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Slovenia: caught by inflation

Backed by continued investment expansion, Slovenia's GDP grew by 5.4% in the first quarter of 2008. Investment activities were focused first of all on construction, while investments in machinery and equipment were only modest. Household and government consumption grew by 3.4% each; government expenditures rose at a much higher rate than in the years before, probably due to the approaching parliamentary elections in autumn this year. The contribution of foreign trade to GDP growth was almost nil. Growth of industrial production, reporting a weak performance during the first quarter, has somewhat recovered recently and increased by 3.5% during the first five months of the year. Apart from the production of coke and petroleum products, the export-oriented chemical and car industries were the most successful during that period.

Highest inflation rate in the eurozone

Accelerating inflation is still the most critical economic issue. Consumer prices rose by 6.5% on annual average during the first five months of 2008, largely due to galloping prices of food and beverages (13.3%), housing, water and electricity (10.5%) and hotels and restaurants (7.1%). The price rises are mostly attributable to external factors, particularly the surge of world market prices of food and energy. An important domestic factor is the high concentration of the country's retail trade sector (four retail chains control 90% of the market). Wages, by contrast, have so far had no impact on inflation. During the first quarter of the year average gross wages grew by only 1.1% in real terms, net wages by 0.9%. However, after a long time, public sector wage growth has taken the lead again. The stipulations of the new wage system envisaging a reduction of income disparities within in the public sector by the end of 2010 will very likely worsen the situation. The new salary system was finally introduced in mid-June 2008 and will be applied to 160 thousand employees in the public sector. In order to curb inflation, the government introduced stricter controls of regulated prices and instructed the state competition regulators to investigate possible illegal price agreements in the retail sector. In a further attempt at bringing inflation under control the Slovenian parliament approved a revised budget for 2008 aiming at a surplus versus the originally planned small budget deficit.

Employment continued to benefit from GDP growth. National account data indicate a 3% rise in employment, particularly in construction, transport and business services. Labour force survey data, by comparison, put employment growth at only 1.4% and the unemployment rate at 5.1% in the first quarter of 2008. Work permits for foreign workers have been increasing steadily over recent years, amounting to about 72 thousand in March. Most foreign workers are engaged in construction or other jobs requiring only elementary or no education at all.

External position deteriorating

On the external side, goods imports grew faster than exports, resulting in a widening of the trade deficit. This may indicate a weakening of competitiveness following the introduction of the euro (prior to this the Slovenian tolar had been 'adjusted' regularly). Consequently the current account deficit increased significantly compared to the first quarter of 2007. Apart from the rising trade deficit, this deterioration was caused by growing imbalances both in the incomes (interest payments on foreign debt) and current transfers items. Trade in services performed dynamically in both directions, leading to a slightly higher surplus than a year earlier. As opposed to the past three years, when Slovenia was an FDI net exporter, FDI inflows were higher than outflows in the first quarter of 2008. Gross foreign debt continued to rise rapidly and stood at EUR 36.5 billion by the end of March, about EUR 2 billion more than by the end of 2007. The bulk of that increase was due to the borrowing of commercial banks abroad.

Back on moderate growth path

Slovenia's growth prospects in the medium term are sound, but less favourable than in the boom year 2007. GDP growth will decelerate to below 5% in 2008 owing to weaker exports. In contrast to our earlier expectations investments are still very strong, particularly in the construction sector (residential buildings). As regards other demand components, we expect an election-related boost to government spending; growth of household consumption will remain constant at about 3% backed by wage increases and, to a lesser extent, credit growth. The slower economic growth, expected to continue in the coming two years, will translate into moderate employment gains averaging about 1% per year in the period 2008-2010. Unemployment should remain almost stagnant at around 5% measured by the labour force survey. Labour shortages will continue, particularly in the segment of the lower educated. Public finances are well under control, turbulence is not in sight yet. Inflation is expected to decelerate during 2008, resulting in an average rate of 5.5%. The return to a more moderate level of inflation in the coming two years is conditioned both on the absence of further major shocks to world market prices of food and energy and, excessive wage claims. The export performance will largely depend on the economic environment, particularly in the EU. Assuming a deceleration of fixed capital formation, a main driver of growth, over the next years, the import growth rate should taper off.

Beyond 2008 wiiw expects GDP to grow by 4.3% to 4.8%. Growth of government consumption is likely to return back to normal after the election year 2008, while household consumption will remain stable up until 2010. Infrastructure investments are expected to dwindle, particularly in motorway construction from 2009 onwards.

Table SI

Slovenia: Selected Economic Indicators

| | 2004 | 2005 | 2006 | 2007 ¹⁾ | 2007 1st quarter | 2008 | 2008 | 2009 | 2010 |
|--|---------|---------|---------|--------------------|---------------------|-----------------------|----------|-------|-------|
| | 1997 | 2001 | 2009 | 2019 | | | Forecast | | |
| Population, th pers., mid-year | 1997 | 2001 | 2009 | 2019 | . | . | . | . | . |
| Gross domestic product, EUR mn, nom. ²⁾³⁾ | 26677.5 | 28243.5 | 30448.3 | 33541.8 | 7678.5 | 8496.5 | 37100 | 40600 | 44000 |
| annual change in % (real) ²⁾ | 4.4 | 4.1 | 5.7 | 6.1 | 7.2 | 5.4 | 4.3 | 4.3 | 4.8 |
| GDP/capita (EUR at exchange rate) | 13402 | 14114 | 15162 | 16610 | . | . | . | . | . |
| GDP/capita (EUR at PPP - wiiw) | 18430 | 19460 | 20660 | 22430 | . | . | . | . | . |
| Gross industrial production | | | | | | | | | |
| annual change in % (real) ⁴⁾ | 4.8 | 3.3 | 6.1 | 6.5 | 8.7 | 1.7 | 3 | 3.5 | 4.5 |
| Gross agricultural production | | | | | | | | | |
| annual change in % (real) | 19.2 | -1.4 | -7.0 | . | . | . | . | . | . |
| Construction output | | | | | | | | | |
| annual change in % (real) ⁵⁾ | 2.5 | 3.0 | 15.3 | 18.2 | 35.5 | 33.0 | . | . | . |
| Consumption of households, EUR mn, nom. ²⁾³⁾ | 14196.5 | 14967.7 | 15955.6 | 17205.2 | 3881.0 | 4308.9 | . | . | . |
| annual change in % (real) ²⁾³⁾ | 3.0 | 2.9 | 4.0 | 3.1 | 2.3 | 3.4 | 3 | 3 | 2.8 |
| Gross fixed capital form., EUR mn, nom. ²⁾³⁾ | 6783.8 | 7210.0 | 7959.7 | 9631.3 | 2076.5 | 2508.9 | . | . | . |
| annual change in % (real) ²⁾³⁾ | 7.3 | 2.5 | 8.4 | 17.2 | 21.2 | 17.1 | 8 | 4 | 5 |
| LFS - employed persons, th, avg. | 943 | 949 | 961 | 985 | 958 | 971 | . | . | . |
| annual change in % | 5.1 | 0.6 | 1.3 | 2.5 | 1.3 | 1.4 | . | . | . |
| Reg. employees in industry, th pers., avg. ⁶⁾ | 239.7 | 239.3 | 235.5 | 237.4 | 236.9 | 237.3 ^{I-II} | . | . | . |
| annual change in % ⁶⁾ | -1.0 | -1.7 | -1.6 | 0.8 | 0.8 | 0.3 ^{I-II} | . | . | . |
| LFS - unemployed, th pers., average | 64 | 67 | 61 | 51 | 58 | 52 | . | . | . |
| LFS - unemployment rate in %, average | 6.3 | 6.6 | 6.0 | 4.9 | 5.7 | 5.1 | 5 | 4.7 | 4.6 |
| Reg. unemployment rate in %, end of period | 10.1 | 10.2 | 8.6 | 7.3 | 8.1 | 6.9 | 7.2 | 7 | 6.8 |
| Average gross monthly wages, EUR ³⁾⁷⁾ | 1117 | 1157 | 1213 | 1285 | 1238 | 1335 | . | . | . |
| annual change in % (real, net) ⁷⁾ | 2.1 | 3.5 | 2.5 | 4.2 | 5.2 | 0.9 | . | . | . |
| Consumer prices (nat. def.), % p.a. | 3.6 | 2.5 | 2.5 | 3.6 | 2.4 | 6.6 | 6 | 5 | 3.5 |
| Producer prices in industry, domestic, % p.a. | 4.3 | 2.7 | 2.3 | 5.4 | 4.5 | 5.9 | 4 | 3.8 | 3 |
| General governm. budget, EU-def., % GDP ⁸⁾ | | | | | | | | | |
| Revenues | 44.2 | 44.5 | 44.1 | 43.2 | . | . | . | . | . |
| Expenditures | 46.5 | 46.0 | 45.3 | 43.3 | . | . | . | . | . |
| Net lending (+) / net borrowing (-) | -2.3 | -1.5 | -1.2 | -0.1 | . | . | -0.8 | -1.0 | -1.0 |
| Public debt in % of GDP ⁸⁾ | 27.6 | 27.5 | 27.2 | 24.1 | . | . | . | . | . |
| Discount rate % p.a., end of period ⁹⁾ | 3.3 | 3.8 | 3.8 | 4.0 | 3.8 | 4.0 | . | . | . |
| Current account, EUR mn | -719.7 | -561.4 | -856.5 | -1641.4 | -260.3 | -620.6 | -1600 | -1500 | -1500 |
| Current account in % of GDP | -2.7 | -2.0 | -2.8 | -4.9 | -3.4 | . | -4.3 | -3.7 | -3.4 |
| Gross reserves of NB excl. gold, EUR mn ¹⁰⁾ | 6464.0 | 6824.1 | 5341.7 | 669.7 | 836.8 | 710.9 | . | . | . |
| Gross external debt, EUR mn | 15343 | 20508 | 24034 | 34358 | 28433 | 36462 | . | . | . |
| Gross external debt in % of GDP | 57.5 | 72.6 | 78.9 | 102.4 | . | . | . | . | . |
| FDI inflow, EUR mn | 665.2 | 472.6 | 511.7 | 1072.5 | 186.9 | 259.5 | 1200 | . | . |
| FDI outflow, EUR mn | 441.0 | 515.6 | 718.5 | 1153.8 | 307.0 | 137.1 | 1000 | . | . |
| Exports of goods, BOP, EUR mn | 12932.8 | 14599.2 | 17028.3 | 19777.0 | 4781.5 | 5102.6 | 21600 | 23800 | 26900 |
| annual growth rate in % | 13.3 | 12.9 | 16.6 | 16.1 | 18.7 | 6.7 | 9 | 10 | 13 |
| Imports of goods, BOP, EUR mn | 13941.6 | 15625.0 | 18179.3 | 21441.1 | 5027.9 | 5566.9 | 23600 | 25700 | 28800 |
| annual growth rate in % | 16.6 | 12.1 | 16.3 | 17.9 | 18.7 | 10.7 | 10 | 9 | 12 |
| Exports of services, BOP, EUR mn | 2782.6 | 3142.8 | 3449.5 | 4115.6 | 829.3 | 988.2 | 4800 | 5600 | 6600 |
| annual growth rate in % | 12.9 | 12.9 | 9.8 | 19.3 | 23.1 | 19.2 | 16 | 16 | 17 |
| Imports of services, BOP, EUR mn | 2095.0 | 2293.5 | 2583.8 | 3075.5 | 624.9 | 765.2 | 3600 | 4200 | 5000 |
| annual growth rate in % | 8.8 | 9.5 | 12.7 | 19.0 | 16.7 | 22.5 | 18 | 16 | 18 |
| Average exchange rate EUR/USD ³⁾ | 0.803 | 0.804 | 0.797 | 0.731 | 0.763 | 0.667 | . | . | . |
| Average exchange rate EUR/EUR (ECU) ³⁾ | 0.997 | 1.000 | 1.000 | 1.000 | 1.000 | 1.000 | 1 | 1 | 1 |
| Purchasing power parity EUR/USD ³⁾ | 0.610 | 0.614 | 0.617 | 0.624 | . | . | . | . | . |
| Purchasing power parity EUR/EUR ³⁾ | 0.725 | 0.725 | 0.734 | 0.741 | . | . | . | . | . |

Note: The term 'industry' refers to NACE classification C+D+E.

1) Preliminary. - 2) According to ESA'95 (FISIM adjusted and real change based on previous year prices). - 3) Slovenia has introduced the Euro from 1 January 2007. For statistical purposes all time series in SIT as well as the exchange rates and PPP rates have been divided by the conversion factor 239.64 (SIT per EUR) to EUR-SIT. - 4) From July 2005 new methodology. - 5) Enterprises with at least 20 employees. - 6) From January 2005 data from Statistical Register of Employment, years before from Monthly Report on Earnings. - 7) From January 2005 including legal persons with 1 or 2 employees in private sector. - 8) According to ESA'95, excessive deficit procedure. - 9) From 2007 ECB main refinancing rate (minimum bid rate). - 10) From January 2007 (Euro introduction) only the foreign currency reserves nominated in non-euro currency are included.

Source: wiiw Database incorporating national statistics; Eurostat; wiiw forecasts.