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Executive Summary

Economic growth in the euro area strengthened slightly in the first quarter, and the situation on the labour market also improved. The figures available for the second quarter indicate for the moment that growth has remained moderate at best. Consumer confidence declined in the second quarter, while the economic sentiment indicators were stable, although growth in industrial production weakened in April. The latest forecasts for the euro area suggest a continuation of moderate growth, while the expectations for certain major global economies have actually been reduced slightly.

Economic growth in Slovenia strengthened again in the first quarter, significantly outpacing overall growth in the euro area. In line with the increased confidence, the situation is improving in an increasing number of segments of the private sector, which is gradually raising turnover on the domestic market. This relates in particular to transactions within the corporate sector, as domestic final consumption remains relatively weak, and growth is limited to consumer durables, mostly from imports. The recovery in domestic consumption, which is being constrained by the situation on the labour market and restrictive fiscal policy, remains well behind the overall recovery in the euro area. Slovenia's above-average growth is primarily being driven by faster growth in export-oriented industrial production, which is based on a relatively low number of sectors. According to the available figures for activity and confidence, economic growth is expected to slow slightly in the second quarter.

Developments on the labour market remained positive in the first quarter and April, as employment rose and registered unemployment fell. Total employment increased further, which on this occasion was primarily attributable to expansions in wholesale and retail trade and in manufacturing, while employment remained unchanged in the construction sector after five years of decline. Uncertain forms of employment remain prevalent (the proportion that they account for actually increased), and in the future employment is primarily expected to rise on account of work via employment agencies. Firms are mainly forecasting increased employment of manual labourers, which remains likely to lead to merely minimal wage growth, which for the moment remains significantly behind growth in economic activity.

The current account surplus remained high over the first four months of the year, although its structure altered slightly. Last year's very large surplus in merchandise trade narrowed slightly as a result of lower export growth, which alongside the slowdown in car exports was also attributable to the contraction in the Ukrainian and Russian markets. However, exports of services have strengthened sharply this year. The main increase was in exports of travel services, as a result of an improvement in the ratio of the number of overnight stays to the number of arrivals by foreign visitors. After last year's widening the deficit in primary income narrowed slightly, as a result of smaller outflows of dividends and improved terms for government refinancing. The deficit in secondary income remained stable.

The gradual improvement in the macroeconomic situation is bringing an improvement in financing conditions. Saving outstripped investment in all non-government sectors last year, and was significantly larger than government sector's deficit, while the surplus with the rest of the world amounted to 10% of GDP. The corporate sector primarily directed its surplus into debt repayments, while households focused on saving and on increasing bank deposits.

This is an indication of the restoration of confidence in the banks, which last year improved their funding structure, thereby reducing systemic risks. The banks have maintained high credit standards on corporate loans, but access to loans has improved with this year's sharp falls in lending rates.

The government's main objective for this year in the fiscal realm is the sustainable elimination of the excess general government deficit, thereby moving Slovenia to the preventive arm of the Stability and Growth Pact. The general government deficit is forecast to narrow to 2.9% of GDP this year. The available figures for developments in the first half of the year suggest for the moment that the plans are feasible, although precise monitoring and prompt action in the event of deviations will be required. General government revenues according to the ESA 2010 recorded faster year-on-year growth in the first quarter than did expenditure. Expenditure on interest increased again, but significantly less than in previous quarters, while investment was similar to that recorded a year earlier. According to the figures based on cash flows, revenues from taxes and social security contributions during the first five months of the year were up approximately 4% in year-on-year terms. Hedging of currency risk was the sole factor raising the general government debt in the first quarter, which stood at 81.9% of GDP. Attention in the coming months will focus on measures to reduce the general government deficit in 2016. In this year's update to the Stability Programme the government announced the replacement of short-term measures with longer-term or structural measures.

Price developments remain under the influence of low global commodity prices and the constraints of the domestic market. Deflation in the second quarter deepened relative to the first quarter, reaching a new low: year-on-year growth in the harmonised index of consumer prices was down 0.3 percentage points at -0.8%. By contrast, average inflation in the euro area has already re-entered positive territory, albeit at low levels. The gap is largely attributable to domestic demand, which is recovering more slowly in Slovenia, while firms are also not subject to cost pressures. The majority of the core inflation indicators also moved into negative territory in the second quarter in the wake of the significant negative contribution made by energy prices.

Main macroeconomic indicators

	2012	2013	2014	14Q3	14Q4	15Q1	2012	2013	2014	14Q3	14Q4	15Q1
	Slovenia						*euro area*					
Economic developments	*y-o-y growth rates in %*											
GDP	-2,6	-1,0	2,6	3,2	2,4	2,9	-0,8	-0,4	0,8	0,8	0,9	1,1
- industry	-2,3	-0,1	4,3	4,8	5,1	5,9	-0,5	-0,5	0,4	0,5	0,2	0,8
- construction	-7,5	-8,8	10,9	10,3	-0,7	-1,7	-5,9	-2,9	-0,7	-1,8	-1,2	-1,3
- mainly public sector services	1,3	-0,5	0,8	0,6	1,2	0,4	0,2	0,0	0,7	0,7	0,5	0,6
- mainly private sector services	-2,9	-0,6	3,6	4,2	3,6	3,3	-0,8	-0,3	0,9	0,9	0,9	1,2
Domestic expenditure	-5,7	-2,1	0,8	1,8	-1,6	2,6	-2,3	-0,7	0,9	0,6	0,8	1,4
- general government	-1,5	-1,1	-0,5	-0,4	1,2	-0,5	-0,1	0,2	0,6	0,7	0,7	1,4
- households and NPISH	-3,0	-3,9	0,3	0,3	-0,8	0,4	-1,3	-0,6	1,0	1,0	1,4	1,8
- gross capital formation	-16,5	2,2	3,6	7,8	-7,0	11,8	-7,1	-2,0	0,8	-0,8	-0,6	0,2
- gross fixed capital formation	-8,9	1,9	4,8	8,1	-0,9	-0,8	-3,7	-2,4	1,2	0,6	0,7	1,0
- inventories and valuables, contr. to GDP growth in pp	-1,8	0,1	-0,3	0,0	-1,2	2,5	-0,8	0,1	-0,1	-0,3	-0,3	-0,1
Labour market												
Employment	-0,8	-1,5	0,7	0,9	0,8	1,0	-0,5	-0,7	0,6	0,7	0,9	0,8
- mainly private sector services	-1,3	-1,7	0,7	1,0	0,9	1,1	-0,6	-0,9	0,5	0,7	0,9	0,9
- mainly public sector services	1,1	-0,6	0,3	0,4	0,3	0,4	-0,1	0,0	0,7	0,7	0,7	0,5
Labour costs per employee	-1,2	1,9	-0,2	1,1	-2,6	0,4	1,6	1,6	1,4	1,4	1,2	1,4
- mainly private sector services	-0,6	2,1	1,2	1,2	0,8	0,3	1,8	1,6	1,5	1,4	1,2	1,4
- mainly public sector services	-3,4	0,9	-4,4	1,9	-4,4	-3,8	0,9	1,7	1,3	1,3	1,1	1,5
Unit labour costs	0,3	0,9	-2,6	-1,6	-4,9	-1,5	1,7	1,2	1,1	1,2	1,3	1,2
- industry	3,3	0,8	-1,1	-1,6	-1,8	-3,7	1,8	1,7	1,8	1,7	2,0	1,4
	in %											
LFS unemployment rate	8,9	10,1	9,8	9,3	9,6	9,8	11,4	11,9	11,6	11,0	11,5	...
Foreign trade	*y-o-y growth rates in %*											
Current account balance as % of GDP	2,7	5,6	5,8	6,4	6,7	5,0	1,5	2,2	2,3	2,9	3,3	0,0
External trade balance as contr. to GDP growth in pp	2,9	1,0	1,9	1,5	4,0	0,5	1,4	0,4	0,0	0,2	0,1	-0,2
Real export of goods and services	0,3	2,6	6,3	6,8	8,4	5,4	2,7	2,0	3,8	4,3	4,4	3,7
Real import of goods and services	-3,9	1,4	4,1	5,3	3,3	5,4	-0,7	1,3	4,1	4,0	4,6	4,6
Financing	*in % of GDP*											
Banking system's balance sheet	141,0	128,0	116,8	120,9	116,8	114,7	322,9	298,2	299,5	300,8	299,5	309,8
Loans to NFCs	52,9	44,8	31,5	35,3	31,5	30,0	44,6	42,0	40,2	40,7	40,2	40,1
Loans to households	23,0	22,4	21,5	21,6	21,5	21,3	52,4	51,9	50,7	50,8	50,7	50,6
Inflation	*in %*											
HICP	2,8	1,9	0,4	0,1	0,0	-0,5	2,5	1,3	0,4	0,4	0,2	-0,3
HICP excl. energy, food, alcohol and tobacco	0,7	0,9	0,6	0,4	0,3	0,7	1,5	1,1	0,8	0,8	0,7	0,7
Public finance	*in % of GDP*											
Debt of the general government	53,7	70,3	80,9	77,7	80,9	81,9	89,1	90,9	92,0	92,1	92,0	...
One year net lending/net borrowing of the general government	-4,0	-14,9	-4,9	-12,8	-4,9	-4,6	-3,6	-2,9	-2,4	-2,4	-2,4	...
- interest payment	2,0	2,5	3,3	3,1	3,3	3,3	3,0	2,8	2,6	2,7	2,6	...
- primary deficit	-2,0	-12,4	-1,6	-9,7	-1,6	-1,3	-0,6	-0,1	0,2	0,3	0,2	...
- deficit excl. bank recapitalisations	-3,8	-4,8	-3,9	-4,3	-3,9	-3,7						
- primary deficit excl. bank recapitalisations	-1,8	-2,3	-0,7	-1,2	-0,7	-0,4						

Source: SORS, Eurostat, Bank of Slovenia, ECB, Ministry of Finance.

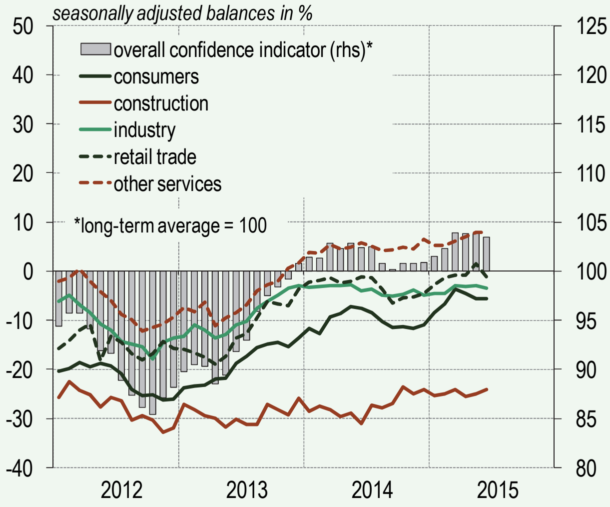
1 International Environment

Economic growth in the euro area strengthened slightly in the first quarter, and the situation on the labour market also improved. The figures available for the second quarter indicate for the moment that growth has remained moderate at best. Consumer confidence declined in the second quarter, while the economic sentiment indicators were stable, although growth in industrial production weakened in April. The latest forecasts for the euro area also suggest a continuation of moderate growth, while the expectations for certain other major global economies have actually been reduced slightly. The euro was stable against the US dollar at around USD 1.12 in June, while oil prices fell slightly.

Economic sentiment

Economic sentiment in the euro area was unchanged in the second quarter, while consumer confidence deteriorated despite a slight improvement in the situation on the labour market. Employment in the euro area in the first quarter was up 0.1% in quarterly terms and 0.8% in year-on-year terms. The harmonised unemployment rate continued to fall, reaching 11.1% in May, its lowest level of the last three years. Consumer confidence nevertheless declined in the second quarter. The rise in economic sentiment also came to an end at the beginning of the second quarter. Both indicators nevertheless remained above their long-term averages. The largest improvement in confidence was recorded by the service sector, while other sectors were unchanged.

Figure 1.1: Confidence indicators – euro area



Source: European Commission.

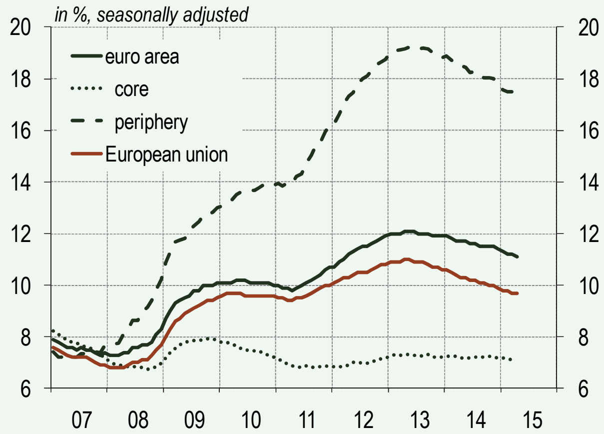
The aggregate PMI for the euro area rose in June to its highest level of the last four years. The rise in the composite PMI as measured by Markit, an analytical house, was attributable to an increase in activity in both, manufacturing and services. Strong growth in June saw the composite PMI rise more in the second quarter than in the first quarter, reaching its highest level of the last four years. The developments varied from country to country. While the rise in the index in France in the second quarter was the largest since 2011, the rise in the index in Germany in the second quarter was less than in the first quarter. Growth in new orders in the euro area slowed in June for the third consecutive month. Growth in employment also slowed slightly in June, but the composite index nevertheless indicates that average growth in new orders and employment in the second quarter was the highest of the last four years.

Economic activity and forecasts

Economic growth in the euro area strengthened slightly in the first quarter, but is expected to have remained merely moderate in the second quarter. GDP in the first quarter was up 0.4% in quarterly terms, and 1.0% in year-on-year terms. The quarterly growth was attributable to an increase in gross investment, which accounted for 0.2 percentage points of the growth, and the strengthening of private consumption, which accounted for 0.3 percentage points, while the contribution made by net trade was slightly negative. The figures for retail trade indicate that private consumption is strengthening further. Year-on-year growth in industrial production in the euro area slowed to just under 1% in April, while the amount of construction put in place was unchanged in year-on-year terms in April after falling in the first quarter.

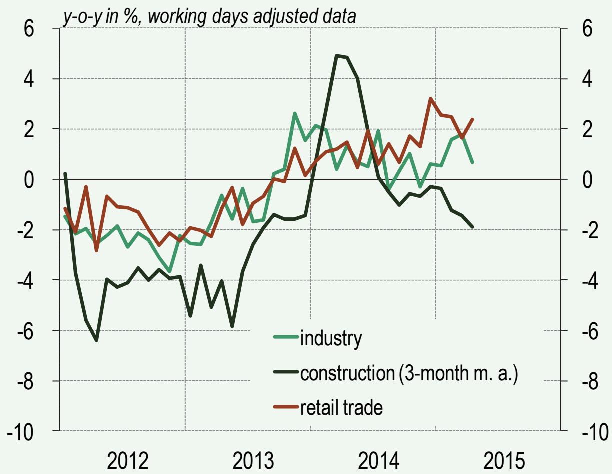
The release of the economic figures for the first quarter of this year did not affect the forecasts for the pace of the recovery in the euro area, although the forecasts for numerous other major economies were revised slightly downwards. According to Consensus's June forecasts, GDP in the euro area will rise by 1.5% this year and by 1.8% in 2016, both figures remaining unchanged from the May forecasts. At the same time Consensus[1] lowered its GDP growth forecast for certain other major economies, most notably the US, the UK and Canada. Of Slovenia's main trading partners, it lowered the forecast for this year's growth for Austria and Germany by 0.1 percentage points, but raised the forecasts for Italy and France by the same amount. In eastern Europe Consensus raised its GDP forecast for Russia for the fourth consecutive month in June: economic activity is forecast to decline by 3.5% this year and to increase by 0.5% in 2016. In its June forecasts the World Bank re-

Figure 1.3: Harmonised unemployment rate



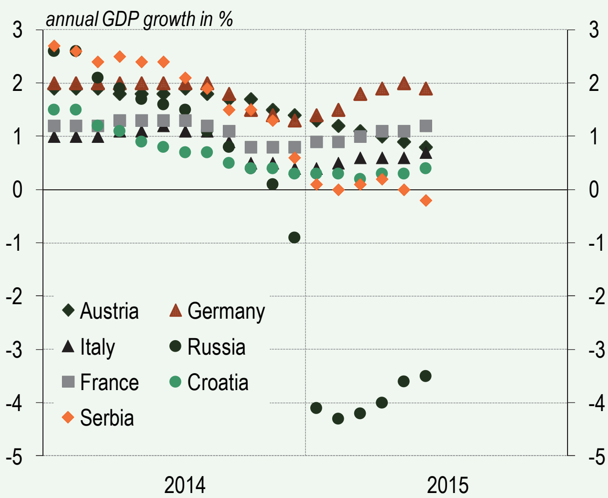
Note: The Euro area core is the average of data for AT, BE, DE, FI, FR, LU, NL, weighted by the active population size. The Euro area periphery is the weighted average of data for CY, ES, GR, IE, IT in PT.
Sources: Eurostat, Bank of Slovenia calculations.

Figure 1.2: Volume turnover in retail trade, real value of construction put in place and industrial production volume – EA



Source: Eurostat, Bank of Slovenia calculations.

Figure 1.4: Consensus forecasts of economic growth in main trading partners in 2015



Source: Consensus Economics.

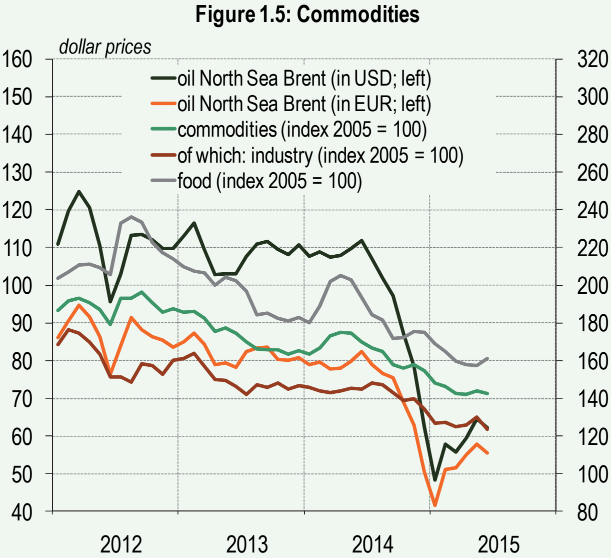
[1] Consensus lowered its GDP growth forecasts for the US and Canada by 0.3 percentage points between May and June, and by 0.1 percentage points for the UK.

duced its expectations with regard to this year's economic growth in OECD and BRICS countries. It also lowered its forecast for this year's global economic growth from 3.0% in January to 2.8%.[2]

Euro exchange rate and commodity prices

The euro was stable against the US dollar at around USD 1.12 in June, while oil prices fell slightly. The monthly average euro exchange rate against the US dollar rose in June for the second consecutive month, taking the overall rise to almost 4%. The euro averaged USD 1.122 over the month. The euro also rose against the majority of other major global currencies in June, most notably by 3.0% against the Japanese yen, and was up 31.0% against the Russian ruble in year-on-year terms. After reaching USD 65 per barrel, the price of Brent crude fell in June to end the month at USD 61. After two months of growth, US dollar prices of industrial commodities fell by almost 5% in monthly terms in June, as metals prices fell by just over 7%. After a long period, the fall in food prices came to an end in June, at least temporarily. This year's trend of falling food prices has been attributable to an increase in the supply of major agricultural products.

Figure 1.5: Commodities

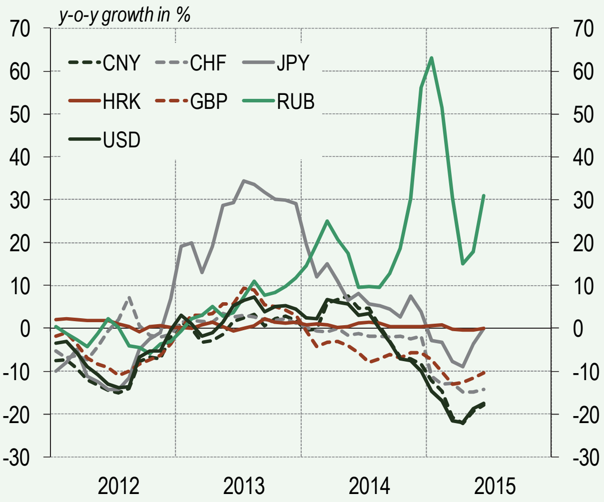


Source: The Economist, Bloomberg, Bank of Slovenia calcuations.

International financial markets

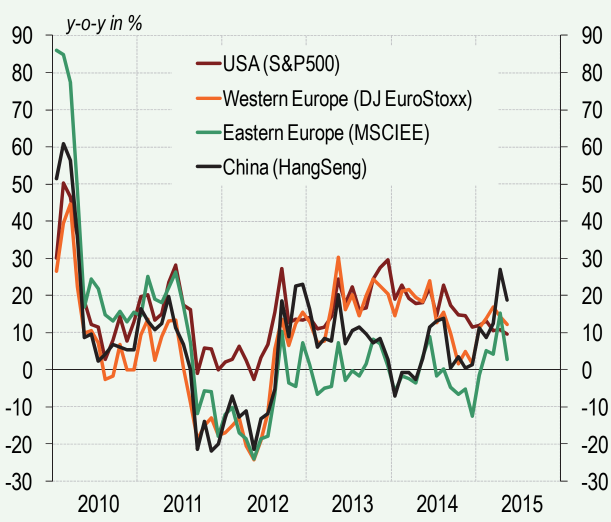
The main factor in developments on the foreign financial markets during the first five months of the year was the beginning of expansionary monetary policy measures by several central banks. Other factors were the good corporate results released in the EU and the US, the slightly improved economic outlook in the euro area, and the negotiations to resolve the issue of Greece's debt.

Figure 1.6: Exchange rates



Source: ECB, Bank of Slovenia calculations.

Figure 1.7: Foreign stock exchange indices



Source: Bloomberg.

[2] In its June report the World Bank revised its economic growth forecasts upwards from January by 0.2 percentage points for Russia and 1.1 percentage points for India, and downwards by 0.5 percentage points for the US, 0.3 percentage points for the UK, 2.3 percentage points for Brazil, and 0.1 percentage points for Japan. This year's economic growth forecast for China remained unchanged at 7.1%.

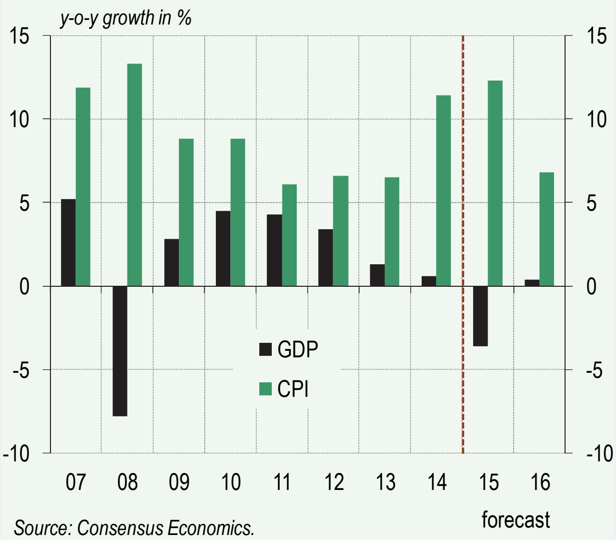
Box 1.1: Economic developments in Russia and their impact on merchandise trade with the EU and Slovenia

Economic developments in Russia were affected by two adverse external shocks in late 2014 and early 2015. The first shock was international sanctions introduced by the EU[1] and other countries targeting individual Russian banks, oil companies and other firms and restricting their access to financial markets in the EU and the US. A ban was also imposed on exports of certain technologies and products to Russia. The second external shock was a sharp fall in oil prices to less than USD 50 in January of this year, down from USD 115 in mid-June 2014. In the wake of rising uncertainty and capital flight, the Russian currency fell sharply, which also brought a rise in inflation. Inflation as measured by the CPI exceeded 11% at the end of last year, its highest level of the last five years. As inflation rose and disposable income fell, growth in household consumption slowed sharply last year, while gross investment even declined. Economic growth in Russia in 2014 stood at just 0.6%, the lowest figure of the last five years. Russia's GDP in the first quarter of 2015 was down 1.9% in year-on-year terms, less than expected.

The economic growth forecasts for Russia have been revised sharply downwards. The latest forecasts suggest a contraction of around 3.5% in 2015, and merely weak growth in 2016. Because Russia's fiscal and current accounts are highly dependent on energy exports, low energy prices are worsening the outlook for public finances and the balance of payments via a direct impact on government revenues and export earnings, and via curbs on investment in energy projects. These developments are increasing the risk to economic activity, which is also affecting the financial system and asset quality at the banks. Overall the banking system is thought to have sufficient capital. Four major Russian banks, which together account for half of all customer deposits, are either under majority government ownership or will receive significant government assistance in the event of a deterioration in their assets. In the second quarter the rise in oil prices to over USD 60 brought a slight improvement in the economic growth forecasts.

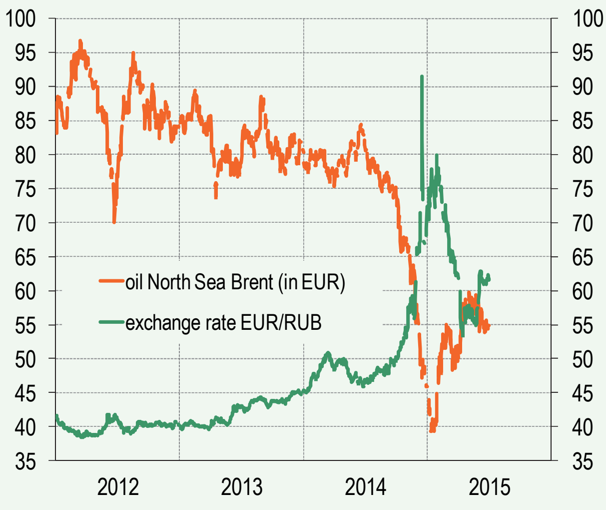
In response to the external shocks Russia introduced measures to support the domestic economy last year and in the early months of this year. Last year the ruble fell almost 40% against the euro and almost 50% against the US dollar. The depreciation was most pronounced in the final quarter when slightly over 90 rubles were needed for one euro in mid-December. The Russian central bank intervened on the currency markets in order to maintain macroeconomic and financial stability, and made sales of USD 12 billion in December alone.[2] The exchange rate stabilised in January of this year, and the ruble later appreciated to stand at just 61 against the euro by June. In light of the inflation and the shocks on the financial markets, the central bank of Russia raised the key interest rate in December 2014, and simultaneously took several measures to support the financial system, primarily to ensure liquidity and to secure funding for bank recapitalisations. The financial markets stabilised, and in the wake of the stabilisation of the ruble exchange rate the central bank has lowered the key interest rate three times since the beginning of the year and has continued its interventions on the currency markets and its measures to maintain macroeconomic and financial stability. Year-on-year inflation reached 16.9% in March, then began to fall, reaching 15.8% in May. Capital

Figure 1: GDP and CPI



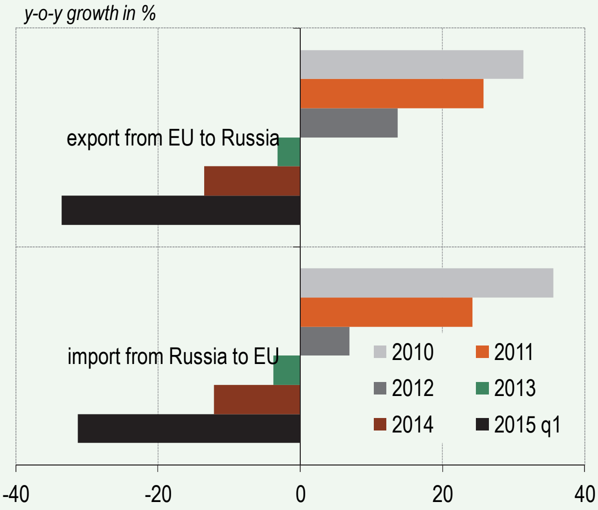
Source: Consensus Economics.
Note: CPI - y-o-y growth at the end of the year.

Figure 2: Brent oil and exchange rate EUR/RUB



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

Figure 3: Trade in goods with Russia



Source: European Commission, Eurostat.

flows slowed, and FDI remained uncertain in light of the economic sanctions and the geopolitical tensions.[3]

Merchandise trade between Russia and the EU declined sharply as a result of the sanctions and the Russian embargo[4] on food imports from countries that have introduced sanctions, and the fall in the ruble. According to European Commission figures, merchandise imports from Russia fell by 12.1% in 2014, while merchandise exports to Russia fell by 13.5%, the largest fall of the last five years. EU exports to Russia fell to EUR 103 billion last year, down from EUR 120 billion in 2013, while imports from Russia fell from EUR 207 billion in 2013 to EUR 182 billion last year. Exports to Russia in the first quarter of this year were down just over a third in year-on-year terms, while imports were down just over 30%. Fossil fuels and mineral products account for just over 75% of all EU imports from Russia.

Slovenia's trade with Russia also declined. Exports from Slovenia to Russia had risen in recent years, and in 2013 Russia accounted for almost 5% of Slovenia's total merchandise exports. While merchandise exports exceeded EUR 1 billion and imports stood at EUR 451 million in 2013, there was a sharp decline in merchandise trade in 2014. Merchandise exports to Russia were down just over 2% in year-on-year terms, while imports were down more than 9%. Imports were down more than 40% in year-on-year terms in the first quarter of this year, while exports were down just over a quarter. The decline in exports to Russia reduced year-on-year growth in Slovenia's total merchandise exports in the first quarter by just over 1 percentage point.

[1] For details of the sanctions introduced by the EU, see http://europa.eu/newsroom/highlights/special-coverage/eu_sanctions/index_en.htm.
[2] An overview of the Russian central bank's interventions on the currency markets is available here: http://www.cbr.ru/eng/hd_base/?PrtId=valint.
[3] For more on FDI, see http://www.cbr.ru/Eng/publ/ddcp/2015_01_ddcp_e.pdf.
[4] For details of Russia's counter-measures, see http://government.ru/en/news/14199/ and http://www.europarl.europa.eu/RegData/etudes/BRIE/2014/536291/IPOL_BRI(2014)536291_EN.pdf.

The ECB launched its public sector bond purchases programme (the PSPP) in March. Mario Draghi, president of the ECB, confirmed that the purchases within the PSPP will last until September 2016, and that the Eurosystem will also purchase securities at negative interest rates, albeit no lower than the interest rate on the deposit facility. On the basis of expectations of the beginning of the PSPP, European share markets had already recorded high growth in the first two months of the year, which continued in March and April, when volatility increased on the markets as a result of the uncertainty surrounding the resolution of the issue of Greece's debt. European exchanges fell in May for this particular reason.

A number of global indices reached record highs or at least approached them. This was attributable to the postponement of the first rate rises by the Fed until the end of the year, and a decision by the People's Bank of China (the Chinese central bank) to lower the reserve requirement for all financial institutions (from 19% to 18%).

The market yields on German and US government bonds fell significantly during the first three months of the year, primarily as a result of the expectation and then the actual realisation of an expansion to the ECB's securities purchases programme. A similar trend was seen in the majority of the euro area periphery countries. Market yields on bonds first fell in April, reaching record lows, then rose significantly in the final days of the month, primarily in the longer reaches of the yield curve, approaching the level of 9 March, when the PSPP began. The markets attributed the rise primarily to technical factors, such as the liquidation of positions (because bonds were overvalued) and sales because of the increased volatility on the markets. The rise in yields on European bonds continued in the first half of May, before a reversal and a small fall in the second half of the month.

2 Economic Trends and the Labour Market

Economic growth in Slovenia strengthened in the first quarter, again significantly outpacing overall growth in the euro area. In line with the increased confidence, the economic situation has been improving in an increasing number of segments of the private sector, which are gradually increasing turnover also on the domestic market. This relates largely to transactions within the corporate sector, as domestic final consumption remains relatively weak, and growth is limited to consumer durables, mostly from imports. The recovery in domestic consumption, which is profoundly under the influence of restrictive fiscal policy, remains sharply behind the overall recovery in the euro area. Slovenia's faster growth is primarily being driven by faster growth in industrial production, which is based on a relatively low number of sectors. According to the available figures for activity and confidence, economic growth is expected to slow slightly in the second quarter.

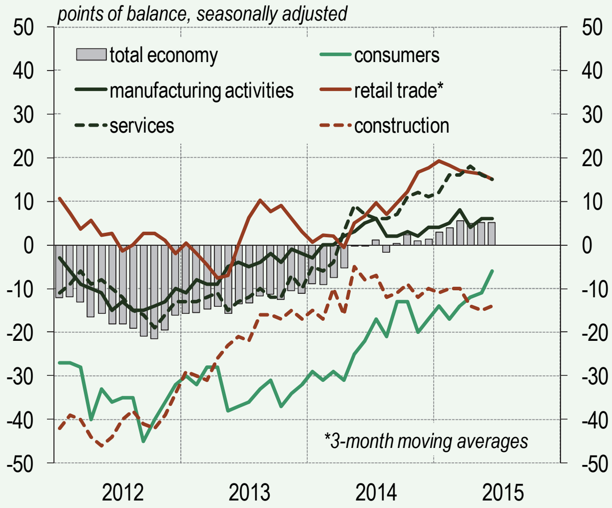
Developments on the labour market remained positive in the first quarter, as employment rose and registered unemployment fell. At the same time there was a change in the breakdown of the fall in unemployment: there were fewer people newly registering as unemployed, even though the number of deregistrations for reason of employment also fell. One of the possible reasons is the decline in the amount of funding to subsidise employment, as certain programmes require registration with the Employment Service. Total employment increased further, which on this occasion was primarily attributable to expansions in wholesale and retail trade and in manufacturing, while employment remained unchanged in the construction sector after five years of decline. Uncertain forms of employment remain prevalent (the proportion that they account for actually increased), and in the future employment is primarily expected to rise on account of work via employment agencies. Firms are mainly forecasting increased employment of manual workers, which remains likely to lead to merely minimal wage growth, which is now significantly less than growth in economic activity.

Confidence indicators and limiting factors

Economic sentiment stabilised at a relatively high level in the second quarter. Confidence in the manufacturing sector remained stable, in the wake of relatively favourable expectations with regard to export demand and the situation on the domestic market. There were no major changes in private-sector services other than retail, as firms remained relatively optimistic with regard to current and expected demand. The retail confidence indicator remained at a high level, despite corrections, which to a certain extent does not accord with the figures for private consumption. These also do not correspond entirely with the consumer confidence indicator, which strengthened significantly in the second quarter. Construction confidence declined, and estimated order books remained significantly below last year's level.

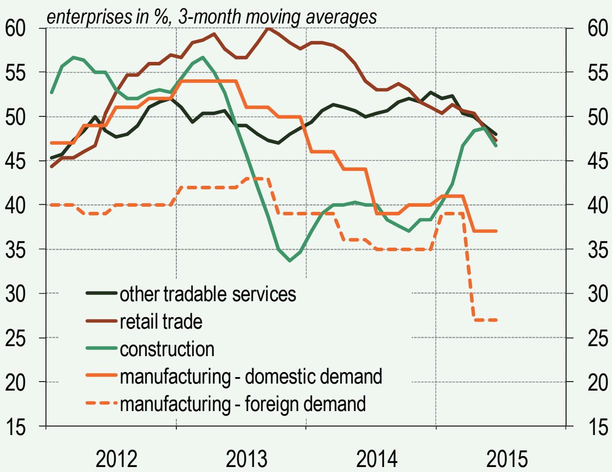
The proportion of firms facing insufficient demand is gradually declining across the economy, although domestic consumption remains significantly weak. The proportion of manufacturing firms facing insufficient

Figure 2.1: Confidence indicators



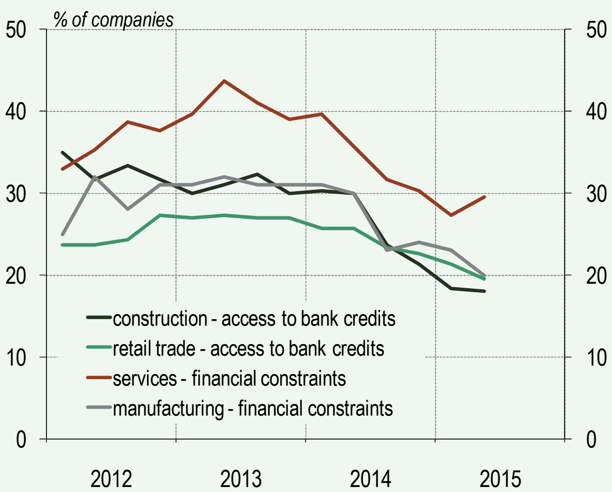
Source: SORS, Bank of Slovenia calculations.

Figure 2.2: Limiting factors – insufficient demand



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

Figure 2.3: Limiting factors – financing



Source: SORS.

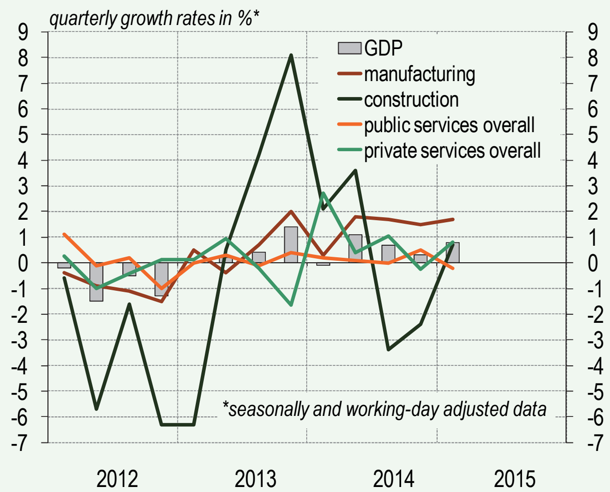
foreign demand declined significantly in the second quarter, a sign that the weaker export developments in the first quarter were probably only temporary. Domestic demand for industrial goods was also slightly stronger. Another indication that domestic demand is gradually recovering comes from firms in retail and other service activities. The situation on the labour market nevertheless remains difficult, as almost half of service-sector firms are still facing insufficient demand. The situation in construction is worse than last year, an indication of the shortage of private-sector orders and delays in the realisation of public investment planned for this year.

Firms are mostly reporting improved financing conditions. The proportion of firms facing financing problems has declined by approximately 10 percentage points over the last year, and stands around a fifth in the majority of sectors. This is partly the result of a structural effect related to the closure of non-performing firms, but in recent months financing via the domestic banks has also become more accessible.

GDP

After a slowdown in the final quarter of last year, economic growth picked up in the early part of this year, with positive contributions from the vast majority of private-sector activities. GDP was up 0.8% in quarterly terms, 0.5 percentage points more than in the previous

Figure 2.4: GDP components, production side



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

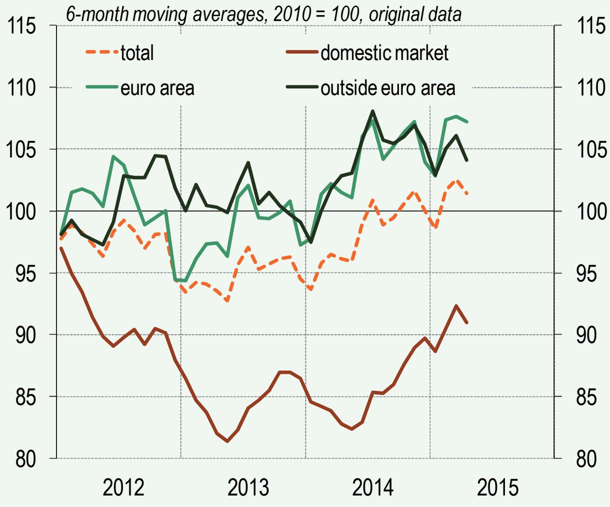
quarter, which thereby restored the high pace seen in mid-2014. The faster pace was mostly the result of improved situation in private-sector services, where value-added increased by almost 1% after falling in the final quarter of last year. This was attributable to increased foreign demand and weak growth in private consumption, which has been reflected in growth in value-added in retail trade. There was a notable reversal in the sectors of professional, scientific and technical activities and administrative and support service activities, where value-added increased by just under 3% after falling by almost 5% at the end of last year. Value-added in construction also increased, after six months of decline. The breakdown of construction put in place suggests a gradual beginning to the final phase of public infrastructure construction co-financed by European financial scheme that is expiring at the end of this year. Growth also picked up in the manufacturing sector, where part of the increased output was directed at inventory build-up as exports weakened slightly. At the same time there was an increase in demand on the domestic market, where sales of capital goods were notable. Compared with the final quarter of last year, there was a rise in the number of manufacturing segments contributing to overall growth in output. It nevertheless remains predominantly based on the automotive, electrical and metal industries.

In the first quarter, economic growth outpaced that of the euro area primarily due to industry performance. Year-on-year growth in value-added in industry was 5 percentage points higher in Slovenia, and reflects differences in the structure of economic growth between Slovenia and the euro area overall. While exports continue to drive economic growth in Slovenia, the euro area recovery is primarily based on domestic demand. Year-on-year GDP growth in the first quarter stood at 2.9% in Slovenia, 1.8 percentage points more than in the euro area.

Aggregate demand

In the first quarter, contribution to GDP made by high quarterly growth in domestic demand was reduced by the negative contribution of net trade. Growth in domestic demand was mostly the result of changes in

Figure 2.5: Volume turnover in industry

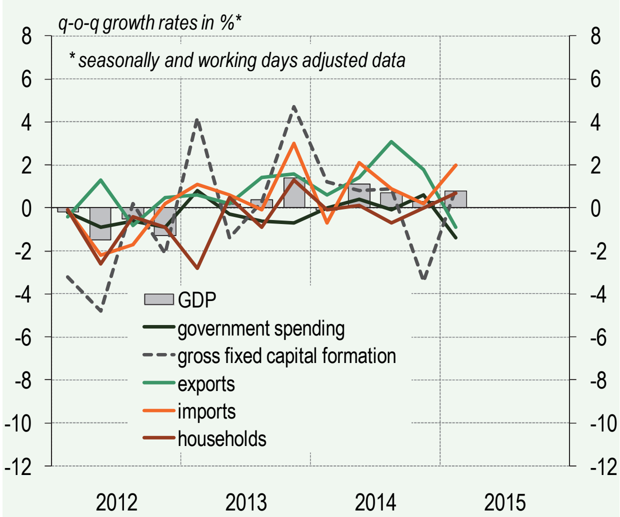


Source: SORS, Bank of Slovenia calculations.

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

Soures: Eurostat, Bank of Slovenia calculations.

Figure 2.7: GDP components, expenditure side



Source: SORS, Bank of Slovenia calculations.

Box 2.1: Differences in the economic recovery between Slovenia and the euro area

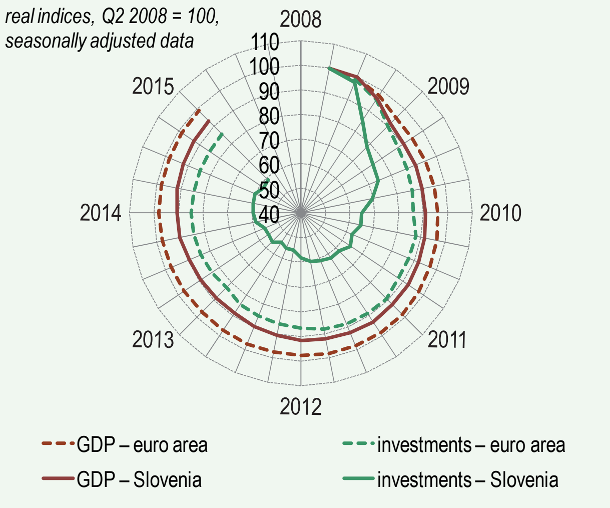
The gap by which GDP remains below its pre-crisis level is significantly larger in Slovenia than in the euro area overall, despite the relatively high quarterly growth in the last two years. Slovenia's GDP increased by almost 5% between its lowest point of the first quarter of 2013 and the first quarter of 2015, but is still just under 7% down on its pre-crisis high. The corresponding gap in the euro area overall is 1.5%, even in the wake of a merely moderate recovery.

The first reason for a larger gap is the significantly larger fall in activity immediately after the outbreak of the crisis at the end of 2008. Given that the shock in international trade hit Slovenian industry to a similar extent as industry across the euro area, the difference in the fall derives mostly from the bursting of the investment bubble in Slovenia, which hit the construction sector hardest. The bursting of the investment bubble was the result of the sudden interruption in the inflow of foreign financial resources, which had allowed the financing of investment via the domestic banks, and the completion of the main works in the construction of the motorway network. An indication that growth in fixed capital formation before the crisis was unsustainable comes from its ratio to GDP. This approached 30% in 2007 and 2008, 7 percentage points more than the euro area average, and an excessive figure even allowing for the lower level of development. Subsequently in the crisis, alongside the high level of uncertainty, the lower level of private-sector investment was attributable to the over-leveraging of part of the economy[1] and a pronounced credit crunch.[2]

The secondary reason was the adverse impact of the austerity measures introduced in 2012. These choked the recovery after 2009, and were significantly more stringent than the euro area average. Confidence declined sharply, particularly household confidence, as did domestic consumption and employment. Although general government investment spending in 2011 and 2012 fell sharply across the euro area, according to European Commission figures its fall in Slovenia was significantly deeper at 20%, which again forced the pace of investment well below the euro area average. Final government consumption in Slovenia in 2013 was down more than 5% on 2011, compared with an increase of just over 2% across the euro area over the same period. Expenditure on social transfers declined by 2.4% in Slovenia, while compensation of employees declined by more than 7%. Social transfers increased by almost 5% over the same period across the euro area, while compensation of employees was up just under 1%. The non-investment portion of government consumption in Slovenia remained more restrictive in 2014 and early 2015.

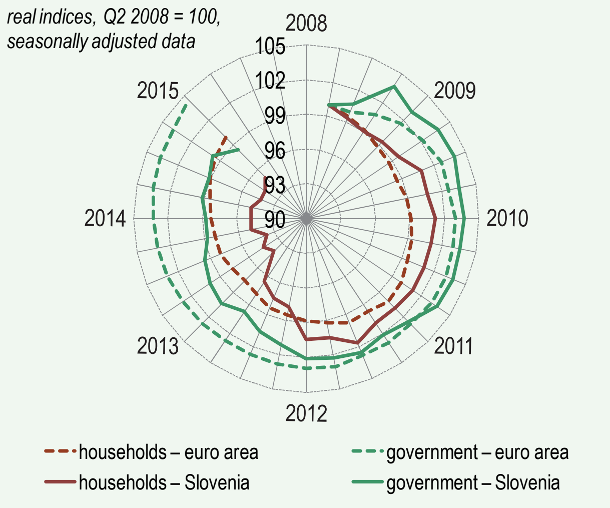
In early 2015 Slovenia was behind the euro area overall in all the main aggregates of domestic demand. The possibilities of raising final government consumption are limited over the medium term by the need to achieve fiscal balance. In the wake of low wage growth, the strengthening of household consumption, which is 6.5% down on its peak in mid-2011, is expected to be merely gradual. There are greater possibilities in an expansion of private-sector investment. The strengthening of investment since 2013 has been conditioned by increased disbursement of EU funds at the conclusion of the

Figure 1: GDP and gross fixed capital formation – Slovenia compared to euro area



Source: Eurostat, Bank of Slovenia calculations.

Figure 2: Final consumption expenditure of households and general government – Slovenia compared to euro area



Source: Eurostat, Bank of Slovenia calculations.

Figure 3: Unemployment rate – Slovenia compared to euro area

Source: Eurostat.

financial perspective and by local elections. Government investment will continue making positive contributions to GDP growth this year, but is then expected to decline sharply as a result of a significant decline in the disbursement of funds under the new financial perspective. Corporate restructuring, bank recovery and resolution, the anticipated gradual revival of lending and the improvement in the economic situation in the international environment are improving the conditions for the strengthening of private-sector investment. Capacity utilisation in industry is high, and corporate earnings were also relatively high last year.[3] The stabilisation of the economic environment is opening space for a reversal in investment in productive capacity by the private sector, which is vital to maintaining a favourable economic dynamic over the medium term.

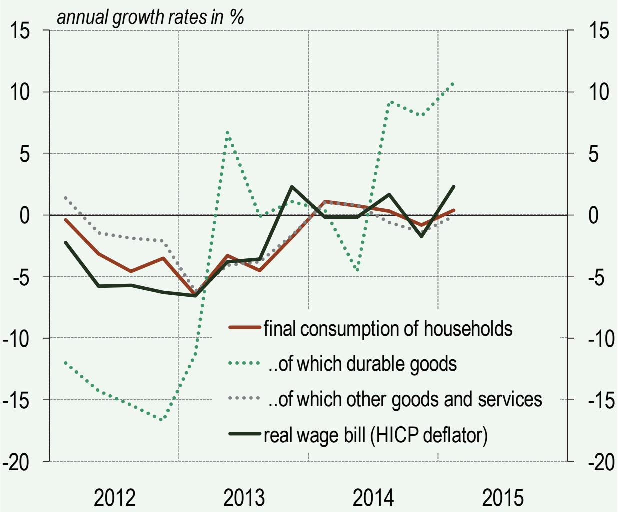
[1] See Financial Stability Review, May 2015, p 22 and 25; http://www.bsi.si/iskalniki/reports.asp?MapaId=784.

[2] According to ECB figures, the stock of bank loans to non-financial corporations (adjusted for sales and securitisation) at the end of 2014 was down almost 30% on the end of 2009 in Slovenia, compared with just under 3% across the euro area.

[3] According to AJPES calculations, corporate net profit in 2014 was up EUR 515 million on 2013 at EUR 887 million, while the net profit of sole traders and other individuals pursuing registered business activities was up EUR 70 million at EUR 366 million.

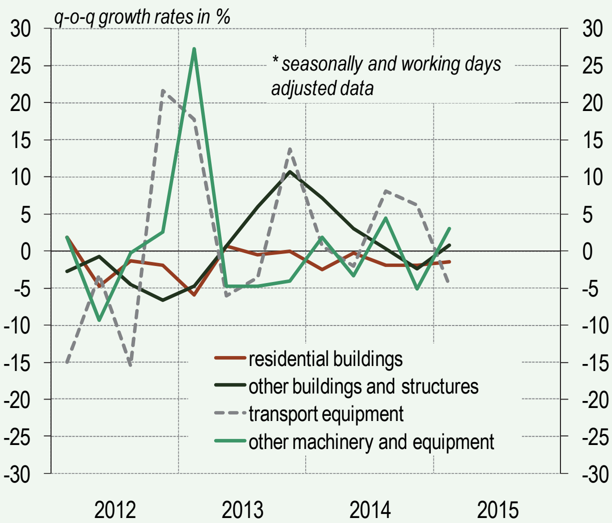
inventories. According to the SORS, inventories of merchandise and work in progress increased sharply. This accords with the favourable expectations with regard to growth in sales on the domestic market, and the discrepancy between growth in industrial production and the quarterly decline in exports. Final consumption remained weak. It was up just 0.1% in quarterly terms, and was still only 0.5% above its bottom from the third quarter of 2013. The sole factor of growth in final consumption remains household purchases of consumer durables, most notably cars. At the same time final government consumption reached a new low in the first quarter of this year. After declining in the final quarter of last year, gross fixed capital formation increased slightly in quarterly terms in the early part of this year. The structure was a greater positive than the actual rate of growth: growth was primarily driven by increased investment in other machinery and equipment. Alongside last year's relatively high earnings,

Figure 2.8: Final consumption of households and wage bill



Source: SORS, Bank of Slovenia calculations.

Figure 2.9: Gross fixed capital formation



Source: SORS, Bank of Slovenia calculations.

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.

the improved financing conditions and the continuing growth in sales, this might well be an indication that the reversal in private-sector investment is faster than anticipated at the beginning of the year. There was a significant quarterly increase in imports in real terms, primarily as a result of investment in inventories, which acted to reduce quarterly growth in GDP.

Growth in final consumption remains significantly below the euro area average, despite signs of a weak recovery. Although consumer confidence is increasing, and consumer purchasing power is gradually recovering, the consequences of the crisis and the austerity measures mean that this has not yet been notably reflected in consumption. It was up just 0.4% in year-on-year terms in the first quarter of this year, 1.4 percentage points less than in the euro area overall. At the same time the need for fiscal consolidation means that final government consumption remains restrictive. It was down 0.5% in year-on -year terms in the first quarter, while government consumption across the euro area made a positive contribution to year-on-year growth in GDP for the eighth consecutive quarter.

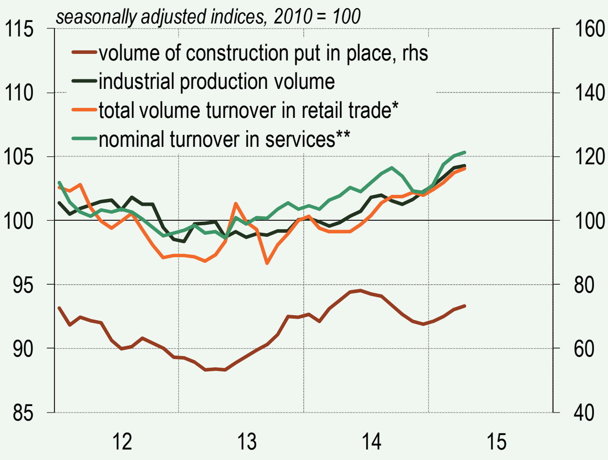
Gross fixed capital formation in the first quarter was down in year-on-year terms for the second consecutive quarter, in contrast to the euro area overall. The reason was the decline in public investment in infrastructure after the completion of the main works before the local elections of last October. In line with government plans, which are forecasting an increase of 15% in investment this year, the relative slowness at the turn of the

Table 2.1: Economic activity

	12 m. to Apr.14	*12 m. to Apr.15*	*2015 Feb.*	*2015 Mar.*	*2015 Apr.*	*2015 Jan.*	*2015 Apr.*
			y-o-y in %			*monthly ++*	
Industrial production: - total *	-0.6	3.1	5.3	4.0	4.2	1.5	*1.5*
- manufacturing	-0.3	4.9	6.4	4.8	6.1	2.3	*1.1*
Construction: - total **	13.3	9.0	4.9	-2.3	-7.5	-3.4	*7.4*
- buildings	-5.7	0.4	-6.2	-8.2	-3.9	-4.8	*-1.9*
- civil engineering	20.9	12.8	9.7	-0.2	-8.8	0.6	*13.6*
Trade (volume turnover)							
Total retail trade	-1.8	-0.1	2.7	0.1	-0.5	-0.8	*0.8*
Retail trade except automotive fuel	-2.3	0.0	0.7	1.2	2.5	0.9	*0.4*
- food, beverages, tobacco	-2.6	-0.5	-1.0	-0.1	2.8	2.4	*-1.2*
- non-food (except automotive fuel)	-1.8	0.6	2.4	1.9	2.9	0.3	*1.6*
Retail trade and repair of motor vehicles	8.2	7.5	11.1	11.8	11.9	5.2	*3.0*
Private sector services * +**	1.2	2.6	5.8	2.1	2.5	-0.7	*2.5*
Transport and storage +	2.2	4.6	6.5	0.3	1.7	-0.1	*1.1*

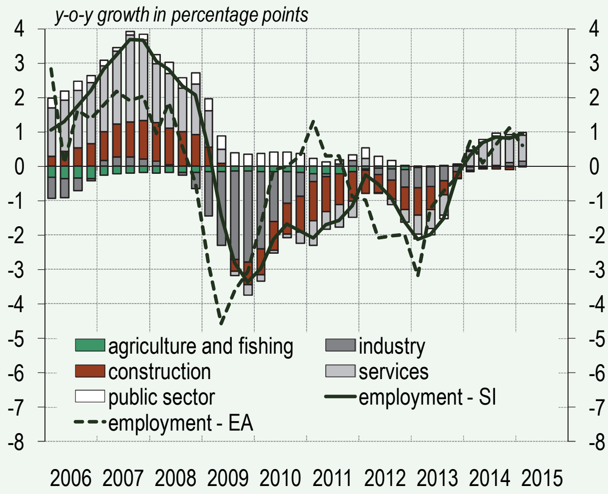
Source: SORS, Bank of Slovenia calculations.
Notes: Data are working days adjusted.
** Volume of industrial production. ** Real value of construction put in place. *** Excluding trade and financial services. + Nominal turnover.*
++: 3-month moving average compared to the corresponding average 3 months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

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.*

Figure 2.12: Contributions to employment growth



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

year is likely to be merely temporary. However the risks to the realisation of the planned investment are increasing, as the current figures for the first quarter show that public investment according to the cash flow methodology was down 6% in year-on-year terms.

Economic developments in the second quarter of 2015

The available monthly indicators of activity signal easing of economic growth in the second quarter. Total industrial production was unchanged in monthly terms in April, as a result of a decline in the energy sector. Growth in output in manufacturing was also slower than in the first quarter at 0.3%. Turnover in the retail sector continued to record moderate growth in April and May. The real-terms year-on-year indices in wholesale and retail trade excluding motor vehicles ranged from 2% to 3% in May, and remained notably high in trade in motor vehicles at 21%, where current growth also remained positive. Monthly growth in turnover in other private-sector services was weak in April. April saw a standstill in growth in the construction sector, where the amount of civil engineering work put in place was down significantly in monthly terms.

Employment

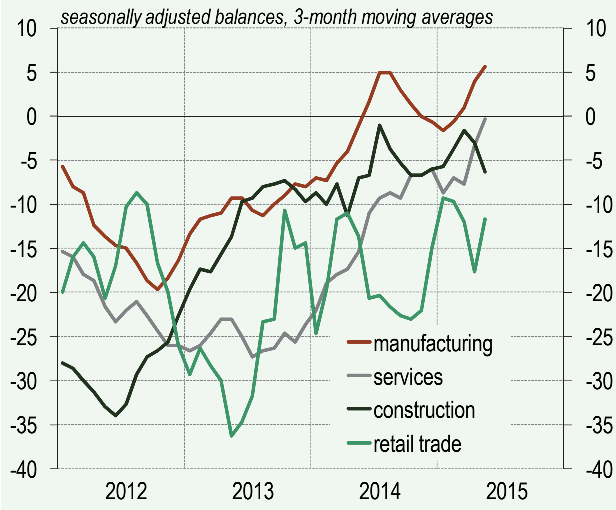
Total employment is rising in line with economic growth. Employment began gradually rising in early 2014, the rate of growth reaching 1% in the first quarter of this year. The number of employees was up almost 1.5% in year-on-year terms in the first quarter, while the number of self-employed fell for the first time in three years, by approximately 0.5%.[3]

Total employment in the private sector continued to grow in the first quarter of this year. The figure was up 1.1% in year-on-year terms. The biggest contribution to growth was the increase in the number of employees in wholesale and retail trade, vehicle repair, transportation and storage, accommodation and food service activities, and manufacturing. After several years of decline, employment in wholesale and retail trade, transport, and accommodation and food service activities began rising in the middle of the year, and was up 1.4% in the first quarter of this year. The number of employees in manu-

[3] The employment analysis uses national accounts figures. According to the monthly figures, the workforce in employment in the first quarter of this year was up 1.8%. The discrepancy is the product of the different methodologies used to monitor employment. The national accounts figures for employment include permanent employees, self-employed and assisting family members in private farming, self-employed in other household activities, student work and other forms of temporary employment, employment in sea and coastal transport on Slovenian vessels, employment at Slovenian diplomatic and consular offices in the rest of the world, and firms without employees. The monthly figures only count employees with employment contracts and the self-employed in the workforce in employment.

facturing has also been rising gradually since the second quarter of last year, the increase reaching almost 1% in the first quarter of this year. The majority of the growth last year was attributable to employment agencies, which assigned the majority of workers to the manufacturing sector. The number of employment agency workers was unchanged in the first quarter of this year, which was partly related to the abolition of the half night shift at Revoz. Employment in the construction sector was unchanged, after more than five years of falls. Employment in financial and insurance activities has been falling for four years as a result of the restructuring of the banking sector, although the fall had slowed to less than 1% by the first quarter of this year.

Figure 2.13: Expected employment



Source: SORS.

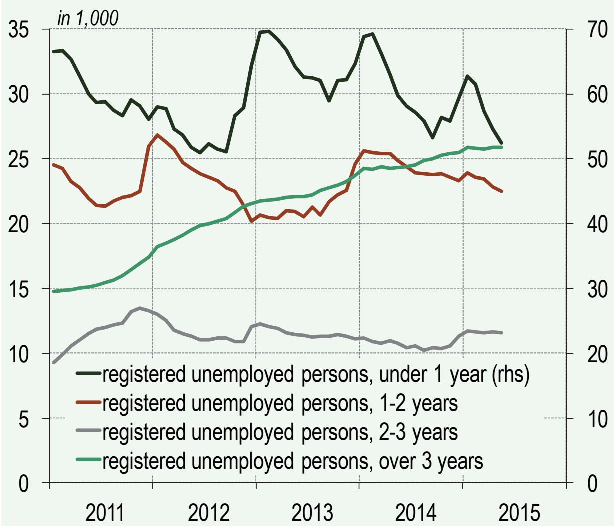
Employment in mostly public services has been rising for a year now.[4] Employment in public services began rising last year, and was up just under 0.5% in the first quarter of this year. The rise was slightly smaller in the government sector, at 0.2%. The number of employees in sectors not under direct government control, where private supply is also present, is continuing to rise. This is confirmed by the monthly SORS figures, which are not entirely 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 number of employees in the human health and social work recorded its largest rise since September 2012 in March, at 2.1%.

The employment expectations indicators are improving in the majority of sectors. According to SORS survey figures, firms in manufacturing, wholesale and retail trade, and other private-sector services are expecting an increase in employment in the summer months. The Employment Service's *Employment Preview 2015/1* is forecasting 0.6% growth in employment for the second half of the year, the largest rises continuing to be recorded by sectors where employment agencies are present, and in construction and manufacturing. Firms are forecast to primarily recruit manual workers. The gap between the

Figure 2.14: Labour shortage and labour force

Source: SORS, Bank of Slovenia calculations.

Figure 2.15: Long-term unemployed persons



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

[4] Public administration and defence, education, human health and social work activities (Sectors O, P and Q under the SKD 2010).

Table 2.2: Unemployment and employment

	2010	2011	2012	2013	2014	14Q1	14Q2	14Q3	14Q4	15Q1
						in 1,000				
Registered unemployed persons	100.5	*110.7*	110.2	119.8	120.1	128.8	120.2	114.5	116.9	121.6
Unemployment rate						*in %*				
- LFS	7.3	8.2	8.9	10.1	9.8	10.8	9.3	9.3	9.6	9.8
- registered	10.7	11.8	12.0	13.1	13.1	14.1	13.1	12.5	12.7	13.2
Probability of transition between employ. and unemployment						in %				
- probability to find a job[1]	14.2	13.8	13.2	13.6	15.4	16.1	17.8	14.5	13.1	17.9
- probability to lose a job[2]	2.8	2.6	2.8	2.8	2.6	3.3	2.2	2.2	2.9	3.1
						in 1,000				
Total employment[3]	961.7	946.0	938.2	924.3	930.5	918.5	927.4	941.5	934.7	927.3
						year-on-year growth in %				
Persons in paid employment	-2.7	-2.1	-1.1	-3.0	0.4	-0.3	0.2	0.6	1.0	1.4
Self-employed	0.3	0.5	0.5	5.1	1.8	3.0	2.5	1.8	0.0	-0.6
By sectors										
A Agriculture, forestry and fishing	-2.0	-2.5	-1.0	0.0	-0.2	-0.3	-0.3	-0.1	-0.3	-0.3
BCDE Manufacturing, mining and quarrying and other industry	-5.7	-0.1	-1.1	-1.9	0.0	-0.4	-0.1	0.1	0.4	0.7
F Construction	-9.4	-11.4	-7.8	-7.1	-0.9	-0.8	-0.5	-1.1	-1.3	0.0
GHI Trade, accommodation, transport	-2.4	-2.4	-1.2	-1.2	0.2	-0.9	-0.2	0.8	1.0	1.4
J Information and communication services	0.8	0.3	2.1	2.3	1.2	1.9	1.9	1.9	-0.8	-1.1
K Financial and insurance activities	-0.7	-2.8	-1.7	-2.7	-2.1	-2.1	-2.1	-2.1	-2.1	-0.9
L Real estate activities	0.0	-2.7	-1.4	0.9	0.5	-1.9	0.0	1.9	1.9	1.9
MN Professional, technical and other business activities	2.6	0.7	1.4	-3.0	4.6	4.7	5.2	4.3	4.2	3.6
RST Other activities	1.7	-1.9	0.2	6.1	2.9	2.3	3.2	3.5	2.6	2.0
- mainly private sector (without O..Q)[3]	-3.1	-2.2	-1.3	-1.7	0.7	0.3	0.8	1.0	0.9	1.1
- mainly public services (O..Q)[3]	2.3	0.9	1.1	-0.6	0.3	0.2	0.4	0.4	0.3	0.4
Total employment[4]	-2.2	-1.6	-0.8	-1.5	0.7	0.3	0.7	0.9	0.8	1.0

[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.

shortage of skilled workers and the shortage of workers in general, which is one of the indicators of structural mismatching on the labour market, widened slightly, as a result of an increased shortage of skilled workers. As is evident from the aforementioned survey, there is again a shortage of manual workers and vocational profiles (drivers of heavy goods vehicles and tractor units, welders, toolmakers, lathe operators, electricians, chefs, etc.).

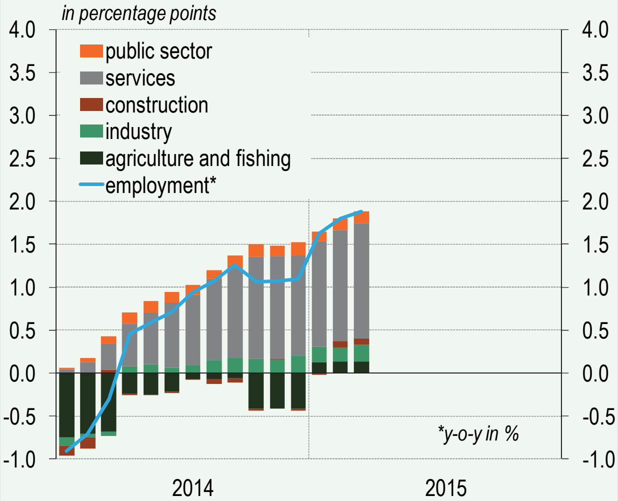
The improved economic situation is also being reflected in a rising number of job vacancies. Although the figures are not entirely comparable[5] in methodological terms, at almost 9,300 the number of job vacancies in the first quarter of this year was the highest figure of recent years. Manufacturing and construction recorded the largest number of job vacancies.

[5] In April 2013 the Labour Market Regulation Act abolished the mandatory notification of vacancies at the Employment Service for all employers other than the public sector and companies under majority government ownership. Between April 2013 and the end of 2014 the figures were no longer complete, for which reason the SORS introduced independent surveying of vacancies in the first quarter of 2015. The sample framework included all business entities with at least one employee whose primary registered business activity was in one of Sectors B to S.

Box 2.2: Impact of agency workers on sectoral breakdown of employment and cost competitiveness of industry

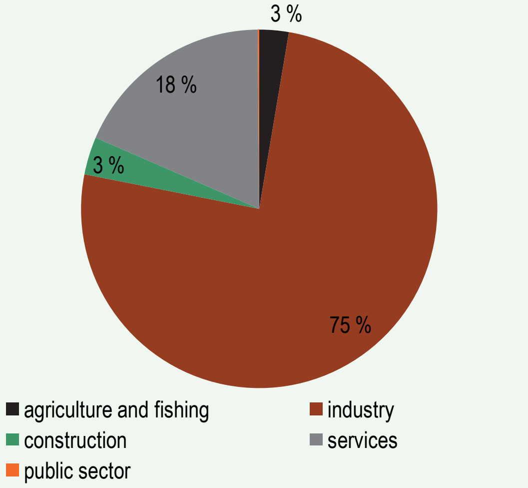
During the current economic recovery the large-scale use of agency workers is fogging the picture of the sectoral breakdown of employment. Employment agencies employ people, but assign them to work at other firms. Under the law and regulations[1] adopted last year, agencies must now report annually on the sectors to which they have assigned workers. The data obtained in this manner allows for a more realistic assessment of actual employment in each sector, as it makes it possible to reallocate workforce in employment from the sector of administrative and support service activities, where employment agencies are classed, to the sectors to which the agencies assign workers. There are significant differences between the official SORS figures for the workforce in employment in each sector and the adjusted figures; the latter are more in line with the breakdown of growth in value-added.

Figure 2: Contributions to employment growth - official data



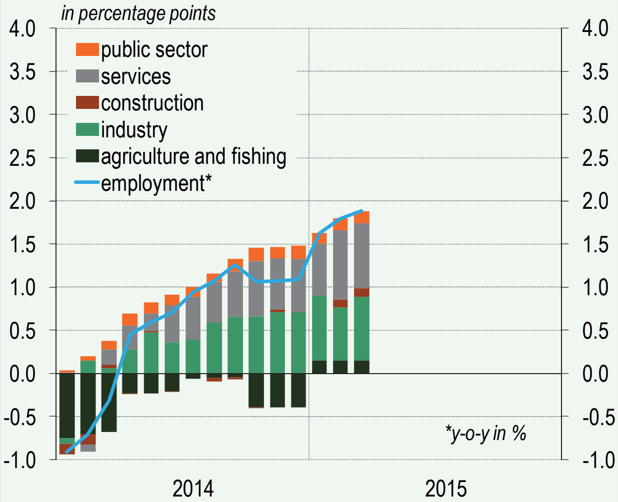
Source: SORS, Bank of Slovenia calculations.

Figure 1: Sectors where agency workers were transfered to in 2014



Source: Ministry of Labour, Family, Social Affairs and Equal Opportunities, Bank of Slovenia calculations.

Figure 3: Contributions to employment growth – adjusted data



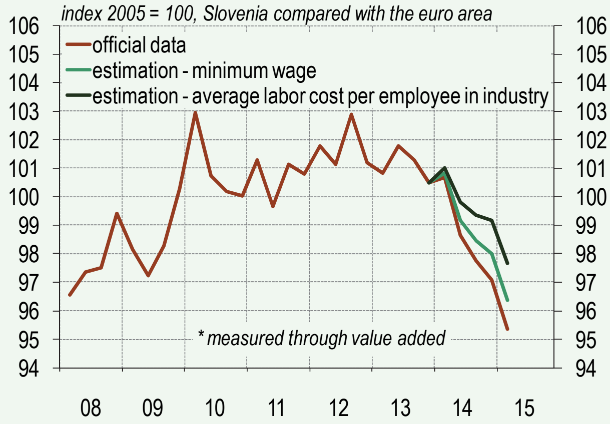
Source: SORS, Bank of Slovenia calculations.

Table 1: Differences in growth of the workforce employment by sectors considering agency workers employment

y-o-y in %	**2014**		**15Q1**	
	official	adjusted	official	adjusted
overall growth of the workforce employment	0.5	0.5	1.8	1.8
agriculture and fishing	-7.5	-7.2	3.2	3.7
industry	0.3	1.7	0.6	2.8
construction	-0.5	-0.3	0.6	1.0
services	1.8	0.9	3.1	1.7
public sector	0.5	0.5	0.6	0.6

Source: SORS, Ministry of Labour, Family, Social Affairs and Equal Opportunities, Bank of Slovenia calculations.
Note: Adjusted overall growth of the workforce employment by sectors for 2015 Q1 is calculated by using agency employment workers structure from 2014.

Figure 4: Relative nominal unit labour costs*, industry



Source: Eurostat, Bank of Slovenia calculation.
Note: ULC estimations are calculated with inclusion of the number of agency workers in the industry in 2014 and the first quarter of 2015. In the first case, gross minimum wage is considered as labour cost, whereas in the second case labour cost is expressed as average labour cost per employee in industry.

According to the official figures, the largest increase in workforce in employment in 2014 was recorded by private-sector services, while according to the adjusted figures it was recorded by industry. Agencies assigned 75% of their workers to industry, and the increase in total employment in industry thus amounted to 1.7%, 1.4 percentage points more than according to the official figures. The contributions made by individual sectors to overall growth in the workforce in employment have also been revised appropriately. The contribution made to the 0.5% growth in total employment in 2014 stood at just 0.1 percentage points according to the official figures, but 0.4 percentage points according to the adjusted figures.

Assuming that the assignment of agency workers to individual sectors is the same as in 2014, similar developments are expected to have continued in the first quarter of this year. According to the adjusted figures, the workforce in employment in industry increased by 2.8%, which accounted for 0.7 percentage points of the 1.8% growth in the total workforce in employment, while the increase was just 0.6% according to the official figures, accounting for 0.2 percentage points of the growth.

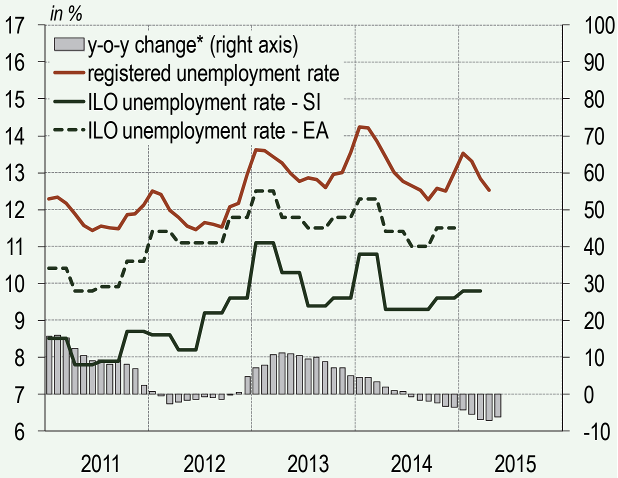
Unit labour costs in industry are declining relative to the euro area overall, even if agency workers are taken into account, albeit slightly more slowly. ULCs were down 4.7% in the first quarter of this year on the basis of the official figures. When agency workers are taken into account, ULCs were down 2.4% under the assumption of average labour costs per employee in industry, or down 3.6% under the assumption of gross minimum wages plus agency commission.

[1] On 1 March 2014 the amended Labour Market Regulation Act and the Rulebook on the pursuit of the activity of providing work for workers, which *inter alia* set out the obligation to complete statistical reports, entered into force. The report encompasses the attributes of the assigned workers (duration of the assignment, level of qualifications, type of employment), the sectors to which assignments are made, and assignments to other countries. The Ministry of Labour, Family, Social Affairs and Equal Opportunities requires the statistical report to be submitted once a year.

Labour market flows and unemployment

The number of deregistrations from unemployment for reason of employment began falling in the second quarter of this year, while temporary employment remained prevalent among new hires. The number of people deregistering from the Employment Services for reason of employment was up further in year-on-year terms in the first quarter, by 5.2%, but fell significantly in April and May. The number of people deregistering for reason of employment during the first five months of the year was down 2.3% overall, having risen by almost a fifth in the same period last year. The smaller number of deregistrations for reason of employment is likely largely related to the decline in the funding for active employment policy from EUR 105 million last year to EUR 47 million this year. At the same time temporary employment contracts remain prevalent among new hires. Despite the

Figure 2.16: Unemployment



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

labour market reforms,[6] three-quarters of all new hires in the first quarter were in the form of temporary employment contracts, while among young people (aged 15 to 29) the figure rose to 81%.

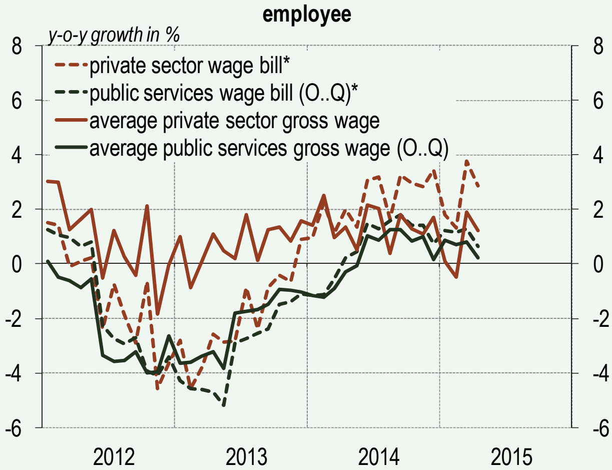
The number of registered unemployed is falling rapidly this year, but unemployment remains high and increasingly structural. The fall in the number of unemployed over the first five months of the year was in absolute terms the largest to date, and in relative terms the largest since 2008. Unemployment was down 7% in year-on-year terms in April, and down 6.1% in May. Unemployment nevertheless remains high. There were 112,385 people registered as unemployed in May. The registered unemployment rate has been falling for almost a year, but remains high. It stood at 12.5% in April. The fall in the number of long-term unemployed since the beginning of the year is slightly more than in the same period last year, although the proportion of total unemployment that they account for increased again in May, to 53%, as a result of the decline in the number of people newly registering as unemployed. Further evidence that structural employment is becoming more ingrained comes from the figure for the proportion of unemployed people who have been registered at the Employment Service for more than three years. This stands at 43% of total long-term unemployment, and the figure is continually increasing.

The fall in the number of people newly registering as unemployed has continued this year. The figure over the first five months of the year was down 7.1% in year-on-year terms. The largest factors in this decline were falls of approximately 18% in inflows of first-time jobseekers and 15% in inflows of people made redundant. The number of people registering as unemployed over the first five months of the year for reason of the loss of temporary employment was unchanged from the same period last year, although it was up just over 5% in May.

Wage developments

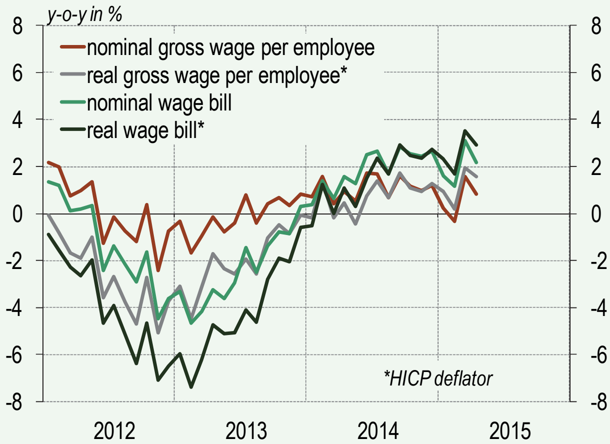
The gap by which economic growth is outpacing wage growth widened further this year. The average nominal gross wage in the total economy rose over the first four months of the year by just 0.6% in year-on-year terms, comparable to the second half of 2013. Gross wages in the private sector were up just 0.7%. The rise in wages was primarily the result of a rise in wages in primarily export-oriented manufacturing, and rises in the sectors of financial and insurance activities and informa-

Figure 2.17: 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 2.18: 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.

[6] The labour market reforms passed on 5 March 2013 incentivised against temporary employment by limiting the chaining of contracts for the same job to a maximum of two years, introducing severance pay in the event of termination of temporary employment at a level comparable to severance pay for permanent employment, increasing the employers' contributions to unemployment insurance on temporary contracts, and exempting employers from paying the contribution for the first two years after hiring an employee permanently.

Table 2.3: Labour costs indicators

	2010	2011	2012	2013	2014	14Q1	14Q2	14Q3	14Q4	15Q1
					in EUR					
Average gross wage	1495	*1525*	1526	1523	1540	1527	1528	1524	1581	1535
					nominal year-on-year growth, %					
Average net wage	3.9	2.1	0.4	0.6	0.8	0.8	0.8	0.9	0.9	0.1
Average gross wage	3.9	2.0	0.1	-0.1	1.1	0.9	1.1	1.3	1.1	0.5
- mainly private sector (excl. O..Q)[1]	5.0	2.6	0.9	0.7	1.4	1.6	1.3	1.4	1.4	0.5
- mainly public services (O..Q)[1]	-0.1	0.0	-2.2	-2.3	0.2	-1.1	0.2	1.1	0.7	0.8
Average gross wage in manufacturing	8.9	3.9	2.5	2.8	3.3	3.9	2.8	3.1	3.2	2.1
Average real net wage[2]	1.8	0.1	-2.3	-1.3	0.5	0.2	0.0	0.8	0.9	0.7
Labour costs per hour worked[3]	1.0	2.0	-0.3	-2.1	1.9	2.3	2.2	2.2	1.0	2.5
Labour costs per hour worked in manufacturing[3]	3.2	1.9	2.9	0.6	3.7	3.2	2.6	5.8	3.2	1.9
Gross wage per unit of output[4]	0.4	-0.3	1.9	-0.6	-0.8	-0.8	-1.1	-0.9	-0.5	-1.4
Gross wage per unit of output in manufacturing[4]	-4.9	0.8	4.0	1.2	-1.4	0.0	-1.2	-1.8	-2.6	-3.9
Unit labour costs[4,5]	0.5	-0.7	0.6	1.4	-2.1	-1.2	-1.8	-1.1	-4.2	-1.5
Labour costs per employee[5]	4.0	1.6	-1.2	1.9	-0.2	0.5	0.3	1.1	-2.6	0.4
Output per employee	3.5	2.3	-1.8	0.5	2.0	1.7	2.2	2.3	1.6	1.9
Output per employee - manufacturing	14.4	3.0	-1.4	1.6	4.7	3.8	4.1	5.0	5.9	6.2
HICP	2.1	2.1	2.8	1.9	0.4	0.6	0.8	0.1	0.0	-0.5
GDP deflator	-1.1	1.2	0.3	1.4	0.4	1.5	0.5	0.4	-0.7	0.6

[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.

tion and communication activities. After last year's pronounced growth, wages declined significantly in the sectors of mining and electricity, gas, steam and air conditioning supply. Wages in the accommodation and food service activities sector were down almost 2%. Wages in mostly public services have been rising in year-on-year terms since the middle of last year. Wages rose most notably in public administration and defence, by 1.5%, but were unchanged in education and human health.

Growth in employment and wages has also been reflected in a rise in the nominal wage bill. The nominal wage bill over the first four months of the year was up 2% in year-on-year terms, having increased by 2.4% in the private sector and 1.1% in mostly public services. Growth in the real wage bill stood at 2.6%, owing to the deflation.

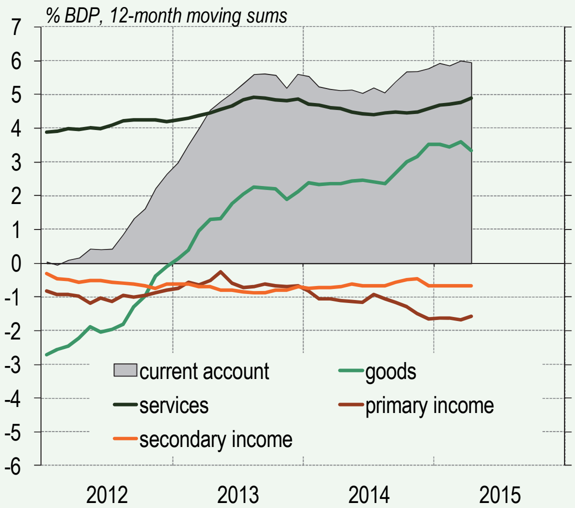
3 Current Account and Competitiveness Indicators

The current account surplus remained high over the first four months of the year, although its structure altered slightly. The surplus in merchandise trade, which was pronounced last year, has narrowed slightly this year as a result of lower growth in exports. Alongside the slower growth in car exports, this was also attributable to the deterioration in relations between Russia and the West. In contrast to merchandise exports, exports of services strengthened. The main increase was in exports of travel services, as a result of an improvement in the ratio of the number of overnight stays to the number of arrivals by foreign visitors. After widening last year the deficit in primary income narrowed slightly, as a result of smaller outflows of dividends and improved terms for government refinancing. The deficit in secondary income, which towards the end of the year is seasonally affected by the increased inflow of certain types of EU funding, remained stable.

Current account position

The 12-month current account surplus as a ratio to GDP remained high over the first four months of the year. It stood at 6% of GDP in April, and has been maintained at this level in recent months by the widening surplus of trade in services. This has been gradually widening since last autumn, approaching 5% of GDP in April. In the wake of lower nominal growth in exports, the merchandise trade surplus over the first four months of the year was down slightly on last year, but nevertheless remained above 3% of GDP. Last year's increase in the 12-month deficit in primary income has at least temporarily come to an end this year at 1.6% of GDP, while the deficit in secondary income has also remained stable.

Figure 3.1: Current account components



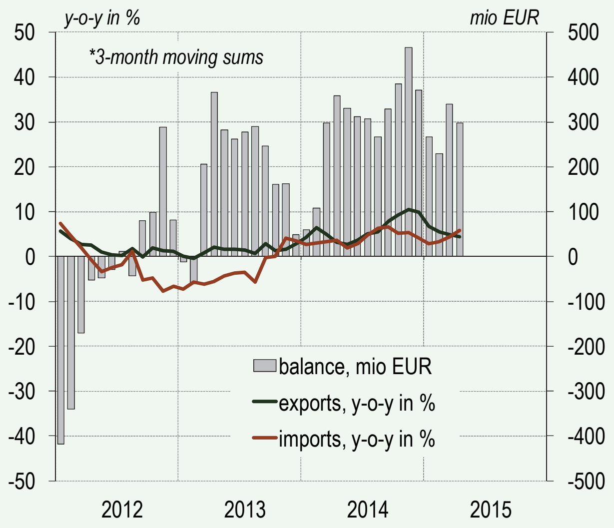
Source: Bank of Slovenia.

Merchandise trade

Nominal growth in exports slowed significantly over the first four months of the year, which reduced the merchandise trade surplus. Merchandise exports were up just over 3% in year-on-year terms; the low rate was primarily attributable to weak exports in January and April. Merchandise imports increased by just over 4% over the same period, comparable to last year's growth. The merchandise trade surplus over the first four months of the year thus narrowed by EUR 50 million in year-on-year terms to EUR 390 million.

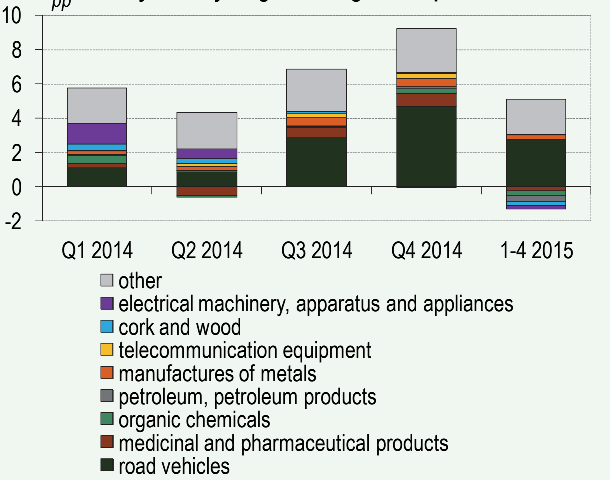
Growth in total exports slowed as a result of lower growth on EU markets and the tensions between

Figure 3.2: Goods trade*



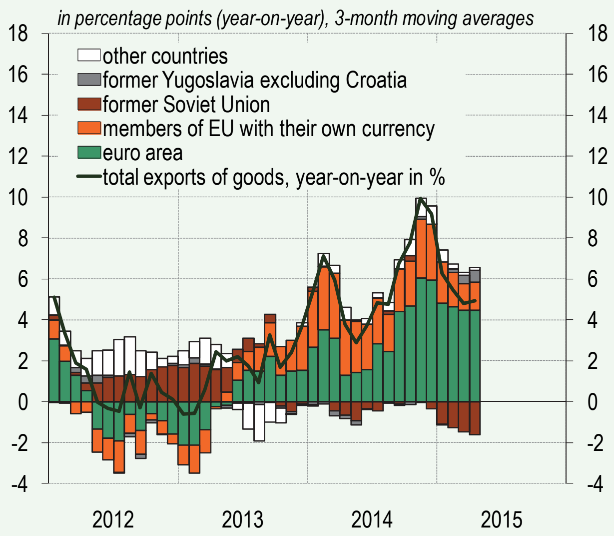
Source: Bank of Slovenia.

Figure 3.4: Contributions of major product groups to nominal year-on-year growth of goods export



Note: Groups of products as defined by 2-digit SITC classification.
Source: Bank of Slovenia.

Figure 3.3: Contributions to export growth by country groups



Source: SORS, Bank of Slovenia calculations.

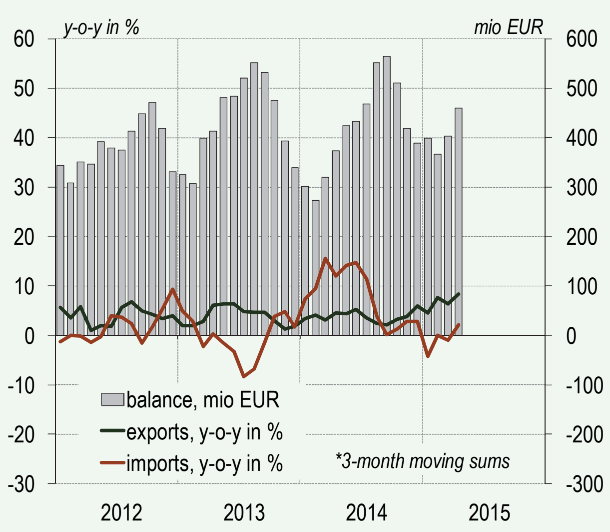
Russia and the West. The contribution made to overall export growth by exports to the euro area was down just under a third on the second half of last year at 3.7 percentage points, while the contribution made by exports to EU countries outside the euro area was down just over a half at around 1 percentage point. As a result of the Ukraine crisis and the deterioration in the Russian economy, exports to the markets of the former Soviet Union declined sharply, which reduced overall export growth by approximately 1.5 percentage points. The only individual country grouping to record an increase in export growth was the former Yugoslav republics other than Croatia.

The largest contributions made to the decline in overall growth in nominal merchandise exports by a product group came from the slowdown in growth in car exports and the falls in exports of pharmaceutical products, chemical products and oil. There was pronounced growth in car exports in the final quarter of last year due to a production of new models at Revoz, but the rate slowed this year, which reduced the contribution to overall export growth by 2 percentage points to 2.8 percentage points. Exports of pharmaceutical products declined significantly over the first four months of the year as a result of the fall in exports to Russia and Ukraine. Lower oil prices meant that the contribution made by the re-export of oil and refined petroleum products was negative, and were also a likely partial factor in the nominal fall in exports of organic chemical products. Exports of wood were down in year-on-year terms as a result of a base effect in the wake of last year's glaze ice storms.

Trade in services

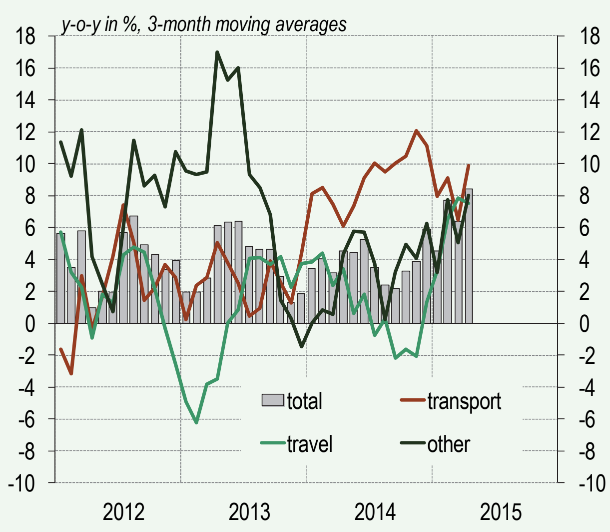
Exports of services increased over the first four months of the year as a result of faster growth in exports of travel services. Exports of services over the first four months of the year were up almost 7% in year-on-year terms. Growth in exports of transport and travel services exceeded 7%, while growth in exports of other services was also solid at almost 6%. Imports of services over the first four months of the year actually declined,

Figure 3.5: Trade in services*



Source: Bank of Slovenia.

Figure 3.6: Services exports



Source: Bank of Slovenia.

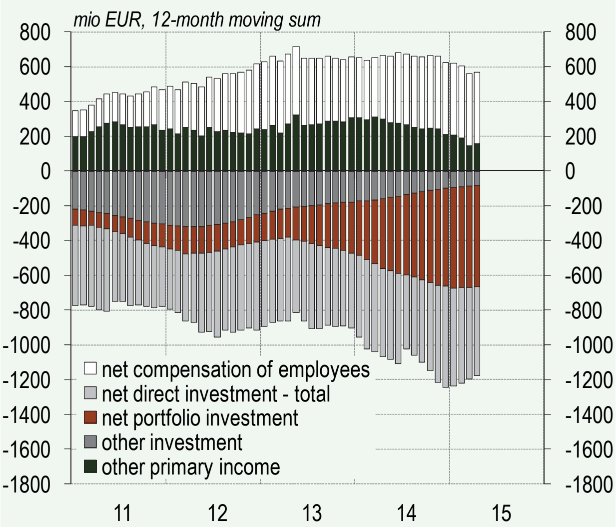
thereby widening the surplus of trade in services by EUR 131 million in year-on-year terms.

Exports of travel services strengthened sharply after falling in the second half of last year. The number of arrivals by foreign guests over the first four months of the year was up 10%, while the number of their overnight stays was up 6%. The ratio of overnight stays to arrivals was significantly better than last year, which had a profound impact on revenues. Over the first four months of the year they were up 7.4% in year-on-year terms, compared with just 3.6% in the same period last year. Growth in imports of travel services slowed sharply at the same time. The surplus of trade in travel services over the first four months of the year thereby widened by EUR 38 million in year-on-year terms.

Growth in exports of transport services slowed compared with the second half of last year, in line with growth in merchandise trade. Exports of transport services over the first four months of the year were nevertheless 7.7% up on the same period last year. The slowdown was primarily attributable to slightly lower growth in freight transport by road and railway. There was a sharp slowdown in imports of transport services at the same time, as a result of a decline in imports of air transport and rail transport services. The surplus of trade in transport services widened by EUR 36 million in year-on-year terms.

The deficit in trade in other services narrowed significantly over the first four months of the year. Exports of services other than transport and travel were up 5.8% in year-on-year terms, as the average rate of growth over the first four months of the year remained comparable to the final quarter of last year. Exports of telecommunications, computer and information services and of other business services increased sharply. Imports of construction services declined sharply, in line with the year-on-year decline in activity in the construction sector. Imports of other business services, which include accounting, book-keeping and auditing services, were down in year-on-year terms, having increased sharply in January of last year due to payments linked to the banking system's recovery procedures. The deficit of trade in other services

Figure 3.7: Net primary income



Source: Bank of Slovenia.

over the first four months of the year thus narrowed by EUR 58 million in year-on-year terms.

Primary and secondary income

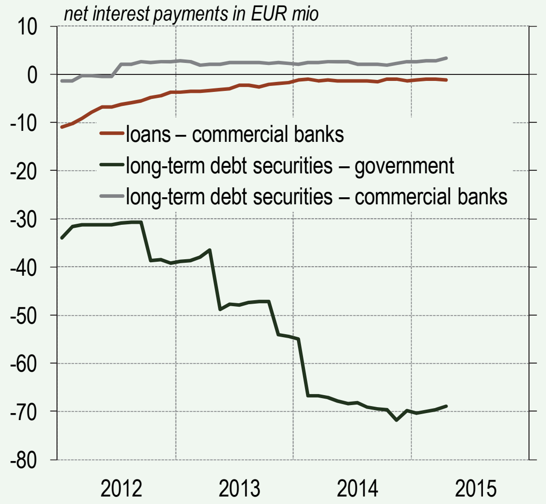
After widening rapidly last year, the deficit in primary income declined in year-on-year terms over the first four months of this year. It amounted to EUR 100 million, EUR 14 million less in year-on-year terms. After increasing significantly during the crisis period, the surplus

Table 3.1: Components of the current account

				in 12 months to							
	2012	2013	2014	Apr.14	Apr.15	13Q4	14Q1	14Q4	15Q1	Apr.14	Apr.15
						in EUR million					
Current account balance	954	2,027	2,150	1,872	2,241	480	338	634	441	254	241
1. Goods	-36	763	1,307	857	1,257	48	298	370	339	141	50
2. Services	1,509	1,755	1,707	1,672	1,838	339	320	389	404	148	196
2.1. Transport	633	654	719	672	755	151	162	174	185	60	73
2.2. Travel	1,278	1,345	1,322	1,319	1,360	309	255	319	281	98	109
2.3. Other	-401	-243	-334	-318	-277	-121	-97	-103	-62	-10	13
3. Primary income	-292	-243	-612	-402	-598	-2	-115	-179	-133	1	33
3.1. Labour income	376	348	416	363	412	94	94	96	91	43	42
3.2. Investment income	-911	-899	-1,238	-1,066	-1,167	-170	-292	-315	-244	-101	-78
3.3. Other income	243	309	210	301	157	75	83	40	20	59	69
4. Secondary income	-227	-249	-252	-255	-257	95	-165	53	-169	-37	-38
						in % of BDP					
Current account balance	2.7	5.6	5.8	5.1	6.0	5.2	3.9	6.7	5.0	8.1	7.5
1. Goods	-0.1	2.1	3.5	2.3	3.3	0.5	3.5	3.9	3.8	4.5	1.5
2. Services	4.2	4.9	4.6	4.6	4.9	3.7	3.7	4.1	4.5	4.7	6.1
2.1. Transport	1.8	1.8	1.9	1.8	2.0	1.6	1.9	1.8	2.1	1.9	2.3
2.2. Travel	3.5	3.7	3.5	3.6	3.6	3.3	3.0	3.4	3.2	3.1	3.4
2.3. Other	-1.1	-0.7	-0.9	-0.9	-0.7	-1.3	-1.1	-1.1	-0.7	-0.3	0.4
3. Primary income	-0.8	-0.7	-1.6	-1.1	-1.6	0.0	-1.3	-1.9	-1.5	0.0	1.0
3.1. Labour income	1.0	1.0	1.1	1.0	1.1	1.0	1.1	1.0	1.0	1.4	1.3
3.2. Investment income	-2.5	-2.5	-3.3	-2.9	-3.1	-1.8	-3.4	-3.3	-2.7	-3.2	-2.4
3.3. Other income	0.7	0.9	0.6	0.8	0.4	0.8	1.0	0.4	0.2	1.9	2.2
4. Secondary income	-0.6	-0.7	-0.7	-0.7	-0.7	1.0	-1.9	0.6	-1.9	-1.2	-1.2
						nominal year-on-year growth rates in %					
Export of goods and services	1.6	2.4	6.1	2.8	6.0	2.7	4.6	9.2	5.1	2.8	0.8
Export of goods	1.0	2.1	6.6	2.5	6.3	2.9	4.9	9.9	4.9	1.7	-0.9
Export of services	4.1	3.9	4.1	3.9	4.8	1.8	3.2	5.9	6.4	7.8	8.3
Transport	2.9	3.4	9.5	4.2	9.6	4.4	7.5	11.1	6.4	6.3	11.1
Travel	1.7	1.5	0.4	3.9	1.4	3.7	2.4	1.3	7.8	6.7	6.3
Other	8.0	7.1	4.1	3.7	5.0	-1.5	0.5	6.2	5.0	9.9	7.9
Import of goods and services	-2.3	-1.6	4.7	1.1	4.4	3.3	4.8	3.9	3.6	3.3	3.0
Import of goods	-3.1	-1.7	4.2	0.7	4.7	3.5	3.3	4.1	4.3	1.7	4.1
Import of services	2.8	-1.2	7.4	3.2	2.5	1.7	15.6	2.8	-1.0	13.5	-3.1
Transport	-1.6	3.4	9.1	2.6	7.1	6.5	7.5	8.3	0.2	2.1	1.3
Travel	-10.6	-4.9	4.3	2.2	-1.6	-7.1	36.0	-3.2	2.9	19.1	-2.7
Other	10.0	-1.6	7.9	3.7	2.4	2.3	14.4	2.3	-2.4	16.6	-4.8

Source: Bank of Slovenia.
Note: Shares in GDP are calculated on the basis of monthly estimates of GDP.

Figure 3.8: Net interest payments on loans and long-term debt securities



Source: Bank of Slovenia.

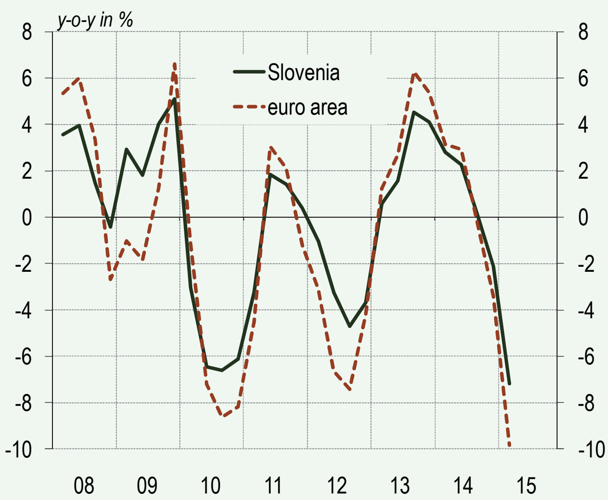
in net labour income was practically unchanged at EUR 134 million. The deficit in net capital income narrowed sharply by EUR 70 million in year-on-year terms to EUR 333 million. The largest factor was net outflows of dividends, which were down EUR 76 million in year-on-year terms. The year-on-year widening of the deficit in interest income on debt securities slowed sharply to just EUR 22 million, compared with EUR 110 million over the first four months of last year, as a result of better general government refinancing terms. The deficit in net interest on investments (loans and deposits other than securities) narrowed by EUR 14 million, primarily as a result of the smaller deficit recorded by financial intermediaries other than banks, insurance corporations and pension funds, which is in line with lower interest rates. At the same time the government sector's surplus in primary income narrowed by EUR 60 million, which is related to the larger deficit in net taxes on products and a deterioration in the disbursement of EU funding for agriculture.

The deficit in secondary income remains stable. It amounted to EUR 207 million over the first four months of the year, up just EUR 5 million on the same period last year. The government sector's deficit in secondary income, which is based on payments of EU own resources based on VAT and gross national income, remained practically unchanged at EUR 153 million. Other sectors' deficit in secondary income also remained practically unchanged from the first four months of last year, at EUR 54 million. The main factors in the other sectors' deficit remain outflows of current taxes on income and assets, social security contributions and non-life insurance claims, while there remains a surplus in social security benefits.

Selected competitiveness indicators[7]

The euro's slide against the currencies of the majority of the main trading partners increased sharply in the first quarter of 2015, which led to a record decline in the euro area's harmonised competitiveness indicators against external markets. Slovenia's price competitiveness indicator against other euro area countries also strengthened, as a result of domestic deflation. In the early part of the year the euro fell most against the Chinese yuan, the US dollar and the South Korean won, and also fell more than in 2014 against the pound sterling and the Swiss franc. The year-on-year fall in the euro as measured by Slovenia's nominal harmonised competitiveness indicator against 19 major trading partners outside the euro area was at its highest since 2000, which in the wake of the negative growth in domestic prices sharply strengthened Slovenia's price competitiveness against these countries, and also against euro area countries. The nominal external competitiveness

Figure 3.9: Nominal harmonised competitiveness indicator (vis-a-vis 19 trading partners outside the euro area)



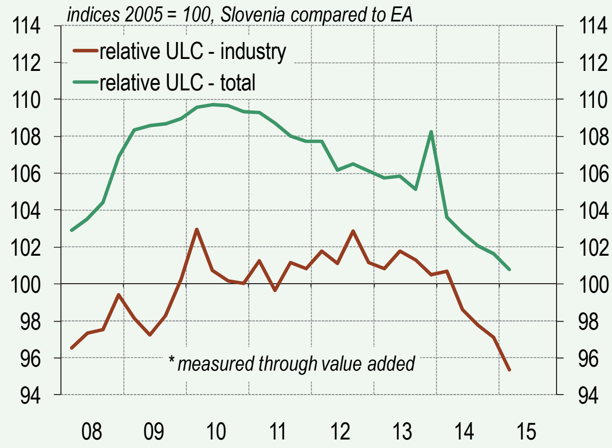
Source: ECB.

[7] 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 3.10: Harmonised cost competitiveness indicators* (based on ULC deflators)

Source: ECB.

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.

indicator across the euro area improved more than did Slovenia's, as a result of the different make-up of exports and the corresponding difference in the shares of foreign currencies in the indicator.

Slovenia's cost competitiveness as measured by unit labour costs (ULCs) strengthened in year-on-year terms at the end of last year relative to the majority of major trading partners inside and outside the euro area. Developments in domestic ULCs remained favourable in the first quarter of 2015. Domestic ULCs fell again in year-on-year terms in the final quarter of 2014 in all the main industrial sectors, and also in the majority of services, in contrast to the previous quarter. ULCs in the total economy fell by 4% in year-on-year terms, which was mostly attributable to a base effect in the public sector as a result of the extraordinary payment for the elimination of wage disparities in the final quarter of 2013. The year-on-year fall in domestic ULCs therefore slowed slightly in early 2015, although the trend remained downward. As in the majority of last year, the key factor is growth in labour productivity in industry. ULCs also fell in all the main service sectors other than financial and insurance activities. In the sectors of wholesale and retail trade, transportation and storage, and accommodation and food service activities, this was attributable not only to growth in labour productivity, but also for the first time since 2012 to a decline in employee compensation. Of the other euro area countries, only Cyprus and Belgium saw a fall in ULCs in the first quarter of 2015. Growth in ULCs across the euro area remained at around 1.3%. This was again primarily the result of a rise in compensation per employee in all the major sectors of the economy.

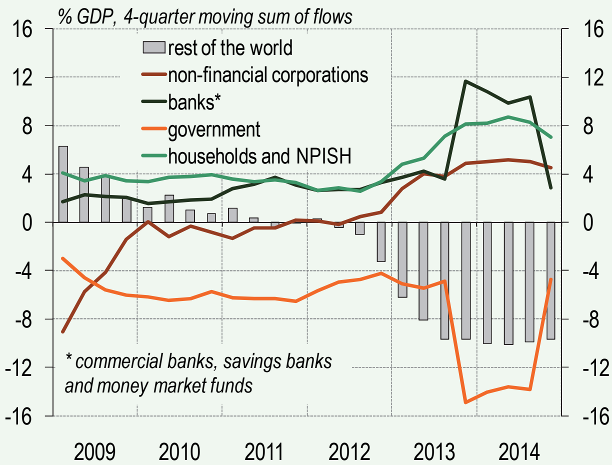
4 | Financing

The gradual improvement in the macroeconomic situation is bringing an improvement in financing conditions. All the non-government sectors generated financial surpluses last year, which significantly exceeded the government deficit and resulted in Slovenia generating an overall financial surplus against the rest of the world in the amount of 10% of GDP. The corporate sector primarily directed its surplus into debt repayments, while households focused on saving and on increasing bank deposits. This is an indication of the restoration of confidence in the banks, which last year improved their funding structure, thereby reducing systemic risks. Despite favourable funding conditions, the banks remain cautious in their investments, and are maintaining credit standards that remain a strong limiting factor on the loan supply side.

Saving-investment gap by sector

The recovery of the domestic economy based on sharper export demand and weaker domestic demand has been reflected in a large surplus in saving over investment. The surplus, which is evidenced as a financial surplus against the rest of the world, stood at just under 10% of GDP last year, practically unchanged from 2013. In the context of weak real growth in investment, corporates continued to generate a financial surplus last year, which narrowed slightly in the second half of the year to end the year at just over 4% of GDP. The surplus was primarily directed into debt repayments and into the recovery of their balance sheets and deleveraging. An even larger surplus of around 7% of GDP was generated last year by households, which, given the adverse situation on the labour market and high unemployment, were cautious in their spending. Like the corporate sector, households slightly reduced their surplus in the second half of the year as the situation in the economy improved slightly and deposit rates fell. The banking sector's financial surplus increased significantly, albeit only temporarily, as a result of government capital transfers to stabilise the banking system, which also brought a temporary increase in the government sector's financial deficit.

Figure 4.1: Savings-investment gap



Note: Figures for Q4 2013 were influenced by the transfer of bank assets to BAMC after AQR/ST.
Source: Bank of Slovenia - nonconsolidated financial accounts, SORS.

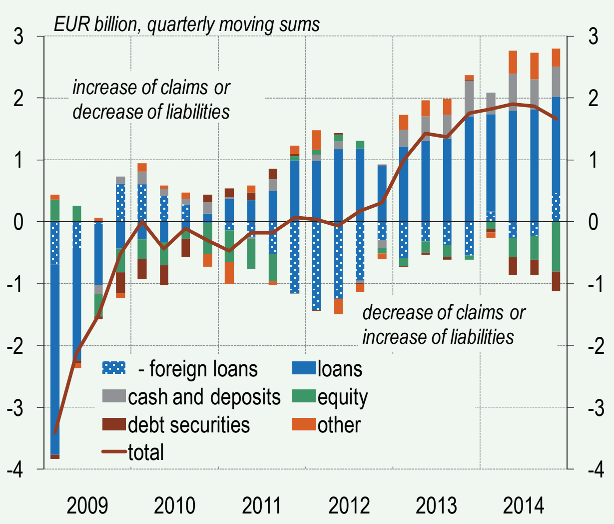
Financing and corporate financing conditions

Corporates are continuing to make debt repayments and are strengthening their balance sheets. They are primarily earmarking the positive financial flow from operating activities to make loan repayments and to increase liquidity, and partly to increase equity. Corporates thus succeeded in repaying around EUR 2 billion of loans last year. Whereas two years ago corporates made debt repayments to domestic banks by raising new loans abroad, last year their loan exposure to other countries actually declined. This was facilitated by the improved situation on the money and financial markets after the successful recovery of domestic banks on one side and the ECB's expansionary monetary policy on the other side. In the situation of low interest rates, corporates are maintaining part of the surplus in cash and sight deposits, particularly to protect against still-present payment indiscipline. To improve their balance sheets and credit ratings, last year they also earmarked part of the surplus into increasing equity. Liabilities for equity increased by almost EUR 1 billion last year, primarily to the rest of the world.

The recovery of corporate balance sheets is essential for investment and stable economic growth. The improved economic situation in the last two years allowed for a gradual improvement in the corporate sector's net financial position. Leverage has declined significantly over the last two years, and stood at just 110% at the end of last year. Although this figure is still higher than in certain other European countries, the gap with the average is continuing to narrow. In addition to the recovery of the banking system, the recovery of corporate balance sheets was the final obstacle before the renewal of private-sector investment and more-stable economic growth. Given the current situation on the money and financial markets, private-sector investment could even strengthen this year.

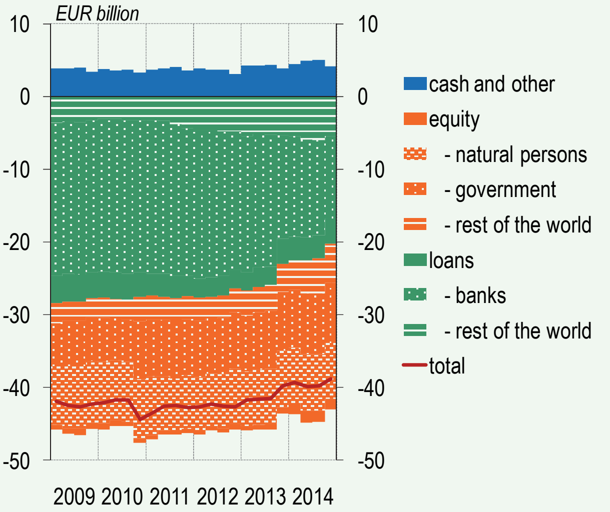
Corporate financing conditions are improving, in terms of price and other factors. The ECB began additionally expanding the money supply with the launch of a programme of purchases of certain government bonds,

Figure 4.2: Net financial transactions of NFCs (S.11)



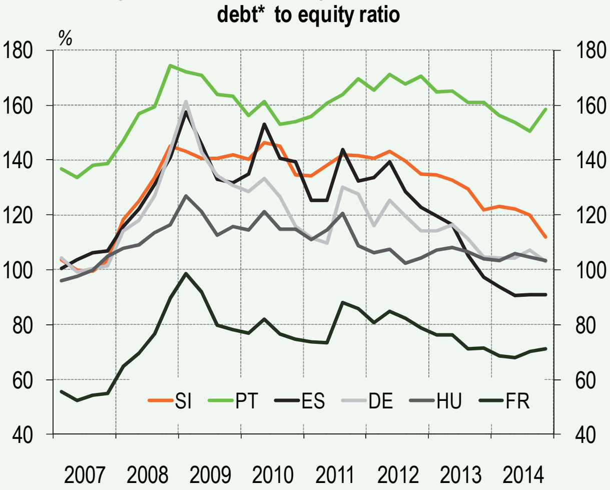
Source: Bank of Slovenia, consolidated data.

Figure 4.3: Net financial position of NFCs and sources of financing



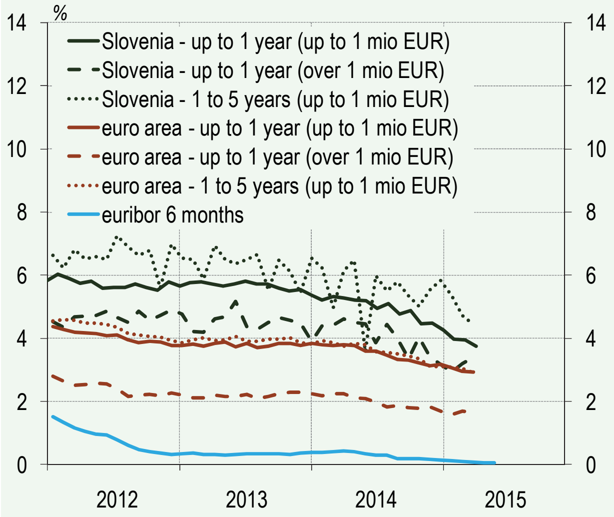
Source: Bank of Slovenia.

Figure 4.4: Cross country comparison of NFCs debt* to equity ratio



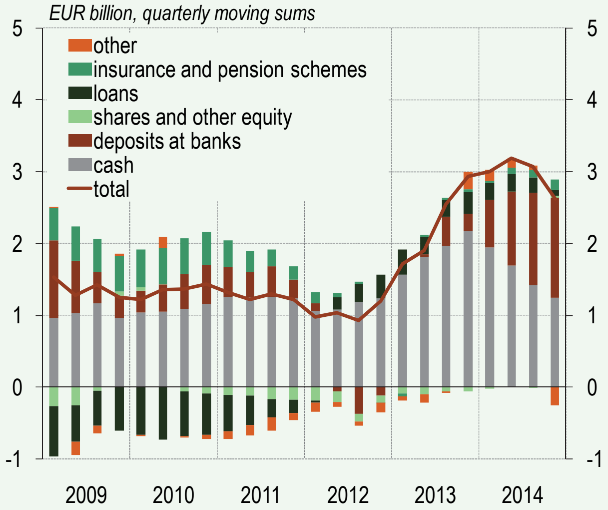
Source: ECB, BoS calculations.
Note: *Securities other than shares, loans and other accounts payable.

Figure 4.5: Interest rates on loans to NFCs



Sources: ECB, Bank of Slovenia.

Figure 4.6: Net financial transactions of households and NPISH



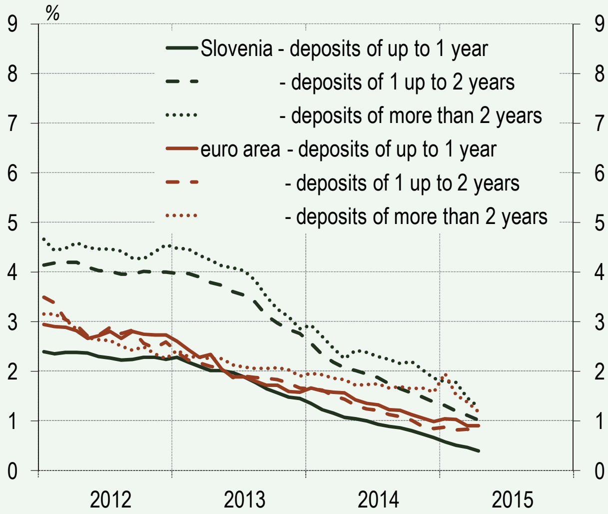
Source: Bank of Slovenia, consolidated data.

aiming towards further reduction and convergence in interest rates. Interest rates in Slovenia remain above the euro area average, but the spread is narrowing. It is narrowest on short-term interest rates, at just under 1 percentage point, while the spread on long-term interest rates is around 2 percentage points. Bank surveying reveals that in the context of fierce competition in the banking sector the excess liquidity and the low cost of money have also brought an easing of credit terms in addition to lower interest rates.

Household financing and saving

Households slightly reduced their investments last year, but increased their confidence in the banking system. Like corporates with investments, households were cautious too in their spending last year, despite a gradual rise in disposable income and a fall in prices. They thus saved almost EUR 3 billion in financial assets last year, only slightly less than in the previous year. In the previous year the financial surplus was primarily directed into the statistical aggregate of cash, while last year cash accounted for less than half of the total surplus and the rest went into sight deposits and fixed-term deposits. This is additional indication of the successful recovery of the banking system, and of households' increased confidence in the commercial banks and the domestic banking system. Households nevertheless

Figure 4.7: Interest rates on household deposits, by maturity

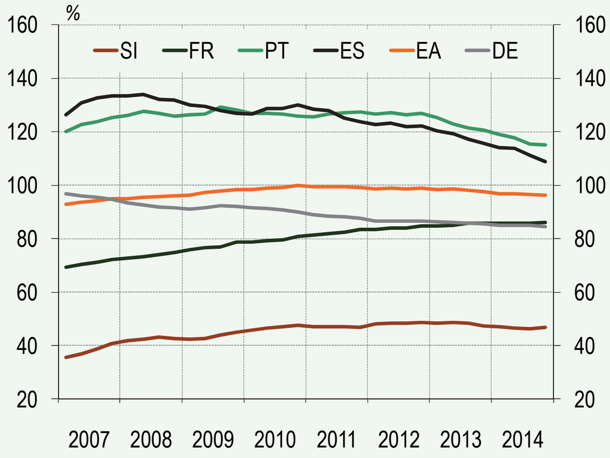


Sources: ECB, Bank of Slovenia.

remain cautious as sight deposits accounted for the vast majority of deposits.

In addition to precautionary motives, the fall in interest rates remains an additional factor in average deposit maturity. Interest rates on deposits of all maturities fell last year in Slovenia and in the other euro area countries. In the wake of additional expansionary measures by the ECB, the fall has continued this year, thereby bringing a further deterioration in the terms of depositing. Interest rates on short-term deposits in Slovenia remain below the euro area average, which could in the future cause the gradual outflow of deposits or a search for alternative higher-yielding investments. By contrast, interest rates on medium-term and long-term deposits remain above the

Figure 4.8: Cross country comparison of household indebtedness*

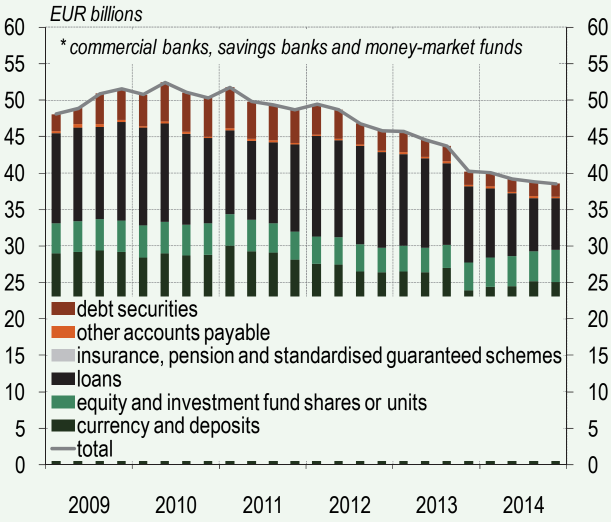


Source: ECB.
*Note: * Indebtedness is calculated as debt (loans+debt securities) over gross disposable income.*

euro area average, which is preventing their potential outflow and is maintaining favourable conditions for financing long-term private-sector investment.

Despite the favourable financing situation, households did not undertake additional borrowing last year, and remain among the least-indebted. Household financial liabilities amounted to just over EUR 12 billion at the end of last year, broadly unchanged from the end of 2013. Long-term loans declined slightly, but this led to an increase in commercial credits, which are growing. In an environment of low interest rates and fierce competition, commercial credits are becoming increasingly popular among the retail sector in the form of providing interest-free financing of goods they are selling to

Figure 4.9: Financial liabilities of banks* (S.122 and S.123)



Source: Bank of Slovenia, non-consolidated data.

households. Nevertheless, Household indebtedness in Slovenia remains low, and is barely half of the euro area average. Slovenian households also remain in the lowest -risk class of bank customers with less than 5% of non-performing loans.

Bank funding

The increased confidence in the banking system also helped to a gradual improvement in the structure of bank funding. The gradual rise in deposits by the non-banking sector, households in particular, is an indication of the restoration of confidence in the domestic banks and the banking system. Because these deposits are the most stable and most important class of bank funding, systemic risks are also diminishing. In addition to the rise in deposits, last year the banks succeeded in making early repayments of a significant portion of the liabilities to the ECB, which as a ratio to total assets are now below their pre-crisis level. The structure of bank funding has altered significantly in the last year, and is becoming similar to that seen before the period of increased borrowing from abroad.

The banks remain cautious in their investments, despite the favourable funding conditions. The banking sector's financial assets declined by an additional EUR 2.5 billion last year to stand at EUR 42.3 billion at end of the year. The breakdown of bank investments altered in favour of investments in securities, primarily on account of the decline in loans transferred to the BAMC. Despite the fall in lending interest rates and the narrowing spread with euro area interest rates, the banks' credit standards remain a strong limiting factor on the supply side. These have been tightened more than in other euro area countries since the outbreak of the crisis.

Domestic financial market

The cumulative volume of trading in shares on the Ljubljana Stock Exchange over the first five months of this year declined by 37% to EUR 140.9 million. The negative trend in the volume of trading in shares is having a negative impact on the turnover ratio, which has

Box 4.1: Bank performance in 2014 and early 2015

The contraction in the banking system's total assets has continued in 2015. Continuing debt repayments on the wholesale markets saw the banks' funding structure approach that of ten years ago, before the banks began borrowing extensively on foreign markets. Following the final repayment of liabilities from the 3-year LTRO, the banks also sharply reduced their financing at the Eurosystem. Corporate lending remains weak, although recently there have been signs of a potential reversal in bank lending activity. The quality of the banks' credit portfolio is continuing to improve, despite the contraction in turnover, while thanks to good coverage by impairments and increased capital adequacy the banks are more resistant to any credit risk losses.

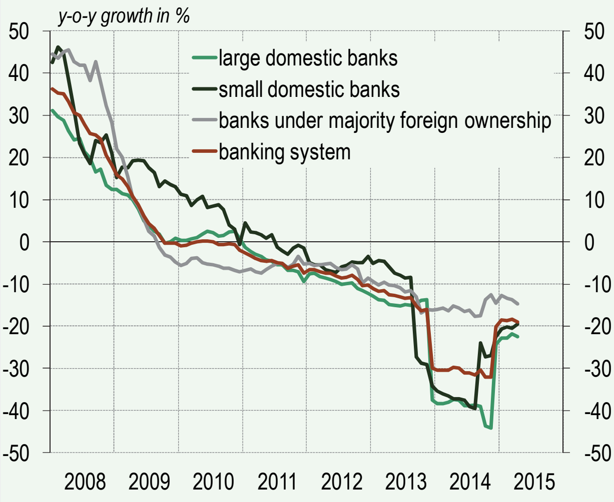
The year-on-year contraction in loans to the non-banking sector reached 11.4% at the end of April, or 8.9% if the transfers to the BAMC in the final quarter of last year are excluded. The contraction in loans to non-financial corporations began to slow in the first quarter at the large domestic banks, and also at the small domestic banks, as a result of growth in lending at the savings banks. New loans in the maturity segment of more than 1 year have been increasing since the second half of last year. The trend came to an end in April: after year-on-year growth of 10% in new long-term loans in the first quarter, the rate of growth fell slightly below zero in April, and remains negative for short-term loans. The banks have maintained high credit standards on corporate loans, but access to loans has improved with this year's sharp falls in lending rates. Average interest rates on loans of up to EUR 1 million fell by 0.8 % over four months. The spread over average interest rates across the euro area declined to below 1 percentage point, down from a high 3.5 percentage points in 2010 and 2 percentage points in 2013.

Growth in household loans has improved in the early part of this year, from last year's average of -3.5% to around zero. Growth in housing loans remains at 2.5%, while growth in consumer loans is still negative in the amount of 5.5%. The figures for new loans to households notably reveal an increase in housing loans, while long-term consumer loans are increasing as short-term consumer loans decline.

Over the first four months of the year the stock of securities on the banks' balance sheets remained similar to last December, while the relatively high year-on-year growth of 17% was primarily the result of additional recapitalisations and the receipt of BAMC securities by two banks in the final quarter of last year. Securities account for a quarter of the banks' total assets, up 10 percentage points on the end of 2008. The increase in the figure over this period is partly a reflection of the aforementioned institutional factors, and partly a reflection of the banks' switch to lower-risk investments.

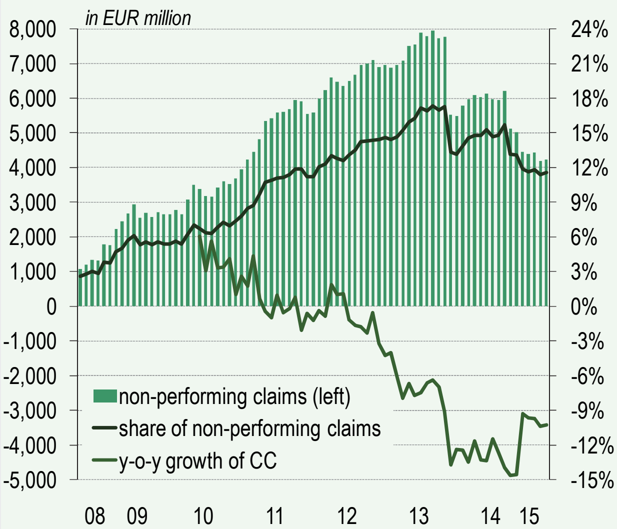
The banks' non-performing claims declined significantly as a result of the transfers to the BAMC, but the developments since the second half of last year, particularly since October, indicate an improvement in the quality of the claims in the remaining part of the portfolio. This was attributable to positive trends in the corporate sector, which last year doubled its net profits, which increased debt servicing capacity. Non-performing claims accounted for 11.6% of the banks' classified claims in April, compared with 11.9% at the end of 2014. This year's largest decline in the proportion of non-performing

Figure 1: Loans to non-financial corporates



Source: Bank of Slovenia.

Figure 2: Non-performing claims



Source: Bank of Slovenia.

claims over the first four months of this year was recorded by non-residents: the figure was down 2.6 percentage points at 18.2%. Non-performing claims also declined in absolute terms in the corporate segment, although the ongoing contraction in the portfolio meant that the proportion of classified claims against the sector that they account for increased by 0.3 percentage points to 18%. The proportion of non-performing claims against households fell from its peak of 4.6% in November 2014 to 4.2% in April.

Even after the transfer of non-performing claims to the BAMC construction remains the sector with the highest proportion of non-performing claims, but the trend of decline seen throughout 2014 continued over the first four months of the year. A decline in terms of both stock and relative proportion was also recorded by manufacturing and by wholesale and retail trade.

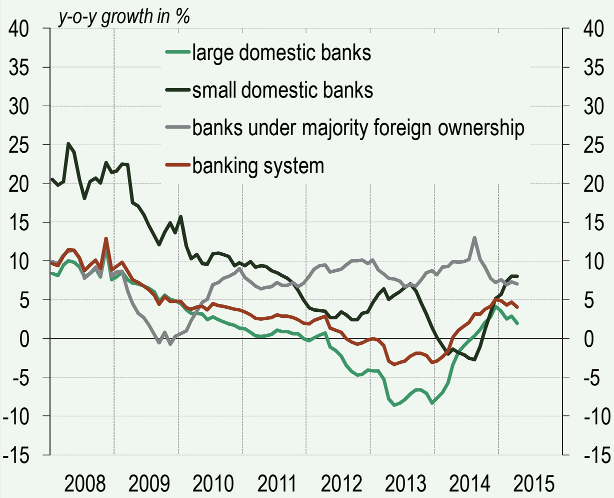
Slovenian banks have further reduced their liabilities to the Eurosystem this year. In January and February they repaid the remaining debt from the 3-year LTROs. The banks minimally increased their liabilities to the Eurosystem in the third TLTRO in March of this year. The Eurosystem accounted for just 2.3% of funding in April.

This year's debt repayments to banks in the rest of the world have been similar to last year, at just under EUR 0.5 billion. Recently it has primarily been the banks under majority foreign ownership making debt repayments, the large domestic banks having made intensive debt repayments to foreign banks in previous years. The stock of issued debt securities also declined, as a result of bond repayments in the amount of close to EUR 0.5 billion. Total wholesale funding accounted for just 13.5% of bank funding in April, compared with 35% at the end of 2008.

Deposits by the non-banking sector increased by EUR 0.55 billion over the first four months of the year, and were up 4.7% in year-on-year terms in April. The government sector is most notable in terms of the increase, primarily as a result of short-term fluctuations in these deposits owing to temporary changes in overnight placements at the end of 2014 in order to meet the macro-prudential instrument. Growth in household deposits is slowing, but still reached 4.1% in April. Some deposits have been redirected into investment funds, which have been recording increased net inflows from households since last March. Investor conservatism means that it is unlikely that savings will be directed more into higher-risk investments.

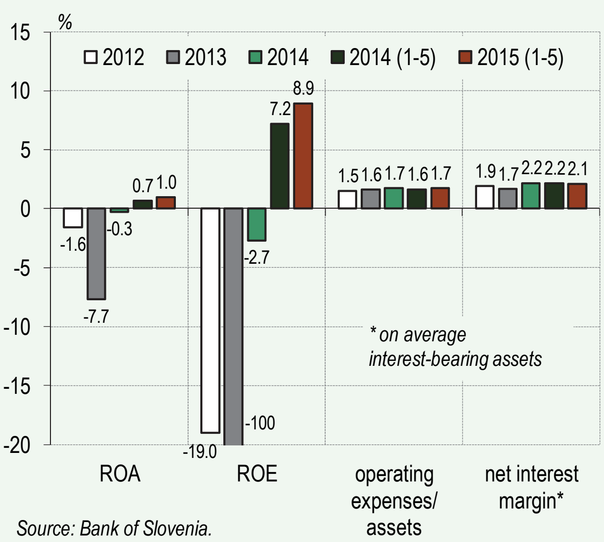
The banks generated a pre-tax profit of EUR 123 million over the first four months of the year, primarily as a result of a decline in impairment and provisioning costs. The banking system's gross income over the first four months of the year was down 4% in year-on-year terms, as a result of a decline of 6.8% in net interest. Interest income was down 21%, while the decline in interest expenses was significantly larger at 41%. The latter declined as a result of the fall in interest rates and also the shortening of average deposit maturities, most notably the increase in the proportion of sight deposits. Impairment and provisioning costs amounted to EUR 60 million, down 47% in year-on-year terms. The solid profit saw the banks realise favourable performance indicators.

Figure 3: Household deposits



Source: Bank of Slovenia.

Figure 4: Banking performance indicators

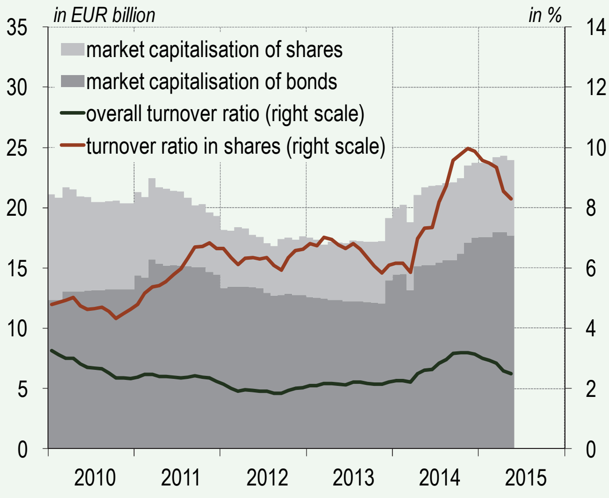


Source: Bank of Slovenia.

been continuously declining over the last six months. Shares in three issuers, whose market capitalisation amounted to EUR 215.8 million at the end of last year, were delisted from the stock exchange over this period. The delisting of the issuers' shares did not have a significant impact on the market capitalisation of shares, which increased by 0.9% over the first five months of the year to EUR 6,267.1 million. This was partly attributable to the rise of 1% in the SBI TOP, Slovenia's main share index.

The volume of trading in bonds also fell over the first five months of this year. It was down 54% on the same period last year at EUR 15.4 million. SOS2E bonds maturing in June 2016 accounted for 59.1% of all trading. The market capitalisation of bonds increased by 0.8% over the first five months of the year to EUR 17.7 million. During this period the government issued a new 20-year benchmark bond with a total nominal value of EUR 1 billion, a coupon rate of 1.5% and a yield to maturity of 1.553%. With this issue the government covered its needs for financing the state budget for 2015, and part of those for 2016. In May the Ministry of Finance held an auction for 3, 6- and 12-month treasury bills in the total amount of EUR 63.5 million on the domestic market. The average yield at issue in May was slightly higher than in April, while there was no demand at the auction of the 3-month bills.

Figure 4.10: Market capitalisation on the LJSE in EUR billion and annual turnover ratios (TR)



Source: Ljubljana Stock Exchange.

5 Public Finances

The government's main objective for this year in the fiscal area is the durable correction of the excessive general government deficit, thereby moving Slovenia to the preventive arm of the Stability and Growth Pact. The general government deficit is targeted at 2.9% of GDP this year. The available figures for developments in the first half of the year suggest for the moment that the plans are feasible, although precise monitoring and prompt action in the event of deviations will be required. General government revenues according to the ESA 2010 recorded faster year-on-year growth in the first quarter than did expenditure. Expenditure on interest increased further, but significantly less than in previous quarters, while investment was similar to that recorded a year earlier. According to the available figures, revenues from taxes and contributions (cash flow figures) during the first five months of the year were up approximately 4% in year-on-year terms. Hedging against currency risk was the sole factor raising the general government debt in the first quarter, which stood at 81.9% of GDP. The required yields on euro area government bonds have been favourable in recent months, which has also been reflected in the required yields on Slovenian government bonds.

Attention in the coming months will focus on measures to reduce the general government deficit in 2016. In this year's update to the Stability Programme the government announced the replacement of short-term measures with longer-term or structural measures.

General government deficit

Slovenia is expected to reduce its general government deficit to below 3% of GDP after six years above. The general government deficit was large in the preceding period because of the adverse general economic situation and moreover because of transactions of a one-off nature, but this year's developments have been more favourable. Economic growth is forecast to again exceed 2%, while government recapitalisations of banks, which were the main reason for the large deficit in 2013 in particular, are not anticipated.[8] The deficit is targeted at 2.9% of GDP this year, while after interest payments a primary surplus of 0.2% of GDP is planned. The primary position is thus forecast to improve again relative to last year, when a primary deficit of 0.2% of GDP was recorded (after the exclusion of interest payments, bank recapitalisations, liabilities to Ljubljanska banka savers for principal on the basis of a judgement by the European Court of Human Rights, and concession fees for mobile telephony radio spectrum).

General government revenues in the first quarter of this year were up in year-on-year terms, which was attributable to the improved economic situation and higher taxation. General government revenues were up 3.4% in year-on-year terms, as a result of the introduction of certain legislative changes and the improved situation

[8] For any such future interventions the Bank Resolution Authority and Fund Act was adopted in December 2014: in case of need, bank recapitalisations are to be executed from the aforementioned fund in future.

Table 5.1: General government deficit and debt in Slovenia 2012–2019

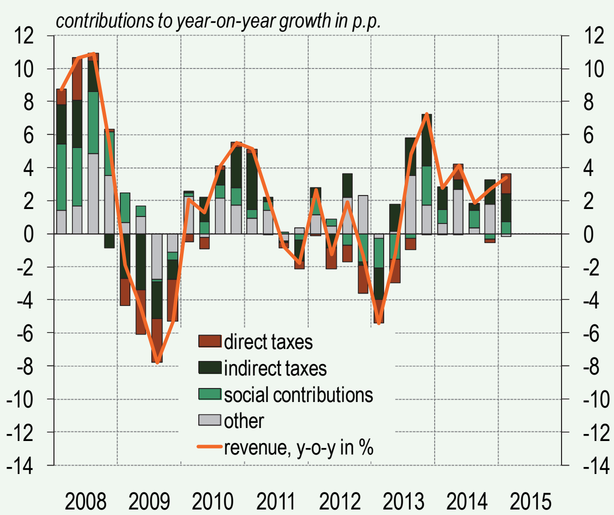
	SORS			Draft Budgetary Plan		Stability Programme					EC	
as % BDP	**2012**	**2013**	**2014**	**2014**	**2015**	**2015**	**2016**	**2017**	**2018**	**2019**	**2015**	**2016**
Revenue	44.6	45.0	45.0	45.3	44.4	44.7	43.1	42.5	42.0	41.5	44.8	43.4
Expenditure	48.6	59.9	49.8	49.7	47.2	47.6	45.3	44.3	43.4	42.4	47.7	46.2
of which: interest	2.0	2.5	3.3	3.3	3.2	3.1	2.9	2.6	2.5	2.4	3.1	2.9
Net lending (+) / borrowing (-)	-4.0	-14.9	-4.9	-4.4	-2.8	-2.9	-2.3	-1.8	-1.4	-0.9	-2.9	-2.8
excl. support to fin. Institutions	-3.8	-4.8	-3.9	-3.5	-2.8	-2.9	-2.3	-1.8	-1.4	-0.9	-2.9	-2.8
Structural balance	…	…	…	-2.8	-2.4	-2.2	-1.6	-1.3	-1.0	-0.8	-2.4	-2.9
Debt	53.7	70.3	80.9	82.2	83.2	81.6	78.7	79.6	79.4	78.2	81.5	81.7
Real GDP (growth, %)	-2.6	-1.0	2.6	2.0	1.6	2.4	2.0	2.1	2.2	2.2	2.3	2.1

Source: SORS (realization), Ministry of Finance – Draft Budgetary Plan 2015 (October 2014) and Stability Programme (April 2015), European Commission (EC, May 2015).

on the labour market. The legislative changes include a higher tax on financial transactions and insurance services, a rise in the amount payable for a unit of CO_2 emissions, and a rise in excise duties. This year also saw a rise in the taxation of student work as a result of the introduction of contributions for pension and disability insurance. With regard to income tax, the fourth bracket has been retained for this year. The highest growth in the first quarter was recorded by revenues from direct taxes. Indirect taxes were up 5.1% in year-on-year terms in the wake of weak real growth (a nominal decline) in consumption, and the aforementioned legal changes. The rise in revenues was also attributable to favourable developments on the labour market, which was evidenced in a rise of 2.1% in net social security contributions.

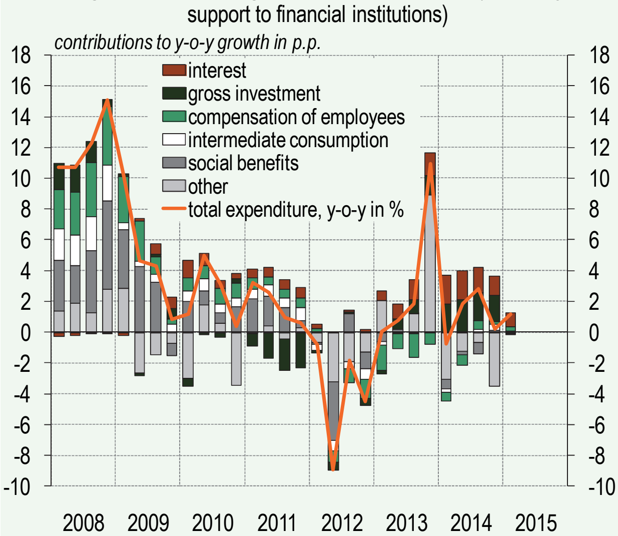
Growth in general government expenditure in the first quarter was slower than that of general government revenues. Growth in interest expenditure slowed, while investment was at approximately the same level as last year. Year-on-year growth in general government expenditure stood at 1.2% in the first quarter. All the main categories of expenditure other than social benefits and investment increased. Expenditure on intermediate consumption increased by 0.5%, slightly less than last year. Investment in the first quarter was approximately unchanged in year-on-year terms, but according to the Ministry of Finance's projections is expected to significantly

Figure 5.1: General government revenue



Source: SORS, Bank of Slovenia calculations.

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

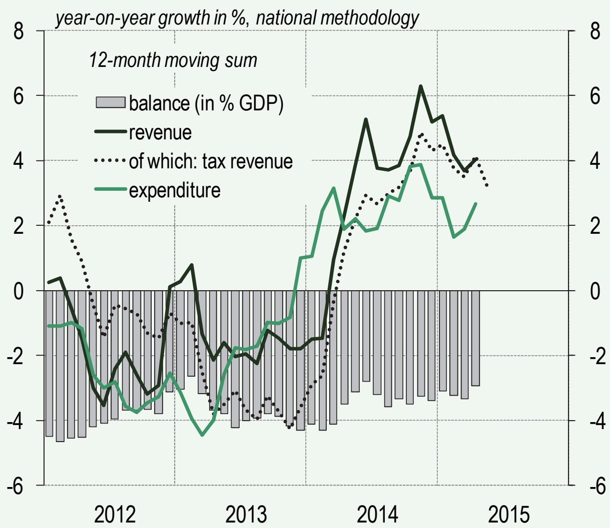


Source: SORS, Bank of Slovenia calculations.

Box 5.1: Public finance developments according to cash flow methodology, January to April/May 2015

The consolidated general government deficit over the first four months of this year narrowed by EUR 155 million in year-on-year terms to EUR 551 million. Having been at last year's level in the first quarter of this year, in April the position was significantly better in year-on-year terms. The main increase during the first four months of the year was in tax revenues, while non-tax revenues were down. Growth was recorded by all the major categories of taxes and contributions. The largest increase was recorded by corporate income tax, partly as a result of April's settlements for the previous year. Personal income tax and social security contributions increased in line with the wage bill (by around 3% in year-on-year terms). VAT payments were up just over 5%, while excise duties were up even more. The sharp growth in certain taxes is a reflection of legislative changes, including a rise in the level of excise duties, a rise in the charge for CO_2 emissions, and a rise in the tax on financial services. The macroeconomic situation is also more favourable. By contrast, non-tax revenues declined, as a result of a reduced payment of surplus from the government's management of the single treasury account into the state budget. The state budget position in May deteriorated by EUR 139 million in year-on-year terms, mostly as a result of lower non-tax revenues (last year saw the payment of the concession fee for mobile telephony radio spectrum), while

Figure 1: Public finance developments



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

Table 1: Consolidated general government (GG) balance*

	2014	last 12 months to Apr.15			2014 Jan.-Apr.	2015 Jan.-Apr.	Jan.-Apr.15
	EUR millions		% GDP	y-o-y, %	EUR millions		y-o-y, %
Revenue	**15,494**	**15,649**	**41.6**	**4.0**	**4,920**	**5,075**	**3.2**
Tax revenue	13,193	13,454	35.8	4.1	4,263	4,525	6.1
- goods and services	5,191	5,304	14.1	4.3	1,616	1,728	7.0
- social security contributions	5,272	5,327	14.2	3.1	1,740	1,794	3.1
- personal income	1,916	1,933	5.1	2.4	673	690	2.6
- corporate income	468	537	1.4	22.9	166	235	41.3
From EU budget	1,040	1,049	2.8	9.3	307	315	2.7
Other	1,261	1,146	3.0	-1.5	350	236	-32.7
Expenditure	**16,755**	**16,756**	**44.5**	**2.7**	**5,625**	**5,626**	**0.0**
Current expenditure	7,043	7,040	18.7	3.3	2,546	2,543	-0.1
- wages and other personnel expenditure (incl. contributions)	3,610	3,616	9.6	-0.1	1,207	1,213	0.5
- purchases of goods, services	2,233	2,198	5.8	0.0	715	680	-4.9
- interest	1,097	1,098	2.9	23.6	595	595	0.1
Current transfers	7,592	7,568	20.1	-1.2	2,574	2,551	-0.9
- transfers to individuals and households	6,335	6,349	16.9	0.4	2,093	2,107	0.7
Capital expenditure, transfers	1,717	1,734	4.6	21.9	309	327	5.5
To EU budget	403	413	1.1	-2.9	195	206	5.3
GG surplus/deficit	**-1,261**	**-1,106**	**-2.9**		**-705**	**-551**	

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.*

tax revenues were also down, albeit only because of the deferral of certain excise duty payments to the next month.

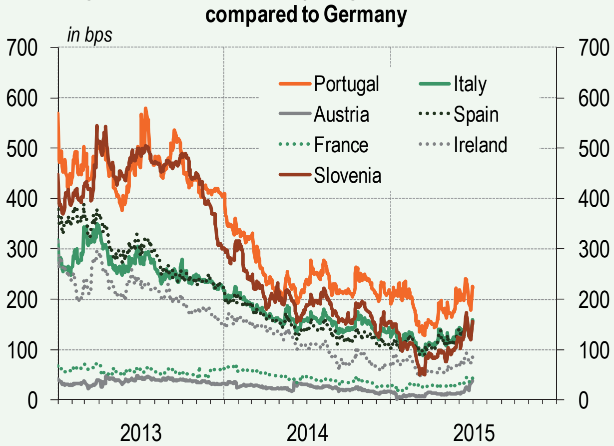
Consolidated general government expenditure over the first four months of the year was approximately at the level of last year, although developments in individual types of expenditure varied. The stabilisation of interest payments at the level of the previous year is most notable development, while growth in investment also slowed. These were two categories of expenditure that had grown faster in the previous period. Expenditure on goods and services and expenditure on subsidies declined. Growth in transfers to individuals and households was low. Expenditure on unemployment benefits is continuing to decline, while expenditure on social security transfers is increasing (both at rates of around 10%). Growth in expenditure on pensions slowed significantly, to 0.5% in year-on-year terms. Growth in the number of pensioners slowed to approximately the same level.

increase again this year (by just under 15%) owing to the conclusion of the European financial perspective. Expenditure on compensation of employees was up 1.3%, as employment in the government sector rose by 0.2%. Expenditure on social benefits was approximately the same as in the same period last year.

General government debt and government guarantees

The general government debt increased in the first quarter of this year as a result of developments in the hedging against currency risk from bonds issued in US dollars. The general government debt amounted to EUR 30,748 million or 81.9% of GDP at the end of March, up 1 GDP percentage point on the end of last year. The increase is the result of an increase in the amount of hedging[9] paid up by foreign banks for currency risk from bonds issued in US dollars. Excluding the hedging against currency risk, the debt would have declined by around EUR 0.5 billion.

Figure 5.3: Spreads on 10-year government bonds as compared to Germany



Sources: Bloomberg, Bank of Slovenia calculations.
*Note: Spread is calculated as a difference between yield of 10-year government bond and the yield of reference German bond on a daily basis and is used as a measure of country's credit risk. *In the picture, SLOREP 09/24 is used after 1. January 2013.*

Guarantees remain at their level of the end of last year. The stock of guarantees stood at EUR 8.3 billion or 22% of GDP at the end of the first quarter of this year, the same as at the end of last year. Guarantees represent a contingent liability for the government, although a portion of guarantees in the amount of around 6.5% of GDP is already included in the debt. These are guarantees for securities issued by the BAMC, and a portion of the guarantees from the EFSF, the fund designed to bail out euro area countries in financial difficulties.

The required yields on Slovenian government bonds remain low. Required yields on 10-year Slovenian government bonds continued to fall on the financial markets in the first quarter, as did those of other euro area countries, primarily under the influence of the ECB's non-standard monetary policy measures. This was followed in May and June by a partial upward correction, which in late June was also the product of the uncertainty surrounding developments in Greece. Required yields averaged around 2.2% in June, similar to the end of last year.

[9] The government issued bonds in US dollars between 2012 and 2014. The paid-up amount of hedging against currency risk changes weekly, and is primarily dependent on the movement of the current euro exchange rate against the US dollar compared with the exchange rate agreed in the cross currency swap contract. The amount is used when the bond matures for repaying the principal, which is settled in US dollars, but until the maturity of the bond it merely represents hedging and has the nature of a bank deposit.

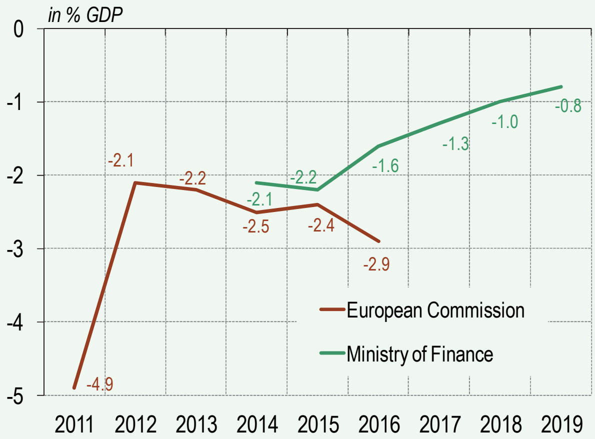
Planned developments in the general government deficit

Slovenia's key fiscal target for this year is to correct the excessive deficit. Slovenia has been in the excessive deficit procedure since 2009, and according to government plans is set to correct it by the stipulated deadline of 2015. The government confirmed its commitment to durably reducing the deficit to below 3% of GDP in this year's update to the Stability Programme. According to the European Commission's spring forecasts, the general government deficit is expected to stand at 2.9% of GDP this year, and 2.8% of GDP next year. The risks to the realisation of the targeted deficit encompass a potential deterioration in the macroeconomic situation, a smaller-than-planned impact from the measures, and uncertainty related to calculation of the deficit under the ESA 2010.[10] According to Ministry of Finance estimates, the structural deficit is expected to actually deteriorate slightly in 2015.

In the Stability Programme Slovenia is planning the gradual reduction of the general government deficit over the 2016 to 2019 period and approaching to the structural balance. After the durable correction of the excessive general government deficit, Slovenia will move to the preventive arm of the Stability and Growth Pact. In this arm the key is the development of the structural general government deficit and the attainment of the medium -term objective. The medium-term objective for Slovenia is a balanced structural position. In general, a country needs to ensure an annual convergence of 0.5% of GDP, but even more if the debt exceeds 60% of GDP and the cyclical conditions in the economy are normal. Slovenia therefore needs to improve its structural deficit by 0.6% of GDP annually. The Stability Programme envisages such an improvement in 2016 only, and later merely by around 0.3% of GDP annually. A structurally balanced general government position is planned for 2020, which is later than forecast in last year's update to the Stability Programme.

Measures to reduce the deficit need to be more structural in nature. Measures of a temporary nature should be replaced with appropriate structural measures. However, May's update to the Stability Programme does not provide detailed information in certain areas as to what the measures would be, and the extent to which they are expected to have an impact. Among the important measures cited by the programme is the need to maintain the current VAT rate as a permanent measure. A more precise specification of (other) measures is expected in the autumn, when the state budgets for 2016 and 2017 are drafted. Activities to this end are already underway, the government having adopted guidelines in June for negotiations with the public sector unions on the wage bill next year.

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 2015.

The government is preparing a review of the health sector, and a white paper on pensions. In conjunction with the World Health Organisation, the Ministry of Health is drawing up analysis of the healthcare system to act as the basis for preparing healthcare reforms. The analysis, including proposals, should be completed by the end of the year, and will be used also for preparing reforms to long-term care. A white paper on reform of pension and disability insurance is also being drawn up, and will act as the basis for public debate on potential measures for the sustainability of the pension system. Attention has also been draw to the urgency of structural reforms in the areas of pensions, healthcare and long-term care in a Euro-

[10] The uncertainty surrounding the calculation under the ESA 2010 is partly related to information (e.g. annual returns of personal income tax and corporate income tax, final accounts) that will only be available after the end of the budgetary year.

pean Commission Ageing Report,[11] where according to the projections Slovenia is notable among the euro area countries for the largest increase in expenditure by 2060 for reason of the ageing population. The estimated increase for Slovenia is 6.8% of GDP, compared with an average of just 1.5% of GDP of additional expenditure for euro area countries by 2060.

[11] European Commission Ageing Report 2015 (May 2015).

6 Price Developments

Price developments remain under the influence of low commodity prices on global markets, and the constraints of the domestic market. Deflation in the second quarter of this year deepened relative to the first quarter, reaching a new low: year-on-year growth in the harmonised index of consumer prices was down 0.3 percentage points at -0.8%. By contrast, average inflation in the euro area has already re-entered positive territory, albeit at low levels. The gap is mainly due to domestic demand, which is recovering significantly more slowly in Slovenia, while firms are also not subject to cost pressures. All of this is also being reflected in negative core inflation.

Macroeconomic factors and core inflation indicators

Deflation deepened in the second quarter of this year. The ongoing fall was primarily due to significantly slower growth in services prices, and, in May, last year's rise in excise duties on alcohol and tobacco dropping out of the year-on-year calculation. There were no other major changes. The negative year-on-year rates in headline inflation have been determined since last autumn by the large fall in global oil prices.

Core inflation entered negative territory in the second quarter. All the core inflation indicators point to lower price growth in Slovenia than in the euro area. Core inflation as measured by the HICP excluding energy, food, alcohol and tobacco fell by 0.9 percentage points to average -0.2% in the second quarter, re-entering negative territory after almost four years. The largest contribution to this fall has for some time come from negative

Table 6.1: Breakdown of the HICP and price indicators

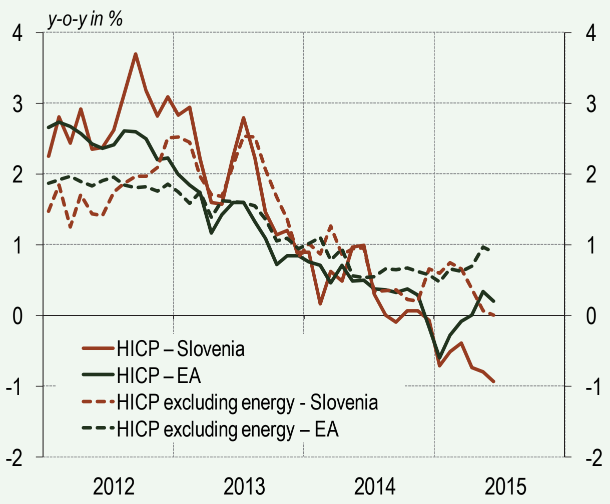
y-o-y in %		quarterly average				*last 12 months average*		month		
	weight	**14Q3**	**14Q4**	**15Q1**	**15Q2**	**Jun.14**	**Jun.15**	**Apr.15**	**May.15**	**Jun.15**
HICP	*100.0%*	0.1	0.0	-0.5	-0.8	1.2	-0.3	-0.7	-0.8	-0.9
Breakdown of HICP:										
Energy	*14.7%*	-1.5	-2.0	-7.5	-6.5	-0.3	-4.4	-7.2	-5.8	-6.3
Food	*23.6%*	0.3	0.6	0.7	1.1	2.4	0.7	1.6	1.0	0.8
processed	*16.1%*	1.7	1.1	1.4	0.7	2.6	1.2	1.7	0.4	-0.1
unprocessed	*7.5%*	-2.6	-0.7	-0.6	2.1	2.0	-0.5	1.6	2.2	2.6
Other goods	*26.4%*	-1.3	-1.4	-0.8	-1.1	-0.6	-1.1	-1.4	-1.1	-0.7
Services	*35.2%*	1.5	1.5	1.7	0.4	2.3	1.3	0.9	0.4	0.0
Core inflation indicators:										
HICP excl. energy	*85.3%*	0.3	0.4	0.7	0.2	1.4	0.4	0.4	0.1	0.0
HICP excl. energy and unprocessed food	*77.8%*	0.6	0.5	0.8	0.0	1.3	0.5	0.3	-0.1	-0.2
HICP excl. energy, food, alcohol and tobacco	*61.7%*	0.4	0.3	0.7	-0.2	1.0	0.3	-0.1	-0.2	-0.3

Source: SORS, Eurostat, Bank of Slovenia calculations.

year-on-year growth in prices of non-energy industrial goods, while in recent months there have also been sharp falls in services prices. Growth in the HICP excluding energy and unprocessed food also slowed by 0.8 percentage points in the second quarter, taking the year-on-year rate to zero. Growth in the HICP excluding energy slowed by a little less overall, and remained positive as a result of stronger growth in prices of unprocessed food. All the core inflation indicators thus fell below the euro area average during this period, core inflation having risen slightly across the euro area during the same period.

Uncertainty on the labour market and low growth in nominal wages are limiting growth in final household consumption, as households remain cautious. The low core inflation is the product of both demand-side and supply-side factors. The current positive developments on the labour market are mostly in uncertain forms of employment where low wages are prevalent, which is limiting consumption despite the rise in the real wage bill owing to deflation. Households remain cautious, and are maintaining a high level of saving and modest consumption. This has also been reflected in this year's continuing decline in the stock of consumer loans. There are also no major pressures on the supply side: wage developments during this period have been outpaced by productivity growth, while prices of input commodities have remained low.

Figure 6.1: Inflation in Slovenia and euro area

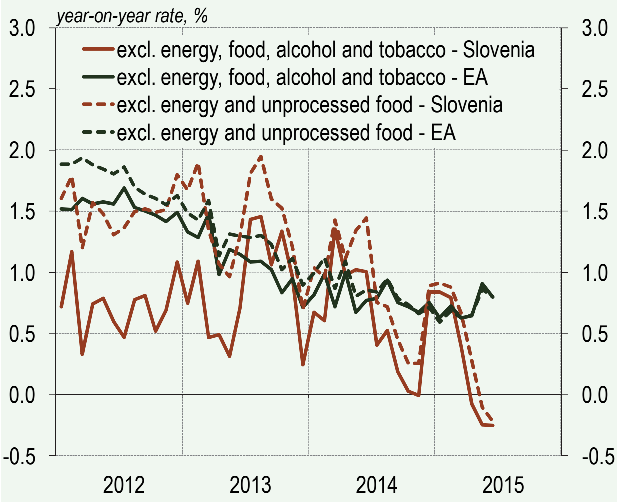


Source: Eurostat.

Structure of inflation

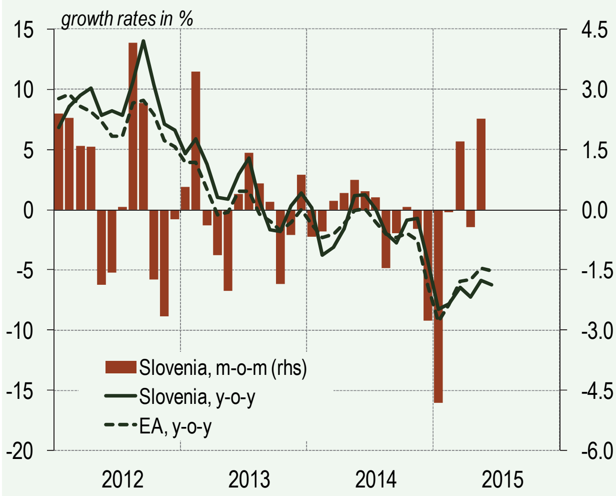
Year-on-year growth in energy prices remains strongly negative, mainly as a result of low oil prices. It will remain at similar levels until the end of the year, when last year's fall in oil prices will drop out of the year-on-year calculation. Growth averaged -6.4% over the second quarter, up 1.1 percentage points on the previous quarter, but down 5.0 percentage points on last year's average. The year-on-year fall in prices of refined petroleum products slowed relative to the previous quarter, as a result of a slight slowdown in the fall in US dollar oil prices, which was further mitigated by the additional

Figure 6.2: Core inflation in Slovenia and euro area



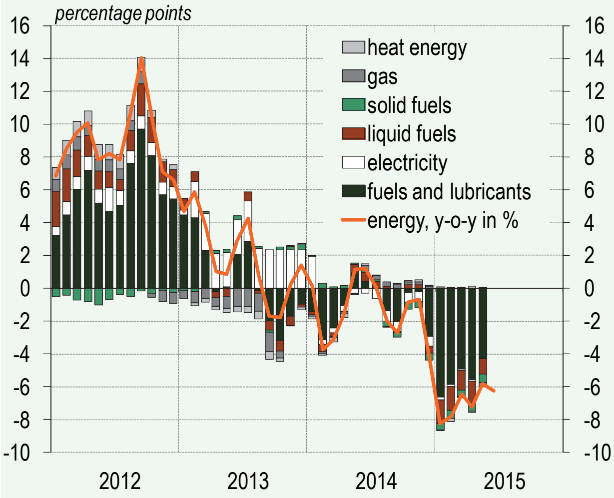
Source: Eurostat, Bank of Slovenia calculations.

Figure 6.3: Energy prices



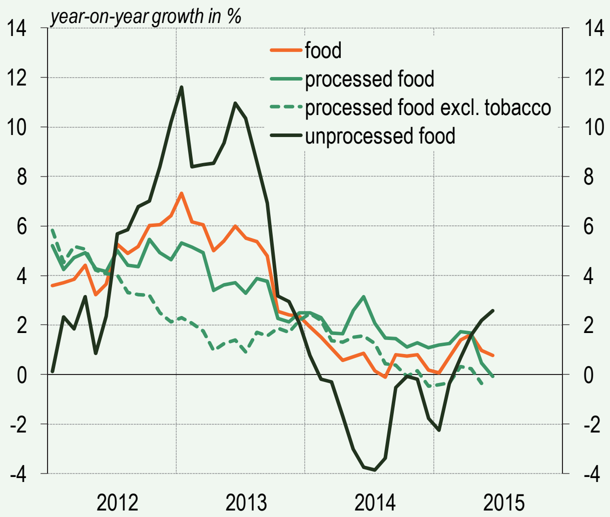
Source: Eurostat, Bank of Slovenia calculations.

Figure 6.4: Contributions to energy inflation



Source: ECB.

Figure 6.5: Food prices

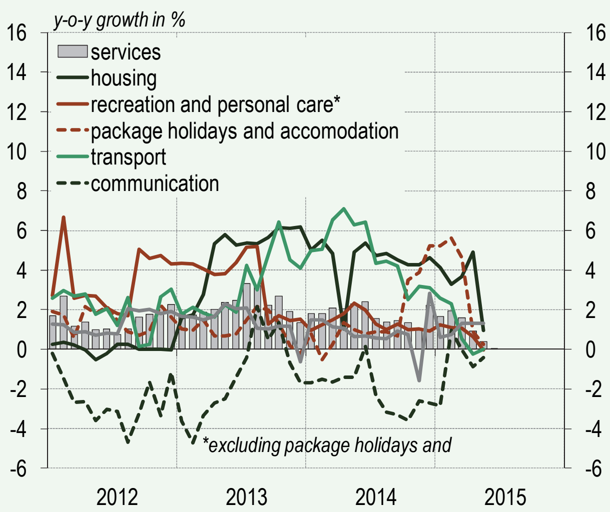


Source: Eurostat, Bank of Slovenia calculations.

year-on-year depreciation in the euro. By contrast, the year-on-year contribution made by excise duties declined. Last year's fall in electricity prices has almost come to an end this year, while in contrast gas prices fell more sharply in the second quarter as providers responded to previous falls in wholesale gas prices, which are strongly related to developments in oil prices. The year-on-year fall in energy prices across the euro area in the second quarter of this year was slightly smaller than in Slovenia. One of the reasons was the negative contribution made by excise duties in Slovenia. In addition, prices of electricity and solid fuels are falling in year-on-year terms in Slovenia, in contrast to the euro area.

The renewed rise in prices of unprocessed food fuelled year-on-year growth in food prices, while growth in prices of processed food is primarily under the influence of base effects. Growth in food prices averaged 1.1% over the second quarter, up 0.4 percentage points on the previous quarter. After a year in negative territory, growth in prices of unprocessed food passed zero in March and strengthened further in the second quarter. This was primarily attributable to prices of fruit and vegetables, growth in which strengthened sharply in the second quarter owing to a base effect related to the favourable weather conditions in the first half of last year. Year-on-year growth in prices of meat has been negative for the last two quarters. Growth in prices of unprocessed food averaged 2.1% over the second quarter, up 2.7 percentage points on the previous quarter, and up 3.6 percentage points on the average rate in 2014. By contrast, year-on-year growth in prices of processed food remains low. It strengthened slowly over the first four months of the year, but fell sharply again at the end of the second quarter. The fall was primarily the result of a base effect from last year's rise in excise duties on tobacco, year-on-year growth in prices of processed food excluding tobacco having risen by 0.1 percentage points[12] relative to the previous quarter. In addition, growth in prices of processed food has recently been reduced by prices of dairy products, which began falling as a result of excess supply on the European market.

Figure 6.6: Prices of categories of services



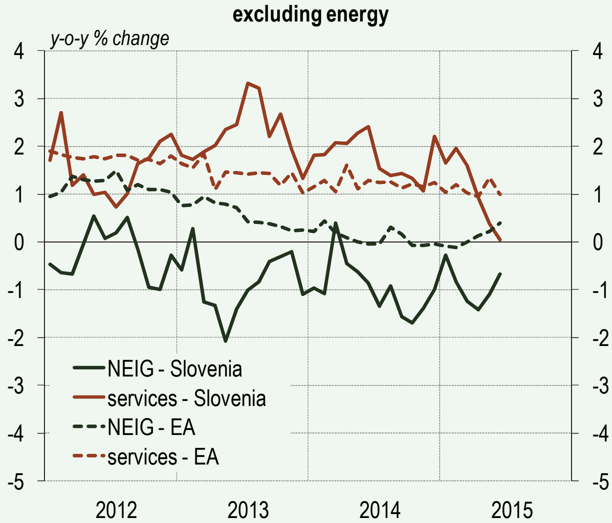
Source: Eurostat.

[12] Figure up to May 2015.

Growth in prices of processed food averaged 0.7% over the second quarter, down 0.7 percentage points on the previous quarter. Year-on-year growth in food prices thus fell slightly below the euro area average after a long period.

Year-on-year growth in prices of marketable services and public services declined sharply in the second quarter of this year, and growth in services prices is likely to remain low until the end of the year. After strong growth last year, which continued in the first quarter of this year, year-on-year growth in services prices averaged just 0.4% over the second quarter, down 1.3 percentage points on the first quarter. Prices of package holidays fell sharply in April, which is unusual for that month. This brought a sharp slowdown in year-on-year growth, which had been high for the previous two quarters, also as a result of unusual seasonal price developments, and accounted for 0.5 percentage points[13] of the fall in overall growth in services prices. A sharp fall in prices of passenger air transport and the drop-out from the year-on-year calculation of last year's rise in sewerage prices each contributed 0.2 percentage points[14] to the decline in growth in services prices in the second quarter. The decline in year-on-year growth in services prices was also attributable to last year's rise in prices of car insurance and Slovenian Railways' prices dropping out of the year-on-year calculation. Inflation in the services category also fell below the euro area average of 1.1% in the second quarter of this year.

Figure 6.7: Prices of services and industrial goods excluding energy



Source: Eurostat, SORS, Bank of Slovenia calculations.

After a temporary slowdown, prices of non-energy industrial goods fell more sharply again in the second quarter. The year-on-year fall in prices of non-energy industrial goods averaged 1.1% over the second quarter, 0.3 percentage points more than in the previous quarter. The largest contribution to the sharper fall came from prices of clothing and footwear, which rose less than usual upon the arrival of new collections on the shelves, which led to strongly negative rates of growth in the last few months. Prices of furniture and floor coverings fell sharply, while year-on-year growth in car prices has also remained in negative territory. By contrast, prices of sports equipment rose sharply as a result of a base effect. The fall in prices of household appliances began to slow, and last year's fall in water supply prices dropped out of the year-on-year calculation. Prices of non-energy industrial goods remain a significant element in the differences in inflation between Slovenia and the euro area overall. Year-on-year growth in prices in this category averaged 0.2% across the euro area in the second quarter, 1.3 percentage points more than in Slovenia.

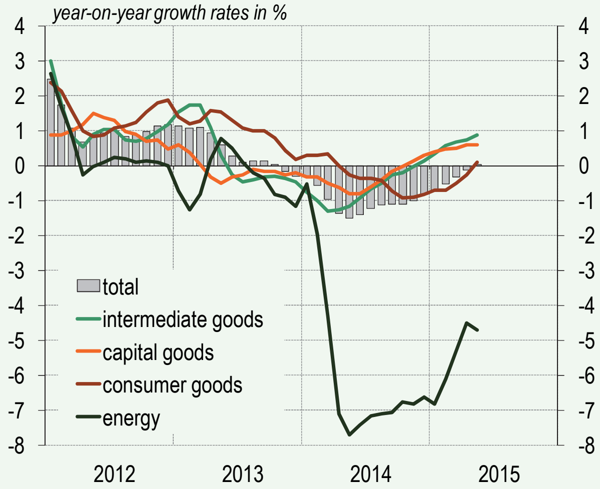
Industrial producer prices

The year-on-year fall in industrial producer prices on the domestic market continued to slow in the early months of this year, and the rate of growth entered positive territory in May. This was primarily attributable to producer prices of intermediate goods, growth in which has continued to slowly strengthen in recent months, despite the fall in commodity prices on global markets, on account of the fall in the euro. After falling by 0.9% in 2014, prices in the manufacture of basic metals averaged growth of 2.9% over the first five months of this year, and the trend of growth remains. Prices in the manufacture of computer and optical products also rose more sharply. Prices of capital goods have recently reached a similar dynamic. Year-on-year growth in prices in the manufacture of energy products has continued to make a positive

[13] Figure up to May 2015.
[14] Figure up to May 2015.

contribution to the change. Growth dipped downwards again in May, although this was the result of a base effect from last year's rise in water supply prices. The year-on-year fall in prices in electricity, gas, steam and air conditioning supply is continuing to slow. Year-on-year growth in prices of consumer goods also entered positive territory, thanks to prices of consumer durables, which have recorded high year-on-year growth in recent months, although prices of non-durables are still falling in year-on-year terms as a result of low input costs.

Figure 6.8: Producer prices on domestic market



Source: SORS, Bank of Slovenia calculations.