

## 23. SLOVENIA

### Sharp falls in exports and investment point to competitiveness challenges

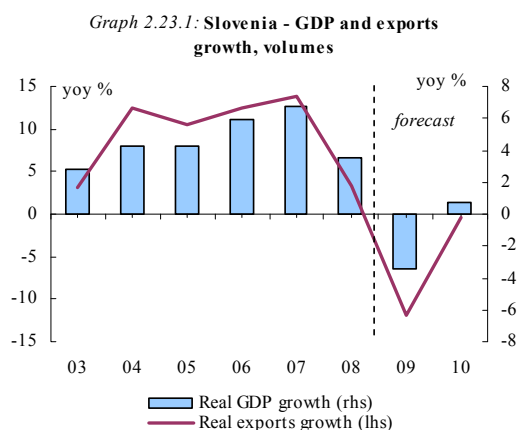
#### Real GDP growth halved in 2008

Economic growth is estimated to have halved to 3.5% in 2008 from close to 7% in the previous year. Activity decelerated markedly throughout 2008. In the final quarter real GDP fell sharply by 4.1% q-o-q, led by exports and investment. This constitutes a very negative growth impulse into 2009.

While supported by a strong increase in employment and wages, private consumption was negatively affected by high inflation and falling consumer confidence. Hence, private consumption expanded by only just over 2%. Government consumption, which rose by 3.7%, made an important contribution to growth. With a strong carry-over from 2007, investment posted a solid growth rate, especially in non-residential construction. However, a gradual decline set in from the second quarter in line with a loss of confidence in construction and manufacturing. Due to the weakening international environment and rising unit labour costs, exports expanded by a lacklustre 3.3% after double-digit growth in 2007, with a dramatic fall in the final quarter. As the growth rate of imports moderated in line with domestic demand and exports, net exports made only a small negative contribution to growth.

#### Sharp drop in exports and investment in 2009

As a highly open economy, Slovenia is expected to suffer significantly from the deepening global recession. Real GDP is projected to contract by 3.4% in 2009, followed by positive growth in 2010



(0.7%).

Business and consumer confidence indicators fell further in the first few months of 2009, confirming the downward momentum. All demand components except public consumption should decline in 2009. A sharp fall in employment and a rise in precautionary savings are expected to dampen private consumption in spite of lower inflation and additional transfers. Higher public investment, to modernise the railway network, will be more than offset by an across-the-board cut in private investment. The global recession, together with a further loss in competitiveness, is expected to entail a marked fall in exports. With imports contracting significantly in response to the decline in exports and investment, the contribution of net exports to growth should be slightly positive.

Exports are projected to gradually improve in 2010 in line with the assumed international economic turnaround. Private consumption should return to positive, albeit low, growth reflecting a lower pace of job losses and a slight acceleration in wage growth. Government spending is projected to continue to support economic activity. Investment should gradually benefit from these developments, but is expected to post a slightly negative growth rate for the year as a whole also on account of a strong negative carry-over from 2009.

#### Significant contraction in employment

As in 2007, employment expanded by some 3% in 2008. However, it has been on a downward trend since September and the unemployment rate has edged up since late 2008. The recession is likely to lead to significant job losses of close to 5%, while the unemployment rate should reach 6<sup>3</sup>/<sub>4</sub>%. An assumed fall in the labour force, driven by a reversal of the net immigration recorded in previous years, limits the impact on unemployment. At the same time, the government's wage subsidy to encourage shorter working time is expected to stem the number of layoffs. A further but less pronounced worsening of the labour market is foreseen for 2010.

While average wages grew by as much as 8<sup>3</sup>/<sub>4</sub>% in 2008, the forecast assumes that the agreed pay terms for the private sector will not be applied in

full in 2009 as a result of the ongoing recession. Instead, nominal wages are expected to broadly stabilise. In the public sector, the recently-revised collective wage agreement still foresees a significant rise in wages. The projected moderate rebound in economic activity in 2010 is expected to result in an acceleration in overall wage growth.

In 2008, inflation averaged 5.5%, driven by commodity price shocks and strong domestic demand. A sharp decrease is expected for 2009 due to much lower commodity prices and weakening economic activity. Still, the rate should remain above the euro area average reflecting, inter alia, increases in excise duties throughout the year, on energy, alcohol and tobacco products. In 2010, inflation is projected to increase due to reviving economic activity.

#### Marked deterioration in public finances

The general government balance is estimated to have recorded a deficit in 2008, of 0.9% of GDP, after a surplus of 0.5% in the previous year.

In 2009, the deficit is projected to widen significantly to 5½% of GDP as a result of declining activity levels and the government's recovery measures. On the revenue side, the

impact of the direct tax relief for businesses and the phase-out of the payroll tax is expected to be less than fully compensated by higher excise duties. On the spending side, higher subsidies and transfers together with a sizeable increase in the wage bill lead to a steep increase in the expenditure ratio. The deficit is projected to widen further to 6½% of GDP in 2010 on a no-policy change basis.

Having fallen gradually over several years, gross government debt stood at 22¾% of GDP in 2008. Due to the increasing deficit and the denominator effect, and including the recapitalisation of the state-owned Slovene Export and Development Bank (0.4% of GDP), the debt ratio is projected to rise to 29% in 2009. A further hike is expected in the following year. No impact on the public finances of the government's guarantees for banks and companies (none called on to date) is included.

Table 2.23.1:

#### Main features of country forecast - SLOVENIA

	2007		Annual percentage change							
	bn Euro	Curr. prices	% GDP	92-04	2005	2006	2007	2008	2009	2010
GDP at previous year prices	34.5	100.0		3.2	4.3	5.9	6.8	3.5	-3.4	0.7
Private consumption	18.0	52.2		3.8	2.6	2.9	5.0	2.2	-0.4	0.6
Public consumption	6.1	17.7		2.9	3.3	4.1	2.5	3.7	2.9	2.9
Gross fixed capital formation	9.5	27.5		6.7	3.8	10.4	11.9	6.2	-13.6	-1.1
of which : equipment	3.8	11.2		9.7	5.1	15.6	9.6	3.5	-13.3	-0.5
Exports (goods and services)	24.2	70.2		3.8	10.6	12.5	13.8	3.3	-11.8	-0.3
Imports (goods and services)	24.6	71.5		6.0	6.6	12.2	15.7	3.5	-12.0	-0.6
GNI at previous year prices (GDP deflator)	33.8	98.0		3.2	4.7	5.5	5.9	3.0	-3.2	0.8
Contribution to GDP growth :										
Domestic demand				4.1	3.0	5.0	6.3	3.5	-3.5	0.6
Stockbuilding				0.4	-0.8	0.8	1.8	0.2	-0.4	-0.1
Foreign balance				-1.3	2.2	0.2	-1.3	-0.2	0.5	0.2
Employment				-	-0.1	1.5	3.0	2.9	-4.7	-0.6
Unemployment rate (a)				-	6.5	6.0	4.9	4.4	6.6	7.4
Compensation of employees/head				-	5.3	5.5	6.3	8.5	2.3	3.1
Unit labour costs whole economy				-	0.8	1.1	2.5	7.9	1.0	1.7
Real unit labour costs				-	-0.8	-0.9	-1.5	3.7	-0.9	-0.4
Savings rate of households (b)				-	-	17.1	16.4	17.3	18.7	18.6
GDP deflator				20.9	1.6	2.0	4.1	4.0	1.9	2.0
Harmonised index of consumer prices				-	2.5	2.5	3.8	5.5	0.7	2.0
Terms of trade of goods				1.1	-2.4	-0.4	0.2	-2.0	1.3	-0.1
Trade balance (c)				-2.7	-3.6	-3.8	-4.9	-7.3	-5.9	-5.7
Current account balance (c)				0.1	-1.8	-2.4	-4.0	-6.1	-4.6	-4.4
Net lending(+) or borrowing(-) vis-à-vis ROW (c)				0.1	-1.7	-2.3	-3.7	-6.1	-4.6	-4.4
General government balance (c)				-	-1.4	-1.3	0.5	-0.9	-5.5	-6.5
Cyclically-adjusted budget balance (c)				-	-1.3	-2.1	-1.7	-2.5	-4.9	-5.2
Structural budget balance (c)				-	-1.3	-2.1	-1.7	-2.5	-4.9	-5.2
General government gross debt (c)				-	27.0	26.7	23.4	22.8	29.3	34.9

(a) Eurostat definition. (b) gross saving divided by gross disposable income. (c) as a percentage of GDP.