SUMMARY

Amid the stimulating impacts from the external environment and a relatively large contribution of changes in inventories, gross domestic product increased by 1.2% in 2010. The positive signals from foreign demand that started to boost economic activity in the second half of 2009 strengthened in 2010. Slovenia's economic recovery was mainly limited to the export-oriented and technology-intensive sectors of the economy, and this became even more pronounced during the year, while domestic factors hampered the recovery. Domestic consumption was only 0.4% higher than in 2009, with a visible positive contribution coming only from change in inventories (1.6 p.p.), while the other main aggregates remained lower than in 2009 (gross fixed capital formation) or recorded modest growth (private and general government consumption).

The Spring Forecast of Economic Trends is based on the implemented or adopted economic policy measures. The basic scenario of the Spring Forecast presented in the following sections is based on the adopted budgets for 2011 and 2012, and takes into account valid regulations and agreements on wage policy in the public sector. The adopted budgetary documents anticipate a slower consolidation compared with the commitments made in the Stability Programme at the beginning of 2010. This does not yet have an inhibitory effect, but nevertheless creates uncertainty regarding Slovenia's meeting of its commitments on fiscal consolidation, which could crucially affect lender risk perception and impair access to sources of finance.

Economic activity is expected to increase by 2.2% or 2.6%, respectively, in 2011 and 2012, which is less than the medium-term average before the crisis. Against a background of slower growth in foreign demand, the chances for a more rapid recovery of Slovenia's economy have narrowed due to loss of competitiveness of the economy, a tighter financial environment for businesses and the deteriorated situation in the public finances. With the impact of these factors continuing, economic growth will remain relatively low compared with pre-crisis levels and lower than projected in the autumn.

Export demand, having already played a crucial role in the recovery of Slovenia's economic activity last year, remains a vital driver of economic growth in the whole period covered by the forecast. Forecasts by international institutions for economic activity and import growth in Slovenia's main trading partners, which were taken into account in our spring forecast, have improved since the autumn, but the positive impact of foreign demand on the export-oriented part of Slovenia's economy will ease gradually this year and the next. Slovenia failed to fully exploit foreign demand, which had already been indicated by last year's movements when Slovenian exports recorded lower growth than foreign demand. Exporters are facing pressures on competitiveness from both labour costs and rises in commodity prices, amid much greater shocks from the international environment than projected in the autumn. Faster recovery of Slovenia's exports is also hampered by problems arising from insufficient technological restructuring in the past. As a result of these factors, total growth in exports will decline from last year's 7.8% to 6.9% this year and to 6.7% in 2012.

The financial conditions for businesses mainly tightened further in Slovenia last year, and this will affect Slovenia's economy significantly in 2011 and in the years to come. Banks continued to repay foreign liabilities last year while the government was withdrawing its deposits from the banking system. Amid a deterioration in the quality of banks' assets, banks were rapidly increasing impairments and provisioning. With regard to banks' risk assessment of clients, the structure of bank loans is shifting towards greater caution in granting corporate loans and towards increasing the volume of household loans. Financial conditions for enterprises,

which are heavily indebted in certain industries, are thus fairly tight when it comes to sources of finance. Moreover, with a less expansionary monetary policy, the cost of borrowing is expected to start to rise in the euro area.

The pick-up of investment activity will be crucially affected by the international environment, the availability of financial sources and the situation in the construction sector. Financial conditions will play an important role in the recovery of investment activity, amid the expected movements in the international environment, which influence corporate decision-making on expansion of production capacity. The continuation of economic recovery in Slovenia's main trading partners and related growth in merchandise exports will, as in 2010, favourably impact investment in machinery and equipment. The expressly negative movements in the construction sector that have been recorded over the last two years are set to ease gradually, but economic activity in individual construction segments (residential construction, in particular) is not yet projected to start growing this year. Amid the expected moderation of negative trends in construction investment, gross fixed investment is also forecast to increase this year (2.9%). Gross fixed investment growth is expected to see a transitory cyclical upswing to 4.5% next year. After three years of strong decline in investment in construction work, activity in this segment is set to recover next year; business investment will also continue to grow.

Economic circumstances are also reflected in poor prospects for growth in private and government consumption. Growth in private consumption will be relatively modest this year and in 2012, consistent with the estimated growth of disposable income amid poor labour-market prospects. It is projected to be 0.7% in 2011 and 2012. Having already eased last year (from 3% to 0.8%), government consumption growth will also be low in this year (0.8%) and the next (0.6%). Amid continuing employment growth in education, and health and social work, and in the absence of additional economic-policy measures, compensation of employees is expected to grow further in real terms according to this scenario. Against the background of high unemployment, social benefits in kind are also projected to grow in real terms, reflecting the increasing need for different types of social support. Expenditure on intermediate government consumption will remain more or less at the level achieved.

The labour market is expected to see a further decline in employment and an increase in unemployment, but both will be less pronounced than last year. The number of employed persons continued to fall last year and similar movements are also expected this year and in 2012, albeit to a lesser extent. Since the beginning of the economic crisis, enterprises have, despite last year's economic revival, continued to cut jobs and to adjust employment to changes in the economic environment, reflected in the level of GDP (which has yet to reach that in 2008), mounting labour-cost pressures and the financial standing of enterprises. This adjustment is expected to continue, albeit to a lesser extent than in 2009 and 2010. In 2011, the average number of employed persons is projected to be by 1.2% lower relative to last year, largely due to the slump at the end of last year, and by 0.3% next year (according to national accounts statistics). Following sizeable increases in unemployment at the end of last and at the beginning of this year, the average number of unemployed persons is set to climb to around 114 thousand in 2011 (116 thousand in 2012); the average registered unemployment rate will rise to 12.1% this year and 12.3% next year. This persistence of unfavourable trends is a consequence of the expected relatively sluggish economic growth, and the age and educational-attainment structure of the unemployed, as well as of regulatory changes in the labour market. Looking at the structure of unemployment, higher unemployment of older people and those with lower education, who are relatively less employable, was recorded last year. Furthermore, a number of amendments to regulation came into force this year, which could increase inflows into unemployment in the short term, but are positive from the aspect of the necessary changes on the labour market.

The expected total nominal growth of wages (2.5%) will this year result from wage growth in the private sector, as it did last year, but next year's acceleration to 3.8% based on the agreements now in force will also be due to wage rises in the public sector. This year, private-sector wages are projected to increase by 3.3% in nominal terms, nearly 2 p.p. less than in last year, as the effects of the adjustment to the new level of minimum wage in that part of the economy where wages have yet to be adjusted and of changes in employment structure will be much smaller this year. However, with a gradual economic recovery, private-sector wages are expected to see higher growth again next year (4.3%). After last year's stagnation, the average gross wage in the public sector will see similar movements this year, increasing by only 0.3% in nominal terms. In 2012, wage growth will strengthen to 2.5%, according to the agreements now in force, due to a gradual reinstatement of some, currently frozen components of wages of public servants.

This year's inflation, projected to reach 3% y-o-y by the end of the year, will be significantly affected by commodity price rises, but is set to decline somewhat next year, assuming that these pressures will ease. Amid relatively sluggish growth in domestic economic activity, upward pressures on prices continue to come from the international environment, particularly from increases in energy prices, which had already spilled over into retail prices last year, while global food and other commodity price rises are beginning to affect retail prices this year. The expected continued growth in economic activity will contribute to somewhat higher core inflation in 2012 than this year, but price growth of commodities is anticipated to slow down consistent with the assumptions on oil and commodity prices in the international environment, which is why lower y-o-y inflation at the end of the year (2.7%) is also expected.

Under the impact of factors that had already widened the deficit of some sub-balances of the current account last year, the current account in total will witness a higher deficit this year and the next. The current-account deficit is set to rise to 2.3% of GDP this year and 2.4% of GDP in 2012. The merchandise trade deficit will thus narrow somewhat next year, after this year's increase, which will be largely related to the assumed movements of export and import prices, as the terms of trade are projected to deteriorate again this year and then stabilise in 2012. At the same time, we anticipate a further increase in net interest payments on the private-sector and government debts. These movements are based on the expected growth of borrowing and the increase in interest rates by central banks and a consequent further rising of interbank interest rates. Due to the dynamics of repayments of interest on government bonds, interest from this source will also increase. The surplus in trade in services will fluctuate around last year's level in 2011 and 2012. Assuming that the absorption rate of EU funds will be similar to last year's, Slovenia's net position will remain relatively favourable in 2011 and 2012. With a somewhat wider deficit in the current transfers of the private sector, the current transfer balance will remain roughly balanced.

Due to the need for fiscal consolidation and weakened potential for growth in the medium-term period, the government has prepared a set of measures to improve the position of the public finances. These measures aim at limiting growth in compensation of employees, investment and subsidies, and increasing the efficiency of the general government sector. In the short term, they may result in somewhat weaker economic growth, but the medium-term prospects would improve compared to the baseline scenario of the spring forecast. The labour-market situation would, similarly, also deteriorate in the short term, but in the medium term, new possibilities for hiring would open up amid faster economic growth than anticipated in the baseline scenario of the spring forecast. These results confirm the pressing need for consolidation, but the consolidation method foreseen seems insufficient, given the persistence of high unemployment rates and the absence of measures to increase the efficiency of the broader public sector.

The risks for realisation of the spring forecast arise from the international environment. They are mainly related to commodity prices and a possible deepening of problems on international financial markets. Instability in a number of oil-producing countries may push oil prices above the current levels in the months to come and higher than assumed in the spring forecast. Higher growth in other commodity and food prices also remains a risk. Realisation of these risks would raise inflation and add pressure on the competitiveness of enterprises. Other risks to the realisation of the forecast relate to the tightening of international financial markets, given that the difficulties of the largest borrowers in the euro area may deepen and affect economic activity in the EU countries, and hence Slovenia. Materialisation of this risk may reduce economic growth in the euro area by 2.5 p.p. relative to the baseline scenario, according to the IMF estimate. If this scenario is realised this year, this is likely to have the greatest impact on economic activity in Slovenia next year. Simulations of this scenario, which would particularly impact investment and exports, show that in this case economic activity would remain at this year's level in 2012.

Spring forecasts of the main macroeconomic aggregates

	2009	2010	2011	2012
			Spring forecast	
GROSS DOMESTIC PRODUCT, real	-8.1	1.2	2.2	2.6
GDP in EUR m (current prices)	35,384	36,061	36,843	38,788
GDP per capita in EUR (current prices)	17,331	17,597	18,052	18,967
GDP per capita in USD (current prices)	24,174	23,351	24,586	25,890
POPULATION, EMPLOYMENT, WAGES AND PRODUCTIVITY				
Population on 30 June, in '000	2,042.3	2,049.3	2,041.0	2,045.0
Employment according to the SNA, growth in %	-1.9	-2.2	-1.2	-0,3
Number of registered unemployed (annual average, in '000)	86.4	100.5	114.0	115,8
Registered unemployment rate, in %	9.1	10.7	12.1	12,3
ILO unemployment rate, in %	5.9	7.2	7.9	8.0
Gross wage per employee, real	2.5	2.1	0.2	0.8
- private sector	0.9	3.3	1.1	1.3
- public sector	5.6	-1.8	-1.9	-0.5
Labour productivity (GDP per employee), real	-6.4	3.4	3.4	2.9
INTERNATIONAL TRADE				
Exports of goods and services, real	-17.7	7.8	6.9	6.7
Exports of goods	-18.1	10.2	7.7	7.4
Exports of services	-16.1	-1.1	3.4	3.3
Imports of goods and services, real	-19.7	6.6	5.1	6.0
Imports of goods	-20.9	7.7	5.2	6.0
Imports of services	-12.3	1.1	4.7	6.0
Current account BALANCE, in EUR m	-526	-409	-865	-924
- as a % of GDP	-1.5	-1.1	-2.3	-2.4
Saldo menjave s tujino v mio EUR	415	84	-91	69
- as a % of GDP	1.2	0.2	-0.2	0.2
DOMESTIC DEMAND, real				
Final consumption	0.2	0.6	0.8	0.7
of which:				
Private consumption	-0.8	0.5	0.7	0.7
Government consumption	3.0	0.8	0.8	0.6
Gross fixed capital formation	-21.6	-6.7	2.9	4.5
EXCHANGE RATES AND PRICES				
USD/EUR exchange rate	1.393	1.327	1.362	1.365
Real effective exchange rate – CPI deflator*	0.7	-1.4	-0.2	1.1
Inflation, year-end stock	1.8	1.9	3.0	2.7
Inflation rate (annual average)	0.9	1.8	2.2	3.0
Oil price (Brent crude, USD/barrel)	61.7	79.6	110.0	115.0

Source: up to 2010 SORS, BS; 2010–2012 forecasts by IMAD.
Note: * A rise in the value indicates real appreciation of national currency and vice versa.

The Spring Forecast of Economic Trends 2011 has been prepared using statistical data, information and adopted measures available by 14 March 2010.