SLOVENIA: Worst flooding in decades is the defining moment of the year

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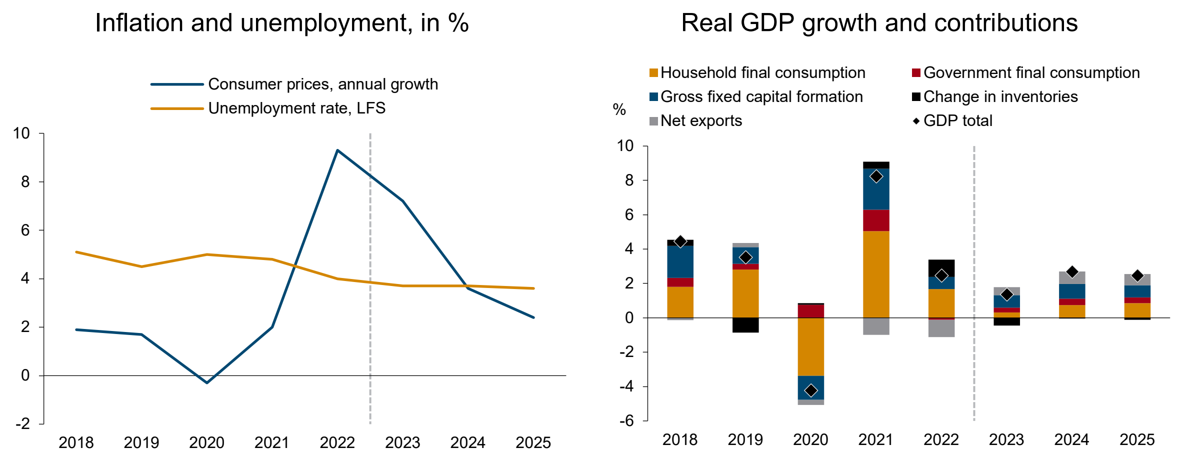
The reconstruction efforts following the floods in August – the worst in decades – will require several billion euro and will take years to complete, boosting government spending. Growth in 2023 will be subdued, at an estimated 1.3%, as private consumption has slowed significantly. Inflation will be high, but is showing clear signs of decreasing. Industrial output will shrink, as manufacturers face reduced foreign demand. The growth in exports will stall, but imports will fall, leading to a positive current account balance. The labour market is very tight, with the unemployment rate at historically low levels.

Figure 6.21 / Slovenia: Main macroeconomic indicators



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

On 8 August, Slovenia was hit by the worst environmental disaster since independence. Torrential rain caused several rivers to flood, most severely in parts of Gorenjska and Koroška. Seven people died, 120 houses were completely destroyed and hundreds more were damaged. Some companies will face disruption to their operations for months to come. Immediately after the disaster, a work-free day, known as a 'day of solidarity' was announced to encourage the population to help in the clean-up efforts. To date, tens of thousands of people have provided some form of help.

The first estimates of direct damage, announced by PM Robert Golob, were EUR 4.7bn; it is expected that the final figure will be in the region of EUR 7bn. The first official estimate of direct damage to publicly owned buildings and infrastructure reached EUR 2.7 bn. The government has passed legislation aimed at offering direct financial assistance to afflicted households, companies and infrastructure. Measures in the Emergency Law range from direct financial help to a moratorium on bank credit repayments. EUR 520m has been secured through a rapid reallocation of the 2023 government budget. New ways to finance the reconstruction work are being considered, including a special tax of 0.3% on income, a nationwide workday on a chosen Saturday and a tax on bank balance sheets. The EU has promised significant funds for reconstruction, including EUR 400m from the Solidarity Fund. Reconstruction is expected to take years to complete. Water infrastructure (and water management practices) will have to be significantly upgraded and anti-flood measures implemented. The disaster has also sparked public debate on the need to invest in climate adaptation measures and to rethink the current practice of building in areas that are at risk of flooding.

We forecast real GDP to grow by 1.3% in 2023. In Q2 2023, real GDP grew by only 1.4%, and further weakening is expected in the second half of the year. In an unexpected announcement, the official growth figure for 2022 was revised significantly downwards, from 5.4% to 2.5%. The official explanation for this focuses on the extraordinary circumstances in 2022 related to inflation and post-Covid recovery, which affected the reliability of the quarterly data used to provide the first official estimate. More worryingly, it also shows that the post-Covid recovery was less robust than previously thought. We have reduced our previous forecast for real GDP growth in 2023 by 0.1pp because of a drop in industrial activity, and to a lesser extent because of the disruption to economic activity due to the floods. Although the damage to infrastructure, residential buildings and companies was disastrous, in macroeconomic terms the floods are not expected to make a significant dent in GDP growth in 2023, since only a small part of the economy was (and still is) disrupted. However, private consumption will grow by only 0.8%, as households face higher prices, and consumer confidence is at a two-year low. Growth will be driven primarily by investment – mostly in infrastructure and buildings – as well by net exports, despite a cooling of foreign demand.

Inflation in 2023 will be above the EU average, but it is expected to fall back in 2024. In the first 8 months of 2023, inflation averaged 8.2%. Annual inflation has been decreasing steadily since April 2023, and this trend is expected to continue into 2024. The gradual decline in inflation is due primarily to stabilisation in the growth of food and energy prices. Core inflation, which excludes the costs of energy and food, remains high and is driven primarily by the increased cost of services. For these reasons, inflation in 2023 will be high, at 7.2%. In 2024, we expect this figure to drop to 3.6%.

In the H2 2023 and throughout 2024, exports will be hampered by high inflation and weaker foreign demand. Exports are expected to grow by only 0.1% this year. Industrial production is forecast to drop by 1.7%, as exporting companies reduce their output because of high energy prices and a technical recession in Germany – the main export market. Companies producing energy-intensive basic materials have been disproportionately affected. Imports will shrink by 0.4%, as household consumption is growing only slowly. After the current account balance went into the red in 2022, foreign trade will once again contribute positively to growth this year, and the current account is projected to improve to 1.3% of GDP. In part, this is due to a successful tourist season. In 2024, we expect exports to recover somewhat (by 3.8%), while imports will grow by 3.5%.

Unemployment in 2023 and 2024 will reach a new record low of 3.7%. The labour shortage is continuing to pose a problem for the economy, particularly in construction, manufacturing and hospitality. New employments have been gradually slowing in H2 2023. The vast majority – 90% or so – of new employments involve foreign workers. We expect this situation to become the ‘new norm’. The emptiness of the labour pool means that unemployment is not expected to rise in 2024, unless the Euro area slips into a recession.

Nominal wages will grow by 7.6% this year, but by only 1.1% in real terms. The largest wage increases have been seen in sectors with a significant labour shortage. The rises in public-sector salaries and in the minimum wage that were implemented in H1 2023 have also contributed to the overall wage growth. In 2024 wages are projected to rise by 5.5%.

The reconstruction after the recent flooding will push government spending above its planned levels. The budget for 2023 and 2024 will have to be renegotiated, and disaster relief efforts will likely increase the deficit in 2023 (to 4.2% of GDP) and 2024 (3.5% of GDP). The final mix of sources of funds to finance the reconstruction has yet to be determined; however, it is likely that additional debt will need to be taken on, which will somewhat hamper the steady downward trajectory of government debt reduction. In 2024, government debt is expected to reach 68.5% of GDP.

The floods represented a rare moment of political unity, and have overshadowed other political events. The coalition of Robert Golob has thus far failed to deliver the promised healthcare reform, and has announced delays to other reforms (such as the public salary system), citing the floods. While healthcare reform will remain the government's priority, the coalition's ability to deliver reforms, many of which come with promises of increased spending, remains to be seen.

In 2024, we expect GDP growth to rebound to 2.7%, as inflation recedes. Private consumption will grow by 1.4% and the current account surplus will rise further, to a projected 2.2% of GDP. Increased government spending (of 1.9%) on flood reconstruction will also drive growth. Industrial production will return to growth (of 2.2%). However, as the outlook for the euro area deteriorates, so the possibility of a plunge in foreign demand could endanger Slovenia's growth performance in 2024 (and 2025).

Flood reconstruction will continue to be an important factor as we move into 2024. Since some transfers from the Cohesion Fund and the Recovery and Resilience Facility are expected to be redirected to support flood recovery, their contribution to growth is harder to estimate. It is likely that the short-term effect on growth will be higher, since the projects will have to be prepared and implemented quickly, and will help the construction and civil engineering sector. However, if funds are diverted from long-range investments, that could have repercussions for Slovenia's long-term ability to improve productivity.

Table 6.21 / Slovenia: Selected economic indicators

	2020	2021	2022 [1)]	2022	2023	2023	2024	2025
				January-June			Forecast	
Population, th pers., average	2,102	2,108	2,112	.	.	2,115	2,119	2,125
Gross domestic product, EUR m, nom. [2)]	47,045	52,279	57,038	28,330	31,783	62,000	66,000	69,200
annual change in % (real)	-4.2	8.2	2.5	9.3	1.1	1.3	2.7	2.5
GDP/capita (EUR at PPP)	26,780	29,190	31,460	.	.	.	.	.
Consumption of households, EUR m, nom. [2)]	23,293	26,530	30,157	14,833	16,389	.	.	.
annual change in % (real)	-6.5	10.2	3.3	16.6	0.9	0.6	1.4	1.6
Gross fixed capital form., EUR m, nom. [2)]	8,893	10,582	12,330	6,138	7,155	.	.	.
annual change in % (real)	-7.2	12.6	3.5	8.3	9.7	3.4	4.0	3.2
Gross industrial production								
annual change in % (real)	-5.3	10.3	1.2	4.6	-3.8	-1.7	2.5	3.0
Gross agricultural production								
annual change in % (real)	5.0	-13.3	-0.8	.	.	.	.	.
Construction industry								
annual change in % (real)	-0.7	-0.5	22.1	18.8	24.4	.	.	.
Employed persons, LFS, th, average [3)]	978.0	971.6	986.1	983.5	984.2	1,000	1,010	1,020
annual change in %	-0.5	0.3	1.5	3.2	0.1	1.2	0.9	0.6
Unemployed persons, LFS, th, average [3)]	51.2	48.4	41.2	43.9	37.5	40	40	40
Unemployment rate, LFS, in %, average [3)]	5.0	4.8	4.0	4.3	3.7	3.7	3.7	3.6
Reg. unemployment rate, in %, eop	8.9	6.7	5.4	5.5	4.7	.	.	.
Average monthly gross wages, EUR [4)]	1,856	1,970	2,024	1,976	2,177	2,330	2,550	2,730
annual change in % (real, gross)	5.9	4.1	-5.5	-7.0	1.0	7.2	5.5	4.6
Average monthly net wages, EUR [4)]	1,209	1,270	1,319	1,282	1,416	1,430	1,510	1,580
annual change in % (real, net)	6.6	3.1	-4.6	-6.1	1.3	1.1	2.0	2.5
Consumer prices (HICP), % p.a.	-0.3	2.0	9.3	7.7	8.9	7.2	3.6	2.4
Producer prices in industry, % p.a.	-0.3	5.5	19.7	18.7	11.1	10.2	4.0	2.8
General governm. budget, EU def., % of GDP								
Revenues	43.7	44.9	43.9	.	.	45.1	46.9	47.4
Expenditures	51.4	49.5	47.0	.	.	49.3	50.4	49.5
Net lending (+) / net borrowing (-)	-7.6	-4.6	-3.1	.	.	-4.2	-3.5	-2.1
General gov.gross debt, EU def., % of GDP	79.6	74.4	72.3	.	.	71.0	68.5	68.1
Stock of loans of non-fin. private sector, % p.a.	0.0	5.9	10.2	10.4	4.1	.	.	.
Non-performing loans (NPL), in %, eop [5)]	2.6	1.6	1.5	1.6	1.4	.	.	.
Central bank policy rate, % p.a., eop [6)]	0.00	0.00	2.50	0.00	4.00	.	.	.
Current account, EUR m	3,398	1,732	-578	-378	1,925	810	1,480	1,580
Current account, % of GDP	7.2	3.3	-1.0	-1.3	6.1	1.3	2.2	2.3
Exports of goods, BOP, EUR m	29,622	35,255	42,628	21,045	21,884	47,230	51,290	54,680
annual change in %	-7.4	19.0	20.9	23.2	4.0	10.8	8.6	6.6
Imports of goods, BOP, EUR m	27,289	34,373	44,802	22,074	21,008	49,370	53,120	56,570
annual change in %	-11.1	26.0	30.3	37.1	-4.8	10.2	7.6	6.5
Exports of services, BOP, EUR m	6,985	8,471	11,133	4,916	5,379	13,030	14,060	15,170
annual change in %	-19.3	21.3	31.4	40.3	9.4	17.0	7.9	7.9
Imports of services, BOP, EUR m	5,072	6,273	7,651	3,404	3,609	9,030	9,480	10,050
annual change in %	-11.8	23.7	22.0	32.5	6.0	18.0	5.0	6.0
FDI liabilities, EUR m	446	1,856	2,051	1,362	931	1,500	.	.
FDI assets, EUR m	708	1,442	763	795	330	810	.	.
Gross reserves of CB excl. gold, EUR m	913	1,838	1,962	1,965	1,992	.	.	.
Gross external debt, EUR m	48,049	50,923	51,825	51,769	55,708	53,300	56,200	58,500
Gross external debt, % of GDP	102.1	97.4	90.9	90.8	90.4	86.0	85.2	84.6

1) Preliminary. -2) Half-year GDP data 2022 unrevised. - 3) From 2021 the new LFS methodology is applied in line with the Integrated European Social Statistics Regulation (IESS). - 4) Wage increase in 2020 due to COVID emergency relief compensations. - 5) Loans more than 90 days overdue and those unlikely to be paid. - 6) Official refinancing operation rates for euro area (ECB).

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