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Abbreviations used in Macroeconomic Developments and Projections

AQR	Asset Quality Review
AT	Austria
BAMC	Bank Assets Management Company
BE	Belgium
BG	Bulgaria
BIH	Bosnia and Herzegovina
bps	Basic point
BRIC	Brazil, Russia, India, China
CPI	Consumer price index
CY	Cyprus
CZ	Czech Republic
DARS	Motorway Company in the Republic of Slovenia
DE	Germany
DK	Denmark
EA	Euro area
EC	European Commission
ECB	European Central Bank
EE	Estonia
EFSF	European Financial Stability Facility
EMU	Economic and Monetary Union
ERM II	Exchange rate mechanism
ES	Spain
ESA95	European System of Accounts (1995)
ESCB	European System of Central Banks
EU	European Union
EUR	Euro
Euribor	Euro Interbank Offered Rate
Eurostat	Statistical Office of the European Communities
FDI	Foreign direct investment
Fed	Federal Reserve
FI	Finland
FR	France
GDP	Gross domestic product
GR	Greece
HICP	Harmonised Index of Consumer Prices
HII	Health Insurance Institute
HR	Croatia
HU	Hungary
IE	Ireland
ILO	International Labour Organization
IMAD	Institute of Macroeconomic Analysis and Development of the Republic of Slovenia
IMF	International Monetary Fund
IT	Italy
LT	Lithuania

LTRO	Longer-term refinancing operation
LV	Latvia
MDAP	Macroeconomic Developments and Projections
NFCs	Non-financial corporations
NKBM	Nova Kreditna Banka Maribor d.d.
NL	Netherlands
NLB	Nova Ljubljanska Banka d.d.
NPISH	Non-profit institutions serving households
OECD	Organisation for Economic Co-operation and Development
PDII	Pension and Disability Insurance Institute
PL	Poland
p. p.	Percentage point
PPI	Producer price index
PT	Portugal
Q	Quarter
QE	Quantitative Easing
RO	Romania
SE	Sweden
SI	Slovenia
SK	Slovakia
SORS	Statistical Office of the Republic of Slovenia
TEŠ 6	Block 6 of Šoštanj power station
UK	United Kingdom
ULC	Unit labour costs
US	United States of America
USD	US dollar
VAT	Value added tax
WEO	World Economic Outlook
ZUJF	Fiscal Balance Act

Executive Summary

In 2013, GDP declined by 1.1% overall. Nevertheless, there was a significant upswing in quarterly growth rates in the second half of the year due to more favourable external environment, and also gradual recovery of domestic demand. In the final quarter, economic growth was also influenced by certain one-off and statistical effects. Higher economic growth in the external environment translated into solid growth of the export sector, which was supported by gains in cost competitiveness. As domestic consumption stabilised, and measures were taken to curb the shadow economy, total value-added in private services also increased. Towards the end of the year, construction activity increased primarily as a result of public infrastructure investment financed by EU funds. Investment thus made the largest contribution to growth in domestic consumption at the end of the year, while private consumption stabilised as the contraction in the real wage bill slowed. By contrast, the contraction in final government consumption strengthened in 2013. In the second half of the year, the fall in employment slowed, particularly in the private sector, while in public services employment is falling, in particular where the government has greater direct control. Although registered unemployment rose to around 130,000 in early 2014, the trend of rising unemployment stopped, partly as a result of stronger flows from unemployment into employment. In the first quarter of 2014, inflation fell further and only remained positive because of fiscal consolidation measures. Core inflation has remained low as a result of weak household consumption and cost-cutting in the economy.

Export growth and weak domestic demand contributed to an increase in the current account surplus, which stood at 6.3% of GDP in 2013. The main factor behind the increase was the change in merchandise trade position from a deficit to a significant surplus, largely as a result of exporters' successful refocusing on EU markets as demand cooled from markets outside the EU. The surplus of trade in services also widened, while the deficit in factor income narrowed.

In a situation of favourable growth in the export sector and deleveraging of the economy, the current account surplus is reflected in high net savings by the private sector. In the last year and a half, corporates have become net savers as well, and are increasingly using financing alternatives to bank loans, while they continue to reduce indebtedness and exhibit cautious investment behaviour. In 2013, the stock of corporate liabilities from bank loans declined. Last year, households recorded an increase in their financial surplus, having reduced debt and consumption. The decline in the banking system's total assets was the result of banks' debt repayments to the rest of the world, reduction in liabilities on the basis of debt securities and write-offs of subordinated debt instruments in the capital increase process. The contraction on the investment side was the result of a further reduction in loans to the private sector, the transfer of loans to the BAMC and additional loan write-offs. In 2013, the government was the only sector to widen its financial deficit, primarily as a result of the measures to stabilise the banking sector. According to SORS figures, the general government deficit widened to 14.7% of GDP, while by the end of the year the general government debt increased to 71.7% of GDP.

GDP growth is projected at 0.6% this year, and is expected to fluctuate around 1.5% in the next two years. Compared with the previous projections, the upward revision for this year is the result of a faster recovery in foreign demand, easing of the situation on domestic labour market at the turn of the year, and also slightly increased confidence in the economy. By the end of 2016, employment is projected to fall by just over 0.5% overall. Solid export growth supported by favourable foreign demand and further adjustments in labour costs, and lagging import growth as a result of the slow recovery in domestic demand could widen the current account surplus to more than 7% of GDP. In the absence of demand-side pressures and supply shocks, inflation is expected to remain low in the coming years.

For the entire projection period, the risks to economic growth are mostly on the downside. The main factors that could reduce economic growth relative to the baseline scenario are potential additional fiscal consolidation measures and weaker foreign demand. From a technical point of view, potential data revisions, particularly for the final quarter of 2013, are a major risk. However, the activities of the BAMC in restructuring the corporate sector and increased confidence in the banking system could encourage lending, witch would lead to a stronger increase in domestic consumption than projected. The inflationary risks during the projection period are balanced.

* * *

For stable economic growth and gradual decrease of high unemployment in a small open economy, it is vital to ensure the conditions for a further gradual improvement in competitiveness to stimulate activity of the export sector. It is thus necessary to continue ensuring that productivity growth outpaces growth in labour costs. A sustained reduction in corporate indebtedness, a stable institutional framework, an effective public sector and well-judged structural reforms are also vital. A priority among the latter is improving the quality of the business environment, and in particular improving the functioning of the rule of law, where the emphasis should be on a more effective fight against corruption. In conjunction with measures to strengthen human capital, the aforementioned measures would contribute to long-term economic potential. In a situation of weak economic growth, it is particularly important that otherwise unavoidable fiscal consolidation is carried out with the least short-term adverse impact on domestic demand.

								Projections					
								2014		2015		2016	
	2007	2008	2009	2010	2011	2012	2013	Apr.	Δ	Apr.	Δ	Apr.	Δ
Activity, employment and wages	*growth rates, %*												
GDP (real)	7.0	3.4	-7.9	1.3	0.7	-2.5	-1.1	**0.6**	1.3	**1.4**	0.0	**1.7**	…
Employment	3.3	2.6	-1.8	-2.2	-1.6	-0.8	-2.0	**-1.1**	1.3	**-0.2**	0.2	**0.6**	…
Compensation per employee	6.2	7.2	1.8	3.9	1.6	-1.0	0.1	**1.0**	1.3	**1.3**	1.0	**1.6**	…
Productivity	3.5	0.8	-6.2	3.5	2.4	-1.7	0.9	**1.7**	-0.1	**1.6**	-0.1	**1.3**	…
ULC (nominal)	2.6	6.4	8.6	0.4	-0.7	0.8	-0.8	**-0.6**	1.4	**-0.2**	1.2	**0.3**	…
Contribution to GDP growth	*percentage points*												
Domestic demand, excl. chg. in inventories	6.9	4.2	-6.5	-2.6	-0.9	-4.5	-1.8	**-0.5**	2.2	**0.3**	0.9	**1.1**	…
Net exports	-2.0	0.1	2.6	1.8	1.1	3.8	1.3	**1.1**	-0.9	**1.0**	-1.0	**0.6**	…
Changes in inventories	2.1	-1.0	-4.1	2.0	0.6	-1.8	-0.5	**0.0**	0.0	**0.0**	0.0	**0.0**	…
Domestic demand	*real growth rates, %*												
Domestic demand	9.0	3.2	-10.3	-0.5	-0.3	-6.4	-2.5	**-0.6**	2.4	**0.3**	1.0	**1.2**	…
Private consumption	6.3	2.3	-0.1	1.5	0.8	-4.8	-2.7	**-0.7**	2.6	**0.2**	0.8	**1.2**	…
Government spending	0.6	5.9	2.5	1.3	-1.6	-1.3	-2.0	**-1.3**	0.5	**-0.5**	1.5	**-0.3**	…
Gross fixed capital formation	13.3	7.1	-23.8	-15.3	-5.5	-8.2	0.2	**0.6**	3.3	**1.7**	0.9	**2.9**	…
Balance of payments	*growth rates, % (if not specified otherwise)*												
Exports of merchandise and services	13.7	4.0	-16.1	10.2	7.0	0.6	2.9	**2.8**	0.7	**4.6**	1.2	**5.1**	…
Imports of merchandise and services	16.7	3.7	-19.2	7.4	5.6	-4.7	1.3	**1.5**	2.1	**3.9**	2.8	**5.1**	…
Current account: EUR billion	-1.4	-2.0	-0.2	-0.1	0.1	1.2	2.3	**2.5**	0.1	**2.7**	0.0	**2.6**	…
as % GDP	-4.2	-5.4	-0.5	-0.1	0.4	3.3	6.3	**7.1**	0.3	**7.4**	-0.3	**7.0**	…
Terms of trade*	0.9	-1.5	3.7	-3.9	-1.4	-1.0	0.9	**-0.2**	0.9	**-0.6**	0.5	**-0.5**	…
Prices	*average annual growth rates, %*												
Consumer prices (HICP)	3.8	5.5	0.9	2.1	2.1	2.8	1.9	**0.5**	-1.2	**1.1**	-0.4	**1.3**	…
HICP excluding energy	3.8	4.9	1.7	0.3	1.0	1.8	1.9	**0.8**	-1.0	**1.3**	-0.3	**1.5**	…
HICP energy	3.4	9.4	-4.5	13.9	8.8	9.0	1.8	**-1.6**	-2.5	**0.5**	-0.1	**0.4**	…
International environment	*growth rates, % (if not specified otherwise)*							**Assumptions**					
Foreign demand**	9.0	3.0	-14.0	10.6	7.1	0.9	1.1	**1.6**	-0.9	**3.3**	-0.5	**3.6**	…
Oil (USD per barrel)	73	98	62	80	111	112	109	**110**	0	**110**	0	**110**	…
Non-oil commodities	17.4	10.1	-23.0	37.1	17.9	-7.2	-5.2	**-2.8**	-2.2	**2.0**	0.0	**4.8**	…
EMU inflation	2.1	3.3	0.3	1.6	2.7	2.5	1.4	**0.9**	-0.4	**1.3**	-0.1	**1.5**	…
PPI Germany	1.3	5.4	-4.0	1.5	5.1	1.7	0.0	**0.9**	-0.7	**1.9**	0.3	**2.3**	…

Notes: * Based on national accounts deflators. ** Volume of imports from the basket of foreign partners.
Δ : Difference between current projections and projections in Macroeconomic Developments and Projections, October 2013.
Source: Bank of Slovenia, Consensus Economics, Eurostat, JP Morgan, OECD Outlook, SORS, ECB.

1 International Environment

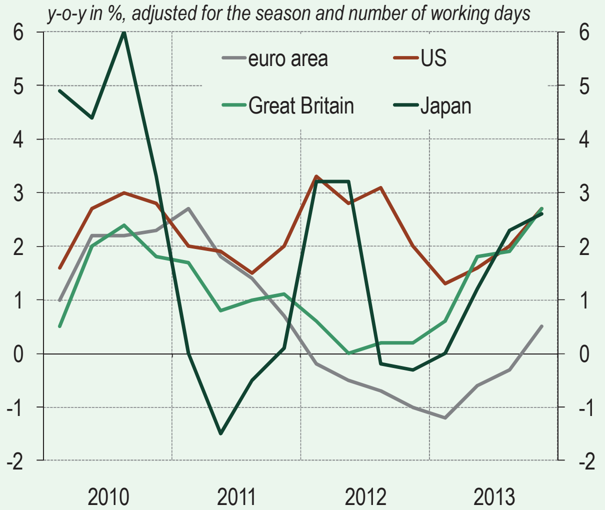
In the second half of the year the global economy saw a faster recovery in developed economies and a slowdown in growth in developing countries. Alongside the rapid growth in the euro area core countries, economic activity at least stabilised temporarily in the periphery, and economic sentiment has again strengthened in the early part of this year. In addition to a slowdown in economic growth, a number of developing countries saw a rise in political tensions, uncertainty on the financial markets, and a significant decline in their currencies at the turn of the year. Monetary policy in the majority of developed countries remained expansionary, although the Fed began its gradual scale-back of QE purchases of long-term securities. Commodity prices fell significantly last year, and remained lower in year-on-year terms in the first three months of this year.

Economic developments

The contribution made to global economic growth by developed economies increased last year. GDP in the euro area declined by 0.4% overall, as a result of weak economic developments moving into 2013, but then the euro area emerged from recession. GDP in the final quarter was up in year-on-year terms for the first time since 2011, by 0.5%. This growth was driven by net exports and domestic final consumption, which increased despite the high unemployment rate, which remains at 12%. The improvement in the economic sentiment in the euro area continued in the early part of this year. GDP in the US was up 1.9% in 2013, having increased by 2.5% in year-on-year terms in the final quarter. This growth was driven by higher private consumption and net exports. Gross investment also increased, while government consumption declined. The unemployment rate fell in 2013. It fell again this January, to 6.6%, the lowest figure in the last five years. Economic activity also increased in Japan last year, driven by growth in domestic consumption, year-on-year growth in GDP reaching 2.6% in the final quarter. The UK recorded economic growth of 1.8%.

Figure 1.1: GDP growth in developed economies

y-o-y in %, adjusted for the season and number of working days



Source: Eurostat, BEA, Trading Economics.

Economic growth in most of the BRIC countries slowed last year. In Russia, year-on-year growth in GDP in the final quarter of last year strengthened to 2.0%, but

Figure 1.2: GDP growth in BRIC countries

Source: Trading Economics.

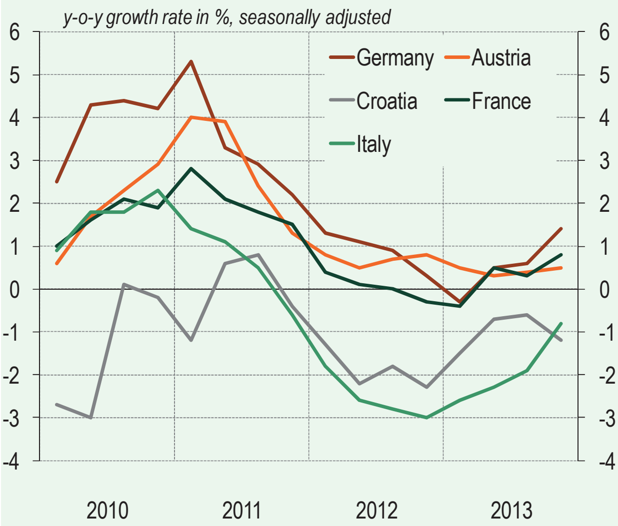
the annual figure was the lowest since the crisis year of 2009. Economic growth in India stood at 4.7% in the final quarter, below the average of the last three years. Last year's economic growth in China was slightly lower than in the previous years, and stood at 7.7% in the final quarter. Economic growth in Brazil strengthened from 1.0% in 2012 to more than 2% in 2013, a relatively low figure compared with 2010 and 2011.

Economic developments were relatively favourable towards the end of the year in the majority of Slovenia's main trading partners. In the final quarter of 2013 there were quarterly increases of 0.4% in Germany, 0.3% in Austria and France, and 0.1% in Italy. The majority of the other major EU trading partners also recorded a strengthening of economic activity in the final quarter. The exception was Croatia, where GDP declined by 1.2% in year-on-year terms. Of the more important markets outside the EU, Serbia recorded positive economic growth last year.

Financial markets and commodity prices

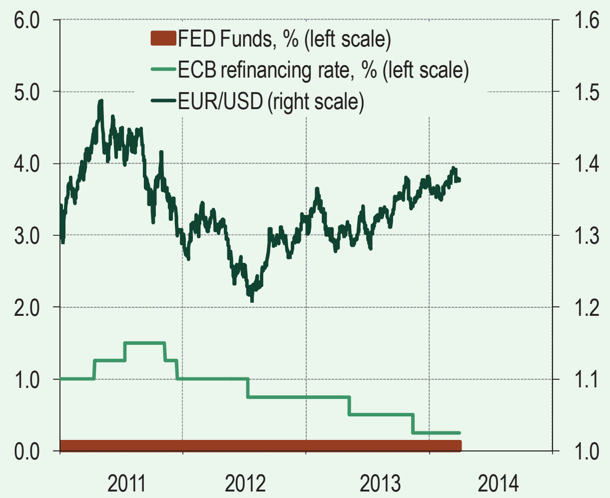
Monetary policy at the central banks of the major developed economies remained expansionary in 2013 and in early 2014. The most active in implementing non-standard measures was the Japanese central bank, which significantly expanded such measures last year as it raised its inflation target to 2%, most notably purchases of long-term government bonds and, to a lesser extent, other securities, while in February of this year it extended the favourable loan scheme for corporate lending. Given the increase in economic activity and the fall in unemployment, at the end of 2013 the Fed began to gradually scale back its QE purchases of long-term securities. Monetary policy in the US nevertheless remains expan-

Figure 1.3: GDP growth in main EU trading partners



Source: Eurostat, Trading Economics.

Figure 1.4: Euro / US dollar exchange rate and central bank interest rates



Source: ECB, Federal Reserve.

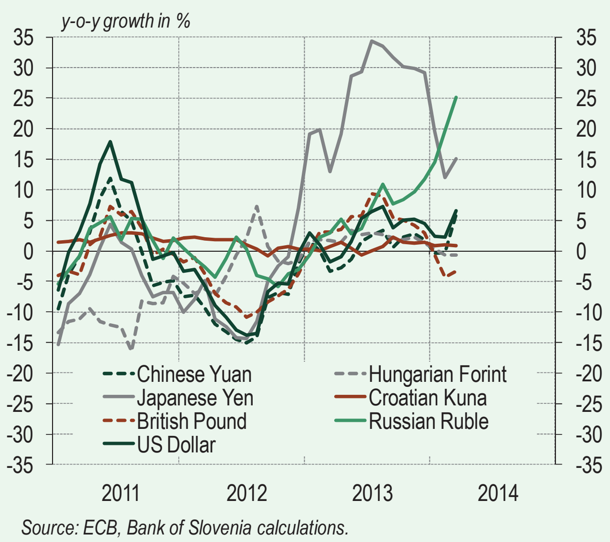
sionary, the key interest rate remaining in the interval between zero and 0.25%. As a result of weak economic activity in the first half of the year and a significant fall in inflation in the second half of the year, the ECB lowered its key interest rate twice last year, and it now stands at 0.25%. It also began signalling its future monetary policy stance in forward guidance in July. It announced that the key interest rate would be held at the current level or below it for some time.[1] The Bank of England's key interest rate has been unchanged since March 2009 at 0.5%, while the non-standard monetary stimulus remained unchanged in value terms last year and in early 2014, as despite signs of stronger economic activity the assessment of the Bank of England is that unemployment remains high and capacity utilisation in the economy is relatively low.

The euro rose significantly against the US dollar last year. Other factors in this rise alongside the more favourable macroeconomic figures were reduced uncertainty surrounding the euro area periphery countries and a decline in excess liquidity. The euro averaged USD 1.3281 last year, up 3.4% on 2012. The euro also rose by 4.7% against the pound sterling, and by fully 26.5% against the Japanese yen. The Japanese yen fell sharply, primarily as a result of measures taken by the Japanese central bank. The year-on-year rise in the euro against the US dollar and the Japanese yen remained strong in the first quarter of this year, although the euro began to fall against the pound sterling.

The price of a barrel of Brent crude fell slightly in 2013, while prices of other commodities fell more sharply. The US dollar price of Brent crude fell by 2.8% last year, while US dollar prices of other primary commodities fell by 8.6%. The largest falls were recorded by food prices. As a result of the economic recovery and the Fed's announcement that it would scale back QE purchases of long-term securities, liquidity on the stock markets began withdrawing to other investments in the second half of last year, and oil and food prices also fell as a result of an increase in inventories. Commodity prices remained relatively low in the first quarter of this year.

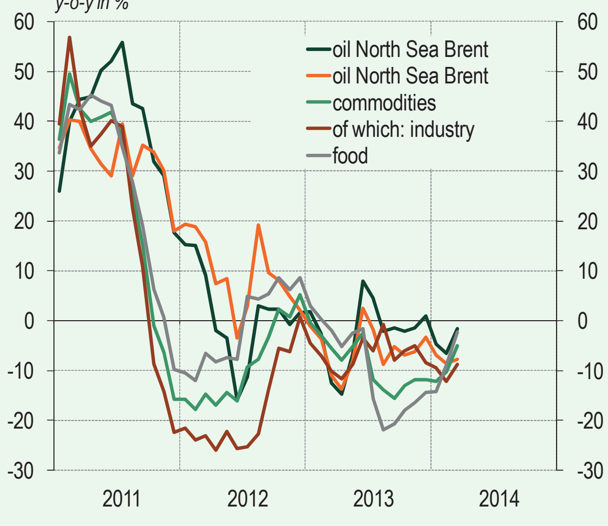
At the very beginning of 2014 there was a sharp deterioration in the situation on the financial markets of individual developing countries. Alongside political crises and the deterioration in the economic situation, this uncertainty was also the result of scaled back securities purchases by the Fed, which brought a sharp decline in investors' exposure to these countries. Developments on

Figure 1.5: Exchange rates



Source: ECB, Bank of Slovenia calculations.

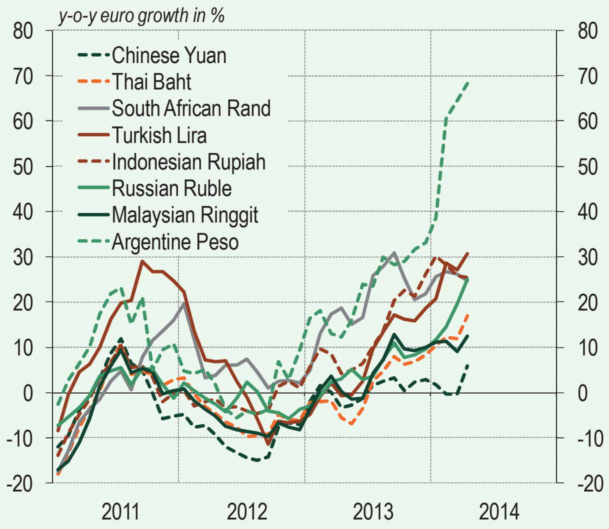
Figure 1.6: Commodities



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

[1] For more on this decision, see http://www.ecb.europa.eu/press/pressconf/2014/html/is140306.en.html.

Figure 1.7: Exchange rates of developing countries



Source: ECB, Bank of Slovenia calculations.

the stock markets in Turkey, South Africa, Argentina, Indonesia and certain other countries were negative in late 2013 and early 2014, which was followed by a sharp fall in their currencies against the euro and the US dollar. In March the euro was up 30.6% in year-on-year terms against the Turkish lira, 24.7% against the South African rand, 68.2% against the Argentinean peso and 25.4% against the Indonesian rupiah. As tensions rose in Ukraine, the ruble fell further, and was down 25.1% in year-on-year terms against the euro in March. The financial markets in developed countries were stable in early 2014. As appetite for risk increased, there was a further fall in the required yields on government bonds of euro area periphery countries.

2 Economic Trends and the Labour Market

A comprehensive revision of data[2] during the release of the national accounts figures for the final quarter of last year brought a significant change to the economic picture for Slovenia. Quarterly GDP growth increased to 1.2% at the end of the year, and the overall year-on-year decline in activity in 2013 was significantly less than forecast at 1.1%. Industry responded to the recovery in foreign demand with growth in production and exports. Total value-added in private-sector services increased as domestic consumption stabilised, and also as a result of the statistical effect of measures to curb the grey economy. Activity in the construction sector at the end of the year was high, due mostly to public investment in infrastructure. Together with a strong effect of changes in inventories this made the largest contribution to the increase in domestic consumption, while private consumption also stabilised with the slowing down of the decline in the real wage bill. Only final government consumption was still diminishing, with its sharpest fall in the middle of the year. Another indication of the reversal in the trend of domestic demand in the second half of last year was growth in imports and net taxes on products.

The decrease in employment slowed sharply in the second half of 2013. This was the case for export-oriented sectors, and also for service sectors that primarily do business on the domestic market. For the former the main factor was an increase in foreign demand, while for the latter the main factor was the absence of further fiscal shocks that had previously had a strongly negative impact, which resulted in the stabilisation of domestic consumption. Employment in public services is falling in particular where the government has greater direct control. Although registered unemployment rose to around 130,000 in early 2014, the trend of rising unemployment ended, partly as a result of stronger flows from unemployment into employment. Wages began to rise moderately in the second half of the year as the economy showed signs of recovery.

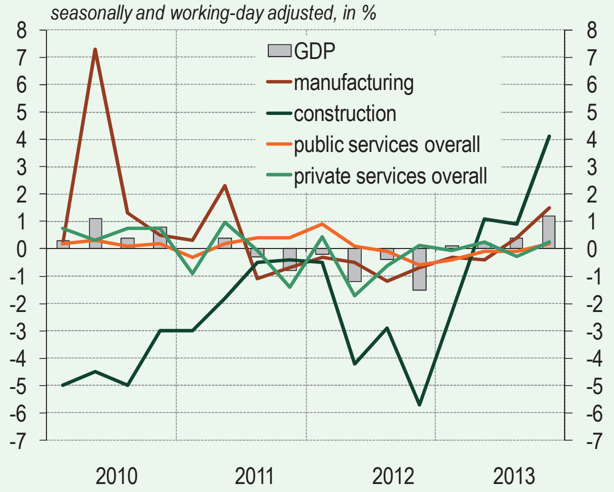
[2] The quarterly GDP growth figures for the first three quarters of 2013 were revised upwards by a cumulative total of 1.1 percentage points when the national accounts were released on 28 February 2014. In the breakdown of domestic demand, year-on-year growth in all key domestic consumption aggregates was revised upwards, with the largest revisions made to third quarter figures. Compared with the national accounts data released on 29 November 2013, the year-on-year decline in domestic consumption in the third quarter was 1 percentage point smaller, primarily due to higher estimated growth in gross fixed capital formation (revised from -4.4% to -1.1%). At the same time the contribution made to GDP growth by net trade was revised from 1.9 percentage points to 1.1 percentage points, primarily as a result of lower estimated real growth in exports of services. The estimated year-on-year change in value-added in the third quarter was revised from -1.3% to -0.5%. The year-on-year rates of growth were revised upwards in all sectors other than agriculture, forestry and fishing. At the same time there was a sharp downward revision in the estimated year-on-year change in net taxes on products, from +3.5% to -0.7%. See also Box 2.1.

Gross domestic product

Economic recovery intensified last year, and activity at the end of the year was up in year-on-year terms in the majority of sectors. Following a significant revision of the figures, it is apparent that quarterly GDP growth had already turned positive by the first quarter of last year, and by the third and final quarters was significantly outpacing average euro area growth. GDP fell by 1.1% last year, which was significantly less than anticipated. The decline was solely the result of the very low level of activity at the end of 2012. In the last quarter year-on-year GDP growth amounted to more than 2%. The key factor was the 1 percentage point contribution by net taxes on products, which was related to high inflows of VAT. Industry made a positive contribution to GDP growth for the first time in two years, at 0.5 percentage points, which was primarily the result of an increase in merchandise exports following the recovery in foreign demand. Growth in the construction sector was high, due mostly to increased investment in public infrastructure, partly financed by European funds. Value-added in private-sector services also began to increase sharply in the

Figure 2.1: GDP quarterly growth rates in Slovenia

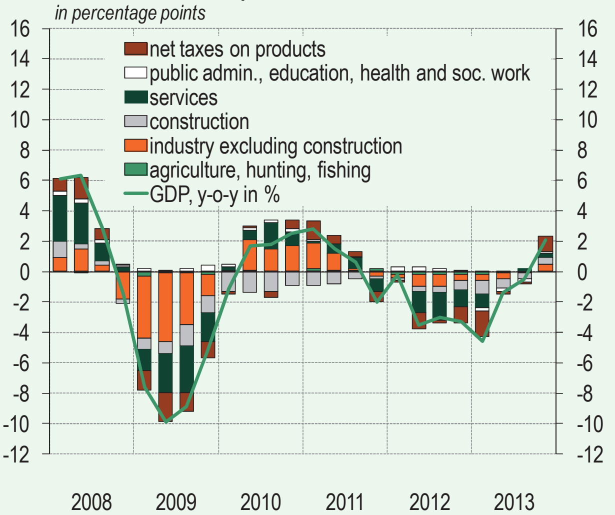
seasonally and working-day adjusted, in %



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

Figure 2.2: Contributions to y-o-y GDP growth, production side

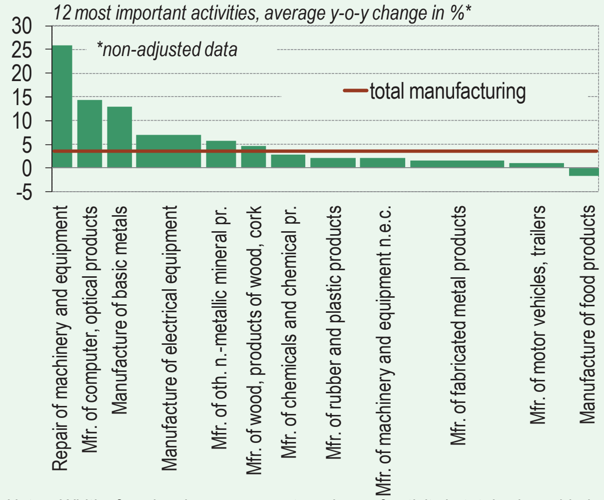
in percentage points



Source: SORS.

Figure 2.3: Manufacturing production: Nov. 2013 – Jan. 2014

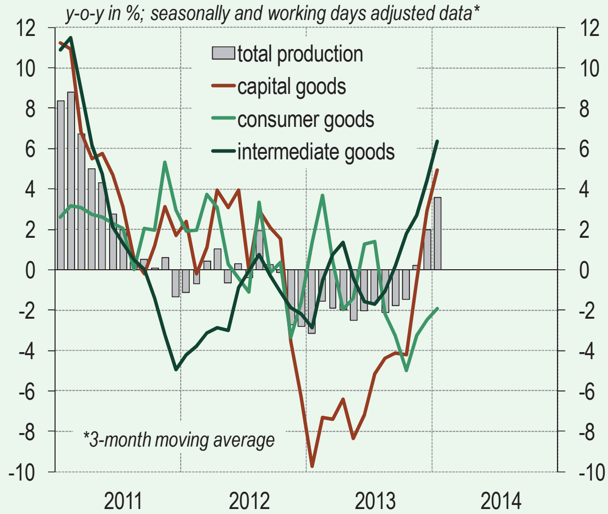
*12 most important activities, average y-o-y change in %**



Notes: Width of each column represents a share of activity in total value added in manufacturing in 2012.
Source: SORS, Bank of Slovenia calculations.

Figure 2.4: Industrial production by main industrial groups

*y-o-y in %; seasonally and working days adjusted data**



Source: SORS, Bank of Slovenia calculations.

Box 2.1: Revision of the national accounts, the carry-over effect, and real GDP projections

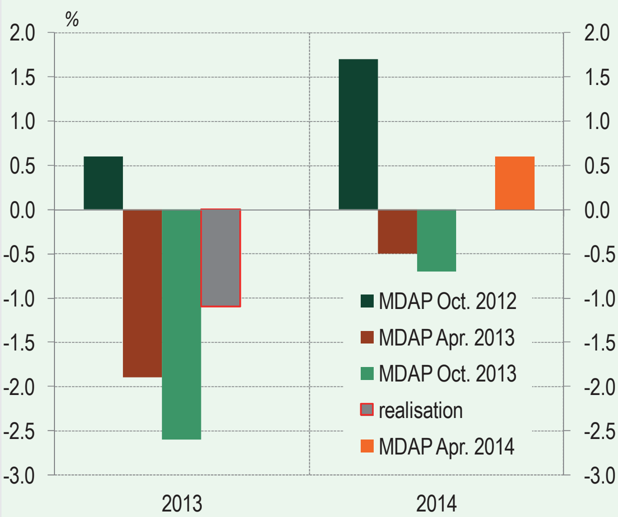
Last year economic growth forecasts were again affected by the high uncertainty in the domestic and international environment, as well as discrepancies between the monthly figures and the figures from the national accounts. In addition, the impact of the revision of the national accounts was also more pronounced than usual, partly on account of the method of seasonal adjustment.[1] This hindered the forecasting of economic growth, which was reflected in large gaps between BoS projections and the subsequent national accounts figures published by SORS. This Box examines the revisions of the real GDP growth figures, and their impact on the carry-over effect and thus on projections of real GDP.

The carry-over effect serves as a reference point for short-term forecasts of annual average real GDP growth. It is defined as the impact of quarter-on-quarter (q-o-q) real GDP growth dynamics[2] in the previous year (t-1) on annual average real GDP growth in the current year (t). It reveals what annual average real GDP growth in year (t) would be were all the q-o-q rates of GDP growth in the current year (year t) equal to zero.[3]

The carry-over effect c_t in year (t) can be mathematically estimated as the weighted sum of q-o-q growth rates $q_{(t-1);2-4}$ in the previous year (t-1) (Tödter, 2010)[4]:

$$c_t = \frac{1}{4}q_{(t-1);2} + \frac{2}{4}q_{(t-1);3} + \frac{3}{4}q_{(t-1);4}$$

Figure 1: Projections of real GDP growth and realisation



Source: SORS, Bank of Slovenia calculations.

The annual average real GDP growth can be divided into the carry-over effect and growth within the year (Figure 2). In the 2006 to 2014 period the carry-over effect averaged 0.4%, with a standard deviation of 1.9. The effect was particularly pronounced in 2013, when it stood at -1.6%. This was primarily the result of an extremely weak final quarter of 2012, the q-o-q growth rate for this quarter having been revised from -1% when the figures for the first quarter of 2013 were released to -1.5% when figures for the final quarter of 2013 were released. The growth dynamics during 2013 was positive, and stood at 0.5%. According to current figures, a significant positive carry-over effect (1.2%) can be expected for 2014, which given the economic circumstances provides a high starting point for this year's annual average real GDP growth.

The carry-over effect can also be mechanically calculated for each quarter of the current year. The carry-over effect can thus be expanded, and the expected annual real GDP growth rate obtained. Here it can again be assumed that the q-o-q GDP growth rates in the subsequent quarters are equal to zero. The new q-o-q figures[5] thus provide additional information on the expected annual real GDP growth.

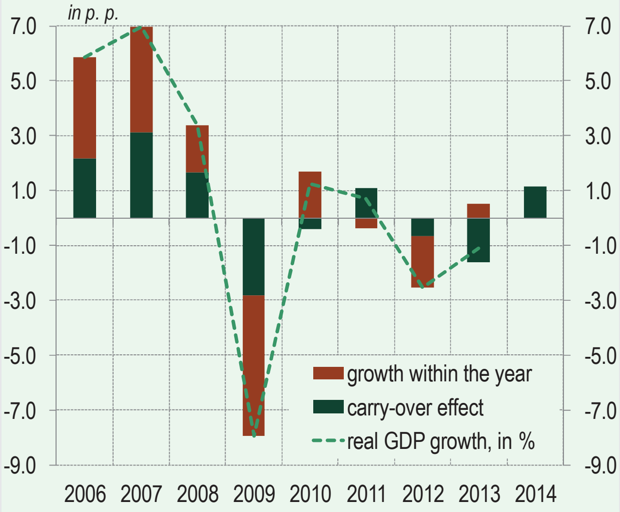
The expected annual real GDP growth in year (t) is estimated as the sum of the carry-over effect in year (t) and the already released q-o-q GDP growth figures during the current year (t):

$$g_t = c_t + \frac{4}{4}q_{(t);1} + \frac{3}{4}q_{(t);2} + \frac{2}{4}q_{(t);3} + \frac{1}{4}q_{(t);4}$$

The calculation of the carry-over effect and the expected annual real GDP growth derived there from represent a point of reference for the GDP projections. However, changes in the q-o-q GDP growth dynamics resulting from the revision of figures could significantly alter the carry-over effect and the expected annual real GDP growth, and could thus sharply disrupt GDP projections (Figure 3).

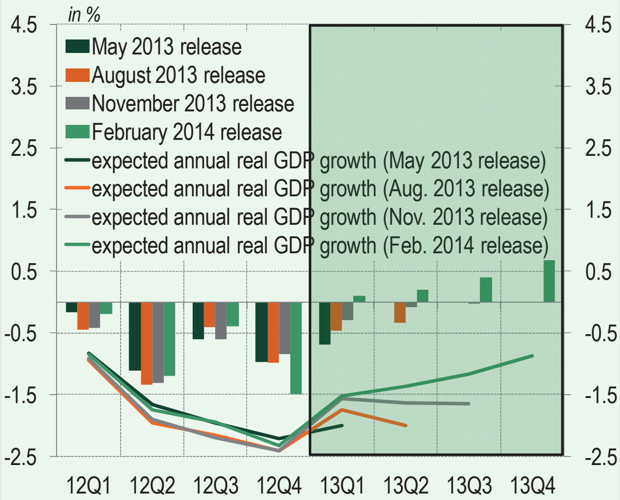
In April 2013 projections[6] the Bank of Slovenia projected a decline of 1.9% in GDP for 2013. The carry-over effect according to the figures available at that time amounted to -1.3%. After the initial release of figures for Q1 2013 (May 2013), when the q-o-q decline in GDP stood at -0.7%, the expected annual real GDP growth[7] was reduced sharply to

Figure 2: Decomposition of annual averagege real GDP growth



Source: SORS, Bank of Slovenia calculations.

Figure 3: Releases of q-o-q GDP growth rates and expected annual real GDP growth, based on carry-over effect



Source: SORS, Bank of Slovenia calculations.

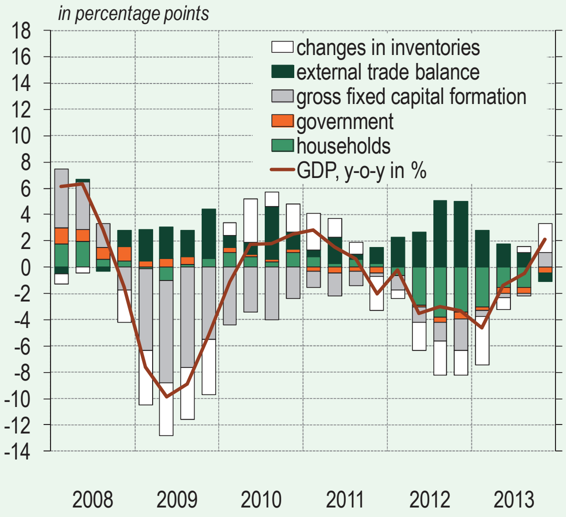
-2%. The latter rate was similar after the initial release of figures for Q2 2013 (August 2013), which were included in the preparation of the October 2013 projections,[8] as a result of which the growth forecast for 2013 was revised downwards accordingly to -2.6%. Revisions were also made to q-o-q GDP growth figures when the figures for Q3 and Q4 of 2013 were released. In the most recent release there was a sharp downward revision in the figure for Q4 of 2012, which reduced the carry-over effect from 2012 to 2013 from 1.3% to -1.6%, while the upward revisions in the q-o-q growth profile for 2013 raised the expected annual real GDP growth in 2013 to -0.9% (from -1.3%).

[1] When drawing up its projections of economic developments, the Bank of Slovenia takes account of the figures officially released by the SORS, including the seasonally adjusted series.
[2] Quarter-on-quarter real GDP growth, seasonally and working days adjusted.
[3] This is the same as the assumption that GDP would remain at the level of the final quarter of the previous year.
[4] Tödter, K. H.: "How useful is the carry-over effect for short-term economic forecasting?", Discussion Paper Series 1: Economic Studies 2010, 21, Deutsche Bundesbank, Research Centre.
[5] If there are no retrospective revisions to the figures, more than 60% of the requisite information for the calculation of the expected annual real GDP growth is known after the first quarter of the year, while the corresponding figure after two quarters is over 80%.
[6] Macroeconomic Developments and Projections, April 2013, available at http://bsi.si/en/publications.asp?MapaId=786.
[7] The expected annual real GDP growth rates in 2013 are given in the shaded area of the figure.
[8] Macroeconomic Developments and Projections, October 2013, available at http://bsi.si/en/publications.asp?MapaId=786.

second half of the year. Weaker exports of services meant that the only factors in this increase were the stabilisation of private consumption and a drop in the concealed income in the wake of new measures to curb the grey economy. The total contribution made to GDP growth by private-sector services had increased to 0.3 percentage points by the end of the year, and growth remained relatively favourable in the early part of this year. Only financial services displayed deterioration last year.

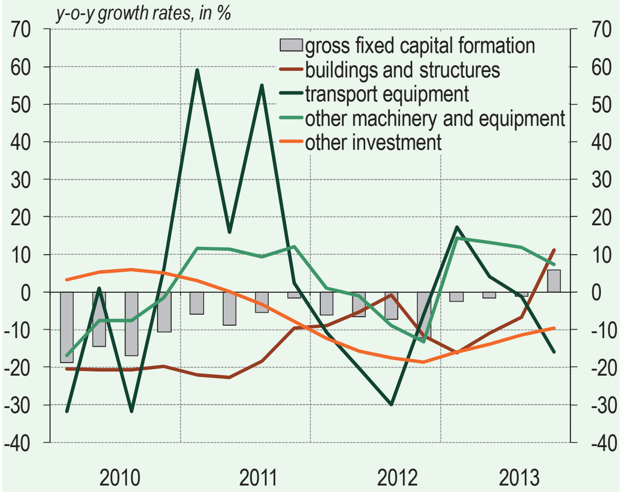
Industry's response to the recovery in foreign demand was rapid, and was evident in the vast majority of sectors. In the first half of the year industrial production was still declining in most sectors of manufacturing, but by the end of the year the situation had improved significantly. The reversal was the result of a recovery in demand in the euro area, while the structure of turnover suggests that domestic demand also stabilised. In line with industrial growth in the euro area, demand for intermediate goods recorded the largest increase. Production

Figure 2.5: Contributions to y-o-y GDP growth, expenditure side



Source: SORS.

Figure 2.6: Gross fixed capital formation



Source: SORS.

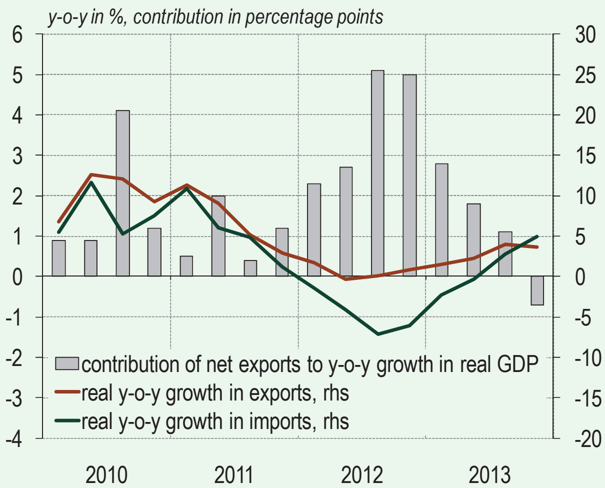
of capital goods was also up, as demand increased mostly on the domestic market. Production of consumer goods recorded the sole decline in the second half of the year, as a result of the ongoing collapse of the textile and wood industries, as well as weaker exports of pharmaceutical products. Growth in industrial production remained relatively good in January of this year.

Aggregate demand

Last year's slowing down of contraction in domestic consumption was primarily the result of growth in gross investment. The key factor was the slowdown in the decline in inventories, which was particularly pronounced at the end of the year. The change in inventories contributed a decline of 1.8 GDP percentage points in 2012, but just 0.5 points last year. Developments in gross fixed capital formation were better than forecast. Growth in investment in machinery and equipment averaged almost 10% over the year, as a result of high quarterly growth in the final quarter of 2012 and the first quarter of 2013. In terms of import figures, investment in machinery and equipment was diverse, although the overall figure was primarily the result of major investments in the energy sector. There was a sharp increase in investments in buildings and infrastructure at the end of the year, due mostly to public investment in infrastructure financed by European funds. The contraction in final household consumption slowed down significantly. The main factors were an increase in the purchases of consumer durables prior to the rise in VAT, and a slight increase in consumption of non-durables at the end of the year. The stabilisation of private consumption in the final quarter was in line with developments in the real wage bill, which were more favourable as a result of the sharp fall in inflation. The contraction in final government consumption increased to 2% last year, as a result of a significant fall in employment in public administration, while the government sector also reduced its expenditure on goods and services.

Growth in imports and exports was higher than forecast. Exports increased by almost 3% overall last year in real terms, as a result of high growth in merchandise exports in the second half of the year, when weakening demand on markets outside the EU was successfully met by the exporters refocusing on EU members. In contrast to merchandise exports, exports of services declined throughout the year, and were down almost 1% in year-on-year terms in the final quarter. In the second half of the year there was also a significant increase in imports.

Figure 2.7: Foreign trade



Source: SORS - national accounts.

The growth in merchandise imports was related to the increase in industrial production, and in the final quarter to the growth in aggregate domestic consumption, while the growth in imports of services was primarily influenced by construction services, partly in connection with the TEŠ 6 project (Block 6 at Šoštanj power station). Due to these developments the contribution to GDP growth by net trade turned negative in the final quarter of last year for the first time in the last five years.

Labour market

The gradual improvement in the economic situation slowed the year-on-year decrease in employment.[3] The year-on-year decline in the workforce in employment, which stood at more than 2.5% in early 2013, had slowed to 1% by the end of the year. Employment stood at 921,200 in the final quarter according to seasonally adjusted figures. The number of self-employed was up in year-on-year terms in the second half of the year. There were similar year-on-year developments in the number of hours worked by employees and the self-employed, where the second half of the year was significantly more favourable than the first half of the year.

Employment in the private sector was down in year-on-year terms at the end of the year in almost all sectors, although the decrease was significantly smaller than in the previous quarters. The year-on-year decrease in employment slowed significantly in the construction sector, to just under 3% in the final quarter, compared with 8.9% a year earlier. Employment in industry was down by just 1.3% in year-on-year terms in the final quarter, the manufacturing sector recording a decline of 1.5%. The year-on-year decline in employment in

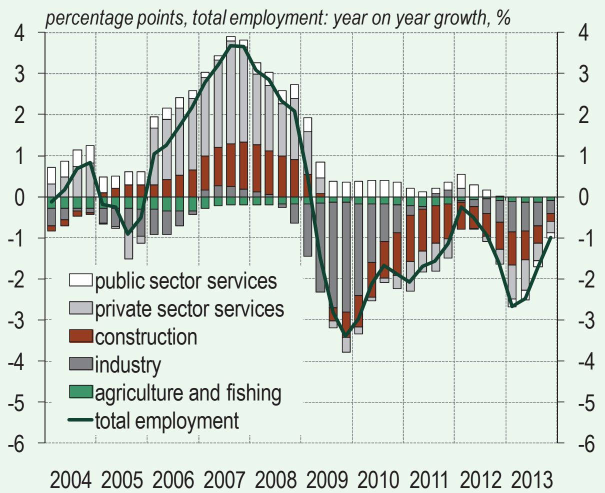
Table 2.1: Employment

	2009	2010	2011	2012	2013	4Q12	1Q13	2Q13	3Q13	4Q13
	average annual growth in %					y-o-y growth in %				
A Agriculture, forestry and fishing	-1.7	-2.0	-2.5	-0.9	-1.4	-1.1	-1.4	-1.5	-1.5	-1.2
BCDE Industry	-8.7	-5.7	0.0	-1.2	-2.5	-2.3	-3.2	-3.1	-2.5	-1.3
F Construction	-0.9	-9.4	-11.4	-7.8	-7.5	-8.9	-11.2	-9.6	-5.8	-2.9
GHI Trade, accommodation, transport	0.1	-2.4	-2.4	-1.2	-2.3	-1.9	-2.6	-2.7	-2.3	-1.8
J Information and communication	4.0	0.8	0.3	2.1	1.1	2.4	1.2	0.8	1.2	1.2
K Financial and insurance activities	1.8	-0.7	-3.1	-1.6	-2.7	-2.4	-2.9	-2.9	-2.5	-2.5
L Real estate activities	4.3	0.0	-3.7	-1.0	-1.4	2.0	0.0	-1.9	-1.9	-1.9
MN Professional, technical and other business activities	-0.5	2.6	0.7	1.4	0.1	0.3	-1.4	-0.4	0.8	1.2
OPQ Public administration and defence; education, health	2.2	2.3	0.9	1.1	-0.9	0.1	-1.0	-1.2	-0.8	-0.6
RST Other activities	3.1	1.7	-1.9	0.2	-1.2	0.0	-1.8	-1.8	-0.6	-0.3
TOTAL	-1.8	-2.2	-1.6	-0.8	-2.0	-1.6	-2.7	-2.5	-1.7	-1.0

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

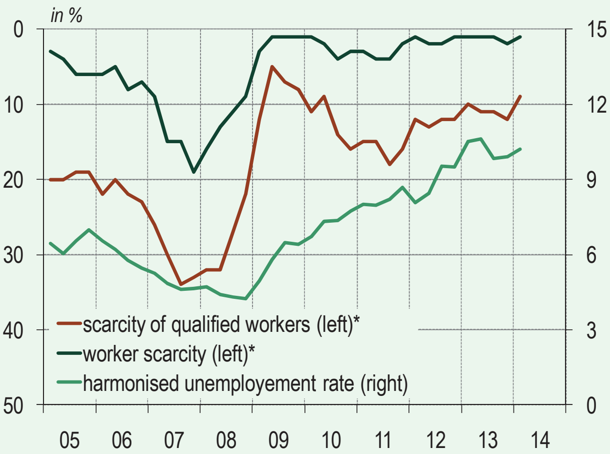
[3] The employment analysis uses national accounts figures, i.e. for employment according to the domestic concept. The figures used are in most cases adjusted for the season and the number of working days.

Figure 2.8: Contribution of sectors to changes in total employment



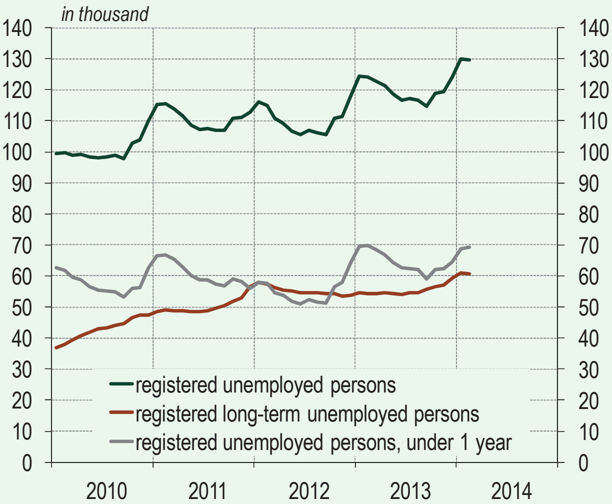
Source: SORS - national accounts, Bank of Slovenia calculations.

Figure 2.9: Worker scarcity, unemployment rate



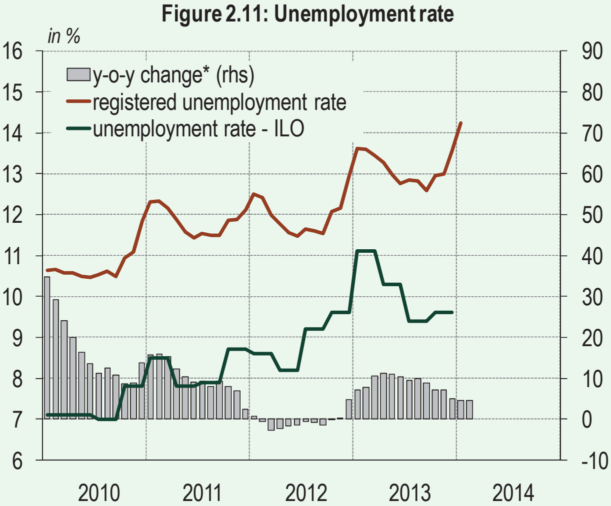
Note: * Precentage of companies that stated worker scarcity as a limitation factor in the quarterly Business tendency survey in manufacturing. Left axis is inverted.
Source: SORS, Eurostat, Bank of Slovenia calculations.

Figure 2.10: Long-term unemployed persons



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

Figure 2.11: Unemployment rate



Note: * Y-o-y change in the number of registered unemployed persons, in %
Source: Employment Office of the Republic of Slovenia, SORS, Bank of Slovenia calculations.

manufacturing stood at 2.6% a year earlier. Employment in professional, scientific and technical activities and administrative and support service activities began to rise in the second half of the year, while the increase in employment in the information and communication sector continued. The improvement in the situation in the manufacturing sector was primarily the result of the recovery in foreign demand, while the improvement in the situation in the service sector was most likely the result of the low basis from the second half of 2012 and the stabilisation of domestic consumption in the absence of additional fiscal shocks that had previously had a strongly negative impact. Total employment in the non-financial corporations sector was down by just 1.1% in year-on-year terms in the final quarter. There was no sign of an easing of the employment situation in the financial sector by the end of the year, and employment fell by 2.7% over the year. Employment was down almost 2% on 2012, although the situation on the labour market was easing towards the end of the year. Despite this, the available data on demand for labour give no indication of a sharp rise in employment.

The decrease in employment in the public sector also slowed last year. Employment in the final quarter was down 0.6% in year-on-year terms, almost half of the decrease from the beginning of the year. There was a similar situation with employment in the government sector, which was down 0.9% in year-on-year terms in the final quarter. According to the monthly SORS figures, employment in the health and social security sector and the education sector was rising from the middle of the year, while employment in the public administration, defence and compulsory social security sector continued to decrease by more than 1.5% in year-on-year terms. This is an indication that government austerity measures to reduce employment had more impact in sectors where the government has greater direct control.

The number of new hires in 2013 was up on the previous year, while the shortage of skilled workers declined slightly. The number of unemployed people deregistering as a result of new hires in 2013 was up just over a tenth in year-on-year terms. The large increase in new hires relative to 2012 was caused mainly by a low basis, 2012 having recorded significantly fewer new hires than previous years as a result of the uncertainty and apprehension surrounding the entry into force of the ZUJF. The shortage of skilled workers in manufacturing has been declining since the end of 2011, but nevertheless still indicates a mismatch between the experience and skills of unemployed workers and the requirements

Table 2.2: Labour cost indicators

	2009	2010	2011	2012	2013	4Q12	1Q13	2Q13	3Q13	4Q13
	nominal y-o-y growth, %									
Gross wage	3.5	3.9	2.0	0.1	-0.1	-1.0	-1.0	-0.5	0.3	0.6
Gross wage in the private sector	1.9	5.0	2.6	0.9	0.7	0.0	0.1	0.6	1.1	1.2
Gross wage in the public sector[1]	6.8	-0.1	0.0	-2.2	-2.3	-3.5	-3.5	-3.0	-1.6	-1.0
Gross wage in manufacturing	0.9	8.9	3.9	2.5	2.8	2.3	1.6	2.9	3.0	3.6
Labour costs per hour worked[2]	3.6	1.1	2.0	-0.3	-2.1	-2.0	-3.3	-5.8	-1.0	2.1
Labour costs per hour worked in manufacturing[2]	5.7	3.2	1.9	2.9	0.6	1.6	4.5	-5.7	-0.5	4.4
Gross wage per unit of output[3]	10.3	0.4	-0.4	1.8	-1.0	0.8	1.0	-1.5	-1.0	-2.5
Gross wage per unit in manufacturing[3]	10.0	-5.1	0.3	3.9	1.2	1.6	1.8	1.9	1.1	-0.1
Unit labour costs[3, 4]	8.6	0.4	-0.7	0.8	-0.8	0.3	1.2	-0.5	-1.1	-2.7
Compensation per employee[4]	1.9	3.9	1.6	-1.0	0.1	-1.4	-0.8	0.6	0.1	0.4
Output per employee	-6.2	3.5	2.4	-1.7	0.9	-1.7	-2.0	1.1	1.3	3.2
Output per employee (manufacturing)	-8.3	14.7	3.6	-1.3	1.6	0.7	-0.2	1.0	2.0	3.7
HICP	0.9	2.1	2.1	2.8	1.9	3.0	2.7	1.8	2.2	1.1
GDP deflator	3.3	-1.1	1.2	0.2	1.0	0.2	0.0	1.6	1.5	0.7

1 Public administration, education, health and culture according to NACE rev. 2.
2 Labour costs according to SORS calculations.
3 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).
4 Labour costs calculated on the basis of employee compensation (national accounts).
Source: SORS, Bank of Slovenia calculations.

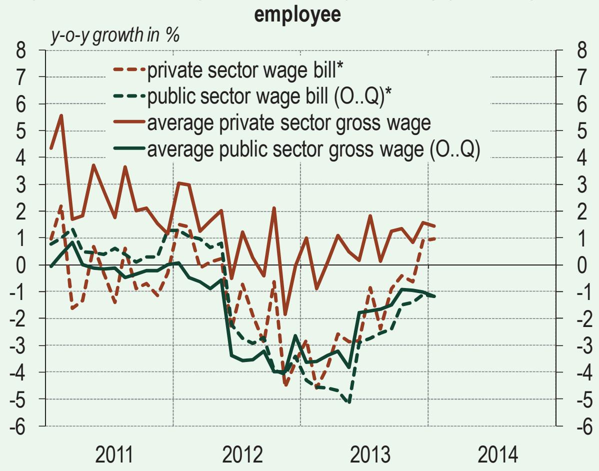
for new labour, as in an environment of significant unemployment firms are not reporting a shortage of workers in general.

The trend of rising unemployment slowed in 2013. The clearest evidence of the more favourable developments in unemployment comes from the figures for ILO unemployment, which fell from 11.1% in the first quarter of last year to 9.6% in the final quarter. The registered unemployment rate in December was also down slightly relative to the beginning of the year at 13.5%. The number of registered unemployed recorded a seasonal increase at the end of the year, but was up just under a tenth over the year, primarily as a result of a sharp increase in late 2012 and early 2013. The number of registered unemployed also recorded a seasonal increase in January of this year, before stabilising at close to 130,000 in February.

Last year the number of people registering and deregistering as unemployed was up approximately 1%, but there was an improvement in the composition of flows. The largest relative increase on the inflow side was in the number of first-time jobseekers, which was up just over 17% in year-on-year terms. Those newly registering as unemployed as a result of the loss of temporary jobs accounted for almost half of last year's total registrations, the number having risen by more than 6%. However, the year-on-year change was negative as of August, while the monthly dynamics were also more favourable than in the previous year overall, which could partly be the result of the new labour legislation from April 2013 aimed at restricting temporary employment.[4] New employments accounted for the largest proportion of deregistrations, at almost two-thirds of the total, the number having risen by more than a tenth last year. Last year there was a sharp increase in the number of those transferred to other categories,[5] although they accounted for less than 2% of the total. Outflows from unemployment for reasons other than employment were down just under 17% in year-on-year terms, out of which outflows due to retirement decreased by more than 18%.[6] The proportion of long-term unemployed rose from 44% to just under 48% in 2013 as a result of the smaller number of new unemployed.

Wages began to rise moderately during the second half of the year as the economy showed signs of recovery. The average nominal gross wage per employee in the total economy declined slightly overall last year, as a result of the year-on-year decrease during the first half of the year. Wages began to rise moderately in the second half of the year, partly due to the low basis from the end of 2012, which was the result of government austerity measures. Wages in public services fell by more than 2% last year. This was the result of measures from June 2012, which reduced wages by more than 3% in year-on-year terms, and from June 2013, which caused the year-on-year decline in wages in the second half of the year to remain above 1%. Average wages in the private sector rose by just under 1% in 2013, primarily due to growth in

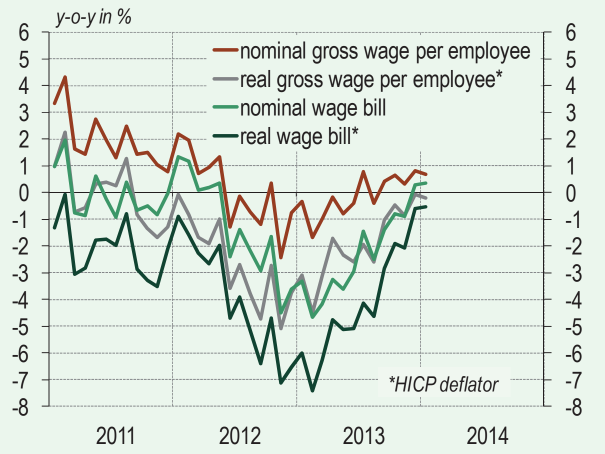
Figure 2.12: Total wage bill and average monthly gross wage per employee



*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.

[4] The measures to limit temporary employment include the introduction of severance payments, constraints on temporary employment contracts, and increased employers' contributions to unemployment insurance for temporary employment.
[5] Other categories include people participating in active employment policy programmes and people who are temporarily unemployable.
[6] The end of 2013 saw the end of the period when under the old legislation the Employment Service paid pension and disability insurance contributions for unemployed workers filing an application before the end of 2010 who were less than three years away from retirement.

Figure 2.13: 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.

the second half of the year. The highest wage growth in the private sector was recorded by the manufacturing sector and the electricity, gas, steam and air conditioning supply sector, where the rates of increase were around 3%. The largest decline of 2.4% was recorded by wages in the professional, scientific and technical activities sector, even as the workforce in employment increased by 1.6% in year-on-year terms. The average real gross wage in the total economy was down approximately 2% in year-on-year terms last year, while the real gross wage bill was down just over 4%.

3 Current Account and Competitiveness Indicators

The current account surplus widened sharply last year. It amounted to EUR 2.2 billion or 6.3% of GDP, a high surplus in merchandise trade accounting for approximately two-thirds, alongside the favourable terms of trade. Nominal growth in merchandise exports increased during the year in line with the economic recovery in the EU, and was the main factor in the slowdown in the contraction in merchandise imports at the same time as the increase in industrial production and the stabilisation of domestic consumption towards the end of the year. Other factors in the increased current account surplus were trade in services and a narrower deficit in factor income.

Slovenia's competitiveness on markets outside the euro area deteriorated, primarily as a result of a fall in foreign currencies against the euro. By contrast, Slovenia's cost competitiveness on the markets of euro area countries increased again last year. Developments in unit labour costs (ULCs) were more favourable in the vast majority of sectors, while inflation also approached the euro area average in the final quarter.

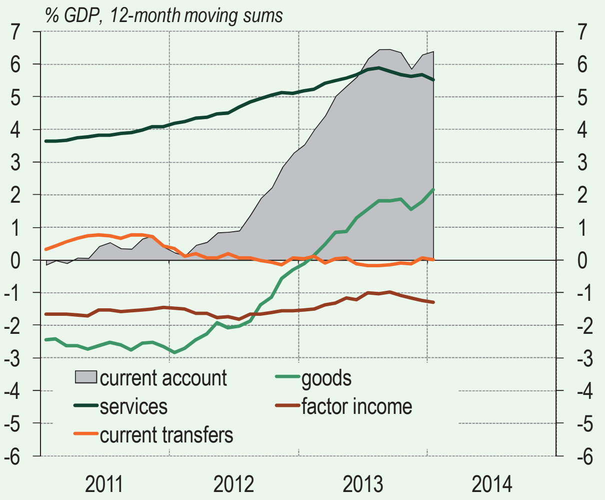
Current account

Last year there was a large surplus in the current account. It amounted to EUR 2.2 billion or 6.3% of GDP, almost double that in 2012. The increase was mostly the result of the shift in the merchandise trade balance from a deficit of 0.3% of GDP in 2012 to a surplus 1.8% of GDP, primarily as a result of high growth in exports. Coverage of imports by exports rose from 99.4% to 103%. The surplus of trade in services also widened, from 5.1% of GDP to 5.7% of GDP, largely as a result of the high surplus of trade in other business services, most notably intermediation services. The deficit in factor income narrowed from 1.6% of GDP to 1.2% of GDP, as a result of the decline in net outflows of income from FDI, while interest payments on loans raised in the rest of the world declined again as a result of further reductions in the banks' debt. Current transfers recorded a small surplus, but only as a result of high inflows of European funds in December.

Merchandise trade

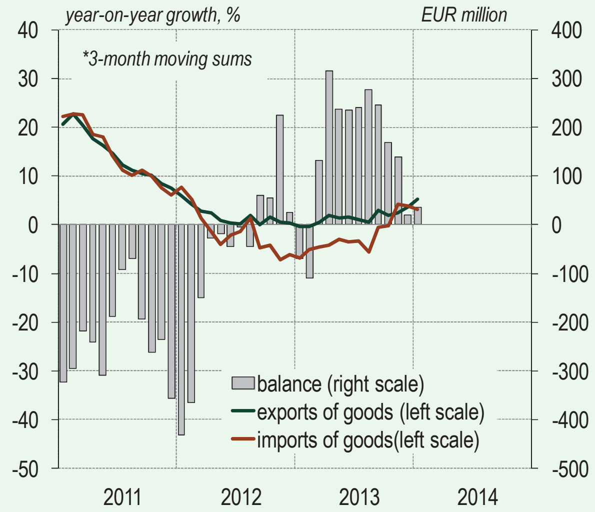
Last year's increase in growth in merchandise exports was the result of an increase in Slovenian exporters' market share in the EU. According to balance of payments figures, growth in nominal merchandise exports stood at 2.2% last year, up 1.4 percentage points on 2012. The sole reason that growth in total merchandise exports was positive in the first quarter was high growth in markets outside the EU. The export situation subsequently reversed. Exports to EU Member States

Figure 3.1: Components of the current account



Source: Bank of Slovenia.

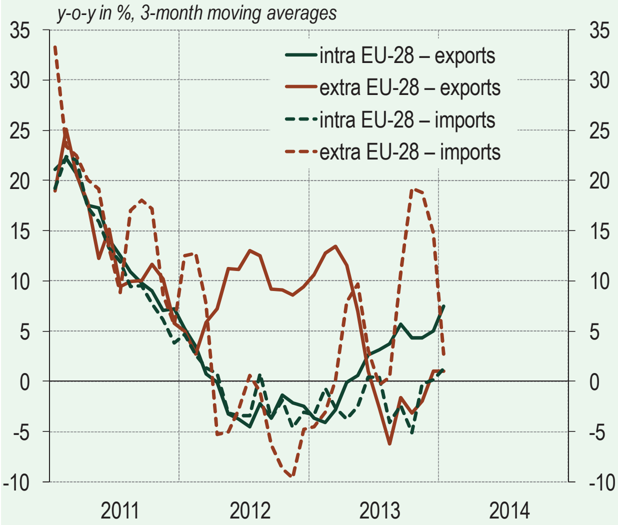
Figure 3.2: Trade in goods*



Source: Bank of Slovenia.

began to increase with the economic recovery in the EU, while growth in other markets slowed sharply partly as a result of a fall in the majority of other currencies against the euro. According to SORS figures, growth in exports to EU Member States stood at 2.6% last year, which entailed a significant increase in Slovenian exporters' market share in the EU as Member States recorded an aggregate decline of 2.8% in imports. Stagnation after the first quarter meant that growth in merchandise exports to markets outside the EU stood merely at just over 3%, down 6 percentage points on 2012. Of the key markets outside the EU, growth in exports to Russia and Serbia slowed, while the decline in exports to Bosnia and Herzegovina accelerated.

Figure 3.3: Goods trade by country groups



Source: Bank of Slovenia.

Merchandise imports were weak overall last year, primarily as a result of the decline in industrial production and thus in imports of intermediate goods in the first three quarters of the year, although there was an increase in the last quarter. Imports of intermediate goods declined by more than 2% last year, despite growth in the last quarter as a result of the recovery in industry at the end of the year. Imports of capital goods increased by just under 6% as a result of high imports in the first half of the year, partly in connection with the investment in the TEŠ 6 project. After a year-on-year decline in the first quarter, imports of consumer goods recorded a significant rise of almost 5% last year. This was partly the result of increased purchases of durables before the rise in VAT, and the weak but positive growth in the consumption of non-durables at the end of the year. There was also a sharp increase in imports of cars from countries outside the EU.[7] The annual decline in imports slowed to 1.2% according to the balance of payments

[7] The simultaneous rise in the number of one-day car registrations in Slovenia, which last year accounted for more than a third of car registrations, suggests the possibility of an increase in car sales to non-residents that has not been recorded in exports.

Box 3.1: Disclosure of merchandise trade with EU Member States

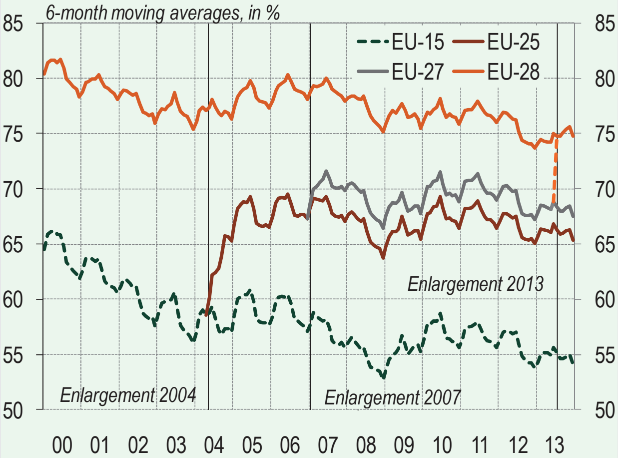
Due to the accession of new countries to the EU, the aggregate data series for Slovenia's merchandise trade with EU markets are not comparable over time. Each enlargement of the EU thus requires adjustments in the time series with regard to the number of Member States.

The largest changes in the export shares of trade with EU countries occurred in May 2004, when the EU15 were joined by ten new countries, among them Slovenia. In May 2004 the proportion of merchandise exports to EU markets as a share of total exports increased by more than 8 percentage points, to almost 68%. The enlargement also brought a significant increase in the proportion of imports from EU markets.

The next EU enlargement occurred on 1 January 2007, when Bulgaria and Romania joined the EU25. Due to the minor importance of their markets to Slovenia's merchandise trade, the changes in proportions were not as significant as in 2004.

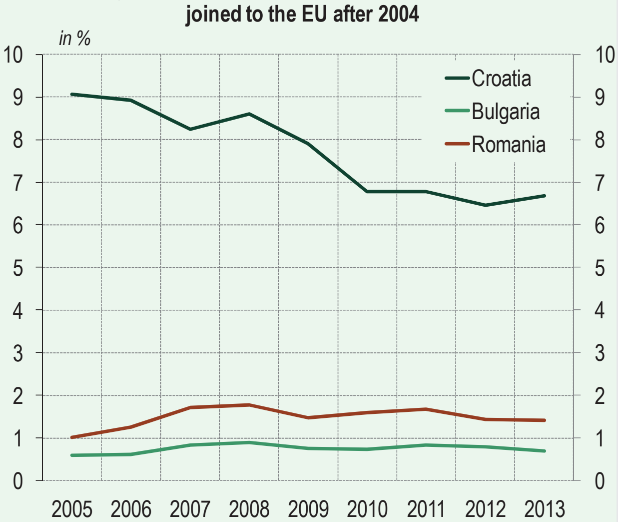
Croatia accounts for a significantly larger proportion of Slovenia's merchandise trade. Exports to Croatia accounted for between 6% and 9% of Slovenia's merchandise exports in the 2005 to 2013 period. Croatia joined the EU27 on 1 July 2013. The proportion of Slovenia's total merchandise exports accounted for by EU markets thus increased by more than 7 percentage points in July 2013, to just under 75%. The changes on the import side were slightly smaller. The proportion of Slovenia's imports and exports accounted for by markets outside the EU declined by the same amount, which should be taken into account in analysis of the geographical breakdown of merchandise trade.

Figure 1: Share of export of RS to the EU markets



Note: Series named EU-25 and EU-27 begin with a month of the enlargement of the EU to the 25 and 27 member states and present an increase of the share of export of RS to the EU markets due to the enlargements of the EU.
Source: SORS, Bank of Slovenia calculations.

Figure 2: Share of export of RS to the markets, joined to the EU after 2004



Source: SORS, Bank of Slovenia calculations.

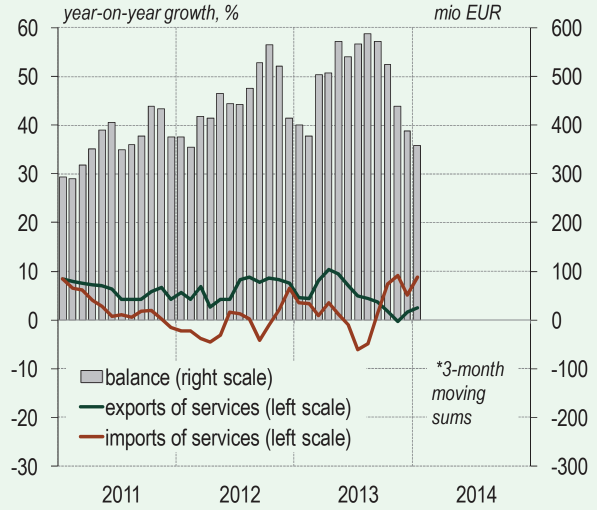
figures, 1.8 percentage points less than in 2012. Imports from other EU Member States declined, while there was a sharp increase in merchandise imports from Russia, Japan, South Korea and the US. The latter were probably the result of a fall in the currencies of these countries against the euro, and thus in the prices of their goods on the markets of the euro area.

The terms of trade were favourable last year. The fall in import prices was faster than the fall in export prices as of the second quarter. The main factor in this was the fall in euro oil prices, primarily as a result of the US dollar's fall against the euro. There was also a sharp fall in other industrial commodity prices and food prices. Export prices fell by 0.8% overall last year, while import prices fell by 1.6%. After deteriorating by 0.8% in 2012, the terms of trade thus improved by 0.7% last year, which contributed 0.4 GDP percentage points to the current account surplus.

Trade in services

Growth in exports of services slowed slightly last year, while imports of services increased, primarily as a result of high growth in the last quarter. Growth in exports of services stood at 5%, down 1.7 percentage points on 2012 as a result of declines in exports of travel services in the first half of the year and, in particular, exports of construction services in the last quarter. In contrast to merchandise exports, growth in exports of services slowed during the year, reaching just 1.6% in the last quarter. After stagnating in 2012, imports of services increased by 1.6% last year. The main factor in this was the growth of 5.2% in the last quarter as a result of an increase in imports of transport services and further rapid

Figure 3.4: Trade in services*



Source: Bank of Slovenia.

Table 3.1: Components of the current account

	2005	2006	2007	2008	2009	2010	2011	2012	2013
				mio EUR					
Current account balance	-498	-545	-1,441	-2,028	-173	-50	146	1,159	2,224
1. Goods	-1,026	-919	-1,456	-2,144	-440	-830	-957	-110	632
2. Services	920	993	1,047	1,428	1,165	1,281	1,476	1,803	2,004
2.1. Transport	398	456	525	561	437	496	585	630	655
2.2. Tourism	743	783	834	904	891	1,002	1,158	1,356	1,399
- of which, exports	1,451	1,555	1,665	1,827	1,804	1,925	1,975	2,090	2,101
2.3. Other	-221	-247	-312	-38	-163	-218	-267	-183	-50
3. Factor income	-295	-440	-789	-1,030	-724	-588	-524	-552	-435
3.1. Labour income	128	107	50	8	96	150	234	377	393
3.2. Capital income	-424	-547	-839	-1,038	-820	-739	-758	-929	-828
4. Current transfers	-97	-178	-243	-282	-174	88	151	18	23
				as % GDP					
Current account balance	-1.7	-1.8	-4.2	-5.4	-0.5	-0.1	0.4	3.3	6.3
1. Goods	-3.6	-3.0	-4.2	-5.8	-1.2	-2.3	-2.6	-0.3	1.8
2. Services	3.2	3.2	3.0	3.8	3.3	3.6	4.1	5.1	5.7
2.1. Transport	1.4	1.5	1.5	1.5	1.2	1.4	1.6	1.8	1.9
2.2. Tourism	2.6	2.5	2.4	2.4	2.5	2.8	3.2	3.8	4.0
- of which, exports	5.1	5.0	4.8	4.9	5.1	5.4	5.5	5.9	6.0
2.3. Other	-0.8	-0.8	-0.9	-0.1	-0.5	-0.6	-0.7	-0.5	-0.1
3. Factor income	-1.0	-1.4	-2.3	-2.8	-2.0	-1.7	-1.4	-1.6	-1.2
3.1. Labour income	0.4	0.3	0.1	0.0	0.3	0.4	0.6	1.1	1.1
3.2. Capital income	-1.5	-1.8	-2.4	-2.8	-2.3	-2.1	-2.1	-2.6	-2.3
4. Current transfers	-0.3	-0.6	-0.7	-0.8	-0.5	0.2	0.4	0.1	0.1

Source: SORS, Bank of Slovenia.

growth in imports of construction services. In contrast to the growth of almost 6% in 2012, growth in exports of travel services was weak last year, at just 0.6%. There was a sharp decline in growth in the number of arrivals by foreign visitors to 2.7%, while the number of overnight stays by foreign visitors rose by just 1%. Imports of travel services declined again last year, by more than 4%, which is in line with the continuing decline in domestic purchasing power.

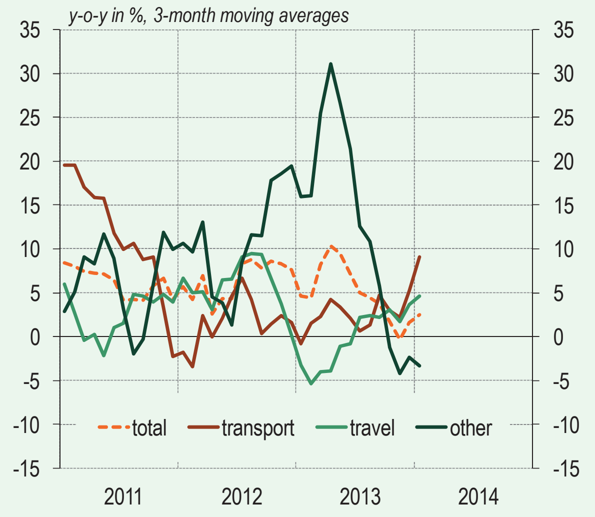
Last year's largest contribution to the increase in the surplus of trade in services came from exports of intermediation services. The surplus of trade in services widened by EUR 200 million compared with 2012 to EUR 2.0 billion. The deficit in other services (excluding transport and travel services) narrowed by EUR 133 million to EUR 50 million. The main factor in this was high growth in exports of intermediation services in the first half of the year, their surplus widening by EUR 100 million. By contrast, the surplus of trade in construction services narrowed by EUR 100 million to EUR 20 million, largely as a result of payments for the TEŠ 6 project. The surplus of trade in travel services increased by EUR 43 million to EUR 1.4 billion, while the surplus of trade in transport services increased by EUR 25 million to EUR 655 million.

Factor income and transfers

The deficit in factor income narrowed last year, primarily as a result of a smaller deficit in income from FDI. The deficit in factor income narrowed by EUR 117 million to EUR 435 million. The deficit in capital income accounted for EUR 101 million of this narrowing. The deficit in income from FDI narrowed by EUR 168 million to EUR 407 million, mostly as a result of a narrower deficit in income from equity. As a result of the ongoing reduction in indebtedness and low reference interest rates, net interest payments on foreign loans declined by EUR 56 million to EUR 147 million. As a result of government borrowing in the rest of the world, net interest payments on debt securities increased by EUR 123 million to EUR 274 million. This figure does not yet include interest payments for bonds issued last year at high interest rates.[8] Given the poor employment opportunities in Slovenia, the number of Slovenian residents working abroad rose further. As outflows remained unchanged, net inflows of labour income increased by more than 3%, widening the surplus in labour income by EUR 16 million to EUR 393 million.

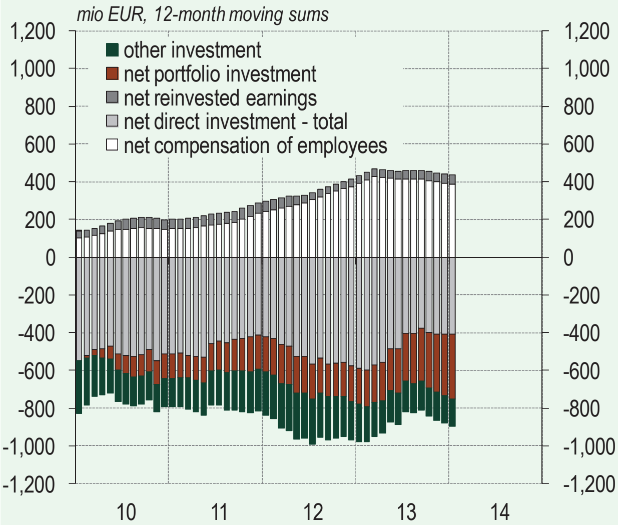
Current transfers recorded a surplus last year, but only as a result of high inflows of European funds in

Figure 3.5: Services exports



Source: Bank of Slovenia.

Figure 3.6: Net factor income



Source: Bank of Slovenia.

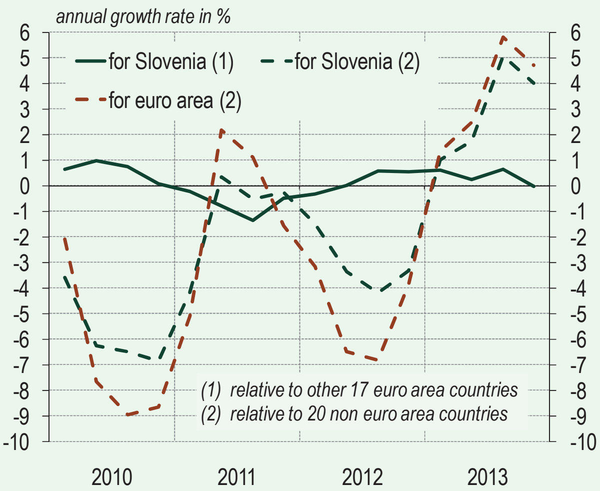
[8] The stock of government debt securities owned by non-residents amounted to EUR 4.6 billion at the end of 2008, but had increased to EUR 16.2 billion by the end of last year.

December. December saw high disbursements from the EU budget for the implementation of the common agricultural and fisheries policies, and funding from the structural funds. The surplus in current transfers amounted to EUR 172 million in December alone, but just EUR 23 million over the whole year. There were no major changes in the position of government transfers and private transfers at an annual level.

Selected competitiveness indicators[9]

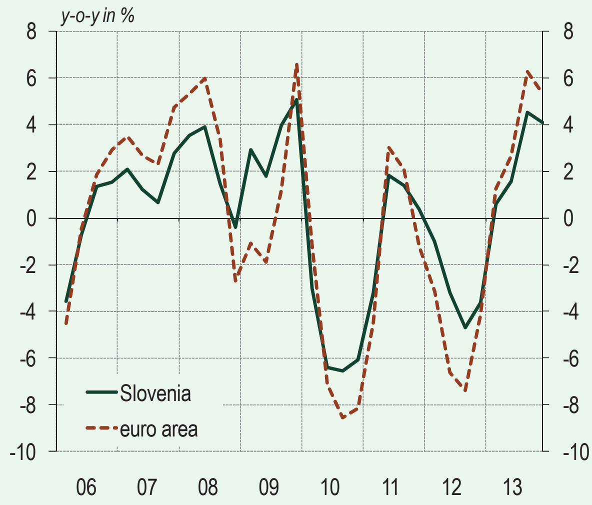
A fall in a number of currencies against the euro last year brought a significant deterioration in Slovenia's price competitiveness on markets outside the euro area. The harmonised price competitiveness indicator measured against 21 countries outside the euro area was up just under 3%, changes in exchange rates accounting for 2.6 percentage points of this increase. There was also a slight rise in domestic inflation. The year-on-year appreciation in the indicator peaked in the third quarter. In the final quarter it declined slightly, but only as a result of a base effect. Growth in this indicator averaged 3.6% across the euro area, the appreciation of the euro contributing almost 4 percentage points as the negative contribution made by the slight fall in inflation was negligible. The main reason that the euro area's loss of price competitiveness was larger than that of Slovenia was the higher proportion in the breakdown of merchandise trade accounted for by the US dollar, the Japanese yen, the pound sterling and the Chinese yuan. Slovenia's price competitiveness against euro area countries deteriorated by 0.4% last year as a result of higher inflation. The deterioration had already ceased by the final quarter as a

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



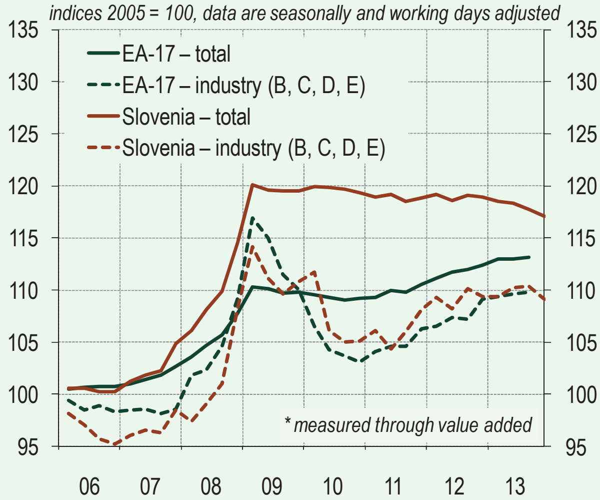
Source: ECB.

Figure 3.7: Nominal harmonised cost competitiveness indicator (vis-a-vis 21 trading partners outside euro area)



Source: ECB.

Figure 3.9: Nominal unit labour costs*



Source: Eurostat, Bank of Slovenia calculations.

[9] 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.

Box 3.2: Equilibrium competitiveness indicator for Slovenia

The equilibrium competitiveness indicator (Collignon, 2012)[1] measures a country's competitiveness under the assumption that the mobility of capital ensures that the return on physical capital is the same within a single currency zone. It is not only labour costs that affect the return on capital, but also capital productivity, which can vary across regions. The equilibrium competitiveness indicator attempts to take account of differences in capital productivity. The equilibrium level of unit labour costs (ULCs) is defined as the level of costs that ensures equal return on capital in the two areas under comparison. The competitiveness of a selected area is then measured as the deviation from the equilibrium level of ULCs. If the actual level of ULCs is higher than the equilibrium, the area is less competitive. The advantage of this indicator compared with the traditional indicators of real effective exchange rates that are often used to measure the competitiveness of a country is that it has a precisely defined equilibrium, and therefore is not dependent on the selection of the base period. The equilibrium is where the difference between equilibrium ULCs and actual ULCs is zero. The weaknesses of the indicator is that it does not take account of any differences in risk premiums, product quality, and some judgements required in the calculation (amount of capital, prices of capital goods), etc.

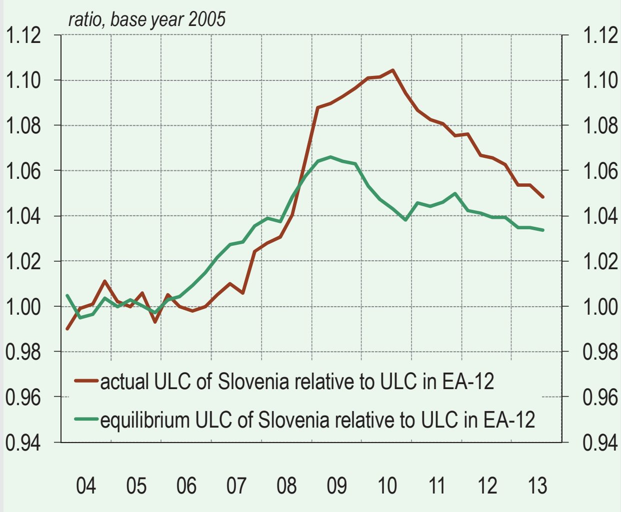
The equilibrium competitiveness indicator[2] for Slovenia is calculated relative to the euro area, as one of the assumptions for calculating the equilibrium competitiveness indicator is membership in the same currency zone. This is relevant to Slovenia, as around 50% of its trade takes place within the euro area.[3] Figure 1 shows Slovenia's actual ULCs and equilibrium ULCs relative to the EA12.

In contrast to the standard competitiveness indicators, where competitiveness deteriorates when the level of the indicator increases (appreciation), in the equilibrium competitiveness indicator it is the difference between the actual ULCs and equilibrium ULCs that is important. An increase in ULCs in one country is not necessarily bad, as some of the increase can be sustainable from the point of view of competitiveness if the average capital productivity is higher than that in the area with which the country is being compared, or if ULCs are rising in the other area. The sustainable level of ULCs is illustrated by the green line in Figure 1. Where the red line is below the green line, it means that ULCs are still lower than ULCs adjusted for the average capital productivity in Slovenia (which means that Slovenia's competitiveness is better relative to the EA12 at that time). Where the red line is above the green line, it means that ULCs in Slovenia are too high compared to the average capital productivity in Slovenia, and that Slovenia's competitiveness is thus worse.

Figure 1 shows that ULCs in Slovenia were close to the equilibrium until the second half of 2006, and then between the second half of 2006 and the final quarter of 2008 the Slovenian economy was more competitive in terms of the equilibrium competitiveness indicator (Slovenia's actual ULCs, relative to the EA12, were below the equilibrium ULCs, relative to the EA12), although competitiveness as measured by actual ULCs was deteriorating as of the third quarter (the gap between the green line and the red line was closing). The deterioration particularly strengthened from the third quarter of 2008, and only ended in the third quarter of 2010. Since then the gap between the actual ULCs and equilibrium ULCs has been rapidly closing.

Figure 2 illustrates the changes in the difference between actual ULCs and equilibrium ULCs in Slovenia and in its main trading partners. Equilibrium labour costs in all countries are measured relative to the EA12.[4] The results for the main trading partners are in line with the results reported by Collignon

Figure 1: Actual and equilibrium ULC of Slovenia relative to EA-12

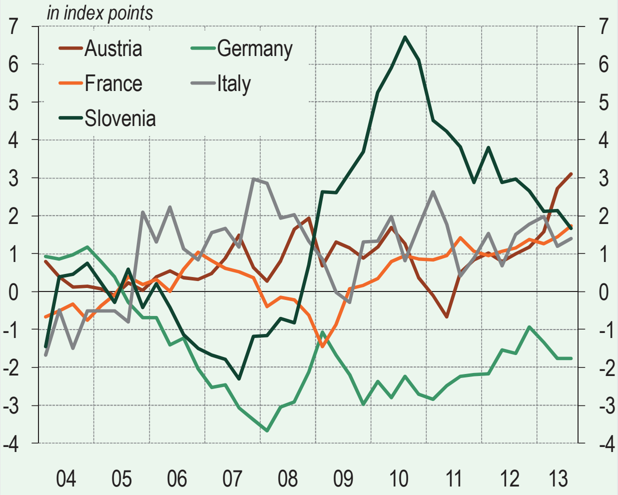


Source: Eurostat, Bank of Slovenia calculations.

(2012). Germany has significantly improved its position since 2005 in terms of the equilibrium competitiveness indicator. The difference between the actual and equilibrium ULCs was negative in Germany throughout practically the whole of the period after the second quarter of 2005, although the gap to equilibrium has been closing very gradually since the end of 2009, while Austria, France and Italy have remained very close to equilibrium over the whole period. For Austria, France and Italy the equilibrium competitiveness indicator reveals a gradual deterioration since the middle of 2011.

The most dynamic feature of Figure 2 is the development of the equilibrium competitiveness indicator for Slovenia. While Slovenia's equilibrium competitiveness indicator tracked Germany's until the middle of 2007, its competitiveness as measured by this indicator subsequently deteriorated sharply. None of the main trading partners saw such a rapid and large deterioration in competitiveness. The deterioration in Slovenia's competitiveness reversed in the third quarter of 2010, and the pace of improvement was very high. By the third quarter of 2013 Slovenia's competitive position was better than Austria's, slightly better than France's, and not significantly behind Italy's. However, Slovenia's equilibrium competitiveness indicator remains worse than in equilibrium, as it is still above zero. Were these developments to continue, the equilibrium level would nevertheless be reached within approximately a year to a year and a half.

Figure 2: Equilibrium ULC of Slovenia and its main trading partners relative to EA-12



Source: Eurostat, Bank of Slovenia calculations.

[1] Collignon, S.: "Macroeconomic Imbalances and Competitiveness in the Euro Area," forthcoming in Transfer: European Review of Labour and Research, 2012

[2] The choice between the EA12, EA15 or EA17 has a negligible impact on calculations. The EA12 (the euro area excluding Slovenia, Cyprus, Malta, Slovakia and Estonia) was chosen because the available GDP figures are more up-to-date than those with broader data capture. The following time series were used in the calculation: the GDP deflator for the EA12 and for Slovenia, nominal ULCs for the EA12 and for Slovenia, nominal GDP for the EA12 and for Slovenia, figures for real investment for the EA12 and for Slovenia, nominal ULCs for the EA12 and for Slovenia, nominal GDP for the EA12 and for Slovenia, figures for real investment for the EA12 and for Slovenia, the capital goods deflator for the EA12 and for Slovenia.

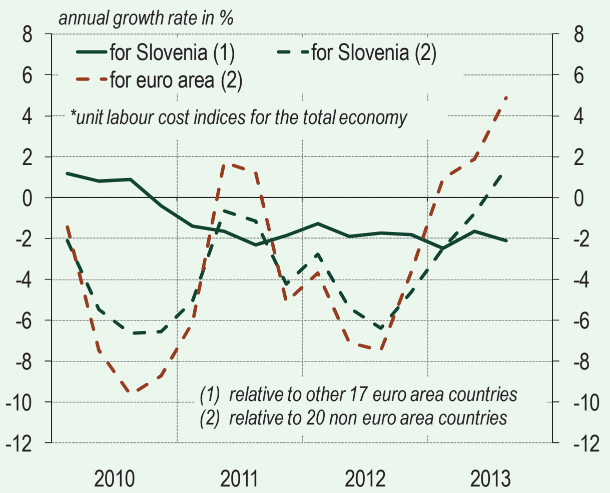
[3] The calculation of the competitiveness indicator is illustrated from 2004, when the fluctuations in the tolar exchange rate became very low as a result of the conditions for the introduction of the euro being met (ERM II).

[4] The methods for calculating capital stock are the same for all countries, and standardised time series are used (Eurostat). The illustration ends in the third quarter of 2013, as certain data required for calculating the equilibrium competitiveness index for the final quarter of 2013 are not yet available.

result of the fall in inflation to a level comparable to the euro area average.

Developments in unit labour costs in Slovenia were more favourable last year than those in the euro area overall for the third consecutive year. Nominal unit labour costs (ULCs) declined by just under 1%, the decline accelerating during the year in line with growth in labour productivity. Labour productivity in the euro area nevertheless increased slightly in year-on-year terms in the first three quarters, but ULCs increased by 1.4% over the same period as a result of high wage growth. Cost developments in Slovenia last year were more favourable than in the euro area overall in the vast majority of segments of the private sector, a reflection of the tradable sector's ability to adapt. The main exception was the financial sector, where ULCs increased sharply as a result of a sharp decline in value-added. Of the other euro area countries, only Cyprus, Slovakia, Spain and Greece re-

Figure 3.10: Harmonized competitiveness indicators* (based on ULC deflators)



Source: ECB.

corded a decline in ULCs. Slovenia's cost competitiveness relative to 21 trading partners outside the euro area as measured by the harmonised indicator began to decline in year-on-year terms in the second half of the year as a result of the prevalence of exchange rate movements.

4 Financing

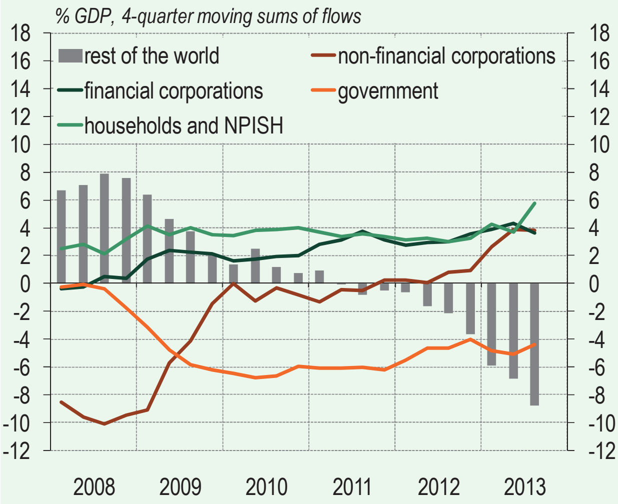
As deleveraging continued, non-financial corporations' weak investment activity and the decline in household consumption were reflected in a sharp increase in the surplus in domestic saving over investment. The non-financial corporations sector sharply increased its financial surplus (net savings) in the first three quarters of 2013. Non-financial corporations again reduced their stock of domestic borrowings via loans last year, while there was an increase in financing from the rest of the world and via internal resources. Households also increased net saving in the third quarter as a result of a decline in consumption and a reduction in bank debts. December's measures to stabilise the banking system, including the transfer of bad loans to the Bank Asset Management Company, had a significant impact on developments at the banks. The banking system's total assets contracted sharply last year. Other factors in the contraction alongside the reduction in the banking system's debt to the rest of the world were the reduction in liabilities from debt securities and write-offs of subordinated debt instruments. Despite a sharp fall in liability interest rates, the banks continue to face a decline in the net interest margin on interest-bearing assets. This has been the result of a sharp decline in lending and high impairment and provisioning costs. For this reason the banks are not passing the fall in liability interest rates through to interest rates on loans to the private sector, which therefore remain significantly higher than in the euro area overall.

Saving-investment gap by sector

In a situation of high uncertainty, non-financial corporations reduced their investments in the first three quarters, while households reduced consumption, which was reflected in a sharp increase in the surplus in domestic saving over investment. The one-year savings-investment (hereinafter: financial) surplus[10] vis-à-vis the rest of the world stood at 8.8% of GDP in the third quarter of 2013. Non-financial corporations[11] (hereinafter: corporates) have continued to reduce indebtedness as investment activity has remained relatively weak. As a result they are increasing internal resources and are becoming strong net savers. Their financial surplus stood at 3.8% of GDP in the third quarter. The household sector's financial surplus has been widening rapidly, reaching 5.7% of GDP in the third quarter. This increase was primarily the result of the decline in consumption brought by the unfavourable situation on the labour market and the reduction in household indebtedness at banks. The issue of two US dollar bonds for the

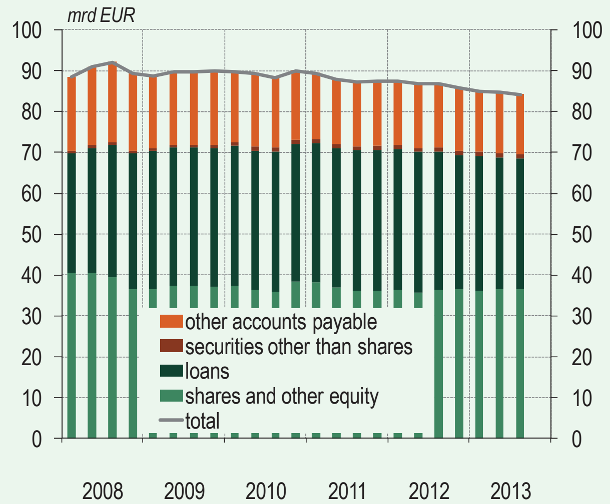
[10] The savings-investment gap is defined as the surplus of financial assets (savings) over financial liabilities (investments).
[11] According to the ESA 95 definition, non-financial corporations (corporates) are legal entities that are market producers of goods and non-financial services.

Figure 4.1: Savings-investment gap



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

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



Source: Bank of Slovenia, consolidated data.

purpose of stabilising the banking system resulted in an increase in the government sector's financial deficit. It stood at 4.4% of GDP at the end of the third quarter.

Corporate financing and financial assets

Corporate financial assets declined by EUR 441 million in the first three quarters of 2013, primarily as a result of a decline in the stock of investments in shares and other equity. The stock of financial assets stood at EUR 42.6 billion in the third quarter. Falls in the value of shares and other equity brought a decline of EUR 396 million in the value of these corporate assets. In line with export growth, there was an increase of EUR 375 million in trade credits granted to the rest of the world, while intra-sectoral trade credits declined by EUR 466 million. Corporates increased their investments in the form of deposits at banks by EUR 468 million over the first three quarters of 2013, the majority of the funds being earmarked for the construction of the TEŠ 6 project.[12]

Corporate financial liabilities declined by EUR 1.7 billion over the first three quarters, primarily as a result of a decline in liabilities on the basis of bank loans and trade credits. Trade credits contracted by almost EUR 1 billion, intra-sectoral liabilities accounting for half of the decline, and the rest of the world for the other half. The latter was in line with the decline in imports in the first half of the year, while the decline in intra-sectoral trade credits was the result of the adverse economic situation and the large stock of outstanding past-due liabilities. Corporates reduced their intra-sectoral liabilities from loans over the first three quarters, while recording net borrowing in the rest of the world. Liabilities from shares and other equity were unchanged over the first three quarters: the decline in intra-sectoral liabilities as a result of negative revaluation changes was compensated for by new investments by non-residents. Corporate liabilities to the government sector increased by EUR 222 million as a result of additional liabilities from various taxes and levies.

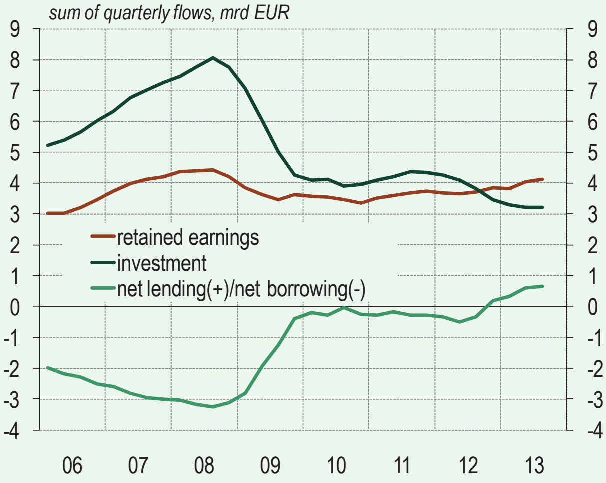
The decline in corporate demand for bank loans, the hampered access to loans and the deterioration in the financing conditions in 2013 were reflected in a further decline in corporate liabilities from bank loans.[13] The latter declined by EUR 4.8 billion in 2013, more than half of which was the result of the transfer of

[12] The firm received the funds for the TEŠ 6 project from the European Investment Bank, and deposited them in Slovenian banks in the short-term.
[13] Loans adjusted for impairments.

claims to the Bank Asset Management Company (BAMC). The stock of bank loans to corporates contracted by EUR 9 billion or 43% between 2008 and 2013. The average loan maturity was changing also in 2013, the stock of long-term loans declining faster than the stock of short-term loans.[14] Corporates are adjusting to the adverse situation in different ways. Corporates with limited possibilities of financing are primarily reducing investment, while other corporates are making use of retained earnings or alternative sources of financing, most notably commercial paper. Last year Slovenian corporates issued six commercial papers with a total nominal value of EUR 193 million.

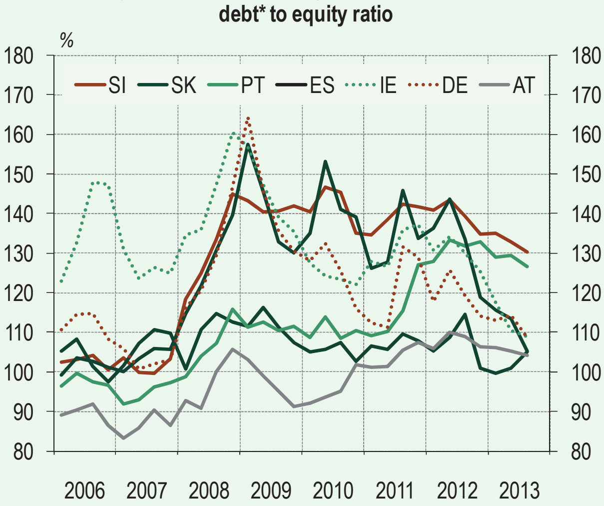
In 2013 interest rates on new loans to corporates remained significantly higher than in the euro area overall. This was primarily the result of limited access to funding, and thus the higher funding costs of the Slovenian banking system (higher interest rates on deposits

Figure 4.3: NFC investment and retained earnings



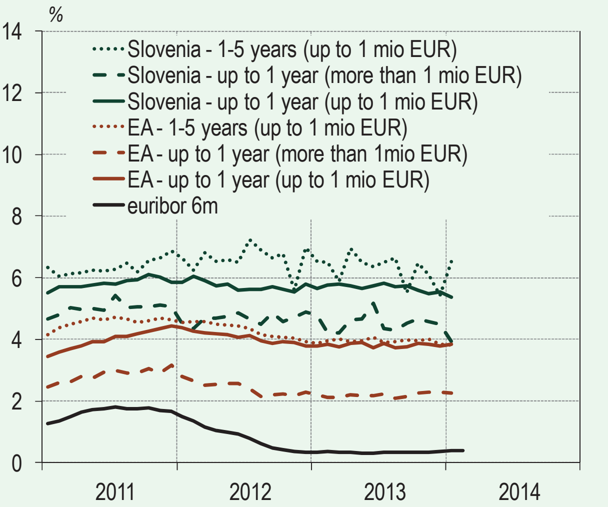
Source: Bank of Slovenia, ECB, SORS.

Figure 4.5: Cross country comparison of NFCs debt* to equity ratio



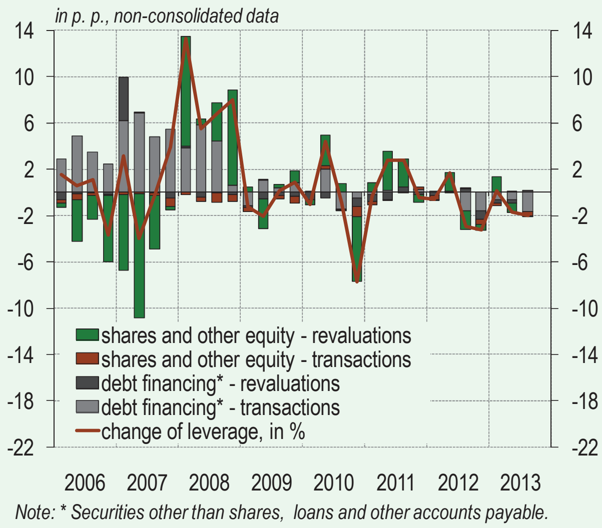
Note: * Securities other than shares, loans and other accounts payable.
Source: ECB, Bank of Slovenia calculations.

Figure 4.4: Interest rates on loans to NFCs



Source: ECB, Bank of Slovenia.

Figure 4.6: Contributions to corporate leverage



Note: * Securities other than shares, loans and other accounts payable.
Source: Bank of Slovenia, financial accounts.

[14] The proportion of new short-term loans is increasing, although a large proportion of new short-term (and also long-term) loans are merely roll-overs.

Box 4.1: Survey on access to finance of enterprises in Slovenia[1]

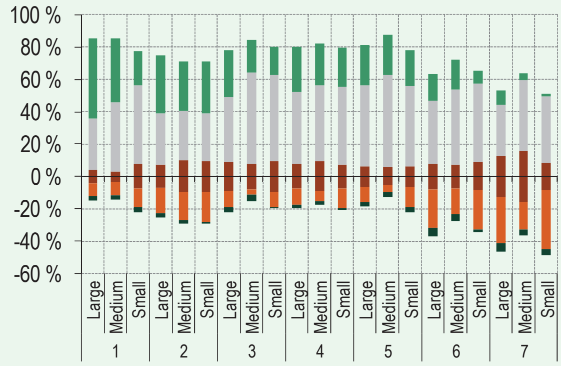
The survey results confirm that access to finance remains a key issue in 2013. In this year, the availability of external finance deteriorated, and therefore companies increased their use of own sources of financing. Most enterprises do not expect any improvement of the external financing position in 2014.

The quality of the business environment in Slovenia is deteriorating. This is reflected in the rising proportion of firms stating payment indiscipline and regulation as the most pressing problems. For small and medium enterprises (SME) the biggest problem was payment indiscipline, followed by competition. In third place was regulation for small enterprises and production or labour costs for medium-size enterprises. The most significant problems for large enterprises were regulation, competition, and production or labour costs.

Slovenian enterprises financed their operations using mostly their own sources of financing (retained earnings, asset sales) and bank loans. The use of internal sources increased due to the diminishing availability of external sources. Last year large enterprises increased their demand for all types of external financing, while SMEs increased demand only for bank overdrafts, credit lines or credit card debt. SMEs demand for other resources remained unchanged. Firms use external financing mainly for financing their current operations, investment and debt restructuring. They do not seek external financing if they have sufficient internal resources (68% of large enterprises, 63% of medium-sized enterprises and 45% of small enterprises), or because the constraints on external financing are too high.

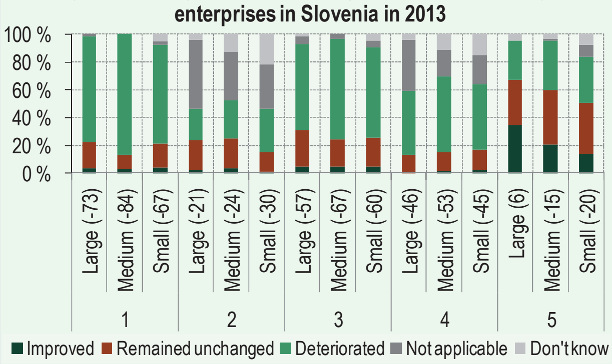
The availability of external financing deteriorated further last year, mainly due to the worsening of the general economic situation and poor cooperation between partners (banks, government and business partners), i.e. due to factors that are not directly dependent on the individual firms. Poor cooperation between partners caused a most substantial drop in bank loans. At the same time firms better assessed factors linked to their operations: they reported that credit history and equity improved last year, while profitability deteriorated in SMEs but improved in large enterprises. Supply of external financing declined further in 2013, while demand decreased only partly. Between 2011 and 2013 SMEs reduced the number of their applications for all types of financing, while large enterprises reduced applications only for current account overdrafts, credit lines, credit card debts and trade credits, and on the other hand increased their applications for bank loans and other external financing. The greatest drop for all enterprises was recorded in applications for trade credits. Between 2011 and 2013 the overall success of applications (a firm obtaining at least some of the required funds) dropped by less than the total success rate (a firm obtaining all of the required funds), because of the rise in the number of firms

Figure 1: External factors of business and their influence in 2013



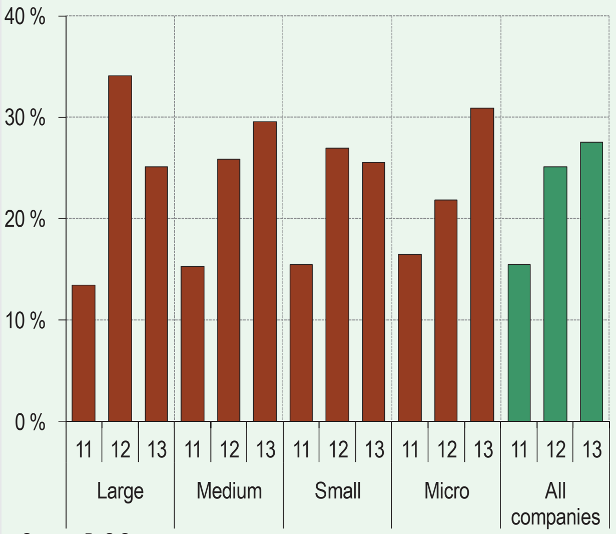
1) Payment discipline. 2) Access to finance. 3) Costs of production or labour. 4) Regulative. 5) Competition. 6) Finding customers. 7) Availability of skilled staff or experienced managers.
Source: BoS Survey, all companies.

Figure 2: Change in the availability of external financing of enterprises in Slovenia in 2013



1) General economic outlook, insofar as it affects the availability of external financing. 2) Willingness of business partners to provide trade credit. 3) Willingness of banks to provide a loan. 4) Access to public financial support including guarantees. 5) Your firm-specific outlook with respect to your sales and profitability or business plan, insofar as it affects the availability of external financing for you. Note: Value in parenthesis represents net percentage difference between firms that have answered "has improved" and those that answered "has detoriated".
Source: BoS Survey, all companies.

Figure 3: Financial gap between 2011 and 2013



Source: BoS Survey.

which received at least some of the required funds. Over this period the number of rejected applications also rose. Last year also 32% of large enterprises, 41% of medium-size enterprises and 45% of small enterprises received all of the required funds for a bank loan, down by 33 percentage points, 24 percentage points and 13 percentage points respectively on 2011, when the survey was first conducted. The proportion of large enterprises receiving some of the required funds for a bank loan increased by 8 percentage points, compared with increases of 12 percentage points at medium-size enterprises and 10 percentage points at small enterprises. The number of rejected applications for bank sources increased most in large enterprises.

Despite deterioration in the price and non-price financing conditions at banks, the increase in the financial gap[2], taking account of other sources of financing, slowed at the aggregate level. Firms nevertheless remain pessimistic with regard to access to finance this year. Both price-related financing conditions deteriorated in 2013: interest rates and other financing costs. Of the non-price conditions, collateral requirements increased, while the majority of firms saw no change in loan size and maturity. The financial gap increased throughout the 2011 to 2013 period for medium-size and micro enterprises, but declined for large and small enterprises. Small and medium-sized enterprises anticipate deterioration in access to all sources of financing, while large enterprises anticipate deterioration in access to external financing. Of the factors of internal financing, large enterprises anticipate an improvement in equity, while earnings from savings are expected to remain unchanged.

[1] The methodology and detailed results of the survey are available at http://www.bsi.si/library/includes/datoteka.asp?datotekaid=5505.

[2] The financial gap is calculated according to ECB methodology. The calculation is based on the responses to questions regarding the need (demand) for individual factors and their accessibility (supply) for all sources of financing other than debt securities, which was mostly of little importance to Slovenian firms. If the indicator increases, the gap between supply and demand for financing increases, and the financial gap widens. The calculation only includes firms that used at least one of the sources of financing.

and higher costs of other resources based on the cost of sovereign borrowing), while some corporates remain high -risk, primarily as a result of their high indebtedness. All of this is hindering the adjustment of interest rates to those in the euro area. Last year short-term interest rates on corporate loans of up to EUR 1 million were almost 2 percentage points higher than the euro area average, while short-term interest rates on loans of more than EUR 1 million were 2.3 percentage points higher. The spreads in long-term interest rates are similar. The spreads in the banks' asset interest rates remained almost unchanged from 2012.

Corporates in Slovenia and in the majority of other euro area countries are reducing their leverage as measured by the debt-to-equity ratio. Slovenian and Spanish corporates reduced leverage by reducing their debt financing, while Irish, Portuguese and German corporates did so by increasing equity. A large proportion of the increase at the latter was the result of positive revaluation changes in shares and other equity. Slovenian corporate debt declined slightly over the first three quarters, but remained significantly higher than in the majority of the aforementioned countries at 130% of GDP.

Household financing and savings[15]

In the context of high unemployment, a decline in disposable income, and the uncertainty surrounding the future financial situation, households have remained very prudent, and are continuing to pay down debt. Household debt declined again, by EUR 120 million over the first three quarters of 2013. The decline in the stock of bank loans was still primarily the result of a contraction in consumer loans, while housing loans remained unchanged.

Interest rates on new housing loans rose slightly above the euro area average in the second half of the year, while interest rates on consumer loans have remained almost 1 percentage point lower. Interest rates on housing loans have been gradually rising since the end of 2012, while interest rates on consumer loans remained at their level from mid-2012 and have not changed significantly. Premiums over the 6-month EURIBOR on housing loans again increased slightly last year, which is probably a reflection of the banks' caution in approving such loans and the need to maintain interest income.

Household assets increased by EUR 350 million over the first three quarters, primarily as a result of an increase in investments in domestic and foreign cash, and a rise in the value of shares and other equity. The increased uncertainty in connection with developments in Cyprus led to a significant decline in time deposits at the domestic banks. Households partly invested these assets in the rest of the world (in the form of time deposits and cash), and partly increased their holdings of domestic cash (by more than EUR 260 million over the first three quarters). There was also switching of deposits from the large domestic banks to the banks under majority foreign ownership. The switching of deposits to the banks under majority foreign ownership was particularly pronounced in the final two months of last year, when there was a high level of uncertainty surrounding the results of the comprehensive review of the domestic banking sector. Confidence was partly restored to the domestic banking system after the release of the stress tests results and the recapitalisation of the largest banks, and households slightly increased their deposits in January of this year, although this was partly of a seasonal nature. Investments in shares and other equity, which account for just over a quarter of total household assets, increased by EUR 76 million over the first three quarters, primarily as a result of positive revaluations.

Figure 4.7: Loans to households

Source: Bank of Slovenia.

Banking system

Measures to stabilise the banking system had a significant impact on developments at the banks last year. The Bank of Slovenia and the Slovenian government passed a resolution in the autumn instructing two banks with no long-term viability on the market to embark on an orderly wind-down process. Following the release of the results of the comprehensive asset quality review (AQR) and stress tests, the government recapitalised five Slovenian banks: a quarter of the total recapitalisation was in the form of government debt securities, while three -quarters came via a government cash contribution. At the same time the government adopted legislation allowing the write-off of subordinated debt instruments issued

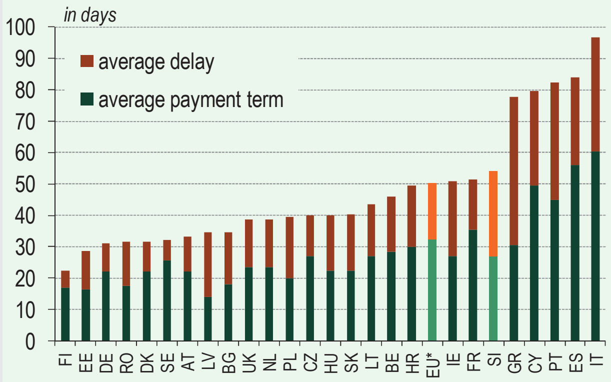
[15] Includes non-profit institutions serving households (S.15) in addition to households (S.14).

Box 4.2: Payment indiscipline in Slovenia as measured by the European Payment Index[1]

Slovenia is classed as having high payment indiscipline relative to EU Member States' data. Its European Payment Index, which stood at 185 points in 2013, was among the highest in the EU, and is an indication of a poor business environment and the malfunctioning of the rule of law. The average across the EU was 157 points. The index was up 3 points on 2012, when Slovenia was included in the survey for the first time. In the EU the index is highest in the less-advanced and economically vulnerable Member States. There were significant differences between EU members already in the years before the crisis, reflecting different payment habits, disruptive to the functioning of the internal market. Of the countries included in the survey for a longer period, payment indiscipline has increased most during the crisis in Greece, Ireland, Latvia, Spain, Hungary, Italy and the UK. With the exception of the last, these are the Member States that have seen the largest decline in GDP since the outbreak of the crisis.

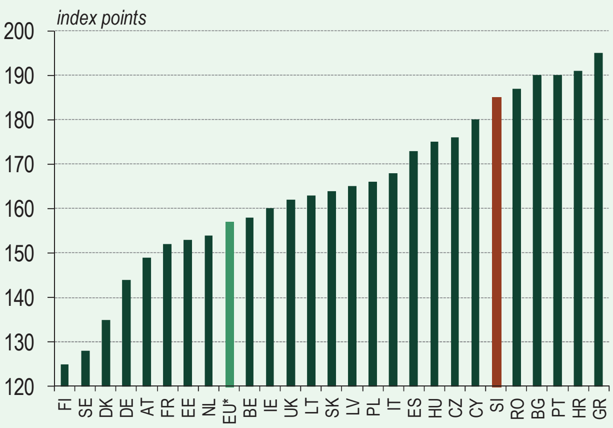
The average number of days required for payment in Slovenia does not differ significantly from the EU average, but mainly on account of the very delayed payments in Spain and Italy. Firms in Slovenia had to wait 54 days for payment in 2013, compared with 50 days in the EU overall. There are significant variations between EU Member States: firms in Greece, Cyprus, Portugal, Spain and Italy have to wait between 78 and 97 days on average, while firms in the north wait only around 30 days. In Slovenia the customer segments that deviate from the EU average are consumers and enterprises, whose payments require five and seven days above average, while the government settles its bills 22 days faster. The countries of the south show considerable payment delays in all segments, particularly the government, whose payments require 133 days in Portugal and 170 days in Italy. Major differences in payment deadlines and delays between the north and the south were evidenced already before the crisis, and are also a factor in a visibly larger share of firms' receivables older than 90 days in the south of the EU. Share of

Figure 2: Average payment duration in 2013



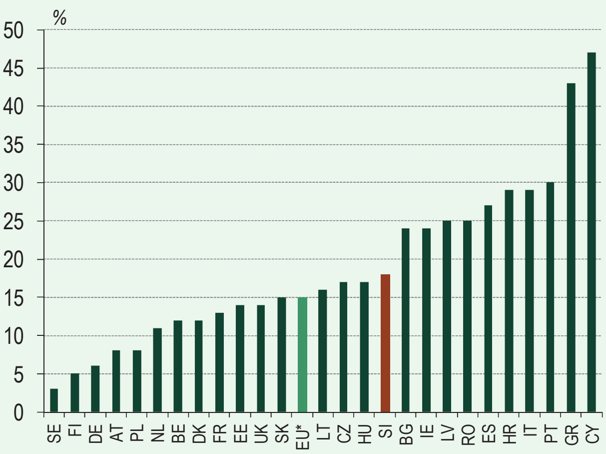
*Note: * EU excluding Luxembourg and Malta. EU average is calculated by using weights of member states in EU GDP, based on European Commission nominal GDP forecasts for 2013. Average payment terms and delays for member states are calculated using weights from survey data structure of customer groups (consumers 30%, corporates 60%, public authorities 10%).*
Source: Intrum Justitia, Bank of Slovenia calculations.

Figure 1: European payment index, EU member states, 2013



*Note: * EU excluding Luxembourg and Malta. EU average is calculated by using weights of member states in EU GDP, based on European Commission nominal GDP forecasts for 2013. Higher index value means lower payment discipline.*
Source: Intrum Justitia, calculation of EU average Bank of Slovenia.

Figure 3: Share of receivables older than 90 days in 2013

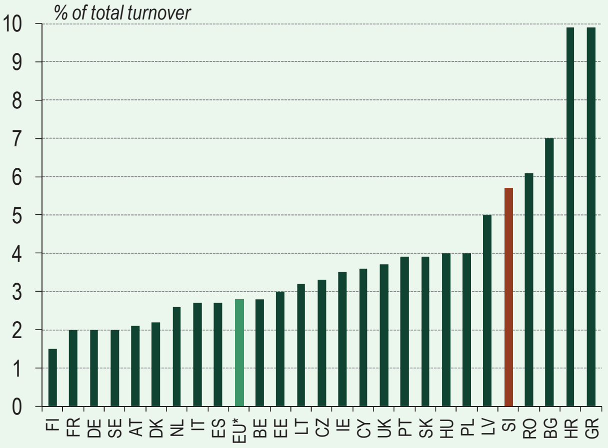


*Note: * EU excluding Luxembourg and Malta. EU average is calculated by using weights of member states in EU GDP, based on European Commission nominal GDP forecasts for 2013.*
Source: Intrum Justitia, calculation of EU average Bank of Slovenia.

receivables older than 90 days in Slovenia stood at 18% in 2013, up 11 percentage points on 2012, which is an indication of the increase in liquidity problems in the economy. The proportion accounted for by such receivables declined in 2013 in the majority of EU Member States.

Compared with the EU average, Slovenia stands out particularly in its proportion of revenue lost in bills never paid. It stood at 5.7% in 2013, compared with the EU average of 2.8%. The figure in Slovenia was up 0.6 percentage points on 2012, as the vast majority of Member States also recorded an increase. The most marked was the 4 percentage points increase in Greece. The proportion of revenue lost because of unpaid bills has increased by approximately 1 percentage point across the EU during the crisis. The proportion of revenue lost and the length of waiting for payment are not altogether correlated; this is most evident in the cases of Spain and Italy, where firms face an extremely long waiting time for payments, but the proportion of revenue lost is below the EU average.

Figure 4: Bad debt loss in 2013



*Note: * EU excluding Luxembourg and Malta. EU average is calculated by using weights of member states in EU GDP, based on European Commission nominal GDP forecasts for 2013.*
Source: Intrum Justitia, calculation of EU average Bank of Slovenia.

Firms in the EU assess the measures of the European Commission and national governments to reduce payment indiscipline as insufficient. To reduce payment indiscipline, the European Commission updated the Directive on combating late payment in commercial transactions in 2011. Slovenia partly transposed its content into national legislation in July 2012 with the implementation of the Prevention of Late Payments Act. The proportion of firms that are of the opinion that government measures are ineffective was around 70% in 2013 at the European level, and was highest in Italy, Spain, Portugal and Greece, where it exceeded 90%. Firms are also critical of the European directive, which was judged ineffective by roughly 80% of the firms surveyed in Slovenia, Spain, Italy, the UK, Finland and Sweden.

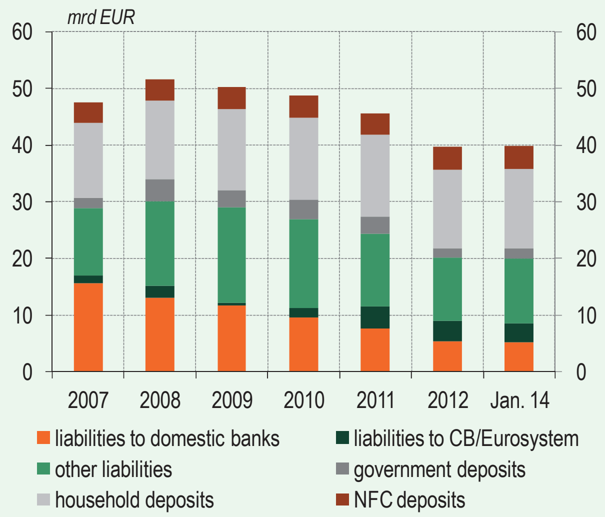
[1] Source: Intrum Justitia: European Payment Index, various issues. The calculations of the European Payment Index are mostly based on data obtained in a standardised survey conducted each year between January and March. The methodological notes are given in Intrum Justitia: European Payment Index 2013, p 13 and p 49.

by these banks. The banks' total subordinated debt thereby declined by EUR 0.5 billion. NLB and NKBM transferred some of their non-performing claims to the BAMC during the government recapitalisation,[16] for which they received BAMC bonds worth almost EUR 1 billion. The two banks transferred gross claims of EUR 3,259 million to the BAMC (a net value of EUR 1,844 million after impairments).

In December 2013, on the basis of the findings of the comprehensive review and the price for the transfer of non-performing claims set by the European Commission in accordance with the rules on state aid, the banks had to recognise additional impairments for debtors transferred to the BAMC. Furthermore, at the request of the auditors the banks also had to recognise additional impairments at the end of the year for debtors not transferred to the BAMC, which further increased their disclosed losses, and led to a further reduction in equity. As a result of all of the aforementioned activities, after the realisation of state aid and government measures (including recapitalisations by private shareholders at the banks under majority foreign owner-

[16] In light of the constraints specified in Title 6 of the Regulation on the implementation of measures to strengthen the stability of banks (Official Gazette of the Republic of Slovenia, No. 103/13), any gains generated in the management of claims transferred to the BAMC will be allocated to the state budget.

Figure 4.8: Selected liabilities of domestic banks



Source: Bank of Slovenia.

ship), by the end of the year the banking system's capital had increased by EUR 606 million[17] while capital requirements had declined by EUR 443 million, as a result of which its overall capital adequacy was up 4.41 percentage points compared to the end of September (at 14.32%).

The banking system's total assets declined as a result of a decline in the banking system's indebtedness to the rest of the world, a decline in liabilities from debt securities and the write-off of subordinated debt instruments. The banks' debt repayments to the rest of the world amounted to more than EUR 10 billion in the last five years, and to EUR 2.3 billion last year. Last year's debt repayments were comparable to the previous two years, the banks under majority foreign ownership again reducing their indebtedness significantly more. The banks also reduced their liabilities from debt securities last year, by EUR 0.5 billion. Maturing liabilities to foreign banks in 2014 will be lower than last year, but the banks will be exposed to high refinancing risk in 2015. EUR 1.8 billion of foreign loans will mature then, and the banks will also have to refinance liabilities from LTROs at the ECB, which amounted to EUR 2.7 billion in mid-March 2014. The stock of deposits by the non-banking sector declined by EUR 1.3 billion last year, primarily government deposits, but also household deposits, which declined by EUR 464 million.

Interest rates on new deposits fell sharply last year, particularly after the state aid activities. The fall was particularly pronounced on longer-term deposits. Interest rates on short-term household deposits fell by 0.7 percentage points last year to the level of the euro area average. Although interest rates on long-term deposits fell by 1.6 percentage points, they remain 1 percentage point higher than the euro area average. Interest rates on corporate deposits recorded an even sharper fall. Interest rates fell by 1.4 percentage points on short-term corporate deposits in 2013, and by 1.6 percentage points on long-term corporate deposits. The banks' interest income on interest-bearing assets is declining also due to the reduction of loans and the high impairment and provisioning costs. The fall in deposit interest rates will only gradually be passed through into interest rates on loans to the private sector, partly because of the persistently high credit risk of some of corporate borrowers that are overleveraged.

[17] The increase of EUR 606 million in the banking system's equity also includes the coverage of the negative equity of Factor banka and Probanka.

5 Public Finances

Measures to stabilise the banking system had a major impact on fiscal results in 2013. According to SORS estimates, the bank recapitalisations temporarily raised the general government deficit by 10.3% of GDP to 14.7% of GDP. Alongside the bank recapitalisations, the main factor in the increase in the general government debt to 71.7% of GDP was the transfer of non-performing claims to the BAMC. Measures strengthening the banking sector will also continue in 2014, with recapitalisations planned at least in Abanka and potentially in Banka Celje, and the further transfer of non-performing claims to the BAMC. In the report on the general government deficit and debt, the Ministry of Finance is forecasting a deficit of 4.2% of GDP in 2014 (3.2% of GDP excluding the bank recapitalisations), and general government debt of 80.9% of GDP at the end of the year. Slovenia issued bonds in the amount of EUR 4.6 billion during the first three months of this year, which should conclude this year's borrowing on the international market. The required yield on 10-year Slovenian government bonds stood at around 3.6% at the end of March. Fiscal consolidation and structural reforms will continue to be required to eliminate the excessive deficit and to achieve the medium-term fiscal objective, particularly in the context of rapid growth in the debt to GDP ratio and the high estimated long-term costs of the population aging.

General government deficit

The general government deficit and debt increased sharply last year, primarily as a result of the measures to stabilise the banking system. The deficit was larger than in the previous year, even without these measures. The general government deficit underwent a significant temporary increase in 2013 to EUR 5,178 million or 14.7% of GDP[18], 10.7 percentage points more than in the previous year. This was more than the 7.9% of GDP forecast in the Stability Programme. It was larger than forecast even after the exclusion of the support for financial institutions, by 0.2 percentage points relative to the forecasts in the Stability Programme. General government debt stood at 71.7% of GDP at the end of the year, but despite increasing significantly in recent it years remains lower than the euro area average, which was estimated at 95.5% of GDP last year. The general government deficit in the euro area was estimated at 3.1% of GDP last year.

The measures to stabilise the banking system expanded the general government deficit by 10.3% of GDP last year, but other one-off factors were also present. The majority of the bank recapitalisations- in 2013 were carried out in December after the release of

[18] According to SORS estimates, the central government deficit amounted to 14.5% of GDP in 2013, while the local government deficit amounted to 0.2% of GDP. The social security funds recorded a balanced position.

Table 5.1: General government deficit and debt in Slovenia 2009–2016

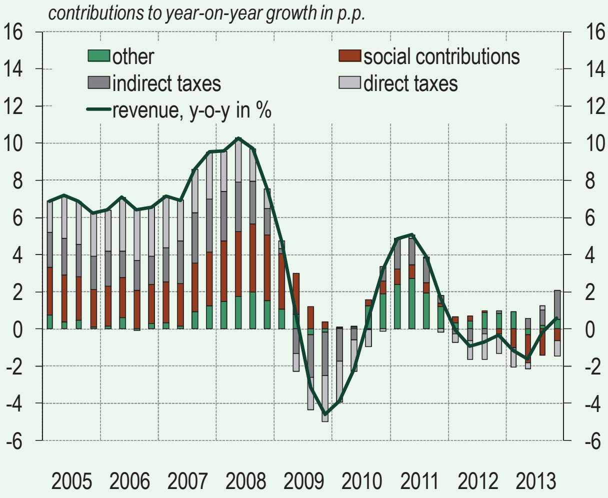
	SORS					Stability Programme					EC		
as % GDP	**2009**	**2010**	**2011**	**2012**	**2013**	**2012**	**2013**	**2014**	**2015**	**2016**	**2013**	**2014**	**2015**
Revenue	42.3	43.6	43.5	44.4	44.7	44.8	45.5	46.8	45.8	45.3	45.0	45.3	44.7
Expenditure	48.7	49.5	49.9	48.4	59.4	48.8	53.4	49.4	47.9	46.7	59.9	49.3	48.0
of which: interest	1.4	1.6	1.9	2.2	2.6	2.1	2.7	2.9	2.8	3.0	2.7	3.0	3.2
Net lending (+) / borrowing (-)	-6.3	-5.9	-6.4	-4.0	-14.7	-4.0	-7.9	-2.6	-2.1	-1.4	-14.9	-3.9	-3.3
excl. support to fin. Institutions	-6.3	-5.9	-5.7	-3.8	-4.4	-3.8	-4.2	-2.6	-2.1	-1.4	-4.6	-3.3	-3.3
Structural balance	…	…	…	…	…	-2.2	-1.8	-0.7	-0.8	-0.8	-2.2	-2.0	-2.5
Debt	35.2	38.7	47.1	54.4	71.7	54.1	61.8	63.2	63.2	61.8	71.9	75.4	78.0
Real GDP (growth, %)	-7.9	1.3	0.7	-2.5	-1.1	-2.3	-1.9	0.2	1.2	1.6	-1.6	-0.1	1.3

Source: SORS (realisation), Ministry of Finance (May 2013), European Commission (EC, February 2014).

the results of the asset quality review and stress tests of the banking system (see Box 5.1), for which reason the deficit was particularly high in the final quarter, standing at 39.9% of GDP. In 2012 recapitalisations widened the general government deficit by EUR 61 million or 0.2% of GDP. The deficit in 2013 was further affected by two transactions of a one-off nature. The first relates to compensation for people erased from the register of permanent residents, and amounted to 0.4% of GDP, and the second relates to a ruling by the Supreme Court with regard to funding for eliminating wage disparities with a 0.3% of GDP net impact on the deficit. These three transactions contributed 10.9 percentage points to the deficit in 2013, approximately the amount by which the ratio of general government expenditure to GDP increased last year, to reach 59.4%.

In light of the adverse developments in the tax base, particularly that dependent on the situation on the labour market, general government revenues increased by just 0.6% last year, despite measures to increase revenues. The main measures on the revenue side were a rise in VAT in July 2013 (the reduced rate was raised by 1 percentage point to 9.5% while the standard rate was raised by 2 percentage points to 22%), a higher tax burden on energy (higher excise duties and the additional effects of the introduction of a charge for emissions of carbon dioxide), and the introduction of a financial transactions tax. The overall effect of the measures on the revenue side was estimated at approximately 1% of GDP, and the measures were concentrated in indirect taxation. Revenues from indirect taxes were therefore up by 4.8% in 2013. The situation on the labour market, in particular the year-on-year fall in the number of employees, caused a decline in social security contributions by 1.9%, while personal income tax dropped by 7.7%. Excise duties also declined, as a result of reduced consumption. The corporate income tax rate was cut by 1 percentage point in 2013 to 17%, while revenues re-

Figure 5.1: General government revenue



Source: SORS, Bank of Slovenia calculations.

Box 5.1: Impact of government support to financial institutions on the general government deficit and debt in the 2009–2014 period

In 2013 Slovenia conducted a comprehensive recapitalisation of the banks and a transfer of bad claims to the Bank Asset Management Company (BAMC).[1] At the request of international institutions, a comprehensive asset quality review and stress tests of the banking system were conducted, which yielded an assessment of the risk-based capital requirements of the banks included in the review. It covered ten banks accounting for approximately 70% of the banking system. An orderly wind-down process commenced at two of these banks in September 2013. After the release of results of the asset quality review and stress tests, in December the government recapitalised the three banks under government ownership and the banks undergoing the orderly wind-down process (see Table 1). The bank recapitalisations carried out in 2013 widened the general government deficit by EUR 3.6 billion or 10.3% of GDP.[2] The first tranche of the transfer of non-performing claims to the BAMC was carried out at the end of 2013, at a transfer value of EUR 1 billion, for which the two banks received BAMC bonds.[3]

Measures benefiting the banking system were the main reason for the significant increase in the general government debt in 2013. It rose by 17.4 GDP percentage points. The bank recapitalisations by the government were undertaken via a cash contribution and via government debt securities. The debt also increased as a result of the transfer of claims to the BAMC, by EUR 1 billion or 2.9% of GDP. Transactions related to the measures to stabilise the banking system thus accounted for approximately three-quarters of last year's increase in general government debt. The government also raised EUR 200 million via bond issues to increase the capital of the BAMC. These transactions will also raise general government expenditure on interest by almost EUR 200 million or 0.5% to 0.6% of GDP this year, which is quite significantly.

The bank recapitalisations and the transfer of non-performing claims to the BAMC will also have an impact on government finances in 2014. The second part of the recapitalisation of Abanka in the amount of EUR 243 million or 0.7% of GDP is planned, which is the upper limit for the impact of these transactions on the general government deficit.[4] In addition, on the basis of the results of the asset quality review and the stress tests, five banks were given until the end of July 2014 to increase their capital using private sector funding. On the basis of opinions and information from the Bank of Slovenia, the government reached a decision in March 2014 that for one of them, namely Banka Celje, it upholds the commitment to recapitalise the bank and to transfer non-performing claims to the BAMC should the bank be unable to recapitalise via private investors. For Banka Celje this would entail the initiation

Table 1: Bank recapitalisations in general government deficit and transfer of non-performing claims to BAMC in 2013

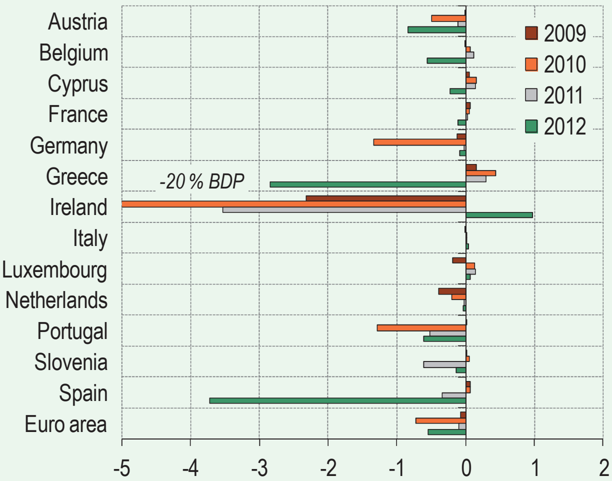
	bank recapitalisations		transfer to BAMC
(in mio EUR)	**2013**	**of which: dec.**	**2013**
(1) state-owned banks	3,188	2,742	1,012
NLB	1,894	1,551	622
NKBM *	945	843	390
Abanka	348	348	0
(2) banks in the orderly wind-down process	445	445	0
Factor banka	269	269	0
Probanka	176	176	0
(3) Total (1) + (2)	**3,633**	**3,187**	**1,012**
in % GDP	***10.3***	***9.0***	***2.9***

*Note: * The amount of recapitalisation included in general government deficit is lower by the amount of recapitalisation exceeding the value of accumulated losses, i.e. by 27 million EUR.*
Source: SORS, Bank of Slovenia, Ministry of Finance, BAMC.

of procedures for obtaining state aid. At the same time Gorenjska banka's deadline for carrying out capital increase measures was extended until the end of 2014. Given the activities carried out and the capital adequacy situation at the end of 2013, the government's recapitalisation commitment is no longer necessary in the cases of Raiffeisen Bank, Hypo-Alpe-Adria Bank and UniCredit Banka Slovenije.

Resolving the problems of the banking sector brought a sharp deterioration in the position of the general government sector across the euro area. The support to financial institutions[5] widened the general government deficit in the euro area by an average of 0.4% of GDP each year between 2009 and 2012. The support to financial institutions in Slovenia during this period was highest in 2011, when it amounted to 0.6% of GDP (recapitalisation of NLB). In the euro area the impact of the support on the deficit was largest in Ireland, where the deficit widened by 20% of GDP in 2010. The largest support for financial institutions in 2012 was earmarked by Spain (3.7% of GDP) and Greece (2.8% of GDP). The latter also recapitalised banks in 2013, in the amount of approximately 11% of GDP.[6] By 2012 support to financial institutions had increased euro area debt by 5.5% of GDP.[7]

Figure 1: Impact of support for financial institutions on general government deficit, in % of GDP*



*Note: * Only countries, in which support for financial institutions was provided.*
Source: SORS, Bank of Slovenia calculations.

[1] More on the comprehensive review of the banking system and associated measures can be found at http://www.bsi.si/library/includes/datoteka.asp?datotekaid=5457 and http://www.bsi.si/library/includes/datoteka.asp?datotekaid=5424.

[2] According to estimates in Luc Laeven, Fabian Valencia: Systemic Banking Crisis Database: An Update, IMF Working Paper 163, 2012, p 26, the fiscal costs of restructuring the banks in Slovenia in 1992 was 14.6% of GDP. In the aforementioned paper fiscal cost is defined as the sum of gross fiscal expenditure in connection with the restructuring of the financial sector. It includes the cost of recapitalising the banks, but not asset purchases or direct liquidity support from the treasury.

[3] The transfer of Abanka's claims will be carried out after the approval of the restructuring programme by the European Commission.

[4] The impact of the bank recapitalisation on the general government deficit should not exceed the amount of the cumulative losses over several years. The amount of the recapitalisations exceeding the amount of cumulative losses is not recorded in expenditures and therefore does not increase the deficit.

[5] The support to financial institutions includes recapitalisations of financial institutions, and also includes commission for government guarantees issued to financial institutions and income from assets (interest and dividends).

[6] European Commission: Winter Forecast, February 2014.

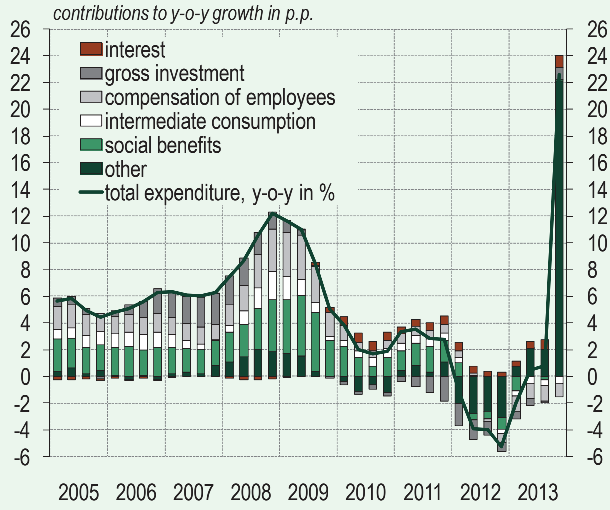
[7] Martynas Baciulis: Support for financial institutions increases government deficits in 2012, Eurostat, Statistics in Focus 10/2013.

mained at the same level as in 2012. The ratio of general government revenues to GDP increased to 44.7% last year.

General government expenditure excluding the support to financial institutions increased by 1.7%, expenditure on interest recording the most notable growth, whereas employee compensation and intermediate consumption declined. General government expenditure in 2013 was up by 22.6% on the previous year, or up by 1.7% if the support to financial institutions is excluded. If the aforementioned transactions of a one-off nature (for the "erased residents" and for "wage disparities") are also excluded, general government expenditure increased by 0.3%. Expenditure on interest increased by just over a fifth to reach 2.6% of GDP. Intermediate consumption declined, and measures on wages reduced employee compensation[19] by 3.7%. The number of employees in the government sector fell by 1.6%. After several years of decline, government investments increased by almost 13% last year. Measures under the ZUJF also had an impact last year, and curbed growth in

[19] The net effect of payments for eliminating wage disparities on the general government deficit in 2013 is disclosed under current transfers, and not under compensation of employees.

Figure 5.2: General government expenditure



Source: SORS, Bank of Slovenia calculations.

social transfers. Despite the pension reform and a minimal alignment with the increase of wages by 0.1%, expenditure on pensions increased by 2.6% last year, as the number of pensioners rose by 2.9% (the number of old-age pensioners rising by 4.1%). Expenditure on family benefits, parental compensations, social security transfers and unemployment benefits all declined.

General government debt and government guarantees

The general government debt increased extremely sharply last year to reach 71.7% of GDP, primarily as a result of the measures to stabilise the banking system. The general government debt stood at EUR 25,307 million at the end of last year, up EUR 6,103 million or 17.4% GDP percentage points on a year earlier. The increase in debt was primarily the result of the measures to stabilise the banking system, which were reflected in the primary deficit (bank recapitalisations in the amount of EUR 3.6 billion) and in the adjustment between debt and deficit (issue of BAMC bonds in the amount of EUR 1 billion).

Borrowing last year and during the first four months of this year has primarily been undertaken via issues of bonds with longer maturities. Total borrowing amounted to EUR 7.1 billion last year according to the consolidated general government financing figures.[20] The increase in borrowing with a maturity of more than 1 year between last January and this April is illustrated in Table 5.3. Another slight increase in stock of debt last year was caused by the assistance to euro area countries in financial distress provided via the EFSF. It amounted to EUR 1.5 billion at the end of the year, or 4.4% of GDP. Under the state budget financing programme for 2014, the borrowing ceiling is set at EUR 7.7 billion, which includes potential borrowing for the repayment of debt principal maturing in the next two years (EUR 4.2 billion). The borrowing requirement for financing the implementation of this year's state budget alone is EUR 3.5 billion after allowing for the pre-financing from 2013. Slovenia borrowed EUR 4.6 billion in the first four months of this year via bond issues. This should conclude this year's borrowing on the international markets.

Table 5.2: Contributions of components to change in general government debt

% GDP	2008	2009	2010	2011	2012	2013
debt	22.1	35.2	38.7	47.1	54.4	71.7
change in debt	**-1.0**	**13.1**	**3.5**	**8.3**	**7.3**	**17.4**
of which: primary balance	0.8	5.0	4.2	4.5	1.9	12.1
difference interest rate-growth rate ("snow-ball effect")	-0.5	2.5	1.6	1.2	3.3	2.7
deficit debt adjustment	-1.2	5.7	-2.3	2.7	2.2	2.6

Source: SORS, Bank of Slovenia calculations.

[20] The consolidated general government includes the state budget, local government budgets, the HII and the PDII, but not the BAMC.

Table 5.3: Issues of bonds and treasury bills with maturity of more than 1 year, January 2013 to April 2014

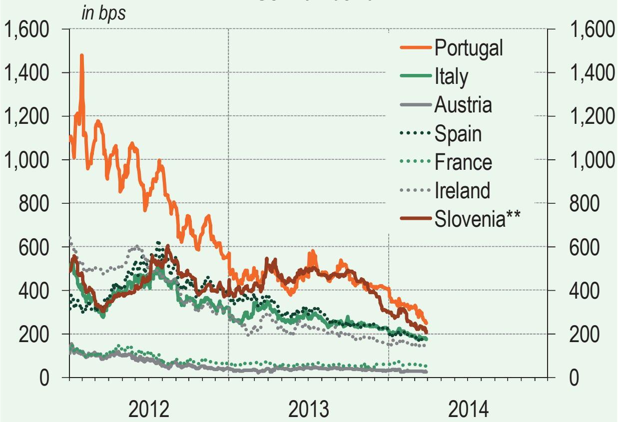
Issue date	Maturity (years)***	Amount (mio)	Currency	Coupon interest rate
19. 04. 2013	1.5	1,109	EUR	4.15
10. 05. 2013	5.0	1,000	USD	4.75
10. 05. 2013	10.0	2,500	USD	5.85
22. 11. 2013	3.0	1,500	EUR	4.70
12. 12. 2013*	3.3	149	EUR	5.63
12. 12. 2013*	3.3	311	EUR	3.50
12. 12. 2013*	5.2	91	EUR	4.38
12. 12. 2013*	6.1	120	EUR	4.13
12. 12. 2013*	1.3	97	EUR	2.75
12. 12. 2013*	7.1	106	EUR	4.38
20. 12. 2013**	2.0	506	EUR	3.75
20. 12. 2013**	3.0	506	EUR	4.50
18. 02. 2014	5.0	1,500	USD	4.13
18. 02. 2014	10.0	2,000	USD	5.25
08. 04. 2014	3.5	1,000	EUR	1.75
08. 04. 2014	7.0	1,000	EUR	3.00

*Notes: * Reopening of bonds already issued in the context of banks and BAMC recapitalisations. ** Bond issued by BAMC. *** Maturity of reopened bonds refers to reopening till maturity.*
Source: Ministry of Finance, Bank of Slovenia calculations.

The stock of government guarantees increased last year, as a result of the bank restructuring measures and the TEŠ 6 project. The stock of government guarantees and sureties stood at EUR 8.3 billion or 23.4% of GDP at the end of the year, up EUR 1.8 billion on the end of the previous year. The majority of the increase relates to government guarantees for BAMC bonds (EUR 1 billion) and for a loan for the construction of TEŠ 6 (EUR 0.4 billion). Guarantees for DARS d.d. and guarantees for liabilities from the EFSF related to the assistance to euro area countries in financial distress accounted for approximately half of the stock of guarantees. EUR 59 million of guarantees were called last year.

The required yield on long-term Slovenian government bonds began to fall in the final quarter of last year. Bond yields also fell in certain other euro area periphery countries at that time, but the fall in Slovenia was more pronounced as a result of the easing of tensions on the financial markets following the release of the results of the stress tests and asset quality review at Slovenian banks. As in other periphery countries, the gradual fall in the required yield continued in the early months of this year. The yield on 10-year government bonds averaged around 3.8% in March, while the spread over the bench-

Figure 5.3: Spreads* on long term government bonds over German bond



*Notes: * Spread is calculated as a difference between the yield of long term government bond and the yield of reference German bond on a daily basis and is used as a measure of country's credit risk. ** SLOREP 09/24 is used after 1. January 2013.*
Source: Bloomberg, Bank of Slovenia calculations.

mark German long-term bonds was close to 225 basis points. The liquidity of Slovenian bonds remains extremely low, which makes issuance more difficult and raises the required yield. The keys to further reducing the required yields are strengthening economic growth, reducing the fiscal deficit, and slowing the rapid growth in government debt or even reducing it. A key prerequisite in achieving these objectives is the further implementation of measures to strengthen bank stability, even though these measures are simultaneously increasing the general government deficit and debt (primarily in the short term).

Planned developments in the general government deficit

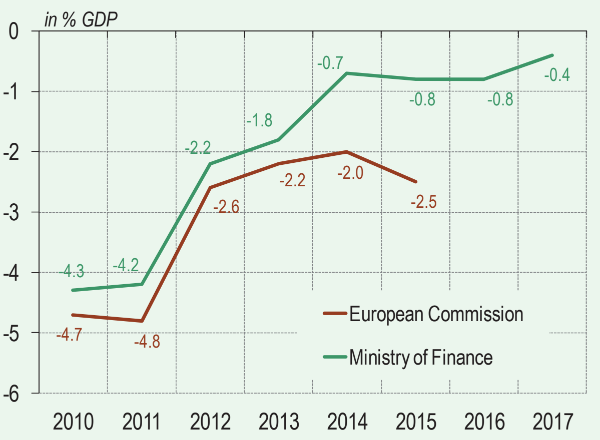
The economic policy objective in the fiscal area is the elimination of the excessive general government deficit by 2015, and then the gradual attainment of a balanced structural position. Slovenia has been undergoing the excessive deficit procedure since December 2009. In June 2013 the European Council extended Slovenia's deadline for eliminating the excessive government deficit by two years to 2015. The extension was based on the finding that Slovenia took effective action to reduce the deficit during the 2010 to 2013 period, but there were unexpected economic developments with major adverse fiscal consequences. The European Council recommendation of June 2013 set the interim nominal deficit targets as 3.7% of GDP in 2013 (or 4.9% including one-off expenditure for recapitalisation of the two largest banks), 3.3% of GDP in 2014 and 2.5% of GDP in 2015. The improvement in the structural balance is thereby estimated at 0.7% of GDP in 2013 and 0.5% of GDP in 2014 and 2015. In the report on the general government deficit and debt the Ministry of Finance is forecasting a deficit of 4.2% of GDP in 2014 (3.2% of GDP excluding the bank recapitalisations), and general government debt of 80.9% of GDP at the end of the year.

Having given a favourable assessment of Slovenia's budget plans in November 2013, in March 2014 the European Commission issued a recommendation for additional measures to meet the required structural adjustment, and Slovenia is to report on the measures taken in the update to the Stability Programme. In the revised state budget for 2014 the deficit is forecast at 2.9% of GDP, while the main measures include a real estate tax, an end to the cuts in the corporate income tax rate, and no indexation of pensions to inflation and wage growth. The European Commission assessed Slovenia's draft budget for 2014 as complying with the rules of the Stability and Growth Pact, albeit with no room for manoeuvre. In light of the risks that Slovenia will not permanently eliminate the excessive deficit by the end of 2015, in early March the European Commission opted to enhance supervision in the form of a special recommendation for further action to eliminate the excessive deficit. Slovenia must thus take appropriate measures to ensure the requisite structural adjustment in keeping with the recommendations of the Council. The overall adjustment according to estimates for 2013 to 2014 trails the recommendations by 0.7% of GDP according to the adjusted change in the structural balance, or by 0.6% of GDP according to the "bottom-up" calculations.[21] Slovenia must report on the measures that will be pursued in April's update to the Stability Programme for 2014.

The medium-term objective remains a balanced structural position, which is expected to be achieved gradually. In May 2013 the National Assembly approved the inclusion of a fiscal golden rule on a balanced budget in the constitution. Slovenia confirmed a balanced structural position as its medium-term objective

[21] The methodology for assessing the sufficiency of measures if the government fails to meet the nominal targets is based on three steps. (1) The estimated change in the structural position is compared with the improvement required in the recommendation within the framework of the excessive deficit procedure. (2) The identified structural improvement is adjusted for potential output revisions, for revenues windfalls/shortfalls not foreseen when the recommendation was issued, and for the effects of other unexpected developments, e.g. natural disasters or statistical revisions. (3) Bottom-up analysis is finally applied, based on the budgetary impact of discretionary measures implemented by the particular country. Should the final analysis indicate that the measures taken are not sufficient, the conclusion is that appropriate measures were not taken, and the procedure can be tightened.

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, May 2013.

in the May 2013 update to the Stability Programme. Under these plans, the headline position and the structural position are forecast to be almost in balance by 2017. According to the European Commission's estimates from February 2014, the structural deficit amounted to 2.2% of GDP in 2013, down 0.4 GDP percentage points on the previous year. Last year Slovenia amended Article 148 of its constitution to include a fiscal golden rule, which stipulates that general government revenues and expenditure must be balanced or in surplus over the medium term. Details of the implementation of the fiscal golden rule will be set out in a special law, which the National Assembly will have to pass with a two-thirds majority.[22]

The reduction of the general government deficit and the stabilisation of the government debt are being hindered by weak economic activity and the ongoing measures to stabilise the banking system. In a situation of low economic growth it is particularly important that additional fiscal consolidation measures designed at the same time minimise the adverse impact on weak domestic demand. The reduction of the deficit is also being hindered by rising interest payments, which are requiring adjustments in other items. Measures to stabilise the banking system will again have an impact on fiscal developments in 2014. The measures planned in the budget for 2014 are forecast to raise general government revenues by approximately 1.2% of GDP, the largest increases coming as a result of the introduction of a real estate tax and last year's rise in VAT. The Constitutional Court rejected the Real Estate Tax Act in March, but the Ministry of Finance is drawing up replacement measures. The measures on the expenditure side include wage restraint, where an agreement is in place until the end of 2014, and the absence of pension indexation.

After the implementation of pension and labour legislation changes, the impact of both will be evaluated. Changes are also needed in other areas, for example in health and long-term care. The evaluation of current pension and labour legislation is due by the end of April 2014. The reports on the impact of the pension reform will lay the ground for the drafting of a white paper that will form the basis for a debate about the pension system after 2020, and new pension reforms are expected to be passed in 2018. However, a systematic approach to problems in the health sector has long been deferred. For example, last year was the third consecutive year that the HII deferred some its payments to the next year, i.e. this year, hospitals recording significant losses in the process. This February brought some changes in the direction of an increase in some categories of health contributions (e.g. the introduction of contributions on contracts for intellectual services). However, the expected revenues are significantly lower than under the initial proposal and are also not sufficient to resolve the problem of financing the health sector. Reform has also long been planned for the system of long-term care, but as yet there is no proposal for public discussion.

Further fiscal consolidation and structural reforms are also required by the high debt and the estimated high costs of the aging population. Demographic factors will have an increasing impact on developments in the general government debt. Although pension reform has improved long-term fiscal sustainability, expenditure on pensions, which account for the largest share of age-

[22] The aforementioned law should be adopted by the end of November 2013.

related expenditure, will begin to rise again (according to the latest estimates) after 2020. In general, debt reduction will primarily be conditioned by attaining primary surpluses, but debt will also be reduced as the banks' non-performing claims are redeemed. Proceeds from privatisations are also to be used for debt reduction. Last year the government identified 15 firms for privatisation, two of which have already seen their sales completed. The firms identified for privatisation include NKBM bank. Its privatisation is scheduled by the end of 2016.

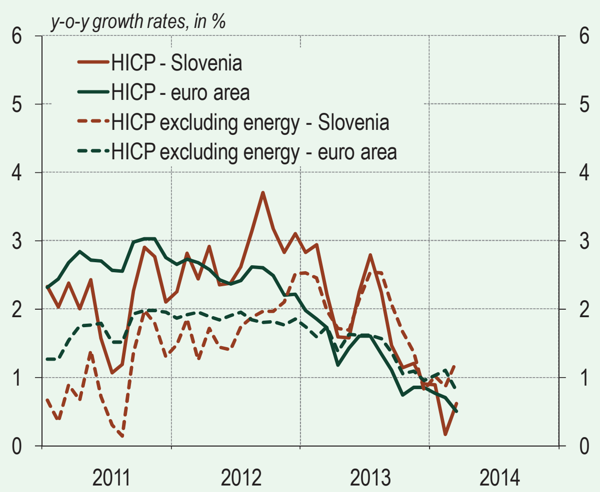
6 Inflation

Fiscal measures applied upward pressure to inflation in Slovenia in 2013 and early 2014, while domestic cost factors applied downward pressure. Growth in the harmonised index of consumer prices stood at 1.9% in 2013, down 0.9 percentage points on the previous year. Core inflation was low, as a result of weak household consumption and the cost cutting required for an improvement in competitiveness. The government measures that had a significant impact on inflation in 2013 included a rise in VAT rates and the introduction of a tax on financial services, the effect of changes in the subsidisation of school meals in September 2012, and the liberation of prices of municipal services, which consequently rose. The fiscal factors continued to have an impact in the first three months of this year.

Structure of inflation

The average annual inflation rate as measured by the HICP stood at 1.9% in 2013, down 0.9 percentage points on the previous year, but 0.5 percentage points more than the euro area average. Food prices and services prices made the largest contributions to headline inflation. The main factors in the high growth in food prices were prices of unprocessed food and tobacco, while the growth in services prices was largely the result of fiscal consolidation measures and the rises in prices of public services. By contrast, growth in prices of non-energy industrial goods was down on 2012. Year-on-year inflation fell significantly at the end of last year and at the beginning of this year as growth in all price subcategories slowed. The rate averaged 0.6% over the first three months of this year.

Figure 6.1: Inflation

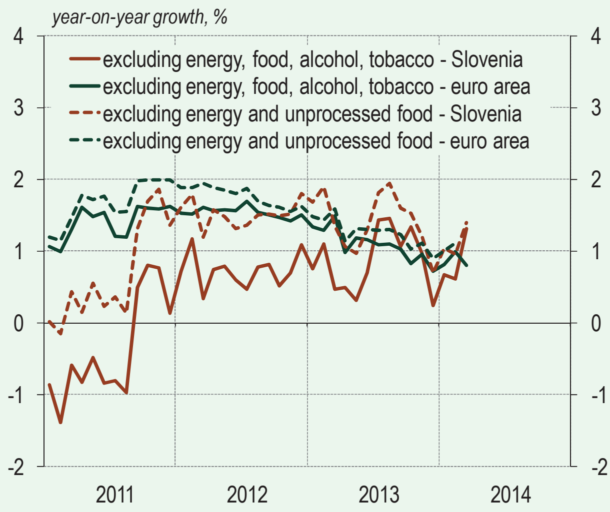


Source: Eurostat, SORS, Bank of Slovenia calculations.

Macroeconomic factors and core inflation indicators

Core inflation remained low in the first quarter of this year. Core inflation as measured by the HICP excluding energy, food, alcohol and tobacco averaged 0.9% in 2013, up 0.2 percentage points on the previous year. Services prices rose again last year as a result of fiscal and administrative measures. Had it not been for these

Figure 6.2: Core inflation



Source: Eurostat, Bank of Slovenia calculations.

measures, prices would have remained unchanged. By contrast, prices of non-energy industrial goods again fell sharply, despite the rise in VAT. Growth in the narrowest core inflation indicator was below the euro area average last year, and in the absence of government measures would actually have been negative over the year. This is an indication of the weak domestic demand in Slovenia, partly as a result of government measures, which are further reducing consumer purchasing power. By contrast, the two broader core inflation indicators were higher than the euro area average last year. This was largely as a result of excise duties on alcohol and tobacco and prices of unprocessed food, which rose significantly faster than in the euro area. Core inflation as measured by the HICP excluding energy and processed food averaged 1.4% last year, compared with 1.3% in the euro area average. The broadest core inflation indicator, the HICP excluding energy, also rose, to 1.9%, compared with 1.4% in the euro area overall. Growth in the narrowest core inflation indicator averaged 0.9% over the first three months of this year, the same as in the euro area average.

Weak consumer purchasing power remains a factor in low core inflation. The uncertain situation on the la-

Table 6.1: Breakdown of the HICP and price indicators

	weight	average year-on-year growth, %					year-on-year growth in quarter, %					
	2013	2009	2010	2011	2012	2013	4Q12	1Q13	2Q13	3Q13	4Q13	1Q14
HICP	*100.0%*	0.9	2.1	2.1	2.8	1.9	3.0	2.7	1.8	2.2	1.1	0.6
Breakdown of HICP:												
Energy	*14.4%*	-4.5	13.9	8.8	9.0	1.8	8.0	4.8	1.6	1.0	-0.1	-2.3
Food	*23.5%*	1.8	2.5	4.8	4.7	4.9	6.2	6.5	5.5	5.2	2.4	1.5
processed	*16.1%*	2.7	2.9	5.0	4.7	3.6	5.0	5.1	3.6	3.6	2.3	2.2
unprocessed	*7.4%*	0.0	1.7	4.3	4.5	7.6	8.5	9.5	9.6	8.6	2.7	0.1
Other goods	*27.9%*	0.0	-2.2	-0.9	-0.2	-0.9	-0.7	-0.5	-1.6	-0.7	-0.5	-0.6
Services	*34.3%*	3.2	1.2	0.0	1.5	2.2	2.0	1.8	2.3	2.9	2.0	1.9
Core inflation indicators:												
HICP excl. Energy	*85.6%*	1.7	0.3	1.0	1.8	1.9	2.2	2.3	1.8	2.4	1.3	1.0
HICP excl. energy and unprocessed food	*78.2%*	1.9	0.2	0.7	1.5	1.4	1.6	1.6	1.1	1.8	1.1	1.1
HICP excl. energy, food, alcohol and tobacco	*62.2%*	1.7	-0.4	-0.4	0.7	0.9	0.8	0.8	0.5	1.3	0.8	0.9
Other price indicators:												
Industrial producer prices on domestic market		-0.4	2.0	3.8	1.0	0.3	1.2	1.1	0.3	0.1	-0.3	
GDP deflator		3.3	-1.1	1.2	0.3	1.0	0.2	0.0	1.6	1.5	0.7	
Import prices[1]		-4.5	6.5	5.6	2.2	-1.1	1.4	0.7	-1.3	-2.3	-1.4	

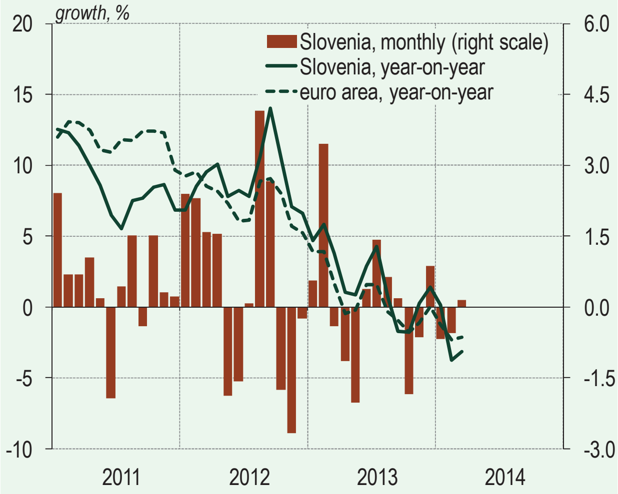
Note: [1] National accounts figure.
Source: SORS, Eurostat, Bank of Slovenia calculations.

bour market is increasing households' cautious behaviour, which given the real decline in wages, the decline in transfers and the higher expenditure brought by fiscal consolidation and other prices of public services is curbing household consumption. Another factor in the weakness of household consumption is the continuing decline in the stock of consumer loans. Wage growth lagged behind productivity growth last year, and corporate cost adjustment thus remains one of the major factors in low core inflation. Given the lower labour costs and input commodity prices, there are no major price pressures on the supply side.

Microeconomic factors and the structure of inflation

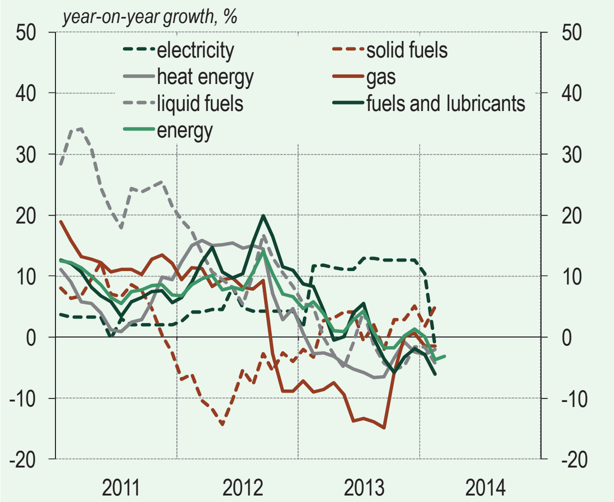
The fall in US dollar oil prices on the international market, the appreciation of the euro and fall in prices of natural gas reduced year-on-year growth in energy prices in 2013, despite a rise in electricity prices and July's rise in VAT. Energy prices rose by 1.8% over the year, 7.2 percentage points less than in the previous year, albeit 1.2 percentage points more than in the euro area average. There was a sharp decline in growth in prices of motor fuels, which averaged 1.2% over the year, while these prices fell by 2.2% in the euro area average. The price of heating oil fell by 1.0% last year. The largest fall were in prices of gas, down 8.8% over the year, compared with a rise of 1.7% in the euro area average. The main factor in the fall in gas prices was the entry of a new supplier at the end of 2012 and its temporary price cut in the summer months. The largest rise in energy prices was recorded by electricity prices, as a result of the rise in network charges in early 2013 and the rise in the charge to support greater sustainability in electricity production. Growth in prices of solid fuels and heat energy was lower than in the euro area average. Year-on-year growth in energy prices averaged -2.3% over the first three months of this year. The fall was primarily the result of base effects, cuts in excise duties on refined petroleum products after the severe winter storms in February, and a year-on-year fall in import prices of oil.

Figure 6.3: Energy prices



Source: Eurostat, Bank of Slovenia calculations.

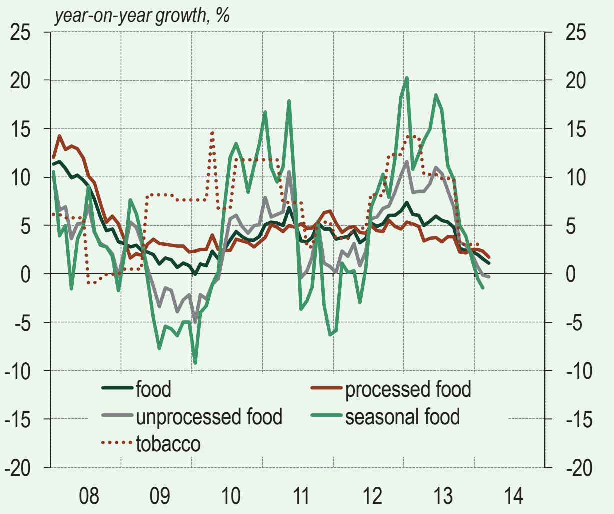
Figure 6.4: Individual energy price categories



Source: Eurostat, Bank of Slovenia calculations.

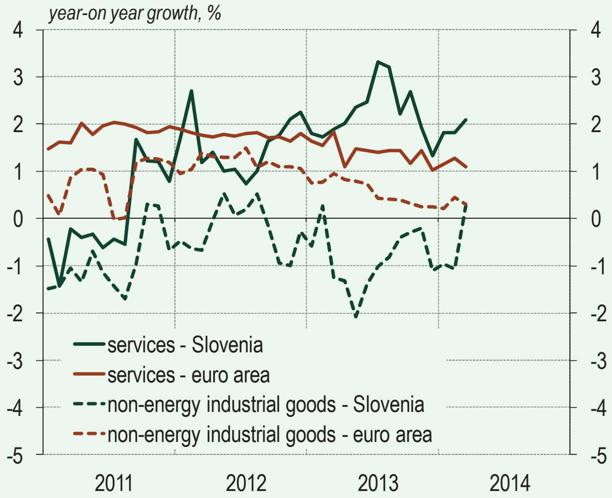
The high year-on-year growth in prices of unprocessed food and excise duties on tobacco were the key factors in the rise in food prices for the majority of the year. The rate of growth averaged 4.9% last year, 0.2 percentage points more than in the previous year, and 2.2 percentage points more than in the euro area average. Growth in prices of unprocessed food almost doubled last year to 7.6%, primarily as a result of sharp

Figure 6.5: Food prices



Source: Eurostat, Bank of Slovenia calculations.

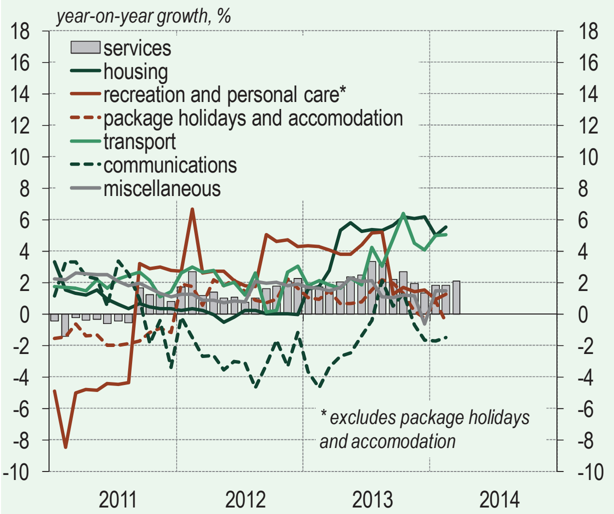
Figure 6.6: Services prices and prices of non-energy industrial goods



Source: Eurostat, Bank of Slovenia calculations.

growth in prices of fruit and vegetables. Year-on-year growth in prices of meat also remained high, averaging 4.8% last year. Growth in prices of processed food averaged 3.6% last year, down 1.1 percentage points on the previous year. The increase was primarily the result of growth in prices of tobacco and the rise in VAT, which suggests that prices of processed food excluding tobacco would mostly have remained unchanged. Growth in food prices began to slow in the final quarter of last year, primarily as a result of lower growth in prices of unprocessed food. This trend continued in the first three months of this year, when year-on-year growth in food prices averaged just 1.5%.

Figure 6.7: Services prices

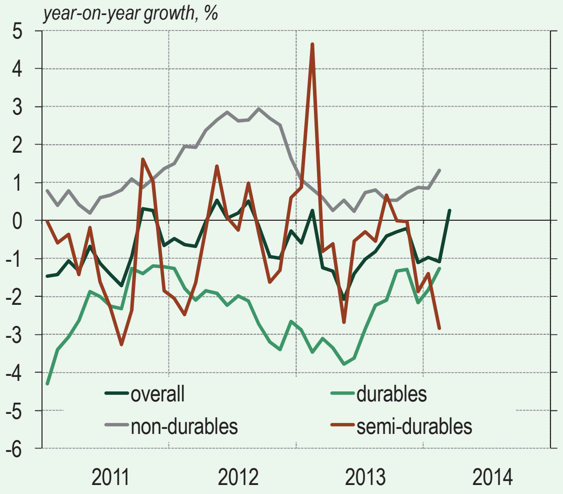


Source: Eurostat, Bank of Slovenia calculations.

Measures related to fiscal consolidation had an impact on services prices in 2013, as did prices of certain public services. Growth in services prices averaged 2.2% last year, 0.7 percentage points more than in the previous year and 0.8 percentage points more than in the euro area average. Growth in services prices was primarily the result of fiscal measures, which in addition to the rise in VAT include the introduction of a tax on financial services, the pass-through effect of changes in the subsidisation of school meals in September 2012, and the rise in prices of municipal services as a result of the release of price controls. Other factors in the growth were prices of package holidays, while prices of telephone and internet services and accommodation and food services fell slightly, particularly in the final quarter. Growth in services prices remained moderate in the first three months of this year, the year-on-year rate averaging 1.9%. This growth was largely in line with the effect of last year's price rises related to consolidation and administrative measures dropping out of the calculation.

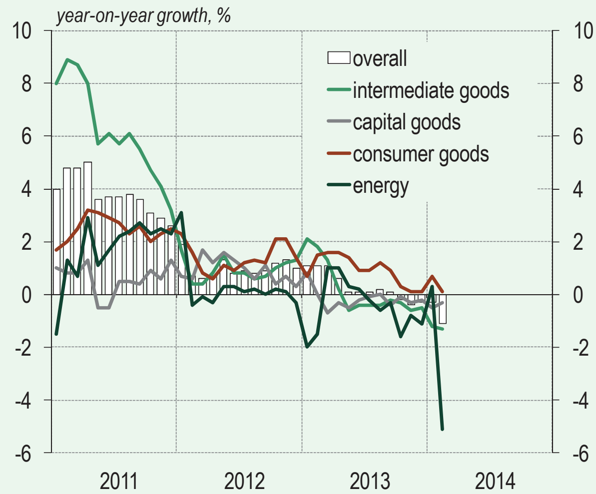
Prices of non-energy industrial goods fell further last year, and continued to fall in the first quarter of this

Figure 6.8: Prices of non-energy industrial goods



Source: Eurostat, Bank of Slovenia calculations.

Figure 6.9: Industrial producer prices on the domestic market



Source: SORS, Bank of Slovenia calculations.

year. The average fall in prices of non-energy industrial goods increased by 0.7 percentage points to 0.9%, compared with growth of 0.6% in the euro area average. The largest factors in the fall in prices of non-energy industrial goods in Slovenia were car prices and prices of household equipment. Car prices have been falling since the end of 2004, and were down 3.4% on average last year. For the first time since the beginning of the measurement of inflation by the HICP, prices of household equipment fell on average, by 1.0%. Prices of certain products for sport, recreation and entertainment and prices of clothing and footwear also fell. Prices of non-energy industrial goods in the first three months of this year were down 0.6% in year-on-year terms, compared with a fall of 0.5% in the same period last year. The main reason that prices in these sub-categories are falling in Slovenia but rising in the euro area is internal macroeconomic factors, most notably weak domestic demand, which is a reflection of the adverse situation on the labour market and the decline in consumer purchasing power.

Industrial producer prices

Industrial producer prices on the domestic market rose by 0.3% on average last year, compared with a fall of 0.2% in the euro area. The prices have been falling in the early part of this year. Average year-on-year growth in prices in all main industrial groups in 2013 was down on the previous year. The largest factor in the decline in growth were commodity prices, growth of which was down by 0.7 percentage points to 0.2%. This was primarily the result of the fall in metals prices on international markets. The largest decline was in growth in prices of durable consumer goods, which was down 2.2 percentage points at -0.1%, growth in prices of all activities is slowing. Prices in the manufacture of consumer non-durable goods also fell slightly, as a result of a fall in prices in the manufacture of food products and in the manufacture of clothing. Prices of capital goods fell by 0.2% on average, primarily as a result of a fall in prices in the manufacture of computer, electronic and optical products. Energy prices also fell on average, in line with the movement of prices in the production of electricity, gas and steam. The fall in industrial producer prices accelerated in the early part of this year. There was a pronounced fall in electricity supply prices, while the year-on-year fall in prices in the production of commodities also picked up pace.

7 Projections of Economic Trends and Inflation 2014–2016[23]

Economic activity will increase only gradually. The projection of economic growth for 2014 was revised upwards, while the projection for 2015 remained unchanged. As the contribution made by domestic demand increases, growth is projected to increase further in 2016. The stabilisation of employment at the end of 2013 and the very beginning of 2014, a faster recovery in foreign demand, the absence of additional consolidation measures and a slight increase in confidence in the economy were the most important factors for the upward revision for 2014, in addition to the strong GDP dynamics at the end of the previous year. This encompasses a smaller contraction in the components of domestic consumption and slightly faster growth in imports and exports than in the previous projections. The contribution made by net trade in the coming years will remain a key factor for growth, and will not be surpassed by the contribution made by domestic consumption until the end of the projection horizon. The latter will remain subject to the weak labour market conditions, where employment will only begin rising very gradually towards the end of the projection horizon. Accordingly, core inflation will remain low in the coming years. In the absence of additional fiscal measures on the revenue side, together with anticipated oil price developments, headline inflation is not expected to exceed 1.3% in 2016.

The risks to economic growth are mostly on the downside for the entire projection horizon, and remain similar to previous projections. Further fiscal consolidation would reduce growth in the short term, but given the increase in the credibility of achieving medium-and long-term sustainability in the public finances it would improve the chances of long-term economic growth. Now that measures to improve the situation in the banking sector have been taken, confidence is gradually increasing, which could encourage lending and increase investment and household consumption more than projected. Foreign demand also remains a major risk. A sizable revision of the figures for the end of 2013 could lead to a deterioration in the outlook for this year's growth.

The inflationary risks are balanced over the projection horizon. Additional fiscal consolidation on the revenue side, higher input commodity prices and the depreciation of the euro could all result in faster-than-forecast growth in prices. A slower recovery in the economy, particularly in final household consumption in connection with the adverse situation on the labour market, could result in slower-than-forecast growth in prices.

[23] *The projections were made on the basis of current statistical methodologies and data available on 14 March 2014. The projections of macroeconomic factors presented in this report are based on assumptions of the movement in variables from the international environment and certain domestic factors dependent on economic policy decisions. The assumptions of the movement in variables from the international environment are taken from the Consensus Forecasts and Eastern Europe Consensus Forecasts (February 2014), the European Economic Forecasts (European Commission, February 2014), the OECD Economic Outlook (November 2013), and the IMF WEO update (January 2014). The assumptions used in the projections are not the same as those used by the ESCB in its projections. For the relationship between the Bank of Slovenia projections and those of the ESCB, see the appendix in the April 2008 Price Stability Report.*

International environment and external assumptions

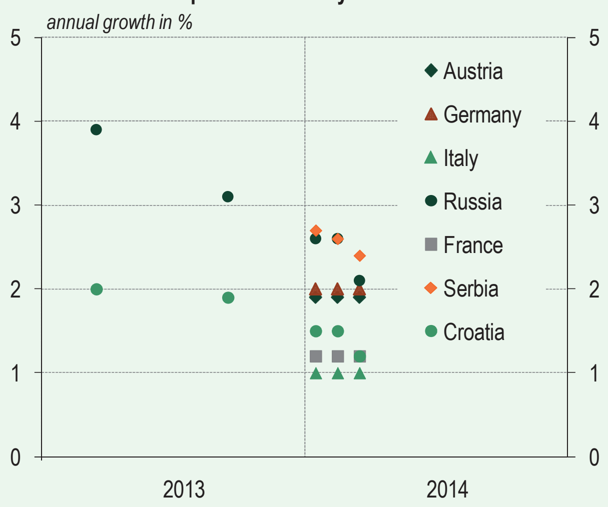
The economic recovery in Slovenia's most important trading partners will be gradual and slightly slower than anticipated in our previous projections. The main decline was in the economic growth forecasts in countries outside the euro area, most notably Russia and the former Yugoslav republics. To the contrary, the growth forecasts for the majority of euro area countries have stabilised or even increased recently. Foreign demand is forecast to grow by 1.6% in 2014, the rate increasing slightly in 2015 and 2016 but remaining below its long-term average. Even faster growth in foreign demand will be constrained by the adverse situation on the labour market in the euro area, and by new political tensions in certain countries outside the EU.

The assumption for US dollar oil prices remained unchanged, while growth in prices of other commodities is expected to be lower, at least this year. The anticipated absence of supply-side shocks and the slowdown in global economic growth is expected to contribute to the maintenance of oil prices at USD 110 per barrel over the projection horizon. Euro-denominated oil prices

Figure 7.1: Projections of GDP growth in Slovenia's main trading partners for the year 2014

Source: Consensus Economics.

Figure 7.2: Projections of GDP growth in Slovenia's main trading partners for the year 2015



Source: Consensus Economics.

Table 7.1: Assumptions for the international environment

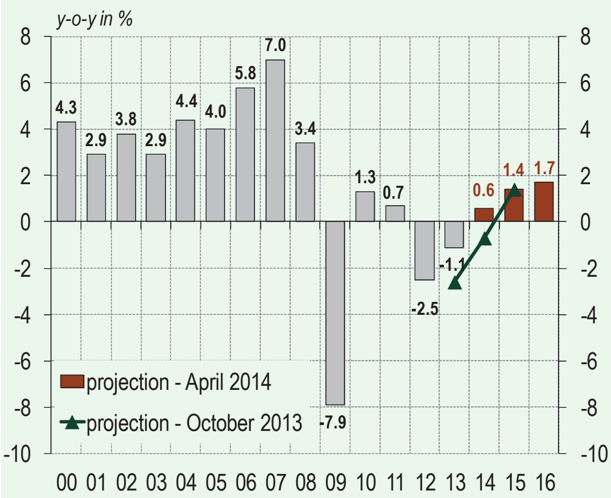
	2009	2010	2011	2012	2013	2014 Apr.	2014 Δ	2015 Apr.	2015 Δ	2016 Apr.	2016 Δ
						Assumptions					
	annual average growth (%) if not stated otherwise										
Foreign demand*	-14.0	10.6	7.1	0.9	1.1	**1.6**	-0.9	**3.3**	-0.5	**3.6**	...
Oil (USD/barrel)	62	80	111	112	109	**110**	0	**110**	0	**110**	...
Non-oil commodities	-23.0	37.1	17.9	-7.2	-5.2	**-2.8**	-2.2	**2.0**	0.0	**4.8**	...
EMU inflation	0.3	1.6	2.7	2.5	1.4	**0.9**	-0.4	**1.3**	-0.1	**1.5**	...
PPI Germany	-4.0	1.5	5.1	1.7	0.0	**0.9**	-0.7	**1.9**	0.3	**2.3**	...

** Volume of imports from the basket of foreign partners.*
Δ: Difference between current assumptions and assumptions in October 2013 Macroeconomic Developments and Projections.
Source: Bank of Slovenia, Eurostat, Consensus Economics, ECB, JP Morgan, OECD Economic Outlook.

Figure 7.3: Commodity prices

Source: ECB, Bloomberg, Bank of Slovenia assumptions.

Figure 7.4: GDP growth projection



Source: SORS,Bank of Slovenia projections.

are forecast to fall by around 1% this year. Prices of other commodities have also been revised downwards since the last projections. They are forecast to fall further this year, while the anticipated stronger global economic climate will be a factor in slightly higher growth in commodity prices in the next two years.

Inflation in the euro area will remain below 1.5% over the projection horizon. The main factors in the low inflation will be the fall and subsequent very slow growth in energy prices and the anticipated absence of stronger consolidation measures in the periphery countries. Core inflation will be curbed by the situation on the labour market, as a result of which demand-side pressures will be limited. Growth in producer prices in Germany will be bounded due to low input costs, and will remain below its long-term average until the end of the projection horizon.

GDP growth

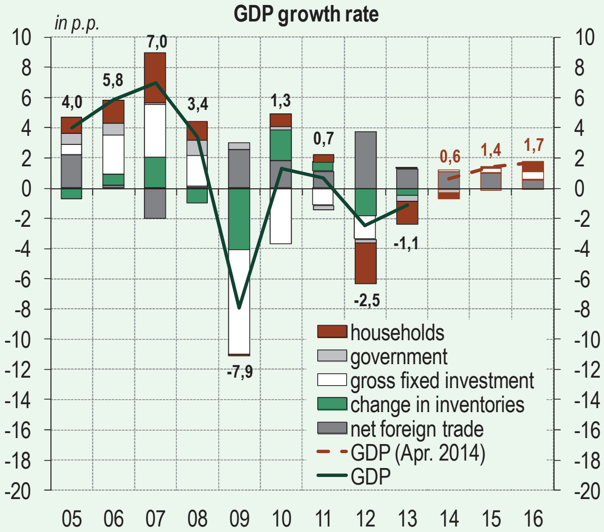
Economic growth is projected at 0.6% this year, and is expected to increase very gradually in the next two years. In addition to the improved situation on the labour market, and the slight rise in the confidence indicators, which are an indication of the stabilisation of the domestic environment, the upward revision of 1.3 percentage points in this year's forecast was also the result of exceptionally high carry-over from 2013. The projection for 2015 remains unchanged, while the economy is expected to grow at 1.7% in 2016. The main improvements since the previous projections relate to domestic demand components. Foreign demand nevertheless remains the main engine of growth, although its contribution to growth will gradually diminish as domestic demand components strengthen. Economic activity in 2016 will still be more than 6% lower than prior to the outbreak of the crisis.

Aggregate demand

Domestic consumption will continue making a negative contribution to growth this year, but is then expected to slowly recover. The stabilisation of employment in the final quarter of 2013, the rise in the indicators of expected orders in the manufacturing, service and construction sectors, the absence of additional fiscal consolidation measures, and the increase in confidence after the results of the comprehensive review and the recapitalisation of the banks are the main reasons for the slightly more encouraging projections for the components of domestic demand. Final household consumption is nevertheless projected to decline by 0.7% this year, before increasing by 0.2% in 2015 and 1.2% in 2016. Stronger growth will be constrained by a high unemployment rate and low wage growth.

Government consumption will continue to decline as a result of the measures to reduce the deficit. The projected path for government consumption is based on information from the 2013 Stability Programme, taking into account the state budgets adopted for 2014 and 2015. Compensation per employee will decline over the entire projection horizon. In line with the guidelines in the Stability Programme, employment is forecast to contract at around 1% annually. The need for further consolidation means that the average gross wage in the general government sector will remain approximately unchanged over the projection horizon. Measures outlined in the agreement on additional measures in the areas of wages and other labour costs in the public sector for balancing the public finances in the period from 1 June 2013 to 31 December 2014 will be a factor for the 2014 projection in this respect. The anticipated path for compensation per employee also includes a payment for eliminating wage discrepancies in 2014 and 2015. Another factor in the decline in government consumption, particularly in 2014, will be a decline in expenditure on intermediate consumption. Government consumption will decline by 1.3% this year, the decline slowing to 0.5% in 2015 and 0.3% in 2016. It is anticipated that government investment will again increase slightly this year, and will remain at the same level in the next two years.

Figure 7.5: Projection of expenditure contributions to GDP growth rate



Source: SORS, Bank of Slovenia projections.

Growth in investment is expected to gradually recover on account of certain new projects and reduced uncertainty. Private sector investment is expected to be limited, as the utilisation of production capacity remains relatively low, and the banks will remain cautious in lending. The stocks of unsold dwellings remain high which signals that activity in the construction of new buildings will be low this year, while civil engineering activity is expected to increase as a result of last year's disbursement of EU funds. These investments will mostly be for renovation purposes. This year's launch of new production lines in the automotive industry will be an important factor in investment in machinery and equipment. Gradual investment in railway and energy infrastructure is also expected.

Table 7.2: Components of domestic demand

						Projection					
						2014		2015		2016	
	2009	2010	2011	2012	2013	Apr.	Δ	Apr.	Δ	Apr.	Δ
	real growth rates in %										
Domestic demand	-10.3	-0.5	-0.3	-6.4	-2.5	**-0.6**	2.4	**0.3**	1.0	**1.2**	…
Private consumption	-0.1	1.5	0.8	-4.8	-2.7	**-0.7**	2.6	**0.2**	0.8	**1.2**	…
Government spending	2.5	1.3	-1.6	-1.3	-2.0	**-1.3**	0.5	**-0.5**	1.5	**-0.3**	…
Gross fixed capital formation	-23.8	-15.3	-5.5	-8.2	0.2	**0.6**	3.3	**1.7**	0.9	**2.9**	…

Δ: Difference between current projections and projections in October 2013 Macroeconomic Developments and Projections.
Source: SORS, Bank of Slovenia.

Net exports will make a positive contribution to economic growth over the entire projection horizon, although the contribution will slowly decline as a result of a recovery in domestic demand. Growth in exports will also increase, and is expected to slightly outpace growth in foreign demand as a result of further adjustments in unit labour costs. The export projection has been revised upwards over the entire projection horizon, partly as a result of the good realisation in 2013. On the other hand, the projection for imports is slightly higher also because of an improvement in the projections for domestic demand components. The latter will reduce the contribution made to GDP growth by net trade towards the end of the projection horizon.

Supply side

The majority of sectors will recover in 2014. While growth in export-oriented sectors will be constrained by only gradual recovery in the international environment over the projection horizon, growth in sectors dependent primarily on the domestic market will primarily be constrained by the very moderate recovery in the labour market. Export-oriented sectors recorded growth already in the final quarter of last year as the EU economy recovered more quickly, and this dynamic has been projected to continue in 2014. Compared with the situation at the time of previous projections, indicators in the manufacturing sector suggest slightly smaller constraints in foreign demand, and smaller problems with non-payment, partly as a result of new bankruptcy legislation. The proportion of manufacturing firms not reporting any limits also increased. Having made significant cost adjustments during the crisis and successfully refocused on markets with higher projected growth, the manufacturing sector has a solid basis for growth over the projection horizon. Growth in the construction sector over the projection horizon will again largely be tied to certain major government investments, while the low basis will also have a major impact on growth rates. Other sectors primarily dependent on the domestic market will also gradually recover, although household consumption will be constrained by the adverse situation on the labour market. The latter will primarily hold back faster growth in value-added in the retail sector. Other services are projected to record slightly faster growth, primarily as a result of an increased focus on foreign markets.

Labour market

Employment is projected to fall further this year and next year, while very gradual recovery is expected towards the end of the projection horizon. The main factor in the slight improvement in the expectations for the labour market relative to the previous projections was the stabilisation of employment towards the end of last year. The unemployment rate also did not increase significantly at the very beginning of this year. This was at least partly the result of new labour legislation. The slightly better expectations for economic growth this year and next year will nevertheless pass through into employment with a lag. Employment will remain constrained by the consolidation in the general government sector, where employment will fall by approximately 1% a year over the projection horizon. Employment in the private sector will remain constrained this year in particular, as firms are likely to exploit internal reserves in recruitment, and new hires will only occur towards the end of the projection horizon. Employment in the private sector is projected to fall by 1.1% this year. It will remain unchanged in 2015, and is projected to rise by 0.8% in 2015. Sectors where value-added is low will see a further fall in employment over the projection horizon, as a result of which structural unemployment is expected to further increase. Employment also remains weak among young people with higher education, which is already causing an outflow of human capital abroad. The ILO unemployment rate is forecast at just under 11% over the projection horizon.

Table 7.3: Activity, employment and wages

						Projection					
						2014		2015		2016	
	2009	2010	2011	2012	2013	Apr.	Δ	Apr.	Δ	Apr.	Δ
	growth rates, %										
GDP (real)	-7.9	1.3	0.7	-2.5	-1.1	**0.6**	1.3	**1.4**	0.0	**1.7**	...
Employment	-1.8	-2.2	-1.6	-0.8	-2.0	**-1.1**	1.3	**-0.2**	0.2	**0.6**	...
Compensation per employee	1.8	3.9	1.6	-1.0	0.1	**1.0**	1.3	**1.3**	1.0	**1.6**	...
Productivity	-6.2	3.5	2.4	-1.7	0.9	**1.7**	-0.1	**1.6**	-0.1	**1.3**	...
ULC (nominal)	8.6	0.4	-0.7	0.8	-0.8	**-0.6**	1.4	**-0.2**	1.2	**0.3**	...
Contribution to GDP growth	*percentage points*										
Domestic demand, excluding changes in inventories	-6.5	-2.6	-0.9	-4.5	-1.8	**-0.5**	2.2	**0.3**	0.9	**1.1**	...
Net exports	2.6	1.8	1.1	3.8	1.3	**1.1**	-0.9	**1.0**	-1.0	**0.6**	...
Changes in inventories	-4.1	2.0	0.6	-1.8	-0.5	**0.0**	0.0	**0.0**	0.0	**0.0**	...

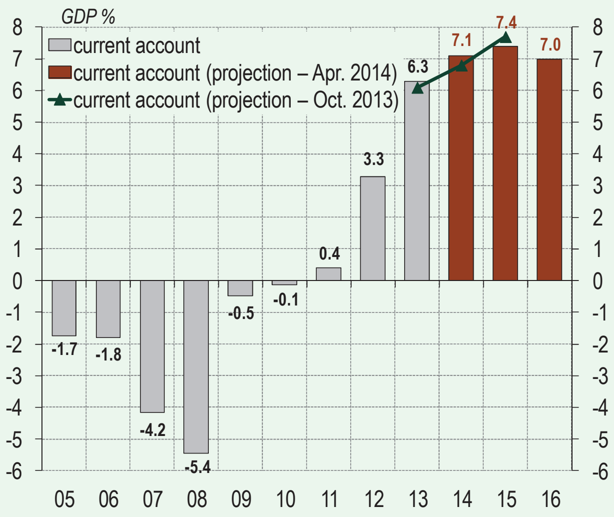
Δ: Difference between current projections and projections in October 2013 Macroeconomic Developments and Projections.
Source: SORS, Bank of Slovenia.

Foreign trade

The current account surplus will widen further this year and next year, and will then begin to narrow in the final year of the projections. As a result of the decline in domestic demand and the gap by which exports outpace imports, the surplus will widen from 6.3% of GDP last year to more than 7% of GDP this year and 7.4% of GDP in 2015, before narrowing to 7.0% of GDP in 2016. The widening of the surplus in 2014 and 2015 will be constrained by the negative terms of trade. Growth in domestic demand will narrow the surplus even further in 2016.

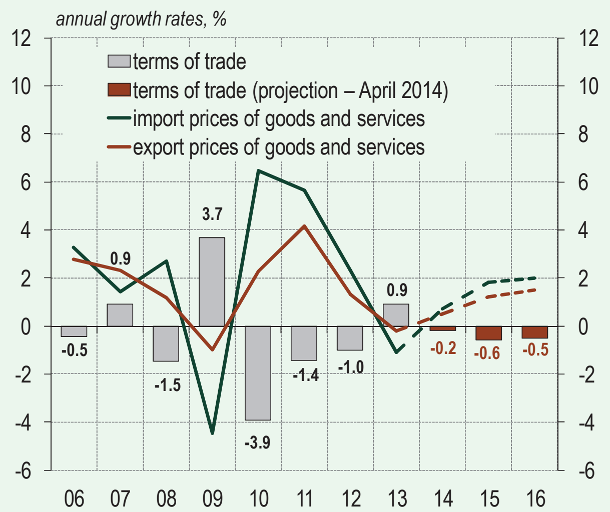
Together with strong surplus in services, the current account surplus will primarily be widened by merchandise trade, while the deficit in factor income is projected to increase. The surplus of trade in merchandise and services is projected to reach 8.6% of GDP this

Figure 7.6: Current account projection



Source: SORS, Bank of Slovenia projections.

Figure 7.7: Terms of trade projections



Source: SORS, Bank of Slovenia projections.

Table 7.4: Current account projections

						Projection					
						2014		2015		2016	
	2009	2010	2011	2012	2013	Apr.	Δ	Apr.	Δ	Apr.	Δ
Exports of goods and services	-16.1	10.2	7.0	0.6	2.9	**2.8**	0.7	**4.6**	1.2	**5.1**	…
Imports of goods and services	-19.2	7.4	5.6	-4.7	1.3	**1.5**	2.1	**3.9**	2.8	**5.1**	…
Current account: EUR billion	-0.2	-0.1	0.1	1.2	2.3	**2.5**	0.1	**2.7**	0.0	**2.6**	…
as % GDP	-0.5	-0.1	0.4	3.3	6.3	**7.1**	0.3	**7.4**	-0.3	**7.0**	…
Terms of trade*	3.7	-3.9	-1.4	-1.0	0.9	**-0.2**	0.9	**-0.6**	0.5	**-0.5**	…

** Based on national accounts deflators.*
Δ: Difference between current projections and projections in October 2013 Macroeconomic Developments and Projections.
Source: SORS, Bank of Slovenia.

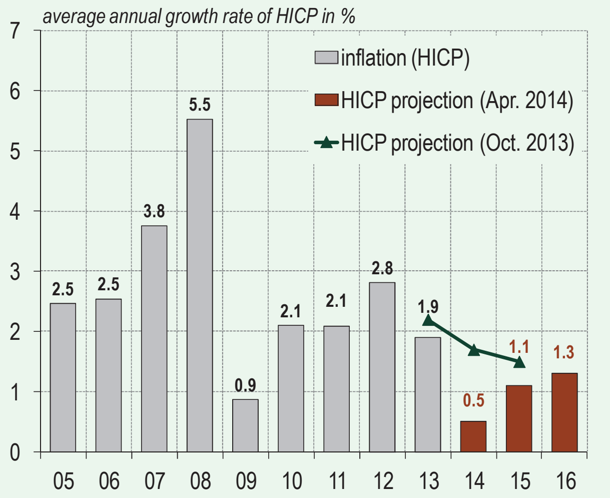
year and to widen to around 9% by 2016. The merchandise trade surplus will widen from 1.8% of GDP last year to 2.6% of GDP this year, and is expected to be at around 3% of GDP in the next two years. The surplus of trade in services will remain at around 6% of GDP over the projection horizon, while the deficit in factor income will widen from 1.5% of GDP this year to around 2% by 2016, partly as a result of increased interest payments on the public debt.

Inflation

Average inflation is forecast at 0.5% in 2014, and is expected to rise slightly in 2015 and 2016, primarily as a result of higher growth in energy prices and prices of non-energy industrial goods. The inflation projections are lower than in the October MDAP because of slower growth in prices of unprocessed food, energy prices and prices of market services in the last two quarters, coupled with lower cost pressures, both in terms of labour costs and commodity prices. Price growth as measured by the HICP is forecast to stand at 0.5% this year, and to rise to 1.1 in 2015 and 1.3% in 2016. Inflation developments will remain subject to measures related to fiscal consolidation, with their impact gradually dropping out of the year-on-year comparison. At the same time, the demand-side pressures will remain absent due to the ongoing decline in real disposable household income. Towards the end of the projection horizon growth in prices of non-energy industrial goods and market services is expected to increase slightly in light of more favourable economic developments.

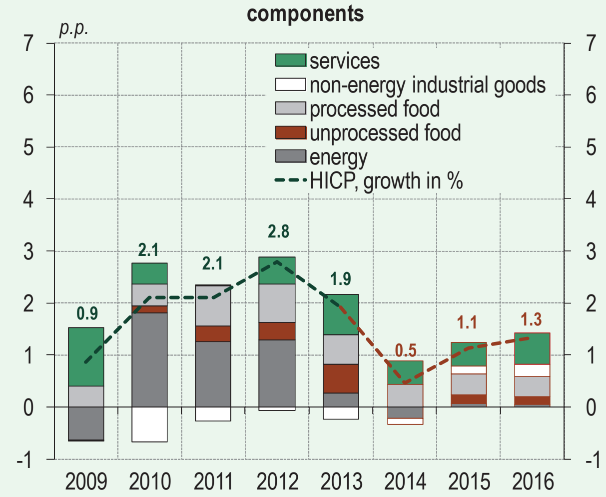
The largest contribution to inflation over the projection horizon is expected to come from prices of services and food. The contribution of energy prices and prices of non-energy industrial goods will be negative this year, before turning slightly positive. Services prices are forecast to contribute around 0.5 percentage points to annual inflation over the projection horizon. The projected 1.3% year-on-year increase in services prices in 2014 will be primarily driven by the effects of the last year's rise in VAT rates. In line with the expected recovery of the economy, a gradual increase in the growth in services prices is forecast in the following years, reaching 1.7% on average in 2016. Prices of unprocessed food are expected to fall slightly this year as a result of base effects, while overall year-on-year growth in food prices is forecast at 1.8% this year. Assuming unchanged excise duties on alcohol and tobacco and no price shocks on foreign food commodity markets, growth in food prices is expected to be moderate at around 2.3% in the following years. The projection of growth in energy prices has been revised downwards due to lower realisation. Energy prices are forecast to fall this year, and to

Figure 7.8: Inflation projection



Source: SORS, Bank of Slovenia projections.

Figure 7.9: Projections of contributions to inflation by components



Note: Due to rounding, sums of components may differ from aggregate values.
Source: SORS, Bank of Slovenia projections.

rise very gradually in the following years. Prices of non-energy industrial goods are forecast to fall further this year, on average by 0.7% in year-on-year terms, and are then forecast to start rising slowly in line with the growth in domestic demand.

Core inflation will remain low over the entire projection horizon. In line with the anticipated further decline in real income and the consequent decline in household consumption, the core inflation indicators will remain low this year. In the second half of this year, growth in the narrowest core inflation indicator will temporarily fall to zero, as the effect of past fiscal and administrative measures vanishes from the year-on-year comparison. At the same time the anticipated fall in commodities prices is expected to influence final prices of non-energy industrial goods via import and producer prices. Growth in the HICP excluding energy, food, alcohol and tobacco is thus forecast to average 0.4% this year. Limited labour cost pressures will also contribute to low core inflation figures

Table 7.5: Inflation projections

						Projection					
						2014		2015		2016	
	2009	2010	2011	2012	2013	Apr.	Δ	Apr.	Δ	Apr.	Δ
	average annual growth, %										
Consumer prices (HICP)	0.9	2.1	2.1	2.8	1.9	**0.5**	-1.2	**1.1**	-0.4	**1.3**	…
food	1.8	2.5	4.8	4.7	4.9	**1.8**	-2.1	**2.4**	-0.3	**2.3**	…
energy	-4.5	13.9	8.8	9.0	1.8	**-1.6**	-2.5	**0.5**	-0.1	**0.4**	…
other goods	0.0	-2.2	-0.9	-0.2	-0.9	**-0.7**	-0.6	**0.3**	-0.2	**0.6**	…
services	3.2	1.2	0.0	1.5	2.2	**1.3**	-0.7	**1.3**	-0.5	**1.7**	…
Core inflation indicators (HICP)											
excluding energy	1.7	0.3	1.0	1.8	1.9	**0.8**	-1.0	**1.3**	-0.3	**1.5**	…
excl. energy and unprocessed food	1.9	0.2	0.7	1.5	1.4	**0.9**	-0.7	**1.2**	-0.4	**1.5**	…
excl. energy, food, alcohol and tobacco	1.7	-0.4	-0.4	0.7	0.9	**0.4**	-0.7	**0.8**	-0.4	**1.2**	…

Δ: Difference between current projections and projections in October 2013 Macroeconomic Developments and Projections.
Source: SORS, Bank of Slovenia.

over the projection horizon. By the end of the projection horizon, core inflation is forecast to rise to 1.2%, in line with the projected economic recovery and the rise in real household purchasing power.

The overall direct impact of the announced government measures on inflation is forecast to be slightly smaller this year compared to last year, since most of the effect of last year's measures will drop out of the year-on-year inflation figures after the first half of the year. At the same time no new measures were announced. Last year's rise in VAT rates will contribute approximately 0.4 percentage points to average inflation this year. In case the government leaves excise duties on refined petroleum products unchanged this year, their contribution to inflation will amount to -0.1 percentage points. This will be due to the pass-through of the reduction in excise duties at the end of last year and their reduction at the beginning of this year. The contribution of last year's introduction of the tax on financial services will be negligible in 2014, while the overall contribution made by government measures is forecast at 0.4 percentage points. No government measures that could have an impact on inflation in 2015 and 2016 have been announced yet.

The available indicators of monetary developments, labour costs and inflation expectations suggest no significant price pressures in the medium term. The stock of bank loans to households declined by 4.2% last year primarily as a result of the extremely sharp contraction in consumer loans. The decline in household lending coupled with a decline in real disposable income suggest no possibility of a rapid reversal in domestic demand. Unit labour costs are forecast to fall this and next year, which will constrain cost pressures on prices. These developments and the reduction in inflation expectations since the middle of last year, when they rose slightly due to the rise in VAT rates, suggest low growth in prices in the future. At the same time, the anticipated economic recovery is limiting the possibility of deflationary developments. In its March forecasts for Slovenia, Consensus is forecasting annual inflation at between 1.5% and 2.0% for the 2013 to 2018 period.

Risks and uncertainties

Risks to GDP growth remain on the downside over the projection horizon. The risks related to the domestic environment have diminished slightly relative to the previous projections. The comprehensive review of the banking system, the recapitalisation of the banks and the successful sovereign financing on the international financial markets reduced refinancing risk in connection with the

Table 7.6: Comparison of forecasts for Slovenia and change from previous forecasts

	Publication of new/previous forecast	GDP growth rate, %				Inflation annual average, %				Current account % of GDP			
		2014		2015		2014		2015		2014		2015	
		new	Δ	new	Δ	new	Δ	new	Δ	new	Δ	new	Δ
Bank of Slovenia	Apr. 14/Oct. 13	**0.6**	1.3	**1.4**	0.0	**0.5**	-1.2	**1.1**	-0.4	**7.1**	0.3	**7.4**	-0.3
IMAD	Mar. 14/Sep. 13	**0.5**	1.3	**0.7**	0.3	**0.3**	-1.6	**1.1**	-0.3	**6.9**	1.9	**6.4**	1.3
Consensus Forecasts	Mar. 14/Feb. 14	**-0.6**	0.1	**0.9**	0.0	**1.5**	-0.2	**1.8**	-0.2	**…**	…	**…**	…
European Commission	Feb. 14/Nov. 13	**-0.1**	0.9	**1.3**	0.6	**0.8**	-1.1	**1.3**	-0.2	**6.9**	0.9	**7.8**	1.3
OECD	Nov. 13/May 13	**-0.9**	-1.0	**0.6**	…	**1.7**	0.5	**1.3**	…	**6.2**	1.4	**7.1**	…
IMF	Oct. 13/Apr. 13	**-1.4**	-2.9	**0.9**	-1.0	**1.8**	-0.1	**2.1**	0.1	**7.0**	4.5	**6.9**	4.9

Δ: Difference between current and previous forecasts.
Source: Bank of Slovenia, IMAD, European Commission, Consensus Economic Forecasts, IMF, OECD, Bank of Slovenia calculations.

banking sector in this respect. After the release of the AQR and stress test results and the recapitalisation of the banks, there was a sharp decline in the spreads on Slovenian debt, and the rating agencies upgraded the banks and maintained a stable outlook for sovereign debt. From a technical point of view potential revisions to the figures for the end of 2013 when the next national accounts are released could have a strong negative impact on the projections for this year's economic growth.

In the context of an increase in the intensity of imports and exports in GDP, foreign demand remains an extremely significant risk factor. Exports of merchandise and services in 2013 amounted to almost 80% of GDP, the Slovenian economy's dependence on foreign markets thus having increased rapidly. The additional slowdown in growth in emerging economies is a factor here, while the outlook for growth in the euro area is unchanged from the previous projections. The risks in the euro area are still tied to a potential deepening of the debt crisis in the periphery countries, where a gradual recovery is in fact projected. In addition, there was a significant increase in the risk surrounding growth in Russia, partly as a result of recent geopolitical tensions.

Although the outlook for employment is slightly better than in the previous projections, there are still risks surrounding the recovery of the labour market. The projected low economic growth will not eliminate the discrepancies on the labour market, and unemployment is projected to stay above 10%. The biggest problem is structural unemployment, which leads to a loss of human capital and incurs social costs.

The risks surrounding the inflation projections are balanced. Inflation would be higher in the event of higher rises in energy prices on foreign markets, the depreciation of the euro or a rise in input commodity prices. Prices could also rise more strongly than forecast in the event of additional fiscal consolidation being undertaken via increases in indirect taxes, and in the event of a rise in prices in sectors with limited competition (e.g. prices of municipal services, electricity, district heating and public transport). Fiscal consolidation on the expenditure side, for example via cuts in public sector wages, could on the other hand further reduce price pressures on the demand side. A weaker-than-forecast recovery of the economy would have a similar effect.