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## **Slovenia: rapid GDP growth with accelerating inflation**

In 2007 Slovenia's GDP recorded the highest growth since gaining independence. Growth was backed by domestic consumption, in particular soaring investments, up almost 20%, while the contribution of foreign trade was negative. Lending activities both to the household and private sectors remained buoyant. Construction was one of the sectors benefiting most from rising investment, increasing its output by nearly one quarter. Industrial output expanded at a record rate of 7% in 2007, of which manufacturing was up 9%; at the same time labour productivity in industry was growing significantly.

### **Inflation not yet under control**

High inflation has become the most debated economic issue in Slovenia recently. Inflation started to accelerate in mid-2007 following considerable price rises for food, beverages and in the hotels and restaurants sector. In general, it turned out that Slovenia is more affected by rising oil prices than other countries in the eurozone due to the higher weight of oil products in the consumer basket of households and the large share of food in Slovenian imports. Slovenian economists also blame weak competition in the country's food processing industry for the extraordinary price rises. Euro changeover effects were initially limited, but seem to have had a larger impact on inflation after the expiry of double pricing and of retailers' commitments not to raise their prices. Consumer prices rose by 3.6% on an annual average, and by 5.6% in December year on year.

The strong GDP growth was reflected in continued employment growth. Both the labour force survey and national accounts data indicate more than 2% growth in employment, mainly in the construction and services sectors, particularly in business services, but also in industry (after years of steady decline). Unemployment eased in 2007 to a record low of 5% measured by LFS and 7.5% based on registration data. The high levels of capacity utilization coincide with growing labour shortages; surveys conducted in companies quote shortages of skilled labour as the most serious barrier to production growth. The strong labour demand was also reflected in a higher vacancy rate and rising wages.

On the external side, imports increased somewhat faster than exports, resulting in a deterioration of the foreign trade deficit. Though FDI inflow more than doubled compared to a year earlier, Slovenia remains a net FDI exporter. The bulk of Slovenian foreign investment is targeted towards the successor states of the former Yugoslavia, encompassing a broad range of activities. Foreign indebtedness rose rapidly during 2007 and reached EUR 34 billion by the end of November, EUR 10 billion more than in December 2006. Part of that increase is due to obligations of the Bank of Slovenia towards the Eurosystem, about EUR 1 billion are related to the Eurobond issue of the Ministry of

Finance in March and the remainder is due to banks borrowing abroad. Foreign net debt stood at only EUR 5.8 billion.

### **Government under pressure**

2007 turned out to be a turbulent year in politics: It took nearly half a year to nominate and confirm a new central bank governor. In November, the former leftist diplomat Danilo Türk won the presidential elections against Lojze Peterle, member of the European Parliament and former conservative prime minister. The outcome was generally interpreted as a confirmation of the growing discontent with the right-wing government led by prime minister Janez Janša. In response to the 'lost' presidential elections and in anticipation of Slovenia's EU presidency, Mr Janša called a vote of confidence which eventually reconfirmed the government's term of office. The next parliamentary elections will be held in October 2008 and this time a change in the government is very likely. At the beginning of 2008 Slovenia took over the EU presidency as the first of the countries that had acceded the Union in 2004.

### **From high to more moderate economic growth**

After last year's record expansion, GDP growth will decelerate to below 5% in 2008 owing to declining domestic demand, particularly lower investment growth, and weaker foreign demand. Housing is expected to weaken, while construction in infrastructure (motorways) will continue. With parliamentary elections ahead, government consumption may increase, and household consumption will grow by around 3%, largely because of significant wage increases in the public sector – based on the Collective Agreement for the Public Sector from July 2007. The volume of lending will taper off gradually due to the tightening of domestic banks' credit conditions. The slower pace of economic growth will be reflected in the labour market: employment is expected to grow by about 1% in the period 2008-2010 and unemployment will hover around 5% based on the LFS. Labour shortages will remain a limiting factor of production. The management of public finances is relatively good; however, the aim of balancing the general government budget by 2010 (as outlined in the Stability Programme Update) appears fairly ambitious. Foreign trade performance will largely depend on the international environment, the EU in particular, since Slovenia as a small and open economy is highly vulnerable to external risks. In view of the envisaged privatizations (telecom operator, insurance company), FDI inflows will increase in the coming years; at the same time Slovenian entrepreneurs will remain very active abroad, particularly in Southeast Europe. Inflation is expected to further accelerate in 2008 as long as prices of (imported) food and oil products are on the increase; an end of the price upsurge is not yet in sight.

Beyond 2008, wiiw expects GDP growth to remain between 4.5% and 5%. Dampened growth will be attributable to a gradual reduction of investment particularly in the

construction sector where the completion of the motorway network is expected for 2008. Growth of government and private consumption is likely to remain stable up until 2010. As a consequence of slower investment growth, imports will moderate and the trade deficit will narrow. Thus, during 2009 and 2010 the current account deficit is expected to decline both in relative and absolute terms.

Table SI

## Slovenia: Selected economic indicators

	2002	2003	2004	2005	2006	2007 <sup>1)</sup>	2008	2009	2010
	Forecast								
Population, th pers., mid-year	1,996	1,997	1,997	2,001	2,009	2,019	.	.	.
Gross domestic product, EUR mn, nom. <sup>2)3)</sup>	22,758	24,716	26,677	28,243	30,448	33,400	36,300	39,300	42,400
annual change in % (real) <sup>2)</sup>	3.7	2.8	4.4	4.1	5.7	6	4.7	4.5	4.8
GDP/capita (EUR at exchange rate)	12,080	12,692	13,402	14,114	15,162	16,542	.	.	.
GDP/capita (EUR at PPP - wiiw)	16,560	17,010	18,430	19,460	20,660	22,330	.	.	.
Gross industrial production									
annual change in % (real) <sup>4)</sup>	2.4	1.4	4.8	3.3	6.1	7.0	5	4	4.5
Gross agricultural production									
annual change in % (real)	13.4	-12.4	17.3	0.2	-5.7	.	.	.	.
Construction output									
annual change in % (real) <sup>5)</sup>	-3.4	-1.7	2.5	3.0	15.3	21.9 <sup>I-XI</sup>	.	.	.
Consumption of households, EUR mn, nom. <sup>2)3)</sup>	12,267	13,358	14,196	14,968	15,956	16,500	.	.	.
annual change in % (real) <sup>2)3)</sup>	1.8	3.5	3.0	2.9	4.0	2.5	3	3	2.8
Gross fixed capital form., EUR mn, nom. <sup>2)3)</sup>	5,318	5,955	6,784	7,210	7,960	8,400	.	.	.
annual change in % (real) <sup>2)3)</sup>	1.0	7.4	7.3	2.5	8.4	18	8	4	5
LFS - employed persons, th, avg.	910	897	943	949	961	980	.	.	.
annual change in %	-0.7	-1.4	5.1	0.6	1.3	2.0	.	.	.
Reg. employees in industry, th pers., avg. <sup>6)</sup>	246.1	242.2	239.7	239.3	235.5	237.4 <sup>I-X</sup>	.	.	.
annual change in % <sup>6)</sup>	1.1	-1.6	-1.0	-1.7	-1.6	0.9 <sup>I-X</sup>	.	.	.
LFS - unemployed, th pers., average	62.0	64.8	64.0	67.0	61.0	54.0	.	.	.
LFS - unemployment rate in %, average	6.4	6.7	6.3	6.6	6.0	5.2	4.9	4.7	4.6
Reg. unemployment rate in %, end of period	11.3	11.0	10.1	10.2	8.6	7.5	7.2	7	6.8
Average gross monthly wages, EUR <sup>3)7)</sup>	982	1,057	1,117	1,157	1,213	1,280	.	.	.
annual change in % (real, net) <sup>7)</sup>	2.1	1.8	2.1	3.5	2.5	4.5	.	.	.
Consumer prices (nat. def.), % p.a.	7.5	5.6	3.6	2.5	2.5	3.6	3.9	3.5	3
Producer prices in industry, domestic, % p.a.	5.1	2.5	4.3	2.7	2.3	5.4	4	3.8	3
General governm.budget, EU-def., % GDP <sup>8)</sup>									
Revenues	44.6	44.4	44.2	44.5	44.1	43.0	.	.	.
Expenditures	47.1	47.1	46.5	46.0	45.3	43.6	.	.	.
Net lending (+) / net borrowing (-)	-2.5	-2.7	-2.3	-1.5	-1.2	-0.6	-1.4	.	.
Public debt in % of GDP <sup>7)</sup>	28.4	27.9	27.6	27.4	27.1	25.6	.	.	.
Discount rate % p.a., end of period <sup>9)</sup>	7.3	5.0	3.3	3.8	3.8	4.0	.	.	.
Current account, EUR mn	247.2	-195.7	-719.7	-561.4	-856.5	-1,600	-1,400	-1,200	-1,100
Current account in % of GDP	1.0	-0.8	-2.7	-2.0	-2.8	-4.8	-3.9	-3.1	-2.6
Gross reserves of NB excl. gold, EUR mn <sup>10)</sup>	6,702	6,798	6,464	6,824	5,342	670	.	.	.
Gross external debt, EUR mn	11,524	13,225	15,343	20,508	24,034	34,007 <sup>XI</sup>	.	.	.
Gross external debt in % of GDP	48.7	52.8	57.5	72.6	78.9	.	.	.	.
FDI inflow, EUR mn	1721.7	270.5	665.2	472.6	511.7	900	1,200	.	.
FDI outflow, EUR mn	165.8	421.3	441.0	515.6	718.5	1,000	1,000	.	.
Exports of goods, BOP, EUR mn	11,082	11,417	12,933	14,599	17,028	19,900	22,200	24,400	27,500
annual growth rate in %	6.0	3.0	13.3	12.9	16.6	17	12	10	13
Imports of goods, BOP, EUR mn	11,347	11,960	13,942	15,625	18,179	21,450	23,600	25,700	28,900
annual growth rate in %	1.9	5.4	16.6	12.1	16.3	18	10	9	12
Exports of services, BOP, EUR mn	2,440	2,465	2,783	3,143	3,450	4,100	4,700	5,200	5,900
annual growth rate in %	12.0	1.0	12.9	12.9	9.8	19	15	11	13
Imports of services, BOP, EUR mn	1,820	1,925	2,095	2,294	2,584	3,100	3,500	3,900	4,300
annual growth rate in %	10.8	5.8	8.8	9.5	12.7	20	13	10	11
Average exchange rate EUR/USD <sup>3)</sup>	1.003	0.864	0.803	0.804	0.797	0.730	.	.	.
Average exchange rate EUR/EUR (ECU) <sup>3)</sup>	0.944	0.975	0.997	1.000	1.000	1.000	1	1	1
Purchasing power parity EUR/USD <sup>3)</sup>	0.588	0.615	0.610	0.614	0.617	0.606	.	.	.
Purchasing power parity EUR/EUR <sup>3)</sup>	0.689	0.728	0.725	0.725	0.734	0.741	.	.	.

Note: The term "industry" refers to NACE classification C+D+E.

1) Preliminary and wiiw estimates. - 2) According to ESA'95 (FISIM adjusted and real change based on previous year prices). - 3) Slovenia has introduced the Euro from 1 January 2007. For statistical purposes all time series in SIT as well as the exchange rates and PPP rates have been divided by the conversion factor 239.64 (SIT per EUR) to EUR-SIT. - 4) From July 2005 new methodology. - 5) Until 2003 Construction output in effective working time with 10 or more persons employed; from 2004 units with at least 20 employees. - 6) From January 2005 data from Statistical Register of Employment, years before from Monthly Report on Earnings. - 7) From January 2005 including legal persons with 1 or 2 employees in private sector. - 8) According to ESA'95, excessive deficit procedure. - 9) From 2007 European Central Bank Interest Rates. - 10) From January 2007 (Euro introduction) only the foreign currency reserves nominated in non-euro currency are included.

Source: wiiw Database incorporating national statistics; Eurostat; wiiw forecasts.