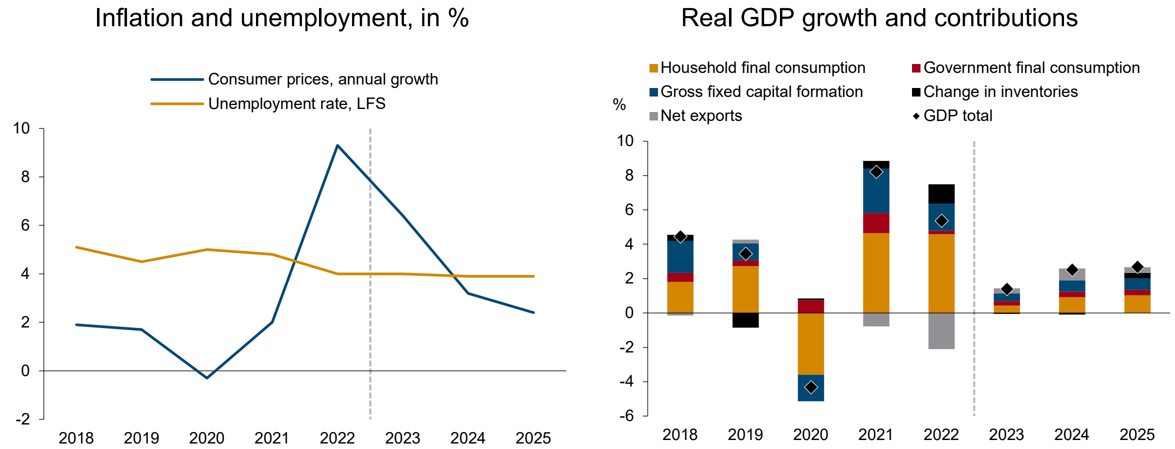
SLOVENIA: The economy expected to stay steady while important reforms are pending

NIKO KORPAR

Slovenia continues to perform well in crisis times. In 2023, real GDP will grow by 1.4%, supported by government spending on infrastructure and solid export performance. At 5.5%, inflation will remain high, but lower than the EU average. Unemployment will be at an all-time low for the second year in a row, while real wages will increase despite high inflation. The government has announced reforms in healthcare, pensions, public salaries and taxes, all of which come with long-term fiscal implications and will be a hot topic in 2023.

Figure 5.21 / Slovenia: Main macroeconomic indicators



Source: wiiw Annual Database incorporating national and Eurostat statistics, own calculation. Forecasts by wiiw.

Slovenia's growth prospects for 2023 are subdued, but remain higher than the EU average. Although the Winter did prove difficult for many companies and household as energy prices rose and some industrial plants decreased production, the country weathered the storm relatively unscathed. Following a disappointing Q4 of 2022, when GDP grew by only 0.2% y-o-y, growth should trend upward in 2023, especially in the second half of the year. 2023 will mark a significant slowdown in private consumption, the main driver of growth in the previous two years. In part due to the end of the post-pandemic rebound and in part due to lower consumer confidence, private consumption will grow only by 0.8% in 2023. Instead, growth will be driven by government spending on construction projects and public buildings, as well as by foreign trade. Much of this spending will be driven by EU cohesion funds from the ending MFF for 2014-2020 and incoming Recovery and Resilience funds. However, private investment growth will recede, and overall growth of investments in fixed capital will decrease from 7.8% in 2022 to 2% in 2023 due to deteriorating economic sentiment and higher interest rates. Overall, we expect Slovenia's real GDP to grow by 1.4% in 2023, an upward revision of our previous forecast by 0.2 p.p. on account of lower energy prices and somewhat resilient foreign trade.

Despite continuing issues with high prices of raw materials, energy, industrial production should still grow by 1.8% in 2023. Energy intensive industries continue to perform worse than mid- and high-tech exporting sectors and this is likely to remain the case as long as energy prices remain at high levels. Construction will keep benefiting from increased public investment that started in 2022 and will continue in 2023 with projects, such as the 3rd developmental axis and the Koper-Divača railway. There are little worries over the possibility of a financial crisis following the recent SVB and Credit Suisse debacles. The banking system of Slovenia operates on solid fundamentals as it continues to consolidate with the Hungarian-owned OTP taking over Nova KBM, the country' second largest bank.

We expect gradual drop in inflation, although it will remain high at least in the first half of the year. After the inflation rate for 2022 settled at 9.3%, March 2023 still saw 10.5% inflation on an annual basis, fuelled by rising prices of food (by 12.9%) and electricity (by 49%) after the initial package of government relief measures ran out. However, from December 2022 to March 2023, prices have risen by only 1%. Since there are signs of gradual price stabilisation of energy markets and supply chains, we have slightly decreased our previous inflation forecast for 2023 by 0.1 p.p., to 6.4 %-

Foreign trade has once more proved to be more resilient than expected. Despite lingering issues with inflation, exports will grow by 2.6% in 2023. Demand for imports will slow down (to 2.3%) as consumers look to buy less imported goods and industrial producers import fewer expensive raw materials. After current account balance turned negative in 2022 for the first time in 10 years, it will again turn slightly positive (with 0.7% of GDP) in 2023 as the economy benefits from an improvement in terms of trade and the continuing revival of tourism.

The labour market continues to perform well as unemployment is expected to stay at historically low levels for the second year in a row. Employment is likely to increase by 1% and the unemployment rate will remain at 4,0% in 2023. There have been instances of industrial plants firing workers due to reduced demand and reorganization of supply chains, such as the once-exemplary case of FDI, the Magna automotive plant near Maribor. Nevertheless, the labour market shows overall no signs of a large slowdown. Instead, the economy is facing a shortage of workers, especially in manufacturing and construction. As a response, the government has eased certain regulations for hiring foreign workers, the majority of which come from Bosnia and Herzegovina and Albania.

Real wages will increase in 2023 despite high inflation. Pressure on wages to increase is high and an implemented uptick in the minimal wage in January 2023 will contribute to gross wages increasing by 6,7% in 2023. The government's somewhat ad hoc promises of increased wages to various groups, such as doctors and judges, have led to practically all major unions to contemplate protests in order to demand what they see as their fair share of wage increases. In response, the government has announced an overhaul of the public salary system.

Higher-than-expected fiscal revenue will keep the fiscal balance in check despite a rising trend in public spending. In 2022, the public deficit was 3,9% of GDP. For 2023, we expect the deficit to be slightly higher with 4,3%, primarily due to increases in wages and measures to address inflation. The total amount spent on anti-inflationary measures in the first three months of 2023 was 237 million EUR.

Of these, the policies addressing energy prices, including lowered VAT on selected energy sources and a temporary exemption to the national carbon tax for the industry, have totalled at over 100 million EUR. The previous three years were marked by expansionary fiscal policy in shape of anti-pandemic, anti-inflation measures and wage increases. The following year is likely to introduce increased spending for healthcare, long-term care, as well as for other purposes, such as the military. However, due to the coming return of the EU's fiscal rules, maintaining budget deficits over 3,5% of GDP, as has been the case since 2020, will likely not be allowed by the EU fiscal rules in the mid-term. To compensate for increased spending, it is likely that a new tax reform will bring increased taxes on wealth and potentially also on real estate.

The government led by Robert Golob has embarked on an ambitious reform programme. It includes long overdue reforms to the healthcare system, the public sector salary system, the pension system, a tax reform and push to build more affordable housing. However, the content of these reforms is yet unclear and the fiscal base for increased spending also remains an unsolved issue. Tensions over perceived social fairness of these reforms could swell up and results in protests or strikes. The healthcare reform will prove to be a particularly sensitive issue since a part of the public sees is it as the last attempt to prevent the slowly creeping privatisation of healthcare. Disagreements over healthcare could cause internal strife in the coalition, but due to the relative strength of Golob's party, the Freedom Movement (Gibanje Svoboda), it is not likely that smaller coalition partners will leave.

We forecast a modest further strengthening of the economic recovery in 2024, with growth increasing to 2,5%, supported by an uptick in private demand (1,7%). Inflation should recede to 3,2% and exports should recover by 4,5%, maintaining the current account surplus. Energy supply for the winter of 2023/2024 does not seem threatened after Slovenia signed an agreement with Croatia, thus securing gas supplies in case of a shortage. The largest risk factors will continue to come from abroad and will depend on the continuation of the war in Ukraine. Domestically, other important decisions that will shape the coming years are still pending and are likely to extend into 2024: more ambitious climate policy and large scale investments to decarbonize energy supply, including a potential new block of the nuclear power plant Krško.

Table 5.21 / Slovenia: Selected economic indicators

	2019	2020	2021	2022 1)	2023	2024 Forecast	2025
Population, th pers., average	2,088	2,102	2,108	2,108	2,115	2,119	2,125
Gross domestic product, EUR m, nom.	48,533	47,021	52,208	58,989	63,600	67,300	70,800
annual change in % (real)	3.5	-4.3	8.2	5.4	1.4	2.5	2.7
GDP/capita (EUR at PPP)	27,760	26,770	29,160	32,540	.	.	.
Consumption of households, EUR m, nom.	25,022	23,145	26,206	31,966	.	.	.
annual change in % (real)	5.3	-7.0	9.4	9.1	0.8	1.7	1.9
Gross fixed capital form., EUR m, nom.	9,496	8,870	10,619	12,961	.	.	.
annual change in % (real)	5.1	-7.9	13.7	7.8	2.0	3.0	3.0
Gross industrial production							
annual change in % (real)	3.1	-5.3	10.3	1.2	1.8	2.5	2.7
Gross agricultural production							
annual change in % (real)	-7.8	5.0	-13.3	-1.1	.	.	.
Construction industry							
annual change in % (real)	3.3	-0.7	-0.5	22.1	.	.	.
Employed persons, LFS, th, average 2)	982.5	978.0	971.6	986.1	1,000	1,010	1,020
annual change in %	0.2	-0.5	0.3	1.5	1.0	0.7	0.5
Unemployed persons, LFS, th, average 2)	45.7	51.2	48.4	41.1	40	40	40
Unemployment rate, LFS, in %, average 2)	4.5	5.0	4.8	4.0	4.0	3.9	3.9
Reg. unemployment rate, in %, eop	7.7	8.9	6.7	5.4	.	.	.
Average monthly gross wages, EUR 3)	1,754	1,856	1,970	2,024	2,300	2,510	2,700
annual change in % (real, gross)	2.7	5.9	4.1	-5.5	6.7	5.7	5.2
Average monthly net wages, EUR 3)	1,134	1,209	1,270	1,319	1,420	1,490	1,560
annual change in % (real, net)	2.1	6.6	3.1	-4.6	1.1	1.8	2.5
Consumer prices (HICP), % p.a.	1.7	-0.3	2.0	9.3	6.4	3.2	2.4
Producer prices in industry, % p.a.	0.6	-0.3	5.5	19.7	6.0	1.9	2.8
General governm. budget, EU def., % of GDP							
Revenues	43.8	43.4	44.6	46.4	45.1	46.8	47.0
Expenditures	43.2	51.2	49.3	50.2	49.3	49.4	49.2
Net lending (+) / net borrowing (-)	0.6	-7.7	-4.7	-3.8	-4.2	-2.6	-2.2
General gov. gross debt, EU def., % of GDP	65.4	79.6	74.5	72.3	71.0	68.5	68.1
Stock of loans of non-fin. private sector, % p.a.	3.5	0.0	5.9	10.2	.	.	.
Non-performing loans (NPL), in %, eop 4)	2.9	2.6	1.6	1.5	.	.	.
Central bank policy rate, % p.a., eop 5)	0.00	0.00	0.00	2.50	.	.	.
Current account, EUR m	2,884	3,552	1,986	-247	500	570	520
Current account, % of GDP	5.9	7.6	3.8	-0.4	0.8	0.8	0.7
Exports of goods, BOP, EUR m	31,999	29,622	35,255	42,611	45,080	47,970	51,140
annual change in %	3.9	-7.4	19.0	20.9	5.8	6.4	6.6
Imports of goods, BOP, EUR m	30,701	27,289	34,373	44,921	47,440	50,520	53,900
annual change in %	3.9	-11.1	26.0	30.7	5.6	6.5	6.7
Exports of services, BOP, EUR m	8,659	6,956	8,447	11,042	12,510	13,340	14,340
annual change in %	6.6	-19.7	21.4	30.7	13.3	6.6	7.5
Imports of services, BOP, EUR m	5,751	4,899	5,992	7,465	8,240	8,650	9,260
annual change in %	4.6	-14.8	22.3	24.6	10.4	5.0	7.0
FDI liabilities, EUR m	1,919	446	1,795	1,642	.	.	.
FDI assets, EUR m	1,157	708	1,397	421	.	.	.
Gross reserves of CB excl. gold, EUR m	767	913	1,838	1,962	.	.	.
Gross external debt, EUR m	44,442	47,998	50,818	51,885	54,900	57,500	60,000
Gross external debt, % of GDP	91.6	102.1	97.3	88.0	86.3	85.4	84.8

1) Preliminary and wiiw estimates. - 2) From 2021 the new LFS methodology is applied in line with the Integrated European Social Statistics Regulation (IESS). - 3) Wage increase in 2020 due to COVID emergency relief compensations. - 4) Loans more than 90 days overdue and those unlikely to be paid. - 5) Official refinancing operation rates for euro area (ECB).

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