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SUMMARY OF MACROECONOMIC DEVELOPMENTS

OCTOBER 2019

Summary of macroeconomic developments, October 2019

Global economic growth slowed in the first half of this year, while the medium-term outlook also deteriorated. Rising trade and political tensions have seen global trade and industry get progressively weaker, and growth in investment also declined. Economic growth in the euro area was low in the second quarter, and the survey indicators suggest that the adverse developments continued in the third quarter. The World Trade Organisation sharply reduced its forecast for this year's growth in global trade, to just 1.2%, while the better outlook for 2020 is contingent on trade tensions easing. The OECD is forecasting a slowdown in global economic growth to around 3.0% over the medium term, while GDP growth in the euro area is expected to barely exceed 1%. With the German economy struggling, the outlook for growth in foreign demand for Slovenian products deteriorated again in September. Within the ECB, we responded to the worsening situation by a set of measures, which include cutting the deposit interest rate, introducing a new TLTRO and announcing a new asset purchase programme. Due to increased uncertainty and low economic growth in the euro area, the euro has continued to gradually depreciate against the US dollar: it was down around 4% in year-on-year terms by mid-October.

The worsening international environment has begun to significantly affect the Slovenian economy. According to the national accounts figures published in September, GDP was merely unchanged in quarterly terms in the second quarter, while the available monthly activity figures and the survey indicators suggest that growth in the third quarter was also rather weak. Growth in industrial production was low over the summer months. It was mostly driven by high-tech sectors, most notably pharmaceuticals. In July, construction activity stagnated in year-on-year terms, as government investment stagnated as well over the summer months. The figures for growth in volume turnover in a number of service sectors were however relatively favourable in July, which coincided with a further rise in exports of services and, at least judging by the relatively high wage growth, the continuation of robust private consumption. The economic climate is gradually cooling; in September, this was mainly attributable to a decline in consumer confidence, although, contrastingly, firms have slightly raised their demand expectations in recent months, at least overall.

The relatively high wage growth and stagnation in productivity raised growth in unit labour costs to significantly above the euro area average. Year-on-year growth in employment is slowing, but remains high relative to economic growth. The survey indicators of employment expectations suggest that this trend will continue at least until the end of the year. The number of people registered as unemployed fell below the 70,000 mark in September, and was down 5.3% in year-on-year terms. Nominal year-on-year growth in the average gross wage increased to 5.2% in July, among the highest rates of the last decade. Real wage growth was also relatively high, which supports domestic demand, but is not in line with changes in productivity. As in the euro area overall, productivity growth has been stagnating since the final quarter of last year. Because wage growth is significantly above the euro area average, growth in unit labour costs is also already deviating notably from the euro area average, as has been the case in the Baltic states, Cyprus, Slovakia and, in part, Germany.

The 12-month current account surplus remains in excess of 5% of GDP. Nominal growth in merchandise imports and exports remains high this year, but only if current figures for trade in pharmaceutical products with Switzerland are taken into account. If trade with Switzerland is excluded, merchandise exports in August would actually be down slightly in year-on-year terms according to the balance of payments figures, while growth in imports would be negligible. Increased imports from Switzerland are the only reason that the merchandise trade surplus narrowed over the first eight months of the year in year-on-year terms. The situation in services exports remains favourable: there was no significant change in growth compared with last year. The surplus of trade in services is thus continuing to widen. Changes in income are having a negative impact on the current account position, albeit primarily because of increased payments of own resources into the EU budget.*

After rising in August, inflation slowed to 1.7% in September. The slowdown was partly the result of a negative contribution by energy prices, and smaller contributions from food price inflation and from non-energy industrial goods, the latter after the spike seen in August. Year-on-year service price inflation rose to 3.7%, in line with expectations amid numerous price rises. Core inflation excluding energy, food, alcohol and tobacco stood at 2.3% in September, 1.3 percentage points higher than the euro area average. Slovenia's relatively high core inflation is attributable to domestic inflation factors, which is confirmed by analysis of the GDP deflator, which is a broader metric of price developments in the economy than the HICP. The largest factor in its increased growth in the first half of the year was the rise in unit labour costs, while the rising profit rate was also a factor in the first quarter. By contrast, domestic inflationary pressures are being eased by the year-on-year fall in import prices seen since June, which has been most pronounced in the energy category, in line with the developments in oil prices.

The government sector is still maintaining a surplus, but macroeconomic risks are increasing. The surplus over the 12 months to June amounted to 0.6% of GDP, as year-on-year growth in general government expenditure in the first half of the year slightly outpaced growth in general government revenues and nominal economic growth. Of the major aggregates, the fastest increase was in investment expenditure, while the largest contributions to growth in expenditure came from employee compensation and social benefits. The tax break for annual leave allowance slowed the growth in general government revenues. The interest burden is declining for the fourth consecutive year. The general government debt stood at 67.7% of GDP at the end of June, having fallen in nominal terms and as a ratio to GDP since the end of last year. The rise in macroeconomic risks demands caution in the planning and pursuit of fiscal policy, including the preparation of the budgets for 2020 and 2021 and other fiscal measures. Slovenia's general government debt is declining, but remains above the benchmark of 60% of GDP. Demographic developments also present a challenge to the public finances.

* There is a high probability of a significant revision in these figures, and with them certain other macroeconomic statistics.

Main macroeconomic indicators

	2016	2017	2018	18Q4	19Q1	19Q2	2016	2017	2018	18Q4	19Q1	19Q2
	Slovenia						euro area					
Economic developments	<i>y-o-y growth rates in %</i>											
GDP	3.1	4.8	4.1	3.8	3.3	2.5	1.9	2.5	1.9	1.4	1.1	1.0
- industry	4.7	7.7	3.6	2.6	2.8	3.4	3.0	3.4	1.9	-0.1	-0.4	-1.5
- construction	-3.4	8.3	8.0	6.2	14.9	7.6	1.6	2.5	3.5	3.8	4.4	3.0
- mainly public sector services	2.3	2.1	1.6	1.6	1.7	1.4	1.6	1.6	1.0	1.0	1.0	1.1
- mainly private sector services	3.3	5.8	4.5	4.3	3.8	2.9	1.8	2.7	2.2	1.5	1.2	1.0
Domestic expenditure	3.0	4.2	4.7	5.0	2.7	4.2	2.4	2.1	1.5	2.0	1.2	1.1
- general government	2.5	0.3	3.2	4.0	3.9	1.0	1.8	1.5	1.1	1.0	1.3	1.7
- households and NPISH	4.4	2.3	3.4	4.1	2.3	3.3	2.0	1.6	1.4	1.3	0.9	1.3
- gross capital formation	-0.5	13.8	9.6	8.6	2.5	9.2	3.9	4.1	2.4	4.7	2.2	-0.2
- gross fixed capital formation	-3.7	10.4	9.4	7.1	10.0	6.9	4.0	3.5	2.3	4.3	3.9	2.4
- inventories and valuables, contr. to GDP growth in pp	0.6	0.7	0.2	0.3	-1.3	0.6	0.0	0.1	0.0	0.1	-0.3	-0.6
Labour market												
Employment	1.8	3.0	3.2	3.1	2.9	2.6	1.4	1.6	1.5	1.4	1.4	1.2
- mainly private sector services	1.7	3.1	3.4	3.4	3.1	2.8	1.4	1.7	1.6	1.4	1.4	1.1
- mainly public sector services	2.1	2.5	2.1	1.9	1.6	1.5	1.3	1.3	1.2	1.2	1.3	1.2
Labour costs per employee	3.1	3.0	3.9	3.8	4.3	5.7	1.3	1.6	2.2	2.2	2.2	2.1
- mainly private sector services	2.5	3.0	4.1	3.9	3.8	5.4	1.3	1.6	2.2	2.2	2.4	2.1
- mainly public sector services	5.2	3.1	3.5	3.5	4.1	4.9	1.3	1.6	2.0	2.1	1.7	2.0
Unit labour costs, nominal*	1.8	1.2	3.0	3.1	3.8	5.9	0.8	0.7	1.7	2.1	2.4	2.2
Unit labour costs, real**	1.0	-0.3	0.8	1.2	1.5	3.0	-0.1	-0.3	0.5	0.6	0.9	0.6
	<i>in %</i>											
LFS unemployment rate	8.0	6.6	5.1	4.4	4.8	4.2	10.0	9.1	8.2	7.9	8.1	7.5
Foreign trade	<i>y-o-y growth rates in %</i>											
Current account balance as % of GDP***	4.8	6.1	5.7	5.7	5.5	5.3	3.1	3.2	2.9	2.9	2.8	2.7
External trade balance as contr. to GDP growth in pp	0.4	1.0	-0.2	-0.8	0.8	-1.3	-0.4	0.5	0.5	-0.5	0.0	0.0
Real export of goods and services	6.5	10.8	6.6	6.5	7.9	9.4	3.0	5.4	3.5	2.3	3.0	1.8
Real import of goods and services	6.7	10.7	7.7	8.2	7.7	12.3	4.2	4.8	2.8	3.7	3.4	2.0
Financing	<i>in % of GDP</i>											
Banking system's balance sheet	99.3	94.0	88.6	88.6	88.8	88.9	276.2	261.2	257.2	257.2	266.1	269.2
Loans to NFCs	22.5	21.8	20.6	20.6	20.5	20.2	37.9	37.0	36.6	36.6	36.5	36.7
Loans to households	21.1	21.5	21.8	21.8	21.7	21.8	49.5	49.5	49.2	49.2	49.1	49.2
Inflation	<i>in %</i>											
HICP	-0.2	1.6	1.9	2.0	1.3	1.7	0.2	1.5	1.8	1.9	1.4	1.4
HICP excl. energy, food, alcohol and tobacco	0.7	0.7	1.0	1.2	1.6	1.8	0.8	1.0	1.0	1.0	1.0	1.1
Public finance	<i>in % of GDP</i>											
Debt of the general government	78.7	74.1	70.4	70.4	68.1	67.7	89.2	87.0	85.1	85.1	85.9	...
One year net lending/net borrowing of the general government***	-1.9	0.0	0.8	0.8	0.6	0.6	-1.6	-1.0	-0.5	-0.5	-0.6	...
- interest payment***	3.0	2.5	2.0	2.0	1.9	1.8	2.1	2.0	1.9	1.9	1.8	...
- primary balance***	1.1	2.5	2.8	2.8	2.5	2.4	0.6	1.0	1.3	1.3	1.2	...

Notes: Data is not seasonally and working days adjusted.

* Nominal unit labour costs are the ratio of nominal compensation per employee to real labour productivity.

** Real unit labour costs are the ratio of nominal compensation per employee to nominal labour productivity.

*** 4-quarter moving sum.

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