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Slovenia:
Caught in political storm

Slovenia's economy will face another year of recession in 2013 and should finally rebound in 2014 provided a strengthening of external demand and a recovery of investment activities. Restructuring of the banking sector, deleveraging of companies and fiscal consolidation will remain the most challenging tasks for the Slovenian authorities.

In 2012 Slovenia faced another year of recession accompanied by fiscal tightening, deleveraging of banks and enterprises, growing social unrest and escalating political turbulence. GDP dropped by another 2% owing to a decline in domestic demand: gross fixed capital formation fell by almost 10%, household consumption dropped for the first time since the outbreak of the crisis and government consumption continued to decrease. Only foreign trade did contribute positively to GDP growth. The slump in investments was reflected primarily in the construction sector, where output continued to decline (-15%). A recovery of the construction sector is not in sight yet: there is still a huge stock of unsold apartments on the market and large infrastructure projects are lacking finance due to fiscal consolidation.

Along with the slowdown in export growth, industrial production stagnated in 2012. In the automotive sector, one of Slovenia's major export industries, the output of vehicles fell by 9%. Owing to declining demand in 2012, Slovenia's car manufacturer Revoz (Renault) was forced to cut shifts and adjust working time to avoid layoffs. In December the company decided to stop serial production until mid-January 2013. On the other hand, remarkable increases in production were reported in the manufacture of computers and optical products and machinery and equipment.

In foreign trade merchandise exports almost stagnated in 2012, and imports contracted. Thus, the trade deficit was reduced markedly (by EUR 750 million) compared with a year earlier. Owing to the declining trade deficit in goods, along with a surplus in the services trade, the current account closed with the highest surplus since the country's gaining independence. In contrast to our earlier expectations, the inflow of FDI remained at a disappointing level of around EUR 100 million.

The labour market situation has further deteriorated. Based on Labour Force Survey data, employment fell for the fourth consecutive year and was down by almost 2%; the unemployment rate rose slightly to 9%, but remained below the EU average. Unemployment based on registration data soared to 12.8%. A labour market reform bill aimed at the flexibilization of the labour market – dealing among other things with the elimination of labour market segmentation, population ageing, notice periods and changes in severance payment regulations – will be discussed in early March. Radical changes, however, are not to be expected due to the rigid stance taken by both the trade unions and the employer associations.

In December the Slovenian parliament adopted the 2013 and 2014 budgets with the main goal of balancing the budget by 2015. Accordingly the deficit should be reduced to 2.8% of GDP in 2013 and 2.5% in 2014, mainly owing to expenditure cuts. The reduction of spending is expected through 'adjustments in the public sector', particularly by the cut of the public sector wage bill by 5% including a reduction of the workforce, increased VAT for certain items, lower transfers to municipalities and by the pension reform through more restrictive pension regulations and lower indexation to wages. On the revenue side the government reckons with high and very likely unrealistic inflows from EU funds. On top, tax increases of e.g. rental income, capital gains, student work and higher VAT rates on certain groups of goods are envisaged. However, there remain uncertainties about the actual amount of the deficit, as it is not yet clear how much the government will have to set aside for state guarantees and further capital injections (as a consequence of rising bad loans) into state-owned banks.

The pension reform, which is very similar to the proposal rejected in 2011 by a referendum, was eventually adopted by the Slovenian government in December 2012 and became effective from January 2013. The new legislation envisages a gradual increase of the retirement age for both men and women to 65 years (instead of currently 58 years for men and 55 years for women) by 2019. Long-term insured with 40 years of contributions are exempted from this regulation and can retire at the age of 60. The number of contributory years will be extended from 35 to 40 for both men and women, as will be the period for the pension assessment base, from the current 18 to 24 years.

A successful USD bond issue in October 2012 and the constitutional courts' ban on referenda concerning the establishment of both a bad bank and a state holding company have – for the time being – staved off the risk of a bailout. Following these court decisions, as well as due to a general easing of the situation in the euro area, the yields of Slovenian ten-year government bonds fell temporarily to below 5% at the beginning of January 2013, after exceeding 7% in August 2012. The government plans to establish the announced bad bank in April 2013, which is very controversially discussed among Slovenian economists mainly because of the arising costs. The bank is envisaged to take over non-performing real estate and commercial loans of Slovenian banks in exchange for bonds backed by up to EUR 4 billion in state guarantees. The actual size of non-performing loans is not clear: according to the IMF definition bad loans amounted to 14.4% (EUR 7 billion) of total loans by the end of November 2012 or about 20% of the country's GDP.

In late December 2012 KBC Bank from Belgium announced to sell its 22% share in Nova Ljubljanska Banka for EUR 2.8 million or EUR 1 per share to the Republic of Slovenia, which thus increased its ownership in the bank to 86%. In January a Restructuring Plan for the bank, which received capital injections by the state twice during the past two years, was submitted to the European Commission. The programme envisages inter alia the sale of all leasing and factoring services of the bank, prohibits the financing of huge construction projects as well as funding for financial holdings. Expected losses of the Slovenian banking system are given by the Bank of Slovenia at EUR 660 million in 2012 (as against EUR 540 in 2011).

When the Slovenian anti-corruption commission in early January 2013 found that Prime Minister Janez Janša and the leader of the main opposition party and mayor of Ljubljana Zoran Janković had systematically and repeatedly violated the law by not reporting their assets thoroughly, all coalition parties (except New Slovenia NSi) requested both politicians to step down. Following the Prime Minister's refusal to resign, three parties out of five left the government coalition. On 27 February Slovenia's parliament dismissed Mr Janša's government by a vote of no-confidence and appointed Alenka Bratušek, the interim leader of the centre-left Positive Slovenia party, as prime minister designate. Ms Bratušek, a financial expert by profession, will have to form a new government coalition of very different parties in the coming weeks – a failure would lead to early elections. The latter would mean the postponement of reform measures, a further loss of credibility, the risk of a further downgrade, and also a bailout becoming more likely. At the beginning of February 2013 Standard & Poor's cut Slovenia's credit rating by one notch to A-, the same level as given by Fitch Ratings. The agency noted that the downgrade reflects Slovenia's higher than anticipated debt burden due to the announced support for the ailing state-owned banks, but also the rising risks related to policy implementation.

Weak external demand and the attempted fiscal consolidation are the main reasons for the continuation of recession in Slovenia in 2013, and the economy will rebound only slowly thereafter. wiiw expects the GDP to decrease by another 1.5% in 2013 as a consequence of the planned austerity measures which will contribute to a continued drop in domestic demand. A slight recovery is likely in 2014 resulting from rebounding foreign demand. The corporate sector will continue to deleverage and the restructuring of the banking sector is still ahead, pending on the establishment of the 'bad bank'. Recession coupled with rising unemployment both in 2013 and 2014 and a reduction of disposable income will dampen household consumption. Overall, it will be essential to continue on the reform path in order to regain credibility. The consequences of a renewed failure of reforms are not foreseeable yet.

Table SI

Slovenia: Selected Economic Indicators

	2008	2009	2010	2011	2012 [1)]	2013	2014 Forecast	2015
Population, th pers., average [2)]	2021.3	2039.7	2048.6	2052.8	2055.0	2055	2055	2055
Gross domestic product, EUR mn, nom.	37244	35556	35607	36172	36450	36800	37720	39240
annual change in % (real)	3.4	-7.8	1.2	0.6	-2.0	-1.5	0.5	2.0
GDP/capita (EUR at exchange rate)	18400	17400	17400	17600	17700	17900	18400	19100
GDP/capita (EUR at PPP)	22700	20300	20500	21000	20900	.	.	.
Consumption of households, EUR mn, nom.	19310	19547	20112	20675	20830	.	.	.
annual change in % (real)	2.5	0.2	1.4	1.0	-2.0	-3.0	0.2	1.5
Gross fixed capital form., EUR mn, nom.	10663	8225	7169	6694	6230	.	.	.
annual change in % (real)	7.1	-23.2	-13.7	-8.1	-9.5	-3.0	0.0	2.0
Gross industrial production								
annual change in % (real)	2.4	-17.3	6.2	2.1	0.0	1.0	2.0	2.0
Gross agricultural production (EAA)								
annual change in % (real)	-1.9	0.0	0.1	-0.5	-10.9	.	.	.
Construction industry [3)]								
annual change in % (real)	15.5	-20.9	-16.9	-25.6	-17.0	.	.	.
Employed persons, LFS, th, average	996	981	966	936	920	900	900	910
annual change in %	1.1	-1.5	-1.5	-3.1	-1.7	-2.0	0.0	1.0
Unemployed persons, LFS, th, average	46	61	75	83	90	.	.	.
Unemployment rate, LFS, in %, average	4.4	5.9	7.3	8.2	8.9	9.5	9.5	9.0
Reg. unemployment rate, in %, end of period	7.0	10.3	11.8	12.1	12.8	13.5	13.0	12.5
Average gross monthly wages, EUR	1391	1439	1495	1525	1525	.	.	.
annual change in % (real, net)	2.0	2.5	2.1	0.3	-2.1	.	.	.
Consumer prices (HICP), % p.a.	5.5	0.9	2.1	2.1	2.8	2.5	2.0	2.0
Producer prices in industry, % p.a.	3.9	-1.4	2.0	4.6	0.9	2.0	2.5	2.5
General governm.budget, EU-def., % of GDP								
Revenues	42.4	43.1	44.5	44.3	44.2	.	.	.
Expenditures	44.3	49.1	50.3	50.7	48.2	.	.	.
Net lending (+) / net borrowing (-)	-1.9	-6.0	-5.7	-6.4	-4.0	-4.0	-3.5	-3.0
Public debt, EU-def., % of GDP	22.0	35.0	38.6	46.9	54.0	58.0	60.0	63.0
Central bank policy rate, % p.a., end of period [4)]	2.50	1.00	1.00	1.00	0.75	.	.	.
Current account, EUR mn	-2295	-246	-210	1	874	600	300	200
Current account, % of GDP	-6.2	-0.7	-0.6	0.0	2.4	1.6	0.8	0.5
Exports of goods, BOP, EUR mn	20296	16410	18762	21264	21446	22100	23200	24400
annual growth rate in %	2.5	-19.1	14.3	13.3	0.9	3.0	5.0	5.0
Imports of goods, BOP, EUR mn	22681	16909	19760	22307	21741	22000	22400	23300
annual growth rate in %	5.7	-25.4	16.9	12.9	-2.5	1.0	2.0	4.0
Exports of services, BOP, EUR mn	4956	4347	4616	4838	5085	5300	5600	5900
annual growth rate in %	19.5	-12.3	6.2	4.8	5.1	5.0	5.0	6.0
Imports of services, BOP, EUR mn	3533	3182	3331	3395	3387	3400	3500	3600
annual growth rate in %	14.0	-9.9	4.7	1.9	-0.2	1.0	2.0	4.0
FDI inflow, EUR mn	1330	-470	271	719	112	.	.	.
FDI outflow, EUR mn	1003	187	-160	81	-85	.	.	.
Gross reserves of NB excl. gold, EUR mn	623	671	695	642	593	.	.	.
Gross external debt, EUR mn	39234	40294	40723	40241	40632	.	.	.
Gross external debt, % of GDP	105.3	113.3	114.4	111.2	111.5	.	.	.
Purchasing power parity EUR/EUR	0.8114	0.8561	0.8467	0.8387	0.8485	.	.	.

Note: Gross industrial production, construction output and producer prices refer to NACE Rev. 2. Gross agricultural production refers to Economic Accounts for Agriculture (EAA).

1) Preliminary and wiiw estimates. - 2) From 2011 according to register-based census 2011. - 3) Enterprises with 20 and more employees and output of some non-construction enterprises. - 4) Official refinancing operation rates for euro area (ECB).

Source: wiiw Database incorporating Eurostat and national statistics. Forecasts by wiiw.