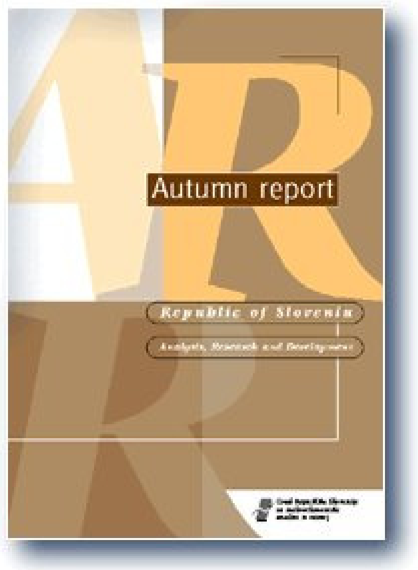

ANALYSIS OF ECONOMIC DEVELOPMENTS IN 1997 AND PROSPECTS FOR 1998

AUTUMN REPORT 1997

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FOREWORD

The Autumn Report reviews economic development and the factors of growth in 1997 and examines prospects for 1998. For several years the Institute of Macroeconomic Analysis and Development (hereafter IMAD) has presented the report in Slovene and English. The Government of the Republic of Slovenia assesses it and draws on it in preparing the Budget Memorandum and the Budget.

The Report is based on official statistics and in particular those of Statistical Office of Republic of Slovenia (SORS), Bank of Slovenia (BS) and Agency of Payments (AP), the expert findings of domestic and foreign institutes and the new National Accounts Estimates for 1997 and 1998 which were prepared by IMAD in October this year.

Transitional problems with statistical coverage of economic trends associated with the harmonisation of domestic with international statistical standards were mitigated to a certain extent in the latter half of 1997. For example, provisional data on industrial production, employment and earnings is now available more quickly. However, most of the substantive problems such as recording trends in the volume of industrial production (taking qualitative changes into account), in construction (inconsistent coverage of the private sector) and investment (the investment outlay indicator is inappropriate) remain unsolved.

1. INTRODUCTION AND SUMMARY - Estimated developments in 1997 and prospects for 1998

In 1997 Slovenia's economic development is characterised by **a mixture of domestic recession and recovery of economic growth in international environment**. Acceleration of economic growth in the world markets and in particular of Slovenia's main trading partners in Europe contributed to slightly more than 3% economic growth in Slovenia (3 1/4 per cent). Continued favourable developments in the international markets forecast by foreign experts for 1998 (IMF, 1997, OECD, 1997 and Link, 1997) could provide more room for structural reforms Slovenia must carry out in the coming years in order to complete the process of transition, stabilise the economy and successfully integrate into the EU. The completion of structural reforms is a precondition for achieving and maintaining macro-economic stability in the long run.

This year the economy continued to grow at a slower rate (like in 1996 when it grew at 3.1 per cent). In the first half of the year, it grew at 2.9 per cent compared to a year earlier. The rate of growth is expected to improve slightly by the end of the year due to: an acceleration in rate of growth of the world economy as a whole and in particular of the EU (EC, 1997); a favourable tourist season and an improved domestic economic climate in the summer months. Thus, **rate of growth should be somewhat higher than last year and is expected to range between 3 per cent and 3.5 per cent.**

Foreign demand has been **the driving force of economic development** this year as it has in real terms soared 7.5 per cent, whilst domestic demand rose around 3 per cent. Growth in household consumption (up 2.3 per cent) has been relatively modest since the rate of growth in wages and other remunerations decreased. On the other hand, investment (gross fixed capital formation) and government consumption rose 6 per cent and 5 per cent, respectively.

On the output side, economic **growth** has been generated by a real increase in the value added **in all sectors, except in mining**. The rate of growth has been the highest in hospitality (up 8.5 per cent), electricity, gas and water supply (up 8 per cent), financial intermediation (up 6 per cent) and business services (up 6 per cent). Based on provisional data, production in manufacturing has been modest despite a jump in exports of goods. It seems that this year the link between production and exports is not as close as in previous years. It may also be due to the way in which the data is collected and classified. This year data on manufacturing might not be an entirely reliable indicator of activity since the Statistical Office has adopted a new classification of activities. Therefore, at present only provisional data on the production volume are available. Delay in the formation of the new Government and the preparation of the Budget had a negative effect on business expectations in the first half of the year and on the growth in domestic demand. Further economic restructuring aimed at reducing the number of unprofitable enterprises contracted the volume of production. However, this contraction was counter-balanced by increase in output by other enterprises. Nevertheless, the growth in production of other economic entities is not sufficient to generate a higher rate of growth on the aggregate level. Finally, modest growth in manufacturing is also a consequence of only moderate investments.

This year's export competitiveness, measured by relative unit labour costs in a basket of currencies, is expected to **remain at the 1996 level**. In 1996 it increased by 5 per cent from a year earlier. Despite a small real appreciation of tolar (by 0.8 per cent) and modest growth in compensation of employees (1.8 per cent in real terms) increase in labour productivity was not high enough to further improve export competitiveness. Provided that similar developments continue (modest growth in employee compensation, further growth in labour productivity and small appreciation of tolar), **export competitiveness should remain at the same level in 1998.**

This year exports of goods jumped as growth in the European Union rebounded and export competitiveness of Slovenia's manufacturing sector improved last year and stagnated this year. Trade in goods, measured in US dollars, remains at approximately last year's level. The stagnation is primarily a result of the 11 per cent appreciation of the US dollar against the Slovenia's basket of currencies. This year, **real exports and imports of goods are expected to increase by around 7.8 per cent and 7.6 per cent, respectively**. The **trade deficit** should be marginally wider than last year. According to balance of payments statistics, it is estimated **at US$ 940 million**. A smaller service surplus is expected owing to lower exports of transport services. This in turn will be the main reason that the **current account** has moved into **deficit** which is **at US$ 100 million** or 0.6 per cent of GDP not alarming.

This year the **consensus between the social partners** on wages has been reached in time. Thus, adequate income policy mechanisms were adopted, which succeeded in keeping the growth in wages lagging behind the growth in labour productivity. The Minimum Wage and Wage Adjustment Act (adopted in July 1997) summarises the agreement reached between the social partners in the area of wages. It sets out a new mechanism of wage adjustment applicable to all wages. The quarterly partial adjustment of wages to the growth in retail prices has been replaced by a yearly partial adjustment of wages to the growth in consumer prices. The base wages are protected from any larger real drop by additional provisions on its adjustment in case of a higher growth in prices. This year the average **real gross wage per**

employee is expected to **increase 2.5 per cent.** Growth in other remuneration has slowed down. After soaring as much as 15 per cent in real terms in 1996, this year it is expected to rise around 2 per cent in real terms. This year's mechanism for the adjustment of base wage and wages paid out based on successful business results will remain in force in 1998. Growth in wages is forecast to remain modest in 1998 so that the growth in real gross wage per employee is expected to lag around a percentage point behind the labour productivity.

This year a more active **price policy** was adopted in order to abolish price disparities. In the period October 1997- December 1996, retail prices increased by 8.5 per cent, including a 4.4 per cent increase in controlled prices. No corrections of the controlled prices are expected by the end of the year. End-year inflation is expected to reach 9.5 per cent and exceed its annual level at the end of 1996 (8.8 per cent per cent). However, average annual inflation will be lower than last year, and is estimated at around 9 per cent (last year, 9.7 per cent).

This year **employment** level, according to the National Accounts statistics, is estimated to be the same as last year. The fall in employment in manufacturing has continued, although less intensively than in previous years. Over the last few years, economic growth has only marginally contributed to higher employment because of the structural character of the unemployment and the ongoing process of restructuring. Registered unemployment has been fractionally higher this year than last year. However, using international standards the level of unemployment was 7.1 per cent in the second quarter of the year, which is slightly less than a year earlier (7.3 per cent). The drop was not a result of a decline in the number of unemployed, but of an increase in persons in employment, in particular persons engaged in the contract work and informal economy and a rise in the number of unpaid family workers.

The delay in adopting the Budget has greatly affected **public finance**. It has been governed by provisional financing rules and the Law on Provision of Additional Funds for Financing Budgetary Expenditure adopted in May. The 1997 Budget proposal was submitted to Parliament at the end of July and should be passed in the beginning of December. However, an amended Budget proposal was proposed by the Government in early . According to the amended Budget proposal, government expenditures should equal SIT 743 billion. Higher budgetary expenditures are primarily a result of the decisions adopted last year with regard to wages, social transfers, and increased transfers to the Pension Fund. Due to the delay in the adoption of the Budget, the Government proposed the budget year to be prolonged until the end of January 1998. A part of sales taxes collected in January 1998 should, therefore, be used to cover the budget expenditures for 1997. Under the amended Budget proposal, general government expenditure would account for 46.5 per cent of gross domestic product, up 1.6 percentage points from a year earlier when it was 44.9 per cent.

Economic and political decisions taken in 1996 reduced the tax burden of enterprises and therefore, the potential general government revenue. Revenue from the fiscal instruments adopted this and last year (payroll tax, tax on CO_2 emissions) will not be high enough to compensate for the contraction of revenue as a result of the reduction in the level of customs duties and social security contributions. If the 1997 Budget is not extended until January 1998 and a part of sales tax collected in January does not form a part of the 1997 Budget the share of general government revenue in gross domestic product will decrease from 45.2 per cent in 1996 to 44.5 per cent in 1997. On the other hand, if the amended 1997 Budget is passed prolonging the budget year until January 1998 general government revenue would account for 45.1 per cent of gross domestic product. Consequently, the **general government deficit** would be higher than forecast in spring and is estimated to account for **1.4 per cent of gross domestic product.**

In the past the public finance policy maintained a balanced general government account. This supported monetary policy since the government did not have to borrow neither at home or abroad and, consequently, no additional pressure was put on the exchange rate or the interest rate. The first substantial general government deficit in Slovenia will directly increase the public debt. The consequences of a larger general government deficit will, however, depend on the way it is financed and spent.

Inadequate level of national savings (this year the level of gross national savings is estimated to account for 23.6 per cent of gross domestic product) has aggravated the problem of financing investments and increased borrowing abroad. The average nominal interest rates for long-term loans increased slightly from their level at the end of 1996 mainly due to the indexation mechanism.

Economic activity in almost all Slovenia's trading partners is expected to increase in 1998. According to the European Commission (EC, 1997), the average rate of economic growth in the EU is forecast at 3 per cent. Furthermore, the rise in economic growth and industrial production of Slovenia's main trading partners should accelerate. The imports of Slovenia seven main trading partners are forecast to increase by 6.8 per cent in real terms.

Provided the same level of export competitiveness is maintained and favourable world trends continue exports are bound to jump in 1998. If so, **the economy is likely to grow by 3.5 to 4 per cent** with exports as its main generator. Domestic demand should advance by around 3.7 per cent. However, the growth in private consumption is not expected to be any higher than around 2.3 per cent due to a slowdown in wage growth.

An almost **balanced current account** should be achieved **in 1998** as well. However, the trade deficit is expected to slightly widen and total around US$ 980 million. The service balance should widen due to the expected good tourist season and should partly cover the trade deficit. Consequently, the current account deficit in the balance of payments should amount to around US$ 40 million.

The **general government deficit** can only **be narrowed in 1998** if: government expenditure is reduced by certain measures regarding in particular wages in public sector and social transfers; new taxes are introduced; and some state assets are sold off in 1998. According to IMAD's projection, general government expenditure should be reduced to 45.5 per cent of gross domestic product, whilst the general government revenue should remain at the same level as in 1997 (45.0 per cent of gross domestic product). New taxes, recently proposed by the Government, should contribute approximately 0.7 per cent of gross domestic product to the government revenues. The Government contemplate to gain additional revenues from the sale of state assets. To reduce the deficit to around 0.5 per cent of gross domestic product, additional revenues should amount to approximately 0.7 per cent of gross domestic product.

The consumer price index will replace the retail price index as a measure of inflation **in 1998**. Price disparities will continue to be abolished (especially in the energy and telecommunications sectors) and a part of controlled prices will be liberalised. **Inflation** is expected **to slightly drop to around 8 per cent** in 1998.

2. INTERNATIONAL ECONOMIC ENVIRONMENT - High rates of economic growth due to a boost in world trade and favourable monetary conditions

According to the International Monetary Fund estimates (IMF, World Economic Outlook, October, 1997), **the rate of growth in world economy will in 1997 and 1998 be the highest** in this decade (between 4 per cent and 4.5 per cent). Favourable economic trends in international environment will have a positive effect on the Slovenian economy and will ensure the continued growth in exports and spur economic growth.

The economic recovery continues in Western Europe despite moderate domestic demand. The easing of monetary conditions since 1995 (drop in interest rates and the depreciation of the German mark and other currencies pegged to it) spurred economic growth. Together with improved international competitiveness it helped boost exports. The IMF has not changed its spring forecast of a 2.5 per cent and 2.8 per cent rate of growth in the EU for 1997 and 1998 respectively. However it has lowered slightly its growth forecasts for 1998 for a number of the larger EU countries (such as France, Germany). European Commission's autumn (EC, October, 1997) forecasts are more optimistic. **It projects growth to average 2.6 per cent in 1997 and 3 per cent in the in 1998 in EU countries.** All EU Member States, except Great Britain, have corrected their spring forecasts upwards. The expected economic recovery is estimated to reduce unemployment slightly in the EU. Nevertheless unemployment is expected to remain high, at around 10.7 per cent. This year France and Greece will not fulfil the Maastricht fiscal criteria for entry into the European Monetary Union. of a maximum 3 per cent general government deficit. France is expected to meet it next year (EC, October 1997).

This year exports were the driving force behind **Germany's** economic recovery. Next year, it should also be spurred by a faster growth in investment. Capacity utilisation has rebound, monetary conditions are favourable (depreciation of German mark, low interest rates) and the world trade is growing. Although it was rather low at the beginning of the year, domestic demand is expected to increase because of a slight drop in the tax burden and a somewhat lower unemployment rate. The European Commission estimates that German economy will grow at 2.5 per cent this and 3.2 per cent next year.

Table 1: Economic growth, growth in industrial production and imports of goods in Slovenia's main trading partners (1996 - 1998)

	Real growth of GDP (in %)			Real growth in industrial production (in %)			Real growth in imports of goods (in %)		
	1996	**1997**	**1998**	**1996**	**1997**	**1998**	**1996**	**1997**	**1998**
EU	1,8	2,6	3,0	nd	nd	nd	5,1	6,0	7,0
Germany	1,4	2,5	3,2	0,1	2,6	3,2	7,0	6,4	6,9
Italy	0,7	1,4	2,5	-1,7	0,5	2,4	-0,5	3,5	6,2
Croatia	4,2	5,0	5,0	3,1	4,0	4,0	nd	nd	nd
France	1,5	2,3	3,1	0,4	3,0	3,8	2,2	5,9	6,8
Austria	1,3	1,6	2,5	1,0	3,5	4,0	3,3	4,8	7,3
Russia	-6,0	0,0	3,0	-5,0	2,0	4,0	nd	nd	nd

USA	2,8	3,7	2,6	3,2	4,7	1,9	7,0	11,9	7,4
Source: OECD Economic Outlook, June 1997; IMF World Economic Outlook, October 1997; WIIW, October 1997; Deutsche Morgan Grenfell, September 1997; European Commission, October 1997;									

Italy's rate of growth this year is expected to exceed the 1.2 per cent forecast in spring. Rate of growth in the first half of the year, the rise in capacity utilisation and the growth in investment support this prediction. Favourable changes in the exchange rate have spurred exports. Despite continued pressures (appreciation of the US$), inflation is falling gradually and is currently running at the around 2 per cent per annum. The European Commission anticipates that Italy will succeed to reduce its general government deficit to 3 per cent of gross domestic product this year. Its ability to maintain the same level in 1998 depends on the 1998 Budget.

After growing only 1.5 per cent in 1996, the **French economy** is expected to grow by more than 2 per cent this year. Foreign demand will be the main lever of economic growth because the growth in domestic demand is weak. Despite expectations of a revival in demand for investment, investments continue to stagnate. The forecast for growth to exceed 3 per cent in 1998 is based on an optimistic expectation that domestic demand will rise (in particular investment and private consumption). The acceleration in economic growth is expected to contribute to the reduction in unemployment rate in 1998.

The **gross domestic product in Austria** grew 1.3 per cent in 1996 and should increase slightly more than that this year. In its latest report the WIFO Institute estimates it should grow by 1.6 per cent (WIFO, September 1997). The European Commission expects it to grow at 1.9 per cent (EC, 1997). Since they jumped 7.5 per cent, real exports were the main generator of economic growth in Austria as well. The rise in exports was spurred by the economic recovery in Europe and improved export competitiveness (the depreciation of the Austrian schilling). The rise in exports of goods accelerated the activity of manufacturing, which should grow by more than 3 per cent this year. Austria will fulfil all EMU convergence criteria this year. Due to a restrictive fiscal policy real growth in private consumption will be modest - less than 0.5 per cent (WIFO, September 1997). This will contribute to lower inflation, whilst unemployment is expected to remain stagnant.

Economic growth in most **CEFTA countries** has continued to slow down this year. The two exceptions are Slovenia, where the slowdown is expected to be halted and Hungary, where economic growth has accelerated.

The official **Czech** estimate that the rate of growth in GDP will range between 2 and 3 per cent in 1997 has not changed since spring (Business Monitor Int. September 1997). The estimates of many foreign analysts are lower and range between 0.5 per cent (Deutsche Morgan Grenfell, September 1997) and 2.0 per cent (IMF, October 1997). Although a stabilisation programme was adopted in spring, a general government deficit, officially estimated at 1 per cent of GDP and unofficially at 2 per cent, is very likely in view of excessive spending to ameliorate summer flood damage. Restrictions imposed on imports in the form of compulsory deposits put pressure on prices to grow. Together with the depreciation of the Czech koruny, the liberalisation of certain prices and the real growth in wages these restrictions pushed up inflation into double digit figures. Despite the measures adopted this year, it is unlikely that the foreign trade deficit will shrink (due rise in imports in order to ameliorate flood damage).

Table 2: Economic growth, inflation and trade deficit in CEFTA countries (1996-1998)									
	Real growth of GDP (in %)			Inflation (in %) [1]			Current account balance (as % of GDP)		
	1996	**1997**	**1998**	**1996**	**1997**	**1998**	**1996**	**1997**	**1998**
Czech Republic	4,1	1,5	2,0	8,6	11,0	10,0	-10,8	-11,5	-9,2
Hungary	1,0	3,0	3,5	19,8	16,9	14,0	-6,2	-5,5	-6,4
Poland	6,1	5,4	4,8	18,6	14,9	12,2	-5,7	-9,5	-11,1
Slovakia	6,9	4,9	1,5	5,4	10,0	15,0	-12,1	-15,7	-16,2
Romania	4,1	-3,0	1,0	56,9	126,4	35,7	-7,0	-3,5	-3,0
Slovenia	3,1	3 1/4	3 3/4	8,8	9,5	8,0	-4,7	-5,2	-5,3
Source: WIIW, September 1997; Deutsche Morgan Grenfell, September 1997; NOMURA, October 1997; *Note* [1] **end year**									

Real gross domestic product in **Hungary** increased 3.2 per cent in the first half of the year on a year earlier. Numerous other indicators confirm that economic recovery is underway. Industrial output soared 7.8 per cent in the first six months compared to a year earlier (WIIW, September 1997). . Exports will be the main generator of this year's economic growth although their growth might not be as high as expected because of the present situation in CEFTA countries (import restrictions) and the depreciation of most European currencies. Investments have increased. The contribution of private consumption to the economic growth remains limited despite a real growth in wages. Inflation has decelerated, although less than expected at the beginning of the year.

The **Polish economy** will grow over 5 per cent for the fourth consecutive year, However, foreign analysts expect it to grow at a somewhat lower rate than last year. The relatively high rate of growth is primarily generated by strong domestic demand. However, the latter has also accelerated the growth in imports and has thereby had a negatively effect on the trade balance. The current account deficit is expected to exceed 5 per cent of gross domestic product this year. Furthermore, this year's general government deficit is expected to amount to 5 per cent of gross domestic product. The main achievements of the Polish economy this year are a slowdown in inflation to around 15 per cent and a 2 percentage points drop in unemployment at the end of the year.

Last year **Slovakia's** economy grew the fastest (6.9 per cent) of all CEFTA countries. Although there are signs of difficulties in foreign trade and the fiscal area, economic growth should remain relatively high this year, at around 5 per cent. These difficulties suggest that a different fiscal policy ought to be adopted and the currency devalued. Growth in domestic demand (private consumption, public consumption and investment) has been the main generator of economic growth in 1997. However prospects for 1998 are not as good as this year's results. Analysts expect that the liberalisation of energy prices, the rapid growth in wages, import restrictions and the expected devaluation of the Slovak koruny will push inflation upwards. Furthermore, unemployment is expected to increase both this and next year.

Although substantially lagging behind in economic development, **Romania** joined CEFTA on the 1st July 1997. Romania was in a deep economic crisis in 1997 marked by a decline in gross domestic product and three-digit inflation. The stabilisation programme is expected to bring inflation down to around 30 per cent next year and economic growth to rebound to around 1 per cent next year.

Croatia is Slovenia's third most important trading partner. Primarily because of a successful tourist season, growth is likely to accelerate further, from 4.2 per cent in 1996 to between 4.5 per cent - 5.0 per cent in 1997. Its inflation remains amongst the lowest in Eastern Europe. Despite a huge current account deficit foreign analysts expect the kuna to remain stable. Foreign analysts (Deutsche Morgan Grenfell, September 1997) forecast a general government deficit of around 3.5 per cent of gross domestic product. Economic prospects for 1998 remain favourable. The forecast rates of growth forecasts range from 4.5 per cent to 5.5 per cent. The privatisation and economic restructuring process must be completed if growth is to be secured in the long run. Both processes will have a primarily negative effect on the labour market. Registered unemployment rate has already reached 17 per cent this year.

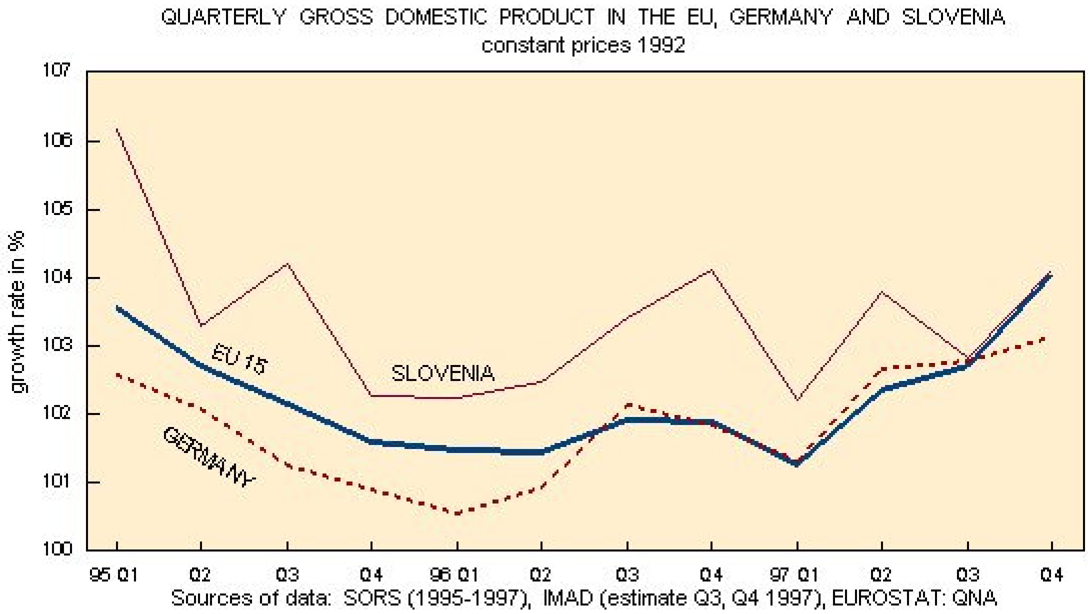
3. THE OUTPUT STRUCTURE OF GROSS DOMESTIC PRODUCT - This year the rate of growth is only slightly higher than last year's; prospects for 3.5 per cent to 4 per cent GDP growth in 1998

Quarterly figures on gross domestic product indicate a gradual rise in economic growth in the first half of 1997. In the first and second quarter, gross domestic product rose 2.2 per cent and 3.8 per cent in real terms, respectively compared to the same quarter last year. In the first half of the year it was in real terms up 2.9 per cent compared to the first half of 1996. Gradual economic recovery is expected to continue to the end of the year as economic growth in the EU continues and export demand rises. Nevertheless, quarterly GDP growth rates are not expected to increase considerably since its level was high in the last quarter of 1996. According to the autumn National Accounts estimate, the spring 4 per cent economic growth forecast is unlikely to be achieved this year. However, the **rate of economic growth is expected to** exceed last year's 3.1 per cent and **reach 3 1/4 per cent**.

On the output side, this year's **economic growth** will be generated by growth **in all sectors except in mining**. The highest real growth rates in value added are estimated to be achieved in electricity, gas and water supply (8 per cent); hospitality (8.5 per cent); financial intermediation (6 per cent); and real estate, renting and business services (6 per cent). These activities generate around 20 per cent of total value added. Increase in value added in real terms is expected to be the lowest in manufacturing (0.5 per cent).

The trend of a declining share of industry in total value added on account of a rising share of services continued in 1997. In the nineties, the share of industry in value added shrank from 40.8 per cent in 1991 to 32.1 per cent in 1997, whilst that of services has been rising. Recently, the share of financial intermediation, real estate, renting and business services and public administration in value added has grown the most. This year, services are expected to generate 60.2 per cent of total value added, up 8.8 percentage points from 1991. The growth in the service sector is also confirmed by data on employment..

Figure 1: Quarterly growth in gross domestic product in the EU, Germany and Slovenia



The forecast favourable economic development of Slovenia's main trading partners may help boost economic growth **in 1998**. However, it is unlikely that the increase will be substantial because of the necessary acceleration of economic restructuring next year. In 1998 **economic growth** is therefore expected at **between 3.5 per cent and 4 per cent**. Above average growth in value added is expected in construction, trade, hospitality and financial intermediation. Higher growth in manufacturing is expected provided foreign demand continues to grow, growth speeds up in the EU and industrial production in Italy and Germany accelerates. Rise in the share of services is expected to continue next year.

In view of the unfavourable weather conditions at the beginning of the year, poor results in the **agriculture, forestry and hunting** sectors were projected. A very warm autumn, however, contributed to a better quality of harvest. Up until July, real purchases of agricultural products (included in the statistics) exceeded last year's. In August they were extremely low and consequently, they were 2.1 per cent lower in the first eight months than a year earlier. Meagre purchases of crops are the main reason for such figures. Real purchases in animal husbandry remained almost at last year's level. More cattle and fewer pigs were purchased. The Agency of RS for Commodity Reserves purchased 6 per cent more wheat than last year.

SORS has ceased providing statistics on the expected and realised harvest. These statistics provided the basis for calculating the value added in agriculture, forestry and hunting. Thus, IMAD's spring forecast of a **1.5 per cent growth** in this sector's value added in 1997 has not changed. Provided the weather conditions are favourable **growth** at **around 3 per cent** is expected in 1998.

Coal mining is the most important activity in the **mining sector** as it generates around 70 per cent of the sector's value added. In the first eight months, production of coal and other energy sources was 3.2 per cent lower than a year earlier. According to the 1997 Energy Balance, production of brown coal should remain the same as last year and that of lignite should pick up 1.6 per cent. Thus, coal mining is expected to grow at least 1 per cent in 1997. In the non-energy part of the mining sector, production was 10.0 per cent lower in the first eight months compared to a year earlier. This was primarily due to the decrease in sand and stone quarrying output which in the past had grown considerably. All these developments point to a **1 per cent decrease in mining's value added in 1997**. **In 1998** production of coal could increase slightly. However, the increase in the sector's value added in real terms is not expected.

Table 3: Value added in factor costs by NACE Rev. 1 and gross domestic product

	Structure in % current prices			Real growth in % (prices 1992)		
	1996	**1997**	**1998**	**1996**	**1997**	**1998**
A, B Agriculture, forestry, hunting, fishing	3,8	3,8	3,7	1,7	1,5	3,0
C Mining and quarrying	1,1	1,1	1,0	-1,3	-1,0	0,0
D Manufacturing	24,2	23,5	23,1	1,4	0,5	2,0
E Electricity, gas and water supply	2,5	2,6	2,5	1,0	8,0	1,0
F Construction	4,8	4,9	5,0	11,1	5,0	5,0
G Wholesale and retail trade, repairs	10,0	10,2	10,3	4,7	5,0	5,0
H Hotels and restaurants	2,7	2,8	2,9	4,5	8,5	5,0
I Transport, storage and communications	6,7	6,7	6,7	3,4	4,0	4,0
J Financial intermediation	3,6	3,7	3,8	2,3	6,0	5,0
K Real estate, renting, business services	10,2	10,4	10,5	4,8	6,0	4,6
L Public administration, defence, social insurance	4,6	4,7	4,7	4,2	4,8	4,5
M Education	4,8	4,8	4,8	2,0	3,0	4,0
N Health and social care	4,7	4,6	4,6	0,6	2,5	2,5
O Other community and personal services	3,0	3,0	3,0	1,3	2,5	2,5
FISIM	-2,2	-2,1	-2,1	1,6	2,5	2,0
1. VALUE ADDED (A ... O + IBS)	84,6	84,6	84,4	2,9	3,2	3,5
2. Correction items (a - b)	15,4	15,4	15,6	4,1	3,3	5,5
a) taxes on production and imports	17,4	17,4	17,5	3,9	3,2	4,1
b) subsidies	2,1	2,1	1,9	2,7	3,1	-3,4
3. GROSS DOMESTIC PRODUCT (3=1+2)	100,0	100,0	100,0	3,1	3¼	3¾

Source: IMAD estimates 1996, 1997, 1998

Note: **GDP and correction items for 1996 by SORS, internal structure of value added by IMAD**

According to SORS's preliminary data, **manufacturing output** edged up 1.3 per cent in the first nine months on a year earlier. Production rose the most in the manufacture of leather and leather products (up 21.2 per cent) and fell the most in manufacture of transport equipment (down 20.0 per cent). In the first nine months, labour productivity in manufacturing was up 5 per cent from a year earlier owing primarily to downsizing.

Except in April and September, there was a negative impulse trend in manufacturing in the first nine months of 1997. Despite the signs of improvement in the economic climate and the confidence indicator because of the high level of production at the end of last year , it is unlikely that the annual growth rates will pick up by the end of the this year. It is estimated that **manufacturing production volume will on average be 0.5 per cent higher than last year**. Therefore, it could be expected that the sector's value added should pick up by 0.5 per cent. The autumn industrial production growth estimates represent a downward adjustment of those made in spring. German and Italian estimates were also adjusted downwards, from 3.4 per cent to 2.6 per cent and from 1.5 per cent to only 0.5 per cent, respectively.

According to the estimates of foreign analysts, industrial production should rise in the EU as a whole and in Slovenia's main trading partners **in 1998** (OECD, 1997). Consequently, domestic manufacturing may grow at a somewhat higher rate, with the sector's **real value added rising 2 per cent** in 1998.

Electricity production is the greatest contributor (80 per cent) to the value added in the **electricity, gas and water supply sector**. Electricity production, measured in MWh, soared 7.7 per cent compared to a year earlier in the first eight months. In the same period electricity consumption rose 2.1 per cent. Consequently, net imports fell by a third (excluding trade in electricity based on joint investment) and import dependency decreased. Net imports represented 6.7 per cent of total electricity consumption. Moreover, the structure of production changed markedly this year. The share of hydro-electric plants production in total production decreased whilst that of thermo-electric and nuclear power plants increased. Growth in value added in production of electricity is estimated to range between 9 per cent and 10 per cent. Other activities in the sector are expected to grow more slowly. According to the energy balance, gas supply will remain at the 1996 level and the distant heating will be up 1.2 per cent. Water supply is expected to increase by around 1 per cent. Therefore, **the value added** in electricity, gas and water supply sector is expected to **increase by 8 per cent in 1997**. Provided that the pace in the growth of production of electricity matches consumption, the sector's value added in real terms will advance another **1 per cent in 1998**.

According to SORS, the real value of **construction works** was down 6 per cent in the first eight months compared to a year earlier. This was largely due to lower value of civil engineering works, and in particular compared to last year when it was extremely high due to investment in the construction of highways. The statistical data, however, do not encompass the small-scale sector, which is estimated to represent 30 per cent of the total value of construction works and employ around a third of workers in construction. Data on the number of people employed by craftsmen and self-employed in construction is indicative of the strengthening of the small-scale sector which has not yet been incorporated in the official statistics. Real revenue from construction services' sales tax increased in real terms by 8 per cent in the first half of the year. There is also still a strong black market in construction activity. The value of construction works abroad was slightly lower in the first quarter of this year than last year. Since certain restrictions were introduced in the German market and the Russian market remains very risky, the value of construction works abroad is not expected to increase this year. Investment of companies has not yet gained the necessary and expected momentum. This year, the **rate of growth** in value added will be lower than in the past two years when it was around 10 per cent. This year it should be around **5 per cent**. Given the expected increase in volume of construction works of the statistically covered part of the sector, a **5 per cent real growth in value added** is expected to be maintained **in 1998**. The revival of residential construction could spur growth in construction in the coming years, since it has been modest in the past. Having a relatively high investment multiplier, growth in residential construction could encourage growth in other sectors as well.

According to the preliminary figures for the first five months, total revenue in retail **trade** and the sale of motor vehicles increased in real terms by 7.5 per cent compared to a year earlier. Sale of non-food products rose the most, up in real terms by 22.7 per cent. This was primarily the result of a real jump of 74.6 per cent in furniture, household appliances and construction material sales. Real sales of food, beverages and tobacco products soared by 7.3 per cent. In the first five months only revenue from sales of motor vehicles and maintenance and repair of motor vehicles fell (down 6.4 per cent and 13 per cent respectively). Gasoline sales have risen in real terms by 15.9 per cent. In view of the expected seasonal increase in trade in the last quarter, **value added in trade, repair of motor vehicles and consumer goods sector is estimated to grow** in real terms **by 5 per cent this year**. **The same rate of growth** is expected **next year**.

In the first nine months the **number of tourists soared** by 12 per cent and the number of overnight stays by 10 per cent. This was primarily due to a 20 per cent surge in the number of foreign visitors. The number of domestic tourists picked up by a mere 3 per cent. The number of overnight stays by foreign visitors soared 24 per cent, whilst that by domestic visitors was stagnant. Foreign tourists represent 53.4 per cent of all tourists and accounted for 48.1 per cent of all overnight stays. More than half of the foreign overnight stays were by Germans (25.7 per cent), Italians (17.1 per cent) and Austrians (14.8 per cent).

According to the preliminary balance of payments figures, the inflow of capital from tourism amounted to US$ 799m in the first eight months. In other words it was in nominal terms down 1.5 per cent on a year earlier. This was partly a consequence of inter-currency changes (in particular in the US$ to DM ratio) and was partly a result of a fall in gasoline sales on the border with Italy and a drop in sales in duty free shops as Austria imposed certain restrictions on the purchase of tobacco products. If an adjustment is made to eliminate the effect of inter-currency changes the foreign currency inflow from tourism in fact rose 8.1 per cent from last year.

Based on the above discussed developments in tourism, it is estimated that the value added in the **hotels and restaurants sector will increase in real terms by around 8.5 per cent this year**. Despite a prosperous tourist season the fact that the hospitality infrastructure is obsolete should not be forgotten. However, future growth of the activity depends not only on investment but also on the quality services. Continued growth is expected **in 1998** although at a slightly lower rate. **Value added** in hotels and restaurants sector is forecast **to rise** by around **5 per cent**.

The steep decline in the railway transport in 1996 was halted this year, despite a strike by railway workers. In the first eight months, freight railway transport increased 1.5 per cent measured in tons per kilometre while passenger transport fell by 0.8 per cent. Data on road transport, which does not include independent private carriers, points to a 6.1 per cent decline in road freight transport and 17.4 per cent decline in passenger transport. Since the number of registered lorries and trucks owned by private carriers rose by 4.7 per cent in the first eight months, it is expected that road freight transport conducted by private carriers will not drop this year. Loading and unloading of goods in the port increased by 13.4 per cent. Maritime freight transport measured in tons per mile edged up 1.7 per cent. On the whole loading and unloading measured in tons of goods loaded and unloaded increased by 6.9 per cent. In the first eight months, domestic air transport picked up by 2.2 per cent on a year earlier, and airport passenger traffic advanced 6.6 per cent. Postal and telecommunication branch grew the most in the transport and communications sector. In the first eight months, postal services jumped by 24.6 per cent. The number of telephone lines is expected to increase by more than 8 per cent this year. Based on the above data it is estimated that **the value added of the transport, storage and communications sector will grow at 4 per cent in 1997** and about **the same** rate **in 1998**.

ANALYSIS OF ECONOMIC DEVELOPMENTS IN 1997 AND PROSPECTS FOR 1998

4. THE EXPENDITURE SIDE OF GROSS DOMESTIC PRODUCT - Foreign demand will be the main generator of economic growth in 1997 and 1998

Last year, the growth in domestic demand only slightly exceeded the growth in foreign demand so that they contributed equally to the 3.1 per cent rate of growth. However, **this year foreign demand is the main generator of growth**. Since Slovenia predominantly exports to the EU, favourable economic developments in the EU have substantially contributed to economic growth. After stagnating in 1996, industrial output in Germany and France resumed to grow this year rising by almost 3 per cent. Industrial output also increased in Austria. The fall in Italy's industrial output is expected to halt this year (see Table 1 in Chapter 2). As industrial output of Slovenia's main trading partners rose so did their imports. The imports of Slovenia's 4 most important trading partners in the EU (Germany, Italy, Austria and France) in real terms rose on average by 4 per cent in 1997. Current trends in exports (see Chapter 5.2) and predictions of further industrial recovery of the four main trading partners (in particular in Germany) suggest that **foreign demand** (export of goods and services) **may increase in real terms by 7.5 per cent this year**.

Table 4: Growth in aggregate demand, in %

	1996	1997	1998
Total aggregate demand	3,0	4,3	4,0
of which:			
Foreign demand (exports)	2,5	7,5	5,3
Domestic demand	3,2	3,4	3,7
intermediate consumption	2,9	3,3	3,5
private consumption	2,6	2,3	2,3
government consumption	2,2	5,0	3,6
gross fixed capital formation	6,9	6,0	7,9

Source: IMAD Estimates of National Accounts

This year **growth in domestic demand has lagged** considerably **behind** the growth in foreign demand. Although rising at a somewhat slower rate, investment demand remains the fastest growing component of domestic demand. A slowdown in growth of investment was already recorded last year. The rise in expenditure for investment (gross fixed capital formation) was again mainly due to investment in economic infrastructure. Signs of a slowdown in growth are also evident in the final consumption of households, which is expected to rise by only 2.3 per cent in real terms in 1997. Growth in private consumption is also expected to be limited in 1998 as wages are not expected to accelerate its growth in 1998. Government consumption is estimated to grow faster than last year because the government assumed new obligations (see Chapter 7). This year, it is forecast to increase by 5 per cent (last year 2.2 per cent). Next year it is expected to grow at a somewhat lower rate of around 3.6 per cent.

Table 5: Gross domestic product by expenditure				
	Structure in %			
	1995	**1996**	**1997**	**1998**
Gross domestic product	100,0	100.0	100.0	100,0
Exports/imports of goods and services	-1,3	-0,9	-1,6	-1,3
Domestic final consumption	101,3	100,9	101,6	101,3
Private consumption	57,9	57,3	57,0	56,2
Government consumption	20,2	20,2	20,5	20,5
Gross fixed capital formation	21,2	22,5	23,3	24,0
Changes in inventories	2,0	0,9	0,8	0,6
Source: SORS: 1995, 1996; BS, IMAD: estimates for 1997 and 1998				

Since 1995 domestic final consumption has exceeded gross domestic product. The surplus in trade of services will not be high enough to cancel out the trade deficit. The trade balance is expected to be negative this year (-1.6 per cent of gross domestic product). In the structure of final GDP consumption in 1997 the share of private consumption decreased by 0.3 percentage points, whilst that of gross fixed capital formation rose the most (up 0.8 percentage points) followed by that of government consumption (up 0.3 percentage points). A 7.9 per cent rate of real growth in investment is expected in view of the continued economic infrastructure building and the revival of corporate investment. In 1998, gross fixed capital formation is expected to account for 24.0 per cent of gross domestic product.

Due to positive factor income and current transfer balance, gross national disposable income exceeded gross domestic product by 1.2 percentage points last year. A positive factor income and current transfers is expected both this and next year (amounting to around 1 per cent of gross domestic product). The share of gross national saving in gross domestic product has remained at around last year's level (23.7 per cent in 1996, 23.6 per cent in 1997). However national savings will not be able to finance domestic investment this year. The shortfall will be financed through borrowing abroad (generating a negative current account balance of around 0.6 per cent of gross domestic product). National savings is a precondition to investment and further growth. Its share in gross domestic product is projected to rise to 24.4 per cent in 1998. This level of savings will enable investment to be financed domestically and thereby the net borrowing abroad in 1998 is expected to amount to 0.2 per cent of gross domestic product.

Table 6: Supply and use of resources				
	Structure in %			
	1995	**1996**	**1997**	**1998**

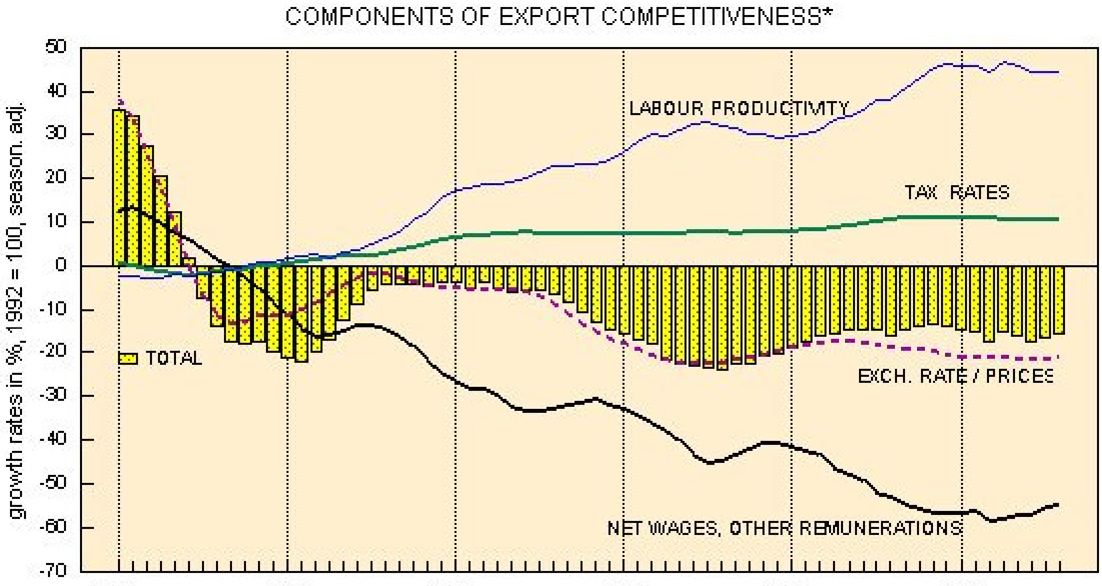
GROSS DOMESTIC PRODUCT	100.0	100.0	100.0	100,0
Factor income balance, net	0,8	0,8	0,6	0,6
GROSS NATIONAL PRODUCT	100,8	100,8	100,6	100,6
Current transfer balance	0,5	0,4	0,4	0,5
GROSS NATIONAL DISPOSABLE INCOME	101,3	101,2	101,0	101,1
Final consumption	78,1	77,5	77,4	76,7
GROSS SAVINGS	23,2	23,7	23,6	24,4
Current account balance	0,0	0,3	-0,6	-0,2
GROSS CAPITAL FORMATION	23,2	23,4	24,1	24,6
of which: gross fixed capital formation	21,2	22,5	23,3	24,0
NET CAPITAL FORMATION	6.5	5.4	5.5	6,0
Source: IMAD's estimate of National Accounts				

5. EXPORT COMPETITIVENESS AND INTERNATIONAL TRADE

5.1. EXPORT COMPETITIVENESS - After an improvement in 1996, export competitiveness stagnated in 1997 and the forecast is the same for 1998

Export competitiveness of manufacturing (measured in terms of the relative unit labour costs in the basket of currencies) **is expected to remain at the 1996 level both this and next year.** After deteriorating slightly in the first half of the year, it improved somewhat in the summer months. Despite the strengthening of the US dollar, the tolar appreciated in real terms by 2 per cent against a basket of currencies in the period from December to June. After the Bank of Slovenia intervened in the forex market in July and August, the tolar depreciated by around 3 per cent in real terms. Based on seasonally adjusted data, real compensation of employees in July was lower than in December. It dropped another 0.5 per cent in August. The decline in labour productivity was halted this summer as employment decreased only modestly and the declining trends in production eased somewhat. Unit labour cost in the basket of currencies was 3.2 per cent higher in June 1997 than in December 1996, whilst in August it exceed the level in December by 1.7 per cent. Export competitiveness improved in August and on average in the first eight months compared to the same period last year.

Figure 2: Components of export competitiveness



Sources of data: SORS, AP, BS, calculations IMAD. Note: growth in the indices indicates an increase in export competitiveness
* for manufacturing - only domestic factors

At the end of September exchange rates of foreign currencies stopped increasing. Despite substantial excess supply in the foreign exchange market, the Bank of Slovenia's ability to intervene will be limited up to the end of the year. If the forecast strengthening of US dollar on the international markets in the next few months eventuates, the real foreign exchange rate will be 1 per cent lower this year than last year. Export competitiveness will remain at last year's level primarily because of the 4.8 per cent growth in labour productivity, but also because of last year's reduction in the level of social security contributions. The tax burden imposed on wages will decrease by around 0.9 per cent and contribute to a slower growth in compensation of employees.

Since the Slovenian tolar is expected to appreciate against the German mark, the Austrian schilling, Italian lira and French franc more than against the basket of currencies, **the export competitiveness will deteriorate compared to that of Slovenia's more important EU trading partners.** The real appreciation of the tolar against the above mentioned currencies is estimated to be on average around 3.5 per cent. This will lead to an increase in relative unit labour costs by around 3 per cent. **Export competitiveness of Slovenia's manufacturing compared to CEFTA countries is expected to improve in 1997**. Based on the current forecasts of changes in the US dollar and trends in wages and labour productivity, Slovenia's export competitiveness will on average increase by 4 per cent in 1997 compared to CEFTA countries .

It is very likely that the tolar will slightly appreciate next year due to the continued excess supply of foreign currency. Consequently export competitiveness is expected to remain unchanged provided: (i) growth in wages and other remunerations eases (forecast 2.7 per cent growth) even though the problems facing public finance have reduced the chances of a further cut in the tax burden on wages; (ii) growth in manufacturing production resumes (at 2 per cent), so ensuring higher growth of labour productivity (5.5 per cent) even though employment declines moderately. Only an adequate growth in productivity can counter the negative effects of the appreciation of the tolar and the real growth in compensation of employees on export competitiveness.

5.2. EXPORT- IMPORT FLOWS AND THE BALANCE OF PAYMENTS - In 1997 real rate of growth in exports and imports of goods has been very high; current account of the balance of payments has been roughly balanced

The rise in the rate of growth in EU countries and in their demand for imports have had a positive impact upon Slovenia's trade in goods. **The value of trade in goods has in US dollars remained at approximately last year's level** owing to the US$ appreciating as much as 11.4 per cent against the basket of currencies in the first nine months. However, **in real terms the rate of growth in goods trade was high**. Slovenia has slightly increased its market share in Germany, Italy and Austria.

Exports of goods in current US dollars fell by 1.2 per cent, whilst imports were approximately at last years' level (down 0.7 per cent) in the first eight months. Because of the considerable inter-currency fluctuations, an annualised comparison of trade in goods in current US dollars is not very appropriate. The US dollars appreciated as much as 11.6 per cent against the basket of currencies in the first eight months compared to a year earlier. Therefore, if adjusted for inter-currency oscillations and the changes in prices in foreign markets, exports and imports, in fact, in real terms rose by 9.5 per cent and 9.2 per cent, respectively.

The share of developmentally favourable investment goods in exports and imports increased in the first eight months. On the other hand, trade in consumer goods declined slightly. Exports of machines and equipment rose from 12.3 per cent last year to 13.1 per cent of total exports.

Exports of goods to the EU in US dollars dropped by 2 per cent in the first eight months on a year earlier. However, in real terms they jumped by as much as 10.1 per cent. Like last year, exports to the EU accounted for 64.5 per cent of total exports in the first eight months. Germany, Italy, Austria and France are Slovenia's main trading partners in the EU (see Table 10 in the Statistical Appendix). About 90 per cent of Slovenia's trade with the EU this year was with these countries. Furthermore, exports to these countries represented 57.6 per cent of total exports and 55.9 per cent of total imports in the first eight months.

The trade deficit with EU countries amounted to US$ 653 million in the first eight months, down US$ 20 million from last year. The trade deficit with CEFTA countries widened by US$ 43.7 million to US$ 149.8 million as imports from these countries grew swiftly. In US dollars terms, exports to countries of former-Yugoslavia remained at last year's level, whilst imports declined 15.7 per cent. Consequently, the trade surplus with these countries widened by US$ 69.6 million to US$ 486.8 million. According to balance of payments figures, the trade deficit (f.o.b./f.o.b.) rose US$ 35.3 million from last year and presently amounts to US$ 630.1 million.

There has been a surplus in the service balance since independence. It amounted to US$ 405.3 million in the first eight months of this year and was down from a year earlier. Its fall was primarily due to a decline in exports of services (by 3.7 per cent) since imports in US dollars stagnated. Exports of services decreased primarily as a result of a 7.3 per cent drop in exports of transport services. Inflow from tourism in US dollars was only fractionally lower than a year earlier and in fact had in real terms grown by 8.1 per cent.

A bigger trade deficit, a smaller service surplus and a smaller surplus in factor incomes generated a current account deficit of US$ 90.7 million in the first eight months (down from a surplus of US$ 21.4 million in the same period last year).

The surplus in the capital account amounted to US$ 110 million in the first eight months. Foreign direct investment stood at US$ 229.9 million. The intervention of Bank of Slovenia reduced the pressures on the tolar to appreciate. Moreover, the interventions of Bank of Slovenia contributed to reduction in the foreign currency reserves of commercial banks, whilst the international currency reserves held by Bank of Slovenia rose.

In view of the current and expected domestic and world economic trends, **exports and imports of goods are estimated to advance 7.8 per cent and 7.6 per cent in real terms, respectively in 1997. The trade deficit** is projected to climb US$ 58 million to **US$ 940 million.** A 6.3 per cent real growth in exports and 5 per cent real growth in imports of **services** should generate **a surplus**, albeit smaller than last year, **of US$ 660 million.** Since the surplus in factor incomes and current transfers is expected to contract, the **current account deficit is expected to amount to around US$ 100 million** and account for 0.6 per cent of the estimated gross domestic product in 1997.

Total foreign exchange reserves are expected to total US$ 4,300 million at the end of the year and exceed total external debt by no more than 2.6 per cent. If so they will be high enough to cover 5 months of imports of goods and services. The total external debt is estimated at 40.7 per cent of total exports (of goods and services) and 23.3 per cent of gross domestic product.

Foreign analysts estimate that the rate of growth of world and EU countries will rise **in 1998** (OECD 1997; IMF; 1997, EC, 1997). The imports of Slovenia's seven most important trading partners are expected to advance 6.8 per cent in real terms (calculations are based on data from OECD, 1997). This, in turn, ought to accelerate the growth in manufacture, which accounts for 98.7 per cent of Slovenia's exports of goods. It ought to also spur exports. **Real exports and import of goods are therefore forecast to rise by 4.9 per cent and 5.1 per cent, respectively.** It is likely that **the trade deficit will slightly widen** to US$ 980 million. However, the **service surplus is expected to widen** and amount to US$ 740 million as a result of the 6.8 per cent real growth in exports and 4 per cent real growth in imports of services. Whether the service surplus will be bigger depends mainly upon the size of the net inflows from tourism. If the services surplus widens **the current account deficit will shrink to US$ 40 million in 1998.**

5.3 FOREIGN DIRECT AND PORTFOLIO INVESTMENT - Foreign direct investment in Slovenia continues to rise whilst direct investment abroad remains moderate

The Bank of Slovenia's latest figures show that **foreign direct investment into Slovenia** has been slightly higher than previously thought. It **was** US$ 1,331.0 million at the end of 1994, US$ 1,744.7 million at the end of 1995 and **US$ 1,934.3 million at the end of 1996.** Somewhat higher figures almost equally resulted from the rise in equity and the reinvestment of profits by foreign investors, as well as a rise in net liabilities of companies with foreign capital to their parent companies abroad. Foreign direct investment rose by US$ 603 million from 1994 to 1996. Of that US$ 296.1 million was on account of a rise in equity investment and reinvestment of profits and US$ 307.2 million on account of a rise in liabilities. The rise in the share of net liabilities in total foreign direct investment suggests not only consolidation of the position of companies with foreign capital in the market but also that corporate lending terms in Slovenia are less competitive.

The inflow of foreign direct investment into Slovenia was US$ 229.9 million in the first eight months of this year. According to data on foreign payment transactions, it was four times higher than last year. However, the payment statistics data on the inflow does not include changes in net liabilities to foreign parent companies, which represented nearly half the increase in stock of foreign direct investment over the last few years. If this fact is taken into account the stock of total foreign direct investment approached US$ 2.5 billion in 1997. It will climb further if announced projects are put in place in the coming months (in particular Goodyear investment in Sava Kranj).

According to the Bank of Slovenia, inward foreign portfolio investment into equity was US$ 97.7 million in 1996 (up from US$ 56.2 million in 1995 and US$ 43.2 million in 1994). The amount of US$ 30.2 million was invested in banking and US$ 67.6 million in other sectors, the corporate sector in particular (purchase of shares of the most prospective companies)

Slovenia's outward direct investment has been lower and more unstable than inward direct investment. Although it jumped from US$ 280.8 million to US$ 403.6 million in the year from end 1994 to end 1995, it then fell to US$ 366.1 million at the end of 1996. Equity investment and profit reinvestment was almost constant over this period. Net claims of Slovenian direct investors abroad oscillated the most. They soared from US$ 8.9 million in 1994 to US$ 114.4 million in 1995 and then fell again to US$ 88.6 million in 1996. It seems that investment abroad is mostly directed to strengthening the position of existing companies. The number of Slovenian enterprises seeking to enter foreign markets in this way is rather small, or almost non.

Although rising from 1994 to 1996, outward portfolio investment has been and remains negligible. At the end of 1996, it totalled US$ 23.4 million, of which banks invested US$ 9.1 million. The remaining US$ 14.3 million was invested by other sectors.

6. INVESTMENT - Growth in investment will slow down in 1997

Since database for monitoring the investment activity of domestic entities is still inappropriate, investment forecasts are primarily based on indirect indicators. The Payment Agency's statistics on monthly investment outlays, which is the only investment indicator presently available, covers a little over 30 per cent of total investment. Moreover, they also cover the transactions related to purchase of equity shares. For this reason, they are a rather irrelevant indicator of investment.

Consequently, indirect indicators on industrial production, construction activity, imports of equipment have been used to estimate gross capital formation. It is estimated that **gross capital formation will be 6 per cent higher in real terms this year than last year.** Its share in gross domestic product is forecast to edge up from 22.5 per cent to 23.3 per cent. The high growth of investment from 1994 to 1995 stems primarily from investment in infrastructure, which is now more significant than corporate investment. The dispersed ownership structure of companies and the high price of capital on the domestic market are most probably the reasons behind low corporate investment .

Given the anticipated investment in infrastructure, a further rise in imports of equipment and somewhat higher corporate investment, gross capital formation should grow at 8 per cent next year. If this eventuates, its share in gross domestic product will rise to 24 per cent in 1998.

In infrastructure development, Slovenia still lags behind the developed EU countries. It has sought to narrow the gap by adopting several strategic policies. According to the Strategy for Economic Development of Slovenia (SEDS, 1995), investment in infrastructure should average 5.4 per cent of gross domestic product per year. However, the estimated demand for investment in infrastructure totals 8.7 per cent of gross domestic product. (Mrak, 1997).

Investment in economic infrastructure amounted to 5.2 per cent of gross domestic product in 1996 and will remain at this level in 1997. It is expected to be somewhat lower (5 per cent of GDP) in 1998, primarily because of limited financial sources The following should be noted concerning sources of finance:

(1) **Infrastructure financing from the budgetary sources is limited and the share of investment in central government expenditure has been falling.** Central government investment in economic infrastructure, non-market activities and public administration accounted for 2.8 per cent of gross domestic product in 1994 and 1995. Due to a rise in other budgetary expenditure, the share fell to 2.67 per cent in 1996. Under the proposed 1997 Budget (National Assembly Gazette, 41/97) the share should drop further to 2.54 per cent. The share of investment in economic infrastructure alone will fall to 1.48 per cent of gross domestic product.

(2) **Opportunities for public sector borrowing are limited**. Because of the drop in the level of government finance and the public sector's lack of own resources to finance investment, since prices of products and public utilities are controlled, the sector is compelled to increase its borrowings. The Ministry of Finance has prepared a proposal of Memorandum on the Conditions for Public Sector Financing in the Period from 1997-2001 to ensure that borrowing would not be excessive. It has been proposed that a ceiling would be set at 1996 level of 9.5 per cent of the gross domestic product.

The gap between the funds available and needed for investment in infrastructure is estimated at between 3.3 per cent and 3.6 per cent of gross domestic product (Mrak, 1997). It should not to be filled by increasing either budget expenditures for investment in infrastructure or public borrowing, but rather **by liberalising prices, privatising the public utility services sector and with private capital investment. In the short run the gap could also be reduced by selective sale of state assets .**

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7. PUBLIC FINANCE - This year the general government deficit will exceed 1 per cent of GDP; The adoption of austerity measures and new taxes, and the sale of a part of state assets are all necessary if the deficit is to be narrowed in 1998.

The following characterised public finance this year: the adoption of the 1997 Budget was delayed; the operation of provisional financing rules was extended three times; the Provision of Additional Funds for Financing Budget Expenditures Act was adopted in May; and general government expenditure rose rapidly as additional expenditure for wages and social transfers was approved last year. Owing to the long delay in adopting the 1997 Budget, the Government has proposed to extend its operation until the end of January 1998. Expenditure proposed in 1997 Budget will partially be covered by sales tax revenue collected in January 1998.

The sources of general government revenue **this year** are very similar to that at the end of 1996. The total social security contribution rate accounted for 38 per cent of gross wages, which is below the 1996 average. Payroll tax thresholds were changed in the middle of the year to lessen the burden on lower wages. The level of average gross wage for exemption from payroll tax was raised. Moreover, the tax was made even more progressive. Pursuant to the Europe Agreement, tariff rates on certain products were reduced causing revenue from customs duties to fall. Sales tax on oil products increased. The tax on CO_2 emissions was introduced this year and is, together with the tax on water pollution introduced in 1995, the only fiscal instrument of environmental protection. The introduction of the value added tax and excise duties is underway. The Value Added Tax and Excise Duties Act was tabled in the Parliament in June 1996. It is expected that the present sales tax will be replaced with the value added tax at the beginning of 1999. The measures adopted in mid-1996 and at the beginning of this year have affected the size and structure of revenue in 1997. Revenue from social security contributions is estimated to drop 2.2 per cent in real terms this year and generate around 35 per cent of total general government revenue. The reduction in contributions and a moderate real growth in earnings last year caused the fall. Due to tariff cuts, revenue from customs duties fell 30 per cent in real terms and substantially exceeded the forecasts made at the beginning of the year. The personal income tax revenue is estimated to increase a mere 1.7 per cent this year. Despite a rise in taxes rates on oil products, sales tax revenue is estimated to rise a mere 2.6 per cent in real terms. The increase is below the projections made at the beginning of the year. However, if the sales tax revenue (in the amount of SIT 17 billion) which will be collected in January 1998 is included in the assessment of revenue for 1997 it will in fact grow in real terms by 7.2 per cent from last year. The CO_2 and payroll taxes which were introduced this year contributed slightly more than 3 per cent to general government revenue. IMAD's spring forecast of a 1.9 per cent rise in real revenue presumed that a tax on motor vehicles, which was rejected by the Parliament, would also be introduced. **General government revenue should**, therefore, **advance 1.5 per cent in real terms in 1997** (if revenue from privatisation is included, but the budget year is not extended to January). **Its share in gross domestic product** (if revenue from privatisation is included) should fall by 0.7 percentage points during the year, from 45.2 per cent to **44.5 per cent.** If the 1997 budget year is extended until January 1998 and a part of the sales tax collected in January forms the 1997 budget revenue it will be higher by 3 per cent in real terms. Its share in gross domestic product will, consequently, amount to 45.1 per cent, which is roughly the same as last year.

Expenditure of the Pension and Disability Insurance Funds is estimated to increase 4.3 per cent in 1997, raising their share of gross domestic product by 0.1 percentage points to 13.5 per cent. More people retired this year as people took advantage of the early retirement privileges under the Victims of War Act.

The programme and benefits of the compulsory health insurance have not changed much this year from the last. Like last year its expenditure (inclusive of funds transferred from the central budget) will this year account for 6.8 per cent of gross domestic product.

The local government expenditure will rise 2.1 per cent in real terms in 1997. However, their share in gross domestic product will fall 0.1 percentage points to 4.8 per cent of the gross domestic product.

The provisional financing rules, which capped the monthly budget expenditure to one-twelfth of last year's, governed **central government expenditure** this year. However, neither the level nor structure set out in the rules meets the needs and requirements of the budgetary users in 1997. Consequently, the Additional Financing of Government Expenditure Act was promulgated in May to provide additional funds to meet government outlays. The 1997 Budget was submitted to Parliament in late July and is still under discussion. According to the amended Budget proposal expenditure should rise 14.2 per cent this year to SIT 743 billion, of which a substantial part will be expended on wages, social transfers and transfers to the Pension and Disability Fund to cover its deficits. The decisions to raise expenditure in these areas in 1996 put pressure on the expenditure to rise in 1997 and altered its structure. If transfers to the Pension, Health-care Funds and local communities are excluded, central government expenditure grew by 10.4 per cent. The level of central government expenditure is estimated to rise from 19.5 per cent of gross domestic product in 1996 to 20.9 per cent in 1997. Since the Budget is yet to be adopted it is very difficult to forecast how much will be expended until the end of the year. However, it is clear that it is unlikely that it will be in line with that set out in the budget proposal. It is estimated to amount to SIT 720 billion, up 10.5 per cent in real terms on last year. Its share in gross domestic product is forecast to rise 0.6 per cent from last year and total 10.2 per cent. If all this is taken into account, general government expenditure will account for 45.7 per cent of gross domestic product in 1997, up 0.8 percentage points from a year earlier.

However, under the amended Budget proposal (of a SIT 743 billion expenditure) **general government revenue is to reach 46.5 per cent of gross domestic product**, up 1.6 percentage points from 1996.

The **general government** account was in surplus (of 0.3 per cent of gross domestic product) in 1996. However, **this year's deficit will exceed 1 per cent of gross domestic product.**. The first Budget proposal forecast a general government deficit of 0.9 per cent of gross domestic product. However, it was based on a higher revenue estimate (to be collected by the end of 1997) than it now seems likely. It therefore seems, assuming the budget year ends in December that the **deficit will total 1.2 per cent of gross domestic product. If the budget year (for revenues and expenditures) is extended until the end of January 1998 it will total 1.4 per cent.**

Since a wider deficit will have numerous negative repercussions, **major efforts must be taken to reduce it in 1998.** Expenditure must be reduced to around 45.5 per cent of gross domestic product, new economically rational and fiscally profitable taxes will have to be introduced and additional revenues will have to be obtained by selling government assets.

The 1998 projections (see Tables 12 and 13 in the Statistical Appendix) presume that new taxes will generate revenue amounting to 0.7 per cent of gross domestic product and that measures to reduce expenditures will be introduced. To reduce the deficit to 0.5 per cent of gross domestic product, the government intends to sell off some of its assets (generating the revenue of 0.7 per cent of gross domestic product). If so, revenue may account for 45 per cent of gross domestic product in 1998. This target might be difficult to achieve since the government could face problems in selling assets (inadequate purchasing power and an undeveloped capital market) and there is likely to be a delay in the adoption of new taxes. Consequently, to achieve this target, by IMAD estimates, expenditure should be reduced by a further SIT 20 billion.

Pension and Disability Insurance expenditure is forecast to drop 0.1 percentage points to 13.4 per cent of gross domestic product in 1998. The expected changes in the pension system, which will increase the number of people retiring, are likely to push it up further. The compulsory health insurance is guaranteed approximately the same level of funds as in 1997. The expenditures for health insurance are forecast to drop 0.1 percentage points to around 6.7 per cent of gross domestic product. Local government expenditure is expected to fall 0.1 percentage points to 4.7 per cent of gross domestic product next year.

Central government expenditure is estimated to amount to SIT 821 billion in 1998. This figure takes into account the effects of the proposed government austerity measures concerning wages in state administration and other institutions and social transfers. These measures will have to be very selective and will seek to avoid reducing developmentally oriented expenditure and expenditure to finance reforms.

8. EMPLOYMENT AND UNEMPLOYMENT - Total employment continues to stagnate and a wide discrepancy between the internationally comparable and registered unemployment data remains

Based on current statistics, employment edged down by 1 per cent and the number of all persons in employment 0.6 per cent in 1996. The decline in employment and the number of persons in employment halted in the first half of 1997. It levelled off in the first quarter and then marginally rose in the second quarter. This together with data on employment levels in the summer months confirms the spring forecast that **employment will stagnate in 1997**. Since economic growth is forecast at 3 1/4 per cent and employment will stagnate, aggregate labour productivity is expected to grow at 3.3 per cent in 1997, down slightly from last year.

As in the previous years, employment in mining and manufacturing dropped the most despite a slight increase in June and July. However, the drop was considerably smaller than in previous years. If the current trend continues until the end of the year, it will fall by less than 4 per cent. Based on the survey data, National Employment Office (NEO, LP-ZAP, April 1997) forecast a 4 per cent drop in employment in companies. The moderate growth in production and less intensive downsizing will result in lower rate of growth in labour productivity in manufacturing. A lower rate of growth in labour productivity in manufacturing is partly due to modest investment in manufacturing and partly due to the enterprises having already quite exhausted the opportunity to raise productivity by reducing the number of employees.

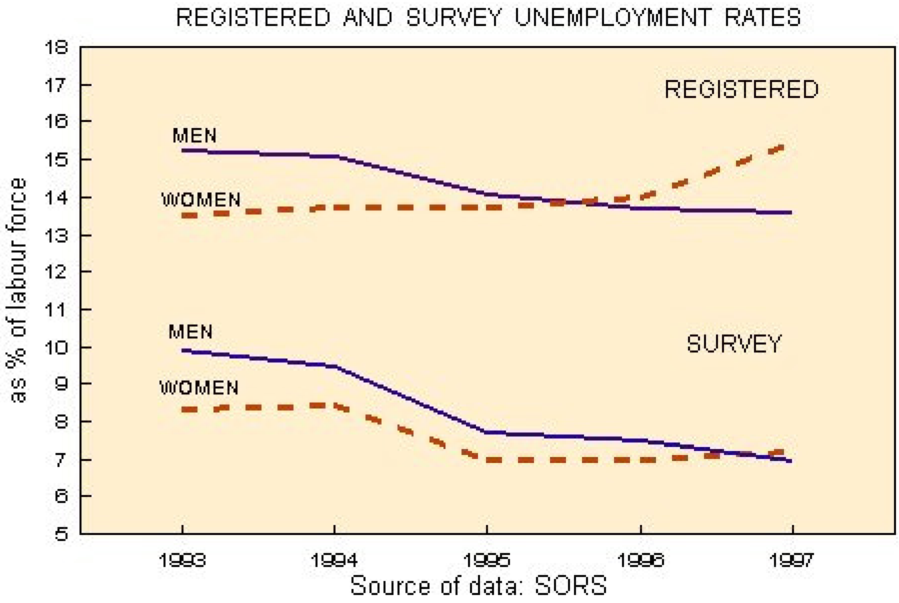
Within the service sector, employment continued to rise at an annual rate of around 5 per cent in public administration and rose between 2 per cent to 4 per cent in financial and business services. It also rose in trade, but dropped in transport and hospitality. Growth in employment in social services (education, health-care, social-care) has been modest (less than 1 per cent).

In view of the anticipated slightly higher rate of economic growth, further growth in investment and the continued introduction of more flexible forms of employment, **total employment is expected to pick up by 0.5 per cent in 1998.** All considered, labour productivity is forecast to increase by more than 3 per cent next year. However, strong competition on domestic and foreign markets will put pressure on the rate of growth of productivity to rise. This may cause employment to stagnate and maybe even decline. Since large structural unemployment diminishes the potential effect of economic growth on employment, very high rates of economic growth are needed in order to increase employment.

Despite stagnant employment, the increase in the **number of registered unemployed exceeded** the level forecast in spring. Analysis of the data on labour force suggests that more people obtained jobs without going to the employment office this year. This was particularly the case for young people. Old unemployed, unskilled, semi-skilled and others who find it particularly difficult to get a job remain registered as unemployed. Thus, despite the seasonal inflow of young unemployed, the share of workers who find it difficult to find a job in total unemployed has risen: the share of job-seekers above 40 years old reached 42 per cent and the share of long-term unemployed was again close to 60 per cent. The number of unskilled unemployed continued to rise although their share in total unemployment has decreased somewhat (around 47 per cent). Less educated workers faced increased labour market difficulties, while highly educated enjoyed relative advantage in terms of ability of switch the job or to exit unemployment during the period of transformational depression (Orazem, Vodopivec, 1995). However, in the period of economic recovery education remains a very important factor affecting the likelihood of getting a job. A comparative study of the educational background of the unemployed and the educational levels of vacancies reported to NEO by companies confirms the strong structural unemployment in the Slovenian labour market and that the unskilled are less likely to get a job. There are on average 5 registered unemployed per job vacancy requiring a non-university or university degree. On the other hand, there are around 10 unemployed per job vacancy requiring vocational or secondary education and there are around 15 unemployed per job vacancy for unskilled or semi-skilled workers.

A comparison of male and female unemployment rates reveals that the transformational depression and the loss of the former-Yugoslav markets have affected the male labour force more strongly. The slowdown in economic growth in 1995 had the opposite effect. In the period from 1992 to 1994, **unemployment rate for women** was lower than for men. In autumn 1995, however, the women unemployment rate **caught up with that of men**. In 1996 it **exceeded it**. This year the gap has even widened.

Figure: Unemployment rate



The number of unemployed who got a job has increased slightly and the number of workers who lost their job decreased slightly this year. Moreover, the inflow of first-time job seekers (school-leavers) is expected to be slightly lower than in the past. The latest data suggests that there were more erasures from the unemployment roll this year. In August there were 125, 200 registered unemployed. No substantial increase in the number of registered unemployed is expected to the end of the year. Therefore around 126,000 unemployed are expected to be registered at the employment office at the end of the year. Unemployment rate should be 14.4 per cent at the end of the year. **The yearly average number of registered unemployed is expected to be around 125,000,** which means **an increase of 4 per cent** compared to 1996. The expected **14.4 per cent average annual rate of registered unemployment** is slightly higher than last year's 13.9 per cent. In the coming years no marked decrease in unemployment is expected because of economic restructuring. Since the new generations of school leavers are more numerous the size of the labour force is expected to expand. Therefore, **the average annual rate of unemployment is expected to average around 14.4 per cent in 1998 as well.**

The internationally comparable unemployment rate (based on the ILO standards for measuring unemployment) **was 7.1** per cent in the second quarter of 1997, **down slightly from last year's level** (7.3 per cent). This further widened gap between the rate of registered and surveyed unemployed. Amongst the registered unemployed, the proportion of unemployed which are not regarded as unemployed under international standards rose to 54.8 per cent of all unemployed (in 1996 and 1995, 50.5 per cent). High unemployment amongst young people (17.4 per cent) and in particular women (19.7 per cent) is alarming and highlights the problems young people have to find a job. The small unemployment rate of the category of people above 50 years old (around 3 per cent) may either suggest that their involvement in the informal or unpaid forms of work is above the average or that they are no longer trying to get a job and are, therefore, no longer regarded as a part of the labour force under the ILO criterion. Furthermore, the Labour Force Survey points to a relatively high share of unpaid family members amongst the employed, and in particular in agriculture.

9. EARNINGS - Income policy was successful this year; average gross wage per employee should again lag behind labour productivity in 1998

The main goal of this year's income policy was to bring the rate of growth in earnings below that of labour productivity in order to improve competitiveness in international markets. Wages are set in collective agreements, individual agreements, the Law on Wage Ratios and in other laws. To ensure that a uniform method of wage adjustment is used a tri-partite agreement has to be adopted. The 1996 Social Agreement expired in May. Negotiations on a new agreement began sufficiently before the previous agreement expired to ensure its timely adoption. The prepared draft of a new agreement is more comprehensive than its predecessors. The social partners have agreed on general goals and policy directions in employment, prices, interest rates, earnings, social security, and housing policy and legal safety. However, disagreements on fiscal policy issues **held up conclusion of the 1997-1999 Social Agreement**. In order to ensure the continuity of income policy, wages had to be regulated as soon possible because of the expiry of the 1996 Social Agreement and the associated implementing law in June. **The Minimum Wage and Wage Adjustment Act** was consequently promulgated in early July. It **incorporates the guidelines on wages for this and next year set down in the Social Agreement.**

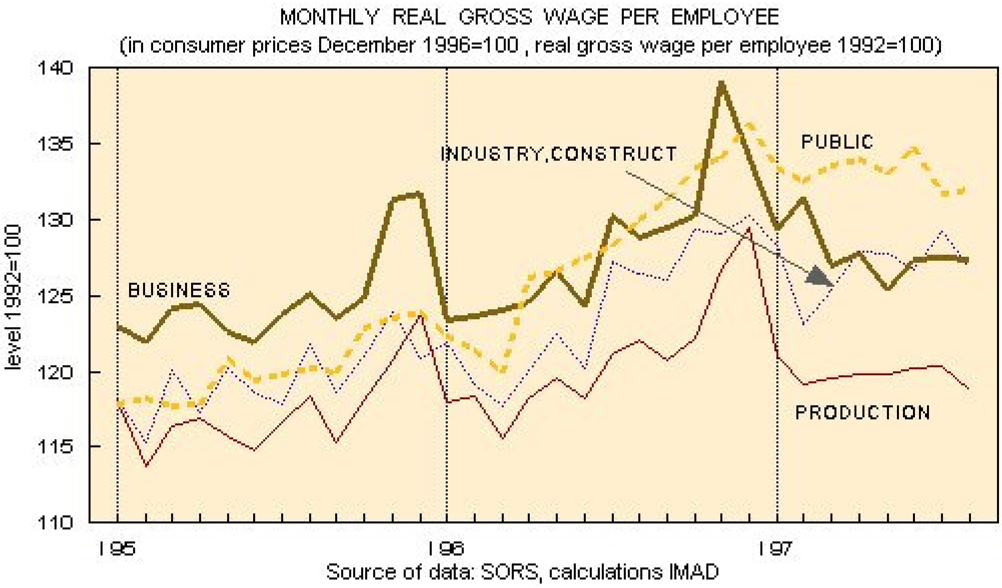
The Minimum Wage and Wage Adjustment Act introduces a base wage adjustment mechanism based on the consumer price index instead of the retail price index as an inflation indicator in the coming year. Unless the Act explicitly permits that social partners change the minimum wage or the mechanism for wage adjustment the Act will remain in force until mid-1999.

Under **the wage adjustment mechanism** the base wage will be adjusted once a year by 85 per cent of the growth in prices. Earlier wages were adjusted every quarter by 85 per cent of growth in retail prices in previous period. Certain "safety" mechanisms have been included to prevent a substantial drop in the real base wages and smooth the transition to a longer adjustment period. The first adjustment is scheduled for January 1998. However, the "safety" mechanism requires earlier adjustment in case that consumer prices since April grow more than 5.5 per cent. Moreover, should the rate of growth in consumer prices exceed 8.8 per cent by the end of the year, the adjustment (rise) in base wage will be done by full rise in prices. A further "safety" mechanism is built into the mechanism for wage adjustment in manufacturing. If growth in the gross wage per employee in manufacturing lags behind that of prices for four consecutive months, it will be adjusted for 90 per cent of the price rise at the next scheduled indexation. Similar "safety" mechanisms will be in force in 1998.

The adjustment mechanism applies to all earnings, also in the public sector. Under the new law salaries negotiated in individual agreements must not grow faster than the rate set for base wages. This ought to prevent the recurrence of the adverse developments of the second half of 1996. Moreover, the law states that no more than an average wage may be paid out given favourable business results and the amount paid out in wages must be less than 25 per cent of the profit generated. Payments can be made only after the annual financial results are published.

The minimum wage is also set out in the Act. The separate Law on Minimum Wage has not yet been adopted. Like other wages minimum wage is indexed to the rate of growth in prices. In addition, it is adjusted for growth in gross domestic product once a year. The method for adjusting minimum wage were agreed on by the social partners this year. However, the minimum wage was set higher than it would result from the general adjustment method and the adjusting to the previous year's rate of GDP growth. Thus, the minimum wage rose by 4.2

per cent, from 56,781 SIT to 59,150 SIT. The minimum wage is slightly higher than the base wage for the third tariff class of the general collective agreement for the business sector.



The 1996 Social Agreement and the law implementing it still governed wages in the first half of 1997. **Wages grew moderately in real terms in the business and the public sector**. The real rate of growth in the gross wage per employee in education was higher in March and in the first part of April because the Amendments to the Law on Wage Ratios in Public Institutions, Government Bodies and Local Community Bodies introduces a mechanism to promote employees in kindergartens, elementary and secondary schools to higher wage tariff classes. Growth in wages remained moderate after the Minimum Wage and Wage Adjustments Act was passed. The real gross wage per employee was almost the same in July as in June (0.2 per cent rise). It declined by 1 per cent in August. Wages have been rising slowly both in the private and public sector.

Payment of Christmas bonuses by companies is likely to boost the growth in wages at the end of the year. Provided that this seasonal increase is moderate, **the rise in real gross wage per employee will be by 2.5 per cent this year**. In this case growth of wages will be almost 1 percentage point **lower than that of labour productivity**.

The Minimum Wage and Wage Adjustment Act adopted in July 1997 will govern wages **in 1998**. The Act imposed restrictions on wages set in collective agreements, individual agreements, the Law on Wage Ratios and in other special laws. **Real gross wage per employee is, therefore, expected to rise 2.5 per cent and lag almost 1 percentage point behind labour productivity in 1998.**

Other remunerations, such as reimbursement for work-related costs and other reimbursements, and contract-work payments advanced around 2 per cent in real terms. This is substantially below last year's level when they soared by 15 per cent in real terms. After rising for a number of years the share of other remunerations in the total wage bill in 1997 is estimated to be lower than in 1996. Nevertheless it will still remain high (42.8 per cent).

10. PRICES - Average annual inflation at around 9 per cent this year; consumer price

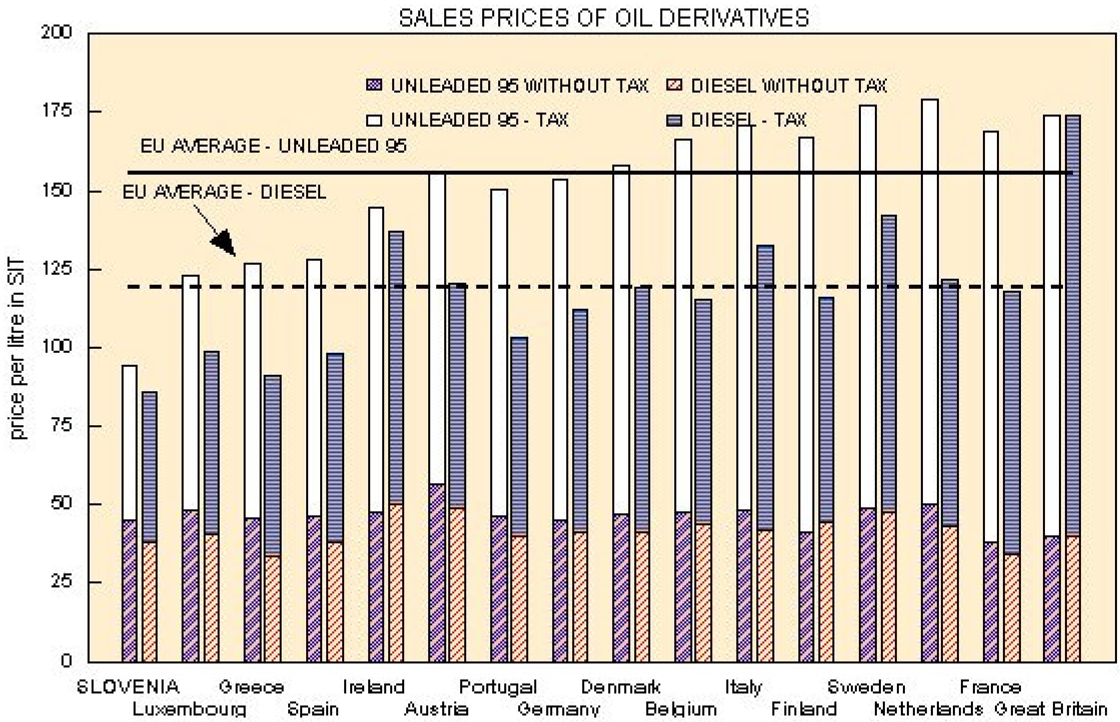
index as a main measure of inflation in 1998; somewhat lower inflation despite continued correction of price disparities in 1998

It is unlikely that the spring goal of maintaining end-year inflation at last year's level of 8.8 per cent will be achieved this year. Retail prices rose 8.5 per cent in the first ten months. Although no additional upward price pressures are expected before the end of the year, end-year inflation is expected to run at around 9.5 per cent . Nevertheless, **the average annual inflation should slightly decelerate** from 9.7 per cent in 1996 **to around 9 per cent** this year.

The annualised rate of growth in retail prices was at the lowest since independence in March 1997. However, it started to rise again in April and peaked in September at 10.1 per cent. The intensive correction of price disparities and the liberalisation of some prices were the main forces in the resumed rise in inflation.

As it has been announced, corrections of controlled prices were quite frequent and intensive in 1997. In previous years controlled prices had been to a some extent held down in order to curb inflation. This year, however, the increase in controlled prices was substantial, in the energy sector in particular. **Price policy contributed 4.4 percentage points of the 8.5 per cent rise in retail prices in October 1997 compared to December 1996.** Energy prices soared 21 per cent and contributed 3.2 percentage points of inflation. Retail prices of oil products surged 22.5 per cent. Since the share of taxes in retail prices of oil products is substantially lower than in EU countries, these prices still lag considerably behind EU average prices. The primary factor in the rise was an increase in sales tax rate on oil products. But, the 3.9 per cent rise in September stemmed from upward adjustment to the higher purchase price of crude oil due to the more expensive US dollar and an increase in world prices of crude oil. The price of household electricity increased 15.7 per cent this year.

Figure: Sale prices of oil derivatives



Source of data: European Commission, DG for Energy. Note: changed in SIT using US$ exchange rate of BS as at 22nd September 1997

The increases in telecommunication and compulsory car insurance prices were amongst the highest rises in controlled prices. They rose 14.0 per cent and 15.8 per cent (from last December to September this year), respectively. Despite the rise, the cost of a local call is still greater than the price charged. The insurance premiums rose because they had been in relative terms lagging in the past years. Prices of utility services have also increased above average (10.9 per cent). It has been typical of the price control in this sector that government rules were not adhered to and prices rose through various special charges. A mechanism to determine prices of basic utilities is expected to be changed in 1998. It will give the local municipalities the power to set prices since they are better acquainted with regional-specific problems than the central government.

The consumer price index, which almost fulfils the criteria of Harmonised Consumer Price Index used in the EU, will become **a main measure of inflation in 1998.** This is part of the statistical methodological changes required by EU standards. This year, the growth in the consumer prices index was slightly lower than that of the retail price index. Consumer goods prices advanced 7.3 per cent in the first ten months and were in annualised terms up 8.7 per cent.

The government and the Bank of Slovenia will strive to further reduce the rate of inflation in 1998. This process will be slow and gradual because price disparities will continue to be corrected (in particular of energy and transport and communications prices) and certain reforms will have an effect on inflation. Consequently, **inflation** is forecast **to edge down to around 8 per cent in 1998**.

11. MONEY AND LIQUIDITY - Despite falling throughout the year, interest rates remain high

For the first time, the Bank of Slovenia (BS) announced its monetary policy objectives for the year 1997 in early May. BS announced target range for M3 growth, as it considered M3 money aggregate as more stable and as more closely linked indicator to nominal output and inflation than M1. It therefore aims to increase M3 by around 18 per cent (plus or minus 4 per cent) in the last quarter of this year compared to the last quarter of 1996 (i.e. between 14 and 22 per cent over the entire year).

The September data shows that **this goal is being achieved**. The **M3** was on average 16 per cent higher in the third quarter this year than in the last quarter of 1996 and 20.4% higher than in the same period last year.

In the first nine months, foreign currency reserves increased 4.7 per cent (in US$ terms) to US$ 4,233.6 million at the end of September. The Bank of Slovenia's reserves rose 43.2 per cent from last December and totalled US$ 3,264 million at the end of September. Their share in total reserves rose from 55.2 per cent last December to 75.5 per cent in September. Their above average rise was a consequence of BS's active interventionist measures aimed at diminishing the appreciation of tolar.

By the end of September loans had grown by 4.3 per cent in real terms compared to last December. The share of loans to companies rose until March and then started to fall. By the end of September their share in total loans dropped by 2.3 percentage points to 62.1 per cent. Loans to households soared 11 per cent. More than 80 per cent of these loans are long-term.

Tolar household savings rose 22.8 per cent in real terms in the first nine months of 1997. Foreign currency deposits were substantially affected by the German mark exchange rate movements. At the beginning they fell, but they resumed to grow in July. In real terms, they were down 0.5 per cent in September compared to last December. Total deposits of households rose 8.7 per cent in the first nine months. The share of foreign currency savings declined 5.1 percentage points to 55.0 per cent. **The rise in the share short-term deposits halted.**

Bank liquidity has been good this year. The interest rate stability on the inter-bank money market confirm this. In nominal terms, interest rates averaged at 10.4 in September, slightly above the base interest rate (TOM). Thus, in nominal terms they had not changed since December but in real terms they had fallen.

Average real interest rate (above the revaluation rate) for short and long-term loans decreased in the first nine months to 9.9 per cent and 11.1 per cent, respectively. The average real rate of interest on a consumer loan fell from 10.3 per cent last December to 8.3 per cent in September. After the Agreement on Maximum Deposit Interest Rate was signed, the real term deposit interest rate fell by 0.8 to 1.3 percentage points in April.

The average nominal interest rate on short and long term deposits **increased** 2.8 percentage points and 3.1 percentage points, respectively in September compared to last December. The average nominal interest rates for time deposits also rose. The rise in nominal interest rates was due to the TOM, which is now calculated using the average monthly rate of growth in retail prices over a 12 month period, rising from 0.5 per cent to 0.8 per cent monthly rate.

Relative liquidity of the business sector slightly deteriorated this year. The share of assets on business sector giro accounts in assets on total giro accounts dropped from 39.9 per cent last September to 39 per cent this September. The public sector's relative liquidity deteriorated, whilst that of households improved from 39.1 per cent per annum to 40.7 per cent.