BANKA SLOVENIJE

BANK OF SLOVENIA

EUROSYSTEM

SUMMARY OF MACROECONOMIC DEVELOPMENTS

APRIL 2019

Summary of macroeconomic developments, April 2019

The available figures for the first quarter of this year point to continued weak economic growth in the euro area. The economic sentiment declined again in March, while the manufacturing PMI reached its lowest level in almost six years. The monthly activity indicators were not promising in January, as industrial production and construction activity were both down in year-on-year terms. At the same time headline inflation was down significantly on last year. The ECB has already responded to the less favourable economic situation: in early March it announced a new series of TLRTOs beginning in September, and signalled that interest rates would be left unchanged until the end of 2019. Following the fall in the euro (on 28 March it was down 9.5% against the US dollar in year-on-year terms), the euro price of a barrel of Brent crude was up fully 7.8% in year-on-year terms at the end of March.

According to the economic sentiment indicators, economic growth in Slovenia may have slowed slightly in the first quarter of this year, although the situation remained significantly better than in the euro area overall. The economic sentiment in March remained down on the beginning of the year, but unchanged from February; firms' assessments of short-term growth in demand suggest a further slowdown in growth in foreign demand while the situation on the domestic market remains solid. These assessments were not yet entirely reflected in the activity indicators in January. After declining in December, industrial production in January was up 5.7% in year-on-year terms. In the wake of a deterioration in European industry in the first quarter, manufacturing firms' surprisingly low assessment of uncertainty in the economic situation was a positive. Growth in turnover in services in January was also up on December. Year-on-year growth in construction activity slowed after the local elections, and remained relatively low in January at 4.3%. Year-on-year growth in the composite activity indicator, which captures the aforementioned economic sectors, increased to 6.0% in January, slightly above the average of the final quarter of last year.

The situation on the labour market remains favourable from the perspective of continuing growth in demand on the domestic market, although at the same time it suggests the possibility of a deterioration in cost competitiveness. Year-on-year growth in persons in employment remains high, despite the structural imbalances on the labour market. Year-on-year growth in persons in employment excluding self-employed farmers stood at 3.1% in January, as the hiring of foreign nationals accounted for almost two-thirds of the growth. The number of vacancies remains high, although the survey indicators of employment expectations declined slightly. Year-on-year growth in the overall gross average wage rose to 4.2% in January, primarily as a result of the entry into force of an agreement on wage growth in the public sector and the resulting year-on-year rise of more than 10% in the average gross wage in public administration. Wage growth stood at 3.7% in the private sector. Higher wage growth in a context of slower economic growth and low productivity growth could lead to a deterioration in cost competitiveness, if such developments were significantly at odds with those in trading partners.

Slovenia's external position on the brink of a shift into a period of lower economic growth is significantly better than it was a decade ago. Weaker growth in foreign demand and the continuing buoyancy of the domestic market are reducing the merchandise trade surplus, although for now this is being compensated for by high growth in exports of services, while the deficit in capital income is also significantly smaller on account of past debt repayment and debt restructuring. The 12-month current account surplus again exceeded 7% of GDP in January. The surplus in domestic saving over investment is reducing the negative net international financial position, which stood at 26.7% of GDP at the end of last year, 23.3 percentage points less than in 2012, when the largest deficit was recorded. There has also been a significant *decline in the net external debt: it was down 9 percentage points last year alone at 13.8% of GDP. Only the government sector has been a net borrower from the rest of the world over the last two years.*

Inflation rose to 1.6% in March, still down 0.3 percentage points on last year's average rate. After falling in January, following a fall in oil prices on global markets at the end of last year, energy prices in March were already reflecting the renewed strengthening of euro oil prices. Year-on-year food price inflation was still slowing, as a result of a small year-on-year rise in processed food prices and a year-on-year fall in unprocessed food prices. The influence of external factors remains weaker compared with last year, while the pressures from the domestic environment are strengthening. Given the higher nominal growth in labour costs on the supply side, and increased purchasing power on the demand side, service price inflation remained high in March at 2.8%, while year-on-year growth in prices of non-energy industrial goods stood at around zero for the third consecutive month. The narrowest core inflation indicator has consequently risen significantly this year. It stood at 1.6% in March, the highest figure since 2009. The figure in the euro area overall stood at 1.1% in February.

The general government sector recorded a surplus in the amount of 0.7% of GDP last year, which was attributable to the favourable cyclical situation and a decline in interest payments. The general government debt declined to 70.1% of GDP. The structural position was close to balance, according to government estimates. In the draft budget plan for 2019, the government is forecasting a surplus of 0.6% of GDP, but the Fiscal Council and the European Commission are warning of the plans' failure to comply with fiscal rules and a possible deterioration in the structural balance. The ratio of general government debt to GDP is below the euro area average, although it is still forecast to exceed the reference value of 60% even after this year's reduction. This entails significantly less room for the government to act counter-cyclically in the event of a deterioration in the economic situation like just over a decade ago.

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Cost competitiveness of the Slovenian economy remained solid in 2018, while technological progress has been slow. Wages again moved largely in line with productivity in 2018, which meant that growth in real unit labour costs was very low, and below the averages in the euro area and in the EU overall. At the same time the euro exchange rate did not bring any significant deterioration in price competitiveness, and domestic inflation did not deviate significantly from the euro area average. But there was also no significant change in the technological complexity of merchandise exports. According to a survey of financing conducted by the Bank of Slovenia at the end of last year, it is difficult to expect any major changes even in the medium term, as the proportion of firms intending to invest in research and development is expected to remain more or less unchanged from its level between 2016 and 2018. Labour-extensive economic growth and insufficient focus on research and development are weak signs for Slovenia's ability to jump into creating higher value-added, and thereby to close the gap with more advanced European countries.

Main macroeconomic indicators

	2016	2017	2018	18Q2	18Q3	18Q4	2016	2017	2018	18Q2	18Q3	18Q4
	Slovenia						*euro area*					
Economic developments	*y-o-y growth rates in %*											
GDP	3.1	4.9	4.5	4.1	5.0	4.1	2.0	2.4	1.8	2.3	1.6	1.3
- industry	4.6	7.7	4.0	4.9	2.9	2.5	3.5	3.1	1.4	3.0	0.7	-0.1
- construction	-3.7	8.5	12.7	11.1	18.2	9.5	1.5	3.1	3.5	3.9	3.4	3.5
- mainly public sector services	2.3	1.6	2.1	2.3	1.8	2.1	1.3	1.1	1.1	1.2	1.0	1.1
- mainly private sector services	3.3	6.0	5.0	4.7	5.5	4.6	2.0	2.7	2.0	2.6	1.8	1.3
Domestic expenditure	2.9	3.9	4.6	3.8	5.0	3.7	2.4	1.7	1.7	1.6	2.0	1.6
- general government	2.7	0.5	2.6	4.9	2.6	1.5	1.8	1.1	1.0	1.1	0.9	1.2
- households and NPISH	3.9	1.9	2.2	1.9	1.3	2.1	2.0	1.6	1.3	1.3	0.9	1.2
- gross capital formation	0.0	13.2	12.6	7.7	16.9	10.0	4.3	2.4	3.4	2.8	5.8	3.3
- gross fixed capital formation	-3.7	10.7	10.6	10.3	13.8	8.3	4.0	2.6	3.0	3.3	3.3	2.6
- inventories and valuables, contr. to GDP growth in pp	0.7	0.6	0.6	-0.3	0.9	0.4	0.1	0.0	0.1	-0.1	0.5	0.1
Labour market												
Employment	1.8	2.9	3.0	3.0	2.8	2.8	1.4	1.6	1.5	1.6	1.4	1.3
- mainly private sector services	1.7	3.0	3.2	3.2	3.0	3.1	1.4	1.7	1.6	1.7	1.5	1.3
- mainly public sector services	2.2	2.6	2.0	2.1	1.9	1.8	1.4	1.3	1.2	1.3	1.2	1.1
Labour costs per employee	3.0	3.2	4.0	4.6	3.2	4.1	1.2	1.6	2.2	2.2	2.5	2.2
- mainly private sector services	2.4	3.2	4.0	4.7	3.4	4.1	1.2	1.7	2.3	2.3	2.6	2.1
- mainly public sector services	5.2	3.1	3.8	4.2	3.8	3.8	1.3	1.4	2.1	1.9	2.4	2.3
Unit labour costs, nominal*	1.8	1.2	2.5	3.5	1.1	2.8	0.6	0.8	1.9	1.5	2.3	2.1
Unit labour costs, real**	1.0	-0.3	0.2	0.7	-1.4	1.3	-0.2	-0.3	0.5	0.2	0.9	0.6
	in %											
LFS unemployment rate	8.0	6.6	5.1	5.2	5.0	4.4	10.0	9.1	...	8.2	7.8	...
Foreign trade	*y-o-y growth rates in %*											
Current account balance as % of GDP***	5.5	7.2	7.0	7.4	7.2	7.0	3.2	3.2	3.0	3.6	3.3	3.0
External trade balance as contr. to GDP growth in pp	0.5	1.3	0.3	0.6	0.5	0.7	-0.4	0.8	0.2	0.8	-0.2	-0.2
Real export of goods and services	6.4	10.7	7.2	8.6	5.4	6.8	3.0	5.2	3.0	4.4	2.8	1.8
Real import of goods and services	6.6	10.3	7.7	8.9	5.5	6.6	4.2	3.9	2.9	3.1	3.7	2.5
Financing	*in % of GDP*											
Banking system's balance sheet	99.3	93.9	88.3	91.0	89.2	88.3	275.7	260.7	256.7	260.9	259.0	256.7
Loans to NFCs	22.6	21.8	20.5	21.0	20.8	20.5	37.8	36.9	36.5	36.7	36.6	36.5
Loans to households	21.1	21.5	21.7	21.5	21.5	21.7	49.4	49.4	49.1	49.0	49.1	49.1
Inflation	*in %*											
HICP	-0.2	1.6	1.9	2.1	2.1	2.0	0.2	1.5	1.8	1.7	2.1	1.9
HICP excl. energy, food, alcohol and tobacco	0.7	0.7	1.0	1.0	1.1	1.2	0.8	1.0	1.0	1.0	1.0	1.0
Public finance	*in % of GDP*											
Debt of the general government	78.7	74.1	70.1	72.6	71.1	70.1	89.1	86.8	...	86.3	86.2	...
One year net lending/net borrowing of the general government***	-1.9	0.0	0.7	0.4	0.5	0.7	-1.6	-1.0	...	-0.5	-0.4	...
*- interest payment****	3.0	2.5	2.0	2.2	2.1	2.0	2.1	2.0	...	1.9	1.9	...
*- primary balance****	1.1	2.5	2.6	2.6	2.6	2.6	0.6	1.0	...	1.4	1.5	...

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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**** 4-quarter moving sum.*
Source: SORS, Eurostat, Bank of Slovenia, ECB, Ministry of Finance, Bank of Slovenia calculations.