SLOVENIA: Encouraging economic performance tempered by concerns over inflation

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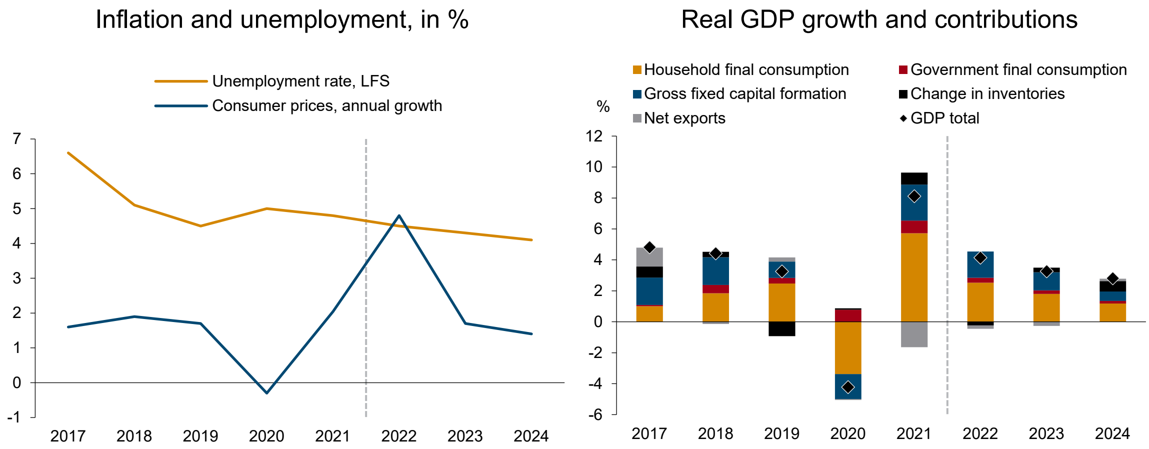
For 2022, we project real GDP to grow by 4.1% – unchanged from our previous forecast. Growth will be affected positively by strong private spending and investment, and negatively by the war in Ukraine, which will impact the economy through higher inflation and lower demand for exports. Inflation will reach 4.8%, and will spill over from energy into food and services. Due to the geopolitical situation, public finance is becoming a matter of some concern, following a period of high spending. The parliamentary elections in April will likely result in a new coalition.

Figure 4.21 / Slovenia: Main macroeconomic indicators



Source: wiiw Annual Database incorporating national and Eurostat statistics, own calculation. Forecasts by wiiw.

Up to the beginning of the Ukrainian crisis, economic momentum in Slovenia was strong. In Q4 2021, growth was the highest in the euro area (10.4% year on year) – largely a result of further increases in private consumption, investment and a strong trade performance. All this occurred during the fifth wave of the pandemic (which saw the highest daily number of infections since the beginning of the pandemic) and during a prolonged period of rising energy prices. Although inflation was already starting to have an adverse impact on manufacturing, the automotive industry saw a rise in exports. This situation was also reflected in the labour market, which saw the pool of available workers almost depleted. In 2021, real GDP grew by 8.1%, the highest rate since Slovenia's independence in 1991. And the actual growth rate for 2021 was considerably higher than wiiw's most recent forecast of 6.6%.

The scale of the repercussions of the war in Ukraine is difficult to estimate. In recent years, Slovenia has recorded a surplus in trade with both Russia and Ukraine. Together, those countries represented only 2.7% of Slovenia's exports, with the pharmaceutical industry accounting for almost half of that. Although there is some exposure to sanctions, the main channel by which negative spill-overs will be felt is increased inflation. The higher prices for raw materials and energy sources will place additional pressure on operational costs in export-oriented manufacturing industries, which claim a higher share of Slovenia's GDP than the EU average. Inflation could be accompanied by falling demand for products from abroad, amidst a downturn in consumer confidence, as well as by potential disruptions to supply chains. Since Germany is likely to be badly impacted by events in Ukraine, the overall effect of the crisis could be disproportionately felt in Slovenia, owing to the prominent role of its exports to Germany; this reinforces the rule that the magnitude of an economic shock suffered by small, open economies is typically greater than that experienced by their larger trade partners. One way of illustrating the deterioration in the economic outlook is through our forecast for industrial production for 2022 (3.9%), which is 3 percentage points (pp) lower than our previous forecast (6.9%).

Further economic woes could arise if it is necessary to discontinue the flow of Russian oil and gas rapidly. In 2020, Slovenia imported 45% of its energy (below the EU average), with gas providing about 13% of all its energy needs. Imports of Russian gas represented about 9% of the country's total energy consumption in 2020; however, Russia provided 77% of its imported natural gas. A large part of the gas imports is utilised by industry. The size of Slovenia's economy means that the volume is small in absolute terms; however, the pressure to reduce the country's reliance on Russian oil and gas will be felt by households and companies alike. As a response, the government has started to explore new opportunities to secure a gas supply in the Middle East.

Despite the considerable uncertainty, we forecast strong growth of 4.1% for 2022. While this forecast is consistent with our previous projection, issued in December 2021, it should be noted that the current forecast has been generated in a markedly different economic context, with momentum operating in two opposing directions. On the positive side, strong growth from Q4 2021, supported by private spending (which received an additional boost in February, when most COVID restrictions were lifted), suggests that the economy and households have largely adapted to the new reality and have not been fazed by the rising prices and the early signs of geopolitical tension. Private spending is forecast to remain strong in 2022, increasing by 4.9%; government spending will rise by 1.6%, as will investment (6.9%). On the negative side, the war in Ukraine will assuredly decrease the potential for growth in 2022, mostly because of inflation, supply-side issues and reduced demand for exports. Prolonged conflict, a possible embargo on Russian oil and gas and early signs that high inflation could continue in 2023 may act to suppress Slovenia's GDP growth in 2022.

International trade will suffer due to the crisis, but is likely to remain buoyant: exports are projected to grow by 6.4% and imports by 7.1% in real terms. As a consequence of high domestic demand for imported products, the current account surplus more than halved in 2021, compared to 2020, reaching 3.3% of GDP. In 2022, we expect this trend to continue, with imports growing faster than exports, thus denting the net contribution of trade to economic growth. The rising prices of manufactured products have considerably increased the value of exports: in December 2021, the nominal value of exports was 30% higher year on year. However, the nominal value of imports was 43% higher. Should inflation exceed the projections, trade is likely to decrease further.

In 2022, we expect inflation to reach 4.8% on average – an upwards revision of 1.6 pp, compared to the previous forecast. Slovenia had one of the highest inflation rates in the euro area in February – 7%, an 18-year high. High inflation is being felt predominantly in the cost of energy and food, and is likely to spill over to wage growth. The government has responded to the issue of rapidly rising prices for municipal heating and energy by introducing a cap on fuel prices and initiating direct transfers to households and companies worth EUR 200m. These measures will likely assist in keeping inflation somewhat lower than in other countries in Slovenia's eastern neighbourhood. It should be stressed that the forecast does not assume drastic escalations or a prolonged conflict in Ukraine. If things pan out differently, and if energy prices keep on rising, inflation could end up much higher and may exceed 10%. Especially worrying are the hikes in producer prices, which could reach 6% in 2022. In 2023 and beyond, we expect inflation to fall back substantially and to return to a rate of 2%.

Pressure on wage growth could add to the pressures on prices. After growing by 6% in 2021, real wages are expected to increase by 2.6% in 2022. The reasons are not related solely to inflation: for months, medical doctors have been demanding higher salaries. Their protests are threatening to undermine the system of public salaries and have already sparked similar demands from other public-sector workers. These calls for public-sector wage rises could have repercussions for the public finances.

This will be the third consecutive year to be marked by high public deficits – the downside to high growth figures. The deficit in 2021 was somewhat lower than expected, at 5.2%, and the national treasury will benefit from the lifting of the COVID-19 restrictions. However, given the need to subsidise energy, and in light of the lower growth projections, we forecast that the public deficit in 2022 will be 3.6% of GDP. Public debt has fallen to below 80% of GDP as a consequence of high growth, and in 2022 it will hover at around 74%.

Despite positive short-term signs, the long-term fiscal outlook has raised some concern among Slovenia's top economists. Interest rate hikes by the European Central Bank, coupled with the effects of the Ukrainian war on the financial markets, could lead to higher costs for debt refinancing, especially for smaller countries. Since 2020, Slovenia has increased its structural deficit considerably, and the current government has been spending freely (including on the adoption of a regressive income tax reductions in March 2022). This has resulted in a high level of public debt and several consecutive years of deficit. The country could soon face the need to cut public spending, if its credit ratings are not to suffer. An additional cause for concern is the uncertainty over the future system of fiscal rules at the EU level.

The ruling Slovenian Democratic Party could again gain most votes in the parliamentary elections at the end of April, but it is unlikely to end up in a position to form an administration. Despite Prime Minister Janša's attempts to present himself as an experienced war leader and his use of strong rhetoric against Russia, his visit to Kyiv has not translated into increased support in the polls. The government's latest push to influence programming and staffing at the national radio and television service RTV has led to outrage in the media and civil society. Any potential new coalition will have to deal with the legacy of an altered media environment, politically influenced staffing decisions in various public institutions and populist spending choices. Responding to these challenges could serve to unite a coalition formed from several opposition parties; but the need for tough decisions to rein in public expenditure, provide housing and reform the health and pension systems could split it asunder.

In 2023, we expect GDP growth to slow and settle down at around 3% per year. In general, all components of GDP are likely to see a drop compared to 2022. Private consumption will subside, growing at about 3.5% per year, while investment activity is likely to remain strong, boosted by the incoming funds from the Recovery and Resilience Facility. The growth in trade will also slow somewhat, since the high figures for 2021 and 2022 have benefited from a strong base effect; but it should still exceed 5% in 2023. The labour market is likely to see further issues, as the pool of available workers is virtually depleted: there will be a need to bring more workers in from abroad. Finally, the issue of the cost of housing has begun to dominate public discourse and is likely to remain of key importance: in 2021, the cost of new housing units rose by 15% – a matter of great concern to the younger generation, which is struggling to reap the benefits of strong economic growth.

Table 4.21 / Slovenia: Selected economic indicators

	2018	2019	2020	2021 1)	2022	2023	2024
						Forecast	
Population, th pers., average	2,074	2,088	2,102	2,108	2,112	2,115	2,119
Gross domestic product, EUR m, nom.	45,864	48,397	46,918	52,020	56,800	59,700	62,200
annual change in % (real)	4.4	3.3	-4.2	8.1	4.1	3.3	2.8
GDP/capita (EUR at PPP)	26,450	27,660	26,540	29,070	.	.	.
Consumption of households, EUR m, nom.	23,463	24,919	23,160	26,835	.	.	.
annual change in % (real)	3.6	4.8	-6.6	11.6	4.9	3.5	2.3
Gross fixed capital form., EUR m, nom.	8,834	9,495	8,861	10,483	.	.	.
annual change in % (real)	9.7	5.5	-8.2	12.3	8.4	5.8	3.0
Gross industrial production							
annual change in % (real)	5.1	3.1	-5.3	10.3	3.9	3.8	4.2
Gross agricultural production							
annual change in % (real)	28.5	-7.8	5.5	-12.0	.	.	.
Construction industry							
annual change in % (real)	20.0	3.3	-0.7	-5.8	.	.	.
Employed persons, LFS, th, average 2)	980.6	982.6	978.1	971.6	990	1,000	1,010
annual change in %	2.2	0.2	-0.5	.	1.7	1.4	1.1
Unemployed persons, LFS, th, average 2)	52.8	45.7	51.2	48.6	50	40	40
Unemployment rate, LFS, in %, average 2)	5.1	4.5	5.0	4.8	4.5	4.3	4.1
Reg. unemployment rate, in %, eop	8.1	7.7	8.9	6.7	.	.	.
Average monthly gross wages, EUR 3)	1,682	1,754	1,856	1,970	2,120	2,210	2,280
annual change in % (real, gross)	1.7	2.7	5.9	4.1	2.6	2.4	1.9
Average monthly net wages, EUR 3)	1,093	1,134	1,209	1,270	1,370	1,430	1,480
annual change in % (real, net)	1.2	2.1	6.6	3.1	2.7	2.4	1.8
Consumer prices (HICP), % p.a.	1.9	1.7	-0.3	2.0	4.8	1.7	1.4
Producer prices in industry, % p.a.	2.1	0.6	-0.3	5.5	6.1	4.5	1.9
General governm. budget, EU def., % of GDP							
Revenues	44.2	43.8	43.6	43.9	44.6	45.1	45.4
Expenditures	43.5	43.3	51.3	49.1	48.2	45.5	45.6
Net lending (+) / net borrowing (-)	0.7	0.4	-7.7	-5.2	-3.6	-0.4	-0.2
General gov. gross debt, EU def., % of GDP	70.3	65.6	79.8	74.7	74.4	71.3	68.5
Stock of loans of non-fin. private sector, % p.a.	3.0	3.5	0.0	5.9	.	.	.
Non-performing loans (NPL), in %, eop 4)	5.6	2.9	2.6	1.6	.	.	.
Central bank policy rate, % p.a., eop 5)	0.00	0.00	0.00	0.00	.	.	.
Current account, EUR m	2,731	2,898	3,462	1,736	820	200	-10
Current account, % of GDP	6.0	6.0	7.4	3.3	1.4	0.3	0.0
Exports of goods, BOP, EUR m	30,808	32,013	29,656	35,335	39,720	42,980	45,730
annual change in %	8.6	3.9	-7.4	19.1	12.4	8.2	6.4
Imports of goods, BOP, EUR m	29,535	30,702	27,290	34,816	40,390	43,980	47,060
annual change in %	10.4	4.0	-11.1	27.6	16.0	8.9	7.0
Exports of services, BOP, EUR m	8,124	8,659	6,900	8,254	9,180	9,790	10,440
annual change in %	9.9	6.6	-20.3	19.6	11.2	6.6	6.6
Imports of services, BOP, EUR m	5,500	5,751	4,904	5,859	6,740	7,320	7,870
annual change in %	7.0	4.6	-14.7	19.5	15.0	8.6	7.5
FDI liabilities, EUR m	1,307	1,919	431	1,569	.	.	.
FDI assets, EUR m	373	1,157	697	1,066	.	.	.
Gross reserves of CB excl. gold, EUR m	702	767	913	1,838	.	.	.
Gross external debt, EUR m	42,139	44,277	47,792	50,477	54,100	57,000	59,200
Gross external debt, % of GDP	91.9	91.5	101.9	97.0	95.3	95.5	95.1

1) Preliminary and wiiw estimates. - 2) From 2021 the new LFS methodology is applied in line with the Integrated European Social Statistics Regulation (IESS). - 3) Wage increase in 2020 due to COVID emergency relief compensations. - 4) Loans more than 90 days overdue and those unlikely to be paid. - 5) Official refinancing operation rates for euro area (ECB).

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