SLOVENIA: Racing towards full economic recovery while combating vaccine hesitancy

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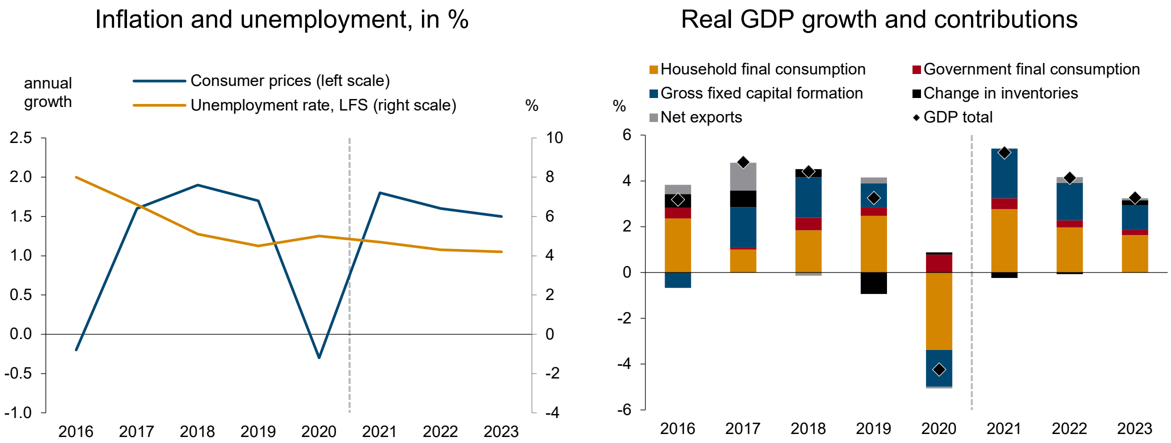
GDP has almost recovered to its pre-crisis levels. Strong economic performance has led our forecast for economic growth to be revised upwards to 5.2%. Q2 2021 saw an increase in private expenditure, a renewed growth in services and strong private investment activity. Exports and trade-oriented industrial sectors have already grown beyond 2019 levels. Inflation has stabilised and is not likely to exceed 2% in 2021. With a surge in infections, the slow progress of vaccination is a risk factor for the winter.

Figure 4.21 / Slovenia: Main macroeconomic indicators



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

Economic recovery is proceeding more rapidly than was previously expected. Despite the long second wave of the pandemic, the first half of 2021 saw a rebound in both private and public economic activity. In Q2 2021, the economy grew by 16.3% (partly due to the recession of Q2 2020). In July 2021, Slovenia's real GDP was just 0.2% smaller than in 2019. Strong investment activity and increased spending by households are two of the main developments of Q2 2021. Investments are projected to grow by 10% in 2021, and a major share of capital accumulation is being directed towards equipment. Private consumption has grown by 4.4% quarter on quarter, providing a boost in particular to retail trade and services, which grew by 30% year on year in Q2 2021. After reaching record levels of 25% in 2020, the savings rate has also declined, indicating a new propensity to make larger purchases, mostly in real estate. Manufacturing and exports have benefited from strong foreign demand, as has the transport sector. Construction, which boomed in late 2020, has since slowed: it contracted in the first half of 2021 on account of supply issues, but that state of affairs is expected to be only temporary.

In 2021, real GDP is now expected to grow by 5.2% – up 1.6 percentage points (pp) on our previous forecast. The solid performance of the economy in the first half of the year – coupled with rising foreign demand, the continuation of government support measures and a re-emerging consumer confidence – gives good reason to expect another strong (albeit slightly more subdued) showing in the second half of the year, despite what is shaping up to be a new wave of infections. This has prompted us to revise our forecasts for economic growth upwards.

Resurgent hospitalisation rates and low vaccine uptake give grounds for concern, although further lockdowns are unlikely. After a long second lockdown period, most restrictions were lifted around mid-April. After the initial success of the vaccination programme, vaccination rates slowed considerably after June. As of mid-September, 45% of the total population is fully vaccinated. Vaccine scepticism is rampant among large sections of the population. After August, infection rates started to rise again and in mid-September were comparable to those in April. In response, the government has instituted a mandatory 'green pass' system for almost all public spaces and retail outlets (including filling stations), and for non-essential hospital appointments. This move has proved unpopular and has led to protests that have erupted into violence. According to (rather inconclusive) statements by politicians, lockdown measures will not be instituted again.

Manufacturing, construction and transport services are leading the way. Most industrial sectors, as well as the related transport services, actually exceeded pre-crisis levels of value added in the first half of 2021. The key exception is the automotive sector, which is still 10% below its 2019 output – largely because of an inadequate supply of semiconductors and the high cost of other inputs, especially metals. Expensive raw materials are also causing issues in other industrial sectors that cannot easily raise their output prices, because of heavy competition. Autumn is likely to witness a general slowdown in industrial activity, due to the aforementioned supply-side issues.

The volume of trade in goods has exceeded pre-crisis levels, but trade in services is still lagging. A strong upsurge in demand from Slovenia's key trade partners (expected to exceed 9% in 2021) was instrumental in the recovery of exports of goods, which exceeded pre-crisis levels in Q1 2021. The export of services has seen a year-on-year rise for the first time since the beginning of the pandemic, growing by almost 30% year on year in Q2 2021. However, a return to the 2019 levels is expected only in 2022 – and tourism is likely to require significantly longer. Strong domestic demand has led to imports rising faster than exports: they will grow by 12% in 2021. Nevertheless, Slovenia will continue its long run of high current account surpluses, with 5.7% of GDP in 2021 and beyond.

So far, fears of high inflation have not materialised and are unlikely to do so during the forecast period. The deflation of 2020 was followed by a prolonged lockdown, which acted as a brake on price hikes. After the reopening in April, prices rose by 2% year on year. From then until mid-September, growth stabilised at around 2%. In 2021, we expect the consumer price index to grow by 1.8% for the year. The largest contributor to inflation is the cost of energy. Food prices in September 2021 are still lower than in 2020. In August, the cost of services began to rise for the first time since the pandemic struck. Meanwhile, producer prices have grown considerably, due to the rising cost of raw materials: in July 2021, they were 6% higher than in July 2020. Most of these price hikes involve products destined for export, and so do not pass through to domestic consumer prices. Next year, inflation should hover around 1.6%, depending on the pressures on the labour market and movements in oil prices.

The demand for labour has been growing steadily since February 2021. The labour market – still supported by government measures, such as basic income for the self-employed and furlough schemes – showed resilience in the long lockdown of Q1 2021, and since then has been performing better than expected. From the beginning of 2021 until July 2021, the unemployment rate fell from 5.3% to 4.0%. At the end of August, there were 21% fewer unemployed workers than in August 2020. For 2021, we project an unemployment rate of 4.7%, a downward revision of 0.8 pp compared to our previous forecast. After a prolonged period of shedding employees, the service sector is once again on the lookout for new workers – a development that benefits mostly women and the young. We expect the continued revival of the economy in 2022 to lead to a further reduction in the unemployment rate to 4.3%. Due to the altered methodology, which considers COVID-related payments and benefits, wages in 2021 will once again grow markedly, by 4.5%, largely because of the lockdown in Q1 and Q2 2021. Next year, wage growth should slow to 1.8%.

Key government support schemes have been extended until the end of the year, but participation is decreasing. Government-sponsored furlough, basic income for the self-employed, the debt moratorium and tourist vouchers continue to support the economy and preserve jobs. It is estimated that they cushioned the fall in GDP by 4 pp in 2020. The removal of restrictions after spring automatically reduced the share of workers and companies covered under these schemes. In June 2021, 27,000 workers were still included on various government schemes designed to protect employees – 13,000 down on the previous month. Nevertheless, about 38% of all self-employed workers received basic income in June 2021.

The fiscal situation remains the most problematic consequence of the pandemic. In 2021, government spending is projected to grow by 2.3%. Early signs point to the government's spending exceeding its own targets. Therefore, we forecast a public deficit of 7.3% of GDP, 2 pp higher than was set by the government at the beginning of the year. As a result of two consecutive years of high budget deficits, public debt will increase again in 2021, but only by 1 pp, compared to 2020. Our projections for public debt as a share of GDP place it at 80.8%. This represents an almost 20 pp rise in public debt since 2019. Government spending in the first half of 2021 was 18.6% higher than in the first half of 2020, mostly due to investments and COVID-related costs. The total direct cost of COVID-related measures from January 2021 to September 2021 was EUR 2.25bn, or 4.5% of real GDP in 2021. Public debt will shrink in the coming years (to 80.5% in 2022); this will mostly be due to economic growth, as no significant reductions in spending are likely in 2022, an election year. Although the gradual end of the pandemic should act as an automatic brake on public expenditure, the government is expected to keep running deficits in the coming years.

The government is keeping up its feuding with national and international institutions, with few real-world consequences. With the exception of the occasional inflammatory statement or Tweet by Prime Minister Janez Janša (from which the EU Commission is quick to distance itself) and apart from the ongoing European Parliament investigation into the state of media freedom in Slovenia, the country's Presidency of the Council of the EU is progressing relatively calmly. In his European agenda, Prime Minister Janša sticks to promoting the sovereignty-oriented and anti-immigration rhetoric of his Polish and Hungarian counterparts. Domestically, the Slovenian Democratic Party-led government operates with a parliamentary minority and is unlikely to pass any major reforms until the next parliamentary elections, scheduled for spring 2022. An early election cannot be ruled out – potentially in response to the public outcry over the handling of the pandemic, disagreements over the 2022 budget, or further strife within the minority coalition partner DeSUS.

In 2022, the recovery will be almost complete. Aside from tourism, services should also catch up with their 2019 level of employment and output. International trade will continue to act as a driver of growth, as will construction, both private and public. The EU's Recovery and Resilience Facility will also become an important factor. The first tranche (about 13%) of the EUR 2.764bn of funds and loans should be available to the government by the end of 2021. Investments in public infrastructure will also be boosted by the approaching end of the current EU budget – a time when the acquisition of EU funds usually accelerates. The key risk factor remains the pandemic. A slow rate of vaccination and new variants could put the brake on private spending. Some of the other variables that may adversely affect the economy in 2022 include the premature removal of the remaining COVID-related measures, high rates of inflation and a low intensity of absorbing European funds.

Table 4.21 / Slovenia: Selected economic indicators

	2018	2019	2020 1)	2020 January-June	2021 January-June	2021 Forecast	2022 Forecast	2023 Forecast
Population, th pers., average	2,074	2,088	2,102	.	.	2,115	2,120	2,125
Gross domestic product, EUR m, nom.	45,864	48,397	46,918	22,336	24,768	50,300	53,200	55,800
annual change in % (real)	4.4	3.3	-4.2	-6.3	8.8	5.2	4.1	3.3
GDP/capita (EUR at PPP)	26,410	27,660	26,770	.	.	.	.	.
Consumption of households, EUR m, nom.	23,463	24,919	23,160	10,889	12,004	.	.	.
annual change in % (real)	3.6	4.8	-6.6	-8.2	8.8	5.6	4.0	3.3
Gross fixed capital form., EUR m, nom.	8,834	9,495	8,861	4,203	4,912	.	.	.
annual change in % (real)	9.7	5.5	-8.2	-12.3	13.4	11.5	8.6	5.8
Gross industrial production								
annual change in % (real)	5.1	3.1	-5.3	-9.6	14.3	6.9	4.2	3.0
Gross agricultural production								
annual change in % (real)	28.5	-7.8	8.9	.	.	.	.	.
Construction industry								
annual change in % (real)	20.0	3.3	-0.7	-6.8	-2.9	.	.	.
Employed persons, LFS, th, average 2)	980.6	982.6	978.1	974.8	953.5	990	1,010	1,020
annual change in %	2.2	0.2	-0.5	-1.0	.	1.0	1.6	1.4
Unemployed persons, LFS, th, average 2)	52.8	45.7	51.2	49.7	50.0	50	50	40
Unemployment rate, LFS, in %, average 2)	5.1	4.5	5.0	4.9	5.1	4.7	4.3	4.2
Reg. unemployment rate, in %, eop	8.1	7.7	8.9	9.2	7.3	.	.	.
Average monthly gross wages, EUR 3)	1,682	1,754	1,856	1,834	1,981	1,970	2,040	2,120
annual change in % (real, gross)	1.7	2.7	5.9	5.8	7.3	4.5	1.8	2.5
Average monthly net wages, EUR 3)	1,093	1,134	1,209	1,196	1,273	1,290	1,340	1,390
annual change in % (real, net)	1.2	2.1	6.6	7.0	5.7	5.0	1.9	2.1
Consumer prices (HICP), % p.a.	1.9	1.7	-0.3	0.2	0.7	1.8	1.6	1.5
Producer prices in industry, % p.a.	2.1	0.6	-0.3	-0.3	2.4	2.5	1.4	0.6
General governm.budget, EU-def., % of GDP								
Revenues	44.3	43.7	43.0	.	.	44.0	44.5	44.8
Expenditures	43.5	43.3	51.3	.	.	51.3	47.8	45.6
Net lending (+) / net borrowing (-)	0.7	0.4	-8.3	.	.	-7.3	-3.3	-0.8
General gov.gross debt, EU def., % of GDP	70.3	65.6	79.8	.	.	81.7	80.5	79.6
Stock of loans of non-fin.private sector, % p.a.	3.0	3.5	0.0	0.9	1.7	.	.	.
Non-performing loans (NPL), in %, eop 4)	5.6	2.9	2.6	2.6	1.9	.	.	.
Central bank policy rate, % p.a., eop 5)	0.00	0.00	0.00	0.00	0.00	.	.	.
Current account, EUR m	2,731	2,898	3,462	1,702	1,338	2,890	2,880	2,660
Current account, % of GDP	6.0	6.0	7.4	7.6	5.4	5.7	5.4	4.8
Exports of goods, BOP, EUR m	30,808	32,013	29,656	14,287	16,991	33,360	36,230	38,840
annual change in %	8.6	3.9	-7.4	-12.2	18.9	12.5	8.6	7.2
Imports of goods, BOP, EUR m	29,535	30,702	27,290	13,151	16,219	31,140	34,100	36,830
annual change in %	10.4	4.0	-11.1	-14.8	23.3	14.1	9.5	8.0
Exports of services, BOP, EUR m	8,124	8,659	6,900	3,217	3,427	7,840	8,870	9,620
annual change in %	9.9	6.6	-20.3	-19.1	6.5	13.6	13.1	8.5
Imports of services, BOP, EUR m	5,500	5,751	4,904	2,304	2,451	5,460	6,220	6,970
annual change in %	7.0	4.6	-14.7	-13.4	6.4	11.3	14.0	12.1
FDI liabilities, EUR m	1,307	1,919	431	262	1,078	730	.	.
FDI assets, EUR m	373	1,157	697	205	392	470	.	.
Gross reserves of CB excl. gold, EUR m	702	767	913	859	970	.	.	.
Gross external debt, EUR m	42,139	44,277	47,792	48,183	50,002	49,000	51,100	53,300
Gross external debt, % of GDP	91.9	91.5	101.9	102.7	99.4	97.5	96.0	95.5

1) Preliminary. - 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.