

Slovenia Business Forecast Report Q2 2014

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Abstracts

Core Views

Political instability will remain elevated as the four-party government coalition attempts to push through harsh austerity measures that will very likely prompt parliamentary tensions and social unrest.

The short-term economic outlook has improved in light of accelerating regional economic activity and a slight rebound in domestic demand. The corporate sector remains overleveraged and will remain a major risk to the banking sector unless some form of restructuring takes place. This could include restructuring the loans to reduce debt servicing costs, or cost cutting (shedding jobs/trimming investment).

Major Forecast Changes

We have adjusted our real GDP growth forecasts to take into account recent data and now expect that Slovenia will exit recession in 2014, growing by 0.5% against our previous forecast for a 0.5% contraction.

Key Risks To Outlook

Politics remains a key risk to the national reform programme, with the details of how to slash the budget deficit during a downturn likely to highlight differences between coalition partners. Any sign that the reform programme is at risk of delay or suspension will have an immediate and punishing impact on market sentiment towards Slovenia, pushing the country closer to a bailout.

A big risk to the Slovenian economy lies abroad. A major deterioration in the eurozone sovereign debt crisis, or even just a greater-than-expected slowdown in the core

eurozone nations, would have severe knock-on effects on the Slovenian economy, not only via depressed trade and investment flows, but also via credit channels and broader economic sentiment.

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BMI Political Risk Ratings

Domestic Politics

Economic Conditions Likely To Bolster Coalition Support

Despite growing challenges from the opposition, economic conditions will remain the ultimate determinant of the government's popularity. Based on our expectations for the country to exit recession in 2014, we expect that support for the coalition will continue to improve this year.

Table: Political Overview

Long-Term Political Outlook

Economic Slump A Test For Stability

Although the EU will remain a policy anchor for Slovenia over the long term, massive economic pressure will be a major test for the country's political institutions. A structural shift in policy and/or governing institutions is unlikely, though we caution that failure to develop a long-term growth model will increase challenges to governance, potentially exacerbating political party divisions.

CHAPTER 2: ECONOMIC OUTLOOK

SWOT Analysis

BMI Economic Risk Ratings

Economic Activity

Worst Now Over For Growth

It appears the positive trends seen in leading indicators have translated into real GDP growth, suggesting the worst may now be over for the Slovenian economy.

Nonetheless, inclement weather and a slowdown in regional growth in Q1 may slow the recovery.

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Cautious Towards Fiscal Sustainability

While risks emanating from the banking sector have resided considerably since the last quarter, we still remain cautious about the longterm sustainability of Slovenia's public accounts. Having opted to avoid requesting any external financial assistance, the government will have to adopt tight fiscal management in order to ensure that debt levels stabilise over the next five years.

Table: FISCAL POLICY

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We expect euro strength against the US dollar and on a trade-weighted basis to persist in H114. However, we continue to argue that the economic and monetary policy cycles in the eurozone are lagging further behind peers in the US and UK, which will trigger a re-pricing of the euro towards the end of 2014. We believe that weak eurozone economic growth and lingering deflationary risks will spur the European Central Bank to loosen monetary policy further.

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Slovenia's current account balance will remain in surplus over the coming years, bolstered by strong demand from Germany, although it will be gradually eroded by improving domestic demand. Over the long term we expect that the current account will gradually diminish, falling back into a deficit by 2017.

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Convergence To Slow Markedly

We expect Slovenia's real macroeconomic convergence with the Western European developed states to continue through our 10-year forecast period, though at a far reduced pace to the decade leading up to 2007. While continued capital market and trade integration with the eurozone following the adoption of the euro in 2007 will remain a core factor underpinning productivity gains, we caution that reduced foreign capital flows resulting from the 2008-2009 financial crisis as well as domestic banking sector woes will constrain growth over the long term. This is likely to result in reduced external asymmetries, and we forecast both the current account deficit to fall steadily through to 2022.

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