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Table of contents

Figures, tables and boxes:

Figures:

Tables:

Boxes:

Executive Summary

Economic growth in Slovenia over the first three quarters of 2014 was significantly higher than the euro area average. Export growth strengthened, which in the wake of weaker import growth maintained the contribution made to GDP by net trade at a high level, and made a key contribution to the widening of the current account surplus to 5.7% of GDP. The first signs of increased investment in industrial production capacity began to appear, conditioned by rising capacity utilisation and improved access to foreign financing. Another factor in the significant change in economic dynamics was the reversal in fiscal policy, which acted to stimulate economic growth over the first three quarters of the year with the support of EU funds, as the positive contribution made by public investment was significantly larger than the negative contribution made by the decline in final government consumption. Public infrastructure investment had a beneficial impact on construction activity, despite the negative reversal in the third quarter, while weak growth in private consumption and increased corporate turnover on the domestic market promoted growth in the majority of private-sector services.

Economic growth is already being reflected more strongly on the labour market. Unemployment fell, primarily as a result of high outflows to employment, which increased most sharply in private-sector services. Employment agencies were prominent in this process, having made the largest contribution to the growth of almost 1% in total employment in the third quarter, which is fogging the actual picture of the sectoral breakdown of employment, particularly in industry and construction. Following labour market reforms, which partly tightened the conditions applying to temporary employment, the increase in employment via agencies was most likely the result of firms' response to the demand for flexible forms of employment. Average wages are also gradually rising in the wake of the employment growth, although their growth remains behind the growth in labour productivity. The fall in inflation towards zero brought an increase in the real wage bill, particularly in the third quarter, which is increasing consumer purchasing power.

The economic recovery in the narrower external environment remains weak, despite the ECB's expansionary monetary policy. At the same time sanctions and plummeting oil prices are weakening the Russian economy. There were therefore further reductions in late 2014 in the economic growth forecasts for 2015 in the majority of the key export markets. The forecasts nevertheless remain slightly more favourable on average than the estimates for 2014, which, given the improvement in the competitiveness of Slovenia's export sector, is providing the main basis for further growth in domestic economic activity.

The positive economic turnaround is not being reflected in domestic inflation. Inflation as measured by the HICP stood at zero in the final quarter of 2014, largely as a result of falling commodity prices, and averaged just 0.4% over the year 2014, the lowest figure to date. In addition to headline inflation, the core inflation indicators were all below the euro area average as well. The differences primarily derive from a greater loss of purchasing power in the crisis and the cautious behaviour of domestic consumers, who have mostly not transferred the real increase in the wage bill into their final consumption. This is primarily being reflected in further falls in prices of industrial goods. Lower prices of input commodities and the outpacing of wage growth by productivity growth also suggest the absence of price and cost pressures at firms.

There was a large general government deficit in 2014, as a result of the increased burden of interest payments and one-off factors related to bank recapitalisations and the repayment of old foreign currency deposits. On the other hand, there was a significant increase in general government revenues. According to the estimates of the Ministry of Finance from the end of December, the deficit stood at 5.3% of GDP, while the primary deficit after the exclusion of one-off effects and *interest payments was estimated at just 0.1% of GDP. The general government debt was estimated to increase to 82.2% of GDP by the end of 2014, partly as a result of the pre-financing of bond repayments in 2015. Sovereign borrowing terms improved significantly. The required yield on 10-year Slovenian government bonds stood at just 2.1% in December, down 3.1 percentage points on a year earlier.*

Despite the rapid economic recovery in 2014 and the improved medium-term outlook, Slovenian economic policy continued to face a number of challenges. Among the most significant ones are the non-functioning of the credit channel, high unemployment, fiscal consolidation and the restructuring of the economy. These challenges can partly be addressed through responsible and measured corporate ownership restructuring.

Main macroeconomic indicators

	2011	2012	2013	14Q1	14Q2	14Q3	2011	2012	2013	14Q1	14Q2	14Q3
	Slovenia						*euro area*					
Economic developments	*y-o-y growth rates in %*											
GDP	0.6	-2.6	-1.0	2.1	2.9	3.2	1.6	-0.7	-0.5	1.1	0.6	0.8
- industry	2.4	-2.3	-0.1	2.9	4.0	4.9	3.0	-0.6	-0.7	1.1	0.0	0.8
- construction	-10.1	-7.5	-8.8	15.7	19.8	10.1	-2.8	-4.7	-3.4	1.4	-1.0	-1.1
- mainly public sector services	0.0	1.3	-0.5	0.9	0.4	0.5	0.7	0.3	0.0	1.0	0.9	0.7
- mainly private sector services	0.4	-2.9	-0.6	3.1	3.5	4.3	2.0	-0.7	-0.5	1.1	0.5	0.8
Domestic expenditure	-0.8	-5.7	-2.1	0.8	2.1	1.9	0.7	-2.2	-0.9	1.0	0.7	0.5
- general government	-1.3	-1.5	-1.1	-1.7	-0.9	0.0	-0.2	-0.2	0.2	0.8	0.9	1.1
- households and NPISH	-0.1	-3.0	-3.9	1.1	0.5	0.8	0.2	-1.3	-0.7	0.4	0.8	1.1
- gross capital formation	-1.8	-16.5	2.2	2.5	9.7	7.0	2.9	-6.5	-2.8	2.8	0.3	-1.6
- gross fixed capital formation	-4.6	-8.9	1.9	4.6	6.8	7.2	1.6	-3.4	-2.4	2.5	0.6	0.1
- inventories and valuables, contr. to GDP growth in pp	0.6	-1.8	0.1	-0.4	0.6	0.0	0.3	-0.7	-0.1	0.1	-0.1	-0.3
Labour market												
Employment	-1.6	-0.8	-1.5	0.3	0.7	0.9	0.1	-0.5	-0.8	0.0	0.4	0.6
- mainly private sector services	-2.2	-1.3	-1.7	0.3	0.8	1.0	0.2	-0.6	-1.0	-0.1	0.4	0.7
- mainly public sector services	0.9	1.1	-0.6	0.2	0.4	0.4	0.0	-0.1	-0.2	0.5	0.5	0.4
Labour costs per employee	1.6	-1.2	1.9	0.5	0.3	1.1	2.1	1.7	1.7	1.8	1.4	1.4
- mainly private sector services	2.0	-0.6	2.1	1.3	1.4	1.2	2.4	2.0	1.7	1.8	1.4	1.4
- mainly public sector services	-0.1	-3.4	0.9	1.4	0.8	1.9	1.3	0.9	1.7	1.5	1.4	1.3
Unit labour costs	-0.4	0.3	0.9	-1.9	-2.0	-1.6	0.5	1.7	1.3	0.7	1.2	1.1
- industry	0.0	3.3	0.8	0.3	-1.0	-1.6	0.0	2.1	2.0	0.7	2.5	1.4
	in %											
LFS unemployment rate	8.2	8.9	10.1	10.8	9.3	9.3	10.1	11.3	11.9	12.3	11.4	...
Foreign trade	*y-o-y growth rates in %*											
Current account balance as % of GDP	0.2	2.7	5.6	4.8	5.0	5.4	-0.1	1.5	2.1	2.3	2.2	2.1
External trade balance as contr. to GDP growth in pp	1.3	2.9	1.0	1.3	0.9	1.4	0.9	1.5	0.4	0.1	0.0	0.3
Real export of goods and services	7.0	0.3	2.6	4.9	5.1	6.8	6.6	2.4	2.0	3.8	2.9	4.1
Real import of goods and services	5.0	-3.9	1.4	3.4	4.2	5.5	4.3	-1.0	1.2	3.8	3.3	3.7
Financing	*in % of GDP*											
Banking system's balance sheet	142.1	141.0	128.0	126.6	123.2	121.0	332.8	323.4	299.0	298.8	299.2	301.7
Loans to NFCs	55.1	52.9	44.8	38.1	37.0	35.4	46.2	44.7	42.1	41.8	41.3	40.8
Loans to households	22.5	23.0	22.4	22.0	21.8	21.6	52.6	52.5	52.0	51.7	51.3	51.0
Inflation	*in %*											
HICP	2.1	2.8	1.9	0.6	0.8	0.1	2.7	2.5	1.3	0.6	0.6	0.4
HICP excl. energy, food, alcohol and tobacco	-0.4	0.7	0.9	0.9	1.0	0.4	1.4	1.5	1.1	0.8	0.8	0.8
Public finance	*in % of GDP*											
Debt of the general government	46.2	53.4	70.4	77.1	78.3	78.1	85.8	89.0	90.9	91.9	92.7	...
One year net lending/net borrowing of the general government	-6.2	-3.7	-14.6	-13.3	-12.7	-13.0	-4.1	-3.6	-2.9	-2.8	-2.6	...
- interest payment	1.9	2.0	2.5	2.7	2.9	3.1	3.0	3.0	2.8	2.8	2.7	...
- primary deficit	-4.3	-1.7	-12.0	-10.6	-9.8	-9.9	-1.1	-0.6	-0.1	0.0	0.1	...
- deficit excl. bank recapitalisations	-5.6	-3.6	-4.5	-4.2	-4.1	-4.4						
- primary deficit excl. bank recapitalisations	-3.7	-1.6	-2.0	-1.7	-1.5	-1.3						

Source: SORS, Eurostat, Bank of Slovenia, ECB, Ministry of finance, Bank of Slovenia calculations.

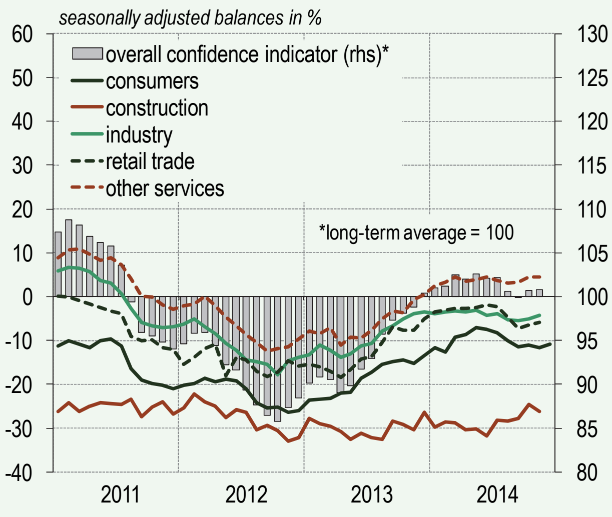
1 International Environment

The economic growth forecasts for some of Slovenia's most important trading partners were cut again in December. The economic recovery in the euro area remained relatively weak in the third quarter, and the available figures suggest that growth remained low also at end of the year. The indicator of economic sentiment in the euro area and the harmonised unemployment rate remained stable in November. Monetary policy in the major developed economies remained expansionary. There was no change in the ECB's key interest rate in December, although previously announced non-standard monetary policy measures were implemented. The euro fell again in December. Oil price continued to fall sharply, reaching its lowest level of the last five years.

Economic sentiment

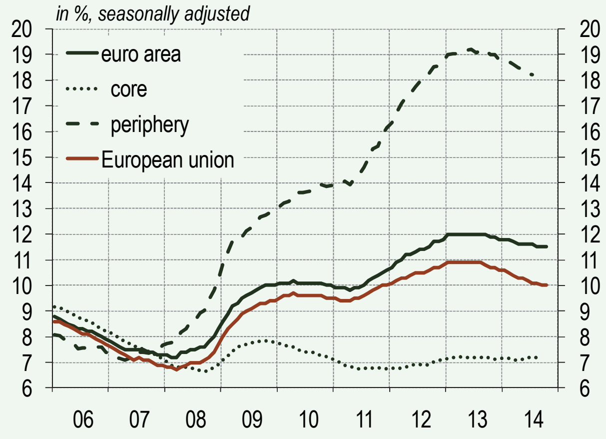
The economic sentiment in the euro area remained stable in November and slightly above its long-term average, although consumer confidence stalled at a low level in the second half of the year. The harmonised unemployment rate in October remained unchanged for the third consecutive month at 11.5%, down

Figure 1.1: Confidence indicators – euro area



Source: European Commission.

Figure 1.2: Harmonised unemployment rate



Note: The Euro area core is the average of data for AT, BE, DE, FI, FR, LU, NL, weighted by the active population size. The Euro area periphery is the weighted average of data for CY, ES, GR, IE, IT in PT.
Source: Eurostat, Bank of Slovenia's calculations.

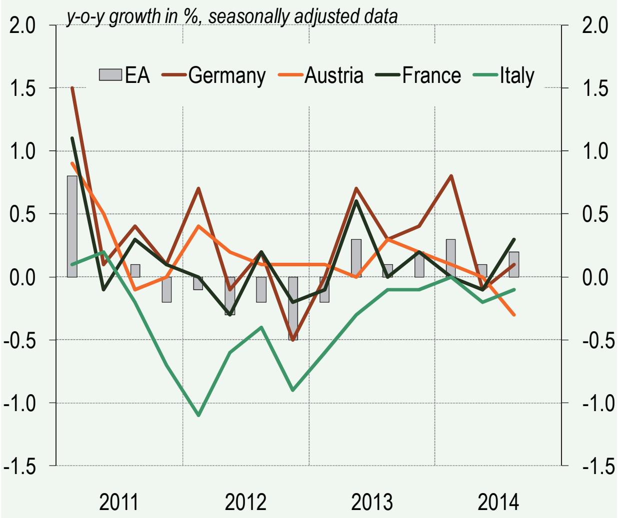
just approximately 0.5 percentage points on its peak in 2013. While unemployment remained stable but high, towards the end of the year consumer confidence remained significantly down on its level in the middle of the year. The economic sentiment indicator remained practically unchanged in November at a level slightly above its long-term average. The largest rise in the confidence indicators was recorded by financial services, while construction recorded the largest decline.

The aggregate PMI for the euro area strengthened slightly in December. The PMI as measured by Markit, an analytical house, rose slightly in December according to the initial figure, but remained close to the year's low recorded in November, an indication of the very weak economic growth in the final quarter. Industrial production in manufacturing in December is thought to have remained unchanged from November, while activity in the service sector is likely to have increased. New orders fell in November, but are thought to have risen in December, although growth was weak in both industry and in services. Economic activity as measured by the PMI is expected to have declined in France for the eighth consecutive month, while growth in Germany is expected to be at its weakest of the last year and a half. Overall business activity in the other euro area countries is expected to have recorded its largest increase of recent months.

Economic activity and forecasts

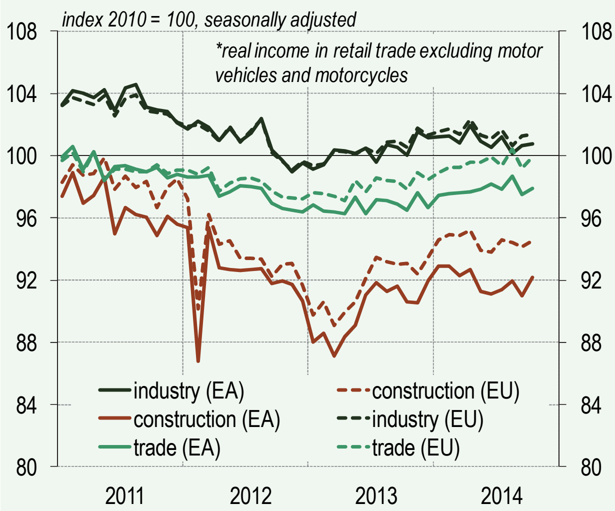
Economic growth in the euro area was again relatively weak in the second half of 2014. Euro area GDP in the third quarter was up 0.2% in quarterly terms, while year-on-year growth remained at 0.8%. The quarterly growth was attributable to increased growth in private consumption, while growth in public consumption remained the same as in the second quarter. Growth in imports and exports slowed in the third quarter, while gross investment declined again. Of the major euro area countries, GDP was up in quarterly terms in Germany, France and Spain, but declined again in Italy, which thereby slid again into technical recession. Economic developments remained relatively weak in the early part of the final quarter. Turnover in retail trade in October was up 0.4% in monthly terms, and 1.4% in year-on-year terms. The increase was primarily attributable to strong growth in retail in Germany. Industrial production in the euro area in October was unchanged in monthly terms, but was up 0.7% in year-on-year terms. Among the major euro area countries, industrial production was unchanged in monthly terms in Germany, and declined in France, Spain and Italy. After declining in September, the amount of construction put in place strengthened in October, by

Figure 1.3: GDP in the euro area



Source: Eurostat.

Figure 1.4: Economic activity in the euro area and EU

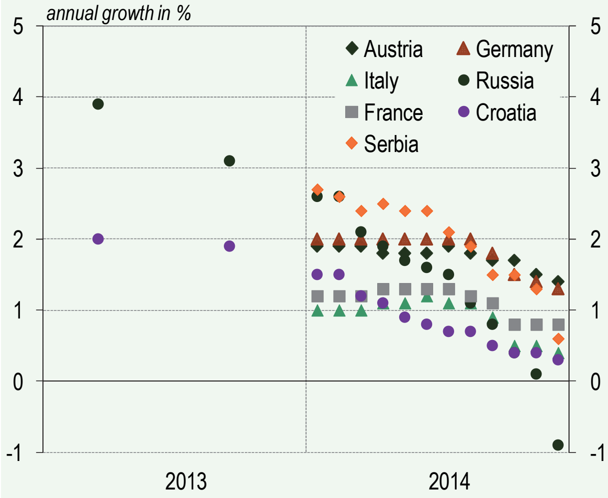


Source: Eurostat.

just over 1% in monthly terms and in year-on-year terms. The increase was attributable to an increase in the construction of buildings.

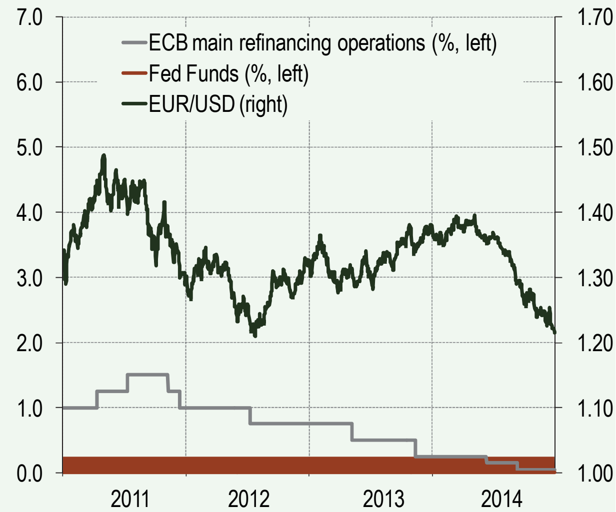
Economic growth forecasts for some of Slovenia's most important trading partners were cut again. Of Slovenia's most important trading partners in the euro area, in the final months of 2014 Consensus significantly cut its forecasts for Germany, Austria and Italy. In December the 2015 economic growth forecasts for Germany and Austria were cut for the fourth and third consecutive months respectively, to 1.3% and 1.4%. Both forecasts were down 0.1 percentage points on November. The economic growth forecast for Italy was also cut, to 0.4%, while the economic growth forecast for France remained unchanged at 0.8%. Consensus's economic growth forecasts for the euro area for 2014 and 2015 remained unchanged in December at 0.8% and 1.1% respectively. In its forecasts for eastern Europe, in December Consensus again reduced its 2015 economic growth forecasts for Russia and Serbia, to -0.9% and 0.6% respectively, down 1.0 percentage points and 0.7 percentage points on the November forecasts. It also cut its forecast for Croatia, to 0.3%, down 0.1 percentage points on the November forecast.

Figure 1.5: Projections of GDP growth in Slovenia's main trading partners for the year 2015



Source: Consensus Economics.

Figure 1.6: EUR/USD exchange rate and central banks' interest rates



Source: ECB, Federal Reserve.

Monetary policy

The major central banks are mostly maintaining an expansionary monetary policy. In light of the weak economic activity and falling inflation, the key interest rates in certain developed economies remained low. In December there was no change in the ECB's key interest rate, which has remained at 0.05% since September 2014, although certain previously announced non-standard monetary policy measures were carried out.[1] The Federal Reserve ended its QE programme in October, while its key interest rate remains unchanged in the range from zero to 0.25%. The Bank of England has maintained its key interest rate at 0.5% since March 2009, and left the volume of government bond purchases unchanged in December. The Bank of Japan has held its key interest rate in the range between zero and 0.10% since October 2010, and continued to pursue its programmes of non-standard economic stimulus measures. By contrast, the central banks of certain countries (Russia, Brazil) raised their key interest rates in December, owing to shocks on the financial markets and high inflation.

[1] These measures include the second auction of targeted longer-term refinancing operations (TLTROs), the covered bond purchase programme (CBPP3) and the ABS programme. Details of the ECB's latest monetary policy measures are available at https://www.ecb.europa.eu/press/pr/date/2014/html/index.en.html.

Euro exchange rate and commodity prices

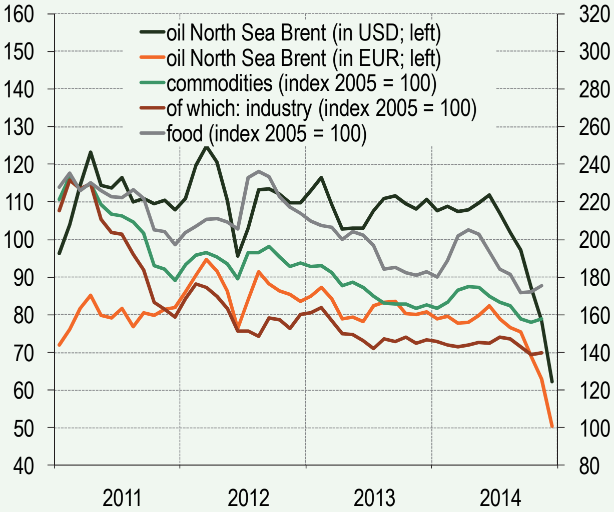
The euro again fell against the US dollar in December. The price of Brent crude fell to its lowest level since 2009. The euro has been falling against most major currencies since the second quarter of 2014. In December it lost over 1% against the US dollar, and was down a tenth in year-on-year terms. The euro averaged USD 1.2331 in December. The euro rose sharply against the Russian ruble: it was up 56% in year-on-year terms. The price of Brent crude fell sharply in December for the sixth consecutive month. The price of a barrel averaged USD 62 over the month, down just over a fifth on November, and down 44% on December 2013. Other commodity prices stabilised in November. After falling for six months, US dollar commodity prices rose by 1.2% in monthly terms in November, food prices recording the most notable rise of 1.8%. They nevertheless remained down just over 3% in year-on-year terms in November.

International capital markets

Risk appetite remained high in the final months of 2014. The positive atmosphere was attributable to the improved economic results announced in the US and strengthened expectations of the introduction of additional non-standard measures by the Japanese and Chinese central banks, and the beginning of QE by the ECB. By contrast, after six years of ensuring cheap money with the aim of stimulating economic growth, the Federal Reserve ended its stimulus programme of government and mortgage bond purchases. The withdrawal of the programme was attributable to the recovery of the US economy, and above all to the positive results on the labour market. The majority of share indices rose significantly over this period, reaching record highs in November (S&P, DJIA, DAX).

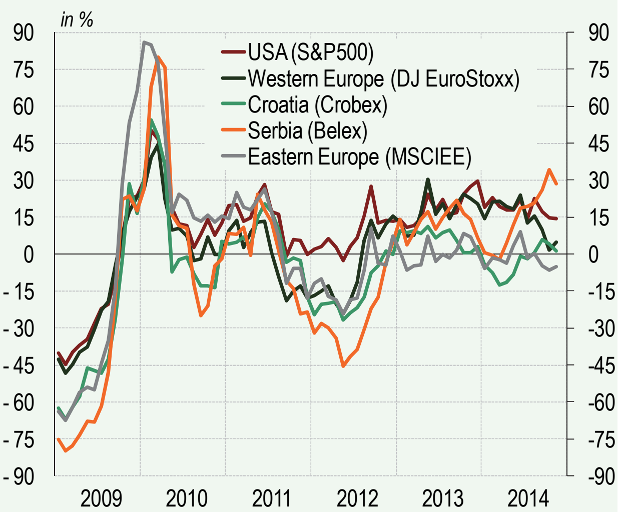
Oil prices have been falling sharply since September, which is increasing volatility on the stock markets. There is growing fear that the low oil price could fuel geopolitical tensions between Russia and Ukraine. The Russian stock market index (RTSI) lost 11% in November alone. Oil and natural gas account for two-thirds of Russia's exports, and almost half of its federal budget revenues. As a result, falling oil prices have a profoundly negative impact on Russia, the largest global oil producer, while the impact on other financial markets remains limited.

Figure 1.7: Commodities



Source: The Economist, Bloomberg, Bank of Slovenia calcuations.

Figure 1.8: Foreign stock exchange indices



Source: Bloomberg.

2 Economic Trends and the Labour Market

Economic growth in Slovenia in the third quarter remained significantly higher than the euro area average. Growth in industrial production strengthened slightly, which is, given the weak economic activity in the majority of the main trading partners, an indication of increased exporters' competitiveness, and net exports continued to make a large contribution to GDP growth. In the context of the merely gradual recovery in private consumption and the end of the decline in final government consumption, there was a further increase in value-added in private-sector services primarily dependent on the domestic market. There was a notable downturn in construction, but this was likely attributable to one-off factors, as public construction investment has continued to grow in the third quarter. This remains the prevailing factor in the gross fixed capital formation, although first signs of a possible recovery in investment in increased production capacity in line with the increase in utilisation are noted.

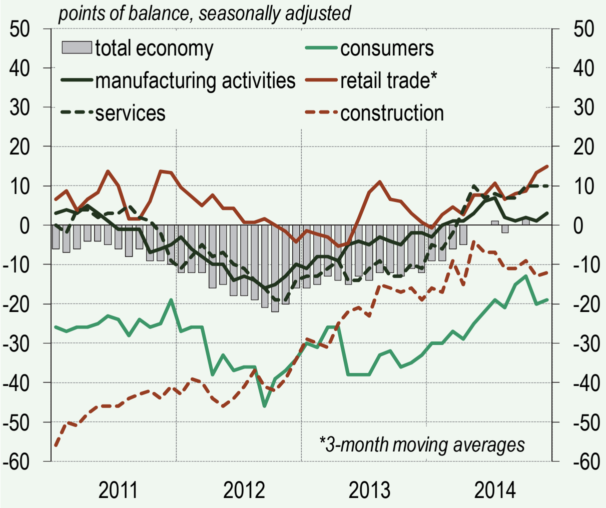
The situation on the labour market improved in 2014. The increase in employment was attributable to an increase in employment in manufacturing, a slowdown in the fall in employment in construction and an increase in employment in private-sector services, in particular at employment agencies. Outflows from registered unemployment into employment over the first nine months of the year were up 15% as a consequence. Inflows into unemployment due to the expiry of temporary employment contracts declined again as a result of labour market reforms, and the unemployment rate also fell. The real wage bill and the average real gross wage in the first ten months of the year were up slightly, although growth in the latter remained outpaced by growth in labour productivity.

Confidence indicators and performance limiting factors

The economic sentiment indicator has predominantly remained unchanged since May, albeit with notable changes within individual sectors. Manufacturing confidence peaked in July and remained at a slightly lower, although still positive, level in the following months. The decline derived from a decrease in the indicators of total orders and expected production, which have strengthened slightly by December. Confidence in construction began to fall in May due to low assessments of expected orders and employment. Confidence in private-sector services was high, primarily as a result of optimistic assessments of sales, which were relatively consistent with the increase in consumer confidence over the first ten months of the year. Consumer confidence declined sharply in November in the wake of the announcement of new fiscal consolidation measures, as all components of the indicator decreased. Consumer confidence improved slightly in December.

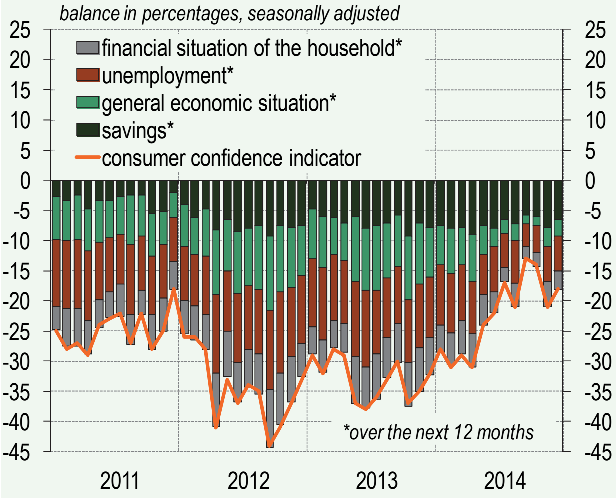
The proportion of enterprises facing insufficient demand continued to vary widely from sector to sector in 2014, but was in the most part significantly lower than in 2013. Problems with demand in manufacturing declined sharply, although this process stalled in the second half of the year. The situation in wholesale and retail trade was also improved, although the proportion of enterprises facing weak demand remained more than 50% at the end of 2014. In contrast to wholesale and retail trade, the corresponding proportion in other private-sector services increased. Considering the increase in turnover this is an indication of the concentration of turnover growth in larger enterprises. Problems with demand in the construction sector declined significantly since the start of the large-scale investment in public infrastructure. Ac-

Figure 2.1: Confidence indicators



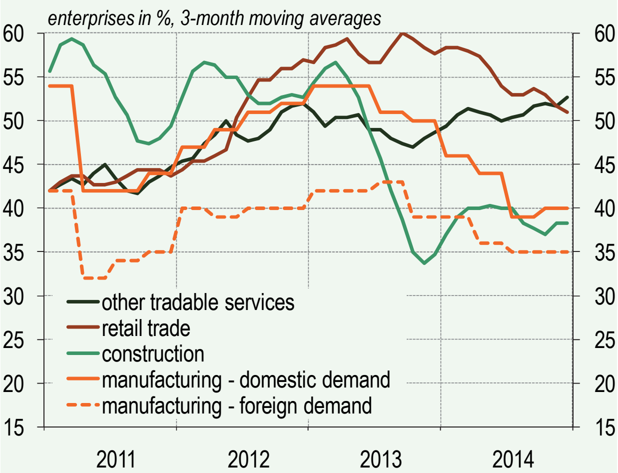
Source: SORS, Bank of Slovenia calculations.

Figure 2.2: Decomposition of consumer confidence indicator



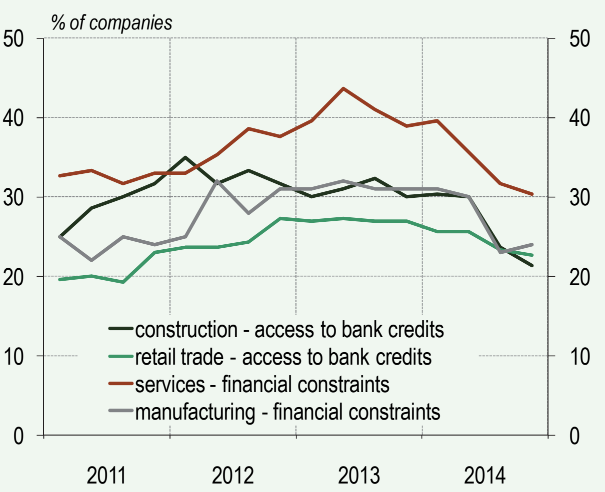
Source: SORS, Bank of Slovenia calculations.

Figure 2.3: Limiting factors – insufficient demand



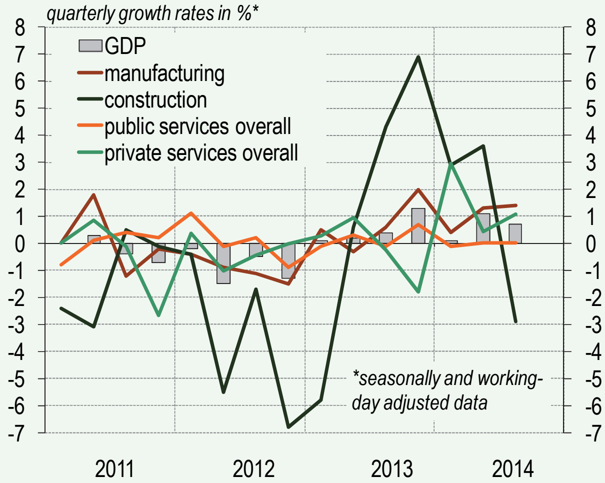
Note: Quarterly data for manufacturing.
Source: SORS, Bank of Slovenia calculations.

Figure 2.4: Limiting factors – financing



Source: SORS, Bank of Slovenia calculations.

Figure 2.5: GDP



Source: SORS, Bank of Slovenia estimates of private sector services' growth rates.

cording to surveys they were the smallest in the sectors primarily dependent on the domestic market.

Surveys reveal a decline in the proportion of enterprises with financing problems. The proportion of enterprises with financing problems declined in all sectors in 2014, although this process stalled in wholesale and retail trade and in manufacturing in the final quarter. Compared to the factors of demand, the proportion of enterprises with financial problems was relatively small. According to SORS survey, construction recorded the lowest figure amongst all sectors in the final quarter. The fall in the proportion was most likely the result of the rise in the number of bankruptcies after the introduction of changes to bankruptcy legislation and the more intensive use of financing, not necessarily connected with the domestic banks.[2]

Gross domestic product

Economic growth remained high in the third quarter, the vast majority of sectors continued to record an increase in activity. GDP was up 0.7% on the second quarter. Growth in value-added in manufacturing kept slightly strengthening, as a result of high growth in exports. Activity in private-sector services kept increasing, due to the recovery, albeit weak, in domestic final consumption, and to the improvement in the labour market situation. Wholesale and retail trade growth strengthened as a result of increased purchases of consumer durables, which had already been indicated by consumer surveys. Sales growth of motor vehicles was particularly notable. Turnover growth in storage services increased due to export growth and the increased dynamic on the domestic market. Higher growth was also recorded by professional, scientific and technical activities, deriving from one-off factors that had an impact on advertising, as well as from the increased demand for services related to construction investment. Real estate activities also expanded to a lesser extent, in connection with transactions in used housing. Value-added in public services remained stable in quarterly terms, in line with employment. Quarterly economic growth was thus held back solely by financial and insurance activities and, after five quarters of growth, by construction.[3]

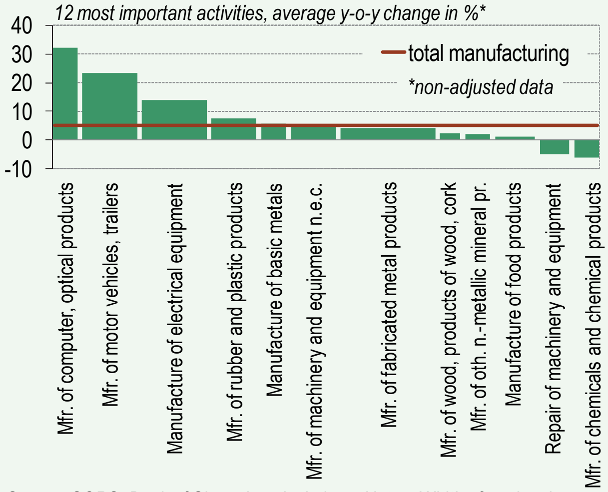
[2] The net stock of bank loans to non-financial corporations excluding the effects of the transfer of non-performing claims to the BAMC, measures in connection with Factor banka and Probanka, and the asset quality review was down almost 13% in year-on-year terms in September.
[3] The quarterly decline of almost 3% in value-added in construction was the result of a decline in the amount of civil engineering work related to public investment co-financed by European funds. The decline was most likely temporary in nature due to bad weather and the completion of works before local elections, since growth in public expenditure on construction investment continued over the same period. In addition, the government is planning a significant increase in investment in 2015.

Figure 2.6: Differences in y-o-y growth rates of GDP components between Slovenia and the euro area - production side*

Soure: Eurostat, Bank of Slovenia calculations.

Figure 2.7: Manufacturing production: Jul. 2014 – Sep. 2014

*12 most important activities, average y-o-y change in %**



Source: SORS, Bank of Slovenia calculations. Notes: Width of each column represents a share of activity in total value added in manufacturing in 2013. Pharmaceuticals are not included due to data confidentiality.

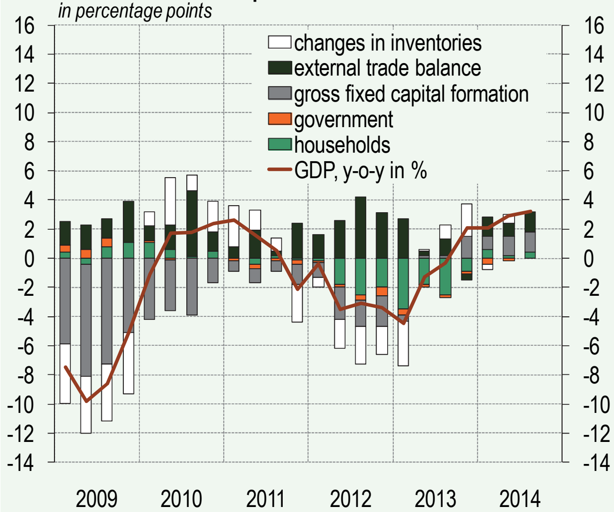
Year-on-year GDP growth in Slovenia has been significantly outpacing the euro area average for one year. All sectors other than public services are contributing to higher growth. Industrial production growth has significantly outpaced growth across the euro area in the last year, which is in accordance with the aim of export-conditioned economic development. After a sharp decline in construction following the bursting of the bubble at the outbreak of the crisis, value-added growth in the sector strongly outpaced the euro area average by the end of 2013 as a result of investment in public infrastructure. The proportion of GDP accounted for by construction was slightly above average in the third quarter. The proportion of total construction put in place accounted for by civil engineering work increased in the second quarter and the third quarter to around 70%, an indication of the uneven nature of the recovery in the sector and the dependence on European funding. Value-added growth in private-sector services outpaced the euro area in 2014 for the second consecutive year, and was a key factor in the recovery of the labour market. GDP in the third quarter was up 3.2% in year-on-year terms, 2.4 percentage points more than average growth in the euro area.

Production increased in most sectors of industry. Industrial production in the third quarter was up almost 6% in year-on-year terms, and increased in 18 amongst 25 sectors. Relatively broad-based growth was also evident from merchandise exports, where at least 50 amongst 65 categories of goods according to the two-digit SITC code recorded at least a slight increase. The highest year-on-year growth was recorded by the manufacture of computer, electronic and optical equipment, which was partly attributable to the base effect, as the level of output in this sector fluctuates sharply. There was a pronounced increase in growth in the car industry, in connection with the launch of new production at Revoz and increased sales of vehicles on the European market. Growth also remained high in the electrical and metal industries, while, after falling in the second quarter, output also began to increase in the pharmaceutical industry, at least in terms of the export figures. The energy sector recorded high year-on-year growth again, in line with accelerated resale of oil and gas, and a slight increase in electricity production.

Aggregate demand

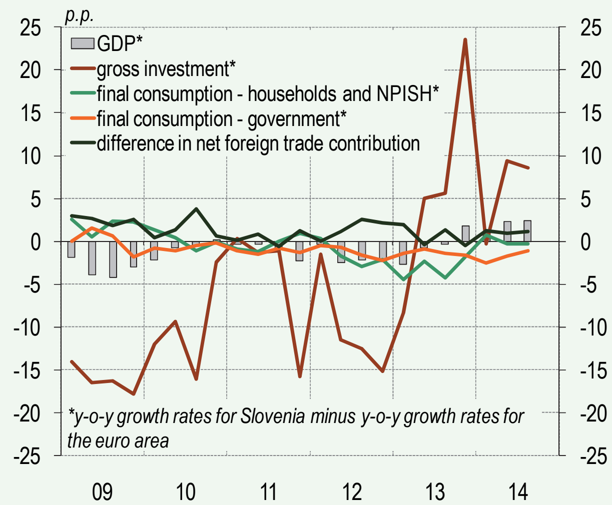
The most pronounced contributions to year-on-year growth in GDP made by demand components were recorded by investment and net exports. Growth in gross fixed capital formation is currently based on construction investment, which is primarily taking place in

Figure 2.8: Contributions to y-o-y GDP growth – expenditure side



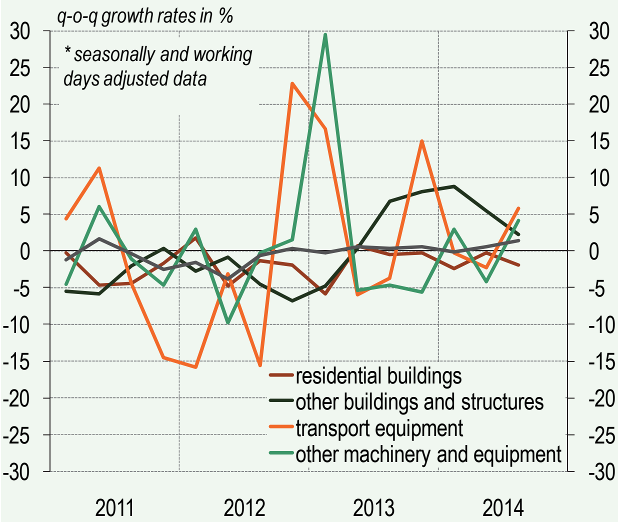
Source: SORS.

Figure 2.10: Differences in y-o-y growth rates of GDP components between Slovenia and the euro area - expenditure side*



Source: Eurostat, ECB, Bank of Slovenia calculations.

Figure 2.9: Gross fixed capital formation

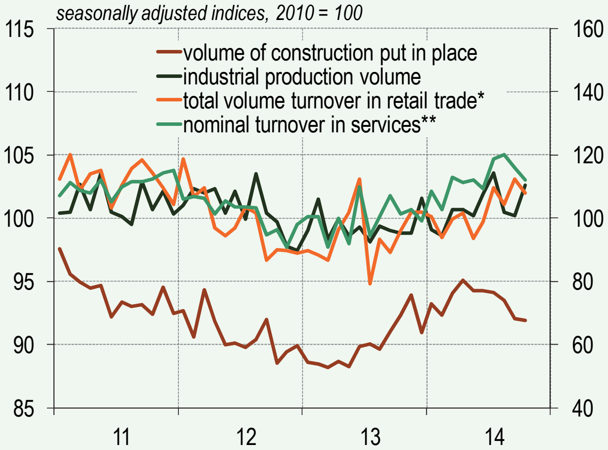


Source: SORS, Bank of Slovenia calculations.

public projects. Investment in housing has continued to decline in line with the freeze in the market for new housing. Prices of the latter fell further this year, and downward pressure is also expected in the future, partly as a result of the sale of the banks' non-performing claims. Despite the dominance of construction investment, the quarterly developments are already indicating gradual growth in investment in production capacity. This is also evident from the increase in imports of capital goods and from the sales revenues for such industrial goods on the domestic market. The onset of investment has coincided with a rise in capacity utilisation, which had already exceeded 80% by the second half of the year, comparable to the figure during the long period of stable economic growth before 2006. Year-on-year growth in investment in machinery and equipment remains negative, as a result of a base effect in connection with the investment in Block 6 of Šoštanj power station. Investment in transport equipment is also strengthening. Private consumption is strengthening merely gradually, and only as a result of growth in purchases of consumer durables. The contribution made to GDP growth by net exports remains high, despite an increase in domestic demand.

Compared with the euro area overall, only final government consumption recorded weaker growth over the first three quarters of the year, while renewed growth in investment was notably stronger. The gap by which government consumption trails the euro area began to widen in 2011 with the beginning of more pronounced fiscal consolidation, and its contraction reduced year-on-year growth in GDP until its stabilisation in the third quarter of 2014. In contrast to Slovenia, the contribution made to economic growth by government consumption in the euro area overall in the third quarter was positive for the fifth consecutive quarter, and accounted for approximately a quarter of the actual year-on-year growth. In line with the change in pitch of the consolidation measures and the recovery of the labour market, the gap by which growth in domestic private consumption trails the euro area disappeared this year. After four years of an extremely sharp decline in investment since the bursting of the investment bubble at the outbreak of the crisis, growth in investment began overtaking the euro area average in 2013. The contribution made by net exports is already larger than the euro area average on account of Slovenia's greater export-orientation as small, open economy, of a more pronounced decline in domestic demand in the crisis, and, since mid-2013, particularly of faster growth in exports.

Figure 2.11: Monthly economic activity indicators



Source: SORS.
*Notes: *Retail trade and trade and repair of motor vehicles. **Private sector services excluding trade and financial services.*

Economic developments in the final quarter of 2014

According to the available monthly figures, economic activity in early part of the final quarter was relatively weak in services in particular. Total turnover in other private-sector services in October was down 1% in monthly terms for the second consecutive month, most notably in transportation and storage. Turnover in wholesale and retail trade excluding vehicles was up in November in monthly terms, but remained below its peak recorded in September. After rapid growth in the third quarter, sales of vehicles slowed significantly in October and

Table 2.1: Economic activity

	12 m. to Oct.13	12 m. to Oct.14	2014 Aug.	2014 Sep.	2014 Oct.	2014 Jul.	2014 Oct.
			y-o-y in %			*monthly ++*	
Industrial production: - total *	-2.4	1.8	0.9	1.0	3.8	1.9	*-0.8*
- manufacturing	-3.1	3.2	3.7	2.4	6.0	1.8	*-0.3*
Construction: - total **	-10.0	24.3	26.5	6.6	-2.5	1.9	*-8.9*
- buildings	-24.7	4.7	15.8	-4.3	-5.0	2.8	*-0.8*
- civil engineering	-1.9	32.6	31.4	11.4	-0.4	-3.1	*-12.0*
Trade (volume turnover)							
Total retail trade	-4.1	0.1	0.7	4.1	-0.4	-0.6	*1.2*
Retail trade except automotive fuel	-4.1	-1.0	-0.3	1.7	-0.5	-0.2	*0.2*
- food, beverages, tobacco	-3.1	-2.2	-2.3	0.3	-1.0	-1.7	*0.4*
- non-food (except automotive fuel)	-4.6	0.3	1.9	2.7	-0.1	0.3	*0.3*
Retail trade and repair of motor vehicles	1.9	6.7	8.4	9.3	9.6	4.0	*2.3*
Private sector services * +**	-1.5	2.9	5.2	2.4	2.6	1.1	*0.6*
Transport and storage +	-1.0	5.7	5.9	8.5	3.0	1.7	*-0.2*

Sources: SORS, Bank of Slovenia calculations.
Notes: Data are working days adjusted.
** Volume of industrial production. ** Real value of construction put in place. *** Excluding trade and financial services. + Nominal turnover.*
++: 3-month moving average compared to the corresponding average 3 months earlier. Data are seasonally and working days adjusted (except for construction where data are seasonally adjusted).

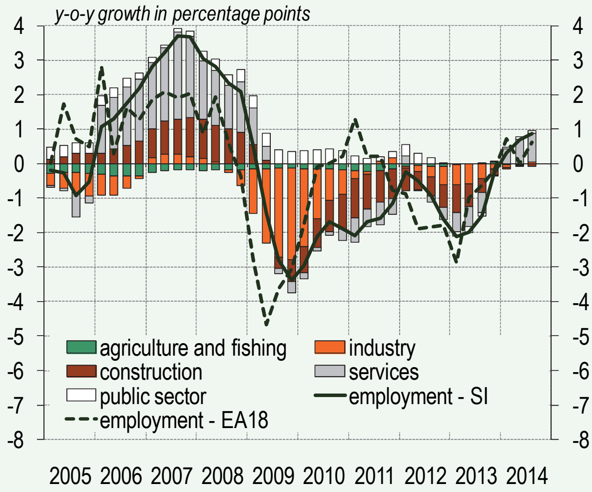
November. The decline in total construction activity slowed in October as a result of an increase in the amount of residential construction put in place. After declining for two months, industrial production increased by 2.4% in October. This was primarily related to the continuing growth in exports, although sales of capital goods on the domestic market also increased sharply.

Employment[4]

The continuation of economic growth had a positive impact on employment. Total employment increased gradually in 2014, the year-on-year increase reaching 0.9% in the third quarter. The number of employees began rising again in the second quarter after five years, the year-on-year rate of growth reaching 0.6% in the third quarter. At the same time growth in the number of self-employed slowed, taking their contribution to total growth in employment to less than the contribution made by employed persons. The proportion of total employment accounted for by the self-employed is still approximately a fifth, around 5 percentage points higher than the euro area average.

Total employment in the private sector was up in year-on-year terms for the third consecutive quarter. Year-on-year employment growth stood at 1% in the third quarter. Employment is increasing at non-financial corporations, with private-sector services being the main factor in the increase. The rise in the number of employees in professional, scientific and technical activities and in administrative and support service activities exceeded 4% over the first three quarters of the year. This is primarily the result of the increase of employment at employment agencies, which is clouding the picture of the sectoral breakdown of actual employment, particularly in industry and construction. Employment increased by 3.5% in other service activities and by 0.8% in wholesale and retail trade, transportation, and accommodation and food service activities. The number of employees in information and communication activities is continuing to rise. Employment in manufacturing in the third quarter was up in year-on-year terms for the second consecutive quarter, by 0.4%. The decrease in employment in construction slowed sharply from 7% in 2013 to just over 1% in the third quarter of 2014. Employment in financial and insurance activities is decreasing owing to the restructuring of the banking sector: it was down 2.1% over the first three quarters of the year.

Figure 2.12: Contributions to employment growth



Source: SORS - national accounts, Bank of Slovenia calculations.

Total employment in mostly public services increased slightly, but not as a result of a rise in the number of employees in the general government sector. The total number of employees in the third quarter was up 0.4% in year-on-year terms in mostly public services, but down 0.1% in the general government sector. The number of employees in sectors not under direct government control is continuing to increase. This is confirmed by the monthly SORS figures, which are not completely comparable to the national accounts figures, but reveal that the workforce in employment in human health and social work and in education has been increasing in year-on-year terms since mid-2013. The decrease in employment has also recently come to an end in sectors

[4] National accounts figures are used for employment, i.e. for employment according to the domestic concept. They represent the total of employed and self-employed persons. According to the monthly figures, the workforce in employment was up again in year-on-year terms in October, by 1.1%.

under direct government control. The year-on-year reduction in employment in the general government sector was its lowest since the end of 2013, while the workforce in employment in public administration, defence and compulsory social security increased slightly in year-on-year terms in September, the first such increase since November 2010.

Labour market flows and unemployment

The number of new hires rose significantly in 2014. The number of unemployed deregistering for reason of employment was up 5% in year-on-year terms in the third quarter, and by 15% over the first nine months of the year. The increase in these outflows relative to registered unemployment was the largest since 2008. This was the result of the demand for labour and of youth employment incentives under the emergency law adopted in November 2013, while the number of people included in active

Table 2.2: Unemployment and employment

	2009	2010	2011	2012	2013	13Q3	13Q4	14Q1	14Q2	14Q3
						in 1,000				
Registered unemployed persons	86.4	*100.5*	110.7	110.2	119.8	116.1	120.7	128.8	120.2	114.5
Unemployment rate						*in %*				
- LFS	5.9	7.3	8.2	8.9	10.1	9.4	9.6	10.8	9.3	9.3
- registered	9.1	10.7	11.8	12.0	13.1	12.8	13.2	14.1	13.1	12.5
Probability of transition between employ. and unemployment						in %				
- probability to find a job[1]	14.0	14.2	13.8	13.2	13.6	13.6	11.6	16.1	17.8	14.5
- probability to lose a job[2]	2.8	2.8	2.6	2.8	2.8	2.5	3.0	3.3	2.2	2.2
						in 1,000				
Total employment[3]	982.9	961.7	946.0	938.2	924.3	933.5	927.1	918.5	927.4	941.5
						year-on-year growth in %				
Persons in paid employment	-2.7	-2.7	-2.1	-1.1	-3.0	-3.1	-1.9	-0.3	0.2	0.6
Self-employed	2.6	0.3	0.5	0.5	5.1	5.4	6.8	3.0	2.5	1.8
By sectors										
A Agriculture, forestry and fishing	-1.8	-2.0	-2.5	-1.0	0.0	0.1	0.4	-0.3	-0.3	-0.1
BCDE Manufacturing, mining and quarrying and other industry	-8.7	-5.7	-0.1	-1.1	-1.9	-1.9	-0.7	-0.4	-0.1	0.1
F Construction	-0.9	-9.4	-11.4	-7.8	-7.1	-5.6	-2.6	-0.8	-0.5	-1.1
GHI Trade, accommodation, transport	0.2	-2.4	-2.4	-1.2	-1.2	-1.2	-0.5	-0.9	-0.2	0.8
J Information and communication services	4.0	0.8	0.3	2.1	2.3	2.3	2.7	1.9	1.9	1.9
K Financial and insurance activities	1.8	-0.7	-2.8	-1.7	-2.7	-2.9	-2.5	-2.1	-2.1	-2.1
L Real estate activities	4.2	0.0	-2.7	-1.4	0.9	0.0	0.0	-1.9	0.0	1.9
MN Professional, technical and other business activities	-0.5	2.6	0.7	1.4	-3.0	-4.2	-1.1	4.7	5.2	4.3
RST Other activities	3.1	1.7	-1.9	0.2	6.1	6.5	7.7	2.3	3.2	3.5
- mainly private sector (without O..Q)[4]	-2.6	-3.1	-2.2	-1.3	-1.7	-1.7	-0.3	0.3	0.8	1.0
- mainly public services (O..Q)[4]	2.2	2.3	0.9	1.1	-0.6	-0.6	-0.1	0.2	0.4	0.4
Total employment[3]	-1.8	-2.2	-1.6	-0.8	-1.5	-1.5	-0.3	0.3	0.7	0.9

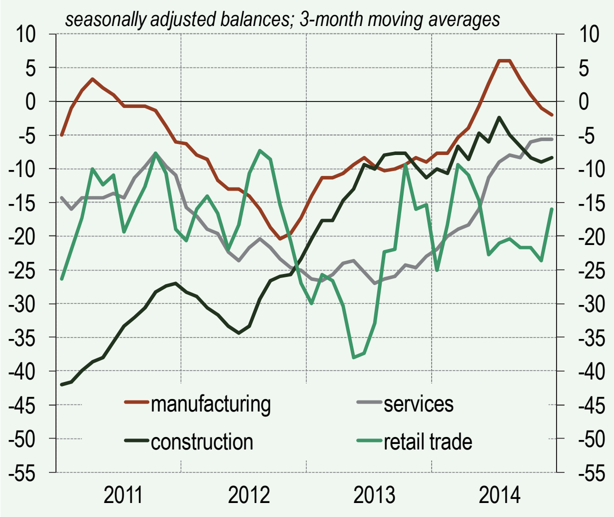
[1] Newly employed as a share of registered unemployed persons according to Employment Service of Slovenia. The higher the indicator's value, the better chance of finding a job.
[2] Newly registered unemployed due to a job loss as a share of total employment. Calculation is based on Employment Service of Slovenia's data and registered data of total employment. The higher the indicator's value, the higher chance of losing a job.
[3] Employed and self-employed persons.
[4] Public administration, education, human health and social work services according to NACE rev. 2.
Source: SORS, Employment Service of Slovenia, Bank of Slovenia calculations.

employment policy was down 5% on the first nine months of 2013. The year-on-year increase in outflows from unemployment for reason of first-time employment was also encouraging. The number was up just over a quarter in the third quarter, and by 46% in total over the first three quarters of the year. This was the highest growth in outflows for reason of first-time employment since 2008, both in absolute terms and relative to total outflows. The favourable developments did not continue in November, the number of outflows for reason of employment falling for the first time in a year and a half, by 4.6%. At the same time there has been a decline in future employment expectations in certain sectors since the middle of the year.

Despite the increase in activity, manufacturing firms are not reporting major problems with recruiting skilled workers. The gap between the estimated shortfall of skilled workers and the estimated shortfall of workers in general has remained unchanged for several years according to SORS figures, and the increase in activity and employment in 2014 did not have any impact on the gap. This is an indication that there has not yet been any significant change in the relative levels of recruitment of skilled and other workers.

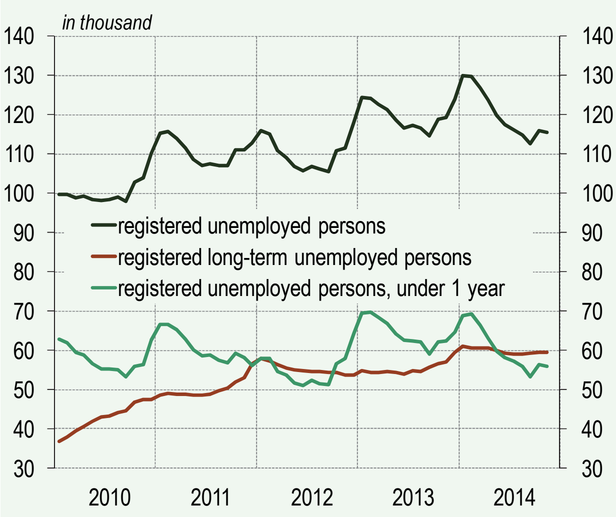
Since peaking in January, the unemployment rate has decreased. The number of registered unemployed decreased in monthly terms between February and the end of September, which is to be expected because of seasonal effects, although the total decrease over the first nine months of the year was the largest since 2008. The number of unemployed recorded a renewed seasonal rise in October as a result of the inflow of those whose student status had expired, although the increase was the smallest in the last six years, partly as a result of a strong outflows for reason of new hires. The number of registered unemployed has been falling in year-on-year terms

Figure 2.13: Expected employment



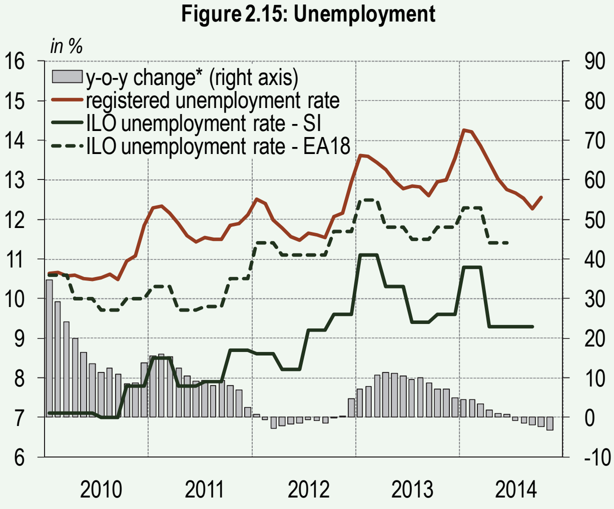
Source: SORS.

Figure 2.14: Long-term unemployed persons



Source: Employment Service of Slovenia, Bank of Slovenia calculations.

Figure 2.15: Unemployment



*Note: * Number of registered unemployed persons, y-o-y change.*
Source: Employment Service of Slovenia, SORS, Bank of Slovenia calculations.

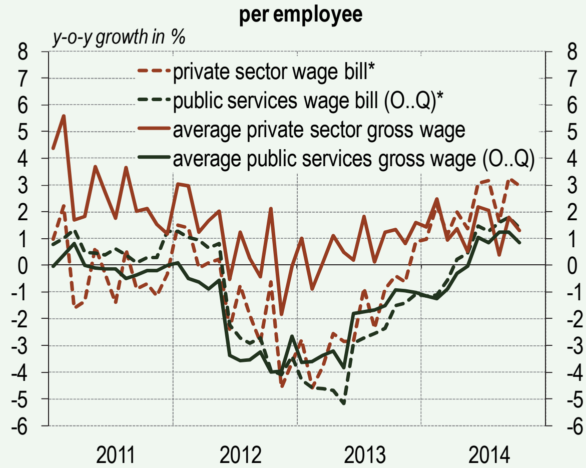
since July: it was down 1.4% in the third quarter, and continued falling in the final quarter. The number of registered unemployed stood at 119,458 in December, down 3.7% on December 2013. The number of long-term unemployed has also fallen since the beginning of 2014, although the proportion of total unemployment that they account for increased from 47% to 53% as a result of a sharper fall in the number of other unemployed. The decrease in the number of unemployed and the increase in the workforce in employment were accompanied by a decline in the registered unemployment rate, which fell by just over a tenth from 14.2% in January to 12.6% in October, the first significant reduction since 2008. The survey unemployment rate stood at 9.3% in the third quarter, significantly lower than the euro area average.

The improvement in the situation on the labour market has also been evidenced in lower inflows into registered unemployment. The number of people newly registering as unemployed in the third quarter was down a tenth in year-on-year terms, and was down 5.3% overall during the first three quarters of the year. Loss of temporary employment accounted for approximately half of those newly registering as unemployed, although their numbers were down 6% on the first nine months of 2013. The figure has been falling since the implementation of the labour market reform, which reduced the dual nature of the market by tightening the restrictions on temporary employment. The reduction in these forms of employment is already slowing, which could indicate that the effects of the labour market reform in terms of the reduction of segmentation are slowly dissipating. Inflows of those made redundant and those losing their jobs in bankruptcies also declined in the third quarter, by a fifth, while inflows of first-time job-seekers declined by 3.1%. Only the inflow of first-time job-seekers recorded an overall increase in the first three quarters of the year, at 4.8%. This is attributable to the more encouraging situation on the labour market, which encouraged this population group to abandon inactivity in order to comply with the conditions for enrolling in public measures to promote employment.

Wage developments

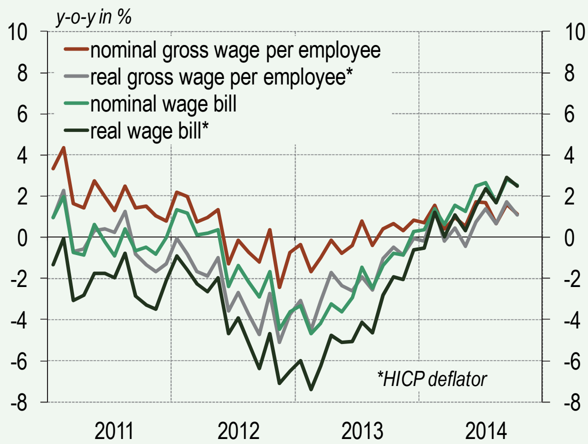
The favourable developments on the labour market have also been evidenced in growth in the average nominal wage, which has been rising in year-on-year terms for a year already. The average nominal gross wage in the total economy over the first ten months of the year was up 1.1% in year-on-year terms, primarily as a result of growth in the private sector, where wages rose by 1.4%. The rise in wages was primarily the result of a rise of 3.2% in wages in primarily export-oriented manufacturing and a rise of 1.1% in wholesale and retail trade.

Figure 2.16: Total wage bill and average monthly gross wage per employee



*Note *The wage bill is calculated as the product of the average gross wage for employees of legal persons who received pay and the total number of employees of legal persons.*
Source: SORS, Bank of Slovenia calculations.

Figure 2.17: Total wage bill and average gross wage per employee



Note: Wage bill is calculated as the product of average gross monthly wages for employees of legal persons who received pay and the total number of employees of legal persons.
Source: SORS, Bank of Slovenia calculations.

Table 2.3: Labour costs indicators

	2009	2010	2011	2012	2013	13Q3	13Q4	14Q1	14Q2	14Q3
					in EUR					
Average gross wage	1439	*1495*	1525	1526	1523	1504	1564	1527	1528	1524
					nominal year-on-year growth, %					
Average net wage	3.4	3.9	2.1	0.4	0.6	1.0	1.0	0.8	0.8	0.9
Average gross wage	3.5	3.9	2.0	0.1	-0.1	0.3	0.6	0.9	1.1	1.3
- mainly private sector (excl. O..Q)[1]	1.9	5.0	2.6	0.9	0.7	1.1	1.2	1.6	1.3	1.4
- mainly public services (O..Q)[1]	6.8	-0.1	0.0	-2.2	-2.3	-1.6	-1.0	-1.1	0.2	1.1
Average gross wage in manufacturing	0.9	8.9	3.9	2.5	2.8	3.0	3.6	3.9	2.8	3.1
Average real net wage[2]	2.5	1.8	0.1	-2.3	-1.3	-1.2	-0.1	0.2	0.0	0.8
Labour costs per hour worked[3]	3.6	1.2	2.0	-0.3	-2.1	-1.0	2.1	2.3	2.3	2.2
Labour costs per hour worked in manufacturing[3]	5.7	3.2	2.0	2.9	0.6	-0.5	4.4	3.1	2.6	5.9
Gross wage per unit of output[4]	10.2	0.4	-0.3	1.9	-0.6	-1.0	-1.8	-0.8	-1.1	-0.9
Gross wage per unit of output in manufacturing[4]	10.0	-5.1	0.3	3.9	1.8	1.3	-1.8	0.2	-0.7	-1.5
Unit labour costs[4,5]	8.5	0.5	-0.7	0.6	1.4	0.2	2.7	-1.2	-1.8	-1.1
Labour costs per employee[5]	1.9	4.0	1.6	-1.2	1.9	1.5	5.2	0.5	0.3	1.1
Output per employee	-6.1	3.5	2.3	-1.8	0.5	1.3	2.4	1.7	2.2	2.3
Output per employee - manufacturing	-8.3	14.7	3.6	-1.3	0.9	1.8	5.4	3.7	3.5	4.7
HICP	0.9	2.1	2.1	2.8	1.9	2.2	1.1	0.6	0.8	0.1
GDP deflator	3.4	-1.1	1.2	0.3	1.4	1.4	2.1	1.3	0.5	0.2

1 Public administration, education, human health and social work services according to NACE rev. 2.
2 HICP deflator.
3 Labour costs according to SORS calculations.
4 Unit of output for the total economy is defined as real GDP per person employed, and in manufacturing as real value added per person employed (both based on national accounts).
5 Labour costs calculated on the basis of employee compensation (national accounts).
Source: SORS, Bank of Slovenia calculations.

Wages have continued to increase in certain sectors with limited competition, most notably electricity supply. The end of a base effect meant that wages in mostly public services have also been increasing in year-on-year terms since June. The average wage in October was up 0.8% in year-on-year terms in public administration and defence, 0.6% in education, and 1.1% in human health and social work. Average wages over the first ten months of the year in public services nevertheless stagnated. The nominal wage bill over the first ten months of the year was up 1.7% in year-on-year terms, having increased by 2.2% in the private sector and 0.5% in public services. Growth stood at 2.5% in October. The average real gross wage and the real gross wage bill are also increasing, which is partly attributable to the simultaneous fall in inflation.

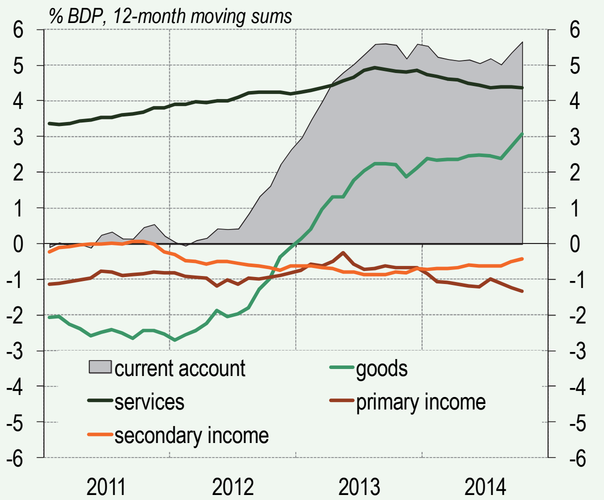
3 Current Account and Competitiveness Indicators

In the 12 months to October the current account surplus amounted to EUR 2.1 billion or 5.7% of GDP, slightly more than a year earlier. It declined slightly in the first half of the year, before increasing again in September and October as a result of a new increase in the merchandise trade surplus. Alongside rapid growth in exports, thanks to an improvement in the competitiveness of the export sector, the terms of trade were also a factor in this increase. The year-long decline in the surplus of trade in services came to an end in the autumn. The widening of the deficit in primary income acted in the opposite direction. This was the result of sharp growth in interest payments on the general government's rising external debt, while the deficit in income on FDI is also expected to widen.

Current account position

After narrowing in year-on-year terms over the first eight months of the year, the current account surplus widened again in the next two months. The current account surplus amounted to EUR 620 million in September and October, and accounted for just over a third of the total surplus over the first ten months of the year. This amounted to EUR 1.8 billion, or just over EUR 80 million more than in the same period of the previous year. The cumulative surplus in the 12 months to October amounted to EUR 2.1 billion or 5.7% of GDP, compared with 5.6% of GDP a year earlier.

Figure 3.1: Current account components

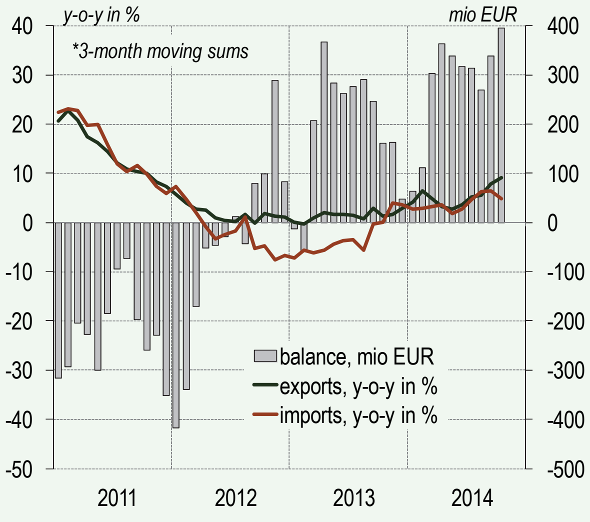


Source: Bank of Slovenia.

Merchandise trade

After slowing in August, year-on-year growth in exports rose sharply in the next two months, significantly outpacing growth in imports. The rate leapt to a high 13.8% in September, and was still 9.1% in October. Year-on-year growth in merchandise imports was just over 6 percentage points less. The merchandise trade surplus over the two months amounted to EUR 420 million, and accounted for just over a third of the cumulative merchandise trade surplus over the first ten months of the year. The 12-month surplus reached EUR 1.137 million or 3.1% of GDP in October, just under 1 percentage point more than a year earlier.

Figure 3.2: Goods trade*

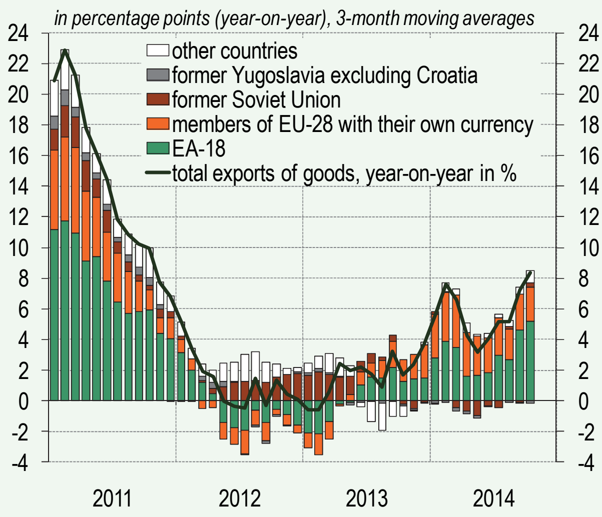


Source: Bank of Slovenia.

Year-on-year growth in merchandise exports has gradually been strengthening since mid-2013, primarily as a result of growth in exports to EU Member States. According to SORS figures, merchandise exports to EU Member States over the first ten months of the year were up 8.3%, while exports to non-EU countries were unchanged over the same period. Alongside the very gradual improvement in the economic situation in the EU and the more favourable developments in export prices, as of July 2013 this has also been attributable to Croatia's entry into the EU. Exports to euro area countries and other EU Member States have accounted for between 80% and 90% of total growth in exports over the last year. Over the same period the contribution by the former Yugoslav republics other than Croatia and the countries of the former Soviet Union was negative overall. Slovenian exporters partly compensated for the downturn on these markets through sales in other markets outside the EU. The proportion of total year-on-year growth in exports accounted for by the latter is gradually increasing.

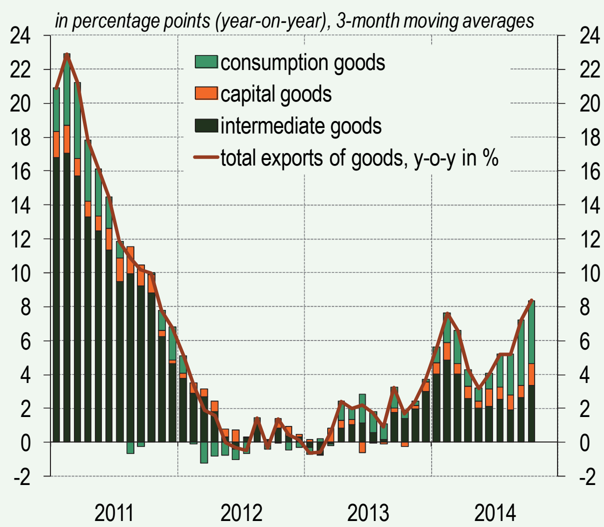
Exports of intermediate goods were the largest factor in the year-on-year growth in exports of goods over

Figure 3.3: Contributions to export growth by country groups



Source: SORS, Bank of Slovenia calculations.

Figure 3.4: Contributions of main BEC groups to export growth



Source: SORS, Bank of Slovenia calculations.

the first ten months of 2014. They accounted for between 50% and 60% of total growth in exports. The contribution made by exports of consumer goods has also been slowly increasing since December 2013. This fluctuated sharply, from zero in April to more than 50% since July, in connection with the renewed boom in the manufacture and export of cars. The contribution made by exports of capital goods averaged just under 20%. The reason for the prevalence of the contribution made by intermediate goods is the large proportion of total exports that they account for. Growth in exports of capital and consumer goods was higher at 9% and 7.2% respectively.

Merchandise imports strengthened in nominal terms in the second half of the year, despite the continuing fall in import prices. In the wake of increased industrial production and exports, growth in imports of intermediate goods has strengthened slightly in recent months. Imports of intermediate goods over the first ten months of the year were nevertheless down 1.1% in nominal year-on-year terms, largely as a result of the sharp fall in oil prices. Growth in imports of capital goods also strengthened sharply in September and October, taking the increase over the first ten months of the year to 6%. Imports of consumer goods recorded the highest growth, of 8.5%, despite the weak growth in private consumption.

Trade in services

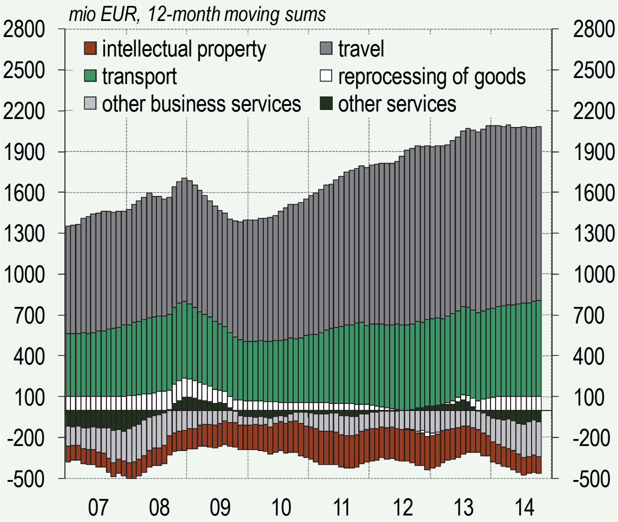
The surplus of trade in services was unchanged in October, while the surplus over the first ten months of the year was narrower in year-on-year terms. Trade in services has gradually strengthened in recent months: year-on-year growth in imports stood at just over 10% in October, while year-on-year growth in exports stood at 7%. Despite a small improvement, growth in exports remains significantly outpaced by growth in imports. Exports of services over the first ten months of 2014 were up just 3.8% in year-on-year terms, while imports were up just over 10%, which narrowed the surplus of trade in services over this period by EUR 132 million to EUR 1.4 billion. The cumulative surplus in the 12 months to October amounted to EUR 1.6 billion or 4.4% of GDP, compared with 4.8% of GDP a year earlier.

The surplus in transport and merchandise handling, i.e. in services closely linked to merchandise trade, widened in year-on-year terms in 2014. Both imports and exports of transport services closely track developments in merchandise trade. Year-on-year growth in imports has slightly outpaced exports since June inclusive, as a result of which year-on-year growth in exports over the first ten months of the year was slightly lower than growth in imports at 8.9%. The most notable increases

Figure 3.5: External trade unit value indices

Source: SORS.

Figure 3.6: Trade in services balance



Source: Bank of Slovenia.

were in freight rail transport and sea and coastal freight water transport, and also in passenger transport by road.

Developments in trade in travel services were less favourable. The number of arrivals by foreign visitors over the first ten months of the year was up 5.7% in year-on-year terms, while the number of overnight stays was up just over 1%. In value terms, exports of travel services were up just 0.2% in year-on-year terms while imports were up almost 12%, partly as a result of an increase of

Table 3.1: Components of the current account

				in 12 months to							
	2011	2012	2013	okt.13	okt.14	13Q2	13Q3	14Q2	14Q3	Oct.13	Oct.14
					in EUR million						
Current account balance	83	954	2,027	2,001	2,107	587	477	563	603	180	300
1. Goods	-936	-36	763	793	1,137	262	247	318	339	68	197
2. Services	1,406	1,509	1,755	1,735	1,624	485	532	433	530	132	131
2.1. Transport	583	633	654	645	702	174	177	186	196	53	59
2.2. Travel	1,158	1,278	1,345	1,328	1,278	322	433	302	412	117	118
2.3. Other	-335	-401	-243	-238	-356	-12	-78	-54	-78	-38	-46
3. Primary income	-302	-292	-243	-240	-497	-76	-192	-129	-199	-19	-61
3.1. Labour income	234	376	348	365	383	70	85	113	94	31	31
3.2. Investment income	-772	-911	-899	-892	-1,129	-259	-317	-321	-300	-53	-100
4. Secondary income	-84	-227	-249	-287	-156	-83	-110	-60	-67	-1	33
					in % of BDP						
Current account balance	0.2	2.7	5.6	5.6	5.7	6.3	5.1	5.9	6.3	5.8	9.3
1. Goods	-2.5	-0.1	2.1	2.2	3.1	2.8	2.7	3.3	3.5	2.2	6.1
2. Services	3.8	4.2	4.9	4.8	4.4	5.2	5.7	4.5	5.5	4.2	4.1
2.1. Transport	1.6	1.8	1.8	1.8	1.9	1.9	1.9	1.9	2.0	1.7	1.8
2.2. Travel	3.1	3.5	3.7	3.7	3.4	3.5	4.7	3.1	4.3	3.7	3.6
2.3. Other	-0.9	-1.1	-0.7	-0.7	-1.0	-0.1	-0.8	-0.6	-0.8	-1.2	-1.4
3. Primary income	-0.8	-0.8	-0.7	-0.7	-1.3	-0.8	-2.1	-1.3	-2.1	-0.6	-1.9
3.1. Labour income	0.6	1.0	1.0	1.0	1.0	0.7	0.9	1.2	1.0	1.0	1.0
3.2. Investment income	-2.1	-2.5	-2.5	-2.5	-3.0	-2.8	-3.4	-3.3	-3.1	-1.7	-3.1
4. Secondary income	-0.2	-0.6	-0.7	-0.8	-0.4	-0.9	-1.2	-0.6	-0.7	0.0	1.0
					nominal year-on-year growth rates in %						
Export of goods and services	11.4	1.6	2.4	1.7	5.1	2.5	3.3	4.0	6.6	2.0	8.7
Export of goods	12.9	1.0	2.1	1.2	5.4	1.6	2.9	3.7	7.9	2.6	9.1
Export of services	5.4	4.1	3.9	3.9	3.7	6.4	4.6	5.3	2.1	-0.7	7.0
Transport	8.2	2.9	3.4	2.0	8.6	2.5	3.9	9.1	9.8	0.2	9.7
Travel	2.6	1.7	1.5	0.7	0.7	0.8	3.7	1.8	-2.2	3.6	1.3
Other	6.7	8.0	7.1	9.1	3.4	16.0	6.8	5.8	3.2	-5.6	11.1
Import of goods and services	11.8	-2.3	-1.6	-3.5	4.6	-3.6	-0.5	4.4	6.0	3.0	3.8
Import of goods	13.6	-3.1	-1.7	-4.1	4.0	-3.7	-0.3	2.8	6.5	2.9	2.7
Import of services	1.6	2.8	-1.2	0.0	8.7	-3.3	-1.5	14.6	3.5	3.2	10.1
Transport	1.3	-1.6	3.4	2.6	8.3	2.0	-1.1	11.6	9.0	11.1	8.1
Travel	-11.5	-10.6	-4.9	-3.7	9.1	-3.6	-4.1	19.1	1.5	-7.7	1.9
Other	8.5	10.0	-1.6	0.4	8.6	-5.0	0.0	14.3	2.8	3.8	13.1

Source: Bank of Slovenia.

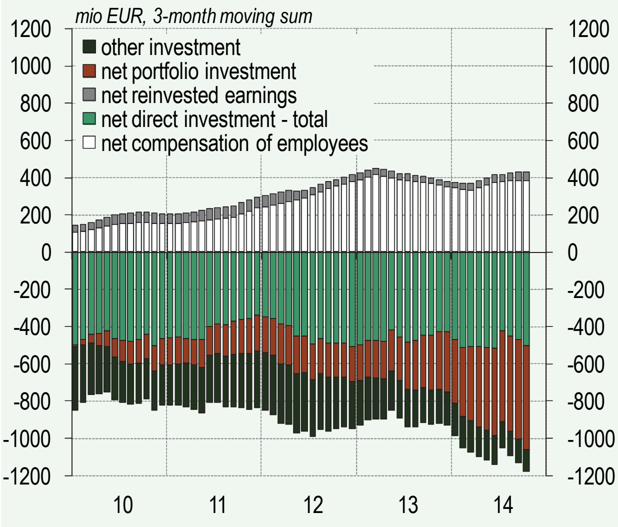
more than 30% in business travel abroad. The surplus of trade in travel services over the first ten months of the year narrowed by EUR 67 million in year-on-year terms to EUR 1,086 million.

The deficit in other business services is widening fastest. The deficit over the first ten months of the year more than doubled in year-on-year terms to just under EUR 200 million. Although it is narrowing in year-on-year terms, the deficit in intellectual property services remains relatively wide at EUR 99 million. The deficit in all other services widened from EUR 26 million over the first ten months of 2013 to EUR 68 million over the same period of 2014, just under half of which was attributable to the widening of the deficit in financial services.

Primary and secondary income

The rapid widening of the deficit in primary income continued in 2014. The deficit in capital income widened by EUR 230 million in year-on-year terms to EUR 1,012 million. The largest factor in the widening deficit was growth in net payments of income on investments in securities, where the deficit widened by EUR 215 million to EUR 443 million. Within this framework, expenditure for financing the external general government debt

Figure 3.7: Net factor income



Source: Bank of Slovenia.

increased by EUR 195 million in year-on-year terms to EUR 611 million. In the context of divestment by Slovenian firms in the rest of the world and the expanded selling of domestic firms, the deficit in income on FDI is also widening. It widened by EUR 75 million in year-on-year terms to EUR 480 million, and is expected to further widen in the coming years as the privatisation process continues. The surplus in labour income widened by EUR 36 million in year-on-year terms to EUR 320 million as outflows remained unchanged. The surplus in other primary income narrowed by EUR 60 million in year-on-year terms to just under EUR 180 million. The cumulative deficit in primary income over the 12 months to October more than doubled in year-on-year terms to EUR 497 million or 1.3% of GDP.

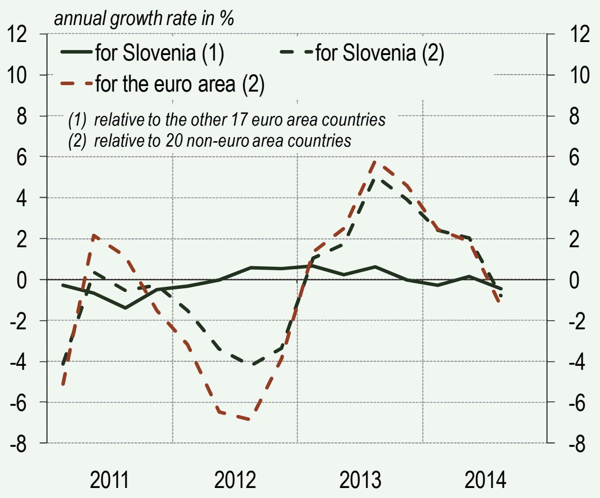
The deficit in secondary income narrowed in year-on-year terms in the second and third quarters, while October saw a surplus of EUR 33 million. The deficit over the first ten months of the year narrowed by EUR 93 million in year-on-year terms to EUR 252 million. The reduction of the general government deficit (primarily government transfers) accounted for EUR 60 million of this narrowing, and other sectors for the remaining EUR 33 million.

Selected competitiveness indicators[5]

Slovenia's price competitiveness over the first three quarters of the year improved as a result of the weaker euro and lower growth in domestic prices. The harmonised price competitiveness indicator measured relative to 20 major trading partners outside the euro area fell by 1.4% between January and September, lower growth in domestic prices accounting for 0.8 percentage points of the decline. The faster fall in domestic inflation and weaker euro, particularly towards the end of the period, also had a favourable impact on the year-on-year change in the indicator. With prices falling faster than in the euro area overall, the price competitiveness of Slove-

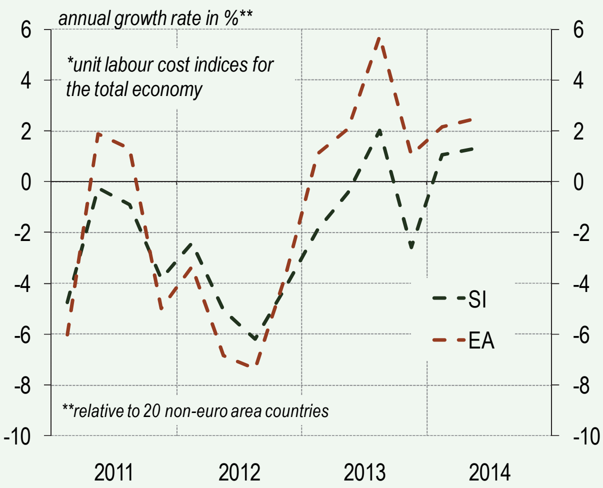
[5] A rise in the value of the harmonised competitiveness indicators (appreciation) entails a deterioration in competitiveness, while a fall (depreciation) entails an improvement in competitiveness in comparison with the selected countries.

Figure 3.8: Harmonised price competitiveness indicators (based on HICP/CPI deflators)



Source: ECB.

Figure 3.9: Harmonised cost competitiveness indicators* (based on ULC deflators)



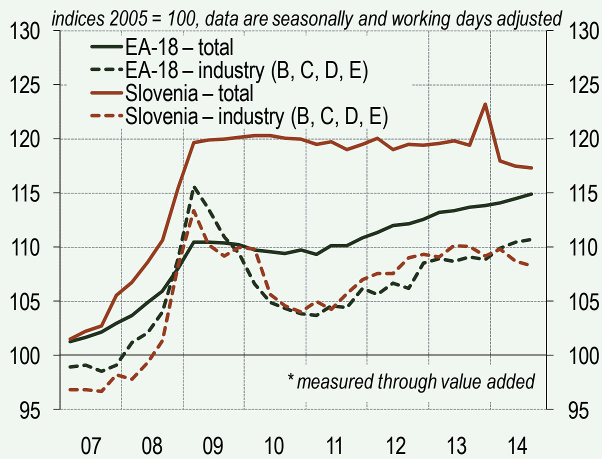
Source: ECB.

nian exporters on euro area markets also improved to a lesser extent.

Cost competitiveness deteriorated in the first half of 2014 on markets outside the euro area, while its improvement on euro area markets strengthened. According to the ECB indicator, developments in nominal unit labour costs were less favourable in the first half of the year relative to trading partners outside the euro area, although the loss of cost competitiveness was smaller than in the euro area overall. Cost competitiveness on euro area markets improved sharply at the same time. Unit labour costs in the third quarter were just 2.1% higher than the euro area average in the total economy, and were 2.2% lower in industry.

Other factors in the good performance of the export sector alongside cost competitiveness were the favourable terms of trade, the gradual strengthening of the technological complexity of production and the geographical diversification of exports. The terms of trade have been improving since mid-2013, which was a factor in the rapid recovery of exports. They are expected to have further improved in the final quarter of 2014, primarily as a result of the sharp fall in oil prices. In terms of export structure and growth, the technological complexity of production is gradually increasing. According to UN

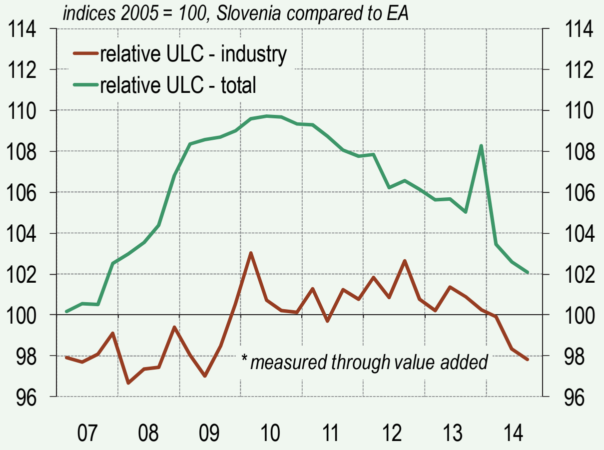
Figure 3.10: Nominal unit labour costs*



Source: Eurostat, Bank of Slovenia calculations.
Note: In the case of Slovenia, the temporary increase in the ULC for the total economy in the last quarter of 2013 is due to the impact of the settlement of wage disparities in the general government sector in the amount of almost 200 mio EUR.

methodology, exports of high-tech products over the first three quarters of the year were up more than 8% in year-on-year terms, outpacing the simultaneous average growth in merchandise exports. Growth in exports of high -tech products also significantly outpaced the euro area average, which stood at just 2%. The proportion of total merchandise exports accounted for by high-tech products already exceeds 20% in Slovenia, and is gradually approaching the euro area average. Slovenia's merchandise exports are strongly dependent on demand in Ger-

Figure 3.11: Nominal unit labour costs* in relative terms



Source: Eurostat, Bank of Slovenia calculations.
Note: In the case of Slovenia, the temporary increase in the ULC for the total economy in the last quarter of 2013 is due to the impact of the settlement of wage disparities in the general government sector in the amount of almost 200 mio EUR.

many, Italy, Austria, France and Croatia, although exporters have a significant presence in at least 15 other markets, an indication of the significant geographical diversification of exports, with Switzerland and the US growing in significance.

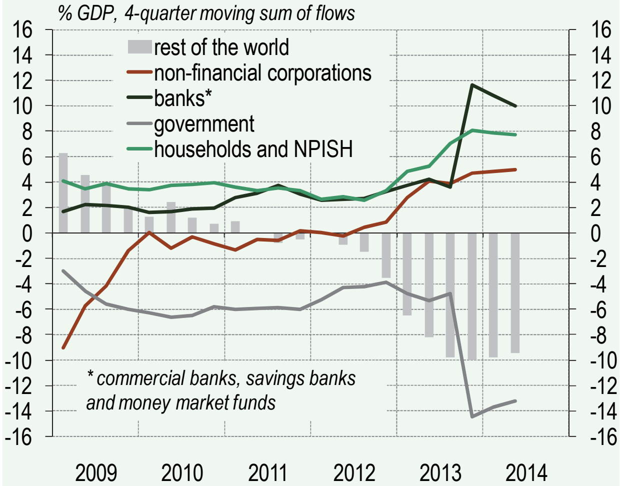
4 Financing

The improved macroeconomic situation in the first half of 2014 contributed to a slight increase in household consumption and the gradual boosting of corporate investment, although the sector's financial surplus nevertheless remains high. Corporates are continuing to reduce their liabilities to domestic banks, which in the first half of the year were more than compensated for by issues of commercial paper and bonds and by borrowing via loans from the rest of the world. The measures to stabilise the banking system restored confidence in the system, which sharply reduced sovereign borrowing costs. At the same time part of the private sector's large financial surplus began flowing into the domestic banks again in the form of deposits.

Savings-investment gap by sector

The improved domestic economic situation has already been reflected in the private sector's financial accounts, and is being evidenced in the stabilisation of its savings-investment gap. The one-year savings-investment (financial) surplus[6] against the rest of the world stood at 9.4% of GDP at the end of the second quarter of 2014, having diminished slightly relative to the end of 2013. Corporates[7] are increasing their retained earnings, and despite the weak growth in investment are increasing their financial surplus, albeit significantly more slowly than in 2013.[8] It amounted to 5% of GDP at the end of the second quarter of 2014. The household sector's financial surplus declined slightly in the first half of the year. It had strengthened sharply in 2013, largely as a result of the fall in consumption in the wake of further deleveraging and the corresponding increase in household saving. In the first half of 2014, the situation on the labour market improved notably, households slightly increased their consumption, causing a decline of their

Figure 4.1: Savings-investment gap



Source: Bank of Slovenia - consolidated financial accounts, SORS.

[6] The savings-investment surplus is defined as the surplus of financial assets (savings) over financial liabilities (investments).
[7] Corporates or non-financial corporations (S.11) are market producers whose core business activity is the production of marketable goods and non-financial services.
[8] The transfer of bank loans to the Bank Asset Management Company (BAMC) in the final quarter of 2013 reduced corporate debt by EUR 2.2 billion.

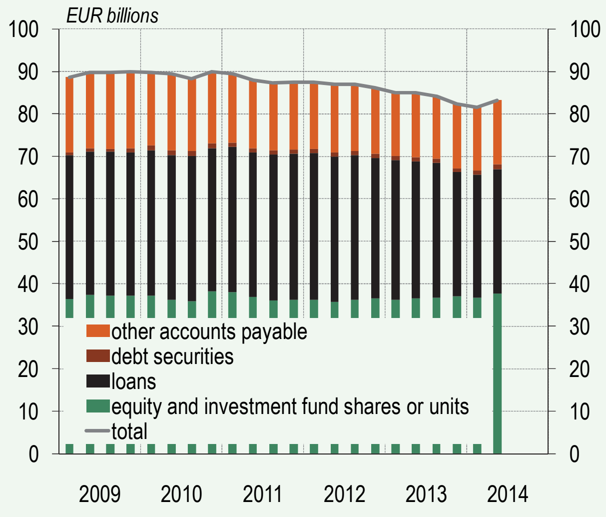
financial surplus to 7.7% of GDP. As a result of government capital transfers designed to stabilise the banking system, financial corporations sharply increased their financial surplus towards the end of 2013, but have nevertheless continued to deleverage and to reduce loans to the private sector. The capital transfers to the banking system sharply increased the government sector's financial deficit, although the stabilisation of the banking system brought a sharp fall in the yields on Slovenian bonds and a pronounced reduction in government borrowing costs.

Corporate financing and financial assets

Corporate financial assets amounted to EUR 43 billion at the end of the first half of 2014, up EUR 0.5 billion on the end of 2013. This was the first significant increase in financial assets since 2009. Corporates recorded the largest increase in their investments in trade credits and advances, which were up EUR 0.5 billion, primarily those granted to the rest of the world. Loans to the rest of the world also increased, but to a lesser extent. In the wake of a gradual increase in retained earnings, corporates further increased their financial surplus, causing increased investments in sight deposits at banks by EUR 0.4 billion. Other claims against the government sector also increased by EUR 0.4 billion, which was partly attributable to increased investment by local government and prepayments for mobile networks. Despite an increase of EUR 1.5 billion in investments via transactions, negative revaluations of shares and other equity reduced corporate financial assets by just over EUR 1 billion.

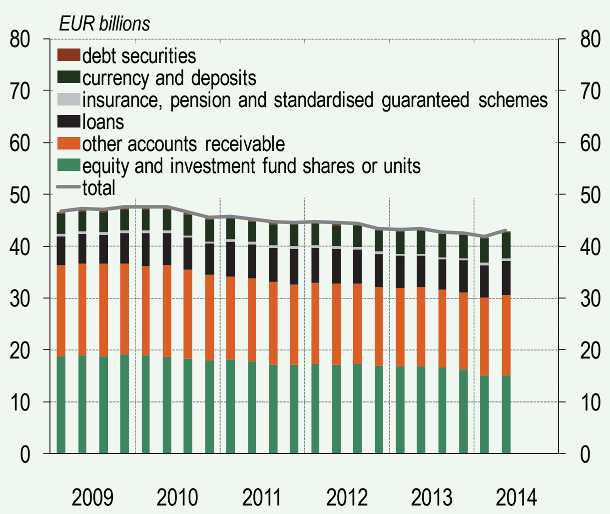
Corporate financial liabilities increased by EUR 0.9 billion in the first half of 2014 to EUR 83.3 billion. This was the first significant increase in

Figure 4.3: Financial liabilities of NFCs (S.11)



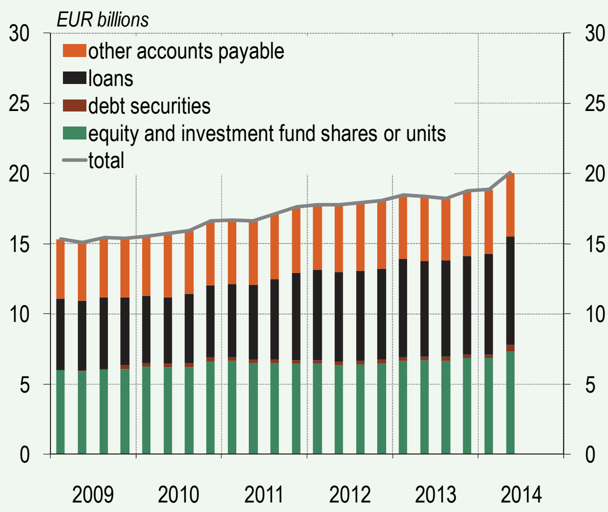
Source: Bank of Slovenia, non-consolidated data.

Figure 4.2: Financial assets of NFCs (S.11)



Source: Bank of Slovenia, non-consolidated data.

Figure 4.4: Financial liabilities of NFCs (S.11) to rest of the world



Source: Bank of Slovenia, non-consolidated data.

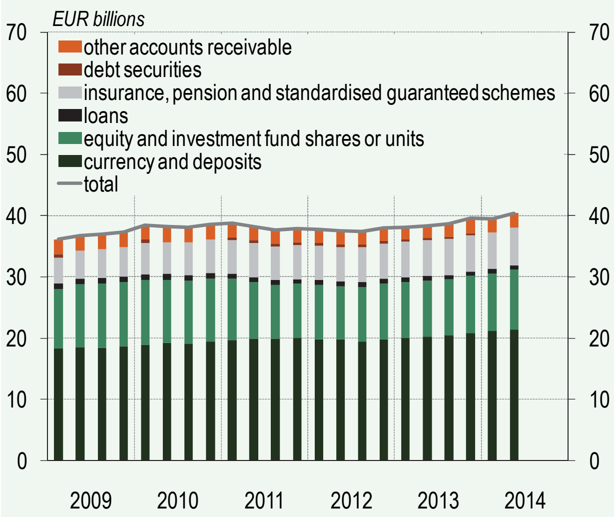
liabilities in the last three years. In the wake of a further decline in domestic financing, corporates increased the financing of their liabilities from the rest of the world, primarily by issuing securities (both equities and debt security), in the amount of EUR 680 million in the first half of 2014. A minority of the debt securities[9] were sold to residents. As domestic bank financing has dried up, loans from the rest of the world are accounting for an increasing proportion of financing. The proportion of total corporate loans that were successfully obtained in the rest of the world had reached 26% by mid-2014, up 5 percentage points on a year earlier. Corporates have continued to make debt repayments at domestic banks, in the amount of EUR 0.5 billion in the first half of the year, while increasing their business-to-business financing via loans by EUR 0.25 billion. Liabilities from trade credits from the rest of the world and intra-sectoral trade credits declined by a total of EUR 0.2 billion.

Household financing and savings

Households increased their investments by EUR 1 billion in the first half of 2014 to EUR 40.7 billion. The increase in household assets is primarily a reflection of the fall in the unemployment rate and growth in the real wage bill, while growth in household consumption was relatively weak. Households invested the surplus in the first half of the year in currency, in the amount of EUR 0.2 billion in Slovenia and EUR 0.4 billion in the rest of the world, and in domestic bank deposits, in the amount of EUR 0.4 billion. The latter was a consequence of the restoration of confidence in the domestic banking system, which had been hit hard by the developments in Cyprus in 2013 and the uncertainty related to the rescue of the domestic banking system. By mid-2014 households had returned almost all of the deposits withdrawn in 2013 to the domestic banking system.

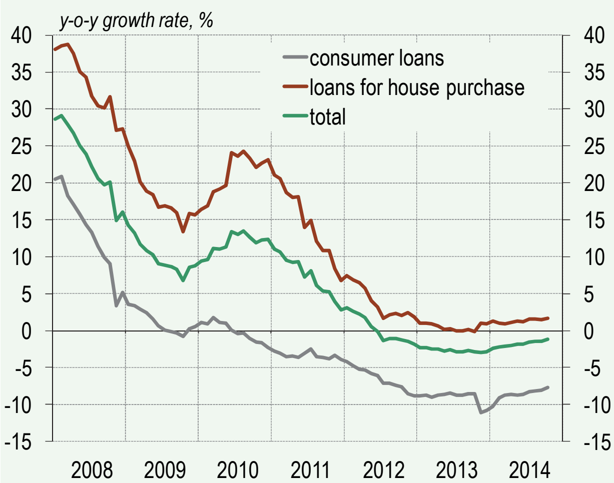
Slovenians households remain among the least indebted: their debt is half of the average household debt in the euro area. Household financial liabilities amounted to EUR 12.2 billion at the end of the second quarter of 2014, down EUR 0.1 billion on the end of 2013. This was a consequence of the net repayment of consumer loans. Consumer loans remained down 8% in year-on-year terms, while housing loans over the first ten months of the year recorded year-on-year growth of more than 1%.

Figure 4.5: Financial assets of households (S.14 and S.15)



Source: Bank of Slovenia, non-consolidated data.

Figure 4.6: Loans to households



Source: Bank of Slovenia.

[9] Corporates successfully issued just over EUR 400 million of commercial paper and bonds in the first half of 2014.

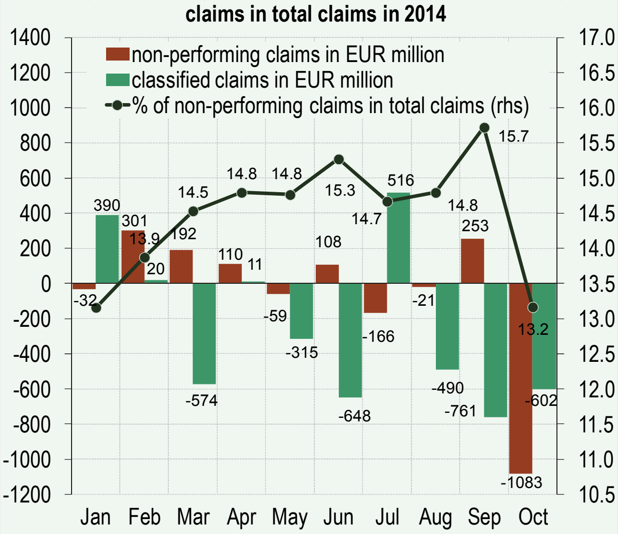
Box 4.1: Risks in the banking sector

The bank recovery and resolution process begun in 2013 has contributed to a significant reduction in risk in the banking system. In the wake of a pronounced improvement in capital adequacy and bank liquidity in December 2013, credit risk remains high and very significant, although the resolution of non-performing claims is stabilising the situation. There needs to be a focus on the banks' income risk, which is increasing in an environment of low interest rates, contracting balance sheets, aversion to the take-up of credit risk and increased corporate financing in the rest of the world and on the capital markets. Refinancing risk and macroeconomic risk are declining for the banks.

Credit risk remains high but is gradually stabilising. Non-performing claims (classified claims more than 90 days in arrears) rose during the first months of the year, but subsequently stabilised. The proportion of non-performing claims declined by 2.5 percentage points in October to 13.2% as a result of the transfer of claims from Abanka to the BAMC, although the figure fluctuated downwards even without the effect of the transfer. Non-performing claims also declined in absolute terms in 2014 in the corporate sector in particular, although the contraction in bank lending activity meant that this was not reflected in an improvement in the quality of the credit portfolio. A declining trend has been seen in accommodation and food service activities and in transportation since the beginning of 2014. The instability of non-performing claims and the upward fluctuations suggest that the risk of a further deterioration in the banks' credit portfolio remains high. The quality of the credit portfolio of non-residents is notably low: it was not subject to resolution via transfer to the BAMC, and is dependent on the economic recovery in the countries of the western Balkans in particular.

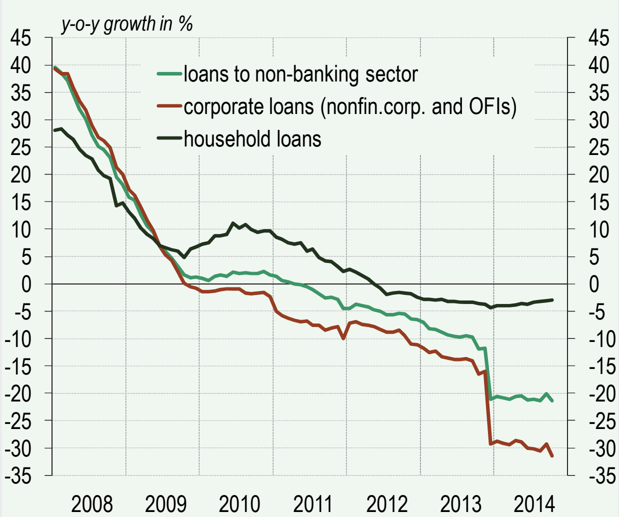
Activity in corporate restructuring and the adoption of measures to further reduce non-performing claims at the banks could significantly contribute to the management of credit risk. A recovery in economic activity could contribute to this process via an improvement in corporates' financial position, liquidity and operating results. Increased lending activity would contribute to an improvement in the quality of bank investments. However, the level of corporate indebtedness as measured by leverage is relatively high, while the maintenance of tightened credit standards is a significant limiting factor on new credit growth. The contraction in corporate loans stopped deepening in 2014, but nevertheless remains sharp. Corporate loans over the first ten months of the year were down 30% in year-on-year terms, or down 11% excluding the effects of measures to stabilise the banking system. The most recent survey figures (BLS) show that (estimated) corporate demand for loans increased in 2014 after a long period of decline, and that the banks' credit standards are not being tightened further, which is increasing the likelihood that the contraction in loans to non-financial corporations will be-

Figure 1: Change in stock and share of non-performing claims in total claims in 2014



Source: Bank of Slovenia.

Figure 2: Loans to non-banking sector



Source: Bank of Slovenia.

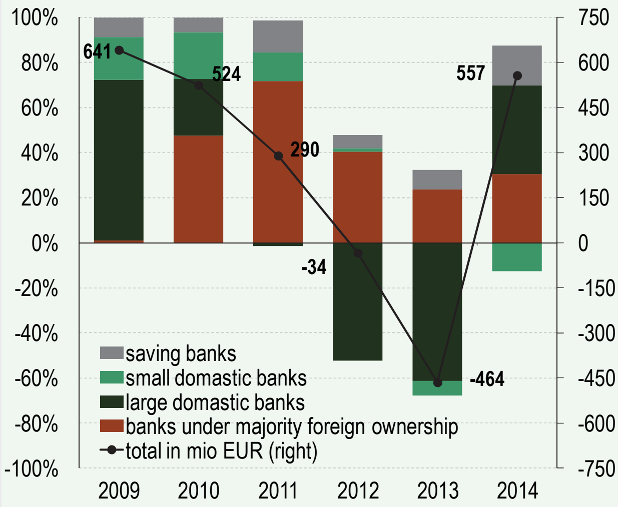
gin to slow in the upcoming period. Growth in consumer loans to households remains negative, growth in housing loans stands at just 1.3%. Loans to households remain the lowest-risk segment of the banks' credit portfolio and, in the context of rising consumer confidence, represent a potential source for improving the quality of the banks' overall credit portfolio.

Income risk is rising. Given the high realisation of credit risk, there is a high likelihood of the additional creation of impairments and provisions, and consequently a rise in income risk at the banks. Income risk is on the rise, despite an improvement in performance and an increase in the net interest margin. Although the banks' net interest income was up 11% in year-on-year terms over the first ten months of the year, interest income has been adversely affected by the contraction in loans. An environment of low interest rates and the question of whether the banks will be able to generate sufficient income to cover operating costs and impairment costs are placing additional pressure on the banks' income risk. The effect of cuts in reference interest rates is passed through primarily into the banks' deposit rates, while lending rates on new transactions are declining very slowly. The retention of high difference over average euro area interest rates is encouraging creditworthy customers to seek financing in the rest of the world, and could result in the loss of a source of bank income over the longer term.

The risk aversion policy is redirecting the banks towards less risky, but less profitable investments. The proportion of the banks' total assets accounted for by securities had risen to 24% by October 2014. The banks' greater focus on government bonds is additionally increasing income risk on account of potential sovereign downgradings or a renewed loss of confidence on the international financial markets in the more vulnerable countries of the euro area.

Refinancing risk declined in 2014 as debt repayments to the rest of the world were intensified. Most banks, particularly those under majority domestic ownership, have already repaid the majority of their debt raised on the wholesale markets. The restoration of confidence in the domestic banks has seen household deposits returning to the banking system. This positive development was particularly notable at the large domestic banks, which in 2013 had seen the largest fall in savers' confidence and decline in household deposits. The

Figure 3: Change in stock of household deposits



Source: Bank of Slovenia. M1-10

banks will remain exposed to the risk of less-stable funding structure as a result of the projected low rates of growth in household deposits in the next two years.

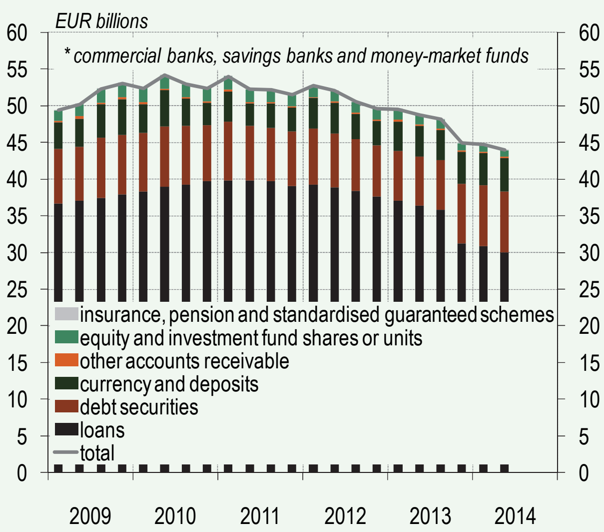
The expected moderate growth in wages in the context of a slight increase in household consumption, the fall in deposit rates and households' renewed interest in alternative forms of investment suggest that growth in deposits will be modest in the future. ECB policy suggests that its funding will remain a sufficient source of liquidity. However, the banks' perception regarding the sufficiency of creditworthy demand is not yet at the level where they would place such funding in corporate loans.

The strengthening of economic growth, largely as a result of the favourable dynamics in exports, and the improvement in the situation on the labour market have brought an improvement in the macroeconomic situation in Slovenia, while the banks are seeing a decline in macroeconomic risks. The risks to GDP growth nevertheless remain on the downside in 2015, as the economic growth forecasts for the main trading partners are being lowered, while the government's new fiscal consolidation measures could have an adverse impact on domestic consumption.

Bank financial assets and liabilities

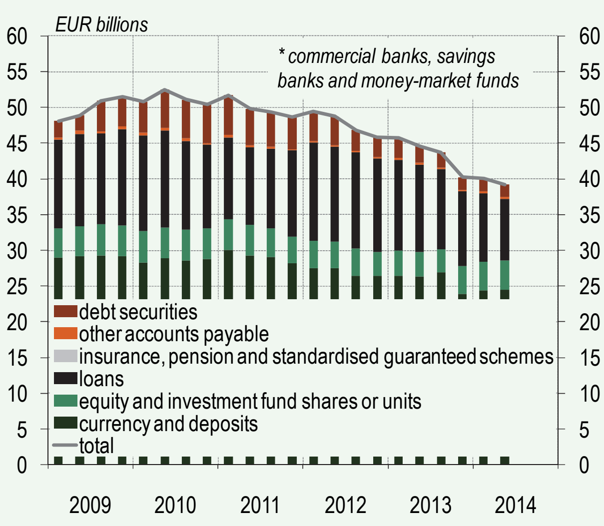
The financial assets of the banking sector[10] amounted to EUR 44 billion at the end of the first half of 2014, up EUR 1 billion on the end of 2013. This was the result of a decline in loans to all sectors: corporate loans were down EUR 0.5 billion, loans to Slovenian banks were down EUR 0.3 billion, household loans were down EUR 0.1 billion and loans to non-residents were down EUR 0.1 billion. The stock of investments in debt securities was unchanged at EUR 8.2 billion, although there was a change in their breakdown: the banks reduced their investments in government securities by EUR 0.4 billion over the first half of the year, and invested the proceeds in foreign debt securities. The sole bank assets to record an increase were deposits (by EUR 0.1 billion). This was primarily a structural effect: the banks reduced their balance at the central bank by EUR 0.9 billion, but invested EUR 1 billion in deposits at foreign banks.

Figure 4.7: Financial assets of banks* (S.122 and S.123)



Source: Bank of Slovenia, non-consolidated data.

Figure 4.8: Financial liabilities of banks* (S.122 and S.123)



Source: Bank of Slovenia, non-consolidated data.

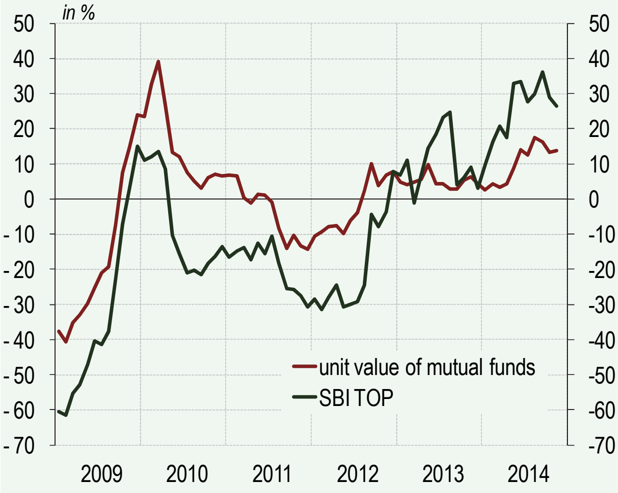
Bank financial liabilities declined by EUR 1 billion in the first half of the year to stand at EUR 39.2 billion at the end of the second quarter. Liabilities from loans recorded the largest declines: by EUR 1.5 billion to the central bank as a result of the repayment of the 3-year LTRO, by EUR 0.4 billion to the rest of the world (primarily debt repayments to foreign banks) and by EUR 0.3 billion to Slovenian banks. The increase was in loans from the government sector, which were up EUR 0.4 billion.[11] Deposits remain the most important source of bank funding, accounting for 62% of the total, of which household deposits account for 39% and corporate deposits for 12%. In addition to households, corporates also increased their deposits at banks, by EUR 0.4 billion and also deposits by the government sector increased by EUR 0.2 billion. Deposits by the central bank and by the rest of the world declined, by EUR 0.6 billion in total. The banks' equity amounted to EUR 4.1 billion at the end of the second quarter of 2014, down EUR 0.2 billion on the end of 2013.

Domestic capital market

After the confirmation of the new government and the continuation of the privatisation process, the situation on the domestic market stabilised, which had a positive impact on domestic stock exchange developments. The successful completion of the sale process for three of the 15 firms being sold by the SSH raised the volume of trading on the Ljubljana Stock Exchange. The

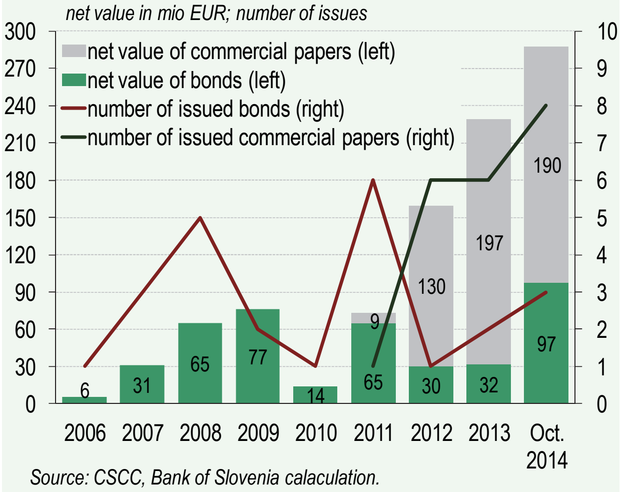
[10] Banks refers to the sector of other monetary financial institutions (S.122 + S.123), which comprises banks, savings banks and money-market funds.
[11] Calling of the government guarantee for Factor banka and Probanka.

Figure 4.9: Slovenian stock exchange indices



Source: Ljubljana Stock Exchange, Securities Market Agency, Bank of Slovenia calculations.

Figure 4.10: Issues of corporate* bonds and commercial papers



Source: CSCC, Bank of Slovenia calaculation.
Note: *It includes data that are consistent within the definition of non-financial companies in the Standard Classification of institutional sectors.

sale processes for a further seven of the firms listed for sale are now in progress. The share market thus remains relatively attractive to non-residents, largely because of privatisation. The largest net purchases of Slovenian shares in recent months (including November) were made by residents of Germany, Austria and Croatia. The largest net sales of shares were made by residents of the US. The proportion of the market capitalisation on the Ljubljana Stock Exchange accounted for by non-residents stood at 25.3% in November.

Thanks to the expansionary monetary policy adopted by the ECB last June, the required yields on government bonds of euro area countries are falling, as are the required yields on domestic corporate bonds. The increased expectation of further non-standard measures by the ECB brought an additional fall in the required yield on government bonds in October. The required yield on domestic corporate bonds also fell as a consequence, which is encouraging domestic firms to seek alternative sources of financing. The diversification of financing is having a significant impact on the stability of the entire system.

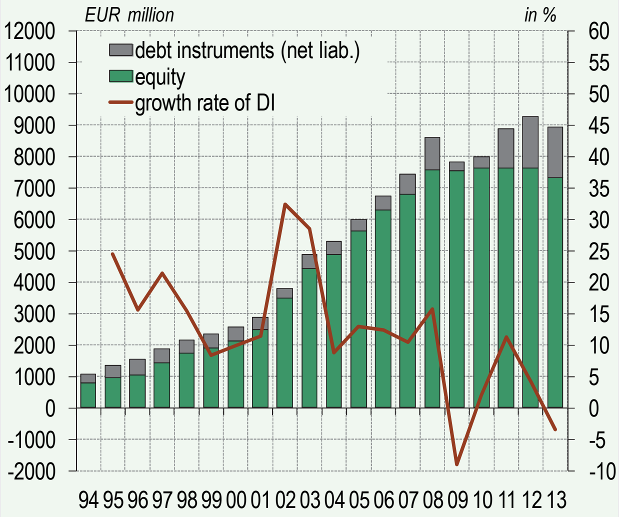
Box 4.2: Direct investment

The stock of inward FDI in Slovenia amounted to EUR 8.9 billion at the end of 2013, down 3.5% on the end of 2012. Foreign owners recorded their worst annual result to date at the aggregate level in 2013 (a loss of EUR 8.4 million), which was largely attributable to the financial and insurance activities sector. Foreign owners provided net financing to Slovenian firms throughout the 1994 to 2013 horizon. Debt instruments accounted for 18.8% of total FDI on average, the figure reaching 22.1% in 2013. The main holdings of inward FDI are those of Switzerland and EU Member States, most notably Austria, Italy, Germany and France, which invest by far the most in the sector of financial services except insurance and pension funding.

At the end of 2013 firms with FDI accounted for 4.5% of the entire population of Slovenian firms (excluding financial intermediaries). The most important sector was manufacturing, which in 2013 accounted for 12.1% of all firms with FDI and employed nearly half of all employees at firms with foreign capital.

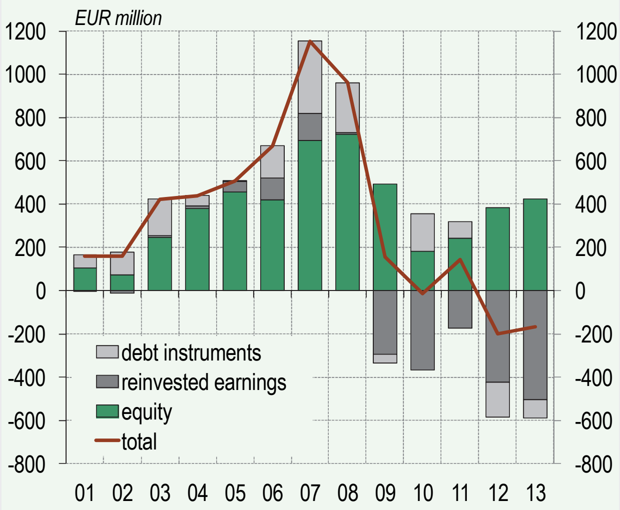
The stock of Slovenian outward FDI amounted to EUR 5.1 billion at the end of 2013, down almost 10% on the previous year. The main factor in this decline was the high losses recorded by affiliates. Firms in the rest of the world with Slovenian owners/co-owners have been generating a loss overall since 2009. The loss amounted to

Figure 1: Foreign direct investment in Slovenia - positions



Source: Bank of Slovenia.

Figure 2: Foreign direct investment in Slovenia - transactions



Source: Bank of Slovenia.

EUR 445.1 million in 2013, the highest figure to date. Equity accounts for three-quarters of outward FDI. The largest holdings of outward FDI at the end of 2013 were in the former Yugoslav republics, which accounted for 75.1% of the total. Service activities prevail in the division of outward FDI between production and services, accounting for 53.8% of the stock of Slovenia's outward FDI at the end of 2013.

By issuing commercial paper, firms are diversifying their short-term debt financing and balancing the fluctuations in their generation of free cash flow. Eight such instruments were issued during the first ten months of the year, with a total nominal value of EUR 190 million. Four firms not listed on the stock exchange also opted for such issuance. In 2013 there was only one such firm, an indication that lower required yields are making commercial paper an increasingly recognised source of short-term financing. There was also a positive response from firms that issued bonds. Three firms issued bonds on the domestic market during the first ten months of the year, the largest issue accounting for 75% of the total nominal value. A non-financial corporation had a successful bond issue on the foreign market for the first time in four years; the 5-year bonds were issued at a fixed coupon rate of 3.25%. Corporate bonds of the same maturity were issued on the domestic market at a fixed coupon rate of 3.85%.

5 Public Finances

According to the latest Ministry of Finance estimates from the end of December 2014, the general government deficit is expected to have amounted to 5.3% of GDP, or 3.4% of GDP excluding one-off effects in connection with bank recapitalisations and the repayment of old foreign currency deposits. This was higher than forecast in the most recent update of the Stability Programme. The figures available for the first three quarters of the year reveal growth in general government revenues as a result of measures implemented and the improved macroeconomic situation, while general government expenditure excluding recapitalisations increased only slightly less, government investment and interest payments having increased sharply. General government debt stood at 78.1% of GDP at the end of September 2014. The increase in debt was partly attributable to the pre-financing of upcoming debt repayments, in addition to the financing of the deficit. Security issues in 2014 were undertaken at significantly lower interest rates.

Slovenia is planning to cut the deficit to less than 3% of GDP in 2015. The European Commission's assessment is that the government will eliminate the excessive deficit, but that the structural adjustment will be less than the requirements. The government is planning the majority of its deficit reduction measures on the expenditure side, although certain taxes have been raised. The largest saving is planned in the area of compensation of employees, which has not been secured in the planned amount by the agreement reached with the public sector unions, for which reason additional measures will be required. Another expenditure item to be curbed is intermediate consumption. Revenue-side measures encompass a rise in tax on financial and insurance services, the maintenance of the 50% bracket for personal income tax in 2015, higher environmental taxes, and further measures to curb the grey economy. The taxation of student work will also be higher.

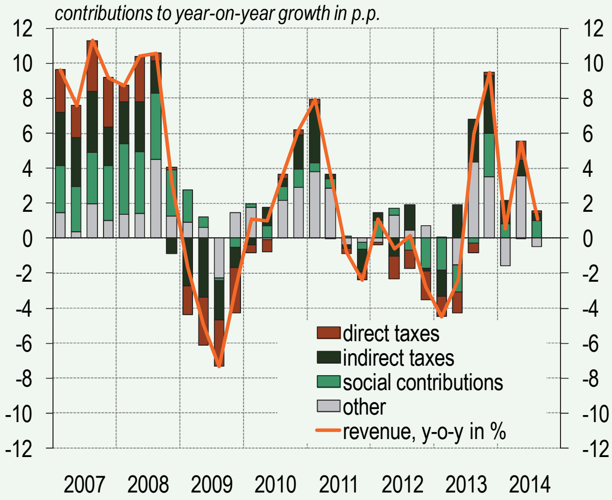
The main challenges in the fiscal area are the implementation of the planned fiscal consolidation and the reduction of the high general government debt. The risks are related to the macroeconomic environment and the potential impact of measures of a one-off nature on fiscal aggregates.

General government deficit

The general government deficit excluding the support for financial institutions and other one-off effects is expected to have amounted to around 3.5% of GDP in 2014 according to the latest estimates. In the Draft budgetary plan for 2015,[12] the Ministry of Finance is forecasting a general government deficit of 4.4% of GDP, including expenditure on bank recapitalisation in the amount of 0.9% of GDP. In its most recent forecasts of November, the European Commission estimated the same figure for Slovenia's general government deficit. According to the latest Ministry of Finance estimates from the end of December 2014, the general government deficit including bank recapitalisation and the repayment of old foreign currency deposits is expected to have amounted to 5.3% of GDP. The deficit in Slovenia was thus larger than the euro area average in 2014 (which European Commission estimates put at 2.6% of GDP), while the general government debt is estimated to have increased to 82.2% of GDP, still significantly less than the euro area average (94.5% of GDP).

General government revenues over the first three quarters of the year increased as a result of higher tax rates and the improved economic situation. Rises in tax rates have recently been applied primarily to indirect taxes. VAT rates were raised in mid-2013, which was the main reason that VAT revenues over the first nine months of 2014 were up 6%. Levels of excise duties on alcohol and tobacco were up on the previous year, while excise duties on energy products were also up in year-on-year terms in the second half of the year in particular. While there were year-on-year increases in excise duty revenues on tobacco (1.1%) and alcohol (7.3%) over the first three quarters of the year, excise duty revenues on energy products declined (by 2.4%). The increase in revenues from direct taxes was attributable to the aboli-

Figure 5.1: General government revenue



Source: SORS, Bank of Slovenia calculations.

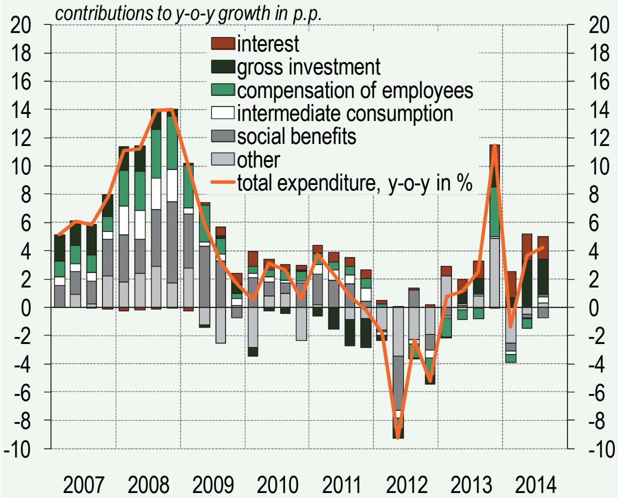
Table 5.1: General government deficit and debt in Slovenia 2011–2018

	SORS			Draft Budgetary Plan		Stability Programme					EC		
as % BDP	**2011**	**2012**	**2013**	**2014**	**2015**	**2014**	**2015**	**2016**	**2017**	**2018**	**2014**	**2015**	**2016**
Revenue	43.6	44.4	45.2	45.3	44.4	46.4	45.5	44.6	43.8	43.4	45.2	44.5	44.0
Expenditure	49.8	48.1	59.7	49.7	47.2	50.5	47.9	46.1	44.5	43.1	49.6	47.4	46.6
of which: interest	1.9	2.0	2.5	3.3	3.2	3.4	3.3	3.3	3.1	3.0	3.3	3.2	3.0
Net lending (+) / borrowing (-)	-6.2	-3.7	-14.6	-4.4	-2.8	-4.1	-2.4	-1.5	-0.7	0.3	-4.4	-2.9	-2.7
excl. support to fin. Institutions	-5.6	-3.6	-4.5	-3.5	-2.8	-3.2	-2.4	-1.5	-0.7	0.3	-3.5	-2.9	-2.7
Structural balance	…	…	…	-2.8	-2.4	-2.0	-1.5	-1.0	-0.7	-0.1	-2.5	-2.2	-2.8
Debt	46.2	53.4	70.4	82.2	83.2	80.9	81.1	76.0	72.5	70.4	82.2	82.9	80.6
Real GDP (growth, %)	0.6	-2.6	-1.0	2.0	1.6	0.5	0.7	1.3	1.7	1.7	2.4	1.7	2.5

Source: SORS (realisation), Ministry of Finance (April 2014), European Commission (EC, November 2014).

[12] The Ministry of Finance submitted the Draft budgetary plan for 2015 to the European Commission on 15 October 2014. During the adoption of the revised state budget for 2014, the Ministry of Finance stated that the revised budget was targeting a general government deficit of 4.3% of GDP.

Figure 5.2: General government expenditure (excluding support to financial institutions)



Source: SORS, Bank of Slovenia calculations.

tion of the automatic indexation of tax allowances and the net taxable base in the scale of personal income tax brackets, and the abolition of personal income tax allowances for those aged over 65. The improved economic situation was evident in the rise in revenues related to the labour market, which saw gradual growth in employment and average wages. As a result there was an increase in revenues from personal income tax (by 1.1%) and net social security contributions (by 1.8%) over the first nine months of the year, the latter partly as a result of the increased taxation of certain categories of health insurance contribution.

The increase in general government expenditure (after the exclusion of support for financial institutions) over the first three quarters of the year was a reflection of government investment activity and the rise in debt. The increased general government expenditure was the result of strengthened government investment activity, particular in local government, in connection with the use of EU funds. The high growth in interest payments was the result of the large increase in debt at the end of 2013 and in the first quarter of 2014. Other categories of expenditure mostly declined over the first nine months of the year. Compensation of employees was down 1.5% in year-on-year terms, as a result of measures adopted in the previous year, and employment also declined by 0.3%. Expenditure on social benefits and social transfers fell in 2014 for the third consecutive year; it was down 1.3% over the first three quarters of the year. Expenditure on intermediate consumption was up by 0.3% over the same period. Interest expenditure amounted to 3.3% of GDP in 2014 according to estimates. This means that the primary deficit, which also excludes expenditure on bank recapitalisations and other one-off effects, was minimal in 2014.

Bank recapitalisations again had an impact on the general government deficit in 2014, albeit significantly less than in the previous year. Two banks were recapitalised in the final quarter of 2014. The second tranche of the recapitalisation of Abanka in the amount of EUR 243 million was carried out in October, while December saw the recapitalisation of Banka Celje in the amount of EUR 190 million. A total of EUR 433 million was allocated to the two banks, equivalent to 1.2% of GDP. The banks also transferred non-performing claims to the BAMC. Bank recapitalisations accounted for the equivalent of 10.1% of GDP in the deficit in 2013.

General government debt and government guarantees

The general government debt amounted to 78.1% of GDP at the end of September 2014,and is expected to have risen to 82.2% of GDP by the end of the year, partly as a result of the pre-financing of bond repayments in 2015. The general government debt stood at EUR 28,933 million at the end of September, up EUR 3.5 billion on the end of 2013. The general government deficit over the first nine months of the year amounted to EUR 1,254 million. Borrowing in the aforementioned period was primarily undertaken via bond issues. There were bond issues of USD 3.5 billion (EUR 2.6 billion) in February, and EUR 2 billion in April. The largest repayment in the aforementioned period was the RS65 government bond, which matured in April in the amount of EUR 1.5 billion. The treasury issued a 7.5-year

Box 5.1: Public finance developments according to cash flow methodology, January to October 2014

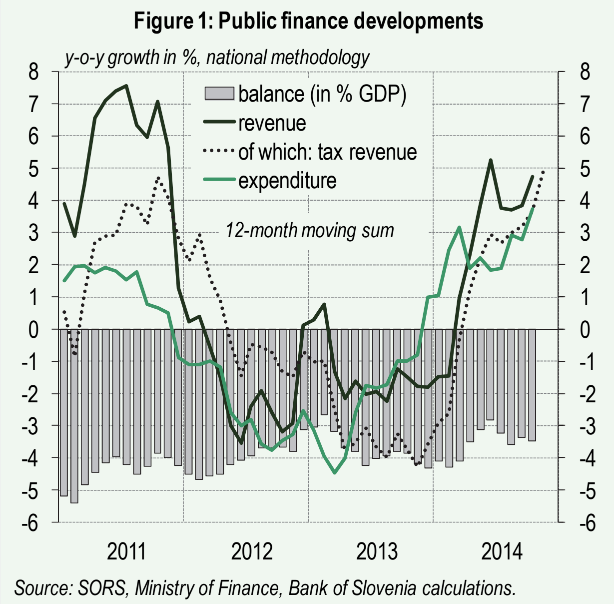
The consolidated general government deficit during the first ten months of 2014 narrowed by EUR 267 million in year-on-year terms. The main year-on-year improvement in the position was in the second quarter, as a result of improved corporate income tax settlements and the payment of the concession fees for mobile telephony radio frequencies. Since July the deficit has been widening in year-on-year terms, primarily as a result of a large increase in investment expenditure and interest expenditure. The deficit is mostly arising in the state budget, where the improvement is also largest. The position is more favourable at the Health Insurance Institute on account of growth in revenues from social security contributions, while the local government position is less favourable on account of the large increase in investment expenditure.

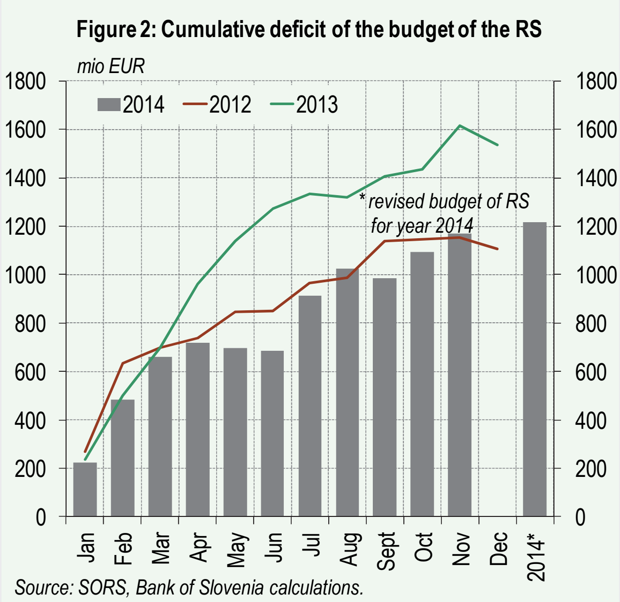
A deficit of EUR 1.2 billion was planned in the revised state budget for 2014, approximately EUR 300 million less than in the previous year. The National Assembly approved the revised state budget for 2014 on 19 November 2014. That the deficit is larger than originally planned (by EUR 200 million) is primarily a reflection of the underestimation of interest expenditure, while the transfer to the Pension and Disability Institute is also higher than planned, KAD having paid in no funds, in contrast to the original plans. There was also considerable change in the breakdown of revenues, in reflection of the replacement of real estate tax with certain other tax revenues and concession fees. The state budget recorded a deficit of EUR 1,169 million over the first eleven months of the year. The deficit in October was EUR 79 million wider in year-on-year terms, primarily as a result of increases in inter-

Table 1: Consolidated general government (GG) balance*

	2013	last 12 months to Oct.14			2013 Jan.-Oct.	2014 Jan.-Oct.	Jan.-Oct.14
	mio EUR		% BDP	medl. rast, %	mio EUR		medl. rast, %
Revenue	**14,728**	**15,410**	**41.5**	**4.7**	**11,923**	**12,605**	**5.7**
Tax revenue	12,648	13,123	35.3	3.7	10,385	10,859	4.6
- goods and services	5,027	5,201	14.0	5.6	4,134	4,307	4.2
- social security contributions	5,127	5,243	14.1	3.6	4,230	4,345	2.7
- personal income	1,868	1,906	5.1	-4.5	1,518	1,555	2.5
- corporate income	265	456	1.2	54.5	197	387	96.9
From EU budget	938	1,019	2.7	20.0	600	681	13.5
Other	1,141	1,268	3.4	5.1	939	1,066	13.5
Expenditure	**16,286**	**16,702**	**44.9**	**3.7**	**13,328**	**13,743**	**3.1**
Current expenditure	6,838	7,024	18.9	4.5	5,691	5,877	3.3
- wages and other personnel expenditure (incl. contributions)	3,617	3,625	9.8	0.9	3,001	3,010	0.3
- purchases of goods, services	2,239	2,201	5.9	-1.9	1,825	1,787	-2.1
- interest	840	1,090	2.9	42.4	759	1,009	33.0
Current transfers	7,671	7,601	20.5	-1.5	6,382	6,311	-1.1
- transfers to individuals and households	6,343	6,334	17.0	0.0	5,305	5,296	-0.2
Capital expenditure, transfers	1,351	1,691	4.6	35.6	876	1,215	38.8
To EU budget	425	386	1.0	-6.1	379	340	-10.4
GG surplus/deficit	**-1,558**	**-1,292**	**-3.5**		**-1,404**	**-1,138**	

Source: Ministry of Finance, Bank of Slovenia calculations.
*Note: * Consolidated central government budget, local government budgets and social security funds (pension and disability insurance fund and health insurance fund) in cash accounting principle.*





est and investment, although there was also an increase in revenues, particularly from EU funds. Alongside increased tax revenues, the latter were the main factor in the year-on-year narrowing of the deficit in November by EUR 106 million.

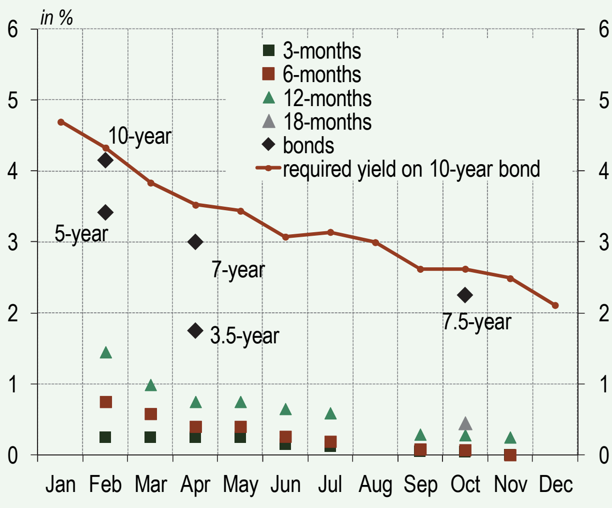
The available monthly figures indicate year-on-year growth in tax revenues in both October and November. According to the figures of the Public Payments Administration (report on allocated general government revenues and coverage), almost all classes of taxes were up in year-on-year terms in these two months. Growth was highest in corporate income tax and property tax, at around 20%, and in excise duties, at 5%; personal income tax and social security contributions were up around 3.5%. VAT revenues were down in year-on-year terms in October and November.

bond with a nominal value of EUR 1 billion in October. October also saw 18-month treasury bills mature in the amount of EUR 1 billion, and a new issue of 18-month treasury bills in the amount of close to EUR 0.5 billion.

Government guarantees amounted to 21.1% of GDP at the end of September 2014, and the level of guarantee calls was higher than usual. The stock of guarantees stood at EUR 7.8 billion at the end of 2014, approximately a third of which related to DARS. A total of EUR 432 million of guarantees were called in the first eleven months of the year, the majority (EUR 428 million) of which related to the orderly wind-down of Probanka and Factor banka.

Required yields and borrowing costs fell on bonds and treasury bills during 2014. The required yield on Slovenian 10-year government bonds averaged 2.6% over September and October. It fell to 2.5% in November and to 2.1% in December, thereby maintaining the falling

Figure 5.3: Interest rates on government bonds and T-bills and required yield on 10-year bond in 2014



Source: Ministry of Finance, Bloomberg, Bank of Slovenia calculations.

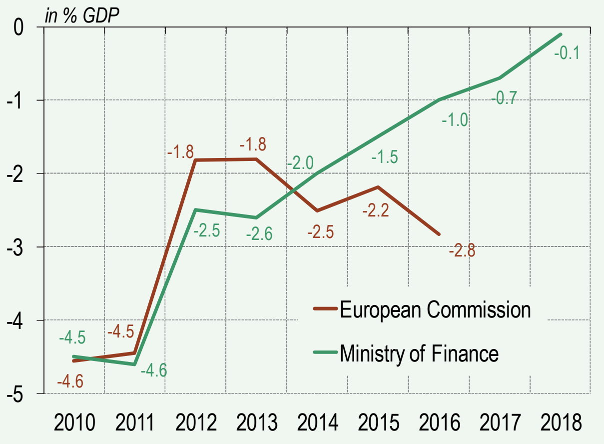
trend seen throughout 2014. The fall in yields began at the end of 2013, after the measures to stabilise the banking system had been taken. The ECB's policy of monetary stimulus also had a beneficial impact on the fall in yields on the government bonds of euro area countries, as in the recent period did the markets' expectations of the introduction of additional non-standard measures by the ECB. Interest rates on treasury bills also fell in 2014. In the last auction in November, the interest rate on issues of 3-month and 6-month treasury bills was zero, while the rate on the 12-month bills was 0.25%.

Planned developments in the general government deficit

In the Stability Programme Slovenia is planning the gradual reduction of the general government deficit and the attainment of structural balance. A deficit of less than 3% of GDP is forecast for 2015. According to the Draft budgetary plan for 2015, the general government deficit in Slovenia should fall to 2.8% of GDP in 2015. This is slightly more than the forecast in the most recent Stability Programme of April 2014, which envisaged the further reduction of the deficit in the coming years and the attainment of structural balance by 2017.

According to European Commission assessments, Slovenia's Draft budgetary plan for 2015 is broadly compliant with the recommendations made in the excessive deficit procedure. Slovenia is expected to reduce the general government deficit to below the reference value of 3% of GDP in 2015. However, in light of the forecast for the fiscal effort, as defined by the change in the structural position,[13] on which the recommendations are based, the target will not be attained. In the recommendation of 2013 Slovenia was instructed to make a fiscal effort of 0.7% of GDP in 2013, and 0.5% of GDP in both 2014 and 2015.[14]

Figure 5.4: Public finance structural balance



Note: Structural balance estimate by the MoF reflects targeted dynamics, while the EC estimate only includes adopted measures.
Source: EC, Ministry of Finance - Stability Programme, April 2014.

The principal measures to cut the deficit in 2015 are based on reductions in compensation of employee, intermediate consumption and certain other expenditure measures, while certain tax rises are also planned. It is evident from an addendum to the Draft budgetary plan for 2015 that the consolidation in 2015 is primarily to be undertaken via expenditure. The greatest savings are expected from the reductions in compensation of employees, and in intermediate consumption and subsidies. On 16 December 2014 the National Assembly approved the Act Regulating Measures in the Area of Wages and Other Labour Costs in the Public Sector for 2015, which is based on the agreement previously reached between the government and the public sector unions. It sets out the extension of the austerity measures applied in 2014 into 2015, and certain additional measures. The savings in the wage bill are estimated to

[13] The cyclically adjusted general government position reveals the position after the elimination of cyclical developments. The structural position is calculated by eliminating one-off effects and other temporary measures in addition to cyclical components.

[14] According to the latest European Commission forecasts and estimates, Slovenia's structural adjustment in 2013 was 0.0% of GDP, and is forecast at -0.4% of GDP overall in 2014 and 2015 (a deterioration of 0.7% of GDP in the structural position in 2014, and an improvement of 0.3% of GDP in 2015). The structural adjustment revised for changes in potential growth and for the effect of revenue windfalls/shortfalls stands at -1.1% in 2014 and 0.3% in 2015. The cumulative revised structural adjustment over 2013 to 2015 (a deterioration of 1.2% of GDP) was the opposite of that recommended (an improvement of 1.7% of GDP). The estimate under the bottom-up approach, which takes account of discretionary measures in revenues and developments in revenues under government control, shows the fiscal adjustment to be 1.5% of GDP short of the recommendation in 2013 and 2014, but higher in 2015 at 2.1% of GDP, compared with the recommendation of 1.5% of GDP.

be around EUR 90 million less than planned. The other measures planned include a reduction in the local government funding basis, and a reduction in expenditure on subsidies and intermediate consumption. The revenue side includes a rise in the tax on financial services and the tax on insurance services, while the 50% personal income tax bracket will remain in force. Environmental taxes were also raised, including the charge per unit of CO_2 emissions. Other planned revenue increases include higher taxation of student work, and further measures to curb the grey economy.

The government is continuing consultations for the adoption of a fiscal rule act. In May 2013 the National Assembly approved the inclusion of a balanced budget rule in the constitution, and the government is preparing a fiscal rule act. It has to be adopted with a two-thirds majority; adoption in the National Assembly is scheduled for February 2015.

The risks in the fiscal area are primarily related to the impact of one-off factors, the macroeconomic situation and the temporary nature of the measures adopted. In previous years measures to ensure the stability of the banking system brought a sharp increase in the general government deficit, and were the main factor in the high rise in debt. The planned bank recapitalisations were carried out by the end of 2014, with the exception of Gorenjska banka, which was given time until the end of the year to take action to strengthen its capital. In July 2014 the European Court of Human Rights gave Slovenia one year to find a systemic solution to the repayment of old foreign currency deposits, which had an impact on the deficit in 2014. The risks in connection with economic activity are related in part to the potential negative impact of the international environment and to the consolidation measures, while the relaxation of certain restrictions on expenditure is tied to GDP growth of more than 2.5%. Another risk is that a significant part of the consolidation is being undertaken via measures of a temporary nature (e.g. in the area of public sector wages, the temporary 50% bracket for personal income tax).

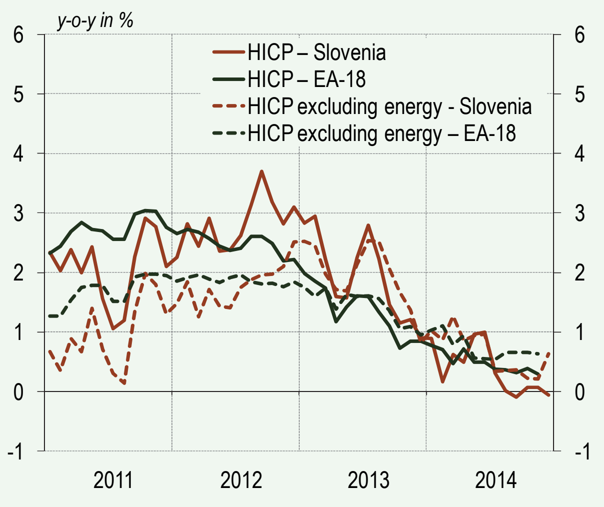
6 Inflation

Inflation dynamics in the last quarter of 2014 was primarily influenced by falling global commodity prices and the effects of past price increases. The annual inflation rate was zero, while the growth of food prices and services was counterbalanced by the fall in prices of industrial goods. Improved situation in the economy has not yet reflected on the inflation, since consumers due to large loss of purchasing power during crisis continues to behave cautiously and private consumption growth is very weak, while at the same time companies do not face price or cost pressures. This keeps core inflation in Slovenia low and below the euro area average. The average annual inflation rate as measured by the HICP was 0.4% in 2014, the lowest recorded level since the calculation of the indicator HICP.

Structure of inflation

Annual inflation as measured by the HICP averaged 0.4% in 2014, the lowest figure to date, and down 1.5 percentage points on the previous year. Food prices and energy prices made the largest contributions to the fall. After recording high growth in 2013, prices of unprocessed food fell sharply in 2014, and made the largest contribution to the fall in inflation. Despite a rise in excise duties on alcohol and tobacco, growth in prices of processed food slowed sharply in 2014 as a result of the policies of certain Slovenian retailers and the fall in food prices on the global market. Global oil prices were also a factor in the fall in prices of refined petroleum products, which brought a sharp fall in energy prices. The slightly reduced impact of fiscal and other administrative measures compared with 2013 brought a slight reduction in the contribution made to inflation by services prices. The average fall in prices of non-energy industrial goods remained almost unchanged.

Figure 6.1: Inflation

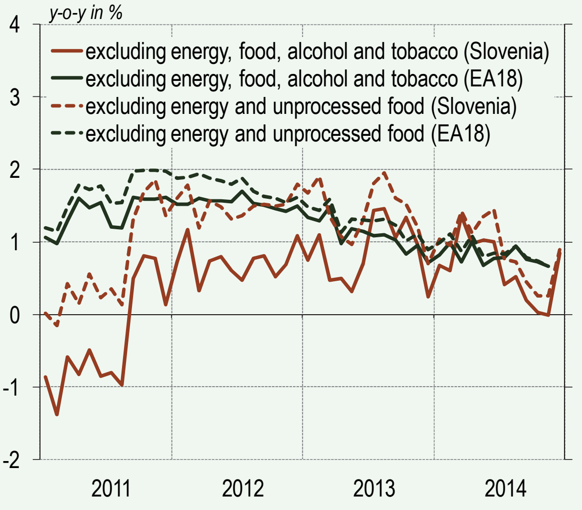


Source: Eurostat.

Macroeconomic factors and core inflation indicators

Core inflation fell again in the final quarter, despite a base effect, and remains below the euro area average. Core inflation as measured by the HICP excluding energy, food, alcohol and tobacco averaged 0.3% in the final quarter, down 0.1 percentage points on the previous quarter. Services prices were the main factor raising the year-on-year inflation in Slovenia, while prices of non-energy industrial goods acted to reduce it. This inflation indicator is 0.3 percentage points less than the euro area average.[15] The differences primarily derive from a greater loss of purchasing power and the cautious behaviour of domestic consumers, who despite the improvement in the situation on the labour market and the real increase in the wage bill have mostly not transferred this purchasing power into their final consumption. Year-on-year growth in the HICP excluding energy and unprocessed food also fell in the final quarter, but remains higher than the narrower indicator at 0.5%, primarily as a result of the rise in excise duties on alcohol and tobacco in the spring months. In contrast to the two aforementioned indicators, the broadest definition of core inflation as measured by the HICP excluding energy rose slightly, as a result of a rise in prices of unprocessed food in the final quarter.

Figure 6.2: Core inflation



Source: Eurostat, Bank of Slovenia calculations.

The positive macroeconomic turnaround is not being reflected in the core inflation indicators. The gradual recovery in purchasing power did not lead to a rise in final consumer prices, which remain significantly down on their pre-crisis level, as a result of which the recovery in private consumption is also weak. In addition, the core inflation indicators are reflecting changes in households' shopping habits. Lower prices of input commodities and the outpacing of wage growth by productivity growth also suggest the absence of price and cost pressures at firms.

Table 6.1: Breakdown of the HICP and price indicators

y-o-y in %	utež	quarterly average				*last 12 months average*		month		
		14Q1	14Q2	14Q3	14Q4	Dec.13	Dec.14	Oct.14	Nov.14	Dec.14
HICP	*100.0%*	0.6	0.8	0.1	0.0	1.9	0.4	0.1	0.1	-0.1
Breakdown of HICP:										
Energy	*14.7%*	-2.3	0.2	-1.5	-2.0	1.8	-1.4	-0.9	-0.7	-4.3
Food	*23.6%*	1.5	0.7	0.3	0.6	4.9	0.8	0.7	0.8	0.2
processed	*16.1%*	2.2	2.4	1.7	1.1	3.6	1.8	1.1	1.3	1.1
unprocessed	*7.5%*	0.1	-2.8	-2.6	-0.7	7.6	-1.5	-0.1	-0.2	-1.7
Other goods	*26.4%*	-0.5	-0.6	-1.3	-1.4	-0.9	-1.0	-1.7	-1.4	-1.1
Services	*35.2%*	1.9	2.3	1.5	1.5	2.2	1.8	1.3	1.1	2.2
Core inflation indicators:										
HICP excl. energy	*85.3%*	1.1	0.9	0.3	0.4	1.9	0.7	0.2	0.2	0.6
HICP excl. energy and unprocessed food	*77.8%*	1.1	1.3	0.6	0.5	1.4	0.9	0.3	0.3	0.9
HICP excl. energy, food, alcohol and tobacco	*61.7%*	0.9	1.0	0.4	0.3	0.9	0.6	0.0	0.0	0.8

Source: SORS, Eurostat, Bank of Slovenia calculations.

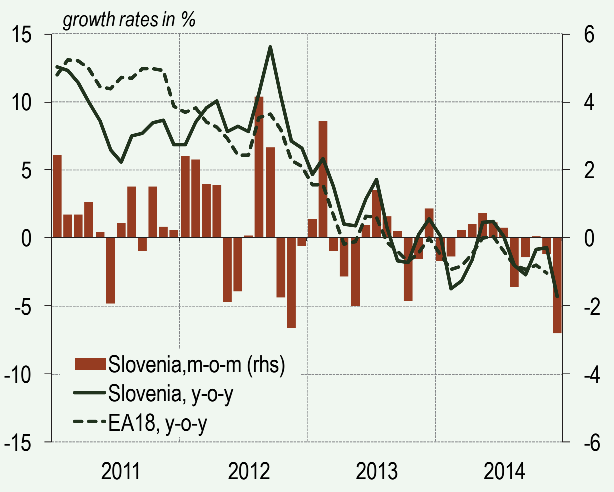
[15] In the analysis of the inflation for the euro area the fourth quarter of 2014 includes only data for October and November due to the data unavailability.

Due to the absence of supply-side and demand-side pressures core inflation remains low.

Microeconomic factors and the structure of inflation

The sharp fall in oil prices on global markets sharply reduced energy prices in the final quarter of 2014, despite the fall in the euro and the rise in excise duties. The overall fall in energy prices in the final quarter of 2014 stood at 2.0% in year-on-year terms, 0.5 percentage points more than in the third quarter. US dollar oil prices on global markets fell by approximately 45% between June and December. This fall did not fully pass through into final prices of Slovenian refined petroleum products, as it was mitigated in the final quarter by the fall in the euro and a rise in excise duties for the needs of fiscal consolidation. Refined petroleum products accounted for 0.3 percentage points of the fall in inflation in the final quarter. Gas prices were down in year-on-year terms over the same period, and prices of solid fuels continued to fall. By contrast, heat energy prices rose slightly in year-on-year terms, while the fall in electricity prices slowed. Energy prices across the euro area fell more than in Slovenia in the final quarter, by 2.3%.

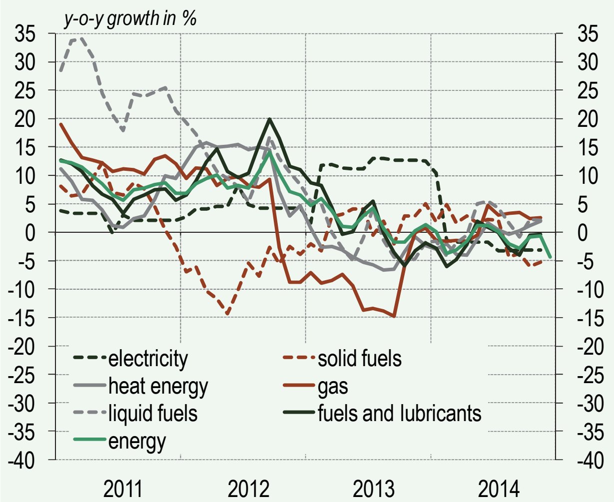
Figure 6.3: Energy prices



Source: Eurostat, Bank of Slovenia calculations.

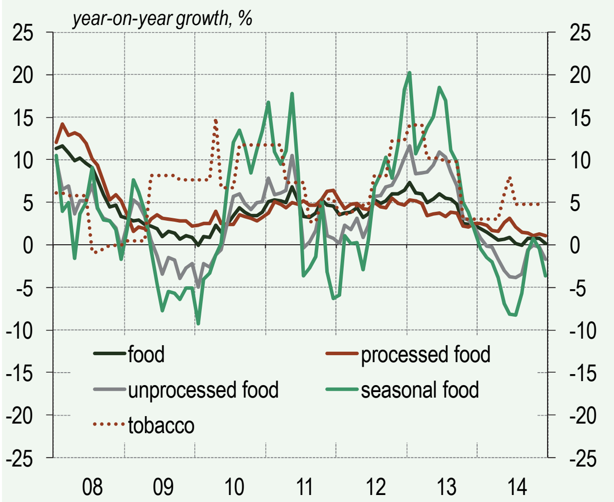
Growth in food prices remained relatively low in the final quarter. Overall growth in food prices slowed in 2014 as a result of a sharp fall in prices of unprocessed food in the second and third quarters. They fell by 0.7% in the final quarter, 1.9 percentage points less than in the third quarter. This was largely attributable to a sharp rise in fruit prices. The slowdown in growth in prices of processed food continued in the final quarter, in line with the year-on-year fall in food prices on global markets. The year-on-year rate of growth was down 0.6 percentage points on the third quarter at 1.1%; prices of processed

Figure 6.4: Individual energy price categories



Source: Eurostat, Bank of Slovenia calculations.

Figure 6.5: Food prices



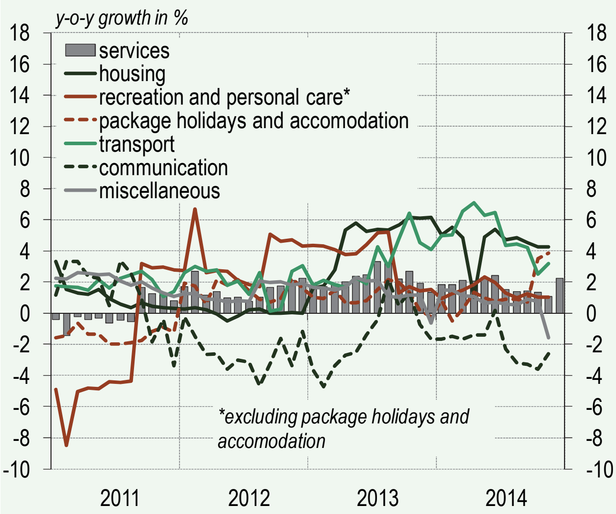
Sources: Eurostat, Bank of Slovenia calculations.

food would have remained unchanged had it not been for the rise in excise duties on alcoholic beverages and tobacco. Overall growth in food prices across the euro area was lower in the final quarter, at 0.3%.

Average year-on-year growth in services prices in the final quarter was primarily subject to one-off factors, and was unchanged from the third quarter. Year-on-year growth in services prices slowed in the second half of the year, to average 1.4% in the final quarter. Rises in the prices of certain services in the first half of the year were followed by a slowdown or price falls in the second half of the year, most notably in prices in passenger air transport, and prices of car insurance and municipal services. Prices of certain marketable services, such as telecommunications and internet services and accommodation and food services, fell further. There were also two notable one-off effects in the final quarter from the temporary reduction in health insurance premiums: a fall in November 2014, and a base effect from the reduction in December 2013. The trend of slowing services prices was also seen across the euro area, where year-on-year growth stood at 1.0% in the final quarter.

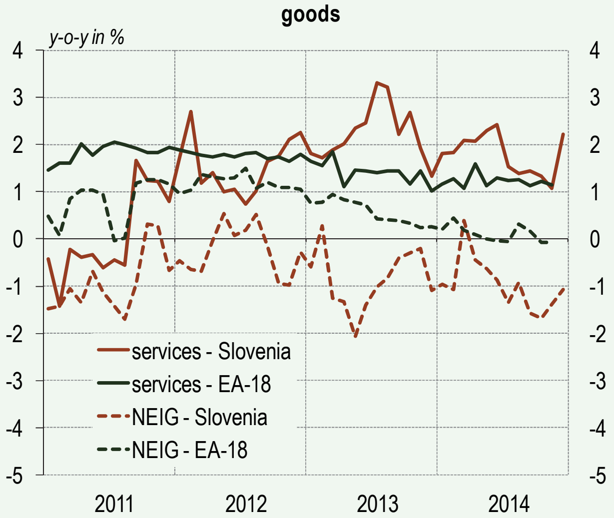
The recovery in economic activity and favourable developments on the labour market have not yet been reflected in prices of non-energy industrial goods, which are still falling. The fall accelerated by a further 0.1 percentage points to average 1.4% over the final quarter. This was largely attributable to a sharper fall in prices of clothing and footwear in the final months of the year. Prices of clothing and footwear in the final quarter were down 2.4% in year-on-year terms, having remained unchanged in the previous quarter. In addition, while it had seemed as though the long fall in car prices had come to an end in the second quarter, there were further falls in car prices in the third quarter, the fall deepening in the final quarter. Prices of household equipment

Figure 6.7: Prices of categories of services



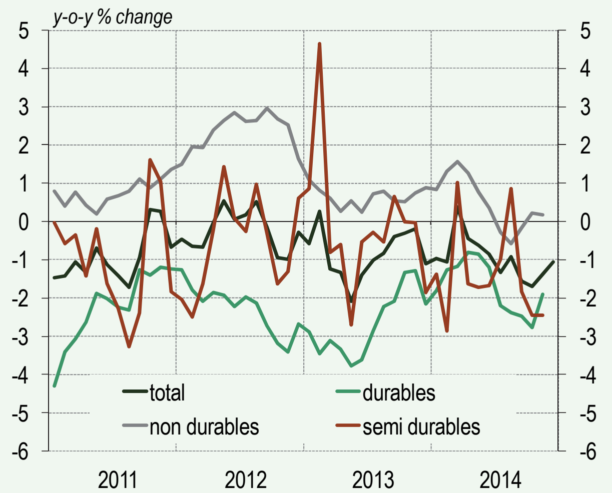
Source: Eurostat.

Figure 6.6: Prices of services and non-energy industrial goods



Source: Eurostat, SORS, Bank of Slovenia calculations.

Figure 6.8: Prices of non-energy industrial goods



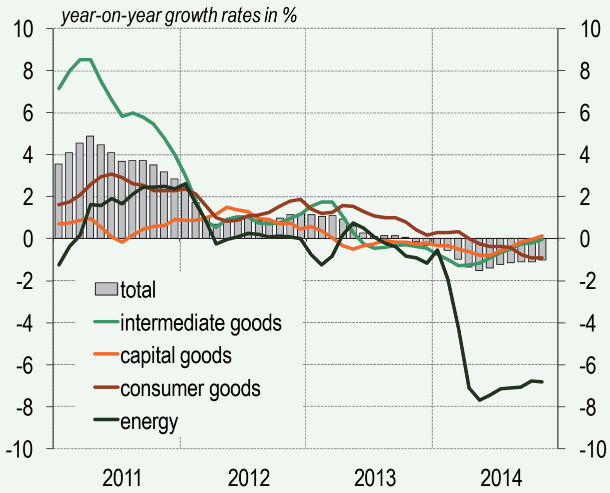
Source: Eurostat.

are also still falling, although the fall was slightly less than in the previous quarter. By contrast, prices of sports equipment rose sharply in year-on-year terms in the final quarter. They had fallen at a rate around 15% for the majority of the year, but were up 17.4% in December.

Industrial producer prices

The year-on-year fall in industrial producer prices on the domestic market began slowly to ease. It averaged 1.1% over the third quarter, 0.3 percentage points less than in the previous quarter. The fall in prices also slowed very gradually in October and November. The largest factor was the stabilisation of intermediate goods prices, where in September prices in the production of basic metals recorded their first rise since December 2011, growth continuing in the next two months. The year-on-year fall in prices in the manufacture of computer, electronic and optical equipment also slowed. Prices of capital goods rose slightly in October and November, after a long period of falls. The fall in energy prices has also eased slightly in recent months, as a result of the further strengthening of year-on-year growth in water supply prices. By contrast, prices in the manufacture of paper and printing began to fall, and prices in the manufacture of chemicals and chemical products also moved into the negative zone. Prices in the production of consumer goods fell slightly more sharply at the same time. In the group consumer non-durables goods, prices in the manufacture of pharmaceutical products fell more sharply, while prices in the manufacture of chemicals and chemical products began to fall. In the group consumer durables goods, prices in the manufacture of furniture and prices in other manufacturing fell.

Figure 6.9: Producer prices on domestic market



Source: SORS, Bank of Slovenia calculations.