BANKA SLOVENIJE

BANK OF SLOVENIA

EUROSYSTEM

SUMMARY OF MACROECONOMIC DEVELOPMENTS

OCTOBER 2017

Summary of macroeconomic developments, October 2017

Global economic growth is strengthening, which the OECD has continued to highlight in its latest forecasts. The euro area economy is also strengthening, which is evidenced by the favourable indicators of economic sentiment. The latest weighted forecasts based on the Consensus forecasts suggest that aggregate GDP growth in Slovenia's main trading partners will strengthen further in 2017 and 2018, which will maintain high growth in Slovenian exports. The monetary policies of the ECB and the Fed remain divergent. Despite this, the euro has strengthened against the US dollar this year. The price of a barrel of Brent crude rose significantly in recent months to reach USD 59 at the end of September, its highest level of the last two years, although the impact on inflation in the euro area has been partly neutralised by the rise in the euro.

Economic growth in Slovenia remains high and balanced. In the second quarter of this year, the economy moved from the recovery phase into the expansion phase. GDP in the second quarter was up 1% on its pre-crisis peak, albeit with a significantly different structure and certain unexploited growth potentials. These primarily relate to the ratio of investment to GDP, which is notably below the euro area average, which is unusual for an economy in the phase of catch-up with more advanced competitors. From a developmental perspective, the most problematic issue is slow growth in investment in R&D. High growth in industrial production, high capacity utilisation in the export sector, and strengthening economies in the international environment are all indicative of the additional need to invest in production capacity. At the same time demand for construction work is gradually strengthening, but has not yet been fully reflected in construction activity itself. Growth in private consumption has slowed this year, in the wake of slightly lower real growth in the wage bill. While exports remained competitive, the slowdown in growth in domestic demand aggregates was reflected in net trade, which accounted for 1.1 percentage points of the GDP growth of 4.4% in the second quarter. According to various survey indicators, economic growth will remain rapid in the months ahead.

Employment growth remains high in the majority of sectors in the wake of a rapid fall in unemployment and increasing structural imbalances on the labour market. Firms are increasingly addressing the issue of the shortage of workers by recruiting agency staff and foreign nationals. The number of registered unemployed stood at 80,990 in September, down 14.9% in year-on-year terms. Structural unemployment is also falling, albeit slowly, as the number of long-term unemployed gradually declines. The registered and surveyed unemployment rates have both been declining since 2014, and according to current figures are now only 2 percentage points above their levels in the period of the overheating in 2007 and 2008. In the wake of the rapid decline in the excess labour supply, the first signs are perhaps being seen of slightly faster growth in wages. In the context of high employment growth, year-on-year growth in the wage bill averaged 5.6% in nominal terms over the first seven months of the year, and 3.9% in real terms. Developments on the labour market are nevertheless not yet hindering external competitiveness: growth in unit labour costs is less than the average across the euro area. A shortage of labour will however be one of the main challenges to the maintenance of high economic growth. A sharp rise in labour productivity and value-added by means of investment targeting high-tech sectors is necessary.

The surplus of trade in merchandise and services has been increasing again this year, as export growth outpaces import growth despite negative terms of trade and the strengthening of the domestic market. There has also been a slight narrowing of the deficit in income, largely because of a decline in interest payments on long-term securities brought by the restructuring of government debt and the implementation of monetary policy via purchases of Slovenian government bonds. The 12-month current account surplus reached 5.7% of GDP in June. The large surplus is the result of the de-

cline in investment in the first wave of the crisis, and later in final consumption after the introduction of government austerity measures, which in the breakdown of GDP were compensated for by the trade surplus. In this surplus there is potential space for a further increase in domestic final consumption and in investment, which should be limited by export growth if the economy wishes to maintain a positive external position over the long term. A trade surplus will be required for covering the deficit in income, on which the increase in foreign ownership of the economy will have a strong impact via reinvested earnings and dividends.

After declining for several years, bank lending to the corporate segment is reviving in 2017. Firms are primarily raising long-term loans, which are favourable from the perspective of the financing of investment, although the total stock of loans raised remains small for now. The banks are increasingly encouraging household lending through favourable terms, consumer loans in particular. Otherwise the banks are increasingly returning to their basic business of lending to the non-banking sector, which in conjunction with rising portfolio quality is producing a good outlook for the financing of future economic activity.

The general government deficit is continuing to narrow, which is attributable to the favourable economic situation and the maintenance of certain austerity measures. The Ministry of Finance is forecasting a general government deficit of 0.8% of GDP for this year, and a further improvement in fiscal performance within the framework of the drafting of the state budgets for 2018 and 2019. A surplus of 0.4% of GDP is being planned for next year. Because Slovenia is moving into the territory of a positive output gap, and the general government debt is relatively high (it stood at almost 80% of GDP in the second quarter of this year), it is vital to generate budget surpluses. Cyclical revenues should be directed into generating savings and reducing debt.

This year's developments in inflation as measured by the HICP have reflected external price shocks on international markets, although some have also been the result of one-off developments on the domestic market. After rising sharply at the beginning of the year, inflation fell and has stabilised at 1.4% in recent months. Core inflation remains low, despite strengthening domestic consumption. It is close to but below the euro area average. This is primarily attributable to prices of non-energy industrial goods, which have been falling for nine years now. The positive economic developments in recent years and the improvement in the situation on the labour market have been rapidly reflected in services prices, growth in which has been close to 2% for more than a year now. The resumption of growth in global oil prices and other commodity prices on the global market has brought a renewed increase in price pressures from imports since July, while according to SURS survey data both firms and households are anticipating price growth over the short term.

Main macroeconomic indicators

	2014	2015	2016	16Q4	17Q1	17Q2	2014	2015	2016	16Q4	17Q1	17Q2
	Slovenia						*euro area*					
Economic developments	*y-o-y growth rates in %*											
GDP	3.0	2.3	3.1	3.5	5.1	4.4	1.3	2.0	1.8	1.6	2.6	1.7
- industry	4.6	1.4	4.4	4.1	7.0	6.6	2.7	4.2	1.8	1.8	3.6	0.9
- construction	10.5	-1.6	-4.4	1.4	13.0	11.3	-0.9	0.2	1.7	1.0	3.9	2.5
- mainly public sector services	-0.1	1.4	2.9	3.4	2.5	2.1	0.5	0.9	1.2	1.2	1.5	1.1
- mainly private sector services	4.6	2.4	3.2	3.9	6.1	5.4	1.5	2.1	1.8	1.6	2.8	1.7
Domestic expenditure	1.7	1.8	2.9	4.7	5.6	3.7	1.3	1.9	2.3	2.0	2.4	2.0
- general government	-1.2	2.7	2.5	1.1	0.9	1.2	0.7	1.3	1.7	1.6	1.1	1.3
- households and NPISH	1.9	2.1	4.2	6.4	4.1	3.2	0.8	1.7	2.1	1.9	1.6	1.7
- gross capital formation	3.8	0.2	-0.1	3.8	14.1	7.4	3.2	3.2	3.6	2.8	6.0	3.4
- gross fixed capital formation	1.1	-1.6	-3.6	0.7	12.8	7.9	1.7	3.1	4.4	3.7	5.3	2.8
- inventories and valuables, contr. to GDP growth in pp	0.5	0.3	0.7	0.5	0.5	0.0	0.3	0.0	-0.1	-0.2	0.2	0.1
Labour market												
Employment	0.4	1.2	1.9	2.4	2.9	2.8	0.6	1.0	1.4	1.4	1.6	1.6
- mainly private sector services	0.4	1.4	1.9	2.3	2.9	2.9	0.5	1.0	1.4	1.4	1.6	1.7
- mainly public sector services	0.4	0.8	2.2	2.7	3.0	2.5	0.9	1.0	1.3	1.2	1.4	1.3
Labour costs per employee	1.3	1.4	2.8	2.1	1.7	2.5	1.4	1.3	1.2	1.3	1.5	1.5
- mainly private sector services	2.4	1.6	2.2	1.7	1.9	2.4	1.5	1.3	1.2	1.2	1.5	1.6
- mainly public sector services	-2.1	0.7	5.2	5.2	4.2	3.0	1.1	1.2	1.3	1.4	1.4	1.4
Unit labour costs	-1.9	0.4	1.6	0.7	-0.7	0.5	0.6	0.4	0.9	1.1	0.5	1.5
- industry	-0.9	1.3	0.7	1.1	-1.6	-0.3	-0.9	-2.2	0.1	0.2	-1.0	1.9
	in %											
LFS unemployment rate	9.8	9.0	8.0	8.1	7.8	6.4	11.7	10.9	10.0	9.8	9.9	9.0
Foreign trade	*y-o-y growth rates in %*											
Current account balance as % of GDP	5.8	4.4	5.2	4.3	4.5	6.4	2.3	0.0	0.0	0.0	0.0	0.0
External trade balance as contr. to GDP growth in pp	1.4	0.6	0.5	-0.9	0.1	1.1	0.1	0.1	-0.4	-0.4	0.3	-0.2
Real export of goods and services	5.7	5.0	6.4	5.6	9.5	8.3	4.6	6.6	3.2	2.9	5.9	3.2
Real import of goods and services	4.1	4.7	6.6	7.5	10.7	7.9	4.7	6.8	4.6	4.2	5.9	4.1
Financing	*in % of GDP*											
Banking system's balance sheet	115.7	107.0	99.2	99.2	99.0	96.2	297.5	282.3	276.7	276.7	278.3	273.3
Loans to NFCs	31.2	26.3	22.5	22.5	22.8	22.5	40.2	38.9	38.0	38.0	37.9	37.7
Loans to households	21.3	21.1	21.1	21.1	21.2	21.3	50.5	49.9	49.5	49.5	49.4	49.4
Inflation	*in %*											
HICP	0.4	-0.8	-0.2	0.7	2.0	1.4	0.4	0.0	0.2	0.7	1.8	1.5
HICP excl. energy, food, alcohol and tobacco	0.6	0.3	0.7	0.8	0.7	0.8	0.8	0.8	0.9	0.8	0.8	1.1
Public finance	*in % of GDP*											
Debt of the general government	80.3	82.6	78.5	78.5	80.2	79.8	91.9	90.1	89.0	89.0	89.3	…
One year net lending/net borrowing of the general government	-5.3	-2.9	-1.9	-1.9	-1.5	-1.2	-2.6	-2.1	-1.5	-1.5	-1.3	…
- interest payment	3.2	3.2	3.0	3.0	3.0	2.9	2.7	2.4	2.2	2.2	2.2	…
balancedeficit	-2.1	0.3	1.1	1.1	1.5	1.7	0.1	0.3	0.7	0.7	0.9	…
- balance excl. bank recapitalisations	-4.4	-2.9	-1.9	-1.9	-1.5	-1.2						
- primary balance excl. bank recapitalisations	-1.1	0.3	1.1	1.1	1.5	1.7						

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