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Slovenia: impressive growth performance

The strong performance of the Slovenian economy prevailing in 2006 has continued in 2007. GDP growth accelerated further, to 7.2% in the first quarter of the year, the best result since 1999. Similar to previous years the rise in GDP was backed by robust domestic demand. Growth of gross fixed investment speeded up sharply, by 21%, with the strongest increases observed in construction and transport equipment. Private consumption rose by about 3%, while growth of government consumption slowed down slightly, to 2.2%. The contribution of foreign trade to GDP growth was neutral. High investment translated into 35% growth in construction, particularly residential building/motorway construction, favoured by good weather conditions.

Industrial output expanded significantly and was up 10% in the first four months of the year, the best performance since the country's independence. The fastest growth was registered for capital goods production (+14.6%), while both the production of intermediate and consumer goods performed below average. Output of manufacturing exceeded the average industrial growth, with the most favourable results achieved in the manufacture of wood and wood products, basic metals, chemicals, as well as machinery and equipment. Slight improvements are recorded in the manufacture of food and beverages and in the production of textiles and textile products – two branches suffering from production losses over the past couple of years. On the negative side, the production of transport equipment decreased and output of leather and leather products continued to fall.

The situation on the labour market continued to improve and in the first quarter of 2007 the LFS unemployment rate fell to 5.7%, much below the EU average rate. Employment according to that measure increased by 1.3%, while the national accounts statistics reported an employment growth by 2.4% in the first quarter of 2007. The fastest rise in the number of employed was observed in construction, business activities and other services; after years of job cuts, a slight employment increase was also registered in manufacturing. In June the Economic and Social Council decided to increase the quota for work permits for foreigners from 18,500 to 24,500. This step became necessary due to labour shortages in the transport, construction, tourism and metallurgy sectors.

Foreign trade grew dynamically in the first quarter of 2007: exports and imports rose by 18% and 17%, respectively, and the trade deficit narrowed as compared to the same period in 2006. In services trade, imports (starting from a low level) grew faster than exports, but these developments caused only a minor reduction in the services trade surplus. A recent Slovenian analysis has shown that between 1995 and 2006 the country's

regional trade structure changed significantly¹: over that period the importance of the EU-15 as a trading partner declined, while trade with the new EU member states gained momentum. At the same time the share of external trade with the successor states of the former Yugoslavia (almost half of which is accounted for by Croatia) rose only slightly. In the first quarter of 2007 the current account experienced some modest deterioration, primarily the result of a worsening of the income balance due to growing payments of dividends, profits and interests. The deficit of current transfers narrowed against the first quarter of 2006. As in the past two years, Slovenia has remained a net exporter of FDI, with most investments directed towards the successor states of the former Yugoslavia, ranging from investments in manufacturing to insurance companies. Gross foreign indebtedness has risen significantly in the past few years, to almost 80% of the country's GDP by the end of 2006.

On 1 January Slovenia entered the euro zone as the first of the new member states joining the EU in 2004. The changeover to the euro is estimated to have caused only a small increase in inflation, about 0.2 percentage points. The average annual consumer price inflation stood at 2.6% in May; however prices in some sub-categories rose considerably faster than average, such as those for services in restaurants and coffee shops, furniture and furnishings and cosmetic products. With production straining capacity limits, producer prices soared by 4.4% during the first four months of 2007.

The appointment of a new governor of the Bank of Slovenia has become the main political topic in recent months. Despite the successful introduction of the euro, the centre-right government led by Janez Janša rejected a second six-year term for Mitja Gaspari (proposed by President Janez Drnovšek, a former centre-left leader). In the second round Deputy Governor Andrej Rant, who is currently heading the bank, also failed to get the necessary votes in the parliament. Recently a new candidate, former Minister of Finance Marko Kranjec, has been proposed by the president and is very likely to become the next governor.

GDP growth in 2007 and 2008 will remain above 4%. Private consumption will probably rise by around 3% thanks to more pronounced wage growth than in the past few years and the effects of the reduced personal income tax rates (the highest rate was lowered from 50% to 41%). However, rising interest rates could be a limiting factor for household borrowing for consumption purposes. Investment growth will continue due to enhanced housing construction favoured by a reduced VAT rate up to the beginning of 2008 (thereafter it is to be raised again as agreed in the transitional agreement with the EU). An additional impetus should come from investments in motorway construction. Inflation prospects are generally moderate, but the effects of the liberalization of the electricity and

¹ *Slovenian Economic Mirror*, March 2007, p. 16.

natural gas market, envisaged to become effective from 1 July, are still uncertain. Experience gained in other EU countries has shown mixed results concerning price developments after the implementation of the electricity directive; as for natural gas prices, the impact of liberalization was hard to assess due to their close linkage to oil prices. In 2008 a (possible) change in the VAT rate might contribute to an increase in inflation. Maintaining a moderate level of the trade deficit together with a modest rise in the services trade surplus, the current account should gradually improve over the coming years. Given the relatively high GDP growth, the situation on the labour market should further improve. There are no signs of a deterioration of either the general government deficit or the general government debt. Slovenia's main foreign policy challenge, however, will be the EU presidency in the first half of 2008.

Table SI

Slovenia: Selected Economic Indicators

	2002	2003	2004	2005	2006 ¹⁾	2006 1st quarter	2007	2007 forecast	2008 forecast
Population, th pers., mid-year	1995.7	1996.8	1997.0	2001.1	2008.5	.	.	.	.
Gross domestic product, EUR-SIT mn, nom. ²⁾	22347.9	24259.5	26171.7	27625.4	29736.3	6844.3	7650.9	32000	34400
annual change in % (real) ²⁾	3.4	2.7	4.4	4.0	5.2	5.0	7.2	5	5
GDP/capita (EUR at exchange rate) ²⁾	11862	12458	13148	13805	14808	.	.	.	.
GDP/capita (EUR at PPP - wiiw) ²⁾	16040	16840	18150	19220	20930	.	.	.	.
Gross industrial production annual change in % (real) ³⁾	2.4	1.4	4.8	3.3	6.5	7.1	9.3	7	6
Gross agricultural production annual change in % (real)	13.4	-12.4	17.3	0.2	-5.7	.	.	.	.
Construction output, in effect. working time annual change in % (real) ⁴⁾	-3.4	-1.7	2.5	3.0	15.3	1.6	35	.	.
Consumption of households, EUR-SIT mn, nom. ²⁾	12115.9	13217.9	14034.5	14854.3	15722.7	3549.7	3855.9	.	.
annual change in % (real) ²⁾	1.3	3.5	2.8	3.6	3.3	3.2	3.4	3	3
Gross fixed capital form., EUR-SIT mn, nom. ²⁾	5055.6	5646.2	6412.7	6748.7	7683.6	1637.5	2055.3	.	.
annual change in % (real) ²⁾	0.9	7.0	7.9	1.5	11.9	8.6	21.6	10	7
LFS - employed persons, th, avg. annual change in %	910	897	943	949	961	946	958	.	.
annual change in %	-0.7	-1.4	5.1	0.6	1.3	1.3	1.3	.	.
Reg. employees in industry, th pers., avg. ⁵⁾	246.1	242.2	239.7	239.3	235.5	234.9	236.8	.	.
annual change in % ⁵⁾	1.1	-1.6	-1.0	-1.7	-1.6	-2.5	0.8	.	.
LFS - unemployed, th pers., average	62.0	64.8	64.0	67.0	61.0	70	58	.	.
LFS - unemployment rate in %, average	6.4	6.7	6.3	6.6	6.0	6.9	5.7	5.8	5.5
Reg. unemployment rate in %, end of period	11.3	11.0	10.1	10.2	8.6	10.1	8.1	8	7.5
Average gross monthly wages, EUR-SIT ⁶⁾	982	1057	1117	1157	1213	1175	1238	.	.
annual change in % (real, net) ⁶⁾	2.1	1.8	2.1	3.5	2.5	3.1	5.2	.	.
Consumer prices, % p.a.	7.5	5.6	3.6	2.5	2.5	2.2	2.4	2.6	2.3
Producer prices in industry, % p.a.	5.1	2.5	4.3	2.7	2.3	1.6	4.5	2.2	2
General governm. budget, EU-def., % GDP ⁷⁾									
Revenues	45.5	45.3	45.1	45.6	44.8	.	.	.	.
Expenditures	48.0	48.0	47.4	47.0	46.3	.	.	.	.
Deficit (-) / surplus (+), % GDP	-2.5	-2.8	-2.3	-1.5	-1.4	.	.	-1.5	-1.4
Public debt in % of GDP ⁷⁾	29.1	28.6	28.9	28.4	27.8	.	.	.	.
Discount rate % p.a., end of period	7.3	5.0	3.3	3.8	3.8	3.3	3.8	.	.
Current account, EUR mn	247.2	-195.7	-719.7	-547.5	-756.2	-163.5	-174.7	-700	-500
Current account in % of GDP	1.0	-0.8	-2.7	-2.0	-2.5	-2.4	-2.3	-2.2	-1.5
Gross reserves of NB excl. gold, EUR mn ⁸⁾	6701.5	6798.2	6464.0	6824.1	5341.7	6840.4	836.8 ⁸⁾	.	.
Gross external debt, EUR mn	11524	13225	15343	19614	23895	21704	26404 ⁸⁾	.	.
Gross external debt in % of GDP	48.7	53.2	58.4	71.0	79.7	.	.	.	.
FDI inflow, EUR mn	1721.7	270.5	665.2	444.9	303.4	44.6	174.1	.	.
FDI outflow, EUR mn	165.8	421.3	441.0	503.4	590.3	108.4	281.8	.	.
Exports of goods, BOP, EUR mn	11081.6	11417.1	12932.8	14599.2	17031.7	4028.2	4771.3	19000	20800
annual growth rate in %	6.0	3.0	13.3	12.9	16.7	19.4	18.4	12	9
Imports of goods, BOP, EUR mn	11346.6	11959.9	13941.6	15625.1	18152.5	4232.1	4936.6	20000	22000
annual growth rate in %	1.9	5.4	16.6	12.1	16.2	19.3	16.6	10	10
Exports of services, BOP, EUR mn	2439.5	2464.9	2782.6	3209.7	3537.8	728.6	782.4	3800	4200
annual growth rate in %	12.0	1.0	12.9	15.3	10.2	19.5	7.4	7	10
Imports of services, BOP, EUR mn	1819.7	1924.7	2095.0	2354.1	2653.0	521.8	585.1	2900	3200
annual growth rate in %	10.8	5.8	8.8	12.4	12.7	16.8	12.1	10	12
Average exchange rate EUR-SIT/USD	1.003	0.864	0.803	0.804	0.797	0.832	0.763	.	.
Average exchange rate EUR-SIT/EUR (ECU)	0.944	0.975	0.997	1.000	1.000	1.000	1.000	1	1
Purchasing power parity EUR-SIT/USD	0.602	0.610	0.609	0.603	0.594	.	.	.	.
Purchasing power parity EUR-SIT/EUR	0.698	0.721	0.722	0.718	0.707	.	.	.	.

Note: 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. 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) From July 2005 new methodology. - 4) From 2004 construction put in place; units with at least 20 employees. - 5) From January 2005 data from Statistical Register of Employment, years before from Monthly Report on Earnings. - 6) From January 2005 including legal persons with 1 or 2 employees in private sector. - 7) According to ESA'95, excessive deficit procedure. - 8) 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.