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Slovenia:
Returning recession

Given the economic deterioration in Slovenia's most important EU trading partners and the need of fiscal consolidation Slovenia will remain in recession in 2012 and rebound only slowly thereafter. The corporate and household sectors will continue to deleverage and asset quality of the ailing banking sector has to be strengthened. Returning recession will exert upward pressure on the unemployment rate not only in 2012 but probably in 2013 as well. Consequently household consumption growth will remain subdued.

Slovenia's GDP continued to shrink in the first quarter of 2012 year-on-year, down by 0.2% owing to a decline in domestic demand. Gross fixed capital formation dropped by about 11%; household consumption rose by 1.4% and government consumption growth was slightly positive after three quarters of steady decline. Only foreign trade contributed positively to GDP growth. The slump in investments was felt primarily in the construction sector, where output continued to decline dramatically (about 20%). Future prospects for the construction sector are also gloomy, since the market is swamped by an enormous stock of unsold flats and large infrastructural projects are in short supply owing to fiscal consolidation.

Along with the slowdown in foreign demand, industrial production growth lost momentum as of mid-2011 and rose by only 0.7% in the first quarter of 2012. In the automotive sector, one of Slovenia's major export industries, the output of vehicles fell by 12%, while output in the furniture industry dropped by 15%. Remarkable increases in production were reported in the manufacture of wearing apparel and leather and related products.

Foreign trade weakened remarkably in the first quarter of 2012: in nominal terms, exports and imports of goods were up 2.8% and 2.4%, respectively. The trade deficit remained almost unchanged compared to a year earlier. Owing to a rising deficit in both the income balance and current transfers along with a stagnating surplus in the trade of services, the current account closed with a higher deficit than in the first three months of 2011. The inflow of FDI was more than double the amount in the first quarter of 2011, yet remained at a comparatively low level (EUR 157 million).

The labour market situation has deteriorated slightly compared to the first quarter of 2011. Based on labour force survey data, employment stagnated in the first quarter of 2012; the unemployment rate rose slightly to 8.6%, but is still below the EU-average. Unemployment based on registration data remained unchanged at 12% compared to March 2011. This was due to fewer people losing their jobs and more people being struck from the register on account of their either neglecting certain duties or participating in public work programmes. In March amendments to the unemployment compensation system were announced. The entitlement period will now be limited to 18 months; the replacement rate will be reduced from 80% to 70% (unemployment benefit as a percentage of a person's gross wage in the last eight months) in the first two months and 60% thereafter; and the maximum unemployment benefit will be cut to around EUR 850 (down from EUR 1,050).[1]

According to the Bank of Slovenia, the losses suffered by the Slovene banking system totalled EUR 436 million in 2011 (as against EUR 98.1 million in 2010). By the end of March 2012, the share of non-performing loans in total loans had reached 11.8%. All major Slovene banks - Nova Ljubljanska Banka (NLB), Nova Kreditna Banka Maribor and Abanka Vipa - are in need of fresh capital. Having received a capital injection of EUR 250 million last year, the NLB had to raise equity capital of EUR 381 million by the end of June to meet the 9% core Tier 1 capital requirement set by the European Banking Authority (EBA). The government, holding the majority in NLB, will purchase EUR 320 million of contingent convertible bonds (CoCo) by using deposits it has in local banks in order not to increase its debt, while KBC the second largest investor will buy EUR 61 million in shares. The government wants to cut its NLB holding to 25% plus one share by the end of this year.

On several occasions since last year, all the major credit rating agencies have downgraded their ratings of the three Slovene banks, the determinant factors being the drop in asset quality and the banks' weak loss-absorption capacity. Slovene banks – for the most part domestically owned – are over-exposed to highly indebted companies in the construction and real estate sectors.

According to the final figures, the general government deficit in 2011 stood at 6.4% of GDP. Part of the deficit (EUR 459 million or 1.5% of GDP) is due to ongoing capital transfers such as the recapitalisation of both the NLB (EUR 243 million) and Adria Airways (EUR 49 million). The state has also assumed Slovene Rail's liabilities totalling EUR 119 million. The dynamics of public-debt growth, although still lower than in a number of other

[1] European Employment Observatory EEO, Quarterly Reports, April 2012, p. 8.

eurozone countries, has become a matter of major concern over the past few years, having risen from 22% in 2008 to 47.6% in 2011. In autumn 2011, the yield of a ten-year Slovene government bond broke the psychological barrier of 7%. Since the beginning of 2012 things have cooled off slightly with the yield on Slovene government bond returning to 5.27% in April. In May 2012, the Slovene parliament adopted the revised 2012 budget, as well as a package of austerity measures aimed at stabilising public finances and cutting the public deficit. Accordingly, the general government deficit should drop to 3.5 - 4% of GDP in the current year and meet the Maastricht threshold of 3% in 2013. The supplementary budget envisages a cut in expenditures of EUR 800 million, mainly by rationalising public-sector operations and welfare activities. Given the unfavourable economic environment, it is likely that in the course of the current year, GDP will decline more pronouncedly than the Slovene authorities anticipated. It will increase, if at all, only slightly next year, with the debt to GDP ratio possibly coming close to the 60% mark as early as 2013.

The austerity package envisages an 8% reduction in public-sector wages as of June 2012. However, civil-service wage cuts will vary widely owing to a harmonisation of the public-sector wage system being launched at the same time. Furthermore, public investment expenditures will be slashed by 22%. In 2012 the bulk of funds will be earmarked for improving road and rail infrastructure, managing natural resources and building an environmental infrastructure. Over and above that, expenditures related to the labour market, health care and social security will also be cut. Even before the austerity package was approved, the Slovene government had reached an agreement with all the major trade unions that they would not block the measures by calling for a referendum (In 2011, four laws were repealed via national referenda, including a bill on raising the retirement age, which ultimately led to the ousting of the former government).

Given the economic downturn among Slovenia's most important trading partners in the EU and the Western Balkan countries (which absorb about 14% of the country's exports) and in view of the need to secure fiscal consolidation, Slovenia will re-enter the recession mode in 2012 and rebound only slowly thereafter. wiiw expects the GDP to decline by 1.5% in 2012 (a more pronounced contraction than we previously forecast). Stagnation or even further contraction is likely in 2013 as a consequence of the continued drop in domestic demand. The corporate and household sectors will continue to deleverage and asset quality of the ailing banking sector will have to be strengthened. The return of recession will exert upward pressure on the unemployment rate not only in 2012, but probably in 2013 as well. Consequently, household consumption growth will remain subdued owing to an expected decline in disposable income.

Table SI

Slovenia: Selected Economic Indicators

	2008	2009	2010	2011 1)	2011	2012	2012	2013	2014
					1st quarter			Forecast	
Population, th pers., average	2021.3	2039.7	2048.6	2050.0	2050.2	2055.5	2050	2050	2050
Gross domestic product, EUR mn, nom.	37280	35311	35416	35639	8362	8406	35810	36710	38010
annual change in % (real)	3.6	-8.0	1.4	-0.2	2.1	-0.2	-1.5	0.5	1.5
GDP/capita (EUR at exchange rate)	18400	17300	17300	17400	.	.	17500	17900	18500
GDP/capita (EUR at PPP)	22700	20500	20700	21000	.	.	.	.	.
Consumption of households, EUR mn, nom.	19544	19434	19577	19966	4495	4686	.	.	.
annual change in % (real)	3.9	-0.2	-0.6	-0.2	0.1	1.4	0.5	-0.3	0.4
Gross fixed capital form., EUR mn, nom.	10730	8268	7651	6941	1632	1476	.	.	.
annual change in % (real)	7.8	-23.3	-8.3	-10.6	-8.2	-10.9	-9	-1	4
Gross industrial production									
annual change in % (real)	2.4	-17.3	6.2	1.3	7.7	0.7	1.5	2	3
Gross agricultural production (EAA)									
annual change in % (real)	-1.9	0.0	-0.3	-0.7	.	.	.	.	.
Construction industry 2)									
annual change in % (real)	15.5	-20.9	-16.9	-25.6	-25.3	-19.9	.	.	.
Employed persons - LFS, th, average	996	981	966	936	928	927	930	920	930
annual change in %	1.1	-1.5	-1.5	-3.1	-3.8	-0.1	-1	-1	1
Unemployed persons - LFS, th, average	46	61	75	83	86	87	.	.	.
Unemployment rate - LFS, in %, average	4.4	5.9	7.3	8.2	8.5	8.6	8.8	9	8.5
Reg. unemployment rate, in %, end of period	7.0	10.3	11.8	12.1	12.2	12.0	13	13	12
Average gross monthly wages, EUR	1391	1439	1495	1525	1505	1529	.	.	.
annual change in % (real, net)	2.0	2.5	2.1	0.3	1.6	-0.8	.	.	.
Consumer prices (HICP), % p.a.	5.5	0.9	2.1	2.1	2.2	2.5	2	2	2
Producer prices in industry, % p.a.	3.9	-1.4	2.0	4.6	5.7	1.3	1.5	2	3
General governm.budget, EU-def., % GDP									
Revenues	42.4	43.2	44.2	44.5	.	.	44.2	44.0	43.0
Expenditures	44.2	49.3	50.3	50.9	.	.	48.5	48.0	46.5
Net lending (+) / net borrowing (-)	-1.9	-6.1	-6.0	-6.4	.	.	-4.5	-4.0	-3.5
Public debt, EU-def., in % of GDP	21.9	35.3	38.8	47.6	.	.	54.0	58.0	60.0
Central bank policy rate, % p.a., end of period 3)	2.5	1.0	1.0	1.0	1.0	1.0	.	.	.
Current account, EUR mn	-2574	-455	-297	-385	-91	-153	-200	-300	-400
Current account in % of GDP	-6.9	-1.3	-0.8	-1.1	-1.1	-1.8	-0.6	-0.8	-1.1
Exports of goods, BOP, EUR mn	20032	16167	18387	20688	5018	5157	21300	22200	23500
annual growth rate in %	1.2	-19.3	13.7	12.5	19.4	2.8	3	4	6
Imports of goods, BOP, EUR mn	22681	16871	19591	22023	5329	5457	22500	23200	24600
annual growth rate in %	5.7	-25.6	16.1	12.4	21.3	2.4	2	3	6
Exports of services, BOP, EUR mn	4956	4347	4634	4820	1049	1093	5000	5200	5500
annual growth rate in %	19.5	-12.3	6.6	4.0	7.0	4.2	4	4	6
Imports of services, BOP, EUR mn	3533	3182	3325	3387	732	722	3400	3500	3700
annual growth rate in %	14.0	-9.9	4.5	1.9	6.1	-1.4	0	3	5
FDI inflow, EUR mn	1330	-470	274	791	72	157	800	.	.
FDI outflow, EUR mn	983	174	-59	40	20	22	.	.	.
Gross reserves of NB excl. gold, EUR mn	623	671	695	642	656	583	.	.	.
Gross external debt, EUR mn	39234	40294	40699	41444	42798	42787	.	.	.
Gross external debt in % of GDP	105.2	114.1	114.9	116.3	120.1	119.5	.	.	.
Purchasing power parity EUR/EUR	0.8114	0.8451	0.8339	0.8286	.	.	.	.	.

Note: Gross industrial production, construction output and producer prices refer to NACE Rev. 2. Gross agricultural production refers to Economic Accounts for Agriculture (EAA).

1) Preliminary. - 2) Enterprises with 20 and more employees and output of some non-construction enterprises.- 3) Official refinancing operation rates for euro area (ECB).

Source: wiiw Database incorporating Eurostat and national statistics. Forecasts by wiiw.