BANKA SLOVENIJE

BANK OF SLOVENIA

EUROSYSTEM

SUMMARY OF MACROECONOMIC DEVELOPMENTS

JULY 2019

Summary of macroeconomic developments, July 2019

The outlook for the global economy is continuing to deteriorate because of rising trade and political tensions, which are weakening trade, industry and investment. The leading international institutions have cut their global economic growth forecasts for 2019 to around 3.1%, while growth in the euro area is forecast to barely exceed 1%. In the first quarter, economic growth in the euro area stood at just 1.2%, and is expected to have remained weak in the second quarter, given that the survey indicators remained rather low, particularly in industry. Central banks responded to the worsening situation, which improved the financial conditions, while fiscal policy is also becoming more expansive. The outlook for growth in foreign demand for Slovenian products has stabilised for now as the weighted forecast for this year's economic growth in the trading partners has stabilized after months of downward revisions. From the beginning of June, the euro rose slightly against the US dollar, and is currently down only around 4% on a year earlier. In the period from January to mid-July, the euro price of Brent crude was down 5.5% in year-on-year terms amidst substantial volatility.

Slovenia too is now finding itself in a period of lower economic growth, although it remains very solid compared with the euro area, and comparable to growth in the majority of the less advanced euro area economies. Although there is a great deal of uncertainty surrounding the European economy, and growth is low, for now the Slovenian export sector remains fairly robust. However, the situation in the manufacturing sector shows substantial variation. Some segments are already facing declining output, which was also the main reason for the run-down of inventories in the first quarter of this year. This was the main factor in the fall in year-on-year growth in domestic demand to 1.8% and in economic growth to 3.2%. Because inventories were also a major factor in the slowdown in growth in imports, their impact was partly offset by a large contribution to growth by net trade. Growth in other domestic demand aggregates has remained relatively high. Year-on-year growth in investment has strengthened slightly from the end of last year, while its structure is shifting towards construction. Growth in investment in machinery and equipment was again weak, which can primarily be attributed to the high-risk external situation. Private consumption has continued to strengthen, coinciding with increased growth in the real wage bill. According to the latest monthly activity and confidence indicators, economic growth is expected to have slowed slightly again in the second quarter, and the situation is thought to have been less favourable in industry in particular.

Employment growth is also slowing as economic growth slows. The first quarter saw the lowest rate for two years, albeit a reasonable 2.6%, mostly driven by the hiring of foreign nationals. The year-on-year fall in unemployment has slowed this year, partly on account of its structure, where the share of difficult-to-employ people is increasing. The surveyed and registered unemployment rates are both continuing to fall, the former to 4.8% in the first quarter, and the latter to 7.6% in April. Year-on-year nominal growth in the gross average wage stood at 4% in April, down on March because of a decline in extraordinary payments. Because productivity growth is low, these wage developments are already raising growth in unit labour costs. For now, the later remains within the limits that maintain external competitiveness as it does not exceed the euro area average substantially, and is actually somewhat lower than in Germany.

The current account surplus is gradually narrowing. It amounted to 5.4% of GDP in the 12 months to May, down 1 percentage point on a year earlier, after allowing for a fundamental revision to the balance of payments. There are various reasons for the narrowing surplus but the main factor is the decline in the merchandise trade surplus, as domestic final consumption is continuing to strengthen, judging by the import data. Growth in nominal merchandise exports remains surprisingly high, at least in comparison with the situation in European industry, but it is largely the result of strong *growth in the pharmaceutical industry, which is less sensitive to cyclical fluctuations. Growth in exports of a wide spectrum of services, which even at the European level are yet to feel a greater impact from uncertainty, also remains high. The surplus of trade in services is thus continuing to increase. As foreign direct investment strengthens, including via privatisation, the deficit in reinvested earnings and dividends is increasing, and reached 2.3% of GDP over the 12 months to May.*

This year, inflation is primarily being determined by domestic factors. Headline inflation reached 1.9% in June, the highest rate since last November, as services remain its primary driver. This is also being reflected in the narrowest core inflation indicator, which also reached 1.9% in June. The domestic inflationary pressures are primarily coming from wage growth, which is raising production costs, but is also allowing them to be passed through into final consumer prices via growth in demand. The higher labour costs are primarily being passed through into growth in services prices, as these are considerably less subject to international competition than industrial goods, or have a very specific position on the market in the case of public service providers. Inflationary pressures from the rest of the world have been relatively weak this year, as oil prices linger at lower levels than a year earlier, which is holding down growth in domestic energy prices. It was a similar case with food commodity prices until May, but they rose in year-on-year terms in June, and played a part in reviving year-on-year growth in food prices, alongside the year-on-year rise in import prices.

Slovenia's fiscal position remains favourable, thanks to the ongoing solidity of the business cycle, and there was also a further improvement in its position on international financial markets. In the first quarter, the general government one-year surplus amounted to 0.6% of GDP, down slightly on last year. General government revenues are continuing to increase relatively rapidly, particularly those tied to the labour market. On the general government expenditure side, investment continues to strengthen, while wage expenditure is also up in line with the agreement between the government and the trade unions. Government measures also resulted in a rise in social security benefits. The interest burden in still declining, and is helping in the consolidation of public finances, while the required yield on Slovenian 10-year government bonds was at historically low levels in early July. Growth in expenditure nevertheless slightly outpaced growth in revenues in the first quarter. There are several measures under preparation that will restructure the tax burden from labour to capital, and will intervene in social transfers and pensions. It is of key importance that the combination of all the measures ensures the long-term sustainability of the public finances, while it is vital to remember that the aging population will intensify the demographic pressures on the public finances.

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Slovenia has seen faster economic growth in the post-crisis period than the majority of other European countries, although it is characterised by labour-intensity, which goes hand in hand with low productivity growth and relatively weak R&D investment. Low productivity growth has even been a recent trait in manufacturing, where productivity has almost ceased catching up with more advanced economies. The level of investment in Slovenia is low for a country in the process of catching up with more advanced economies, while its structure is not the most encouraging, particularly from the perspective of development. Compared with more advanced EU countries, investment in research and development is low, while investment in machinery and equipment is lower than before 2008, despite tax advantages and favourable financial conditions. There is evidently insufficient incentive for a more intensive shift into using new technologies, as firms are achieving good performance, at least on aggregate, without any concerted efforts to make technological improvements. Transitioning into an economy with higher value-added per employee will be difficult without the more concerted use of new technologies and know-how, while the adverse effects of the aging population and the related fiscal sustainability issues will be larger.

Main macroeconomic indicators

	2016	2017	2018	18Q3	18Q4	19Q1	2016	2017	2018	18Q3	18Q4	19Q1
	Slovenia						*euro area*					
Economic developments	*y-o-y growth rates in %*											
GDP	3.1	4.9	4.5	5.0	4.1	3.2	1.9	2.4	1.9	1.7	1.4	1.0
- industry	4.6	7.7	4.0	2.9	2.5	2.8	3.3	3.0	1.2	0.6	-0.7	-0.7
- construction	-3.7	8.5	12.7	18.2	9.5	15.1	1.6	3.3	3.4	3.3	3.7	3.7
- mainly public sector services	2.3	1.6	2.1	1.8	2.1	1.6	1.2	1.1	1.2	1.1	1.2	1.2
- mainly private sector services	3.3	6.0	5.0	5.5	4.6	3.7	2.0	2.7	2.1	1.8	1.5	0.9
Domestic expenditure	2.9	3.9	4.6	5.0	3.7	1.8	2.4	1.8	1.8	2.0	2.0	1.1
- general government	2.7	0.5	2.6	2.6	1.5	3.6	1.8	1.2	1.0	0.8	1.1	1.1
- households and NPISH	3.9	1.9	2.2	1.3	2.1	2.6	1.9	1.7	1.3	0.9	1.2	0.9
- gross capital formation	0.0	13.2	12.6	16.9	10.0	-1.3	4.2	2.4	3.9	5.7	4.8	1.9
- gross fixed capital formation	-3.7	10.7	10.6	13.8	8.3	9.3	3.9	2.7	3.4	3.1	4.2	3.4
- inventories and valuables, contr. to GDP growth in pp	0.7	0.6	0.6	0.9	0.4	-2.1	0.1	0.0	0.1	0.6	0.1	-0.3
Labour market												
Employment	1.8	2.9	3.0	2.8	2.8	2.6	1.4	1.6	1.5	1.4	1.3	1.3
- mainly private sector services	1.7	3.0	3.2	3.0	3.1	2.9	1.4	1.7	1.6	1.5	1.4	1.3
- mainly public sector services	2.2	2.6	2.0	1.9	1.8	1.2	1.3	1.3	1.2	1.2	1.2	1.2
Labour costs per employee	3.0	3.2	4.0	3.2	4.1	4.3	1.2	1.6	2.3	2.5	2.2	2.3
- mainly private sector services	2.4	3.2	4.0	3.4	4.1	3.8	1.2	1.6	2.3	2.6	2.2	2.3
- mainly public sector services	5.2	3.1	3.8	3.8	3.8	4.3	1.4	1.5	2.2	2.4	2.3	2.2
Unit labour costs, nominal*	1.8	1.2	2.5	1.1	2.8	3.6	0.7	0.8	1.9	2.3	2.2	2.6
Unit labour costs, real**	1.0	-0.3	0.2	-1.4	1.3	1.4	-0.2	-0.3	0.5	0.9	0.6	1.0
	in %											
LFS unemployment rate	8.0	6.6	5.1	5.0	4.4	4.8	10.0	9.1	8.2	7.8	7.9	8.1
Foreign trade	*y-o-y growth rates in %*											
Current account balance as % of GDP***	4.8	6.1	5.6	6.1	5.6	5.5	3.1	3.2	2.9	3.1	2.9	2.8
External trade balance as contr. to GDP growth in pp	0.5	1.3	0.3	0.5	0.7	1.6	-0.3	0.7	0.2	-0.2	-0.5	-0.1
Real export of goods and services	6.4	10.7	7.2	5.4	6.8	7.6	3.0	5.1	3.2	2.9	2.4	2.1
Real import of goods and services	6.6	10.3	7.7	5.5	6.6	6.4	4.2	3.9	3.2	3.7	3.7	2.6
Financing	*in % of GDP*											
Banking system's balance sheet	99.3	93.9	88.3	89.2	88.3	88.5	275.5	260.5	256.4	258.8	256.4	265.4
Loans to NFCs	22.6	21.8	20.5	20.8	20.5	20.4	37.8	36.9	36.5	36.5	36.5	36.4
Loans to households	21.1	21.5	21.7	21.5	21.7	21.7	49.4	49.3	49.1	49.0	49.1	49.0
Inflation	*in %*											
HICP	-0.2	1.6	1.9	2.1	2.0	1.3	0.2	1.5	1.8	2.1	1.9	1.4
HICP excl. energy, food, alcohol and tobacco	0.7	0.7	1.0	1.1	1.2	1.6	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	71.1	70.1	67.9	89.2	87.1	85.1	86.4	85.1	...
One year net lending/net borrowing of the general government***	-1.9	0.0	0.7	0.5	0.7	0.6	-1.6	-1.0	-0.5	-0.4	-0.5	...
*- interest payment****	3.0	2.5	2.0	2.1	2.0	1.9	2.1	2.0	1.8	1.9	1.8	...
*- primary balance****	1.1	2.5	2.7	2.6	2.7	2.5	0.6	1.0	1.3	1.4	1.3	...

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