REPUBLIC OF SLOVENIA

2020 Stability Programme

April 2020, the COVID-19 scenario

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1 Economic conditions and fiscal policy in response to COVID-19

The 2020 Stability Programme is adjusted to the current conditions and focuses on 2020, the measures to prevent the spread of COVID-19 and the related exceptional circumstances arising therefrom. The Fiscal Council assessed (on 18 March 2020) that declaring the epidemic in Slovenia represents an unusual event which, as per the Fiscal Rule Act, enables the application of measures in exceptional circumstances intended to mitigate the consequences of such an event, and thus involves a temporary deviation from the medium-term balance of public finances. In such exceptional situation, even a temporary deviation from the fiscal rules derived from the Stability and Growth Pact at the EU level is permissible. The European Commission thus proposed activation of the general escape clause within the Stability and Growth Pact, to which the Economic and Finance Ministers Council also agreed. Temporary derogation from fiscal rules has been enabled on these bases to combat the consequences of the COVID-19 epidemic. The content of the Stability Programme is also based on a joint agreement at the EU level regarding the adjusted programme structure.

The health and economic conditions in numerous European countries, including Slovenia, have changed considerably following the first week of March 2020 due to the rapid spread of COVID-19 and the severe containment measures subsequently implemented. In the short term, economies are facing a collapse of economic activity as the majority of countries in Europe and worldwide have introduced extensive measures to protect health and people. At the global level, the COVID-19 pandemic triggered an unparalleled health and economic crisis, while the uncertainty in the economic sector grows with the global spread of COVID-19. The economic growth projections are very uncertain and sensitive to the changes of conditions (number of new cases, vaccine development progress, and subsequently anticipated duration and the severity of measures to contain the spread of the virus).

It is assessed that the pandemic will cause negative growth in the two forthcoming quarters at the global level, including a negative annual GDP growth (IMF). The severity of the recession and further movement of economic activity will be conditioned by the economic policy response (Danthine, 2020; Kashyap, 2020)[1]. Among other things, the depth of the resultant recession in individual economies will depend on the stability of the health system, average age of the population, openness of the economy, the size of the sectors affected the most and the efficiency of the measures adopted to support the economy and citizens. According to current expectations, the measures limiting business operations due to the pandemic will most negatively impact the service sector, particularly transport and tourism, including hospitality and other personal services, and the processing industries. The economic downturn in individual sectors is the key issue when assessing the potential needs and fiscal effects of the measures.

To mitigate the economic fallout, individual governments and central banks (headed by ECB) are adopting record-high aid measures aimed at preserving jobs, ensuring corporate liquidity and people’s income. Due to increasing infection rates in the country, the Government of the Republic of Slovenia declared the epidemic on 12 March 2020.[2] With the objective of containing the spread of the virus, public passenger transport was temporarily halted, most educational institutions were closed, and the retail sale of non-food or non-essential goods and the provision of non-essential services were prohibited in mid-March. The measures limiting social interaction were supplemented a few days later with a temporary prohibition on gatherings of more than five people in public locations and the temporary closure of a number of public institutions. At the end of March, movement was further limited to individuals or

[1] https://news.uchicago.edu/story/will-coronavirus-pandemic-cause-recession

[2] https://www.gov.si/teme/koronavirus/koronavirus-ukrepi-za-zajezitev-sirjenja.

persons living in the same household, and non-urgent movement of people between municipalities was also prohibited.

Due to the severe negative shock that the restrictions pose for the economy and the income of the population, the Government adopted and drafted an array of measures to limit negative consequences. To this end, the Act Determining the Intervention Measures to Contain the COVID-19 Epidemic and Mitigate its Consequences for Citizens and the Economy (ZIUZEOP) or the so-called anti-corona package 1 and its amendments, and the Act on Additional Liquidity to the Economy to Mitigate the Effects of the COVID-19 Infectious Disease Epidemic (the so-called anti-corona package 2) were adopted. The specific objectives of the measures proposed in package 1 are the preservation of jobs and business operations; improvement of the social security of individuals, particularly of those affected the most by the COVID-19 disease; extraordinary assistance for the self-employed; improvement of corporate liquidity; assistance to science and research projects to combat the COVID-19 epidemic; reduction of attendance fees and salaries of public officials at the national level; exemption from payment of distribution services and assistance to agriculture. Package 2 includes key measures that will enable companies to revive investment activities and thus preserve jobs. Slovenia will implement the financial consequences of the measures within the possibilities of the general escape clause.

From the viewpoint of public finance, the transition in 2020 is relatively favourable as a nominal surplus in the general government sector was achieved despite a slowdown of growth in the amount of 0.5% of GDP, which is more than the eurozone average, but less than what was planned in the 2020 Draft Budgetary Plan. Exceptional circumstances and a significant economic downturn consequently affect a lower estimate of revenue for 2020 that will amount to 43.7% of GDP (it was 44.2% in 2019); simultaneously, the expenditure will increase by 51.8% (it was 43.7% in 2019), which is largely the result of measures introduced to combat the epidemic (including all measures adopted so far[3]). It is assessed that the general government balance will reach -8.1% of GDP. The effect of the anti-corona measures (exceptional circumstance) will presumably total 4.4% of GDP. We thus assess that the general government debt ratio expressed as a percentage of GDP will increase in 2020 to 82.4% of GDP.

2 Economic projections

2.1 Macroeconomic environment in 2020

After higher growth in 2015, economic growth in Slovenia in 2018 and 2019 was still high, but considerably lower than in the previous two years. It stood at 2.4% in 2019, but, nevertheless, exceeded the average of the EU and the eurozone. External demand contributed significantly to the growth of the Slovenian economy in 2019. Due to very low growth in global trade and the diminishing growth of GDP in trade partners, the moderation of export growth continued in 2019, and import growth slowed down as well. The increase in domestic spending was more moderate than in 2018. A stable increase in household consumption was supported by relatively high employment growth, and the growth of wages and social transfers. The growth of gross fixed capital formation slowed down significantly. Final consumption expenditure increased by 2.4% in 2019, which is somewhat less than in the previous year (2.9%). Record favourable rates were recorded in 2019 in the labour market. Total employment further improved and was the highest ever recorded (i.e. since 1995); amounting to 1,045,000. The annual growth of the persons in formal employment (2.3%) was high and the number of employed persons reached its highest yet (894,000 persons in formal employment). The trend towards a reduced number of registered unemployed persons (7.7%) continued in 2019. The

[3] The Government of the Republic of Slovenia anticipated introducing the contents of the third package to combat the epidemic at the end of May. The package will facilitate the transition to as normal a life as possible and potentially extend certain measures from the first package for the industries affected the most, particularly tourism, in which rapid and comprehensive recovery cannot be expected this year.

survey-based unemployment rate reached a record low in 2019 (4.5%). In recent years, economic growth was particularly driven by significant employment growth, unlike the pre-crisis period when labour productivity predominantly contributed to economic growth. Despite improved productivity growth, the level of productivity remained lower than the average in the EU countries and the eurozone countries.

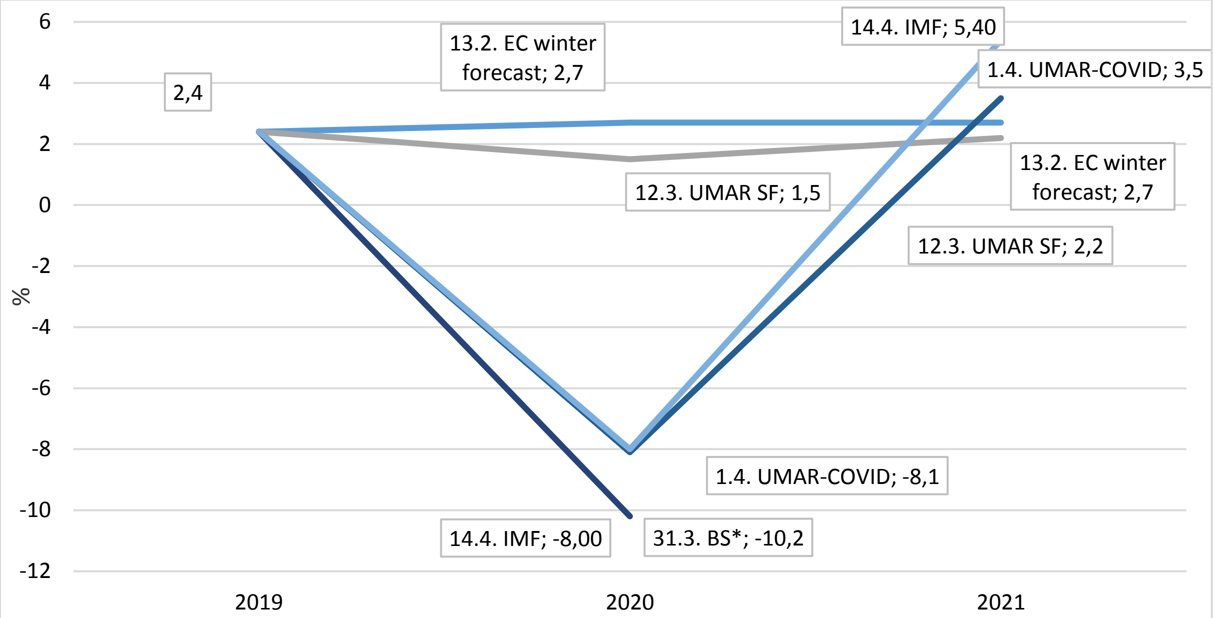
Due to higher growth in the public sector, wage growth strengthened in 2019. The accelerated wage growth in the general government sector which was a result of the wage increases agreed with the trade unions at the end of 2018, of regular promotion and also partly of the increase in the minimum wage at the beginning of 2019, contributed to the higher total average gross salary growth. In the private sector wage growth remained similar to that in 2018, reflecting a shortage of appropriately skilled workers and good business results. In recent years, wage growth in the private sector moved approximately in keeping with its macroeconomic fundamentals (inflation, unemployment and labour productivity). The inflation rate also remained relatively low in 2019. It amounted to 1.6% with almost two thirds of this were contributed by service prices and higher prices of food and energy (IMAD, Spring Forecast 2020). At the start of 2020, Slovenia was in a good economic position.

IMAD's spring forecast of economic trends in 2020 (forecast for 2020) was drafted on the assumption of a cooling down of the global economy even before the onset of COVID-19 and the inclusion of the initial risks regarding the consequences of the disease spreading. The forecast was based on the assumption that the spread of COVID-19 in China and in the European countries would reach its peak in the first six months of 2020, and a gradual stabilisation would occur in the second half of the year. According to the forecast, economic growth in Slovenia would slow down to 1.5% in 2020 and grow somewhat in the next two years (2.2%). The growth of exports and imports is to be halved this year, (business) investment is said to be somewhat lower than in 2019. In comparison to 2020, economic growth is forecast to increase slightly in 2021 and 2022, and a higher growth of exports and imports is also expected, including growth in investment. Private and government spending are to further contribute to the GDP growth in the 2020–2022 period. The external balance contribution to the GDP growth is predicted to gradually reduce and become neutral at the end of the forecast period, while the current account surplus is to remain high (a little over 6%). Employment growth is forecast to slow down in the 2020–2022 period, and wage growth is to be somewhat lower than in 2019 as well. The employment rate is to increase further. However, this growth will gradually become lower; increasingly so due to the decreasing number of the resident population aged 20 to 64. The number of unemployed persons is set to further decrease, but more slowly. In the 2020–2022 period, average wage growth is set to be slightly lower than in 2019. This year's rate of inflation will be similar to that of the last two years (1.7%), but somewhat higher (2.2% or 2%) in the 2021–2022 period.

In the forecast published on 12 March 2020, IMAD highlighted that the situation is very unpredictable and that economic growth in 2020 and 2021 would be lower than forecasted if the COVID-19 epidemic lasts longer in Slovenia and in other EU countries and the conditions in the second half of 2020 are, consequently, not stabilised. The realisation of any of the other risks would additionally contribute to this.

Due to increasing risks related to spreading of COVID-19, the uncertainties of macroeconomic forecasts increased, too. The 2020 forecast is thus only a projection that may be realised under certain assumptions. The uncertainty can be illustrated by means of various forecasts that are contingent upon the time when the forecast is drafted (Figure 1). The forecasts changed dramatically within one month.

Figure 1: Different GDP growth forecasts depending on the time of forecast preparation



* Scenario 2 (BS) is taken into account, which envisages the cessation of economic activity by the end of May

Source: EC winter forecast, 2020; IMAD Spring Forecast, 2020; Bank of Slovenia, 2020; IMF, 2020

In this current time of considerable uncertainty in the economy, the economic growth projections are greatly uncertain and decrease with the spread of the virus. The forecast prepared on 12 March 2020 by IMAD revised the economic growth in 2020 from 3% to 1.5%. The forecast was published at the time when the first cases of COVID-19 were recorded in Slovenia. Since then, the conditions in the economy have changed significantly. On 23 March, IMAD changed its projections, i.e. that the drop in GDP in 2020 would be between -6 and -8% assuming that the current adverse conditions and extremely difficult business operations in the manufactoring and service sectors would last two months. On 31 March 2020, the Bank of Slovenia anticipated a 6-per cent drop of GDP if the epidemic lasted until the end of April, and 10% if the cessation of the economic activity lasted until the end of May, and 16% if the epidemic lasted until the end of June. In its forecast of 14 April 2020 for Slovenia, the International Monetary Fund (IMF) anticipated a drop in GDP of 8% on the assumption that disturbances in the economy due to the measures to contain the spread of COVID-19 in almost all countries, with the exception of China, would mostly be concentrated in the second quarter of 2020 and would be followed by gradual economic recovery.

For the purposes of drafting the state's budget documents, IMAD prepared the COVID-19 scenario of the 2020 spring forecast in April 2020 (hereinafter: COVID-19 scenario) in the form of internal material whereby the economic forecast considered the impact of the spread of COVID-19 in Slovenia and elsewhere in the region.

It anticipated that economic activity would contract significantly in 2020 due to the spread of the COVID-19 epidemic and urgent measures to protect health. The depth of the GDP drop and recovery dynamics after the crisis will depend critically on the extent and speed of the spread of COVID-19 and the timing of the introduction, scope and content of the economic policy measures. The COVID-19 scenario anticipates that the GDP would drop by about 8% in 2020, whereby it: i) assumes that the safeguard and healthcare measures introduced in March that halted non-essential service activities and hamper industrial activities will remain in force until the end of May; ii) assumes gradual stabilisation of the situation and a gradual economic recovery commencing in June; iii) takes into account the measures of economic policies to mitigate the consequences of the epidemic. At this point, the spread of the COVID-

19 epidemic and the effectiveness of its containment cannot be fully ascertained, and there is great risk that the period of severely impaired economic activity will last longer than observed in this scenario, and that the GDP drop will be larger and more lasting. If strict measures to reduce the spread of COVID-19, which seriously hinder economic activity, are prolonged or tightened, the negative consequences will be more significant and far-reaching. Under this scenario, the decline in the GDP may be about 15% (and more) this year, a figure to which point also the scenarios of other institutions.

A decline in added value in numerous activities will contribute to the drop in GDP in 2020 due to substantially reduced economic activity while safeguard measures are in place. In 2020, added value is expected to decline the most in transport, hotel accommodation services, and food and personal services, and the decline in manufacturing activities is also expected to be massive. All components of GDP will decline according to the COVID-19 scenario, except for government consumption, which will transitionally increase due to the crisis. Imports and exports will be severely affected, particularly due to a fall in global trade and international restrictions. The fall in trade will be most significant in the services segment, while trade in goods will contract sharply also. Investment will react strongly to the fall in production in the first half of 2020 and will be held back by considerable uncertainty; investment in machinery and equipment will be most significantly reduced. In the assumed scenario, private consumption will be lower than last year, particularly due to self-isolation, government measures to limit social contacts and greater uncertainty. Private consumption will also decline due to lower disposable income, a drop which will be significantly eased by government measures to mitigate the consequences of COVID-19.

Despite government intervention measures, the adverse conditions will affect the labour market this year (about 2 % lower employment and an increase in the number of unemployed people by almost one fifth are expected), which could (only) partially recover if the situation stabilises next year.

In the COVID-19 scenario, the average gross wage in the private sector would decrease by a little over 3% in 2020 and remain close to this year’s level in 2021. Due to the already adopted agreements, acts and the crisis allowance for the most burdened employees (particularly in health care), the average gross wage in the public sector will be significantly higher in 2020.

Average inflation in 2020 will be lower than last year, which will be largely reflected in lower energy product prices. Moderate price growth is expected this year in other groups. The price growth of communication services and services related to health care, housing and food could be somewhat faster. In the event of gradual economic recovery, inflation could increase in 2021.

2.2 Position in the cycle and economic cycle length

Assessment of the output gap[4] is used to determine the economy’s position in the economic cycle and serves as the basis for managing fiscal policy. The assessment of the output gap is already uncertain in normal conditions as shown in many studies; subsequently, an assessment of where an individual country is in the economic cycle is also uncertain according to the European Commission[5] and the European Central Bank[6]. According to the governments of the Republic of Slovenia, the cyclical positions of the Slovenian economy in the 2016–2019

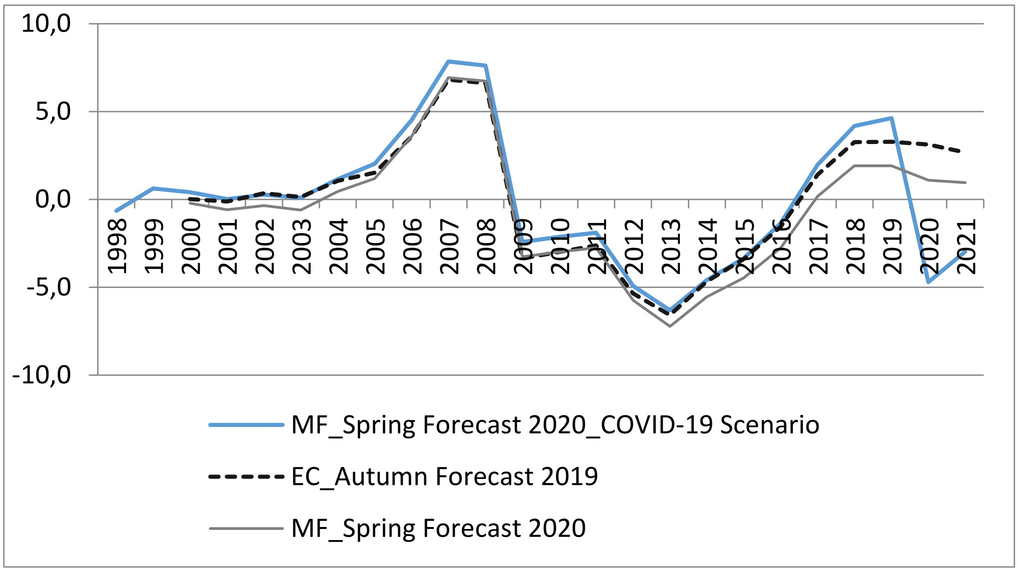
[4] The output gap is the difference between the actual and potential GDP expressed as a percentage of potential GDP. From the macroeconomic viewpoint, the potential gross domestic product is the indicator showing the scope of production an economy may attain without causing additional inflationary pressures (by "overheating").

[5] https://ec.europa.eu/info/publications/economy-finance/quarterly-report-euro-area-qrea-vol14-no3-2015_en

[6] https://www.ecb.europa.eu/pub/pdf/scpops/ecbop156.en.pdf?12f64165c5623d34b98b978cbe614ed

period were not as favourable as estimated by using commonly agreed methodology for calculating output gaps in the EU. In addition to the calculation methodology, (1) the method used for calculation the potential product, (2) changes in the estimated past growth of macroeconomic data and indicators and (3) forecasts of the GDP and other macroeconomic data and indicators used for assessing the output gap in the period of forecasting economic trends also contribute to a certain degree to the uncertainty of the assessment of the output gap.

Figure 2: Estimates of the output gap (in % of potential GDP), Slovenia, before and after the onset of the COVID-19 crisis



Source: Ministry of Finance, IMAD

Consequently, there are great differences in the estimates of output gap prepared by different institutions. Additionally to that, the later estimates of an individual institution frequently quite differ from its previous ones. Not even the potential GDP used in the calculation of the output gap is directly measurable. Its assessment may vary due to factors such as changes in the calculation methodology of the potential GDP, revision of the GDP growth in previous years, changes in the GDP growth forecast and changes in the length of the included time series (Glažar, 2019). Due to these factors, subsequent assessments for the same year may result in notable changes in the assessment of the potential GDP and output gap. In the event of a major shock, the output gap assessments are even more uncertain. This is apparent in the comparison of recent assessments of the output gap when the assessments of output gap for several years in the past are changed significantly due to a major shock in the economy (the outbreak of COVID-19).

The output gap assessments for Slovenia for the 2017−2019 period were corrected upward based on the new data from the COVID-19 scenario, from which it is obvious that the occurrence of a major negative shock in the economy can automatically cause an ex-post inconsistency of the fiscal policy with fiscal rules.

Slovenia’s economic cycles are more pronounced than those of the entire eurozone, which is the result of a small open economy and lower GDP per capita. According to the latest assessment based on the COVID-19 scenario, Slovenia reached the peak of the economic cycle in 2019 when the output gap supposedly attained about 4.6% of the potential GDP, and was already to have reached the bottom of the cycle in 2020 at about -4.7% of the potential GDP. Slovenia would also remain in the negative part of the economic cycle in 2021 (the output gap is to amount to -3% of the potential GDP).

The foregoing shows yet again that the length of the economic cycle is difficult to determine due to the uncertainty of forecasts. It may represent different periods and consequently lead to different mid-term balance calculations. An economic cycle can last from five to eight years or even more. In the case of a national fiscal rule, a joint (with the Fiscal Council) definition of the duration of the cycle and thus the attainment of fiscal objectives is required upon the stabilisation of the current situation. Regarding the management of the fiscal policy in accordance with the EU commitments and the relevant uncertainty of the output gap calculation, Slovenia also has concerns about the suitability of the EU matrix that requires annual fiscal adjustment regarding the economy's position in the economic cycle. Particularly regarding the required annual fiscal adjustment at the time when economies transition from the negative to positive output gap and exceed the threshold of 1.5% of over-potential GDP growth.

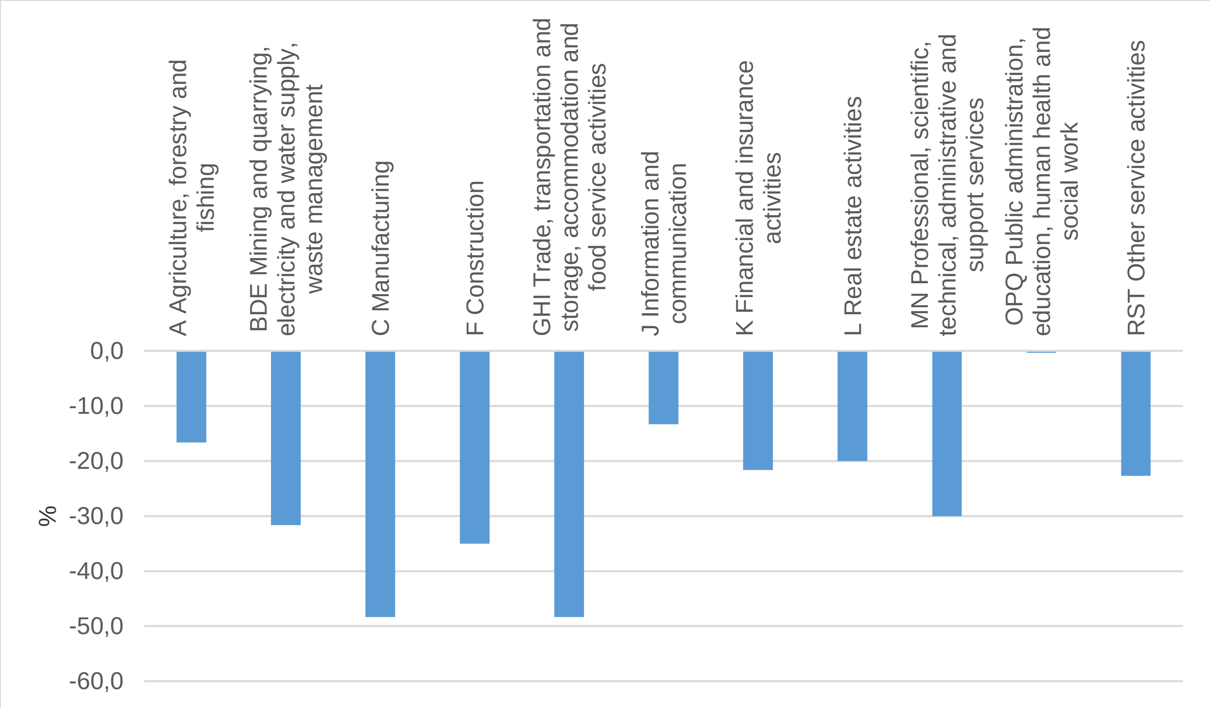
Major and sudden improvements in the output gap are frequent after a lengthy period of low economic growth or recession, which does not necessarily signify overheating of the economy, but merely an adjustment of demand from low levels. Fiscal policy guidelines must be sustainable, planned within a multi-annual framework and without sudden adjustments due to major fluctuations in output gap assessments. In addition, they must not be loosened when the economic situation becomes "good".

2.3 Economic activity by sectors

In simulations of the COVID-19 impact on GDP, our scenario assumes that the "crisis" would last three months, i.e. until the end of May. The simulation anticipates that the economy would gradually return to normal in June. As in other studies, the simulation foresees a decline in added value in the two largest sectors (C – processing activities and GHI – trade and repair of motor vehicles, transportation and food service activities) by half in the first two months, followed by 40% in May and 15 to 20% in June. A drop between 10 and 30% was also anticipated in other sectors, but not in those of administration, defence and protection (O, P, Q), where a decline was not foreseen. Some sectors are expected to recover in June, while others will still record a drop of up to 10%. The relevant scenario also anticipates a drop in GDP by more than 8% in 2020. The GDP was calculated at the formation of anti-crisis measures as these calculations were needed to envisage the consequences and the scope of the measures. The GDP estimate is roughly consistent with that of the IMAD and other projections (Bank of Slovenia). Due to the interruption of work processes in the most exposed sectors, the IMAD anticipates a great loss of revenue, and a drop of up to 70% in added value is also possible.

If in the early phase of the virus outbreak, economic activity was most obviously affected due to interruption of supply chains, the impact of the pandemic on permanently lower aggregate supply and demand, as a result of the loss of income due to the interruption of work processes, uncertainty relating to the time frame involved in containing the pandemic, lower demand and consumer trust, lower liquidity and unfavourable credit conditions, is now coming to the forefront.

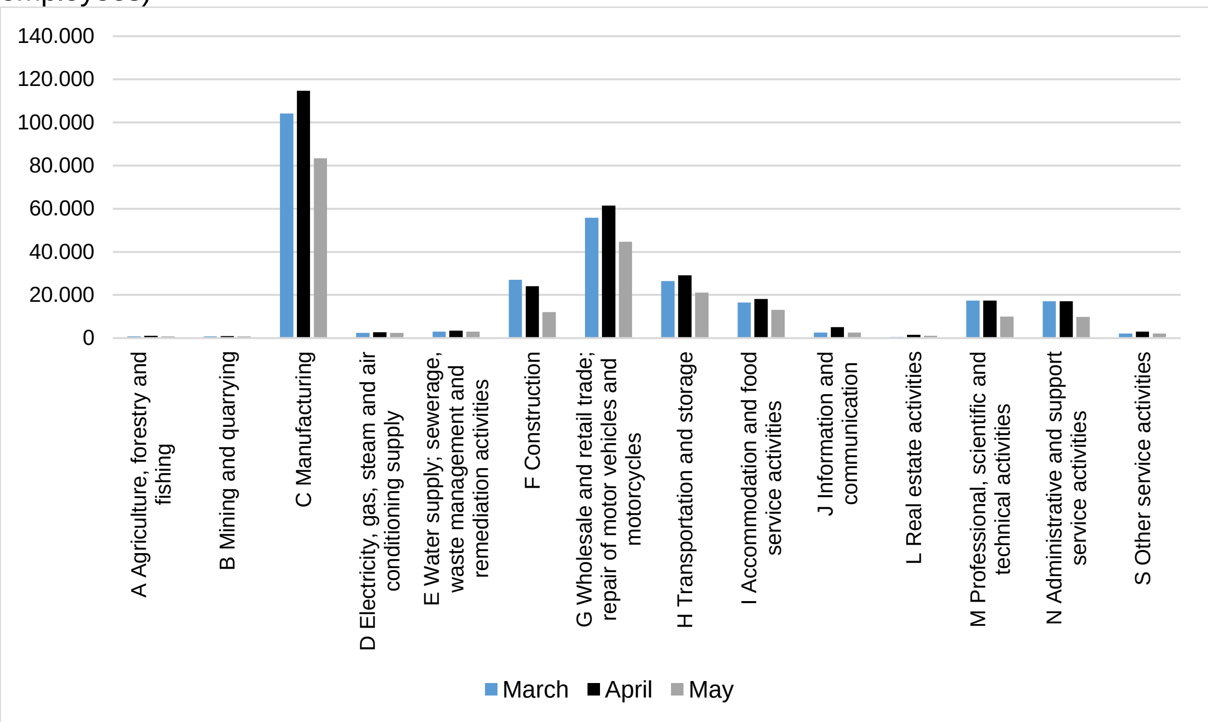
Figure 3: Foreseen decrease of value added by activities (average of three months: March – May)



Source: SURS, own calculations

When no other projections were available, the drop in added value per the number of employees in an individual sector was applied in the assessment of the potential financial consequences of major measures in the fight against the epidemic.

Figure 4: Estimated number of potential employees in the eligible activities (number of employees)



Source: SURS, own calculations

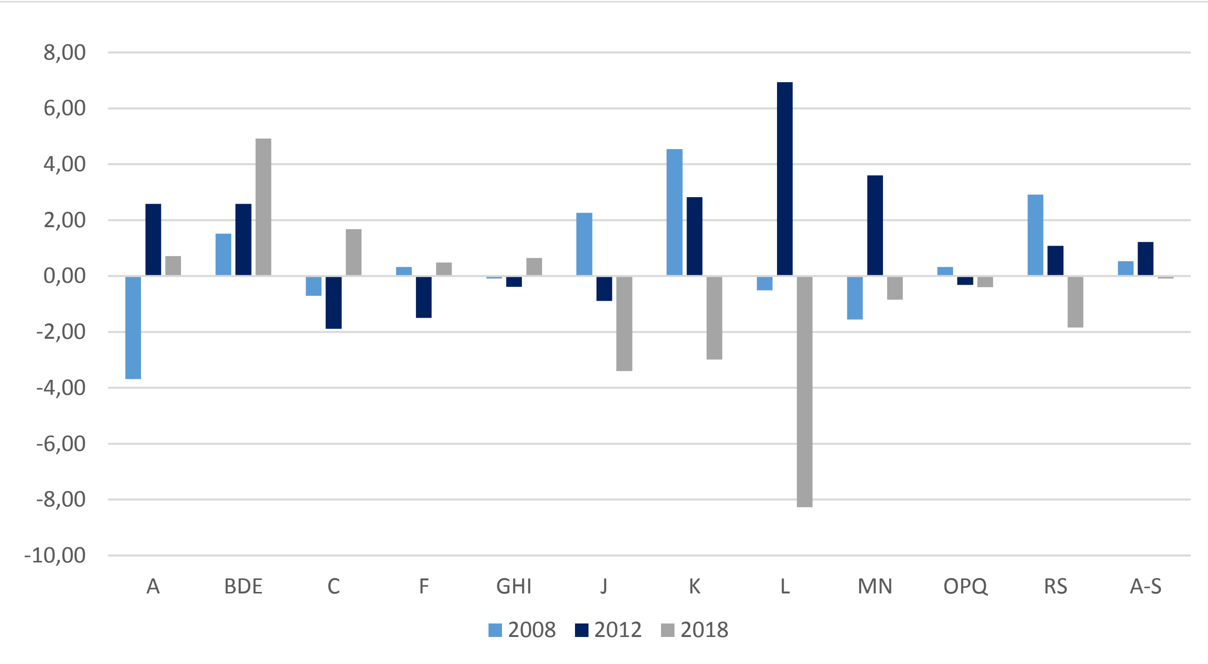
The figure shows the number of persons by sector that could potentially be affected by the measures of temporary layoff due to the economic downturn. The remaining employees could be potential beneficiaries of the measure regarding the payment of pension contributions.

2.4 Financial stability of companies

The financial health of companies, which is among other indicators also displayed by the indebtedness coefficient, was in most sectors significantly better in 2018 than in 2008. The indebtedness coefficient is defined as the ratio between net debt and a rough approximation of a company's cash flow (EBITDA), and shows the company's ability to pay off its financial debt in the future while assuming the same scope of business operations and profits.

Figure 5 shows the average of the indebtedness coefficients of companies (one or more employees) by groups of activities in accordance with the SCA classification in 2008, 2012 and 2018. The indebtedness coefficient in all companies in Slovenia in 2018 amounted on average to -0.09, which indicates that companies in Slovenia had on average more cash than debt. For comparison, the net debt to EBITDA amounted on average to 0.54 in 2008 and still failed to exceed the reference value of 4, at which it is believed that a company will have difficulties when settling its financial obligations in the future and will not be able to acquire new financial sources.

Figure 5: Indebtedness coefficient of the corporations (net debt/EBITDA), average by groups of activities in accordance with SCA classification



Source: AJPES, own calculations

The value of the indebtedness coefficients of companies in 2018 was, if compared to 2008, lower on average in information and communication activities (J) by a multiple of 2.5 (or by 250.4%), financial and insurance activities (K) by a multiple of 1.7 (or by 165.9%), real estate activities (L) by a multiple of 15.2, activities of public administration and defence, compulsory social security, education, health care and social security (OPQ) by a multiple of 2.2, and cultural, entertainment, recreational and other activities (RS) by a multiple of 1.6.

The companies' indebtedness in 2018 increased in comparison to 2008 in the sectors of agriculture and hunting, forestry, fishing (A) by a multiple of 1.2 (or by 119.4%), mining, supply of electricity, gas, steam and water, sewerage, waste management and remediation activities (BDE) by a multiple of 2.2, processing activities (C) by a multiple of 3.4, trade, maintenance and repair of motor vehicles, transportation and storage and food service activities (GHI) by a multiple of 8, construction (F) and professional, scientific, technical and other activities (MN) by a multiple of about a half (or by 49.15% and 45.54%).

2.5 Situation in the banking system

According to the Bank of Slovenia, the Slovenian banking system has a strong capital base and a high degree of liquidity, and is entering the instability period caused by the COVID-19 pandemic in good condition[7].

In its last half-year financial stability review published on 18 December 2019, the Bank of Slovenia on household and corporate borrowing concluded that:

- the financial structure of assets and indicators of household indebtedness in the country on average refer to a relatively high resilience in the case of worsened economic conditions, and that risks in the case of further cooling of the macroeconomic environment and subsequently conditions in the labour market may be reflected particularly in households with incomes lower than the average wage, to whom more than half of new consumer loans were granted in 2018;
- household indebtedness is increasing, but remains stable in the percentage of disposable income and GDP;
- despite relatively low interest rates, households are inclined towards saving, which is increasing;
- the indebtedness of corporates reduced greatly in recent years;
- corporate financing flows has been declining since the second half of 2018. Whereby total funding includes financing via debt and equity instruments, excluding non-financial corporations' own sources; The last year has seen a pronounced decline in the flow of trade credits received, while the inflow of equity into non-financial corporations is also slightly smaller;
- corporates are reducing their financing from all creditor sectors other than financing from other corporates, whether in Slovenia or in the rest of the world;
- the models of corporate financing changed; to a greater extent, companies rely on their internal resources and financing between affiliates;
- the latest survey data on the increase in corporate demand for bank loans still reveal an increase in this demand, but due to the increase in competitiveness between banks, the scope of refused or unconcluded transactions has also increased;
- corporates demand for loans increased in 2018 for the first time in ten years as reported by the banks in regular annual surveys since 2010. The demand for loans increased by 17.7% in 2018, and the increase then moderated to 2.6% in the first six months of 2019.

The latest data on bank operations published in the Monthly report on bank performance of April 2020 reflect the situation before the onset of the crisis in February 2020. In February year-on-year growth in loans to the non-banking sector stood at 6.1%, Corporate loans increased by 5.4% year-on-year, while year-on-year growth in loans to households was 5.9%. As it was expected, the growth in consumer loans in particular slowed down (to 6.7% year-on-year in

[7] https://www.bsi.si/mediji/1478/slovensko-gospodarstvo-bo-v-boju-s-koronavirusom-placalo-visoko-ceno

February). The growth in housing loans somewhat increased (to 5.7% year-on-year). While the growth in deposits from the non-banking sector slowed down to 5.7% year-on-year in February. Higher deposits from households (7.3% year-on-year in February) contributed the most to the growth of these deposits; while the growth in deposits from corporations amounted to 2% year-to-year in February.

Table 1: Review of selected banking system's assets and liabilities, as at 29 February 2020

	in EUR million				growth in %	
	Dec-08	Dec-18	Dec-19	Feb-20	in Feb-20	year on year
Loans to non-banking sector	33,718	22,236	23,520	23,884	0.5	6.1
Non-financial corporations	20,260	8,470	8,877	9,161	0.9	5.4
Households	7,558	10,078	10,703	10,729	0.2	5.9
Government	506	1,740	1,634	1,637	-0.5	-5.6
Other financial institutions	2,829	1,058	1,239	1,253	1.0	20.2
Non-residents	2,515	858	1,036	1,075	2.6	21.6
Liabilities to non-banking sector	20,883	28,979	31,069	31,101	0.0	5.7
Non-financial corporations	3,728	6,788	6,758	6,585	0.0	2.0
Households	13,407	18,733	20,365	20,496	0.3	7.3
Government	1,879	1,040	1,037	1,061	-0.6	-12.7
Other financial institutions	1,065	1,122	1,243	1,301	-5.2	-4.9
Non-residents	475	911	1,228	1,219	0.0	35.8

Source: Bank of Slovenia, Monthly report on bank performance, April 2020

In order to mitigate the consequences of the COVID-19 epidemic, the Government adopted the Intervention Measure Act on Deferred Payments of Borrowers' Obligations, enabling borrowers who are due to the negative effects of the COVID-19 epidemic unable to settle their obligations arising from credit agreements concluded with banks operating in the Slovenian territory to defer their payments for 12 months[8].

Simulations of the Bank of Slovenia reveal that the sum of payments deferred would amount to EUR 2 billion according to the most unfavourable scenario. Bank of Slovenia estimates that even under this scenario Slovenian banks have sufficient liquid assets. The estimated cash shortfalls due to deferred repayments would amount to 35% of primary liquidity.[9]

2.6 Uncertainties and a look into 2021

The risks for the realisation of the COVID-19 scenario are high. At this point, the scope of spread of the COVID-19 epidemic and the duration of its containment in Slovenia and elsewhere in the world are unknown, and there is great uncertainty and risk that the period of severely impaired economic activity will last longer than observed in this scenario, and that the GDP drop will be larger and more lasting. The start of economic recovery will depend crucially on the scope of the epidemic and the scope and content of economic policy measures and the speed of their introduction in Slovenia and other countries. The epidemiologists warn of the likelihood that the pandemic may return in several waves following a temporary de-escalation. A more permanent stabilisation of economic conditions could thus be possible only after the development and general implementation of a suitable vaccine.

[8] Intervention Measure Act on Deferred Payments of Borrowers' Obligations (ZIUOPOK).

[9] https://www.bsi.si/en/media/1478/slovensko-gospodarstvo-bo-v-boju-s-koronavirusom-placalo-visoko-ceno

Under the assumption that the strict safeguard and health measures introduced in March will be eased in June, gradual recovery of economic activity would commence in the second half of the year. As a result of this partial recovery after a severe drop in the first and, particularly, in the second quarter, the GDP growth in 2021 would be higher due to the effect of the base as per the COVID-19 scenario. Based on the COVID-19 scenario and given these assumptions, partial economic recovery would occur in 2021, and a 3.5-per cent economic growth is expected, which could not compensate for this year's decline. Exports and imports would partly recover, as these are linked with the assumed revival of activities in our trade partners, growth in international trade and the gradual recovery of the domestic economy. If conditions stabilise in the second half of 2020, investment would gradually increase after some delay, but it would remain much lower than the level seen before the onset of the epidemic. No increase is foreseen in private consumption in 2021 as the conditions in the labour market will not have improved significantly, and the growth of government consumption is anticipated to level off.

When drafting the Stability Programme 2020, some countries in Europe, including Slovenia, were already planning a gradual easing of measures introduced to contain the spread of COVID-19, which will have favourable effects on economic activity. However, it is difficult to foresee at this point how quickly such an easing will take place and how it will affect domestic demand and the exchange of goods and services between countries.

The response of the global financial markets to the spread of COVID-19 also reveals that the consequences of the spread of COVID-19 for economies will be greater than those of the financial crisis in 2008. The correction on stock markets as a result of the spread of COVID-19 is greater than that which followed the collapse of Lehman Brothers in 2009. The volatility on equity and bond markets also significantly exceeds the volatility on these markets after the Lehman Brothers bankruptcy. An increase in the credit spreads of corporate bonds is significant, particularly in those with a higher required return. Investment funds face great outflows, and monetary markets are also under pressure. Even before the COVID-19 crisis, the foundations of the non-financial corporate sector had deteriorated because the profits of companies had decreased and the credit risks of more risky companies had increased due to slow growth before the COVID-19 pandemic (Fell (ECB), 2020).

2.7 Response and policies in the current situation

The pandemic has a broad spectrum of influence on economic activity. In the first phase of the outbreak, it is reflected particularly as a negative aggregate supply schock due to the adoption of measures to contain the virus and thus the interruption of work processes and supply chains. A decline in productivity growth and the subsequent occurrence of pessimistic expectations of consumers and investors regarding future available funds can result in a recession driven by a lack of aggregate demand (Gali, 2009; Lorenzoni, 2009).

Effective stimulation of aggregate demand by economic policy is thus essential for limiting the impact of the pandemic on the mid- to long-term growth. The capacity of central banks to move the real interest rate below its natural level, which would stimulate consumption and investment activity, is impaired with regard to the zero lower boundary on the nominal interest rate and a low natural rate of interest. This is reflected in the fact that prices of European shares plunged to a record low level when a new financial assistance package by the European Central Bank was announced (De Vijlder, 2020). Dell'Ariccia and others (2020) highlight that the depth and length of the recession will depend on the efficiency of fiscal measures. Fornaro and Wolf (2020) note that the adoption of measures referring to a concrete increase of investment in particular will be of key importance for preserving labour productivity growth and thus long-term economic growth, which has otherwise been declining since the second industrial revolution. Effective fiscal stimulus must include measures that will resolve the economic consequences of the current measures to contain the virus and also support the recovery when kick-starting the economy (Dell'Ariccia and others, 2020). During the interruption of business processes, it is crucial to reduce labour costs to limit the employment decline, to offer liquidity support to companies and thus prevent bankruptcies, and to promote the preservation of international economic integration. It is particularly important to maintain international trade in the science and medical equipment sectors. Effective international coordination of fiscal policies would also enhance the credibility of its holders and subsequently their effectiveness when resolving future crises (De Vijlder, 2020).

Although an increase in the already high level of government debt due to the decline in economic growth is inevitable, Dell'Ariccia et al. (2020) and Draghi et al. (2020) point out that a strong and swift fiscal response is urgent. Furthermore, persistently low interest rates (resulting from a systematic decline in the natural rate of interest in recent decades) will mitigate financing costs. Fiscal multipliers are also greater under the conditions of the liquidity trap (Corsetti and Müller, 2008). Due to positive international externalities, it is important that countries with a smaller fiscal space also respond with equally comprehensive fiscal measures (Draghi, 2020).

The economic shock caused by the COVID-19 epidemic will be extremely large and it is assessed that a general government response of several per cent of GDP will be required. The necessary funds will be ensured by borrowing on debt capital markets, and several financial instruments at the EU level are also available. Under the auspices of the ESM, a special preventive credit line will be shortly available to Member States of the eurozone whereby an individual country will be able to apply for a loan of up to 2% of GDP. The only condition for accessing the credit line will be the country's commitment to use the funds for expenses related to health care, medical treatment and prevention within the COVID-19 epidemic. The credit line will be temporary and available only during the crisis. The temporary instrument SURE (Support to mitigate Unemployment Risks in an Emergency) will also be implemented. This is intended for financing a temporary increase in national expenditure due to the schemes for preserving jobs and certain measures in the field of health. Some EUR 100 billion will be available within this instrument in the form of favourable loans for all EU Member States. The European Commission will provide the funds by borrowing based on guarantees of all Member States. A state will be able to apply for the loan for financing temporary measures intended to preserve jobs, compensate for loss of income and certain measures in the field of health. The instrument will not depend on the content of these national measures. Slovenia will use the relevant EU instruments relating to the situation on debt capital markets.

In order to finance measures in the most affected fields (health, SMEs and labour markets) due to the epidemic, flexible use of unused cohesion policy funds from the 2014–2020 current financial framework is also enabled. The most affected countries will be able to use EUR 800 million of non-refundable funds from the EU Solidarity Fund to finance measures for immediate response to the outbreak of the epidemic.

To coordinate response to the epidemic and its consequences, a general escape clause of the Stability and Growth Pact was activated, which enables the adoption of comprehensive national measures to combat the consequences of the epidemic. For a coordinated response to the situation occurring within the EU, the European Semester Timeline has been maintained. This anticipates the submission of national reform and stability programmes in April. The documents will be drafted in a limited extent with an emphasis on measures to tackle the current situation. Due to great uncertainty about the course of the epidemic and future economic trends, it is an extremely thankless task to forecast budgetary aggregates as such predictions incorporate many uncertain assumptions. Therefore, the cut-off date as stipulated in the document must be observed, from which it is evident which measures were considered when drafting it and which data was available when making the assumptions.

3 Fiscal projections and measures responding to COVID-19

3.1 Fiscal scenario for 2020

From the public finance perspective, the transition to 2020 is relatively favourable because a nominal surplus in the general government sector was achieved in 2019 in the amount of 0.5% of GDP despite a slowdown in growth, which is more than the eurozone average, but less than was planned within the 2020 Draft Budgetary Plan. The difference occurred particularly at the local level of the general government sector and due to accounting adjustments when transitioning from cash flow to the ESA 2010 standard.

The fiscal scenario in 2020 will be adjusted to the COVID-19 epidemic. The Fiscal Council assessed (on 18 March 2020) that declaring the epidemic in Slovenia represents an unusual event which, as per the Fiscal Rule Act, enables the application of measures in exceptional circumstances intended to mitigate the consequences of such an event, and thus involves a temporary deviation from the medium-term balance of public finances. In such exceptional situation, even a temporary deviation from the fiscal rules derived from the Stability and Growth Pact at the EU level is permissible. At the level of the EU, the European Commission assessed on 13 March 2020 that the COVID-19 epidemic is an extraordinary event. On 20 March 2020, it published the communication on the activation of the general escape clause of the Stability and Growth Pact, to which the Economic and Finance Ministers Council also agreed on 23 March 2020. Temporary derogation from fiscal rules has been enabled on these bases to combat the consequences of the COVID-19 epidemic.

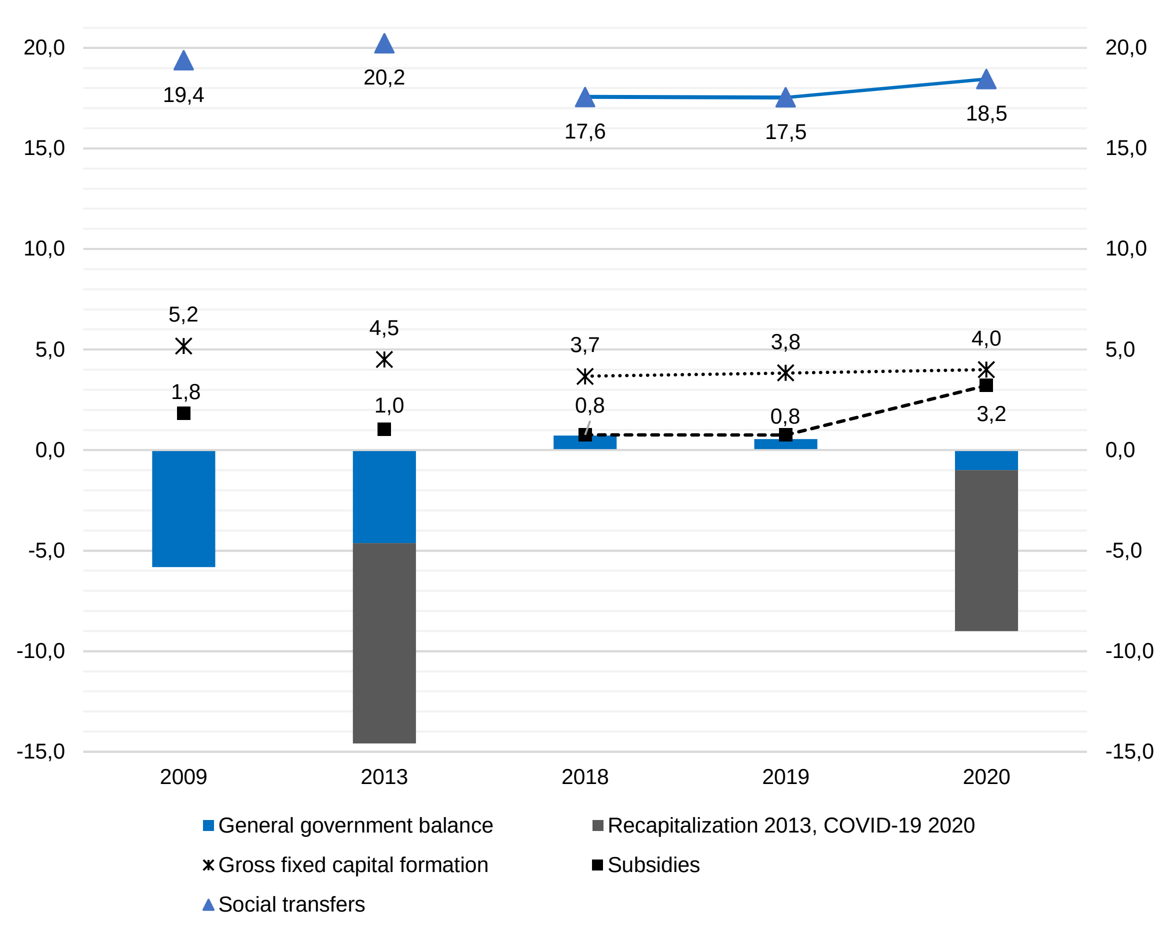
In 2020, the fiscal policy is primarily aimed at the direct fight against the epidemic and measures to mitigate consequences for companies and individuals. Individual packages of measures (so-called anti-corona packages 1 and 2) subsequently persue these objectives. It is also assumed that the consequences of the crisis may last longer and that demand will not return to the level seen before the crisis, which is why further measures will also be targeting these areas (e.g. investment and the so-called anti-corona package 3). The measures are also based on guidelines of the special governmental advisory group[10] comprised of external independent experts (also former ministers).

Exceptional circumstances and a significant economic downturn consequently lead to a lower estimate of revenue for 2020 that will amount to 43.7% of GDP (44.2% in 2019); simultaneously, expenditure will increase by 51.8% (43.7% in 2019), which is largely the result of measures introduced to combat the epidemic (including all measures adopted so far). It is assessed that the general government balance will reach -8.1% of GDP. The primary general government balance is expected to reach -6.45% of GDP.

Although the current crisis and that of 2008, the 2012–2013 financial crisis and the second decline in GDP growth cannot be compared, it is important to display the scope and the type of measures to eliminate the consequences. The high increase in nominal deficit in 2013 stemmed from the recapitalisation of banks that was mitigated by means of austerity measures and the subsequent exit from the corrective arm of the Stability and Growth Pact (2015). Social transfers were decreasing since 2011. Likewise, investment expenditure was oscillating because investment began decreasing, particularly due to the consolidation process after a short period of growth in 2013 and 2014 (also because of closing the 2007–2013 financial framework). On average, investment also declined in the eurozone.

[10] https://www.gov.si/novice/2020-03-24-strokovna-posvetovalna-skupina-o-obseznih-ukrepih-za-zajezitev-posledic-epidemije-za-drzavljane-in-podjetja/

Figure 6: General government balance in specific years, measures against COVID-19 and individual categories of expenditures (in % of GDP)



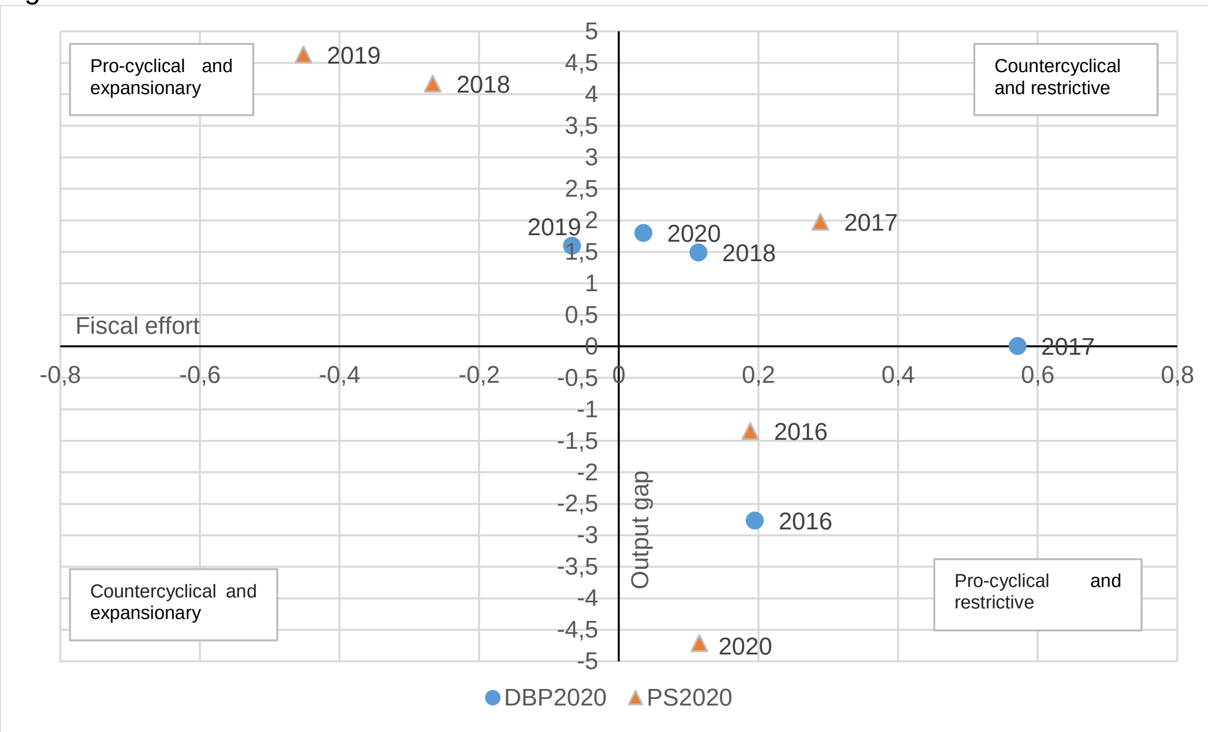
Source: Ministry of Finance and SURS

The nature of this crisis is significantly different, which is reflected in the adopted measures. Response to the current conditions was initially aimed at companies and individuals (to eliminate liquidity problems, reduce labour costs, preserve social security, etc.). To this end, it is assessed that subsidies for companies and social transfers will increase from the public finance perspective. Whereby it must be highlighted that social transfers have been lower than the eurozone average throughout the entire period. We asses that investment will increase somewhat in 2020 despite the current situation which is also important and will have a positive impact on demand. Investment in other general government units (e.g. investment in railway transport) can be pointed out in particular. The growth in investment at the local level is expected (also in relation to the closing financial framework).

The impact of measures of the so-called anti-corona packages (exceptional circumstance and derogation from MTO) will presumably amount to -4.4% of GDP in the current crisis and will have a significantly lesser negative impact on the general government balance than it had the previous crisis. Slovenia is in a different situation than in the past (see Chapter 2).

Due to uncertain scenarios, calculations and derogation from fiscal rules in the stability programme, the public financial structural position or the mid-term framework is not presented. With a simple display, it is nevertheless possible to demonstrate the situation of the structural balance or fiscal stance of the country (between autumn 2019 and spring 2020). The stance is even more procyclical and expansionary in 2019 (only because of a change in the output gap and the forecast). It will be necessary to approach the exit from the crisis from the mid-term and long-term points of view relative to the assessment of the situation in the economic cycle.

Figure 7: Fiscal stance



Source: Ministry of Finance

3.2 Government debt

End of 2019 consolidated gross government debt amounted of EUR 31,744 million or 66.1% of GDP, which was EUR 479 million less in comparison to the year 2018 when it amounted EUR 32,223 million or 70.4% of GDP. Central government debt in 2019 stood at EUR 31,124 million or 64.8% of GDP and is the main driver of decrease of the government debt. Local government debt level stood at EUR 857 million or 1.8% of GDP, which was slightly higher for EUR 51 million in comparison to 2018 when it amounted EUR 806 million or 1,8 % of GDP. In 2019 the social security funds debt stood at EUR 0.4 million.

Following the Public Finance Act, financing of the central government budget execution and debt management operations in a given fiscal year allows the government to borrow, within a given fiscal year, for financing the deficit of central government budget including the Lending and Repayment Account deficit and financing debt repayments in the current and following two fiscal years. Due to favourable market conditions of debt capital markets in 2019 the Republic of Slovenia has seized the opportunity of pre-financing in a total amount EUR 427 million while following all the requirements from the SGP Debt rule.

3.2.1 General Government Debt dynamic before COVID-19 epidemic

According to the adopted Financing program of the Republic of Slovenia for the fiscal year 2020, Republic of Slovenia is allowed to execute the financing of the central government budget in the amount of EUR 1,583,178,645.66.

Early in January 2020 Republic of Slovenia secured financing of EUR 1.5 bn 10-year bond RS82 yielding 0.296% (MS + 0.19%) with coupon 0.275%. At that point 95% of the funding needs for the fiscal year 2020 was covered. As it is envisaged in Financing program, the main central government budget financing instrument remains euro bonds issued on debt capital markets. Complement part represents T-bills of different maturities up to 18-months.

In March, before the COVID-19 epidemic was declared, the general government debt estimate for the year 2020 amounted to EUR 31,908 million or 64.1% of GDP taking into the account IMAD's spring forecast for 2020 GDP. From 2016 until 2019 the Republic of Slovenia fully adhere to SGP debt rule.

Table 2: General government debt development before COVID-19 epidemic

	2018	2019	E2020
General government debt, mio EUR	32,223	31,744	31,908
GDP, mio EUR	45,755	48,007	49,761
General government debt, % of GDP	70.4	66.1	64.1
Stability and Growth pact debt rule, % of GDP	76.6	72.9	69.0
Interest expenditure (EDP D.41), % of GDP	2.0	1.7	1.5

Source: Ministry of Finance, Treasury directorate, SORS, IMAD (Spring Forecast 2020), March 13, 2020

3.2.2 General Government Debt development after COVID-19 epidemic

Since outbreak of COVID-19 epidemic the Ministry of finance provided of EUR 3,581.3 million financing. The average weighted issued yield amounted 0.52%. Interest impact on a yearly basis is estimated at EUR 22.2 million (0.05% of GDP).

On the back of adopted fiscal measures for COVID-19 containment the new estimate for General Government Debt for 2020 was made. The estimate for the general government debt for the end of the year 2020 envisages additional EUR 2.5 billion central government debt issuance, whilst the residual part of the general government debt, i.e. local government and security funds debt level remains unchanged. For GDP estimate the updated IMAD's Spring forecast, including COVID-19 impact, was taken into the account.

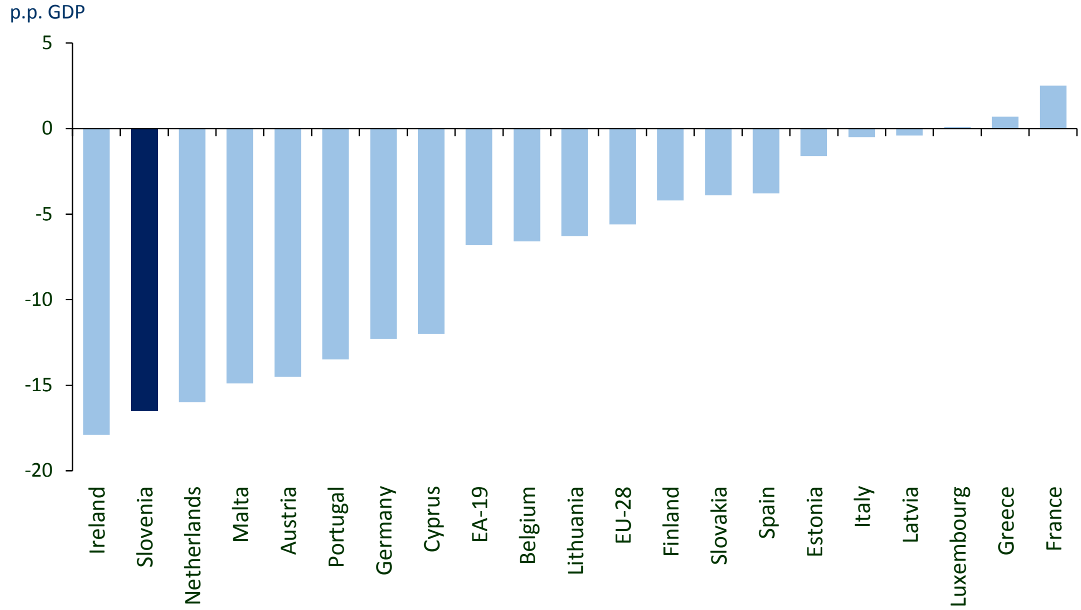
Table 3: General government debt development after COVID-19 epidemic

	2018	2019	E2020
General government debt, mio EUR	32,223	31,744	37,556
GDP, mio EUR	45,755	48,007	45,586
General government debt, % of GDP	70.4	66.1	82.4
Stability and Growth pact debt rule, % of GDP	76.6	72.9	Suspended
Interest expenditure (EDP D.41), % of GDP	2.0	1.7	1.6

Source: Ministry of Finance, Treasury directorate, SORS, IMAD (COVID-19 update Spring Forecast 2020), April 16, 2020

The figure below shows that, in terms of speed of reducing general government debt-to-GDP ratio, Slovenia is ranked second among euro area countries (only behind Ireland), with its debt-to-GDP ratio having declined from 82.6% GDP in 2015 to 66.1% GDP in 2019.

Figure 8: General government debt dynamics in % GDP in EA-19 in the period 2015–2019



Source: Eurostat, 24.4.2020

Table below outlines the liquidity position of the central government budget and state treasury single account (TSA).

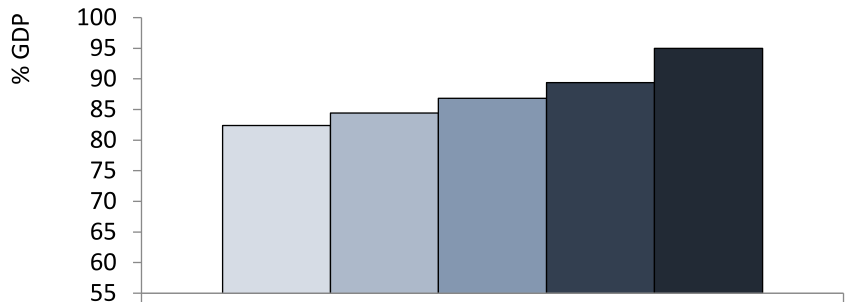
Table 4: Cash buffer of central government budget and Treasury Single Account (TSA)

	16. 4. 2020	
	EUR million	% of GDP
Cash buffer of central government budget	5,188	11.4
Cash buffer of TSA*	5,771	12.7
Balance sheet of TSA	7,450	16.3

Source: Ministry of Finance, Treasury directorate, SORS, IMAD (Spring Forecast 2020 updated with COVID-19 impact), April 16, 2020
*not deposited cash of TSA with the Central bank

The figure below represents different general government debt level scenarios based on different GDP real growth estimates for 2020. There are five different scenarios outlined where scenario “S0” is considered as baseline, i.e. IMAD’s real growth GDP estimate of -8.1% and additional EUR 2.5 billion central government debt issuance in the rest of the year 2020. In all scenarios the estimated general government debt at the end of 2020 is estimated to EUR 37,556 million.

Figure 9: Scenario based estimates for General Government Debt to GDP level in 2020

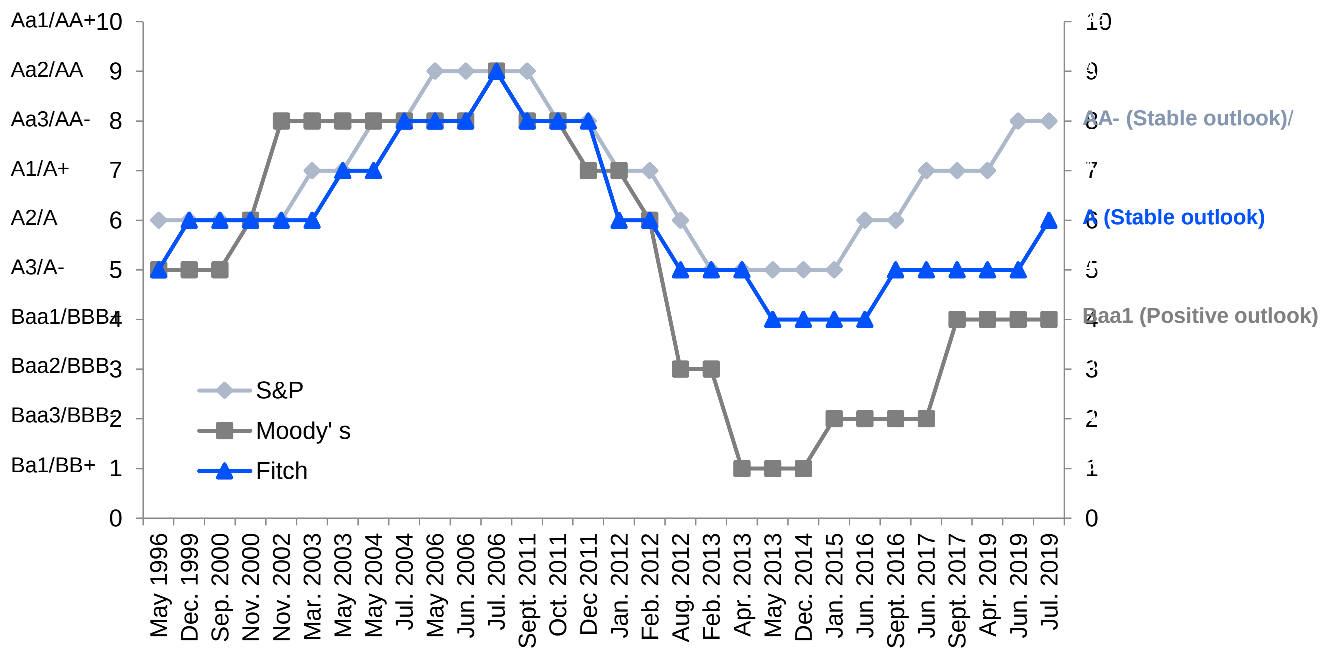


	E2020
S0: GGD as % of GDP (-8,1%)	82,4
S1: GGD as % of GDP (-10%)	84,4
S2: GGD as % of GDP (-12,5%)	86,8
S3: GGD as % of GDP (-15%)	89,4
S4: GGD as % of GDP (-20%)	95,0

Source: Ministry of Finance, Treasury directorate, April 16, 2020

Republic of Slovenia external ratings positive trend started in 2015. In 2019 it reached levels of AA- (S&P) – Stable outlook, A (Fitch) – Stable outlook and Baa1 (Moody's) – Positive outlook.

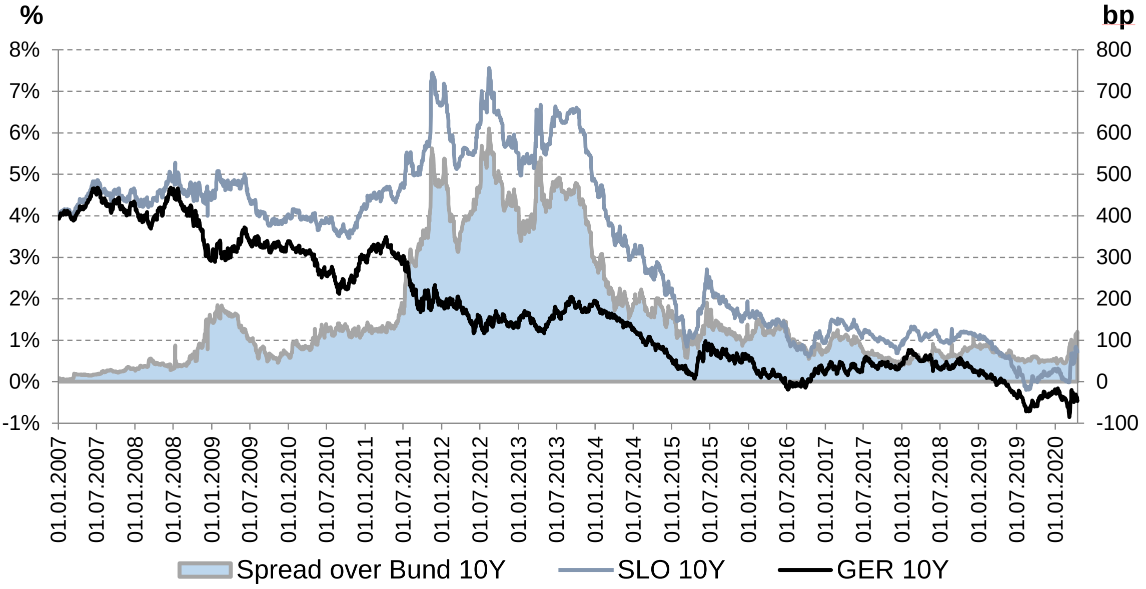
Figure 10: Republic of Slovenia Credit Rating over time



Source: S&P, Moody‘s and Fitch, April 16, 2020

In the last distressed period for the Republic of Slovenia in the period 2012-2013 the spread over 10-year german benchmark (DBR) reached over 600bp. Since 2014 we are observing significantly lower levels. On 16th of April spread stood at 119.5bp.

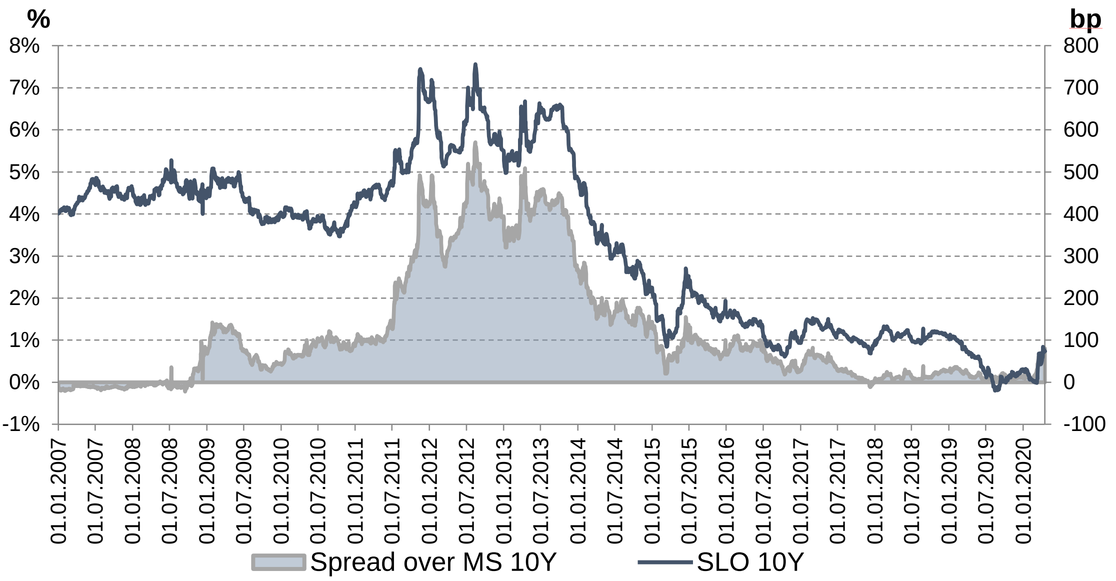
Figure 11: 10-year Euro Yield Dynamics of Republic of Slovenia in Comparison to Germany



Source: Bloomberg, Ministry of Finance interpolation (SI), 16.4.2020

As it is shown in the figure below in the year 2012 the Republic of Slovenia 10-year yield in the secondary market crossed 7% mark for the first time. Since than on we are observing significantly lower levels. On 16th of April 2020 the 10-year yield stood at 0.74% and spread over EUR 10-year mid swap at 81 bp.

Figure 12: 10-year Yield Dynamics of Republic of Slovenia and Spread over EUR 10-year Mid Swap



Source: Bloomberg, Ministry of Finance interpolation (SI), 16.4.2020

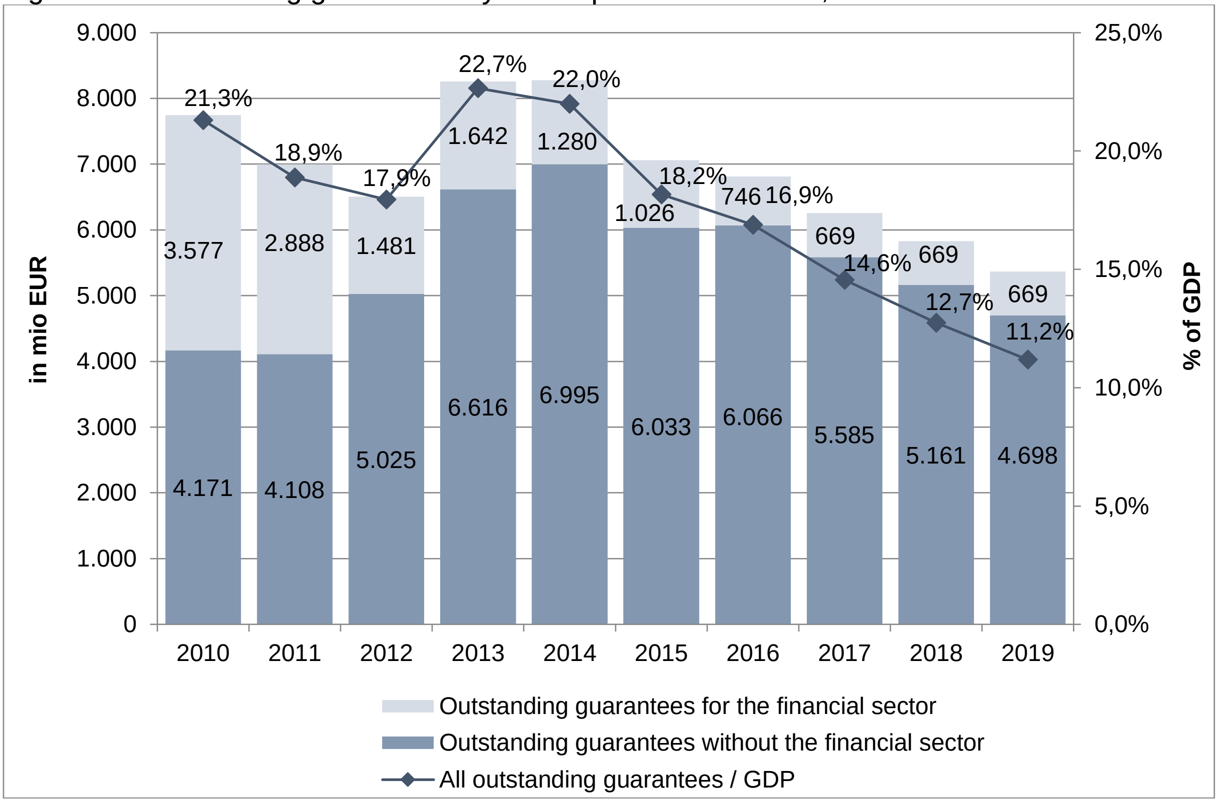
3.3 Guarantees

According to the Constitution, the granting of guarantees of the Republic of Slovenia is possible only by virtue of a law. In the system of guarantees of the Republic of Slovenia, two types of acts have been developed; general and special. A general act regulates the granting of government guarantees to a wider range of recipients. The Act Governing Rescue and Restructuring Aid for Companies and Cooperatives in Difficulty is an example of a general act. Special acts are intended for specific recipients, e.g. the acts on guarantees to Družba za avtoceste v Republiki Sloveniji, d.d. (Motorway Company of the Republic of Slovenia), Slovenski državni holding, d.d. (Slovenian Sovereign Holding), etc.

The Republic of Slovenia may issue government guarantees to public or private sector entities. Most of the guarantees in the private sector were granted to companies in difficulties. Relatively high levels of this type of guarantee were called on, while no guarantees for the public sector are being called on. The issuing of government guarantees of the Republic of Slovenia is regulated by the provisions of a systemic act. The annual quota is set by the act governing the execution of the state budget, while the state may also issue guarantees outside the quota if this is permitted by an individual act.

The balance of guarantees of the Republic of Slovenia as of 31 December 2019 was EUR 5,368 million, of which the balance of government guarantees for the liabilities of the financial sector (S 12) was EUR 669 million.

Figure 13: Outstanding guarantees by the Republic of Slovenia, 2010-2019



Source: Ministry of Finance

Table 5: Projections of guarantees of the Republic of Slovenia, 2020 – 2021

	Balance as of 31.12.2020*		Balance as of 31.12.2021*	
	v mio EUR	v % BDP	v mio EUR	v % BDP
Guarantees of the Republic of Slovenia	7.203	15,8%	6.453	13,5%
Including: financial sector*	669	1,5%	669	1,4%

* In accordance with the Statistical Classification for Institutional Sectors (SCIS), all legal persons with an SCIS designation of S 12 are included.
Source: Ministry of Finance

The data below display the assessment of the balance of guarantees of the Republic of Slovenia at the end of the year, which was prepared on the basis of certain assumptions relating to the repayment of existing guarantees and approvals of new ones. The planned quota for new guarantees for 2020 pursuant to the act governing the implementation of the state budget is EUR 800 million, and a separate EUR 350 million for guarantees of SID banka, d.d. The experience of previous years shows that the actual use of the quota is low since it amounted to 5.7% in 2015 and 14.8% in 2016. In the last three years, the quota was not used because all guarantees in 2017 were allocated to refinance existing obligations, while no government guarantees were issued in 2018 and 2019. The quota allocated for SID banka, d.d. was not used at all.

In 2019, EUR 0.64 million was used to call on government guarantees of the Republic of Slovenia pursuant to the Act on the Natural Persons Guarantee Scheme of the Republic of Slovenia and the Act Regulating Guarantees of the Republic of Slovenia for Financing Companies' Investments, and no guarantees were called on in 2018. In 2020, the use of funds in the amount of EUR 3 million is anticipated (of the previous scheme).

When drafting anti-crisis measures, the Republic of Slovenia will issue guarantees for loans in the amount of EUR 2 billion (the maximum guarantee for small and medium-sized companies amounts to 80%, and 70% for large companies. A conservative scenario anticipates a realisation in the total amount of EUR 485 million in five years (starting in 2021).

3.4 Projections for 2021 and a medium-term scenario

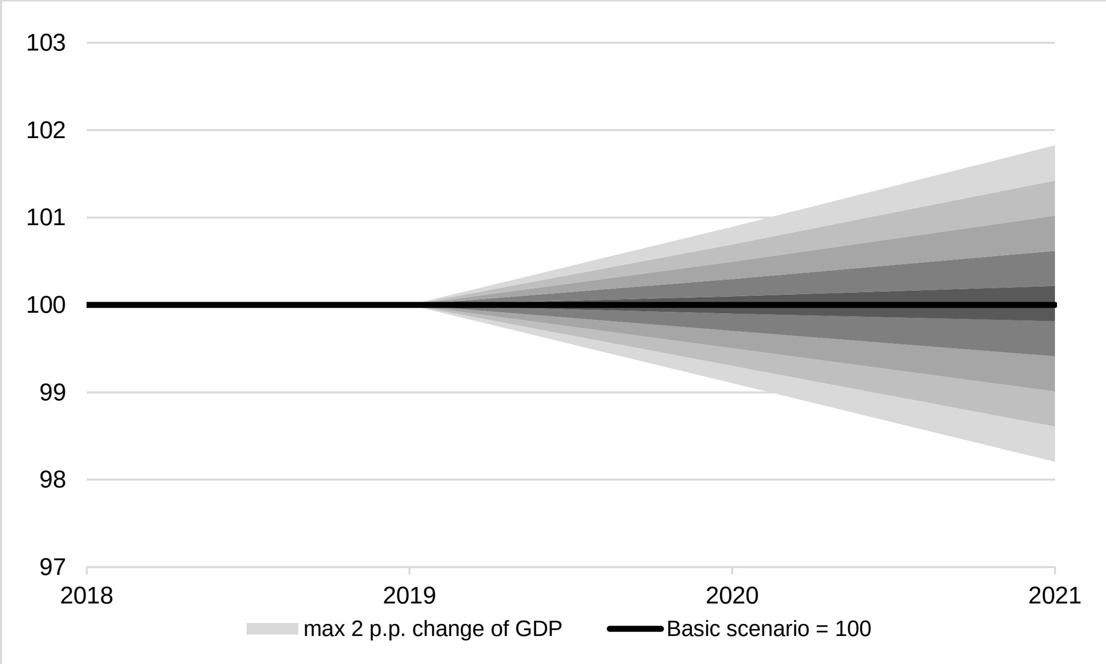
During the current period of exceptional and unprecedented uncertainty in the economy, projections of economic growth are extremely precarious and fast changing. The projections are extremely sensitive to changes of conditions (number of new cases, progress in vaccine development and the subsequently anticipated duration and severity of measures taken to contain the spread of the virus).

Figure 13 shows alternative scenarios of the impact of economic growth fluctuation on general government revenue. For the 2020–2021 period, scenarios assume that nominal GDP growth will be up to 2 percentage points higher or lower than the basic projection (used in this Stability Programme) at the annual level linearly in all years (grey field).

Under the assumption of unchanged policies, general government revenue would improve by 0.9% in 2020 and by 1.8% in 2021 if nominal GDP growth is 2 percentage points higher than anticipated. General government revenue would reach 99.1% of revenue from the basic projection in 2020 and 98.2% in 2021 if GDP growth is 2 percentage points lower than anticipated. General government revenue would be lower by 0.4% in 2020 and by 0.9% in

2021 from the basic projection if the realised GDP growth in 2020 is 1 percentage point lower than anticipated.

Figure 14: Impact of fluctuations in economic growth on general government revenues



Source: Ministry of Finance, own calculations

3.5 Measures to respond to COVID-19

Due to the severe negative shock that the restrictions pose for the economy and the income of the population, the Government adopted and drafted an array of measures to limit negative consequences. To this end, the Act Determining the Intervention Measures to Contain the COVID-19 Epidemic and Mitigate its Consequences for Citizens and the Economy (ZIUZEOP) or the so-called anti-corona package 1 and its amendments, and the Act on Additional Liquidity to the Economy to Mitigate the Effects of the COVID-19 Infectious Disease Epidemic (the so-called anti-corona package 2) were adopted. The specific objectives of the measures proposed are the preservation of jobs and business operations; improvement of the social security of individuals, particularly of those affected the most by the COVID-19 disease; extraordinary assistance for the self-employed; improvement of corporate liquidity; assistance to science and research projects to combat the COVID-19 epidemic; reduction of attendance fees and salaries of public officials at the state level; exemption from payment of distribution services and assistance to agriculture. Package 2 includes key measures that will enable companies to revive investment activities and thus preserve jobs.

Immediately after starting its term, the new Government of the Republic of Slovenia issued important decisions on 13 March 2020 by means of which it ceased all commitments in the state budget (the largest central unit in the general government sector), proposed to change the dynamics of the adopted commitments and to stop the rearrangement rights. It also determined that the spending rights be reduced by 30% of state budget and be allocated to the general reserve. On 14 April 2020, the Government adopted new decisions to temporarily withhold the implementation of the budget, and the budget users had to specify which funds were linked with the COVID-19 epidemic, which measures and programmes may be postponed until next year and which terminated. When drafting the Stability Programme, savings were estimated at about EUR 200 million.

To support measures to mitigate consequences of the COVID-19 pandemic, the Government of the Republic of Slovenia also adopted decisions relating to the implementation of the cohesion policy on 24 March 2020. The budget users involved in the implementation of the cohesion policy had to submit proposals to redistribute funds from the European Social Fund and the European Regional Development Fund into measures to assist companies and preserve jobs and health care, and were invited to draft new or adjusted measures due to the epidemic. The savings are currently estimated at about EUR 185 million. The Coronavirus Response Investment Initiative and the adjustment of possibilities to use EU funds at the EU level enable a prompt use of funds available in the cohesion packages by countries and restrict their redistribution.

As an urgent and speedy measure, the Government of the Republic of Slovenia also enhanced commodity reserves and purchased special equipment to fight COVID-19. In 2020, the funds for the Agency of the Republic of Slovenia for Commodity Reserves[11], which will be reallocated from the savings, will amount to about EUR 176 million.

In consideration of the situation (extraordinary circumstances) and the activation of the general escape clause of the Stability and Growth Pact, the measures proposed as a justification of the general escape clause are evaluated and outlined below.

The measures are divided according to whether they present an additional expenditure or revenue, whether the source of action is a reallocation of funds, a delay of payments, or whether they are guarantees.

<u>Expenditure or revenue measures:</u>

Measures in the field of the labour market and social contributions:

- Benefits for employees temporarily laid off or employees staying at home due to force majeure: the measure is intended to preserve jobs in companies and the number of employees. Employers whose revenue will decline in 2020 due to the epidemic by over 10% as compared with their revenue in 2019 are eligible for support. If they did not conduct activities in 2019 or 2020, employers whose average monthly revenue will decline on account of the epidemic in 2020 by over 10% as compared with their monthly revenue in 2019, or if they did not conduct activities in 2019, employers whose average monthly revenue will decline on account of the epidemic in 2020 by over 10% as compared with their monthly revenue in 2020 by 12 March 2020 are also eligible for support. This is provided that they do not pursue financial and insurance activities and employ more than 10 people or are financed from public sources. Humanitarian and disabled persons' organisations are also eligible for the reimbursement of wage compensation for temporarily laid off workers, regardless of their realised revenue. Workers who must stay home due to force majeure, in this case the closure of schools and kindergartens, are also eligible. They receive up to 80% of wage compensation, whereby the amount cannot exceed the average wage in 2019. The potential number of beneficiaries of this measure amounts to about 260,000 people. The number was estimated on the basis of the assessment of the drop in the activity by sector (see Chapter 2.3). If calculated in accordance with the statistical data on wages by individual sectors and uncertainty, the value of the measure is assessed at about EUR 700 million.

[11] The supplied protective equipment is immediately and in full handed over by the Agency of the Republic of Slovenia for Commodity Reserves to the Administration of the Republic of Slovenia for Civil Protection and Disaster Relief, which distributes it according to the distribution plan drafted by the Ministry of Health, which particularly favours healthcare institutions. The remaining equipment is further distributed through regional civil protection staff.

- Financing of social security contributions for employees who are temporarily laid off or home due to force majeure from the state budget: This measure is part of the foregoing measure as the state will cover social contributions from the base for all temporarily laid off employees. If observing the same assumptions about the beneficiaries as cited in point one, the value of the measure is about EUR 340 million.

- Payment of employee pension insurance contributions: The measure is intended for companies or their employees that remained at work. Only companies that do not pursue financial and insurance activities and employ more than 10 people or are financed from public sources are eligible for support within this measure. An employer must pay to the employee for whom the employer is exempt from the payment of contributions, and who has previously received a wage that did not exceed three times the minimum wage, a monthly crisis allowance in the amount of EUR 200. The state budget will provide for the financing of a monthly crisis allowance for disabled persons in social enterprises and employment centres. The value of this measure amounts to about EUR 195 million. When estimating the number of employees, the share of persons who theoretically remained in work was observed in the assessment of the measure.

- Financing of social security contributions for eligible self-employed persons, farmers and religious workers from the state budget: The beneficiaries are exempt from the payment of all contributions for April and May. The measure is estimated at about EUR 70 million, which is the sum of current payments.

- Payment of the monthly basic income to self-employed persons, farmers and religious workers: The measure is intended to financially assist beneficiaries who cannot implement their activities due to the epidemic or implement it in a limited scope. Extraordinary assistance amounted to EUR 350 in March, and EUR 700 in April and May. A reduced level of activity represents a criterion for allocation and must display at least a 25-per cent decrease in revenue in March 2020 as compared to revenue in February 2020, or at least a 50-per cent decrease in revenue in April or May 2020 as compared to revenue in February 2020. The value of the measure is estimated at about EUR 105 million. The assessment is based on the assumption that more than half of all eligible persons will apply for the income.

Measures in the field of health insurance:

- Sick pay for employees for the first 30 days of sick leave: Before the extraordinary measure, the employer covered sick pay for the first 30 days of an employee's sick leave. The measure transferred this burden to the state budget. The healthcare fund will implement the measure. The measure increases expenditure by about EUR 60 million for the duration of the measure and was assessed on the basis of employers' past costs.

Measures in the field of education:

- Financing private kindergartens: the state will finance 85% of funds per individual child during the epidemic. The value of the measure is estimated at EUR 10 million.

Measures in the field of social care and parental protection:

- A one-off solidarity allowance for retired persons, vulnerable persons and students: The purpose of the measure is to improve the social security of individual target groups. The one-off allowance is paid to retired persons according to the amount of their pension and amounts to between EUR 130 and 300. The beneficiaries are retired persons with pensions under EUR 700, including the recipients of occupational pensions. A little less than 300,000 retired persons are eligible for the allowance. Vulnerable groups include persons with low income who are not retired and will be entitled to EUR 150. All students are also eligible for solidarity allowance. The total estimated value amounts to about EUR 100 million.

- Large family allowance: With this measure, families with three children receive EUR 100 in addition to their large family allowance, and families with four children or more receive EUR 200. The value of the measure is estimated at about EUR 4 million. Families already receiving the large family allowance are eligible under this measure. A parent or another person is eligible for a one-off solidarity allowance in the amount of EUR 30 for each child for whom they are eligible for child benefit in the first to sixth income brackets if they are not simultaneously eligible for the large family allowance.

Measures in the public sector:

- Wages in the public sector: all salaries of public officials at the state level are to be reduced and allowances for hazards and special burdens during the epidemic introduced. The reward scheme is intended for employees and their activation in critical activities and may be paid in the maximum amount of 100% of the basic salary supplement. The state budget will provide funds for financing the allowance for hazards and special burdens during the epidemic for private social protection and healthcare providers who pursue the activity as part of the public services network and are also eligible for hazard pay. On the assumption of applicable staffing plans the reduction of salaries of public officials, that a certain percentage of employees are laid off, that a certain percentage of employees work on the premises of their employers (a large proportion of the most burdened groups) and receive 65% of the allowance and that a certain share of these employees receive an additional 25%, the value of the measure is assessed at about EUR 350 million.
- Payment of wage compensation for employees in public services: The measure is intended for the payment of wage compensation for employees in public bodies, local communities, holders of public authority and public service providers who do not implement public services during the epidemic. The assessed value of the measure is EUR 100 million.

Measures in the field of agriculture, forestry and food:

- Financial assistance in the amount of 80% of the minimum wage is granted to owners or members of agricultural holdings who fall ill (only applicable to those who are insured as farmers as per the Pension and Disability Insurance Act). The value of the measure is estimated at EUR 0.03 million.
- The holders of fishing permits are eligible for compensation of fishing vessel mooring fees in 2020 in the amount of 40% of the full amount assessed at EUR 0.08 million.
- The payment of water tax is reduced by 40% of the full amount for aquaculture farmers in 2020, which denotes a loss of revenue by EUR 0.01 million.

Measures in the field of taxes:

The two measures mitigate liquidity problems of companies and natural persons that implementing activities regarding the payment of taxes. Both measures represent the possibility of continued existence of business entities, their revival and growth:

- freezing the preliminary income tax prepayment and prepayment of income tax on income from activity,

- freezing the corporate income tax prepayment.

  Natural persons implementing activities and legal entities are exempt from the payment of relevant tax prepayment instalments for the duration of the epidemic, presumably until 31 May 2020. It is assessed that about EUR 160 million less will be collected in the state budget therefrom in two months, but annual calculations must be taken into consideration for the entire year.

- Reduction of tax base (by 50%) for potential market income from production on agricultural land in the amount of 50% of cadastral income, and the reduction of tax base for potential market income from apiculture in the amount of 35% of lump-sum estimate of income per beehive for income tax prepayment: Due to the expected loss of income from production of basic agricultural and forestry products in 2020, which will be the result of aggravated cultivation during the implementation of measures to contain the consequences of the epidemic and the expected drop in purchase prices, the tax base of the lump-sum income of taxable persons obliged to pay income tax on income from basic agricultural and forestry activity, whose income is established on the basis of a lump-sum tax base (cadastral income and lump-sum estimate of income per beehive) was reduced by 50%. Thus, the reduced tax base will affect the amount of income tax prepayment for 2020 paid by taxable persons in 2021. It is expected that the amount of prepayments in 2021 will be reduced by about EUR 2 million.

Liquidity measures

Measures in the field of the labour market and social contributions:

- Deferred payment of self-employed persons' social contributions: Self-employed persons may decide to defer the payment of contributions that are due in April, May and June 2020. If anticipating that 50% of the self-employed decides to use this measure, its value will be about EUR 25 million, but it will only have a liquidity effect.

Measures in the field of taxes:

- Postponed submission of tax returns for income from activity and corporate income tax (from March to May) and subsequently lower current prepayments: Taxable persons obliged to pay income tax from activity and business entities are granted more time to safely prepare data. A postponement for submitting tax returns (from March to May) was proposed that enables the social distancing necessary to contain the epidemic. The measure has no financial consequences, but it is only important from the aspect of business entities' operations and meeting their tax obligations, which was curtailed due to restrictions on public life.
- Deferred payment of all taxes for up to two years or instalment payment of all taxes in no more than 24 monthly instalments: The declaration of the epidemic may have a direct impact on company operations, particularly in regard to obtaining income. To ensure the liquidity of business entities, a measure was adopted that envisages the possibility of deferring the payment of all taxes for up to two years or an instalment payment of all taxes in no more than 24 monthly instalments. The measure results in a liquidity shortfall estimated at about EUR 100 million as the measure only allows business entities to bridge negative consequences in business operations during extraordinary circumstances.

Guarantees

- An act was also adopted which regulates guarantees of the Republic of Slovenia provided to banks and saving banks for loans approved between 12 March and the end of 2020 to finance working capital, the payment of liabilities, and new or commenced investments in fixed assets. The companies that did not undergo insolvency proceedings in 2019 and participate in the AJPES' multilateral set-off of liabilities and receivables will be eligible for the loan. Loans will be limited to 10% of annual revenue and annual costs. The amount of individual guarantees will be 70% of the principal of loans provided to large enterprises and 80% of the principal of loans provided to micro, small and medium-sized enterprises. An application for the fulfilment of the guarantee liability of the Republic of Slovenia will be justified only if the bank and the Republic of Slovenia suffer proportionate losses from guarantees under the same conditions.

  The proposed guarantee scheme will address the liquidity problem in the economy, which arose due to the economic crisis brought on by the COVID-19 outbreak, upon the assumption of currently high liquidity and capital adequacy in the banking system. First and foremost, the guarantee scheme addresses the credit risk to which the banking system would be exposed due to liquidity loans to the business sector, while it provides banks with an opportunity for additional liquidity available in the Eurosystem.

  The total amount of guarantees issued by the Republic of Slovenia may not exceed EUR 2 billion according to this act (the conservative expectation of realisation in the amount of EUR 485 million in five years). EUR 200 million from the first package is earmarked for the deferral (ZIUZEOP); the guarantees are thus raised to a total of EUR 2,200 million.

<u>Finance</u>

- Deferral of debt repayment for companies (has no direct impact on public finance).

Other measures:

Other special measures with an impact on public finance are also implemented, but this impact is not evaluated directly, e.g. the closure of borders affects the loss of excise duty, CO_2 tax, suspension of public passenger transport, air transport, closure of shops and services, casinos, postponed vehicle registration and closure of driving schools also negatively impacts the level of revenues obtained from excise duty. The loss is also recorded in concession fees from gaming, tax on gaming, vehicle tax and postponed toll payment. Measures also include the regulation of prices of medical equipment, measures in the field of justice, restrictions on trading with agricultural products and their prices. The measure of reduced water tax and the water rights payment for holders of the water rights for special water use in bathing areas is also in force if mineral, thermal or thermal mineral water is used, and the activity of swimming pools. The accumulation of municipal packaging waste has occurred and its collection at storage sites must be ensured. Employers are exempt from the payment of occupational insurance contributions for employees who continue working and receive salary for their work and for those who receive compensation due to excused absence from work. A new instrument of wage compensation due to job loss during the epidemic was introduced for those who do not meet the conditions for obtaining unemployment benefit.

All these measures will have significant consequences for public finance. The expenditure planned for measures and a drop in government revenue and guarantees (estimate of those called on) are assessed to total some EUR 2.8 billion (or by incorporating risks up to EUR 3 billion according to cash flow and including annually called guarantees).

Table 6: Discretionary measures (ESA 2010 methodology)

Title	Description	ESA Code	Adoption Status	Budgetary impact (% of GDP)		
					2020	2021
Measures in the field of labour market and social security contributions	Wage compensations for employees waiting at home	D.3	Adopted		1.32	
	Payment of social contributions for employees waiting at home	D.3	Adopted		0.66	
	Exemption from payment of contributions for pension and disability insurance for working employees	D.3	Adopted		0.36	
	Sick leave pay for all workers during the epidemic from the first day onwards will be covered by Health Insurance Institute (not the employer)	D.3	Adopted		0.13	
	Special assistance in the form of a monthly basic income for self-employed workers, farmers etc.	D.62	Adopted		0.23	
	Exemption from payment of social contributions for self-employed workers, farmers etc.	D.62	Adopted		0.08	
Measures in the field of education and science	Covering wages for market activities of indirect budgetary units	D.1	Adopted		0.01	
	Financing of private kindergartens	D.62	Adopted		0.02	
Measures in the field of social protection	One-time solidarity assistance for pensioners	D.62	Adopted		0.16	
	One-time solidarity assistance for vulnerable groups	D.62	Adopted		0.03	
	One-time solidarity assistance for students	D.62	Adopted		0.02	
	Allowance to large families	D.62	Adopted		0.01	
Measures in the area of wages in public sector	Reduction of salaries of all high functionaries (by 30 %)	D.1	Adopted		0.00	
	Allowances for special working conditions / direct budgetary units	D.1	Adopted		0.11	
	Allowances for special working conditions / indirect budgetary units	D.1	Adopted		0.26	
	Allowances for special working conditions / indirect local budgetary units	D.1	Adopted		0.05	
Other (expenditure) measures	Purchase of medical, protective equipment and accessories	D.63	Adopted		0.39	
	Payment of the remuneration of employees who perform public services (which can't be provide during the epidemic)	D.62	Adopted		0.11	
Measures in the field of agriculture, forestry and food	Compensations for the mooring fee in fishing ports (40 % of total compensation)	D.62	Adopted		0.00	
	Financial aid to holders or members of agricultural households infected with COVID-19 in the amount of 80 % of the minimum wage (granted only those who are insured by Pension and Disability Institute as farmers)	D.62	Adopted		0.00	
	Reduced tax base for income tax prepayment from the cadastral income and lump sum estimation of income per hive	D.51	Adopted		- 0.00	
	Exemption from payment of water right concessions	D.29	Adopted		- 0.00	
	Exemption from payment of chargers for the use of water	D.29	Adopted		- 0.01	
	Reduced tax base for income from water rights, granted with water permits	D.29	Adopted		- 0.00	
Tax measures	Unsettled and unpaid prepayments for economic activity imposed on each individual income	D.51	Adopted		- 0.04	
	Unsettled and unpaid prepayments of corporate income tax	D.51	Adopted		- 0.24	
	Deferred tax payments	D.21	Adopted		0.11	
				Total*	4.35	

Total* = sum of all the absolute values of measures

Source: Ministry of Finance

Table 7: Guarantees

List of measures	Description	ESA code	Adoption status	Maximum amount of contingent liability (in % of GDP)	
Guarantees	Guarantees for the liquidity of the companies	D99	Adopted		4,8% BDP
				Total	4,8% BDP

Source: Ministry of Finance

Annex: Tables on Macroeconomic and General Government budgetary prospects

Table 1a: Macroeconomic prospects (Macroeconomic scenario)

		ESA Code	Year 2019	2019	2020	2021	2022*	2023*
			Level: EUR million	rate of change				
1.	Real GDP	B 1*g		2.4	-8.1	3.5		
2.	Nominal GDP	B 1*g	48,007	4.9	-5.0	5.1		
	Components of real GDP							
3.	Private consumption expenditure	P.3	24,823	2.7	-3.1	-0.4		
4.	Government consumption expenditure	P.3	8,846	1.6	3.0	1.0		
5.	Gross fixed capital formation	P.51	9,267	3.2	-18.5	7.0		
6.	Changes in inventories and net acquisition of valuables (% of GDP)	P.52+ P.53	684	1.4	-0.3	-0.2		
7.	Exports of goods and services	P.6	40,535	4.4	-19.4	10.0		
8.	Imports of goods and services	P.7	36,149	4.2	-19.4	7.8		
	Contributions to real GDP growth (in percentage points)							
9.	Final domestic demand		43,620	2.1	-6.9	1.3		
10.	Changes in inventories and net acquisition of valuables	P.52+ P.53	684	-0.4	-1.7	0.0		
11.	External balance of goods and services	B.11	4,387	0.5	-1.8	2.2		

Note: *projections for 2022 and 2023: optional

Source: SURS; IMAD, COVID-19 Scenario (April 2020)

Table 1b: Price developments

		ESA Code	2019	2019	2020	2021	2022*	2023*
			Level	Rate of change				
1.	GDP deflator		102.4	2.4	3.3	1.4		
2.	Private consumption deflator		101.8	1.8	0.7	2.5		
3.	Consumer price index - HICP (annual average)		101.6	1.6	0.7	2.7		
4.	Public consumption deflator		103.8	3.8	5.4	0.7		
5.	Investment deflator		102.3	2.3	-0.5	1.0		
6.	Export price deflator (goods and services)		100.1	0.1	-1.8	1.7		
7.	Import price deflator (goods and services)		99.7	-0.3	-4.9	2.3		

Note: *projections for 2022 and 2023: optional

Source: SURS; IMAD, COVID-19 Scenario (April 2020)

Table 2a: General government budgetary prospects

		ESA Code	2019 level	2019	2020	2021	2022*	2023*
			Level: EUR million	% of GDP				
	Net lending (+) / net borrowing (-) by sub-sector (B.9)							
1.	General government	S.13	260.4	0.5	-8.1	n.a.		
1a.	Central government	S.1311	290.6	0.6	-8.1	n.a.		
1b.	State government	S.1312	…	…	…	…		
1c.	Local government	S.1313	-42.1	-0.1	0.1	n.a.		
1d.	Social security funds	S.1314	11.8	0.0	-0.1	n.a.		
	Total general government (S.13)							
2.	Total revenue	TR	21,227.8	44.2	43.7	n.a.		
3.	Total expenditure	TE	20,967.4	43.7	51.8	n.a.		
4.	Net lending / borrowing	B.9	260.4	0.5	-8.1	n.a.		
5.	Interest expenditure	D.41	821.3	1.7	1.7	n.a.		
6.	Primary balance	B.9+D.41	1,081.7	2.3	-6.5	n.a.		
7.	One-off and other temporary measures		0	0.0	0.0	n.a.		
	Selected components of revenue							
8.	Taxes on production and imports	D.2	6,621.7	13.8	13.0	n.a.		
9.	Current taxes on income, wealth, etc.	D.5	3,875.1	8.1	7.4	n.a.		
10.	Capital taxes	D.91	18.2	0.0	0.0	n.a.		
11.	Social contributions	D.61	7,722.8	16.1	16.7	n.a.		
12.	Property income	D.4	409.6	0.9	0.7	n.a.		
13.	Other revenue		2,580.4	5.4	6.0	n.a.		
14.	14.=2. Total revenue	TR	21,227.8	44.2	43.7	n.a.		
	p.m.: Tax burden (D.2+D.5+D.61+D.91–D.995)		18,236.0	38.0	37.1	n.a.		
	Selected components of expenditure							
15.	Compensation of employees and intermediate consumption	D.1+P.2	8,380.9	17.5	19.5	n.a.		
15a.	Compensation of employees	D.1	5,468.8	11.4	13.1	n.a.		
15b.	Intermediate consumption	P.2	2,912.2	6.1	6.5	n.a.		
16.	Social payments (16=16a+16b)		8,416.7	17.5	20.5	n.a.		
	of which: Unemployment benefits		160.1	0.3	0.4	n.a.		
16a.	Social transfers in kind	D.632	1,015.8	2.1	2.6	n.a.		
16b.	Social benefits other than social transfers in kind	D.62	7,400.9	15.4	17.9	n.a.		
17.	17.=5. Interest expenditure	D.41	821.3	1.7	1.7	n.a.		
18.	Subsidies	D.3	360.8	0.8	3.2	n.a.		
19.	Gross fixed capital formation	P.51g	1,813.4	3.8	4.3	n.a.		
20.	Capital transfers, expenditure	D.9	158.7	0.3	0.4	n.a.		
21.	Other expenditure		1,015.6	2.1	2.2	n.a.		

22.	22.=3. Total expenditure	TE	20,967.4	43.7	51.8	n.a.		
	p.m.: Government final consumption expenditure (nominal)	P.3	8,846.2	18.4	n.a.	n.a.		
	Consolidated gross debt at the end of the year							
23.	Gross debt		31,744.4	66.1	82.4	n.a.		

Note: *projections for 2022 and 2023: optional
Source: SURS, projection of Ministry of Finance (based on COVID-19 Scenario by IMAD, April 2020)