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BANK OF SLOVENIA

EUROSYSTEM

SUMMARY OF MACROECONOMIC DEVELOPMENTS

APRIL 2018

Summary of macroeconomic developments, April 2018

The economic figures and expectations in the international environment remain favourable, but the risks to global economic growth have increased significantly in recent weeks. The increased tension in the West's relations with Russia and China has already increased the uncertainty on international financial markets, and could lead to a decline in confidence in the real sector, slower growth in international trade and commodity price inflation on global markets. American sanctions have brought a fall in the ruble, and the beginning of capital flight from Russia. This could worsen the outlook for growth in Slovenia's export sector, which for now remains highly favourable, at least on the basis of the latest medium-term GDP forecasts for trading partners. Signs of a slowdown in growth in the euro area are also appearing, although the rate is nevertheless expected to remain higher than 2% this year. In the wake of the further divergence between the monetary policies of the Fed and the ECB, the euro is for now holding against the US dollar at its high level from the beginning of the year.

In the final quarter of last year, economic growth in Slovenia reached 6%, while the available figures suggest that growth remained elevated also in the first quarter of this year. The magnitude of the growth raises questions of its sustainability, but a comparison of the current structure of growth and funding with the period of overheating before the crisis reveals major differences. The economy is being driven to a greater extent by net exports, while wage growth is for now in line with the rise in productivity, and is not endangering external competitiveness. Corporate indebtedness is lower, as firms are largely financing themselves with internal resources. The external debt is declining, while the current account remains in large surplus. Headline inflation and core inflation remain low, particularly in relation to the high growth in domestic consumption. Fiscal policy also remained restrained last year. However, past experience suggests that caution is not misplaced, as macroeconomic imbalances build up over the long term, before becoming unsustainable.

The investment cycle is strengthening, primarily as a result of growth in construction investment. In the final quarter of last year, total gross fixed capital formation was up almost 12% in year-on-year terms, while construction investment was up more than 18%. Experience from the period of the overheating economy suggests that construction investment is an area of high risk, and that government policy plays an important role in it. Government construction investment contributed to the emergence from recession in 2013 and 2014, when private-sector investment was weak. Now the situation is different: the private sector is now increasing its investments, and is expected to be joined by the government sector through the increased disbursement of funds from the new European financial framework and through major infrastructure projects.

Another of the areas of potential imbalance is the labour market, or more precisely growth in labour costs owing to a shortage of labour. Growth in average wages, and even more notably in the wage bill, increased sharply at the end of last year and remained rather high in January, albeit with a significant change. While the wage growth in November and December was predominantly attributable to extraordinary payments, in January there was a rise in basic wages. Following the sharp fall in unemployment, and given the numerous indicators suggesting firms are having difficulties in finding qualified workers, the risks of higher growth in labour costs are increasing. Past experience suggests that in an environment of labour shortages wage growth is not curbed even by large-scale hiring of foreign labour. Because wages are downwardly rigid, in the event of a reversal in the economic cycle both the private sector and the public sector could again be faced with labour costs that would be unsustainable from the perspective of competitiveness and fiscal stability.

The fiscal position of the country improved significantly last year thanks to moderate growth in general government expenditure, the strong cyclical growth in revenues, and the reduction in the interest payment burden on outstanding debt. The improvement was greater than forecast by the government: the public finance position is now in balance for the first time, compared with the forecast of a deficit of 0.8% of GDP. At the same time the general government debt declined significantly in relative terms for the second consecutive year. It amounted to 73.6% of GDP at the end of the year, down 9 percentage points from its peak at the end of 2015. It also remained significantly below the euro area average. The risks in the fiscal realm nevertheless remain large, as the improved starting position and the projected high economic growth over the medium term could lead to a lack of moderation in the exercise of fiscal policy.

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The economic growth in Slovenia is currently strong but sustainable. Maintaining stability will nevertheless require caution in the exercise of domestic economic and corporate policy. The experience of the errors made in the pre-crisis period could prove useful in this regard. Given the rapid decline in the surplus supply of labour, wage growth at firms is expected to increase, but must nevertheless be held within boundaries that maintain external competitiveness. The inertia level of wages in the wake of reversals in GDP growth also needs to be taken into account. Firms must maintain healthy balance sheets and avoid the risk of over-indebtedness during the next reversal of the economic cycle, particularly in light of the deteriorating situation in the international environment. In the wake of the anticipated very gradual normalisation of monetary policy, the burden of balancing the economic cycle will largely fall on fiscal policy. This must continue to exercise restraint with regard to growth in general government expenditure, and must be financially neutral in any changes in taxation structures to ensure the required improvement in the structural public finance position. Another risk to be highlighted is an excessive increase in investment growth, which could be caused by the government through the disproportionate spending of European funds, the financing of major investment projects and an election-driven investment cycle. This could cause large fluctuations in economic growth, and could generate systemic imbalances in construction and other sectors.

Main macroeconomic indicators

	2015	2016	2017	17Q2	17Q3	17Q4	2015	2016	2017	17Q2	17Q3	17Q4
	Slovenia						*euro area*					
Economic developments	*y-o-y growth rates in %*											
GDP	2.3	3.1	5.0	4.5	4.5	6.0	2.1	1.8	2.4	1.8	2.5	2.5
- industry	1.4	4.4	7.9	6.4	8.2	10.3	3.9	1.9	3.0	1.0	3.2	4.0
- construction	-1.6	-4.4	11.4	11.4	5.6	16.2	0.4	1.7	2.7	2.1	2.5	2.7
- mainly public sector services	1.4	2.9	2.0	1.9	1.2	2.5	0.9	1.3	1.3	1.1	1.4	1.3
- mainly private sector services	2.4	3.2	6.0	5.6	5.5	7.1	2.2	1.8	2.6	1.9	2.8	2.8
Domestic expenditure	1.8	2.9	4.1	3.6	2.9	4.5	2.0	2.3	1.9	2.0	1.8	1.4
- general government	2.7	2.5	2.3	1.1	1.7	5.6	1.3	1.8	1.2	1.0	1.3	1.5
- households and NPISH	2.1	4.2	3.2	2.8	3.0	3.2	1.8	2.0	1.7	1.8	1.9	1.2
- gross capital formation	0.2	-0.1	8.4	8.4	3.8	7.7	3.4	3.8	3.2	3.4	2.3	1.7
- gross fixed capital formation	-1.6	-3.6	10.3	9.0	7.4	11.9	3.3	4.6	2.9	2.3	2.1	2.2
- inventories and valuables, contr. to GDP growth in pp	0.3	0.7	-0.3	0.0	-0.6	-0.8	0.0	-0.2	0.1	0.2	0.1	-0.1
Labour market												
Employment	1.2	1.9	2.8	2.8	2.7	2.7	1.0	1.3	1.6	1.6	1.7	1.6
- mainly private sector services	1.4	1.9	2.9	2.9	2.8	2.9	1.0	1.4	1.7	1.7	1.8	1.7
- mainly public sector services	0.8	2.2	2.5	2.5	2.2	2.2	1.0	1.3	1.3	1.2	1.3	1.3
Labour costs per employee	1.4	2.8	2.8	2.5	2.8	4.0	1.4	1.2	1.6	1.5	1.6	1.7
- mainly private sector services	1.6	2.2	2.7	2.4	2.4	4.1	1.5	1.2	1.6	1.4	1.6	1.7
- mainly public sector services	0.7	5.2	3.0	3.0	2.9	3.0	1.2	1.3	1.7	1.8	1.7	1.7
Unit labour costs	0.4	1.6	0.2	0.4	0.8	0.5	0.5	0.9	0.9	1.4	0.8	0.8
- industry	1.3	0.7	-1.2	-0.1	-2.2	-1.1	-1.8	0.0	-0.4	1.3	-0.5	-0.9
	in %											
LFS unemployment rate	9.0	8.0	6.6	6.4	6.3	5.8	10.9	10.0	9.1	9.0	8.7	8.7
Foreign trade	*y-o-y growth rates in %*											
Current account balance as % of GDP	4.4	5.2	6.4	5.4	6.1	6.4	0.0	0.0	0.0	0.0	0.0	0.0
External trade balance as contr. to GDP growth in pp	0.6	0.5	1.3	1.2	1.9	1.7	0.1	-0.4	0.6	0.0	0.7	1.2
Real export of goods and services	5.0	6.4	10.6	8.4	11.9	12.3	6.4	3.4	5.1	3.1	5.0	6.0
Real import of goods and services	4.7	6.6	10.1	7.7	10.7	11.1	6.7	4.8	4.3	3.5	3.9	3.9
Financing	*in % of GDP*											
Banking system's balance sheet	107.0	99.2	93.3	96.3	94.5	93.3	281.8	276.6	261.6	272.8	268.4	261.6
Loans to NFCs	26.3	22.5	21.7	22.5	22.2	21.7	38.8	37.9	37.1	37.6	37.1	37.1
Loans to households	21.1	21.1	21.4	21.3	21.4	21.4	49.8	49.6	49.5	49.6	49.5	49.5
Inflation	*in %*											
HICP	-0.8	-0.2	1.6	1.4	1.3	1.5	0.0	0.2	1.5	1.5	1.4	1.4
HICP excl. energy, food, alcohol and tobacco	0.3	0.7	0.7	0.8	0.8	0.6	0.8	0.9	1.0	1.1	1.2	0.9
Public finance	*in % of GDP*											
Debt of the general government	82.6	78.6	73.6	79.8	78.5	73.6	89.9	88.9	...	89.0	88.0	...
One year net lending/net borrowing of the general government	-2.9	-1.9	0.0	-1.0	-0.5	0.0	-2.1	-1.5	...	-1.2	-0.9	...
- interest payment	3.2	3.0	2.5	2.7	2.6	2.5	2.4	2.2	...	2.1	2.0	...
- primary balance	0.4	1.1	2.5	1.8	2.1	2.5	0.3	0.6	...	0.9	1.1	...

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