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EUROSYSTEM

SUMMARY OF MACROECONOMIC DEVELOPMENTS

JANUARY 2019

Summary of macroeconomic developments, January 2019

The international environment is becoming less encouraging for Slovenia's export sector. For several months now survey indicators have been pointing to a slowdown in global expansion, and forecasts for this year's global economic growth have also been lowered. Growth in the euro area is continuing to slow: in December the PMI fell to its lowest value of the last four years, while the economic sentiment is also less optimistic. The changing situation is being reflected in a reduced estimate for the weighted forecast of economic growth in Slovenia's main trading partners, which nevertheless suggests that conditions will remain relatively solid for the export sector. In the wake of major divergence between the monetary policies of the ECB and the Fed, and the increased economic activity in the US, the euro has fluctuated mostly below the mark of USD 1.15 over the last three months, its low of the last year and a half, although this is benefitting the price competitiveness of euro area exporters. Inflationary pressures in the international environment have eased over the last three months, as oil prices and other commodity prices fell sharply.

Despite the uncertainties in the international environment, economic growth in Slovenia continues to strongly outpace the euro area average. Year-on-year GDP growth again approached 5% in the third quarter of last year, albeit without any major signs of imbalances occurring. The high contribution made to GDP growth by construction investment was in line with the government investment cycle, while the weaker dynamic in merchandise exports was in line with the lower growth in the euro area, Germany in particular. The contribution made to GDP growth by net trade was nevertheless very large, as growth in imports declined by even more. This was partly attributable to surprisingly weak private consumption, which could at least partly be related to the decline in consumer confidence and lower real growth in wages. The structure of investment growth continued to deteriorate in the third quarter from the perspective of increasing the output potential of the economy. The current dynamic in investment in machinery and equipment was weak again, although the conditions for investment remained good. Investment is most likely being held back mainly by the increased uncertainty in the international environment. Judging by the last available confidence and activity indicators, the economy remained fairly favourable in the final quarter of last year. Growth is likely to have remained high in construction and certain private-sector services.

In the wake of the high economic growth, the proportion of firms facing a shortage of qualified labour is increasing, but employment growth nevertheless remains high. It was again close to 3% in the third quarter of last year, while employment forecasts also remain positive. The surveyed unemployment rate had fallen to 5% by the third quarter of last year, which is not yet giving rise to any wage pressures that would weaken the external competitiveness of the economy. Wage growth averaged 3.4% over the first ten months of last year, up 1 percentage point in year-on-year terms, although the dynamic in real unit labour costs remains better than in the EU overall, particularly compared with other newer Member States.

Slovenia's balance of payments remains strong, despite a decline in the current account surplus. The current account surplus over the 12 months to November amounted to 7.3% of GDP, down 0.4 percentage points on its peak in August. The decline was attributable to a stagnation in goods exports in September, and a sharp increase in imports in October. The export developments did not remain weak in October and November: year-on-year growth in goods exports strengthened to nearly 10%, primarily as a result of increased sales on euro area markets. Year-on-year growth in goods imports temporarily strengthened to almost 20% in October (its structure indicates increased imports of intermediate goods and consumer goods), before falling to below 9% in November. The surplus of trade in services continued to *strengthen, largely as a result of high exports of travel services. The year-on-year reduction in the deficit in primary income slowed last year, as a result of an increase in the deficit in estimated reinvested earnings, which is indicative of increased reinvestment at firms in Slovenia under foreign ownership.*

As price pressures from the rest of the world eased, inflation as measured by the HICP fell sharply in December. It stood at 1.4%, down 0.7 percentage points on November, and 0.2 percentage points less than in the euro area overall. The fall in oil prices and other commodity prices on global markets meant that the previous large influence of external factors eased off towards the end of the year, and domestic factors began to prevail, in line with the Bank of Slovenia's expectations. This is primarily being evidenced in growth in services prices, which accounted for the majority of headline inflation in December. The prevalence of domestic factors is also being reflected in core inflation excluding energy and food prices, which stood at 1.3% at the end of last year.

The fiscal position is continuing to improve, as a result of the favourable cyclical situation, and a decline in interest expenditure. The general government sector recorded a surplus in the amount of 0.7% of GDP over the 12 months to September of last year, while the government debt stood at 71.0% of GDP at the end of last September. Growth in general government revenues remained solid, primarily as a result of increased tax revenues, while growth in expenditure also strengthened further, as a result of increased investment. According to the latest government estimates, the general government surplus is expected to have reached 0.8% of GDP by the end of the year, while the government debt is expected to have fallen to around 70% of GDP. The public finances are expected to have been in structural balance, which is not expected to be the case this year; according to the government's plans, the structural position is forecast to deteriorate, while growth in expenditure is forecast to be higher than prescribed by the fiscal rules. Similarly to the last two years, this year is again expected to see a reduction in the interest burden, while the economic situation is forecast to remain favourable.

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To mitigate the adverse consequences of demographic changes and to prevent the brain drain, Slovenia needs, among other things, an economic advance into creating higher value-added. Given the current structure of the economy there seems to be a shortage of medium-qualified labour, which employers compensate by hiring foreign nationals. Despite the net emigration of Slovenian citizens, the hiring of foreign nationals since 2015 has kept net immigration positive, where the average qualifications and professional skills of foreign workers are weaker than those of domestic workers. By contrast, there is an outward migratory flow among people with tertiary qualifications, which in itself entails a loss of potential to the country after years of investing in their education. We assess that one reason, among others, for this situation is that the structure of the Slovenian economy is largely comprised of activities with relatively low value-added per employee. Failing to transition towards creating higher added value and take direct measures for retention of the highly qualified workers may result in productivity growth insufficient for a swifter catch-up process with the more advanced economies, and a more adverse impact of population ageing.

Main macroeconomic indicators

	2015	2016	2017	18Q1	18Q2	18Q3	2015	2016	2017	18Q1	18Q2	18Q3
	Slovenia						*euro area*					
Economic developments	*y-o-y growth rates in %*											
GDP	2.3	3.1	4.9	4.7	4.0	4.8	2.1	2.0	2.4	2.1	2.3	1.6
- industry	1.0	4.6	7.7	6.0	5.2	3.1	3.6	3.4	3.1	2.1	3.0	0.8
- construction	-1.5	-3.7	8.5	11.8	11.1	17.9	0.8	1.5	3.2	3.3	4.2	3.8
- mainly public sector services	0.9	2.3	1.6	2.1	2.3	1.8	0.8	1.3	1.1	1.3	1.2	1.0
- mainly private sector services	2.6	3.3	6.0	5.1	4.6	5.2	2.2	2.0	2.6	2.4	2.6	1.8
Domestic expenditure	1.9	2.9	3.9	6.1	3.5	3.5	2.4	2.4	1.7	1.6	1.6	2.0
- general government	2.4	2.7	0.5	1.2	4.9	2.5	1.3	1.8	1.2	0.9	1.1	1.0
- households and NPISH	2.3	3.9	1.9	3.7	1.6	0.0	1.8	2.0	1.6	1.7	1.3	1.0
- gross capital formation	0.1	0.0	13.2	16.4	7.2	13.4	5.1	4.2	2.4	2.0	3.1	5.6
- gross fixed capital formation	-1.6	-3.7	10.7	10.7	10.7	12.0	4.9	4.0	2.6	3.0	3.4	3.5
- inventories and valuables, contr. to GDP growth in pp	0.3	0.7	0.6	1.4	-0.5	0.5	0.0	0.1	0.0	-0.2	-0.1	0.5
Labour market												
Employment	1.3	1.8	2.9	3.3	3.0	2.8	1.0	1.4	1.6	1.5	1.6	1.3
- mainly private sector services	1.4	1.7	3.0	3.6	3.2	3.0	1.0	1.4	1.7	1.6	1.7	1.4
- mainly public sector services	0.8	2.2	2.6	2.2	2.1	1.9	1.1	1.4	1.3	1.2	1.2	1.1
Labour costs per employee	1.3	3.0	3.2	3.9	4.6	3.2	1.4	1.2	1.6	2.0	2.2	2.5
- mainly private sector services	1.5	2.4	3.2	3.8	4.7	3.4	1.5	1.2	1.6	2.0	2.3	2.5
- mainly public sector services	0.7	5.2	3.1	3.8	4.2	3.8	1.1	1.3	1.5	2.0	2.1	2.3
Unit labour costs, nominal*	0.3	1.8	1.2	2.4	3.6	1.3	0.3	0.6	0.8	1.4	1.5	2.1
Unit labour costs, real**	-0.7	1.0	-0.3	0.0	0.8	-1.2	-1.1	-0.2	-0.3	0.0	0.2	0.7
	in %											
LFS unemployment rate	9.0	8.0	6.6	5.9	5.2	5.0	10.9	10.0	9.1	8.9	8.2	7.8
Foreign trade	*y-o-y growth rates in %*											
Current account balance as % of GDP***	4.5	5.5	7.2	6.8	7.4	7.4	2.9	3.2	3.2	3.4	3.6	3.3
External trade balance as contr. to GDP growth in pp	0.6	0.5	1.3	-0.8	0.8	1.7	-0.2	-0.4	0.8	0.5	0.8	-0.2
Real export of goods and services	5.0	6.4	10.7	8.4	9.1	5.7	6.6	3.0	5.2	3.1	4.4	2.7
Real import of goods and services	4.7	6.6	10.3	10.6	9.2	4.3	7.7	4.2	3.9	2.2	3.1	3.7
Financing	*in % of GDP*											
Banking system's balance sheet	106.9	99.3	93.9	91.8	91.0	89.3	281.3	275.7	260.7	260.6	260.9	258.9
Loans to NFCs	26.3	22.6	21.8	21.4	21.0	20.8	38.7	37.8	36.9	36.9	36.7	36.6
Loans to households	21.1	21.1	21.5	21.5	21.5	21.6	49.7	49.4	49.4	49.1	49.0	49.1
Inflation	*in %*											
HICP	-0.8	-0.2	1.6	1.5	2.1	2.1	0.0	0.2	1.5	1.3	1.7	2.1
HICP excl. energy, food, alcohol and tobacco	0.3	0.7	0.7	0.8	1.0	1.1	0.8	0.9	1.0	1.0	0.9	1.0
Public finance	*in % of GDP*											
Debt of the general government	82.6	78.7	74.1	75.5	72.7	71.0	89.9	89.1	86.8	86.9	86.3	...
One year net lending/net borrowing of the general government***	-2.8	-1.9	0.1	0.5	0.6	0.7	-2.0	-1.6	-1.0	-0.8	-0.5	...
*- interest payment****	3.2	3.0	2.5	2.4	2.3	2.2	2.3	2.1	2.0	1.9	1.9	...
*- primary balance****	0.4	1.1	2.6	2.9	2.9	2.9	0.3	0.6	1.0	1.2	1.4	...

Note: Data is not seasonally and working days adjusted.
** Nominal unit labour costs are the ratio of nominal compensation per employee to real labour productivity.*
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Source: SORS, Eurostat, Bank of Slovenia, ECB, Ministry of Finance, Bank of Slovenia calculations.