget documents, the growth should be even higher this year, while the outturn to date confirms our previous assessments that the investment plans were too optimistic.

In the first half of the year, the positive impact of favourable labour market conditions and high nominal wage growth on paid social contributions partly alleviated the pressure on the financing of pension and health insurance budgets. With regard to the pension insurance budget, this led to a lower year-on-year transfer from the state budget, despite the highest regular pension adjustment since 2009. The health insurance budget, by contrast, needed an almost three times larger transfer than in the first half of the previous year to achieve minimum surplus, even though the growth in expenditure slowed slightly. In the first half of the year, the surplus in local government budgets was lower year-on-year, despite the rise in lump sum funding and consequently greater revenue from personal income tax, as (in)direct inflation pressures on expenditure (wages and social transfers) largely replaced the standstill in investment activity after the local elections.

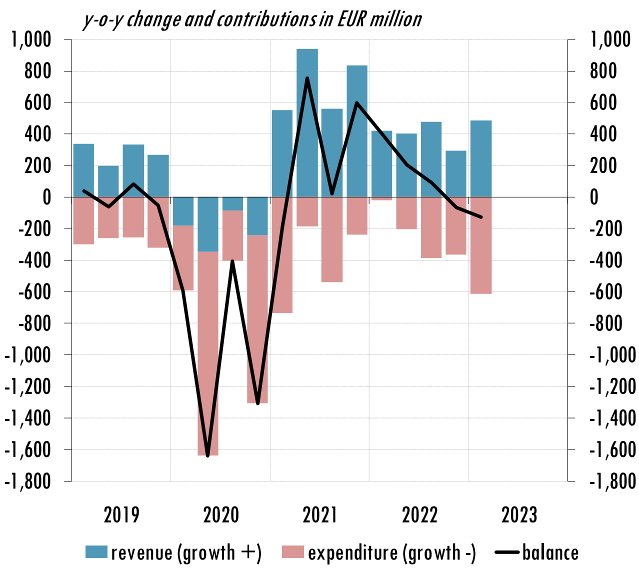
In the first quarter, the gross general government debt-to-GDP ratio fell further (to 69.5%), which is more than 15 pp less than the peak two years ago. The reduction in the debt-to-GDP ratio in the last two years despite the high general government deficit is mostly due to high growth in the nominal GDP. In the last year, the contribution of inflation to the reduction in the debt-to-GDP ratio considerably surpassed the contribution of the declining real economic growth. At the beginning of 2023, borrowing was relatively modest, and by the middle of the year, all this year's liabilities from bonds had been paid. Following a marked increase last year, the required yields have remained more or less unchanged since the beginning of 2023. In the last six months, mark-ups over the German benchmark bond have fallen more than for some comparable countries. Nevertheless, the required yield has been higher than the implicit interest rate since the first half of 2022, and if the debt level remains unchanged, this will result in higher budget expenditure on interest payments when refinancing the outstanding debt. The upward pressure on interest costs will be relatively gradual, as the maturity distribution of debt liabilities remains favourable.

In the period following the adoption of budget documents in the spring, discretionary measures of a permanent nature were adopted (on long-term care and complementary health insurance) whose consequences for fiscal sustainability are purely negative. Much like in the past, the measures are often insufficiently thought out and comprehensive, and there are no accompanying measures to neutralise the negative structural effect on public finance. The consequences of these measures are not yet evident, partly due to high inflation and its temporary impact on higher revenue growth. Such actions significantly limit the fiscal policy's future room for manoeuvre with regard to the announced measures, which are essential for or will have an impact on ensuring the long-term sustainability of public finance (pension reform, financing of the healthcare system and changes in the public sector wage system). The announced return of the rule-based fiscal framework at the EU level next year constitutes an important anchor for a more sustainable functioning of fiscal policy after four years of extraordinary circumstances, when the expectations of stakeholders with regard to fiscal policy capacity have become quite unrealistic. The drafting of budget plans in the autumn should reflect the awareness of fiscal policy limitations.

1. Fiscal trends – general government (ESA 2010 methodology)

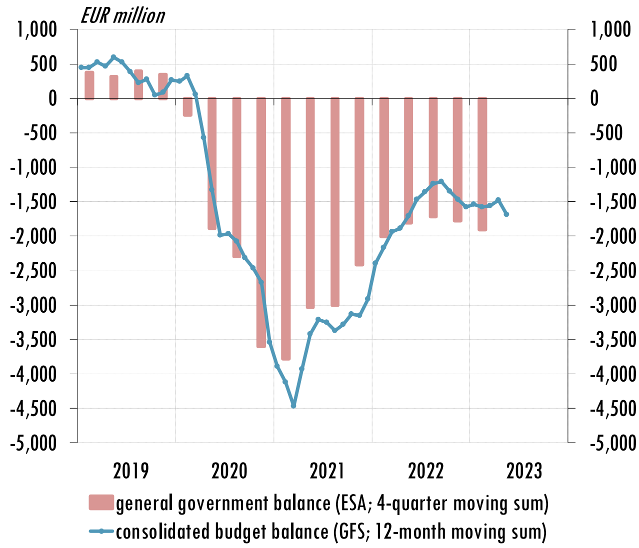
The **general government deficit in** the first quarter of this year amounted to EUR 544 million or 3.6% of GDP, which is slightly more than in the same period last year (EUR 416 million or 3.1% of GDP).[1] Available consolidated balance sheet data under the cash flow methodology suggest a continuation of similar trends up to and including May. The 2023 Stability Programme projects the general government deficit to be higher this year (4.1% of GDP) than last (3.0% of GDP).

Figure 1.1: General governmemt balance (ESA)



Source: SORS, FC calculations.

Figure 1.2: Public finance balances



Source: SORS, MoF, FC calculations.

Revenue growth (8.4%) remained higher than the long-term average and was similarly a result of higher revenue from social contributions due to continuing favourable labour market conditions and relatively high nominal wage growth, as well as higher tax revenues, in particular tax on production and imports (VAT and excise duty). Other relevant revenue categories were also higher year-on-year, interest income standing out with a significant increase.

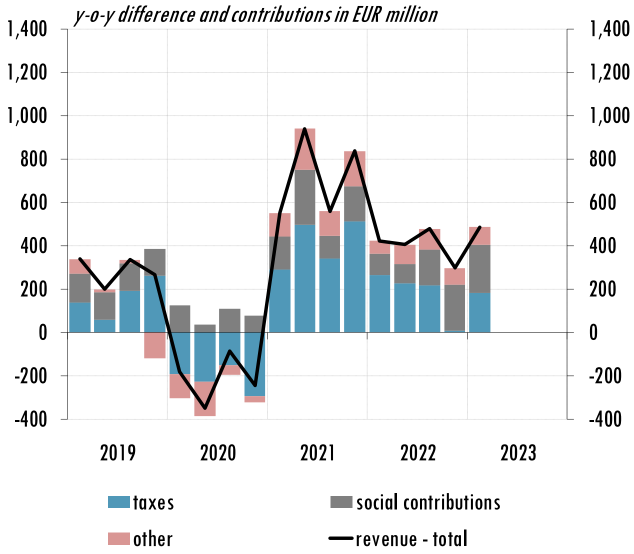
In the first quarter, year-on-year total **expenditure** growth increased (9.9%), mostly due to higher year-on-year growth in compensation of employees as a result of the agreement on wage increase for public employees and a marked increase in the expenditure on subsidies due to the measures to mitigate the cost-of-living crisis. Investment activity continues to grow at a high pace, while the growth in total expenditure on social benefits slowed after most of the relevant COVID-19 and cost-of-living measures ceased to apply. In the last two quarters, interest expenditure was higher year-on-year due to the increased cost of borrowing, thus ending the long period of a downward trend that started at the end of 2015.

According to the most recent **forecast of the European Commission**, issued in May, the deficit in Slovenia will increase this year,[2] while in the EU-27 it is expected to reduce on average and be lower than in Slovenia. If the forecast for this year is realised, the deterioration in the general government balance compared to the pre-crisis year 2019 in Slovenia (4.4 pp of GDP) will be the fourth greatest

[1] In analysing quarterly general government budget outturn, we do not monitor the trends with intervention measures excluded, because last year the Statistical Office of the Republic of Slovenia (SURS) stopped monitoring COVID-19 measures on a quarterly basis, and the monitoring of the cost-of-living measures at the level of general government is difficult for methodological reasons.

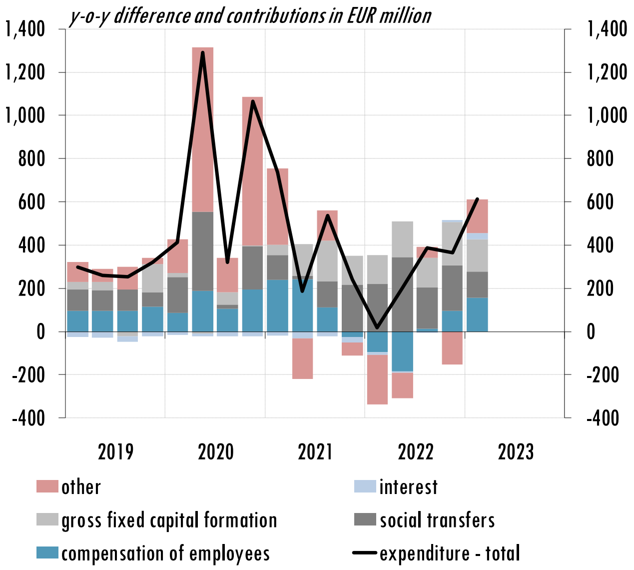
[2] The European Commission forecasts a deficit of 3.7% of GDP for Slovenia this year, which is less than projected in the stability programme.

Figure 1.3: General government revenue (ESA)



Sources: SORS, FC calculations.

Figure 1.4: General government expenditure (ESA)



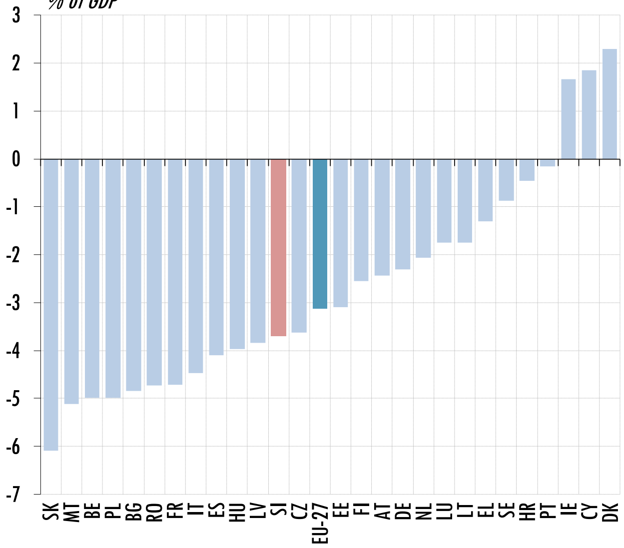
Source: SORS, FC calculations.

Table1.1: Main aggregates of the general government

	Q1				Q2-Q4							
			change				change				change	
	2022	2023	EUR million	%	2022	2023*	EUR million	%	2022	2023**	EUR million	%
REVENUE	**5,783**	**6,268**	**486**	**8.4**	**19,267**	**21,203**	**1,937**	**10.1**	**25,049**	**27,472**	**2,423**	**9.7**
TAXES	2,804	2,986	182	6.5	9,357	9,828	470	5.0	12,161	12,814	652	5.4
Taxes on production and imports	1,706	1,817	111	6.5	5,895	6,130	235	4.0	7,601	7,947	346	4.6
Curr. taxes on income, wealth, etc.	1,094	1,163	69	6.3	3,446	3,683	236	6.9	4,540	4,846	305	6.7
Capital taxes	4	6	2	36.6	16	15	-1	-6.0	20	21	1	3.1
SOCIAL CONTRIBUTIONS	2,252	2,475	223	9.9	7,063	7,720	657	9.3	9,315	10,195	880	9.4
PROPERTY INCOME	60	95	35	58.6	343	355	12	3.6	403	450	47	11.8
OTHER	666	712	46	6.9	2,504	3,301	797	31.8	3,170	4,013	843	26.6
EXPENDITURE	**6,199**	**6,812**	**613**	**9.9**	**20,629**	**23,281**	**2,652**	**12.9**	**26,828**	**30,093**	**3,265**	**12.2**
COMPENSATION OF EMPLOYEES	1,563	1,718	156	10.0	4,885	5,340	455	9.3	6,448	7,058	610	9.5
INTERMEDIATE CONSUMPTION	836	861	25	3.0	2,840	3,040	200	7.0	3,676	3,902	225	6.1
SOCIAL TRANSFERS	2,549	2,669	120	4.7	8,026	8,364	339	4.2	10,575	11,033	459	4.3
INTEREST	155	183	28	18.3	482	562	80	16.6	637	745	108	17.0
SUBSIDIES	156	308	152	97.6	601	1,287	686	114.2	757	1,596	839	110.8
GROSS FIXED CAPITAL FORMATION	630	782	152	24.1	2,455	3,347	892	36.3	3,085	4,129	1,044	33.8
CAPITAL TRANSFERS	24	31	7	29.8	181	372	190	104.8	205	402	197	96.2
OTHER	287	259	-28	-9.6	1,159	969	-190	-16.4	1,446	1,228	-218	-15.1
Balance	**-416**	**-544**	**-127**		**-1,363**	**-2,078**	**-715**		**-1,779**	**-2,621**	**-842**	
Primary balance	**-262**	**-361**	**-99**		**-881**	**-1,516**	**-635**		**-1,143**	**-1,877**	**-734**	
Balance, GDP %	**-3.1**	**-3.6**		**-0.5**	**-3.0**	**-4.2**		**-1.2**	**-3.0**	**-4.1**		**-1.0**
Primary balance, GDP %	**-2.0**	**-2.4**		**-0.4**	**-1.9**	**-3.1**		**-1.1**	**-1.9**	**-2.9**		**-1.0**
Nominal GDP, EUR million	**13,313**	**15,056**		**13.1**	**45,675**	**49,667**	**3,991**	**8.7**	**58,989**	**64,723**	**5,734**	**9.7**

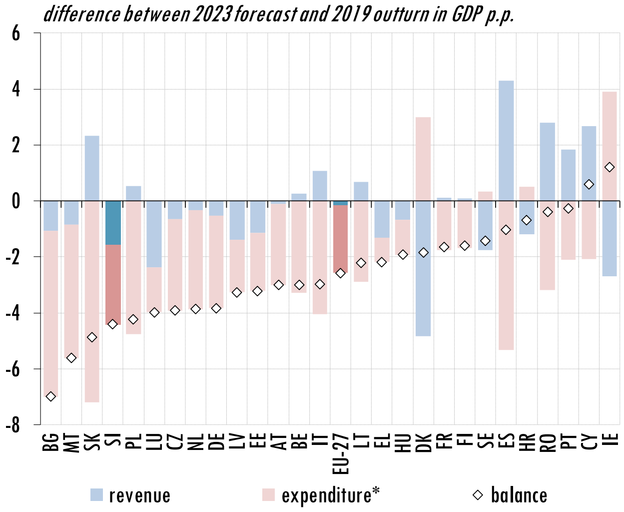
*Source: SORS, IMAD, Ministry of Finance. Notes: *implicitly calculated to match MoF forecast. **MoF Stability Programme 2023 forecast (April 2023) and IMAD Spring forecast (March 2023).*

Figure 1.5: General government balance forecast for 2023 (European Commission)



Source: EC (Spring forecast 2023).

Figure 1.6: Change in general government balance (EC forecast)



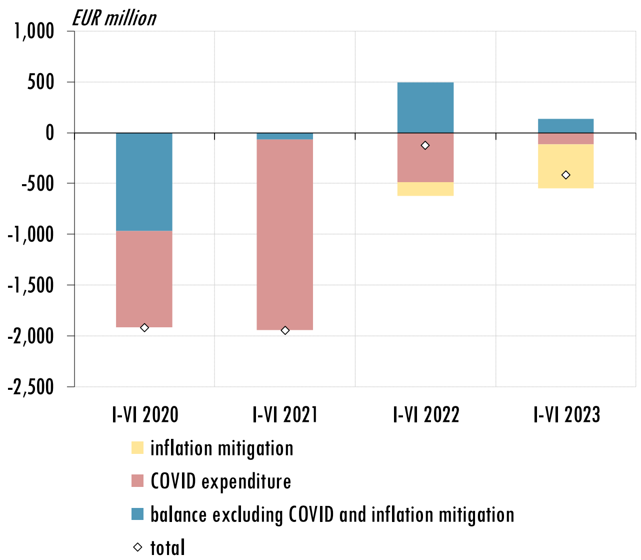
*Source: EC (Spring forecast 2023), FC calculations. Note: * Positive sign denotes a decrease in share, negative sign denotes an increase in share.*

among the Member States and considerably more noticeable than on average in the EU (2.6 pp of GDP). Roughly two thirds of the deterioration in Slovenia is a result of the higher expenditure-to-GDP ratio and the remaining third of the lower revenue-to-GDP ratio, while the deterioration in the EU average is entirely due to the increase in the expenditure-to-GDP ratio.

2. State budget (GFS cash-flow methodology)

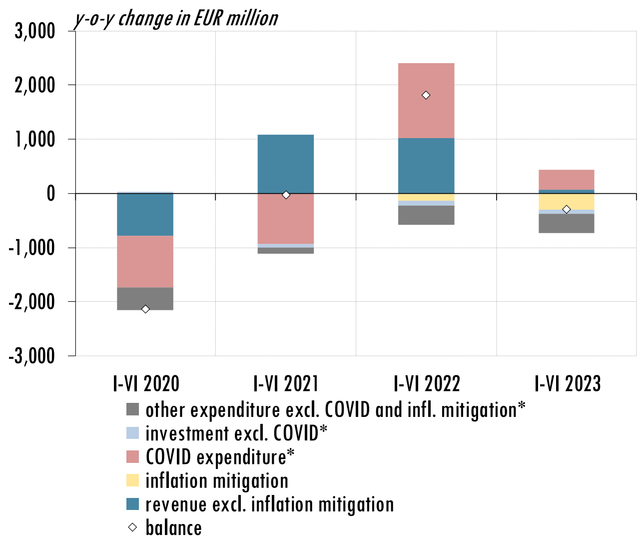
The **state budget** had a higher deficit in the first six months of this year (EUR 413 million) than in the same period last year (EUR 124 million). The surplus excluding the impact of expenditure to mitigate the consequences of the epidemic and the measures to ease the cost-of-living crisis was also lower (EUR 133 million; I–VI 2022: EUR 496 million). Taking into account the usual dynamics during a year, the state budget trends have, for now, mostly been in line with the projections in the revised budget.

Figure 2.1: State budget balance



Source: MoF, FC calculations.

Figure 2.2: Factors of state budget balance change



*Source: MoF, FC calculations. *positive sign denotes a decrease, negative sign denotes an increase.*

The lag in expenditure is slightly greater, but we assess that this is mostly due to overly optimistic investment expenditure projections.

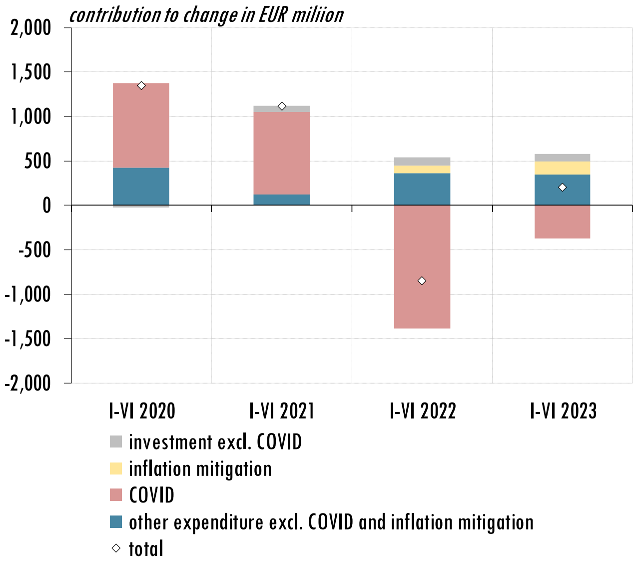
In the first half of 2023, **revenue** was lower year-on-year by 1.3%. The slowing of growth compared to the same period last year is partly due to a high base, slower economic dynamics and the effect of cost-of-living measures. Growth in tax revenues is considerably lower than last year, which is primarily due to year-on-year lower revenues from corporate income tax as a result of a year-on-year lower settlement following a record settlement last year, while the regular tax payments are higher this year. VAT revenue growth, which started to moderate in the second half of last year and has stabilised at lower levels in recent months, is also considerably lower than in the same period last year. In our assessment, the slowdown of year-on-year growth is partly due to the high base effect and the reduced VAT rate on energy products and to slower demand dynamics amid increased uncertainty and high inflation. By contrast, excise duty revenue growth has noticeably picked up in recent months on the back of increases in excise duties on energy products and tobacco. State budget revenue from personal income tax is also lower than in the same period last year, which can mainly be attributed to the increase in the lump-sum funding to municipalities and the further reduction in the tax burden. In the first six months, revenue from EU funds was lower year-on-year, which was mostly due to the low use of the funds under the recovery and resilience plan (RRP) in addition to the standstill in the use of cohesion funds.[3]

Total **expenditure** in the first half of 2023 was 3.1% higher year-on-year, while the so-called "core" expenditure (excluding COVID-19 expenditure and the effect of measures to mitigate the cost-of-living crisis) was 7.3% higher. The year-on-year increase in "core" expenditure was mainly driven by higher expenditure on labour costs as a result of the wage increase agreement reached last autumn. As expected, it was even higher in May, when the second part of the higher payments were made as agreed. Higher transfers into the social security funds, which were partly caused by a higher transfer to the Health Insurance Institute of Slovenia (ZZZS) for current spending and partly also by the June surge in the year-on-year increase in the transfer to the Pension and Disability Insurance Institute of Slovenia (ZPIZ) when the annual allowance was paid to pensioners, also contributed significantly to the increase in "core" expenditure. Year-on-year growth in investment expenditure remains high, although it is slightly lower than in the same period last year. The revised budget envisages that growth this year will be even higher than last year, which we assess to be an overly optimistic assumption, as in order for it to be realised, the realisation would have to be higher by approximately EUR 300 million in the second half of 2023 than in the whole of last year, which was a record year in terms of the government investment activity. In recent months, the statutory adjustment to last year's inflation caused a slight increase in the growth of expenditure on transfers to individuals. Growth in expenditure on goods and services is also increasing.

As expected, the direct **effect of intervention measures** on the deterioration of the state budget balance in the first six months of the year (EUR 546 million) was smaller than in the same period last year (EUR 620 million). Expenditure on COVID-19 measures amounted to EUR 116 million, the bulk of which were wage compensations due to isolation (EUR 46 million) and expenditure related to the cost of vaccination and testing (EUR 34 million). The investments amounted to EUR 22 million, which should constitute the bulk of this year's expenditure for COVID-19 measures envisaged in the revised budget (EUR 147 million of a total of EUR 371 million). The impact of measures to ease the cost-of-living crisis

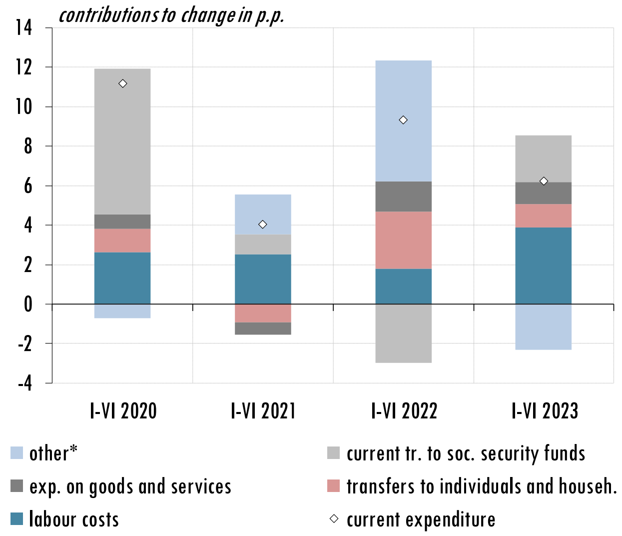
[3] In January 2022, EUR 118 million was received within the second advance payment of RRP funds. In the first half of this year, only EUR 50 million was received as the first instalment of EU grants that according to the initial timetable should have been received last year.

Figure 2.3: Structure of state budget expenditure growth



Source: MoF, FC calculations.

Figure 2.4: Current expenditure factors (excl. COVID and inflation mitigation)



*Source: MoF, FC calculations. Notes: *subsidies, payments to the EU budget, other expenditure.*

Table 2.1: State budget

EUR million, unless stated otherwise	I-VI 2022				I-VI 2023				I-VI 23/ I-VI 22, v %		I-VI 23/ I-VI 22	
	total	COVID	inflation mitig.	ex. COVID and infl. mit.	total	COVID	inflation mitig.	ex. COVID and infl. mit.	total	ex. COVID and infl. mit.	total	ex. COVID and infl. mit.
Revenue	**6,361**		**-45**	**6,406**	**6,275**		**-198**	**6,473**	**-1.3**	**1.1**	**-85**	**68**
VAT	2,280		0	2,280	2,378		-87	2,465	4.3	8.1	99	186
Excise duties	665		-45	710	800		-39	839	20.3	18.2	135	129
Personal income tax	910			910	922			922	1.4	1.4	13	13
Corporate income tax	942			942	742			742	-21.2	-21.2	-200	-200
EU funds	534			534	473			473	-11.4	-11.4	-61	-61
Non-tax	362			362	325			325	-10.1	-10.1	-37	-37
Other revenue	668		0	668	633		-72	705	-5.1	5.6	-34	38
Expenditure	**6,485**	**489**	**86**	**5,910**	**6,688**	**116**	**232**	**6,340**	**3.1**	**7.3**	**204**	**431**
Total labour costs	1,866	29		1,837	2,056	13	6	2,037	10.2	10.9	190	200
Transfers to individ. and hou.	969	84	0	886	979	6	27	945	1.0	6.8	10	60
Exp. on goods and services	690	141		549	616	5	2	608	-10.8	10.7	-75	59
Investment	418	9		409	514	23		491	23.0	20.1	96	82
Curr. transf. to soc. sec. funds	800	68		732	854	0		854	6.7	16.6	54	122
Subsidies	359	26	86	248	466	33	194	239	29.7	-3.6	107	-9
Interest	350			350	378			378	7.9	7.9	28	28
Payments to the EU budget	355			355	325			325	-8.4	-8.4	-30	-30
Other expenditure	677	133		544	501	35	3	464	-25.9	-14.8	-176	-81
Balance	**-124**	**-489**	**-131**	**496**	**-413**	**-116**	**-430**	**133**			**-289**	**-363**

Source: MoF, FC calculations.

in this period amounted to EUR 430 million. The Ministry of Finance estimates that revenues were EUR 198 million lower, as reduced excise duties, the lower VAT rate on energy products and the exemption from the CO2 tax continue to be applied. In the first six months, expenditure on mitigating the cost-of-living crisis amounted to EUR 232 million, the predominant part being the subsidies to businesses under Article 14 of the Act Regulating the Aid to Businesses to Mitigate the Impact of the Energy Crisis (EUR 145 million).

3. Public finance budgetary accounts (GFS cash-flow methodology)

In the first five months of this year, the year-on-year growth of the **Pension and Disability Insurance Institute of Slovenia (ZPIZ)** expenditure (4.3%) was slightly more than half of that in the same period last year (8.3%). The main reason for the slowdown was the fact that this year there was no allowance under COVID-19 measures, which was paid in each of the last three years, amounting to EUR 203 million in total. Against a backdrop of continuing modest growth in the number of pension recipients, the increase in total expenditure was mainly due to higher pensions following the regular adjustment in February, which was the highest since 2009 (5.2%).[4] The financing structure for the ZPIZ is the opposite of last year's, as the growth of revenue from social contributions increased further as a result of favourable labour market conditions and higher nominal growth in the average wage due to high inflation, while the transfer from the state budget is lower due to the end of COVID-19 measures. The transfer from the state budget amounted to EUR 486 million in the first five months of this year, which was 9.6% less year-on-year.

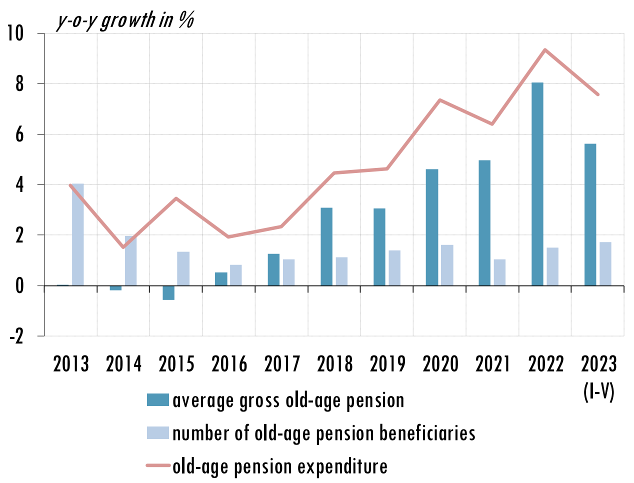
In the first five months of this year, the **Health Insurance Institute of Slovenia (ZZZS)** recorded a surplus (of EUR 22 million), while in the same period last year it recorded a deficit (of EUR 121 million). Revenue growth is markedly greater (16.1%; I–V 2022: 2.7%), which is mostly due to a higher transfer from the state budget for current spending. The growth in revenue from social contributions was also higher than in the same period last year as a result of favourable labour market conditions and higher nominal wage growth. Expenditure growth slowed slightly (6.1%: I–V 2022: 9.7%), primarily due to lower expenditure on sickness benefits, which was mostly a result of the high base from last year.[5] The growth in spending was thus to a great extent caused by noticeably greater growth in transfers to public institutions for labour costs related to the agreed wage increase for healthcare workers. Growth in payments to other public service providers that are not direct budget users was also higher than last year.

In the first five months of this year, the **municipal budgets'** surplus (EUR 24 million) was lower compared to the same period last year (EUR 74 million). Revenue growth fell by more than half (6.1%; I–V 2022: 13.2%). The growth was mostly due to higher personal income tax revenue, also as a result of another increase in the lump sum funding. Despite a slowdown, revenue related to property market trends (fee for the use of building land from legal persons and community infrastructure contribution) also contributed significantly to the growth. Unlike the same period last year, income from property and capital revenue was lower in the first five months of this year. Transfers from the state budget were also lower year-on-year, both for investments and for balancing the development of municipalities, while revenue from EU funds was slightly higher. Expenditure growth also slowed in the

[4] Old-age pensions, which account for around 80% of total pension expenditure, were up 5.6% year-on-year in the first five months of this year, with a 1.7% increase in the number of recipients.

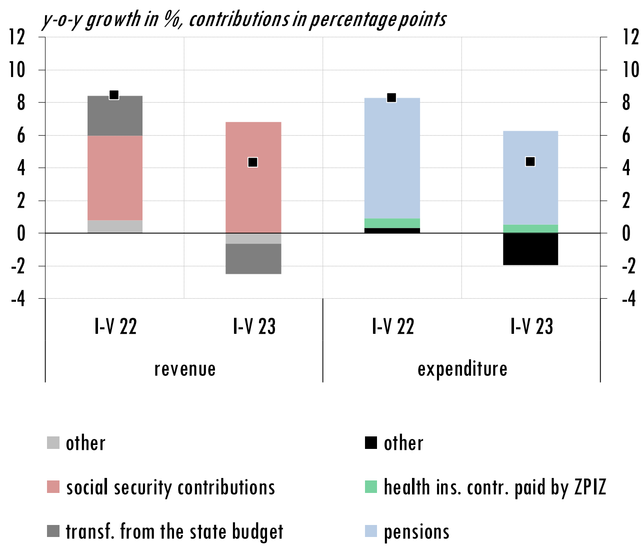
[5] Year-on-year growth in expenditure on sickness benefits further increased significantly in March last year, when the Health Care and Health Insurance Act was adopted, this reducing the period after which the Health Insurance Institute of Slovenia takes over the payment of sickness benefit from the employer from 30 to 20 days.

Figure 3.1: Old-age pensions*



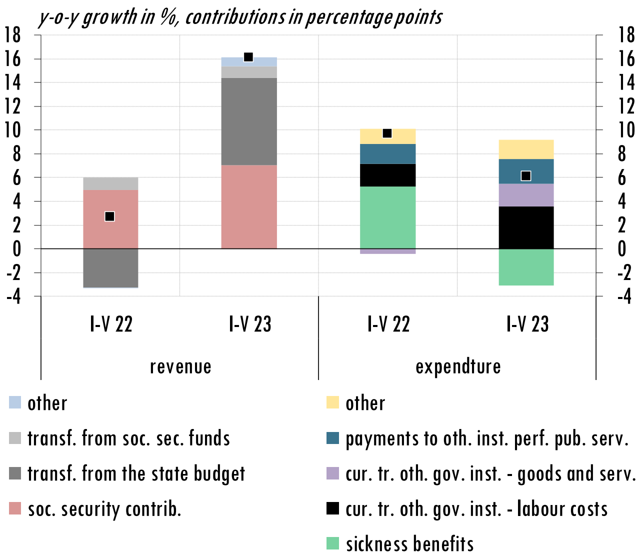
*Source: Pension and Disability Insurance Fund of Slovenia (ZPIZ), MoF, FC calculations. Note: *Old-age pension beneficiaries represented 75 % of all beneficiaries last year, while volume of old-age pension expenditure represented 81% of all ZPIZ pension expenditure.*

Figure 3.2: ZPIZ revenue and expenditure



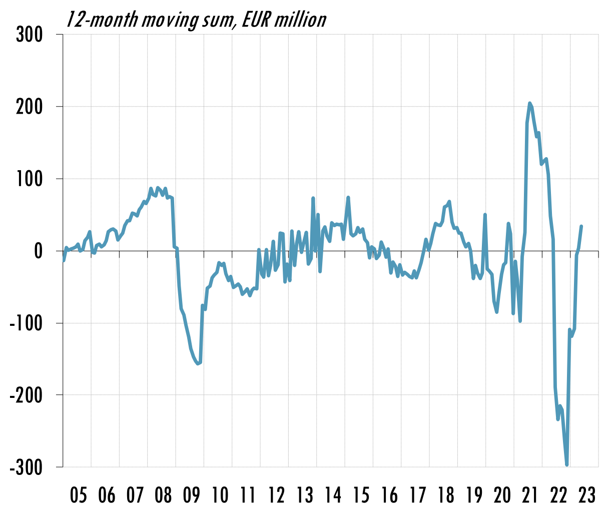
Source: MoF, FC calculations.

Figure 3.3: ZZZS revenue and expenditure



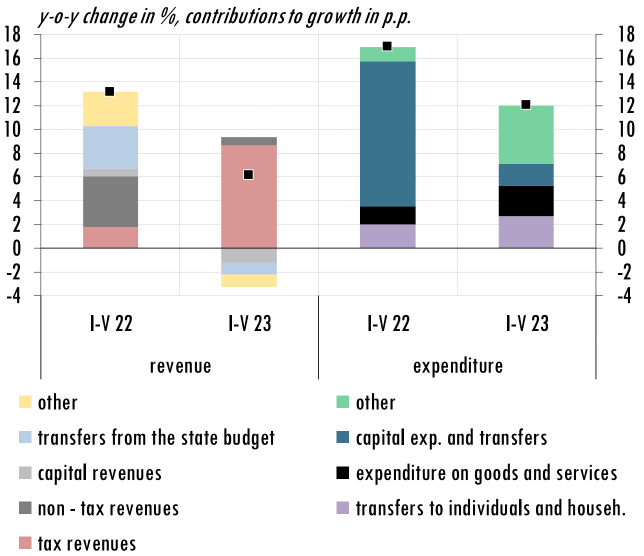
Source: MoF, FC calculations.

Figure 3.4: ZZZS budget balance



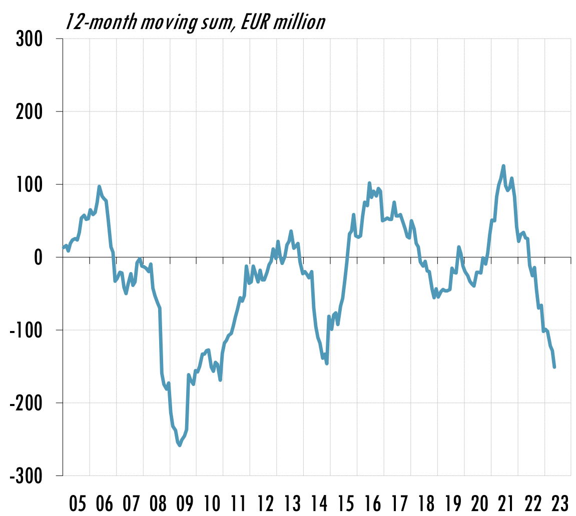
Source: MoF, FC calculations.

Figure 3.5: Revenue and expenditure of local government



Source: MoF, FC calculations.

Figure 3.6: Local government budget balance



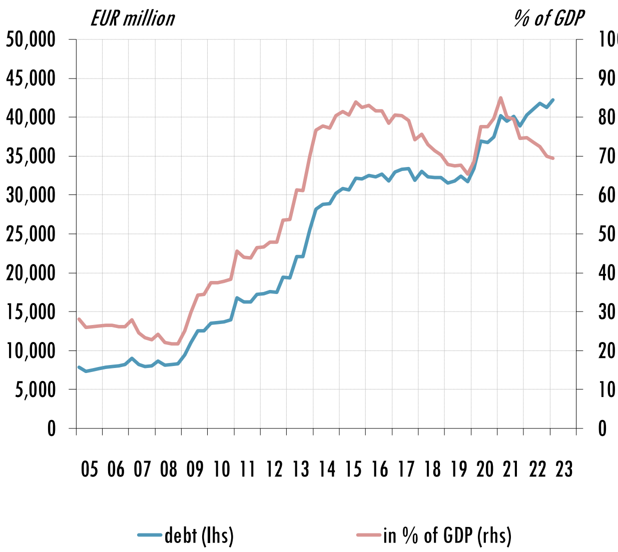
Source: MoF, FC calculations.

first five months of this year (12.0%; I–V 2022: 17.0%), although significantly less than revenue growth. This was mostly caused by a standstill in the growth of investment activity, which was also related to the last year's conclusion of the political cycle at the local level. The growth in spending thus mostly arose from higher growth in transfers to individuals and households, in particular the payments of the difference between kindergarten programme prices and parents' payments. Expenditure on goods and services also grew more than in the same period last year, similarly to transfers to public institutions for labour costs related to the wage increase agreement and for intermediate consumption.

4. General government debt

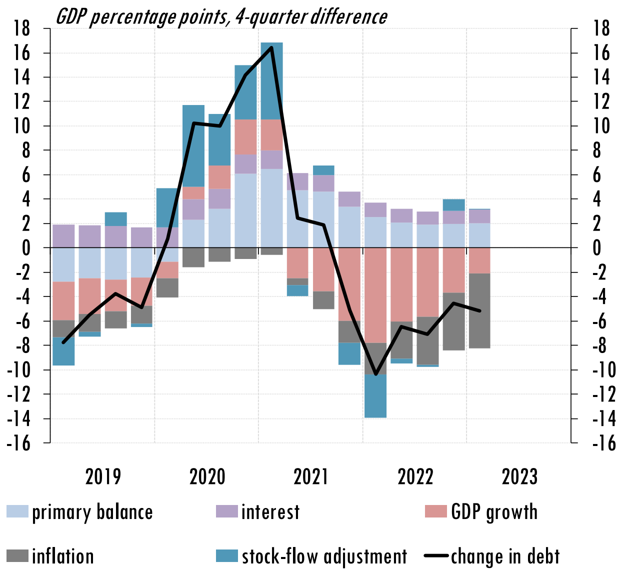
At the end of the first quarter of 2023, the **gross general government debt** stood at EUR 42.2 billion, which was EUR 0.9 billion more than at the end of 2022 and EUR 10.4 billion more than before the

Figure 4.1: General government debt (ESA)



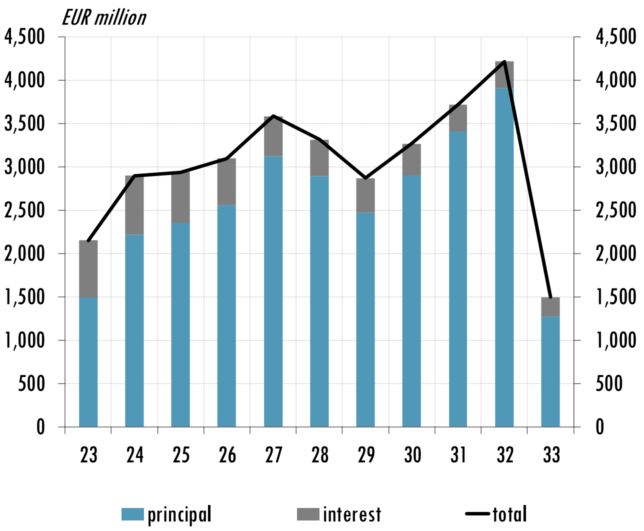
Source: SORS, FC calculations.

Figure 4.2: Change in general government debt



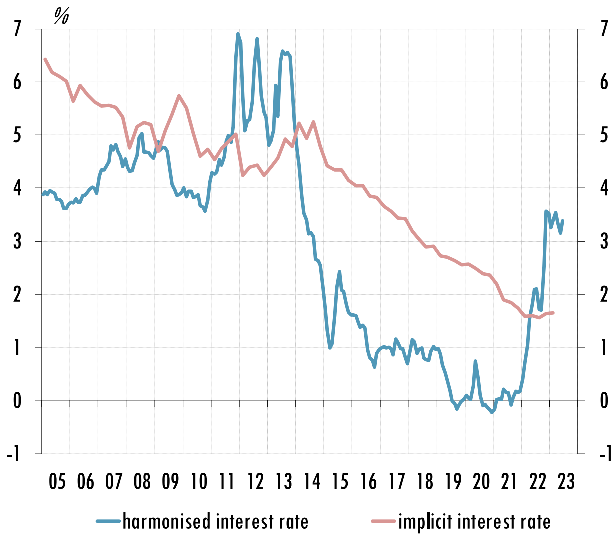
Source: SORS, FC calculations

Figure 4.3: State budget debt repayment schedule



Source: MoF.

Figure 4.4: Harmonised long-term interest rate and implicit public debt interest rate



Source: Bank of Slovenia, SORS, FC calculations.

pandemic crisis at the end of 2019. The debt represented 69.5% of GDP, increasing by around 4 pp of GDP from 2019, although it was lower than in the first quarter of 2021, when it was the highest to date (85% of GDP). The reduction in debt-to-GDP ratio in the last two years has mostly been due to high growth in nominal GDP in the period following the crisis. The contribution of inflation to the shrinking debt share, which amounted to approximately 6 pp in the year before the first quarter of 2023, has already significantly exceeded the contribution of the declining real economic growth.

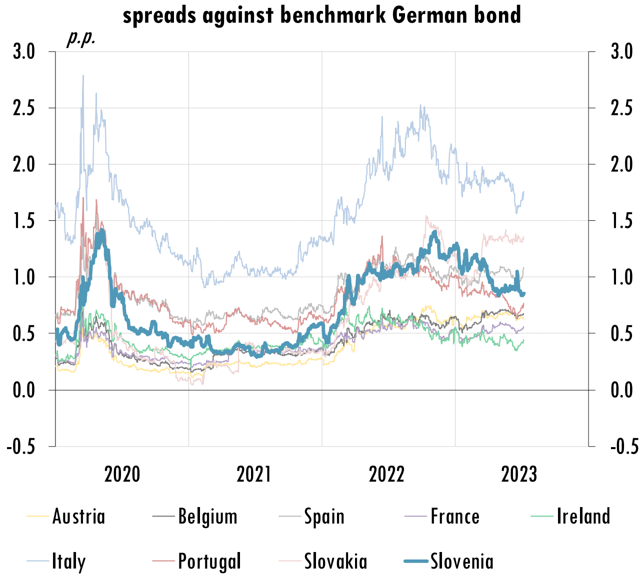
At the beginning of 2023, borrowing was relatively modest. At the beginning of the year, a ten-year sustainability bond was issued for a total of EUR 1.25 billion, with a coupon rate of 3.625%. By the end of June, additional issues of two existing bonds were made in the total value of EUR 450 million. The bonds have a long remaining time to maturity, one maturing in 2045 and the other in 2050. In the first half of 2023, the Treasury also carried out two partial early redemptions of existing bonds with total value of nearly EUR 100 million. One of these bonds matured this year while the other will mature next year. At regular auctions in the first half of 2023, the Treasury issued treasury bills in a total of almost EUR 800 million.

By the middle of the year, all liabilities from bonds that matured this year, amounting to EUR 1.1 billion, had been paid. The **maturity volume** of the currently issued bonds in 2024 is approximately EUR 2 billion higher than this year. In addition, there are treasury bills that will mature next year and amount to roughly EUR 0.27 billion. According to current data, the largest volume of liabilities in the coming years will mature in 2027 (approximately EUR 3 billion). In 2032, the maturity volume of current liabilities is almost EUR 4 billion. In order to limit high financing needs in the future, the primary budget deficit must be kept as low as possible or surpluses must be generated. Structural challenges that could increase the fiscal burden if no action is taken must also be addressed as far as is possible.

As of the end of June, **total funds in the treasury single account** amounted to approximately EUR 8 billion (12.7% of the forecasted GDP). This is less than the record level of EUR 9 billion reached in the middle of last year but still considerably more than the long-term average. This ensures a high liquidity of the state budget, which affords the fiscal policy a certain room for manoeuvre in the event of shocks and can limit the pressure of increased financing costs.

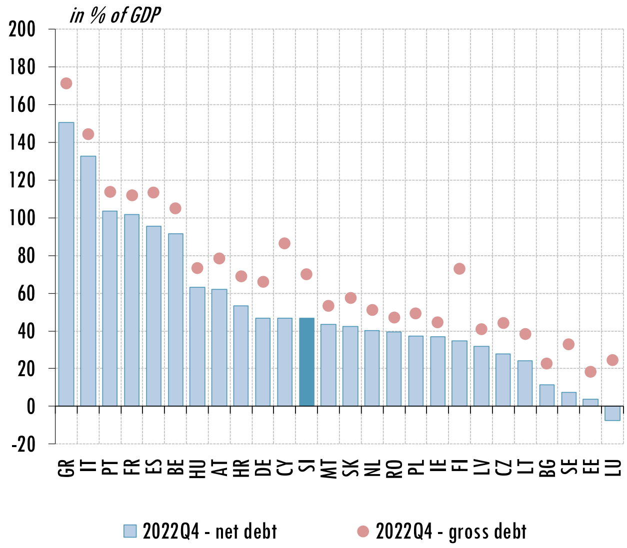
The **required yields** on long-term bonds of euro area countries, including Slovenia, rose noticeably in 2022, mainly due to the ECB's policy shift towards tighter financing conditions, higher inflation expectations and the required inflation risk premium. The interest rates of all treasury bills issued this year are close to 3% for all maturities, which is still negative in real terms given current inflation expectations. From the lowest values reached in the middle of 2021, the required yields on long-term bonds of euro area countries increased by 2.5–3.5 pp by the end of last year (Slovenia: slightly over 3 pp). The required yields have remained relatively unchanged since the beginning of 2023, while mark-ups on Slovenian bonds in relation to German benchmark bond have reduced more than for some comparable countries in this period. The required yield on Slovenian government bonds has been exceeding the implicit interest rate on total government debt since the first half of 2022. If this ratio persists and the debt level remains unchanged, this will entail higher budget expenditure on interest payments when refinancing the outstanding debt. The pressure to increase interest costs will be relatively gradual. The maturity distribution of debt liabilities remains favourable, as the weighted average time to maturity of the debt exceeds 10 years. At the same time, the Treasury has been limiting the impact of interest rate increases on debt interest costs by means of a hedging instrument since 2018, totalling approximately EUR 4.6 billion (data available for the end of 2022). The

Figure 4.5: Reference 10-year government bond spreads against benchmark German bond



Source: Bloomberg, FC calculations.

Figure 4.6: Net and gross general governent debt



Source: Eurostat, ECB, FC calculations.

sovereign debt ratings have remained unchanged in the last year. At the end of 2022 and in the middle of 2023, the leading rating agencies confirmed a stable outlook for the Republic of Slovenia's debt. According to the latest data available, from the end of 2021 to the end of 2022, government guarantees decreased by approximately EUR 200 million to EUR 3.8 billion, representing 7.7% of GDP.

The Slovenian general **government's gross debt-to-GDP ratio is below the EU average**, although the gap (14.1 pp of GDP at the end of 2022) is smaller by half than the long-term average gap (27 pp of GDP).[6] In the fourth quarter of 2022, the increase in the debt-to-GDP ratio with regard to the period before the onset of the pandemic crisis was 1.8 pp of GDP less than the EU average, ranking Slovenia in the middle of EU countries. Excluding general government financial assets, which mainly result from pre-financing, in the last quarter of 2022 the net general government debt stood at 46.6% of GDP, placing Slovenia 14th among the EU Member States in terms of its increase over this period.

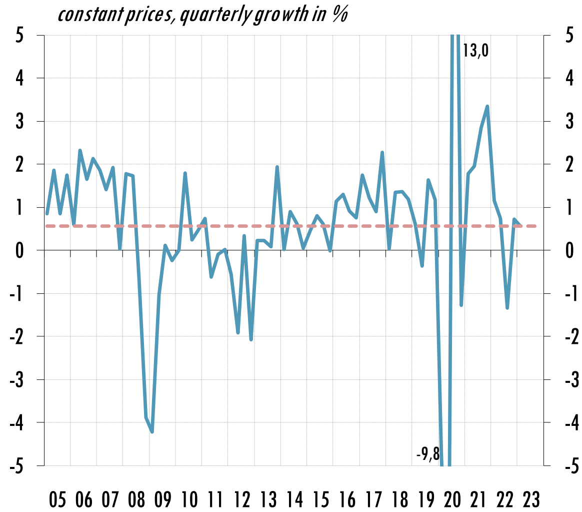
5. Macroeconomic trends and risks

At the end of last and the beginning of this year, **economic activity** in Slovenia was higher than previously expected and was based primarily on domestic consumption. In the last quarter of the previous year and the first quarter of this year, the quarterly dynamics of real economic growth were similar to the long-term average at around 0.7%, while year-on-year GDP growth moderated due to high bases resulting from recovery after the end of the epidemic a year ago. Nevertheless, with the persistently strong price component, the year-on-year growth of the nominal GDP remained high, at around 13%. With a large year-on-year negative contribution of inventories, the quarterly dynamics of all domestic consumption components was positive, while the standstill in international trade that started in the middle of last year continued. Domestic consumption was particularly affected by further growth in gross fixed capital formation, whose dynamics are still based on high growth in construction investments. This growth is to a great extent due to investments in civil engineering works, although

[6] Comparable data are available as of 2000. The greatest difference between the general government debt-to GDP ratio between Slovenia and the EU average was reached in 2000 (42.9% of GDP) and the smallest in 2016 (4.2% of GDP).

Figure 5.1: GDP*

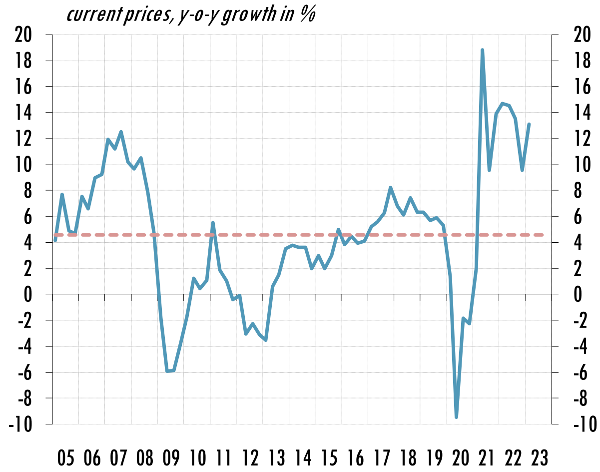
constant prices, quarterly growth in %



*Source: SORS, FC calculations. * seasonally and calendar adjusted data.*

Figure 5.2: Nominal GDP

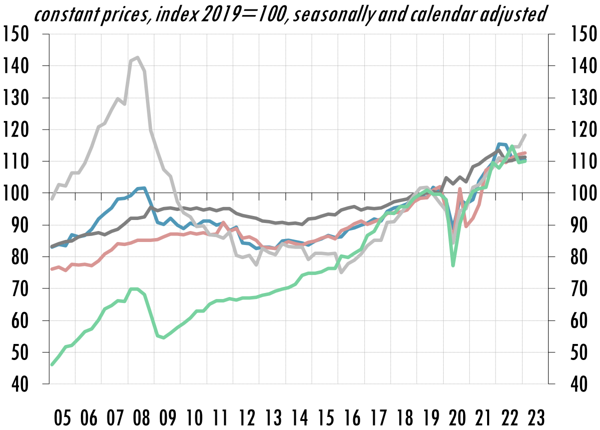
current prices, y-o-y growth in %



Source: SORS, FC calculations.

Figure 5.3: Demand components

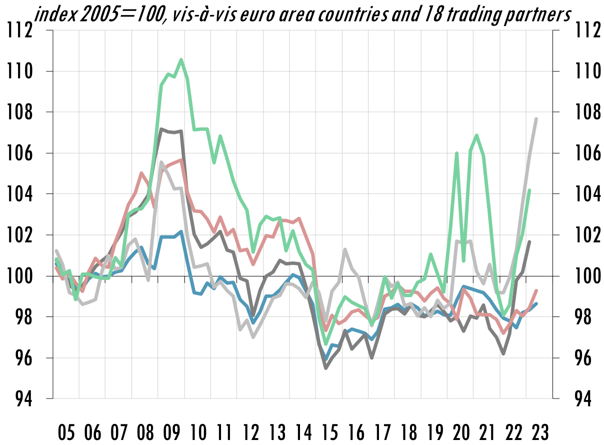
constant prices, index 2019=100, seasonally and calendar adjusted



Source: SORS, FC calculations.

Figure 5.4: Harmonised competitiveness indicators

index 2005=100, vis-à-vis euro area countries and 18 trading partners



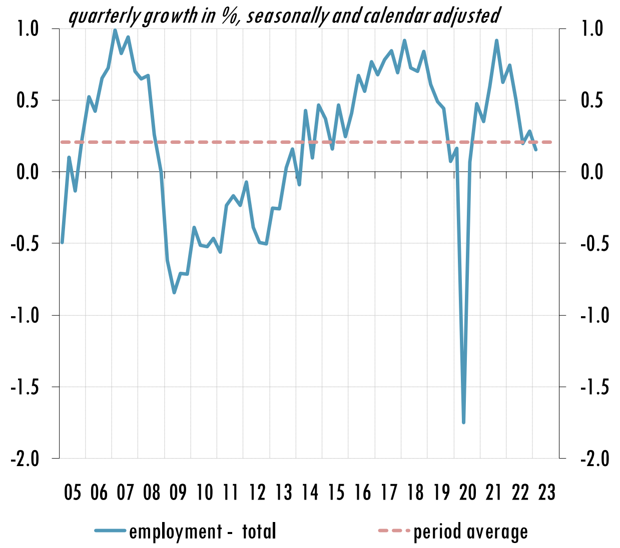
Source: ECB, FC calculations.

house building also shows no signs of abating. These trends are reflected in the rapid growth of the volume of value added in construction industry, which was 11% year-on-year on average over the last two years. In the last six months, the quarterly consumption of households has slowed, but it remains high, with real quarterly growths between 2% and 3% and nominal growth which amounts to approximately 15% year-on-year. The slowdown was mostly a result of the standstill in the consumption of durable products, while growth in the consumption of non-durable products, including the consumption of services, increased further. Following the marked increase in demand for goods while service provision was restricted during the epidemic, the structure of household consumption is now again turning in favour of services. These trends are also reflected in international trade, as in the last year, the current growth in services trade has been considerably higher than in goods trade. It has been noted, in particular, that the quarterly dynamics of export activity has been slowing since the middle of last year, which is mostly in line with the abating economic impetus in major trade partners.

In part, the export standstill may also be attributed to the declining competitiveness, which was particularly noticeable in indicators based on producers' prices.

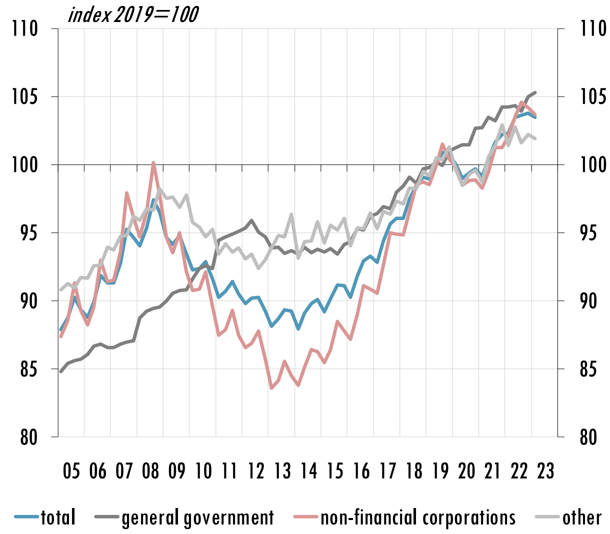
Although employment and unemployment indicators have reached their historically highest and lowest values respectively, the slowdown of economic activity is also reflected in the slowing improvement of **labour market conditions**. At the beginning of the year, the quarterly dynamics of aggregate employment were slightly below the long-term average (roughly at 0.2%), following a long period of over-performance since 2014, with the exception of the fall immediately before and at the onset of the epidemic. This growth was mostly due to the increase in employment in the construction industry. The main contributors to the slowdown in employment growth were various services and the processing industry. The slowdown in employment is also indicated by business tendencies in all activities, except retail trade. The number of unemployed persons continues to fall year-on-year, at a rate now exceeding 15%. The number of registered unemployed persons fell to below 50,000 this year. This is

Figure 5.5: Employment (domestic concept)



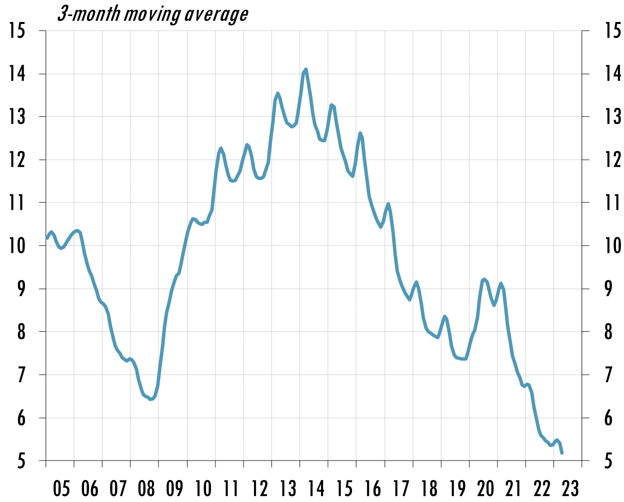
Source: SORS, FC calculaions.

Figure 5.6: Employment



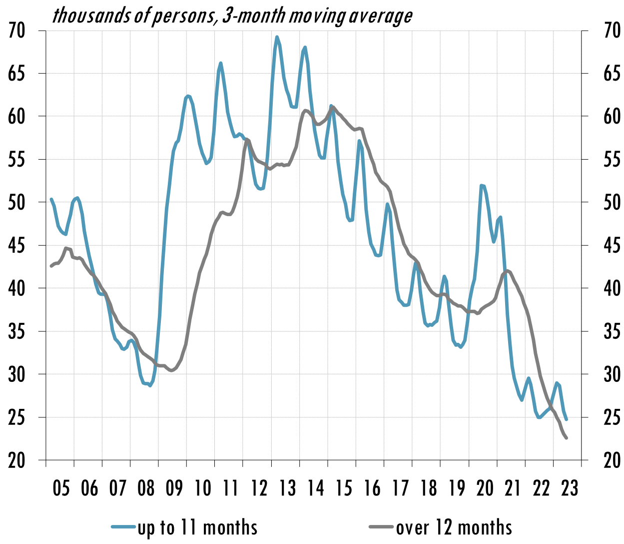
Source: SORS, FC calculations.

Figure 5.7: Registered unemployment rate



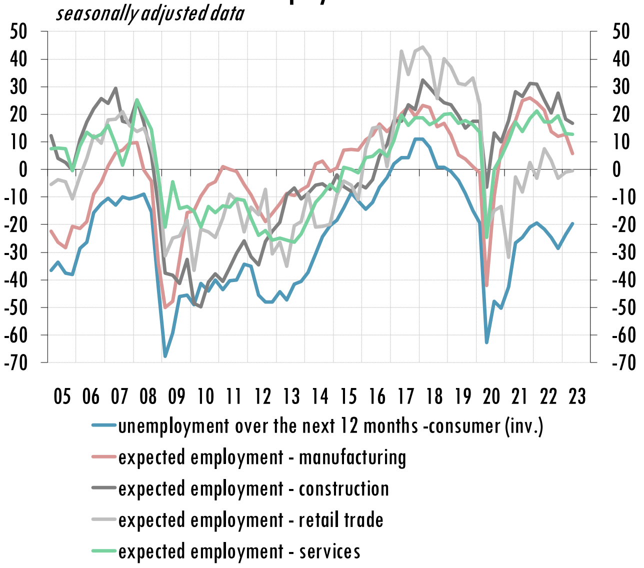
Source: Employment Service of Slovenia, FC calculations.

Figure 5.8: Number of registered unemployed persons



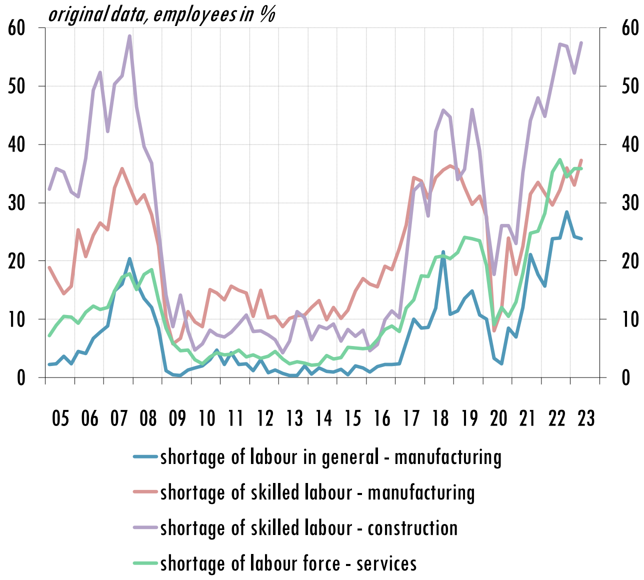
Source: Employment Service of Slovenia, FC calculations.

Figure 5.9: Business tendency and consumer surveys - employment



Source: SORS; FC calculations.

Figure 5.10: Business tendency - limiting factors, labour

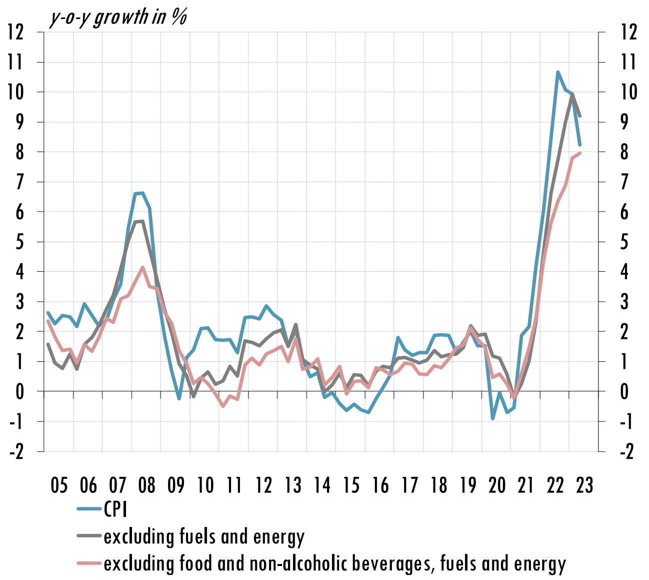


Source: SORS, FC calculations.

increasingly due to the reduction in the number of long-term unemployed persons, which together with the continuing rapid rise in the employment of foreigners indicates labour shortage. Although labour remains an important limiting factor for business according to survey indicators, in the last few quarters, the tightening of restrictions in this area has been lessened slightly, and in some activities, in particular in the manufacturing and construction industries, even reduced. In the first few months of the year, the nominal growth in average gross salary was over 10%, which was mostly a result of a low base, the increase in the minimum wage in January and the partial adjustment of wages to inflation. In real terms, the average wage stagnated in the first four months, while IMAD and the European Commission forecast that the average over the entire year will increase by approximately 1%.

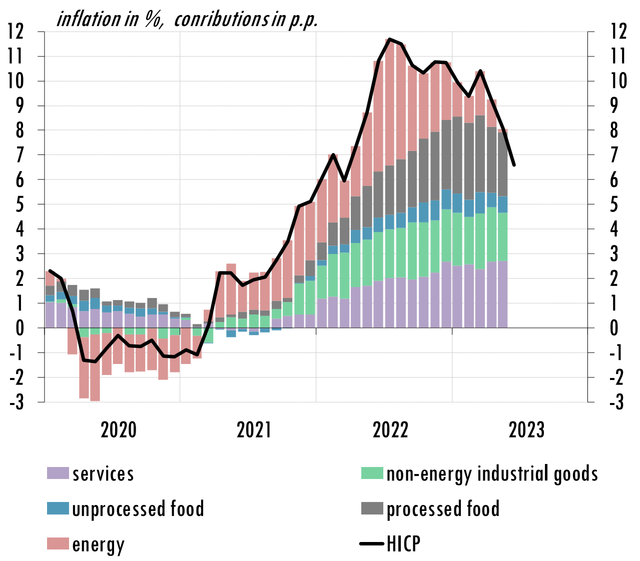
By June this year, **inflation** in Slovenia had fallen from the peak at over 11% in the middle of last year to below 7%. Energy product prices have moderated, but the pressure of prices of all other

Figure 5.11: Consumer price index and core inflation indicators



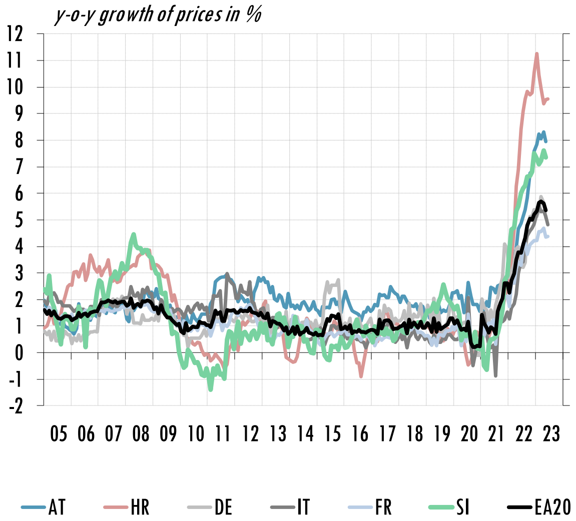
Source: SORS, FC calculations.

Figure 5.12: HICP and contributions



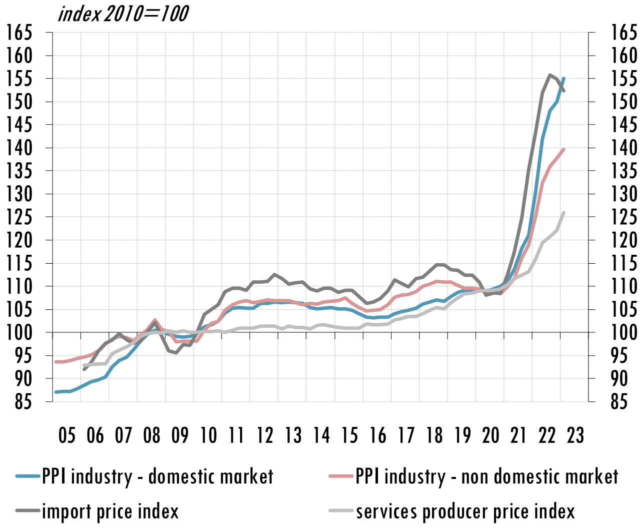
Source: Eurostat, FC calculations.

Figure 5.13: Core inflation - HICP excluding food and energy



Source: Eurostat, FC calculations.

Figure 5.14: Producer price and import price indices



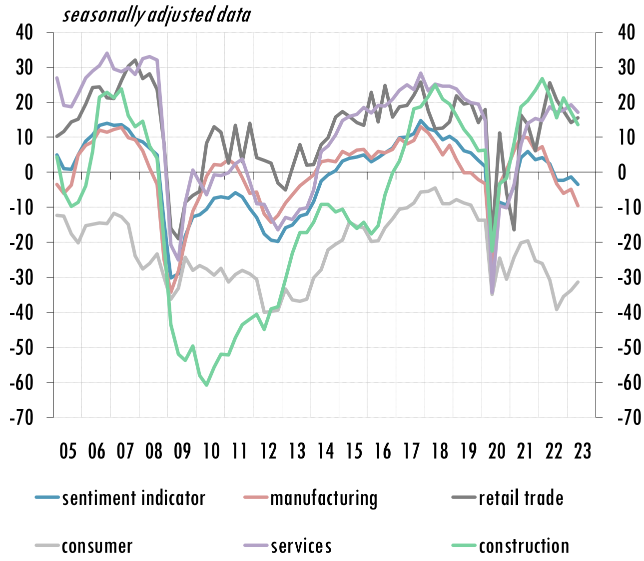
Source: SORS, FC calculations.

price basket components remains and the prices of some components have even increased. This applies in particular to services prices and in part also to the prices of non-energy industrial goods, which maintains the core inflation at relatively high levels and prevents any significant decrease thereof. The same applies to the euro area average, albeit at a lower level (by approximately 2 pp in the last year and a half). While services prices are probably subject to the concurrent effects of increased demand and, due to relatively lower energy intensity, to a more gradual transfer of the initial shock of energy product prices than in the case of goods prices, the rapid decline in the growth of producer prices and import prices are creating conditions for the slowdown in the growth in the prices of non-energy industrial goods. Such trends are also indicated by the indicators of future price growth expectations, which are decreasing among both consumers and businesses, with the smallest decrease being noted in service sector companies.

The majority of **forecasts for real GDP growth in Slovenia** in 2023 range between 1.5% and 2%. In the last six months, growth forecasts have increased by approximately 0.5 pp on average. The nominal economic growth should thus remain near 8%, despite the expected abatement of inflation. This slightly improved outlook is due, in particular, to the final spending and investment activity of government and household consumption. Government spending shows further assistance to households and, in particular, the business sector under the cost-of-living measures, while high investment activity, which partly depends on the use of funds from various EU sources, is to a great extent financed with domestic resources. In addition, since the beginning of the year, construction companies have been reporting a decline in confidence, including with regard to orders and expected employment. Despite the only gradual slowdown of inflation, household consumption should be supported by favourable labour market conditions and relatively high adjustments of public sector wages and social transfers, which will largely prevent the real fall in household income.[7] **Expectation indicators** show that the economic sentiment in Slovenia is currently below the long-term average and that pessimism is also increasing. This is a result of lower confidence in all activities, with the exception of services activities

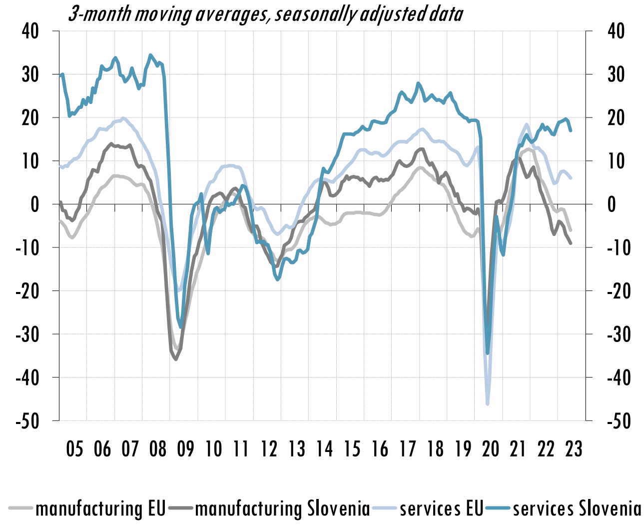
[7] See the Fiscal Council analyses in Box 1 of "Public finance and macroeconomic developments" (February, 2023) and Chapter 1.3 of "Assessment of compliance of the general government budgets with the fiscal rules in 2022" (June, 2023).

Figure 5.15: Business tendency and consumer surveys



Source: SORS.

Figure 5.16: Confidence indicators

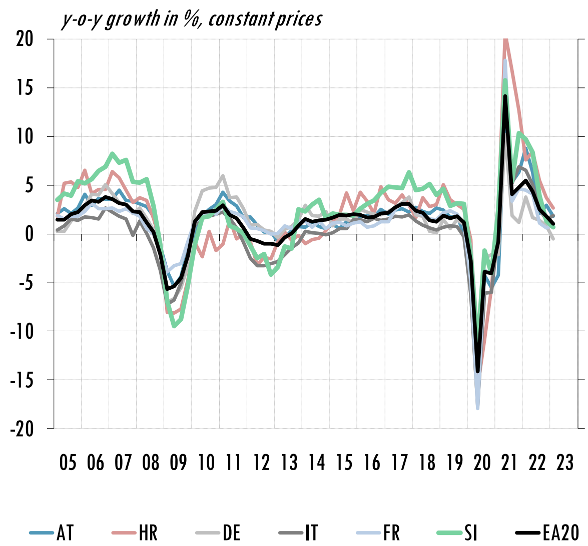


Source: European Commission, FC calculations.

and households. Companies in the services sector are particularly satisfied with their current business position, even though the indicators of the current and expected demand are stagnant. In the last few months, the opinion of households on the future economic situation and their financial situation has particularly improved. Meanwhile, in the manufacturing industry, which contributes most to exports, the majority of confidence indicators show a rise in pessimism, in particular with regard to total orders.

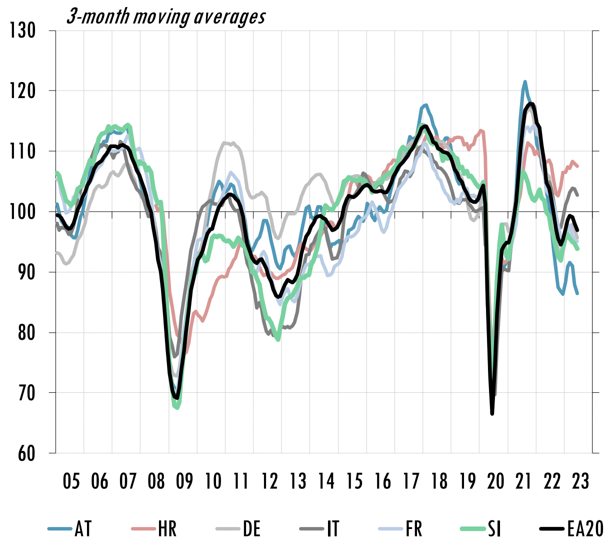
In the last six months, the economic growth forecasts **for Slovenia's major trade partners** have also been increasing. The economic activity in the euro area stagnated at the end of last and the beginning of this year, close to or slightly more favourable than trends projected in the autumn forecasts of the European Commission and the ECB. Such trends reflect the tighter financing conditions with the normalisation of monetary policy functioning and the withdrawal of intervention measures, accompanied by still relatively high inflation. In the majority of countries and in the majority of

Figure 5.17: GDP



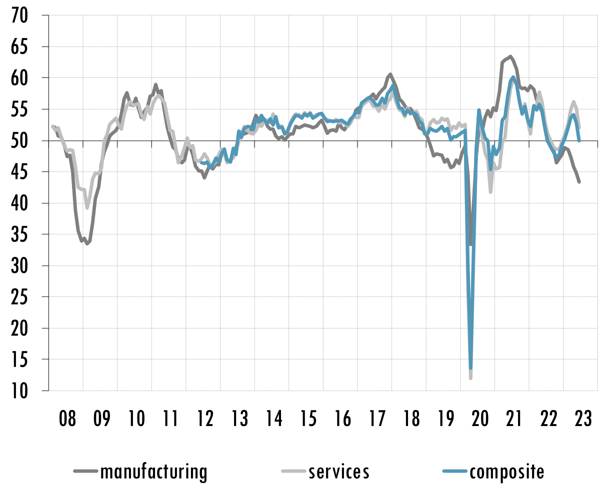
Source: Eurostat, FC calcualtions.

Figure 5.18: Economic sentiment indicator (ESI)



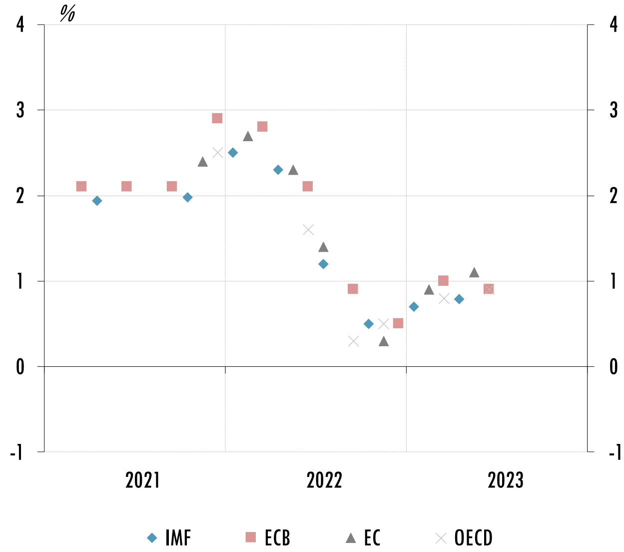
Source: European Commission, FC calculations.

Figure 5.19: Euro area PMI



Source: S&P Global.

Figure 5.20: Real GDP growth forecasts for 2023 - euro area



Source: IMF, European Commission (EC), OECD, ECB.

activities, the confidence indicators remain below the levels of a year ago. Exceptions are confidence indicators in retail and partly also in services activities and the indicators of consumer confidence.

The **risks** to economic activity in Slovenia remain high and predominantly negative. At the global level, compared to past assessments, the geopolitical risks and uncertainties regarding further economic policy actions and their effects in the recent period have been compounded by the risk of increased instability in financial markets and disturbances on the supply side of banks' lending activity. These two risks were the focus of both the IMF and the OECD in their latest forecasts. The effect of their realisation on global growth could be considerable and would also be reflected in approximately 2% lower GDP. Domestic risks are primarily related to future fiscal policy actions, the implementation of development policies and the withdrawal of cost-of-living measures, and in particular to the impact of such actions on economic activity and on the potential extension of the high inflation period. Considering the employment restrictions, this extension will in the short to medium term depend on labour market developments and on the adaptation of companies to the situation in raw materials markets and their pricing decisions at the production and retail levels.