24. SLOVENIA

Investment and consumption driving growth

Economic growth is strengthening, driven by private consumption and investment. Labour market conditions are improving, as unemployment decreases and the employment rate increases. Demand for labour is driving up the compensation of employees, supporting domestic demand. In line with the positive macroeconomic outlook, the general government deficit and debt are expected to continue to decline over the forecast horizon.

Solid growth in 2016

Real GDP grew by 2.5% in 2016, up from 2.3% in 2015. Growth was driven by rising consumption and exports, but held back by decreasing public investment, which resulted from a slow start of the new programming period of EU funds. Nevertheless, investment in machinery and equipment increased by 10.8%, recovering from a low level. Private consumption, backed by rising employment, wages and consumer confidence, was the main driver of GDP growth. Exports continued to grow at a robust rate, but their net contribution to GDP growth was dampened by rising imports.

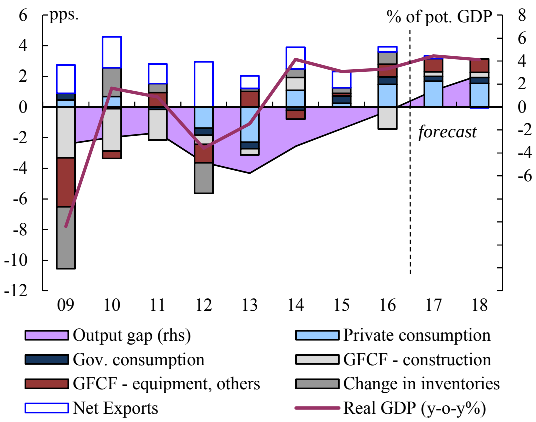
Domestic demand driving growth in 2017-18

Real GDP growth is forecast to reach 3.3% in 2017 and 3.1% in 2018. The year 2017 began with improving consumer sentiment, increasing retail sales and further decreases in unemployment. The fiscal stance is projected to be accommodative. These factors are expected to keep private consumption growth at a rate comparable to that of 2016. Both private and public investment are also projected to positively contribute to growth. Issuance of building permits and construction activity indicators point to a revival in the construction of dwellings. The banking sector has recovered from its previous difficulties and is becoming better capitalised. Therefore, access to credit has improved for households and non-financial companies, further supporting investment. Domestic demand is forecast to be the main growth driver in 2017 and 2018.

Exports are forecast to grow by 5.8% in 2017 and by 5.4% in 2018, driven by increasing demand from trading partners and continued gains in market share. However, due to increased consumer spending and investment, the contribution of net exports to growth is expected to be close to zero in 2017 and 2018. Slovenia's terms of trade are expected to worsen over the forecast horizon, due to rising energy prices. Therefore, the record-high current account surplus reached in 2016 (7%) is also expected to moderate in both 2017 and 2018.

Risks to the growth outlook are tilted to the upside. Upside risks are primarily domestic, as improving sentiment, better access to credit and positive decisions regarding some large investment projects under consideration could increase investment more than expected. The risks to the downside are mainly external and relate to the future development of energy and raw materials prices.

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



Wages and inflation expected to rise

Increasing exports, consumption and investment are expected to boost the demand for labour in the economy. The unemployment rate is expected to decline to 6.3% in 2018, approaching the natural rate of unemployment and strengthening wage pressures. The compensation of employees is forecast to increase above its 2016 growth rate of 2.2% over the forecast years.

HICP inflation picked up in the first quarter of 2017, driven by an increase in service and energy prices. As energy prices weigh heavily in Slovenia's consumer basket, energy price increases are expected to be an important driver of inflation. Wage increases are also expected to drive up core inflation over the forecast horizon.

The Government balance continues to gradually improve

The general government deficit decreased from 2.9% of GDP in 2015 to 1.8% of GDP in 2016, mainly due to higher-than-expected current revenues and a large decline in public investment following the end of the 2007-2013 EU funding period.

After a 34% plunge in 2016, public investment is planned to increase gradually in the coming years, growing around 8% in 2017. This, combined with buoyant tax revenues and social contributions, is expected to result in a further decline of the government deficit to 1.4% of GDP in 2017. Nonetheless, the compensation of public employees and social transfers are projected to rise further.

In 2018, under a no-policy-change assumption, the general government deficit is expected to decrease to 1.2% of GDP, mainly due to economic growth and improved labour market conditions, while public investment is expected to pick up in line with the dynamics of the current EU financial programming period.

The main downside risks to public finances over the forecast horizon stem from expenditure pressures from public wages and pensions, uncertainties regarding the fiscal implications of the activities of the Bank Asset Management Company and possible one-off expenditures from ongoing court cases, for instance from the case of the Slovenian Farmland and Forest Fund.

In structural terms, Slovenia's fiscal position improved in 2016 and is expected to worsen in 2017 and 2018. The deterioration of the structural balance relates to the large change in the output gap, which is projected to turn positive in 2017.

The debt-to-GDP ratio peaked at 83.1% in 2015. Supported by the economic recovery and a reduction in precautionary cash buffers, public debt is forecast to decline continuously to 75.5% in 2018.

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	**2.5**	**3.3**	**3.1**
Private Consumption	20.1	52.1	2.2	-4.0	2.0	0.5	**2.8**	**3.2**	**3.0**
Public Consumption	7.2	18.7	2.4	-2.1	-1.2	2.5	**2.6**	**1.7**	**2.0**
Gross fixed capital formation	7.5	19.5	1.6	3.2	1.4	1.0	**-3.1**	**6.3**	**6.4**
of which: equipment	2.8	7.2	3.7	12.6	-7.5	2.4	**10.8**	**10.6**	**10.5**
Exports (goods and services)	30.1	77.9	6.6	3.1	5.7	5.6	**5.9**	**5.8**	**5.4**
Imports (goods and services)	26.5	68.8	5.7	2.1	4.2	4.6	**6.2**	**6.4**	**6.1**
GNI (GDP deflator)	37.7	97.7	2.5	-0.9	3.6	0.1	**3.7**	**3.2**	**3.1**
Contribution to GDP growth: Domestic demand			2.2	-2.1	1.2	0.9	**1.4**	**3.2**	**3.1**
Inventories			0.0	0.2	0.6	0.4	**0.8**	**0.0**	**0.0**
Net exports			0.5	0.8	1.4	1.1	**0.3**	**0.2**	**-0.1**
Employment			0.2	-1.1	0.4	1.1	**2.0**	**1.9**	**1.6**
Unemployment rate (a)			6.6	10.1	9.7	9.0	**8.0**	**7.2**	**6.3**
Compensation of employees / head			6.6	0.5	1.3	1.4	**2.2**	**2.7**	**3.4**
Unit labour costs whole economy			4.1	0.4	-1.3	0.3	**1.7**	**1.3**	**1.9**
Real unit labour cost			-0.2	-0.4	-2.1	-0.7	**1.1**	**-0.2**	**0.1**
Saving rate of households (b)			13.7	13.4	13.3	14.8	**14.6**	**14.0**	**13.5**
GDP deflator			4.3	0.9	0.8	1.0	**0.6**	**1.5**	**1.8**
Harmonised index of consumer prices			4.9	1.9	0.4	-0.8	**-0.2**	**1.5**	**1.8**
Terms of trade goods			-0.5	0.8	1.1	1.3	**0.8**	**-0.5**	**0.0**
Trade balance (goods) (c)			-3.4	0.8	2.9	3.9	**3.9**	**3.4**	**3.0**
Current-account balance (c)			-1.8	3.6	6.2	5.4	**7.0**	**6.2**	**5.8**
Net lending (+) or borrowing (-) vis-a-vis ROW (c)			-1.7	4.1	6.6	6.4	**6.1**	**6.4**	**6.3**
General government balance (c)			-3.0	-15.1	-5.4	-2.9	**-1.8**	**-1.4**	**-1.2**
Cyclically-adjusted budget balance (d)			-	-12.4	-3.8	-2.1	**-1.7**	**-2.0**	**-2.4**
Structural budget balance (d)			-	-1.9	-2.7	-2.0	**-1.7**	**-1.8**	**-2.3**
General government gross debt (c)			29.5	71.0	80.9	83.1	**79.7**	**77.8**	**75.5**

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