24. SLOVENIA

Solid, broad-based growth ahead

Driven by rising exports and consumption, economic growth in the first half of 2016 showed resilience despite a contraction in public investment. Growth in 2017 and 2018 is expected to be broad-based with a further shift from external to domestic demand. Labour market conditions are expected to improve further. Public finances are projected to improve gradually reflecting the favourable macroeconomic outlook.

Stable economic growth

Slovenia's real GDP grew by 0.5% (q-o-q) in both the first and the second quarter of 2016. Rising inventories, exports and private consumption contributed to this, while investment contracted. The latter was caused by a large fall in public investment (due to the end of the programming period of EU funding) which was only partially compensated by solid private investment growth. Economic activity is likely to have increased further in the third quarter as indicated by strong employment growth and signs of a strong tourist season. GDP is expected to grow by 2.2% in 2016, with all components except investment contributing to growth.

Positive outlook ahead

Private consumption, boosted by rising employment, increasing public wages and coupled with a mild housing market recovery, is set to make a growing contribution to economic growth. Once the effect of a temporary decline due to the new period of EU funding is absorbed, both private and public investment are expected to contribute strongly to GDP growth. High capacity utilisation and continued increase in external demand point to a strong rebound in investment.

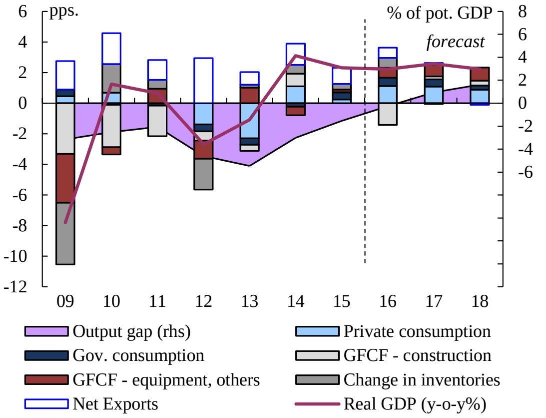
Exports, driven by improved cost competiveness, are expected to stay strong, although they will suffer a slight knock from slowing demand in major trading partners. The contribution of net exports to GDP growth is forecast to fall, as rising domestic demand fuels imports. Real GDP is expected to increase by 2.6% in 2017 and 2.2% in 2018.

Trade surplus boosts current account

Slovenian companies continue to deleverage, while recording a high foreign trade surplus. This has led to a large current account surplus, which is expected to start falling slightly as imports increase.

Risks to the growth forecast are mainly external and broadly balanced. Exports to Slovenia's trading partners could be affected by the slowdown in world trade, and the rebound in public investment could be delayed. On the positive side, large investment projects could accelerate the struggling construction sector. A quicker-than-expected recovery in Russia could boost exports.

Graph II.24.1: **Slovenia - Real GDP growth and contributions, output gap**



Low inflation likely to continue, while employment is expected to rise further

The mild recovery in oil prices this year after last year's slump implies that inflation is likely to remain around zero in 2016. As oil prices are expected to rise further in 2017 and 2018 and wages are also set to increase, inflation is expected to start rising again, although it should remain subdued until the end of the forecast horizon. As the demand for labour is broad-based, job creation should continue as long as wage increases in the private sector remain in line with productivity trends.

General government balance continues to improve

In 2015, the general government deficit fell considerably, to 2.7% of GDP, driven by the phasing-out of temporary measures and positive revisions regarding the impact of the Bank Asset Management Company (BAMC). In 2016, the deficit is expected to decrease to 2.4% of GDP as a result of higher-than-expected tax revenues, a large decline in public investment (following the end of the 2007-2013 EU funding period) and reduction in interest expenditure. Conversely, the public wage bill and pensions are projected to increase in 2016 (by 5% and 0.4%, respectively). In addition, migration related expenditure is set to increase by 0.1% of GDP.

The general government deficit is expected to decline further to 2.0% of GDP in 2017, mainly due to buoyant tax and social contributions receipts. Nevertheless, the compensation of public employees is expected to continue increasing at a strong pace due to the re-negotiation of wages and the reversal of several consolidation measures. The restructuring of the tax system is expected to be fiscally neutral. It consists of a decrease in both the personal income taxes and the taxation of bonuses paid by employers, which together are estimated to reduce tax receipts by 0.3% of GDP. This is partly offset by an increase in the corporate tax rate from 17% to 19%, which should increase revenue by an estimated 0.1% of GDP. Measures to improve the efficiency of tax collection are expected to compensate the remaining cost of the reform. In 2018, under a no-policy-change assumption, the general government balance is expected to decrease to 1.5% of GDP mainly due to economic growth and improved labour market conditions.

The structural balance is expected to worsen in 2016. It is forecast to deteriorate further in 2017, due to a considerable increase in the positive output gap, before slightly improving in 2018, under a no policy change assumption.

The debt-to-GDP ratio is expected to have peaked at 83.1% in 2015. Supported by the economic recovery and a reduction in precautionary cash buffers, public debt is forecast to decrease to 80.2% of GDP in 2016. It is projected to continue declining to 78.3% in 2017 and to 76.6% in 2018.

The main downside risks to public finances over the forecast horizon stem from the uncertainty that remains regarding the fiscal implications of the activities of BAMC and migration related costs.

Table II.24.1:

Main features of country forecast - SLOVENIA

	2015		Annual percentage change						
bn EUR	Curr. prices	% GDP	97-12	2013	2014	2015	2016	2017	2018
GDP	38.6	100.0	2.6	-1.1	3.1	2.3	**2.2**	**2.6**	**2.2**
Private Consumption	20.1	52.1	2.2	-4.0	2.0	0.5	**2.1**	**2.1**	**1.7**
Public Consumption	7.2	18.7	2.4	-2.1	-1.2	2.5	**2.9**	**2.6**	**1.5**
Gross fixed capital formation	7.5	19.5	1.6	3.2	1.4	1.0	**-3.9**	**5.3**	**6.4**
of which: equipment	2.8	7.2	3.7	12.6	-7.5	2.4	**8.3**	**9.5**	**10.5**
Exports (goods and services)	30.1	77.9	6.6	3.1	5.7	5.6	**6.2**	**4.0**	**4.6**
Imports (goods and services)	26.5	68.8	5.7	2.1	4.2	4.6	**6.0**	**4.5**	**5.4**
GNI (GDP deflator)	37.7	97.7	2.5	-0.9	3.6	0.1	**3.3**	**2.5**	**2.2**
Contribution to GDP growth: Domestic demand			2.2	-2.1	1.2	0.9	**0.9**	**2.5**	**2.3**
Inventories			0.0	0.2	0.6	0.4	**0.7**	**-0.1**	**0.0**
Net exports			0.5	0.8	1.4	1.1	**0.7**	**0.1**	**-0.1**
Employment			0.2	-1.1	0.4	1.1	**1.1**	**0.9**	**0.7**
Unemployment rate (a)			6.6	10.1	9.7	9.0	**8.4**	**7.7**	**7.2**
Compensation of employees / head			6.6	0.5	1.3	1.4	**1.8**	**1.8**	**2.9**
Unit labour costs whole economy			4.1	0.4	-1.3	0.3	**0.7**	**0.1**	**1.4**
Real unit labour cost			-0.2	-0.4	-2.1	-0.7	**-0.8**	**-1.2**	**-0.1**
Saving rate of households (b)			13.7	13.4	13.3	14.8	**17.2**	**16.0**	**15.5**
GDP deflator			4.3	0.9	0.8	1.0	**1.5**	**1.3**	**1.6**
Harmonised index of consumer prices			4.9	1.9	0.4	-0.8	**0.1**	**1.5**	**1.9**
Terms of trade goods			-0.5	0.8	1.1	1.3	**1.9**	**-0.5**	**-0.3**
Trade balance (goods) (c)			-3.4	0.8	2.9	3.9	**4.7**	**4.3**	**3.8**
Current-account balance (c)			-1.8	3.6	6.2	5.4	**7.4**	**7.0**	**6.4**
Net lending (+) or borrowing (-) vis-a-vis ROW (c)			-1.7	4.1	6.6	6.4	**7.7**	**7.5**	**7.1**
General government balance (c)			-3.0	-15.0	-5.0	-2.7	**-2.4**	**-2.0**	**-1.5**
Cyclically-adjusted budget balance (d)			-	-12.4	-3.6	-1.9	**-2.2**	**-2.4**	**-2.3**
Structural budget balance (d)			-	-1.9	-2.5	-1.9	**-2.1**	**-2.3**	**-2.2**
General government gross debt (c)			29.5	71.0	80.9	83.1	**80.2**	**78.3**	**76.6**

(a) as % of total labour force. (b) gross saving divided by gross disposable income. (c) as a % of GDP. (d) as a % of potential GDP.