

Problems with banks are putting Slovenian finances at risk

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Over the past few weeks, Slovenia has been mentioned increasingly frequently as a potential applicant for aid from the eurozone rescue funds. The key problem of the Slovenian economy now is the critical condition of its banks. The largest bank, Nova Ljubljanska Banka (NLB), where the state is the majority shareholder (25% of the shares are held by Belgium's KBC), was recapitalised by the state and received 381 million euros on 2 July. In the opinion of Slovenian economists, despite this, the banks will need over 3 billion euros more (an equivalent of almost 10% of Slovenia's GDP) by the end of this year in order to avoid bankruptcy.

According to forecasts, the economy of Slovenia, a country with a population of two million which was severely affected by the crisis in 2009, will go into recession again this year (Eurostat's forecast: - 1.4% of GDP). Meanwhile, the country's debt has been growing dangerously over the past few years. Since 2008, public debt more than doubled to reach 47.6% of GDP in 2011, and – according to the estimates of the European Commission – will grow to a level of 54.7% of GDP by the end of this year.

Commentary

- The lack of structural reforms (above all, concerning the pension system) and the weak banking sector, which is dominated by state-controlled entities (over 50% of the market), have made Slovenia especially vulnerable to a fall in exports and a lower influx of investments during the crisis. Since 2009, the high budget deficit (approximately 6% of GDP annually) has been financed through the issue of bonds, and it was only in May this year that the government embarked on introducing savings on a large scale. Furthermore, over the past few years, all the governments have been avoiding privatisation and opening up to foreign capital, and have failed to introduce solutions to improve the competitiveness of the Slovenian economy, for example through the labour law reform recommended by the IMF and the European Commission. Despite these serious problems, the present Janez Jansa-led government, consisting of five parties, is unlikely to successfully deal with these tasks.

- With its ten-year bonds now yielding a 6% interest rate, Slovenia currently has limited possibilities to become further indebted. Given this fact, should the problems with its

banking sector deteriorate in the next few months, it will be forced to seek aid for its banks as part of EU rescue facilities. This scenario could be avoided if an investor for NLB is found. However, despite the efforts the government has been making over the past few months, no one willing to make such an investment has been found. Finding an investor ready to buy shares in NLB is a complicated task not only given the present situation of the banks in the EU but also due to the Slovenian-Croatian dispute over the money deposited by Croats in Ljubljanska Banka, the predecessor of NLB, when this country was part of Yugoslavia.

- It may be expected that the request to the EU to support the Slovenian banking sector will be used by EU institutions as an opportunity to force Ljubljana to carry out the long-delayed, unpopular reforms – above all, changes in the pension system. The most recent attempt to make changes in this area and to extend the pension age was rejected in a referendum last year and brought about the fall of Borut Pahor's government. It should therefore be expected that the attempt to carry out reforms will cause a crisis on the Slovenian political scene this time as well.