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Slovenia: policy focused on ERM II entry

Available data point to more pronounced growth in 2004 than a year earlier. Driven by domestic demand, GDP grew by 3.7% in the first quarter of the year; gross fixed capital formation accelerated to 8% and private consumption to 3.7% (both indicators exceeding the levels of the previous year). Industrial production grew at a higher rate than in 2003 and growth in the construction sector remained strong (motorway construction, housing programme and building functional border facilities to Schengen standards). Retail trade turnover increased by 5% in real terms in the first quarter of the year.

The accelerated industrial production growth is correlated to a pick-up in export activities. Above-average growth was recorded for the output of both capital and intermediate goods, while the production of consumer goods remained stagnant. Manufacturing grew in line with overall output; productivity continued to rise.

Based on a broad national consensus, the Slovene authorities' prime goal is joining the eurozone at the earliest possible opportunity. Slovenia has entered the ERM II on 28 June at a rate of 239.64 SIT/EUR and intends to adopt the euro in early 2007. In order to curb inflation, the Bank of Slovenia continues to pursue its policy of gradually reducing the tolar's rate of depreciation against the euro (the ERM II allows 15% fluctuation) and lowering nominal interest rates. For its part, the government is continuing its policy of limited increases in administered prices and indirect taxes as well as frequent adjustments of excise duties on oil. Moreover, inflationary pressures will be offset by raising taxes solely in keeping with the general level of prices. In addition, the government is seeking to secure support for its price policy by cooperating with the independent regulators who set prices related to telecommunications, postal services, public broadcasting and electricity supplies. Slovenia has already met the Maastricht criteria pertaining to the fiscal deficit, public debt and long-term interest rates. Although inflation has dropped remarkably, it is still slightly higher than required by the Maastricht criterion. During the first five months of 2004, consumer prices rose 3.7% as against the same period the year previous; prices increased by 3.8% between May 2003 and May 2004.

At the end of April, in an attempt to secure further disinflation, the social partners in Slovenia signed a private sector wage policy agreement for 2004-2005 (a step provided for in the programme for entry into ERM II). The arrangement sets a cap for wage increases: one percentage point below productivity growth. The regulation of wages in the private sector shadows the wage adjustment agreement for the public sector concluded in 2003; the latter foresees real wage increases of 0.5% and 1% for 2004 and 2005, respectively. The government recently adopted a comprehensive tax reform package which envisages, inter alia, amendments to payroll and income taxes. It is thus envisaged that about 40% of the workforce in Slovenia will be exempt from payroll tax: a measure that should help employers to reduce labour costs, particularly in labour-intensive industries.

Data obtained from the labour force survey indicate employment growth for the first time since 2001; the number of employed was 4.2% higher in the first quarter of 2004 than in the corresponding period a year earlier. At the same time, LFS unemployment fell slightly to 6.8%.

Overall exports developed more dynamically than in the years before, up by 7.7% in the first four months of 2004, whereas imports grew by close on 10% over the same period. The trade deficit thus widened some 30% as against the corresponding period the year before. The growth in exports to the EU that was set in motion in the last quarter of the previous year continued on into the first months of 2004. Exports to Russia were especially high (up by 34%) owing to their previously low volume in 2003, while those to the successor states of former Yugoslavia expanded to a lesser degree (up by 13%). As had been customary in the past, the main exports supplied to Russia were medical and pharmaceutical products; those to Croatia were in the energy sector after Slovenia had resumed its electricity supplies to this country. It would appear that in general, exporting firms wanted to benefit from the favourable conditions offered by the bilateral free-trade agreements with those countries which had to be terminated upon Slovenia's entry into the EU. Analyses carried out by Slovene experts came to the conclusion that termination of the free trade agreements, particularly those with the Yugoslav successor states, would exert a negative impact, for example, on agricultural and food exports. On the other hand, the harmonization of tariff structures with the EU and the lifting of barriers to trade in sensitive goods with the EU might well offset these disadvantages. Resulting from the increased trade deficit, the current account was slightly negative in the first quarter of the year. As in 2003, Slovenia was a net exporter of FDI in the first four months of the year, with Slovene investments abroad mainly directed towards the Yugoslav successor states. Just recently the French car producer Renault, sole owner of the Revoz automotive plant and Slovenia's largest export company, decided to manufacture a new car in Slovenia.

Led primarily by domestic demand, in particular investments in infrastructure and a rise in private consumption, GDP should grow by 3.4% and 3.5% in 2004 and 2005, respectively. It is expected that the pick-up in economic activity will be accompanied by a decline in unemployment and a slight increase in employment opportunities. The country's export performance might deteriorate somewhat as a consequence of the Bank of Slovenia's policy of slowing down the national currency's rate of depreciation (in the past the tolar depreciated continuously, thus helping exporters to retain their competitiveness in foreign markets). As a result the current account might also dip slightly. The government plans to maintain its relatively tight fiscal stance in both 2004 and 2005 so as to keep the deficit well below the Maastricht criterion. Indeed, maintaining a low rate of inflation after entry into ERM II will be one of the most challenging tasks facing the Slovene authorities.

Table SI

Slovenia: Selected Economic Indicators

	1999	2000	2001	2002	2003 [1]	2003	2004	2004	2005
						1st quarter		forecast	
Population, th pers., mid-year	1985.6	1990.3	1992.0	1995.7	1996.8	1994.8	.	.	.
Gross domestic product, SIT bn, nom.	3874.7	4252.3	4761.8	5314.5	5726.5	1319	1438	6160	6600
annual change in % (real)	5.6	3.9	2.7	3.4	2.3	2.2	3.7	3.4	3.5
GDP/capita (EUR at exchange rate)	10078	10421	11006	11771	12271	.	.	.	.
GDP/capita (EUR at PPP - wiiw)	14330	15150	15920	16720	17500	.	.	.	.
Gross industrial production									
annual change in % (real)	-0.5	6.2	2.9	2.4	1.4	0.8	4.2	3.5	3
Construction output, in effect. working time									
annual change in % (real)	10.2	-1.2	-2.1	-3.4	-1.7	-7.4	.	.	.
Consumption of households, SIT bn, nom.	2185.1	2373.6	2621.8	2826.9	3066.6	.	.	.	.
annual change in % (real)	5.9	0.3	2.3	0.3	2.9	1.7	3.7	3	3.5
Gross fixed capital form., SIT bn, nom.	1019.5	1066.8	1164.4	1234.8	1350.0	.	.	.	.
annual change in % (real)	21.0	0.6	4.1	2.6	5.4	4.0	8.0	6	6
LFS - employed persons, th, avg.	886	901	916	910	897	885	922	.	.
annual change in %	-1.7	1.7	1.7	-0.7	-1.4	-3.7	4.2	.	.
Reg. employees in industry, th pers., avg.	242.8	241.6	243.5	246.1	242.2	243.2	.	.	.
annual change in %	-1.4	-0.5	0.8	1.1	-1.6	-0.9	.	.	.
LFS - unemployed persons, average	73.0	68.0	63.0	62.0	64.0	67	68	.	.
LFS - unemployment rate in %, average	7.6	7.0	6.4	6.4	6.7	7.0	6.8	6.5	6.2
Reg. unemployment rate in %, end of period	13.0	12.0	11.8	11.3	11.0	11.3	11.1	10.5	10
Average gross monthly wages, SIT	173245	191669	214561	235436	253200	244095	258118	.	.
annual change in % (real, net)	3.0	1.4	3.1	2.1	1.8	1.8	1.8	.	.
Consumer prices, % p.a.	6.1	8.9	8.4	7.5	5.6	6.3	3.7	4	3.5
Producer prices in industry, % p.a.	2.1	7.6	8.9	5.1	2.5	3.0	3.2	3.5	3
General governm.budget, EU-def., % GDP [2]									
Revenues	.	.	.	.	44.0	.	.	.	.
Expenditures	.	.	.	.	45.8	.	.	.	.
Deficit (-) / surplus (+), % GDP	.	-3.0	-2.7	-1.9	-1.8	.	.	-1.9	-1.8
Public debt in % of GDP [2]	25.1	26.7	26.9	27.8	28.6	.	.	29.1	29.5
Discount rate % p.a., end of period [3]	8.0	10.0	7.8	7.3	5.0	6.5	4.5	.	.
Current account, EUR mn	-664.2	-583.0	38.0	329.7	16.7	-25.2	44.0	-100	-150
Current account in % of GDP	-3.3	-2.8	0.2	1.4	0.1	-0.4	0.7	-0.4	-0.6
Gross reserves of NB excl. gold, EUR mn	3159.2	3435.8	4907.5	6701.5	6798.1	6707.8	6791.4	.	.
Gross external debt, EUR mn	8012	9490	10403	11482	12995	11950	13491	.	.
FDI inflow, EUR mn	99.2	149.1	412.4	1706.9	160.4	1.0	46.4	.	.
FDI outflow, EUR mn	44.7	71.7	161.2	98.7	269.4	65.2	68.8	.	.
Exports of goods, BOP, EUR mn	8103.2	9574.2	10454.3	11081.2	11426.5	2763.4	2984.9	12300	12900
annual growth rate in %	0.2	18.2	9.2	6.0	3.1	3.4	8.0	8	5
Imports of goods, BOP, EUR mn	9267.3	10801.2	11138.7	11346.6	11970.8	2914.7	3087.1	12900	13800
annual growth rate in %	5.4	16.6	3.1	1.9	5.5	5.5	5.9	8	7
Exports of services, BOP, EUR mn	1763.5	2051.5	2177.6	2449.2	2464.6	509.1	545.8	.	.
annual growth rate in %	-2.3	16.3	6.1	12.5	0.6	3.0	7.2	.	.
Imports of services, BOP, EUR mn	1434.0	1562.3	1642.1	1822.4	1923.6	369.3	409.0	.	.
annual growth rate in %	5.7	8.9	5.1	11.0	5.6	3.8	10.8	.	.
Average exchange rate SIT/USD	181.77	222.68	242.75	240.24	207.11	215.64	189.84	.	.
Average exchange rate SIT/EUR (ECU)	193.63	205.03	217.19	226.22	233.70	231.30	237.39	238	242
Purchasing power parity SIT/USD, wiiw	124.62	130.79	138.68	148.50	150.24	.	.	.	.
Purchasing power parity SIT/EUR, wiiw	136.17	141.02	150.19	159.28	163.87	.	.	.	.

Notes: 1) Preliminary. - 2) According to ESA 95, excessive deficit procedure. - 3) From 2001 main refinancing rate.

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