Hermine Vidovic

Slovenia:
Slipping into recession again

Given fiscal consolidation and the expected growth slowdown in Slovenia's most important EU trading partners, GDP will decline by 1% in 2012. A rebound of economic activity is expected only in 2013 since public investment will need time to recover and deleveraging of the enterprise sector is still going on. Household consumption will depend on improvements on the labour market. Slovenia's economic recovery will largely hinge on the success or failure of the new government.

GDP growth lost momentum from quarter to quarter and growth reached only 0.5% in the whole year 2011. Growth was backed by external demand, while household and government consumption remained stagnant and investments continued to decline. Gross fixed capital formation fell by 12%, hitting particularly the construction sector where the output contraction continued: in 2011 construction fell by another 25%, which is the largest drop since the outbreak of the crisis; the negative tendencies were felt equally in all segments of the construction sector, with residential building suffering most (investment in machinery and equipment fell as well). Future prospects are gloomy as well since the value of construction orders has fallen significantly recently.

During 2004-2008 Slovenia's construction industry was one of the most booming in Europe, increasing its share in GDP from 5.8% to 8.5%; however, this success was based on excessive borrowing. The dramatic drop of construction output thereafter is mainly due to declining demand both for old and new housing and shrinking public works related to transport and infrastructure. Thus, quite a number of construction companies went bankrupt; for instance, two of the biggest enterprises in that sector, SCT and Vegrad, have gone into receivership in the past two years; this triggered bankruptcies among small suppliers as well. Consequently the credit crunch became a major problem as banks stopped providing new credits and refinancing of short-term credits to firms. Some Slovenian economists argue that only the rehabilitation of the banking sector, Nova Ljubljanska Banka in particular, could help relieve the credit crunch.

Along with the slowdown in foreign demand, industrial production growth lost momentum from mid-2011 and rose by only 3.5% in the year as a whole. Within manufacturing, output of car production, one of Slovenia's major export industries, remained stagnant. The manufacture of computer and optical products, leather and related products, basic metals and fabricated metal products reported remarkable increases in production, while output of labour-intensive branches such as in the textile and furniture industries continued to decline. The crisis has made the structural weaknesses of Slovenia's economy visible: productivity is low compared to other new EU member states due to the small share of high-tech industries and knowledge-based services, and wages are too high, hence unit labour costs are the highest among the NMS. Productivity is far behind the EU average, such as in the manufacture of machinery and equipment and in the manufacture of electrical and fibre-optics equipment; productivity increases were strongest in the production of motor vehicles (dominated by foreign ownership), yet output stagnated and jobs were cut. There are, however, additional signs that the crisis has speeded up (passive) restructuring as the export share of high-tech products has increased significantly since the outbreak of the crisis, while the proportion of low-tech exports declined or became almost nil.[1]

Foreign trade dynamics worsened particularly in the second half of 2011: in nominal terms goods exports and imports were up 13% each (versus 19.5% and 22% respectively in the first quarter). The trade deficit remained almost unchanged compared with a year earlier; owing to a rising surplus in services trade along with a surplus in the balance of transfers, the current account closed only slightly negative. Since the beginning of the crisis the share of exports directed towards the successor states of the former Yugoslavia has been steadily on the decline, from 17% in 2008 to 14% in 2011, while on the import side there has been a slight increase from 7% to 9%. The inflow of FDI exceeded the amount reached in 2010.

The deterioration on the labour market continued. Based on Labour Force Survey data, the number of employed fell by 3% in 2011, which is the strongest decline since the outbreak of the crisis. Employment losses were highest in construction, manufacturing and – to a lesser extent – in market services, trade in particular. By contrast, jobs were created in the non-market services sector, such as health, education and social work; also agriculture reported job increases, which may have acted as an employer of last resort. The LFS unemployment rate rose to slightly over 8% and thus almost doubled

[1] For further details see: Government of the Republic of Slovenia, Competitiveness of the Slovenian Economy, Review and Measures, 17 February 2011.

compared to the pre-crisis level, but is still below the EU average. Unemployment based on registration data has shown a steady increase since September 2008; at the end of December the unemployment rate was at 12%. Given the low GDP growth or even declining economic activity, the risk of rising unemployment is imminent. The Ministry of Labour considers long-term unemployment, the rising share of older workers becoming unemployed and the skill mismatch as the biggest challenges on the labour market in 2012.

Following the parliamentary elections on 4 December 2011, the Slovenian parliament confirmed Janez Jansa, head of the Slovenian Democratic Party (SDS), as the new prime minister on 28 January 2012. This move came after the winner of the elections, Zoran Jankovic, the mayor of Ljubljana and head of the Positive Slovenia party, had failed to form a coalition. Apart from the SDS the coalition consists of four parties: the conservative People's Party (SLS), the Christian People's Party New Slovenia (NSi) and the civic list Gregor Virant (minister in the first Jansa government). The five parties hold 50 out of 90 seats in the Slovenian parliament. The new government was confirmed by the Slovenian parliament on 10 February 2012. Considering that the coalition's parties have quite diverging interests (for instance, the pensioner's party left the former government because of disputes over the pension reform), conflicts seem to be inevitable. Moreover, President Danilo Turk stated that Prime Minister Jansa was lacking legitimacy for the post because of an ongoing trial in which Mr. Jansa is charged with bribery over a Finnish armoured vehicles deal in 2006.

Since September 2011 all major credit rating agencies have cut Slovenia's credit rating due to political instability and lack of reforms. In January 2012 Standard & Poor's and Fitch again downgraded Slovenia's credit rating. S&P cut the rating by one level to A+ and Fitch downgraded the long-term sovereign credit rating from AA- to A- with a negative outlook; in February Moody's cut Slovenia's sovereign rating from A2 to A1 with a negative outlook. At the same time the credit ratings of banks were downgraded as well: Slovenian banks show low capital adequacy compared with the euro area, non-performing loans have been on a steady increase and stood at about 10% of total loans in October 2011 (up from 7% a year earlier) and the stock of loans is declining. Slovenian banks – mostly domestically owned – are very much exposed to highly indebted companies in the construction and real estate sectors, but also in leveraged buy-out holding companies. Janez Sustersic, the new Minister of Finance, stated that the government may have to provide another EUR 400 million capital injection for Nova Ljubljanska Banka if the country's biggest bank fails to attract other investors.

According to first estimates the general government deficit stood at 5.5% of GDP in 2011. The dynamics of public debt growth, although still low than in a number of other eurozone countries, has become a major concern in the past couple of years, when it rose from 22% in 2008 to 45% in 2011. Available data indicate that Slovenia's net budgetary position vis-à-vis the EU budget was positive in the first eleven months of 2011. In terms of receipts from and payments to the EU funds the country realized about 79% and 94% respectively of the planned volume for that year. The absorption capacity of EU funds was highest in agriculture and lowest with respect to the Cohesion Fund. Fiscal consolidation is considered as one of the major tasks of the new government. Expenditures are to be cut to 45% of the GDP in the next couple of years and the public debt to GDP ratio may not exceed 46% of the GDP. The general government deficit is to be reduced to zero by 2015. As a first step, the prime minister announced to cut budgetary expenditures in 2012 by 5% in the frame of a supplementary budget to be adopted soon (the 2012 budget bill was passed already in 2010). In addition, the coalition agreement envisages tax reliefs; e.g. the corporate income tax should be gradually reduced to 15%. With regard to pensions it is planned that early retirement will be curbed and 'that pensions will depend more on years of service than on retirement age and voluntary extension of employment beyond retirement age will be intensified'. Already in December the Slovenian parliament has adopted a bill on freezing public sector wages and pensions until June 2012.

Slovenia's economic prospects will largely depend on the success or failure of the new government's structural reforms, e.g. related to the pension system, withdrawal of the state from a number of enterprises and/or a viable solution regarding the majority state-owned Nova Ljubljanska Banka. Improvements in competitiveness are indispensable. Given the need for fiscal consolidation and in view of the growth slowdown in the EU, wiiw expects the GDP to decline by 1% in 2012. Growth will rebound only slightly in the following two years. Public investment will need some time to recover and will regain strength in 2013 or even only in 2014. Consequently a recovery on the labour market, if at all, may be expected only in the second half of 2013 or at the beginning of 2014 – provided economic growth gathers momentum.

Table SI

Slovenia: Selected Economic Indicators

	2006	2007	2008	2009	2010	2011 [1]	2012	2013 Forecast	2014
Population, th pers., average	2006.9	2018.1	2021.3	2039.7	2048.6	2050	2050	2050	2050
Gross domestic product, EUR mn, nom.	31045.0	34562.3	37279.5	35310.6	35415.8	36300	36660	37950	39290
annual change in % (real)	5.8	6.9	3.6	-8.0	1.4	0.4	-1	1.5	1.5
GDP/capita (EUR at exchange rate)	15500	17100	18400	17300	17300	17700	17900	18500	19200
GDP/capita (EUR at PPP)	20700	22100	22700	20500	20700	21100	.	.	.
Consumption of households, EUR mn, nom.	16167.4	17841.5	19543.5	19434.3	19577.4	19990	.	.	.
annual change in % (real)	2.8	6.0	3.9	-0.2	-0.6	0	-0.5	-0.3	0.4
Gross fixed capital form., EUR mn, nom.	8234.6	9603.6	10729.7	8267.5	7650.6	6870	.	.	.
annual change in % (real)	10.4	13.3	7.8	-23.3	-8.3	-12	-5	0	4
Gross industrial production									
annual change in % (real)	5.7	7.1	2.4	-17.3	6.2	2.5	1.5	2	3
Gross agricultural production (EAA)									
annual change in % (real)	-7.4	3.9	-1.9	0.0	-0.3	-0.8	.	.	.
Construction industry [2]									
annual change in % (real)	15.7	18.5	15.5	-20.9	-16.9	-25.4	.	.	.
Employed persons - LFS, th, average	961	985	996	981	966	940	920	910	920
annual change in %	1.3	2.5	1.1	-1.5	-1.5	-2.7	-2	-1	1
Unemployed persons - LFS, th, average	61	50	46	61	75	80	.	.	.
Unemployment rate - LFS, in %, average	6.0	4.8	4.4	5.9	7.3	8	8.5	9	8.5
Reg. unemployment rate, in %, end of period	8.6	7.3	7.0	10.3	11.8	12.1	12.5	12.5	11.5
Average gross monthly wages, EUR	1213	1285	1391	1439	1495	1525	.	.	.
annual change in % (real, net)	2.5	4.2	2.0	2.5	2.1	0.3	.	.	.
Consumer prices (HICP), % p.a.	2.5	3.8	5.5	0.9	2.1	2.1	2	2	2
Producer prices in industry, % p.a.	2.3	4.4	3.9	-1.4	2.0	4.6	3	3	3
General governm.budget, EU-def., % GDP									
Revenues	43.2	42.4	42.4	43.2	44.3	45	43.1	43	42
Expenditures	44.6	42.5	44.2	49.3	50.1	50.5	48.1	47.5	46
Net lending (+) / net borrowing (-)	-1.4	0.0	-1.9	-6.1	-5.8	-5.5	-5.0	-4.5	-4
Public debt, EU-def., in % of GDP	26.4	23.1	21.9	35.3	38.8	45	49	52	55
Central bank policy rate, % p.a., end of period [3]	3.75	4.00	2.50	1.00	1.00	1.00	.	.	.
Current account, EUR mn	-772	-1646	-2574	-455	-297	-168	-200	-300	-400
Current account in % of GDP	-2.5	-4.8	-6.9	-1.3	-0.8	-0.5	-0.5	-0.8	-1.0
Exports of goods, BOP, EUR mn	17028	19799	20032	16167	18387	20675	21700	23000	24600
annual growth rate in %	16.6	16.3	1.2	-19.3	13.7	12.4	5	6	7
Imports of goods, BOP, EUR mn	18179	21465	22681	16871	19591	21971	22400	23100	24500
annual growth rate in %	16.3	18.1	5.7	-25.6	16.1	12.1	2	3	6
Exports of services, BOP, EUR mn	3573	4146	4956	4347	4634	4992	5300	5600	6200
annual growth rate in %	11.2	16.0	19.5	-12.3	6.6	7.7	6	6	10
Imports of services, BOP, EUR mn	2580	3098	3533	3182	3325	3376	3400	3500	3700
annual growth rate in %	12.5	20.1	14.0	-9.9	4.5	1.5	2	4	5
FDI inflow, EUR mn	514	1106	1330	-470	274	786	800	.	.
FDI outflow, EUR mn	687	1316	983	174	-59	-8	.	.	.
Gross reserves of NB excl. gold, EUR mn [4]	5342	666	623	671	695	642	.	.	.
Gross external debt, EUR mn	24067	34783	39234	40294	40699	41444	.	.	.
Gross external debt in % of GDP	77.5	100.6	105.2	114.1	114.9	114.2	.	.	.
Average exchange rate EUR/EUR	0.9998	1.0000	1.0000	1.0000	1.0000	1.0000	1	1	1
Purchasing power parity EUR/EUR	0.7464	0.7750	0.8114	0.8451	0.8339	0.8377	.	.	.

Note: Gross industrial production, construction output and producer prices refer to NACE Rev. 2. Gross agricultural production refers to Economic Accounts for Agriculture (EAA).

1) Preliminary and wiiw estimates. - 2) Enterprises with 20 and more employees and output of some non-construction enterprises.- 3) From 2007 official refinancing operation rates for euro area (ECB), main refinancing rate of NB before. - 4) From January 2007 (euro introduction) only foreign currency reserves denominated in non-euro currencies.

Source: wiiw Database incorporating Eurostat and national statistics. Forecasts by wiiw.