

**Slovenia entered the exchange rate mechanism (ERM) II** on 28 June together with Estonia and Lithuania. The central parity set at SIT 239.64 per EUR 1 with allowed fluctuations of  $\pm 15\%$  was determined on the basis of the market exchange rate before entry which, according to the Bank of Slovenia, the government and competent EU institutions, is close to the equilibrium exchange rate in the given macroeconomic conditions. The BS is expected to pursue fluctuations within a much narrower band because the actual rate of depreciation was significantly lower in the past few years. During the two-year period of participating in the ERM II, Slovenia must fulfil the Maastricht convergence criteria in order to adopt the euro. Slovenia already satisfies both fiscal criteria and the long-term interest rate criterion, however, it still fails to meet the price stability criterion (see p. 6). In order to bring inflation down to the level set by the Maastricht criterion, it will be crucial to further co-ordinate fiscal, wages and administered prices policies in view of the BS' limited autonomy to conduct monetary policy.

**Consumer prices** rose by 0.3% in June, the same as in June last year. Inflation's downturn compared to May (0.9%) was chiefly due to the fall in oil prices, while the biggest contribution to June's price increase came from the seasonal rise in package holiday prices. Despite the decline in monthly inflation, annual inflation climbed by 0.1 of a percentage point to 3.9% (6.0% in June last year). The average inflation rate continued to fall to total 4.4% in June (6.6% in June last year). According to the latest Eurostat data, the Maastricht criterion concerning inflation was 2.6% in May.

**Economic growth** surged by 3.7% year on year in the **first quarter** after GDP growth only strengthened gradually in the second half of 2003 (2.1% year on year in the first, 2.3% in the third and 2.5% in the last quarter). This year's growth was mainly underpinned by the leap in investment consumption and export growth. Gross fixed capital formation increased by as much as 8.0% year on year (5.0% in the third and 5.5% in the last quarter of 2003) mostly owing to investment in machinery and equipment, while growth in civil engineering (motorway construction) maintained last year's high level. Private consumption, which strengthened in the second half of 2003, increased by 3.7% year on year in the first quarter and roughly maintained the level of the last quarter of 2003 (3.6%). Growth in government consumption, which had already slowed down in the second half of 2003, was low at just 0.6%. Export growth accelerated to 8.8% year on year in the first quarter after it began to recover in the last quarter of 2003 (4.1% year-on-year growth). Following the pick-up in economic activity in the EU, growth in exports to these markets returned to the level of 2001 after faltering in 2002 and 2003 (6.2% year-on-year growth in the first quarter measured in euros). The robust growth in exports to the CEFTA and the former Soviet Union seen in the last two years increased further, especially to Russia. Growth in exports to the countries of former Yugoslavia, which was modest last year, regained momentum this year. Similarly, exports of services recorded positive trends and they rose by 4.3% in real terms in the first quarter after falling in 2003. The increased growth in domestic consumption and exports pushed import growth up (10.4%) so the contribution of international trade to economic growth was still negative (-1.1 percentage points), but lower than in each quarter of 2003.

**Value added** rose by 3.7% year on year in the first quarter, gaining 1.4 percentage points compared to the last quarter of 2003. Higher growth was seen in both primary activities (A to F) and service sectors (G to O) in line with the spring forecasts. As regards the former, growth accelerated in construction, agriculture and electricity, gas and water supply, while manufacturing maintained the relatively high level of the preceding quarter. As regards services, growth increased in mainly market-oriented services (G to K), while public services (L to O) roughly sustained the level of the preceding quarter.

According to April's figures, robust growth in exports and manufacturing's production volumes eased off slightly, however, the continuing high lending activity and economic growth achieved in the first quarter confirm the spring economic growth projections (3.6%). As regards export flows, year-on-year growth slowed down in April compared to the first quarter (in nominal terms) in EU markets and the former Soviet Union countries and accelerated in Bosnia and Herzegovina and Macedonia (see p. 4). **Import growth** increased substantially in April: imports of investment and consumer goods rose the most in line with the surge in investment and private consumption, with imports of intermediate goods also rising (see p. 4). Manufacturing's production volumes declined slightly in April after jumping in March, which reduced growth to 2.9% year on year in the first four months (see p. 12). On the other hand, data on **corporate borrowing** suggest a further rise in private investment. Enterprises mainly undertook long-term borrowing, while borrowing in tolar, which declined in May for the second month running, replaced borrowing in foreign currency which still recorded high growth rates (see p. 8). Banks provide sources for their lending activity in international markets; in the first four months they borrowed abroad much more than last year (EUR 274 million compared to EUR 80 million in the same period last year), while enterprises borrowed less (EUR 119 million and EUR 154 million, respectively). The long-term borrowing of households is also on the increase this year. As far as savings are concerned, **household tolar savings** in banks dropped in May for the third month in a row, foreign currency savings still recorded slight growth, while the high inflows into mutual funds continued (see p. 7).