[SLIDE 1]

[introductory greeting]

First, let me emphasize that Bank of Slovenia is dedicated supporter of your association as it is clearly seen from numerous members from our institution. Needless to say also that most of the ACI members and their respective institutions are Bank of Slovenia's counterparties in our daily operations, so we share same vision and ethical standards, which is to my personal view of crucial importance.

Regarding the fact that your program includes some specialized financial topics and that speakers are highly distinguished professionals, I thought to talk today about something different, however still as fresh as possible. So I propose, if you allow me, to present our macroeconomic projections, which have been published early this week. It is the presentation of projections for GDP growth and inflation for the period 2019-2021 and some underlying factors behind these estimates.

[SLIDE 2]

Let's starting with a short summary.

After the crisis Slovenia experienced quite a favorable GDP growth after 2014. We had the peak in 2017, and also the 2018 economic growth was among highest in the Euro Area, with GDP growth od 4.9 and 4.5%, respectively.

Accommodative monetary policy, solid foreign demand and a reviving labour market, among others, contributed to a relatively robust pace of growth in this period. We now expect that the economy has reached its peak and that we are now entering into a mature phase of the business cycle.

Our projections show that in 2019 and upcoming two years GDP growth will be somehow more moderate, jet still favourable. On general, factors that push GDP growth downwards are external factors, whereas domestic factors tend to be highly positive. I will elaborate later a bit more.

As regards the inflation. In last two years, it has been on the path towards normalization again after long period of inflation rate around 0% plus/minus something. We expect the inflation to reach 2% by 2020.

What drives these figures most strongly are developments on labour market, which remain favourable and I will come to details later on.

There are numerous risks behind these projections. Risks related to the GDP growth are tilted downwards, mostly due to uncertainties in the external environment. On the other hand, risks to HICP inflation are tilted slightly upwards, mainly due to oil price developments and potentially stronger labour cost growth.

[SLIDE 3]

And now the actual projections. First the GDP growth.

The graph on the left hand side shows actual GDP growth until 2018 and projections afterwards until 2021. As already said, after the peak in 2017 and favorable economic growth in 2018, we are now entering into a mature phase of the business cycle, with economic growth around 3%.

Before going into details of the projections, let me first outline some factors, which determine our current projections.

First, the global economy. There are numerous developments on global level, which have contributed to a weakened global trade, decreased confidence among key sectors and consequently resulted in global growth momentum loss especially in the second half of 2018. These of course influenced also our projections. To name few of them:

- escalation of trade tensions between China and US,
- vulnerabilities in emerging market economies,
- disruptions in the automotive industry in Germany,
- cyclical slowdown in China,
- heightened geopolitical tensions with Brexit and the Middle-East.

Second, euro area economy. For the euro area, the slowdown was primarily a result of developments in the manufacturing sector. While a gradual moderation of growth **was** expected due to maturity of the business cycle, already mentioned external factors hit euro area growth sooner and to a larger extent than initially anticipated.

Lastly, developments of Slovene economy. As said, given the high synchronization of Slovene and euro area business cycles, the external factors pushed our estimates of GDP growth down quite substantially, which can be seen also from the graph on the right hand side. Both, net foreign trade and also gross fixed investment, are to a large extend the result of trends and uncertainties coming from the outside. For example, dynamics and risks in the external environment determined the volume of new orders and lowered business confidence especially in manufacturing, causing also slower pace of anticipated private investments.

However and fortunately, there are internal factors, mainly private consumption, that will at least partially offset lower contribution of the two mentioned categories.

So, compared to our December 2018 projections, we expect slightly lower GDP growth in 2019 and 2020 (for 0.2 and 0.1 pp, respectively) and we keep the estimate for 2021 intact.

[SLIDE 4]

Even though our profile of growth is determined by both domestic and external factors, domestic components **do** prevail as the main drivers of growth, primarily due to encouraging labour market developments. So, let's focus a little bit on private consumption and labour market.

Throughout the projection horizon, the labour market will continue to be characterized by accelerated wage growth, continued employment growth and decreasing unemployment rate.

Compared to previous projections, wage growth is expected to strengthen markedly in 2019 and 2020 due to:

- agreements reached with public sector trade unions,
- the increase of minimum wage,
- public sector employment, and
- labour market tightness and structural imbalances.

The pace of employment growth is expected to strengthen further in 2019 and the unemployment rate tend to stabilize just above 4%.

We expect these trends will be reflected in higher growth of private consumption throughout the entire projection horizon. However, there are also some strategic and longer-term implications.

Let me first mention two interesting facts:
1. By the 2019 around **2/3s** of newly employed workers in Slovenia came from abroad.
2. More than 70% of the aggregate growth in employment resulted from employment in activities with **below-average** wages.

With wage growth slightly surpassing productivity growth, unit labour costs will increase, and **as such** may impact the cost competitiveness of the Slovenian export sector.

Rising labour costs and the lack of properly trained workforce are at the same time expected to facilitate technological and automation efforts across companies, supporting the profile of private investments in machinery and equipment in the medium-term and a higher productivity growth. I'm talking about the very same investments that we have been somehow lacking to see in the near past as companies have been rising production – on general – rather with increase of employed than with investments in higher productivity.

[SLIDE 5]

Turning to investments. The general profile of investment growth is expected to moderate yet remain favourable throughout the horizon – see also slide 3.

The strong pace of government investment is expected to continue in the short-term, driven by the execution of large infrastructure projects and growing utilization of EU funds.

Conversely, compared to previous years, growth of private investments is expected to continue to moderate in the short-term. In the medium term, however, we expect for growth of private investment into machinery and equipment to revive gradually, especially due to capacity utilization constraints.

Note that these investments are also necessary conditions for a faster productivity growth.

Besides investment into machinery and equipment, we expect also solid growth of residential investment that – given the favourable developments in the labour market and the relatively low interest rates – will remain solid throughout the horizon.

[SLIDE 6]

Regarding the nominal side, inflation – as measured by HICP – has been revised downwards throughout the projection horizon especially for 2019. Nevertheless, in it is expected achieve 2% in 2020.

The downward pressure on inflation is attributed to the developments in the external environment, which has affected the prices of non-energy industrial goods in particular. Due to their highly tradable nature, their profile is heavily impacted by foreign demand dynamics, which are expected to moderate significantly in the short-term.

On the other hand, the strong dynamics of domestic factors will continue to support a strong increase of services prices, which will qualify as the main contributor to inflation.

[SLIDE 7]

Our current profile of growth projections is subject to numerous risks, originating from both the external and domestic environment.

As with the last projection round, the balance of risks to GDP remains on the downside and the source of the downward pressure continues to originate primarily from the external environment, which remains characterized by trade escalation threats and heightened geopolitical tensions. The materialization of these risks could significantly distort the current outlook for the country.

These external risks to GDP growth are partially offset by domestic risks, which are tilted on the upside and pertain predominantly to possible faster wage growth, which would strengthen private consumption further, and a more efficient utilization of EU funds and accelerated implementation of major infrastructure projects strengthening the pace of government investments.

On inflation, risks are tilted slightly upwards, mainly due to oil price developments and potentially stronger labour cost growth, whereas trade escalation threats and heightened geopolitical tensions could push inflation down a bit.

[SLIDE 8]

Our macroeconomic are broadly in line with projections of other institutions. There are no major differences at least for GDP growth. As regards inflation, there's a puzzle even on euro area level, where the inflation would be. Our (namely ECB's) estimates are on the upper bound of the range of several different econometric models.

[SLIDE 9]

So, to conclude. Slovenia has reached considerable macroeconomic achievements in last couple of years with GDP growth peaking in 2017 with 4.9% and slightly lower in 2018. In addition, the inflation has picked up from around zero level territory.

On one hand, we have quite a nice story to tell on macroeconomic developments and predictions for Slovenia. Our baseline scenario is in a way excellent with real GDP projected to grow at 3.2% this year and slightly below 3% in the upcoming two years and inflation reaching the target of 2% in already in 2020.

Economic growth tend to be broadly based and supported by favourable developments in domestic demand, especially stemming from favourable labour market developments.

We have observed high economic growth also in the pre-crisis period. However, Slovenia's economy is not the same as it was a decade ago. While it is more resilient in numerous aspects, it simultaneously faces challenges that shape its long-term dynamics. Contrary to the pre-crisis period growth, which was driven by large inflows of foreign funds through the banking sector, the current period of accelerated growth is underpinned by a banking sector that is less vulnerable to a liquidity shock as experienced in the crisis. The post-crisis period is largely characterized by stable domestic demand and an increase in investment through retained earnings. This stems from deleveraged firms that have built an equity cushion, making them more easily adjustable to post-crisis economic environment. Simultaneously, while households have increased their borrowing relative to the pre-crisis period, their indebtedness remains among the lowest across in the euro area.

On a more compositional aspect, the structure of growth has also changed. While previously labour productivity accounted for the main driver of growth, most recent growth is entirely different from that seen before the crisis in that it is primarily driven by strong growth of employment. In the medium term, a diminishing working age population due to demographic dynamics could not support the growth of employment any more. In the long run, the contribution of working labour force to growth is even estimated to be negative. Such a composition, to our mind, demands a shift across Slovene enterprises so that technological and automation efforts facilitate and shape production capacities.

We need to take into account that the current fiscal stance also characterizes a challenge, in particular in response to adverse shocks. While before the crisis, the government debt amounted to approximately 30% of GDP, last year it reached around 70%. This represents a significant difference and limitation in comparison to the pre-crisis period. The limitation is primarily attributed to the limited fiscal space in counteracting negative shocks to the economy.

On the other hand, we need to acknowledge that some major adverse developments in the world are indeed happening. I have mentioned some at them.

All these factors could potentially hit our economy in a negative way, maybe not during our latest projection horizon, but maybe on longer-term period. Therefore, this needs to be taken into consideration when interpreting our current projections.

[SLIDE 10]

[closing note]