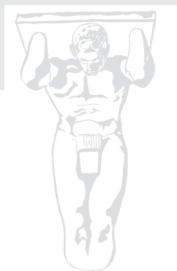


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SUMMARY OF MACROECONOMIC DEVELOPMENTS

JULY 2018

Summary of macroeconomic developments, July 2018

International institutions are still mostly assessing the global economic outlook as favourable, although the risks to growth in global trade have increased significantly in recent months because of growing protectionism. At the same time, the first quarter saw a slight slowdown in economic growth in certain major economies, including the euro area. However, the situation in the euro area remains stable and favourable for now: after previously declining, the economic sentiment indicator remained high in the second quarter, and is signalling a continuation of solid economic growth. The monetary policies of the ECB and the Fed remain highly divergent. At its June meeting, the Fed again raised its key interest rate while the ECB announced the gradual scale-back of net bond purchases within the framework of the APP, while simultaneously maintaining the current interest rate levels at least through the summer of 2019. This was one of the reasons for the additional fall in the euro exchange rate against the US dollar, which approached USD 1.15 in June, the lowest this year. At the same time inflation pressures strengthened again on international commodity markets, as commodity prices in June were up significantly, compared to the previous year.

Economic growth in Slovenia slowed in the first quarter, and was largely driven by domestic demand factors. A slowdown in the current rate of growth and a strong base effect reduced year-on-year GDP growth from 6.0% in the final quarter of last year to a still-high 4.6%. Growth in foreign demand slowed, and with it growth in industrial production and certain services. At the same time, the build-up of inventories brought increased growth in domestic demand. This was also attributable to sustained growth in private consumption, as the factors strengthening household purchasing power remained favourable. All types of investment continued to increase, and there was particularly encouraging growth in investment in intellectual property products, which could contribute to an increase in the productive efficiency of the economy. Growth in exports slowed more sharply than growth in imports, taking the contribution made by net trade into negative territory for the first time in a long time. The available figures for the second quarter suggest the continuation of more moderate economic growth, with the positive impulses prevalingly coming from the domestic environment.

The change in the structure of economic growth has not yet been reflected in the current account surplus, while the positive saving-investment gap is also yet to indicate any changes in the funding of this growth. The former remained highly positive at 7.5% of GDP over the 12 months to April, which was largely attributable to the maintenance of the external competitiveness of the economy, which was reflected in a continuing solid growth in exports, and to the narrowing of the deficit in capital income. In the 12 months to the first quarter, the saving-investment gap was also highly positive, although the investment cycle and growth in household consumption are continuing. This was attributable to the current surplus in government financing, slower growth in household lending, and a change in the pattern of corporate financing. Firms are increasingly relying on internal resources and intra-sectoral financial resources while the proportion of their financial structure accounted for by bank financing is undergoing a sustained decline.

In an environment of high economic growth, higher inflation and firms' increasing problems with labour shortages, wage growth is strengthening, and the first signs of a slowdown in employment growth have appeared. Nominal year-on-year growth in the average gross wage increased to 4.6% in April, up almost 2 percentage points on a year earlier. Wage growth increased in the majority of sectors facing the largest labour shortages. Although year-on-year growth in employment reached 3.0% in the first quarter, the monthly figures for the workforce in employment and the decline in employers' employment expectations are already indicating a slowdown. In this situation, consumer purchasing power is increasing rapidly: real year-on-year growth in the wage bill averaged 6.1% over the first four months of the year.

The general government position moved into surplus in the 12 months to March. According to the Ministry of Finance forecasts in April's supplement to the Stability Programme, which was drawn up under the assumption of no changes in policy, the surplus is forecast to reach 0.4% of GDP this year. According to these forecasts, the general government position will also fluctuate around this level over the next two years. Slovenia would nevertheless not be meeting the requirements of the Stability and Growth Pact, as it would be failing to have the structural deficit converge on the target with sufficient speed. Generating budget surpluses of the right size is vital in the current favourable economic situation. The key is to avoid measures that would cause a deterioration in the structural fiscal position, as general government debt remains high.

Inflation is strengthening, and is embracing more and more price categories. The rate reached 2.3% in June, and continued to outpace the euro area average, which rose to 2.0%. The jump in inflation in Slovenia was primarily the result of higher energy prices caused by rises in oil prices on the global market, but price growth was also driven by consistently high contributions of services prices. Core inflation also strengthened as a consequence, as the ongoing robust growth in private consumption brought by high consumer confidence and rising consumer purchasing power is already allowing retailers to raise prices more significantly. Domestic cost pressures, most notably higher wage growth, have perhaps also begun to contribute to the rise in core inflation, although a more precise assessment will only be possible with the release of the national accounts for the second quarter of this year. The proportion of prices falling or recording growth of less than 1.0% has declined further this year, an indication of the spread of inflation across the basket of prices in the HICP.

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There are signs of possible excessive growth of the residential real estate prices. According to SURS figures, overall residential real estate prices in the first quarter were up more than 13% in year-on-year terms, while new-build prices increased for over a quarter. This further approached the imbalanced high levels seen in the pre-crisis period. The model assessment, which has slightly less reporting value owing to the short nature of the time series, suggests that the current level of residential real estate prices is still in line with supply and demand factors. However, the dynamic in certain indicators is perhaps already suggesting possible excessive growth of the residential real estate prices, most notably the indicator of the real amount of construction put in place, which is displaying a similar dynamic to that recorded during the creation of the real estate bubble before the crisis. The actual level of the indicator is nevertheless still significantly lower than in 2005, which could indicate that price corrections as a result of new supply cannot be expected in the short term.

Main macroeconomic indicators

	2015	2016	2017	17Q3	17Q4	18Q1	2015	2016	2017	17Q3	17Q4	18Q1
	Slovenia						euro area					
Economic developments	y-o-y growth rates in %											
GDP	2.3	3.1	5.0	4.5	6.0	4.6	2.1	1.8	2.4	2.5	2.6	2.2
- industry	1.4	4.4	7.9	8.2	10.3	6.4	3.8	1.9	3.0	3.2	4.1	2.5
- construction	-1.6	-4.4	11.4	5.6	16.2	12.0	0.7	1.3	3.0	2.9	3.3	3.1
- mainly public sector services	1.4	2.9	2.0	1.2	2.5	1.8	0.9	1.4	1.3	1.4	1.2	1.4
- mainly private sector services	2.4	3.2	6.0	5.5	7.1	5.0	2.2	1.8	2.7	2.9	2.9	2.4
Domestic expenditure	1.8	2.9	4.1	2.9	4.5	5.3	2.0	2.3	1.9	1.8	1.4	1.9
- general government	2.7	2.5	2.3	1.7	5.6	0.6	1.3	1.8	1.2	1.3	1.3	1.4
- households and NPISH	2.1	4.2	3.2	3.0	3.2	3.4	1.8	2.0	1.6	1.8	1.3	1.7
- gross capital formation	0.2	-0.1	8.4	3.8	7.7	14.7	3.4	3.5	3.4	2.2	1.8	2.6
- gross fixed capital formation	-1.6	-3.6	10.3	7.4	11.9	9.1	3.3	4.6	3.2	2.3	2.4	3.7
- inventories and valuables, contr. to GDP growth in pp	0.3	0.7	-0.3	-0.6	-0.8	1.3	0.0	-0.2	0.1	0.0	-0.2	-0.2
Labour market												
Employment	1.2	1.9	2.8	2.7	2.7	3.0	1.0	1.4	1.6	1.7	1.6	1.4
- mainly private sector services	1.4	1.9	2.9	2.8	2.9	3.2	1.0	1.3	1.7	1.8	1.7	1.5
- mainly public sector services	0.8	2.2	2.5	2.2	2.2	2.2	1.1	1.4	1.3	1.2	1.3	1.1
Labour costs per employee	1.4	2.8	2.8	2.8	4.0	3.6	1.5	1.2	1.6	1.6	1.7	2.0
- mainly private sector services	1.6	2.2	2.7	2.4	4.1	3.8	1.6	1.2	1.6	1.7	1.8	2.1
- mainly public sector services	0.7	5.2	3.0	2.9	3.0	3.4	1.2	1.2	1.6	1.6	1.6	1.7
Unit labour costs, nominal*	0.4	1.6	0.6	1.0	0.8	2.1	0.4	0.8	0.8	0.8	0.7	1.2
Unit labour costs, real**	-0.6	0.7	-1.4	-1.3	-1.4	-0.1	-1.0	0.0	-0.3	-0.5	-0.4	-0.1
	in %											
LFS unemployment rate	9.0	8.0	6.6	6.3	5.8	5.9	10.9	10.0	9.1	8.7	8.7	8.9
Foreign trade	y-o-y growth rates in %											
Current account balance as % of GDP	4.5	5.5	7.1	9.0	5.9	8.1	3.2	3.6	3.5	4.6	4.5	2.9
External trade balance as contr. to GDP growth in pp	0.6	0.5	1.3	1.9	1.7	-0.2	0.1	-0.4	0.6	0.9	1.3	0.5
Real export of goods and services	5.0	6.4	10.6	11.9	12.3	7.4	6.4	3.3	5.3	5.3	6.2	3.7
Real import of goods and services	4.7	6.6	10.1	10.7	11.1	8.7	6.7	4.6	4.3	3.8	3.8	3.0
Financing	in % of GDP											
Banking system's balance sheet	107.0	99.2	93.3	94.5	93.3	91.2	281.7	276.7	261.4	268.4	261.4	261.4
Loans to NFCs	26.3	22.5	21.7	22.2	21.7	21.3	38.8	37.9	37.0	37.1	37.0	37.0
Loans to households	21.1	21.1	21.4	21.4	21.4	21.3	49.8	49.6	49.5	49.5	49.5	49.3
Inflation	in %											
HICP	-0.8	-0.2	1.6	1.3	1.5	1.5	0.0	0.2	1.5	1.4	1.4	1.3
HICP excl. energy, food, alcohol and tobacco	0.3	0.7	0.7	0.8	0.6	0.8	0.8	0.9	1.0	1.2	0.9	1.0
Public finance	in % of GDP											
Debt of the general government	82.6	78.6	73.6	78.5	73.6	75.1	89.9	89.0	86.7	88.1	86.7	...
One year net lending/net borrowing of the general government	-2.9	-1.9	0.0	-0.5	0.0	0.4	-2.0	-1.5	-0.9	-1.0	-0.9	...
- interest payment	3.2	3.0	2.5	2.6	2.5	2.4	2.3	2.1	2.0	2.0	2.0	...
- primary balance	0.4	1.1	2.5	2.1	2.5	2.8	0.3	0.6	1.1	1.0	1.1	...

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.

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

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