Winter Forecast of Economic Trends 2011/2012

January 2012

Winter forecast of Slovenia's main macroeconomic aggregates

	2010	2011	2012	2013
		Winter forecast		
ECONOMIC ACTIVITY				
GDP, real growth, %	1.4	**0.5**	**0.2**	**2.0**
GDP in EUR m, current prices	35,416	**35,789**	**36,356**	**37,590**
GDP per capita in EUR, current prices	17,286	**17,437**	**17,778**	**18,349**
GDP per capita in USD	22,916	**24,272**	**23,432**	**24,184**
EMPLOYMENT, WAGES AND PRODUCTIVITY				
Employment according to the SNA, growth in %	-2.5	**-1.7**	**-1.4**	**-0.7**
Number of registered unemployed, annual average, in '000	100.5	**110.7**	**116.1**	**118.8**
Registered unemployment rate, in %	10.7	**11.8**	**12.5**	**12.8**
ILO unemployment rate, in %	7.2	**8.1**	**8.6**	**8.8**
Gross wage per employee, real growth, in %	2.1	**0.2**	**-0.1**	**0.3**
- Private sector	3.2	**0.9**	**0.6**	**1.1**
- Public sector	-1.8	**-1.8**	**-1.9**	**-1.8**
Labour productivity (GDP per employee)	4.0	**2.2**	**1.6**	**2.7**
INTERNATIONAL TRADE				
Exports of goods and services, real growth, in %	9.5	**7.3**	**2.9**	**6.0**
Exports of goods	11.0	**8.3**	**3.0**	**6.4**
Exports of services	4.1	**3.5**	**2.5**	**4.5**
Exports of goods and services, real growth, in %	7.2	**5.5**	**1.0**	**4.6**
Imports of goods	8.0	**6.3**	**0.9**	**4.6**
Imports of services	2.6	**1.2**	**1.7**	**4.3**
CURRENT ACCOUNT OF THE BALANCE OF PAYMENTS				
Current account BALANCE, in EUR m	-297	**-192**	**-176**	**321**
- as a % of GDP	-0.8	**-0.5**	**-0.5**	**0.9**
External balance of goods and services, in EUR m	103	**210**	**739**	**1,148**
- as a % of GDP	0.3	**0.6**	**2.0**	**3.1**
DOMESTIC DEMAND				
Domestic consumption, real growth, in %	-0.1	**-0.8**	**-1.2**	**0.8**
of which:				
Private consumption	-0.7	**0.0**	**-0.5**	**0.3**
Government consumption	1.5	**0.3**	**-0.7**	**0.3**
Gross fixed capital formation	-8.3	**-10.5**	**0.0**	**4.0**
Change in inventories, contribution to GDP growth, in p.p.	1.9	**1.3**	**-0.8**	**-0.3**
EXCHANGE RATES AND PRICES				
USD/EUR exchange rate	1.327	**1.392**	**1.318**	**1.318**
Real effective exchange rate – CPI deflator	-1.4	**-0.9**	**-0.6**	**0.2**
Inflation (Dec/Dec)	1.9	**2.0**	**1.8**	**1.8**
Inflation (annual average)	1.8	**1.8**	**1.8**	**1.8**
Oil price (Brent crude, USD/barrel)	79.6	**111.0**	**105.0**	**100.0**

Source: up to 2010 SORS, BS, ECB, EIA; 2011–2013 forecasts by IMAD.
The Winter Forecast is prepared based on statistical data, information and adopted measures available by 6 January 2012.

Summary

The expectations regarding economic trends in the international environment have deteriorated significantly since the autumn forecast was released. The situation in international financial markets has also tightened, which is reflected in growing borrowing costs for an increasing number of euro area countries, and deteriorating access to sources of finance for countries and businesses. Meanwhile, the most recent data show that economic activity in Slovenia was slowing faster than expected already in the second half of 2011. The main risks to the autumn forecast are thus materialising. Based on the latest available data and changed assumptions, we have therefore prepared a revised forecast of economic trends in Slovenia for the period 2011–2013 (Winter Forecast of Economic Trends 2011).

The Winter Forecast retains the assumptions regarding economic policy orientations that will reduce the public finance deficit. The Forecast takes into account the guidelines for fiscal policy pursued at the time of the preparation of the revised budgetary documents for 2011, as well as the guidelines for the following period set in the Stability Programmes. In the context of these guidelines, deficit reduction is focussed on curbing the compensation of public sector employees, transfers to individuals and households, capital and capital transfers of the government, and subsidies. The Act on Additional Intervention Steps for 2012 (Zakon o dodatnih interventnih ukrepih za leto 2012), effective since the beginning of 2012, froze for half of the year the adjustment of public sector wages, transfers to individuals and households, and pensions. Moreover, the implementation of the state budget has also been frozen until the adoption of the supplementary budget, which slows consumption in this period by limiting the use of budgetary funds to the obligations already assumed.

The standstill of economic activity in the first half of 2011 and its decline in the third quarter indicate that economic growth will be very modest in 2011 (0.5%) and almost stagnant this year (0.2%). A faster moderation of GDP growth than projected in the autumn is largely due to changes in the international environment, which will show particularly in slower growth in exports. In addition to a further tightening of financial conditions, this will also contribute to lower growth in investment than expected in the autumn. These economic developments will also affect labour market conditions, which will continue to deteriorate in 2012, while private consumption will drop. As in the last three years, in the absence of commodity price shocks, we expect no pressure on prices.

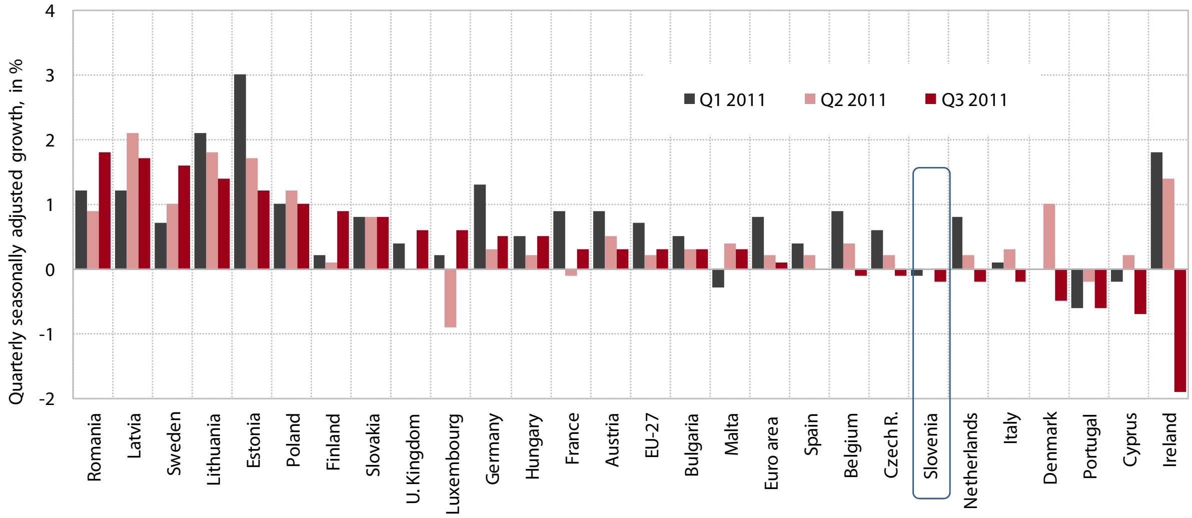
With a slight strengthening of growth in domestic and export demand, we anticipate 2% economic growth in 2013. Global economic growth is set to increase somewhat again in 2013. Growth in domestic consumption will derive from stronger business investment and the realisation of construction works that were interrupted or postponed during the crisis. With an easing of tensions on the labour market, private consumption will also recover gradually.

The risks of a further deterioration remain high. Forecast performance is directly dependent on the stabilisation of the situation in the international environment and Slovenia's banking system, as well as on successful public finance consolidation and reform efforts, which would restore confidence on international financial markets. Simulations show that if due to new tensions as a result of the deepening of the sovereign crisis, economic activity in euro area countries already drops this year, Slovenia's GDP will also decline.

Assumptions of the Winter Forecast

The prospects for economic growth in Slovenia's main trading partners have worsened substantially since the time of the preparation of the autumn forecast. The international economic environment has deteriorated in recent months, mainly due to considerably lower confidence in the ability of euro area countries to solve public finance problems. This led to increased tensions on financial markets. The tightening, which was first reflected in a deterioration of consumer and business expectations, has already started to affect economic activity. In Q3 2011, economic activity was still positive, albeit only slightly (0.1%, seasonally adjusted), but it declined in the last quarter of 2011, according to the most recent forecasts of international institutions, which is worse than expected in the autumn. The institutions expect that economic activity in euro area countries will stagnate or decline further in the first two quarters of 2012 and only start picking up gradually in the second half of 2012.

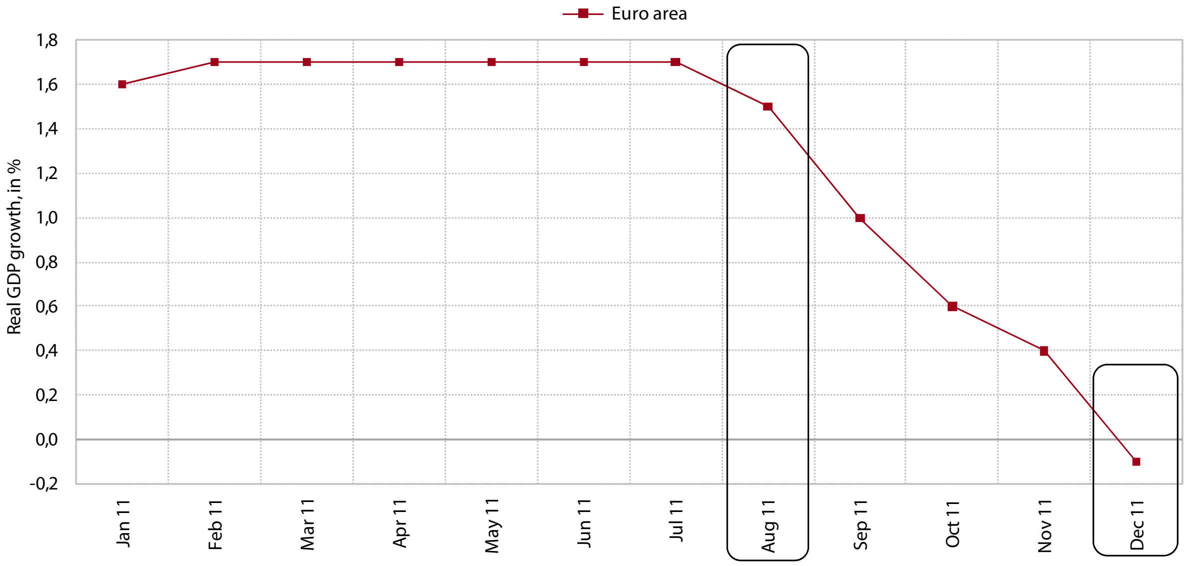
Figure 1: GDP growth in EU countries in the first three quarters of 2011



Source: Eurostat.

With the forecasts for 2012 worsening substantially in recent weeks, downside risks to growth in Slovenia's main trading partners still persist. A number of international institutions (OECD, ECB, Consensus) have cut their forecasts in recent months. The monthly Consensus forecast for euro area economic growth in 2012 was revised downwards by 1.6 p.p. from August's release, which served as the basis for the assumptions of IMAD's autumn forecast, to December's, which was used for the preparation of our winter forecast and already anticipates a mild decline of economic activity (-0.1%). In view of considerable revisions in the last few months and deviations of individual forecasts from the average (which totals -0.1%, while individual forecasts anticipate a larger GDP decline), the risks regarding this year's economic trends continue to exist.

Figure 2: Revision of the forecast for GDP growth in the euro area in 2012



Source: Consensus Forecasts.

Table 1: Assumptions of the forecast regarding economic growth in Slovenia's main trading partners

Real growth rates, in %	2010	2011		2012		2013	
		Autumn forecast (Sept. 11)	**Winter forecast (Jan. 12)**	Autumn forecast (Sept. 11)	**Winter forecast (Jan. 12)**	Autumn forecast (Sept. 11)	**Winter forecast (Jan. 12)**
EU	2.0	1.8	**1.6**	1.6	**0.2**	1.8	**1.3**
Euro area	1.9	1.8	**1.6**	1.4	**-0.1**	1.6	**1.2**
Germany	3.7	3.0	**3.0**	1.8	**0.5**	1.7	**1.7**
Italy	1.5	0.8	**0.6**	0.8	**-1.0**	1.0	**0.3**
Austria	2.3	3.0	**3.2**	1.8	**0.8**	1.8	**1.6**
France	1.5	1.7	**1.6**	1.6	**0.1**	1.7	**1.2**
United Kingdom	2.1	1.1	**0.9**	2.0	**0.7**	2.0	**1.6**
Czech Republic	2.7	2.2	**1.8**	2.2	**0.3**	3.0	**2.5**
Hungary	1.3	1.8	**1.5**	2.5	**-0.3**	3.0	**1.1**
Poland	3.9	3.9	**4.2**	3.9	**2.4**	3.8	**2.5**
Croatia	-1.2	1.0	**0.3**	2.0	**0.0**	3.0	**1.2**
Bosnia and Herzegovina	0.7	2.0	**1.9**	3.0	**1.1**	3.0	**2.5**
Serbia	1.0	2.7	**2.2**	3.5	**2.0**	3.5	**2.5**
Macedonia	1.8	2.0	**3.0**	3.0	**2.6**	3.0	**3.0**
US	3.0	1.8	**1.7**	2.4	**2.1**	3.0	**2.5**
Russia	4.0	4.5	**4.0**	4.4	**3.5**	4.4	**4.1**

Source: 2010 Eurostat; OECD Economic Outlook, November 2011; WIIW Monthly Report, November 2011; Consensus Forecasts, December 2011, Eastern Consensus Forecasts, December 2011; IMAD estimate.

The winter forecast is based on the assumption that commodity prices will remain relatively stable. Oil prices have remained roughly unchanged in the time since the preparation of the autumn forecast. Despite the expected cooling of global economic activity, the prices of this commodity remain relatively high, in contrast to the movements at the end of 2008. As in the autumn, we therefore assume only a minor price drop in 2012 in comparison with 2011. Growth in non-energy commodities was also slowing in line with expectations until the end of 2011. With regard to the forecasts of international institutions, we assume that these prices will also not differ substantially from the levels achieved.

Table 2: Assumptions of the forecast regarding commodity prices

	2010	2011		2012		2013	
		Autumn forecast (Sept. 11)	**Winter forecast (Jan. 12)**	Autumn forecast (Sept. 11)	**Winter forecast (Jan. 12)**	Autumn forecast (Sept. 11)	**Winter forecast (Jan. 12)**
Prices of Brent crude, in USD	79.6	110	**111**	105	**105**	105	**100**
Prices of Brent crude, in USD, growth	29.0	38.2	**39.5**	-4.5	**-5.4**	0.0	**-4.8**
Prices of non-energy commodities, in USD, growth	26.3	23.0	**20.0**	0.0	**-5.0**	0.0	**0.0**

Source: EIA, EIU, ECB, IMF Commodity Price Index; assumptions for 2011-2013 by IMAD.

The winter forecast assumes a US dollar exchange rate of USD 1.318 to EUR 1. The euro has mainly been losing value against the US dollar in the last two months. The assumption in the winter forecast for 2012–2013 is, therefore, also lower. Based on the average ratio in December 2011, it totals USD 1.318 to EUR 1, which is 5.3% lower than in 2011.

The situation on European government bond markets has tightened further since September 2011. In view of further uncertainties regarding the sovereign debt crisis in the euro area, the costs of borrowing increased for almost all euro area countries in November. The required yields of government bonds also rose in hitherto less exposed economies (France, Austria), in addition to Greece and Italy, where they spiked to record highs. Meanwhile, Slovenia's credit rating was also downgraded by all three main rating agencies (by Moody’s two times). The yield to maturity of the 10-year government bond rose significantly: it surged over 7% in November 2011 and remained around that figure in January 2012. If the required yield continues to hover at this high level in the future, the costs of new government borrowing will be much higher than in previous years and will represent a serious challenge to the government financing needs. Taking into account the repayment of the existing debt, a simulation of a 100 b.p. increase in borrowing costs indicates that refinancing costs would rise by EUR 12 m in 2012. Including the borrowing to finance the public finance deficit for this year as foreseen in the Stability Programme – Update 2011, debt refinancing costs increase by EUR 27 m, according to our calculations. In three years, the costs of refinancing the existing debt alone would increase by EUR 32 m; including the anticipated deficit, they would rise by EUR 67 m.

The conditions on interbank markets are also deteriorating. The values of confidence indicators in this market segment have been declining in the last few months. The difference between the borrowing benchmark and overnight index swaps (Euribor/OIS spread) has increased significantly, while the cost of the euro/dollar basis swap surged to the highest level since October 2008 at the beginning of December. The lending standards of euro area banks tightened substantially, mainly due to limited access to funding and negative expectations of banks regarding the economic recovery and their own liquidity. European banks are increasingly relying on the ECB to secure liquidity. Until December 2011, the ECB sources were only short-term (up to 12 months), while in December, the ECB also introduced additional non-standard measures to increase European bank liquidity, in addition to cutting its key interest rate on the main refinancing operations by a further 0.25 p.p. to 1.0%. At the end of December, it thus carried out its first refinancing auction with a maturity of three years. Funds were available in an unlimited amount at an interest rate of 1%. In total, banks borrowed EUR 489 bn. This was followed by an increase in overnight deposits at the ECB, which also reveals the lack of confidence on the interbank market. All this is reflected in the lending activity in the euro area, which was already slowing at the end of 2011.

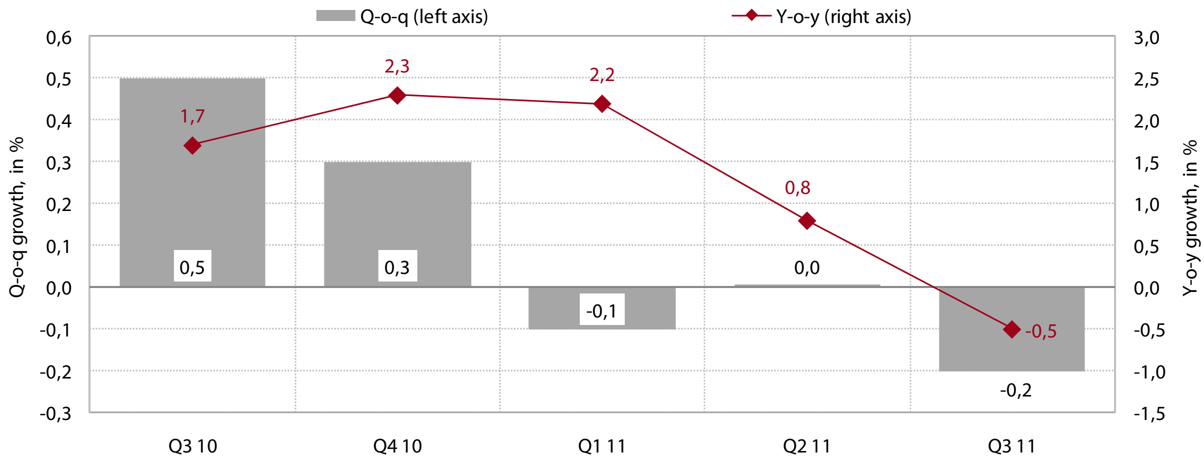
The lending activity in Slovenia will remain modest in 2012, according to our estimate. The main limitation to lending activity will be maturing liabilities of banks and their refinancing needs, as well as, in part, a further deterioration of the quality of banks' assets. The problem of the refinancing of the banking sector is compounded by the downgrade of Slovenia's credit rating and the tightening of the sovereign debt crisis, which makes it more difficult and more expensive for banks to obtain new sources of finance. The ECB's decision to offer euro area banks the possibility of obtaining credit for a period of three years has otherwise eased the pressures on Slovenia's banking system that arise from the repayment of liabilities. However, in view of the increase in non-performing and bad assets and weak growth in economic activity, the conditions for improving bank lending activity will not be established, in our estimation, and we expect no improvement before 2013.

The Winter Forecast retains the assumptions regarding economic policy orientations that will lead to public finance deficit reduction. The Forecast takes into account the fiscal policy guidelines followed at the time of the preparation of the revised budgetary documents for 2011, as well as those for the following period set in the Stability Programmes. Consistent with these guidelines, deficit reduction is focussed on curbing the compensation of public sector employees, transfers to individuals and households, capital and capital transfers of the government, and subsidies. The Act on Additional Intervention Steps for 2012 (Zakon o dodatnih interventnih ukrepih za leto 2012), effective since the beginning of 2012, froze for half of the year the adjustment of public sector wages, transfers to individuals and households, and pensions. Moreover, the implementation of the state budget has also been frozen until the adoption of the supplementary budget, which slows consumption in this period by limiting the use of budgetary funds to the obligations already assumed.

Economic growth

Following a standstill of economic growth in the first half of the year, Slovenia's GDP shrank in Q3 2011. In Q3, GDP was down 0.2% relative to Q2 (seasonally adjusted). As was already suggested by current indicators, export growth moderated and there were no visible signs of domestic consumption recovery. According to the available data for twenty EU Member States, GDP fell in Q3 in only four EU countries besides Slovenia, while it rose by 0.1% relative to the previous quarter in the euro area as a whole. Despite its moderation, export growth also propelled Slovenia's economic activity in Q3. At the y-o-y level, exports were up 5.6% and imports 3.7%, so that external trade continued to make a positive contribution to economic growth in Q3 (1.3 p.p.). Domestic consumption was lower than in the same period of the preceding year for the second quarter in a row, mainly due to a further contraction of gross fixed capital formation, which was down 13.0% y-o-y. Household consumption persisted around the 2010 level throughout 2011, mainly due to tensions on the labour market, deteriorated consumer confidence and further general uncertainty. In the second and third quarters, government consumption was below the 2010 level as well. In Q3, it was down 0.5% y-o-y. In the first three quarters of 2011, GDP was thus just 0.8% higher in real terms than in the same period of 2010, which is below the expectations of the Autumn Forecast.

Figure 3: GDP in Slovenia



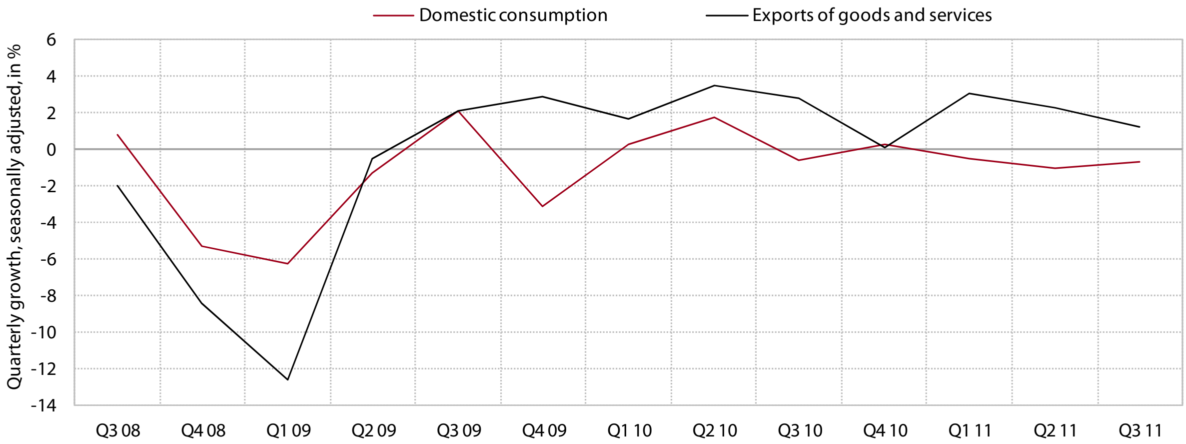
Source: SORS.

Economic growth in 2011 is estimated to be at 0.5%. The rises of exports and gross fixed capital formation fell short of our autumn expectations for 2011. In Q4 2011, the moderation of impulses from the global environment was even more pronounced, according to our estimation. The production in the manufacturing sector, which is highly export-oriented, has already responded to the slackening of foreign demand. Production volume is declining particularly in medium-low-technology industries (the rubber, metal and non-metal industries), which are, as manufacturers of intermediate goods, among the first to suffer from shrinking demand. The moderation in export growth has so far been relatively smaller than in manufacturing production, in our estimation as a result of re-export activity, which is relatively strong particularly in trade in electricity and petroleum products. Despite lower-than-expected growth, exports thus remained the main engine of economic growth in 2011. Lower realisation in Q3 and deteriorated expectations for Q4 contributed to a decline in the forecast for annual growth in fixed capital formation. The prospects for investment in machinery and equipment in that period (i.e. investment in the manufacturing sector) otherwise remain positive[1], so that investment in machinery and equipment may have also exceeded the 2010

[1] According to data on business trends – investment in the manufacturing sector – the share of investment enterprises amounted to 93% in the second half of 2011, which is the highest figure since the beginning of the crisis. Capacity utilisation in manufacturing increased somewhat in Q4 2011, to 79.9%, which is still less than before the crisis (it was highest in 2007 – 85.7%), but nevertheless considerably more than in 2009 and 2010 (71.3% and 76.4%, respectively).

figure annually. On the other hand, construction activity remained weak in Q4, according to our estimate.

Figure 4: Real growth in domestic consumption and exports

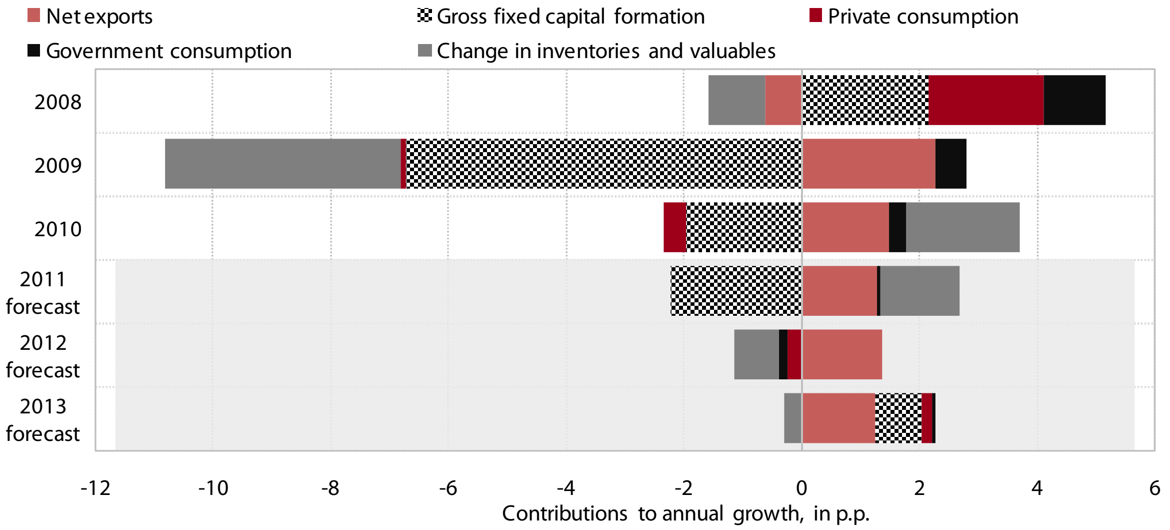


Source: SORS.

Household and government consumption stagnated in 2011. Household consumption declined in real terms in 2009 and 2010, while in 2011, it maintained the level of the preceding year, according to our estimate. In the first three quarters, household consumption was up 0.1% from the same period of the year before, but the available indicators of distributive trades indicate a slight deterioration in Q4. Such 2011 movements are expected, in view of the estimated disposable income, which will decline for the third year in a row. The bulk of household income, which arises from wages, was lower than in 2010, amid a further decline in employment and modest real growth of wages. With a rising number of recipients, strong growth was recorded only for household income from social transfers. Meanwhile, in 2011, households repaid a higher amount of consumer loans than they took out. Growth in government consumption eased to 0.3% in 2011, according to our estimate. In the first three quarters, government consumption remained at the same level as a year earlier, while in the last quarter, it was probably slightly higher y-o-y. According to data for the first three quarters, the fastest growth was recorded for expenditure on social benefits in kind. As a result of the restrictive pay policy and a moderation of employment growth in the general government sector, the growth of the compensation of employees continued to slow, as did the growth of expenditure on government intermediate consumption. This is consistent with the expectations for 2011 as a whole.

In 2012, economic growth is set to be even more stagnant than it was last year. The key revisions with regard to the Autumn Forecast, which anticipated more favourable movements in 2012 than in 2011, is related to the deterioration of international trends and tighter financing conditions for the government and banks. This worsened the prospects for all components of demand, and consequently the forecast for GDP growth, which will be just 0.2% in 2012. In Slovenia's main partners in the euro area, GDP will also be close to stagnation this year, according to the assumed forecasts, while somewhat more favourably movements are expected for certain partners outside the EU (see Table 1). Amid modest foreign demand, Slovenian exports will thus see more than half lower growth than in 2011 (2.9%). The pressures on international financial markets and lower economic growth in the trading partners have also impaired the prospects for investment in the trading sector and business investment in real estate. The investment activity of the non-tradable sector (service activities, in particular) will fare even worse, as this sector still invests much less than before the crisis due to deleveraging and relatively less favourable domestic demand. The pressing need for fiscal consolidation will also strongly impede the possibility of accelerating government investment. Gross fixed capital formation will thus remain at the 2011 level in real terms in 2012. In view of the growing tensions on the labour market, we expect a further contraction of disposable income (-0.3%), as well as a 0.5% real decline in private consumption due to increased uncertainty and precautionary behaviour of consumers. The foreseen fiscal efforts to reduce the public finance deficit will also weigh on government consumption. It is expected to be 0.7% lower in real terms than in 2011, as a result of a continuation of limitations to hiring, particularly in public administration, which we already witnessed last year, as well as owing to the restrictive wage policy and the rationalisation of expenditure of all general government budgets. After inventories continued to grow in 2011, they are expected to decline in 2012 and make a negative contribution to GDP growth (0.8 p.p.).

Figure 5: Contributions of demand aggregates to GDP growth



Source: SORS.

Amid slightly stronger growth in domestic and export demand, GDP growth would reach 2.0% in 2013. Global GDP growth is expected to increase somewhat again in 2013. Growth in domestic consumption will derive from the strengthening of investment activity, both business investment and the realisation of construction works that were interrupted or postponed during the crisis, and from the recovery of private consumption amid the expected easing of labour market tensions. Uncertainty regarding the forecast for 2013 remains significant. Specifically, the forecast is directly dependent on the stabilisation of the situation in the international environment and in Slovenia's banking system, as well as on successful consolidation of public finances and reform efforts that would restore confidence in Slovenia on international financial markets.

Table 3: Forecast for economic growth

Real growth rates, in %	2010	2011		2012		2013	
		Autumn forecast (Sept. 11)	**Winter forecast (Jan. 12)**	Autumn forecast (Sept. 11)	**Winter forecast (Jan. 12)**	Autumn forecast (Sept. 11)	**Winter forecast (Jan. 12)**
Gross domestic product	1.4	1.5	**0.5**	2.0	**0.2**	2.5	**2.0**
Exports	9.5	7.9	**7.3**	6.3	**2.9**	6.7	**6.0**
Imports	7.2	5.2	**5.5**	4.6	**1.0**	4.9	**4.6**
External balance of goods and services (contribution to growth in p.p.)	1.5	1.9	**1.3**	1.3	**1.4**	1.5	**1.3**
Private consumption	-0.7	0.0	**0.0**	0.2	**-0.5**	0.5	**0.3**
Government consumption	1.5	0.3	**0.3**	-0.5	**-0.7**	0.1	**0.3**
Gross fixed capital formation	-8.3	-7.5	**-10.5**	6.0	**0.0**	5.0	**4.0**
Change in inventories and valuables (contribution to growth in p.p.)	1.9	1.1	**1.3**	-0.5	**-0.8**	-0.3	**-0.3**

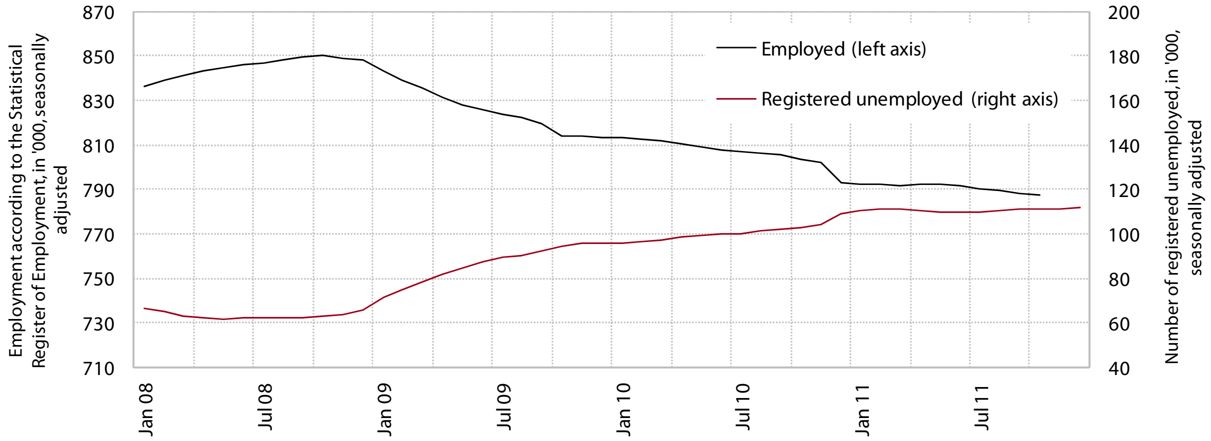
Source: SORS; 2011–2013 forecasts by IMAD.

Labour market

Employment and unemployment

The deterioration of labour market conditions slowed in 2011. Employment continued to decline in 2011, albeit less notably than in the previous two years. In 2011, the average number of employed persons (according to the national-accounts statistics) was thus 1.7% lower than in 2010, according to our estimate. Except in construction, where the number of employed persons slumped further due to a deeper decline of activity in 2011, the negative employment movements in private sector activities eased in 2011 (manufacturing, traditional market services) and some activities even created jobs (information, communication, insurance activities, miscellaneous professional and technical activities). In view of limited general government funds for wages, employment growth in public services and in the general government sector slowed in 2011 (from 1.6% in 2010 to presumably 0.6% in 2011). After soaring at the end of 2010 and in January 2011, unemployment had mainly been falling until August 2011, then rose again in the second half of the year, as expected. The increase in the second half of the year was partly seasonal (inflows into unemployment of persons who finished school, etc.), but given further dismissals for business reasons and due to bankruptcies, unemployment also swelled for other, non-seasonal reasons related to the economic situation. In the year as a whole, the number of unemployed persons averaged 110.7 thousand, 10.1% more than in the year before, and the average registered unemployment rate was 11.8%.

Figure 6: Employed according to the statistical register and registered unemployed



Source: SORS, ESS; seasonal adjustment by IMAD.

Amid the sluggish economic activity, we expect a further decline of employment and growth in unemployment in 2012 and 2013. Due to a further adjustment of employment to the expected level of economic activity and growing structural imbalances, which are mainly reflected in higher long-term and natural unemployment rates, labour market conditions are set to worsen in the short term. Employment will continue to drop in these two years, but in 2013, the decline will already be less pronounced, according to our estimate. In the private sector, employment is expected to shrink further in construction, manufacturing, wholesale and retail trade and transport activities, while it will continue to increase in some business services. Restrictions on public expenditure, which had already slowed hiring in the general government sector in 2011, are expected to remain in place in the next two years. We estimate that the impact of hiring restrictions will be, as in 2011, most visible in the public administration, where employment was falling, while in other activities the increase in 2011 was also among the smallest in the last few years, despite the absence of special measures to limit hiring. More restrictive hiring due to limited public sources for financing public service providers at the same time represents a challenge for increasing the outsourcing of these services to the private sector, particularly in child care, various private education activities, and health and social work. In view of the growing needs for services in these areas, we therefore expect faster employment growth with private than with publicly-funded providers. In 2012 and 2013, unemployment will continue to grow, due to the expected weakness of economic activity and hence a decline in employment, but also, with the number of older unemployed persons and those with a lower education increasing during the economic crisis, as a result of age structure and low educational attainment of the unemployed. The number of registered unemployed persons is thus set to average 116.1 thousand in 2012; the registered unemployment rate and the survey unemployment rate will total 12.5% and 8.6%, respectively). Despite the expected beginning of the economic recovery in 2013, unemployment will increase in that year, as the labour market tends to follow the economy with a lag.

Table 4: Forecasts for employment and unemployment

v %	2010	2011		2012		2013	
		Autumn forecast (Sept. 11)	**Winter forecast (Jan. 12)**	Autumn forecast (Sept. 11)	**Winter forecast (Jan. 12)**	Autumn forecast (Sept. 11)	**Winter forecast (Jan. 12)**
Employment according to the SNA, growth	-2.5	-1.5	**-1.7**	0.0	**-1.4**	0.0	**-0.7**
Number of registered unemployed, annual average, in '000	100.5	110.9	**110.7***	110.6	**116.1**	110.2	**118.8**
Registered unemployment rate	10.7	11.8	**11.8**	11.8	**12.5**	11.8	**12.8**
ILO unemployment rate	7.2	8.0	**8.1**	8.0	**8.6**	8.0	**8.8**

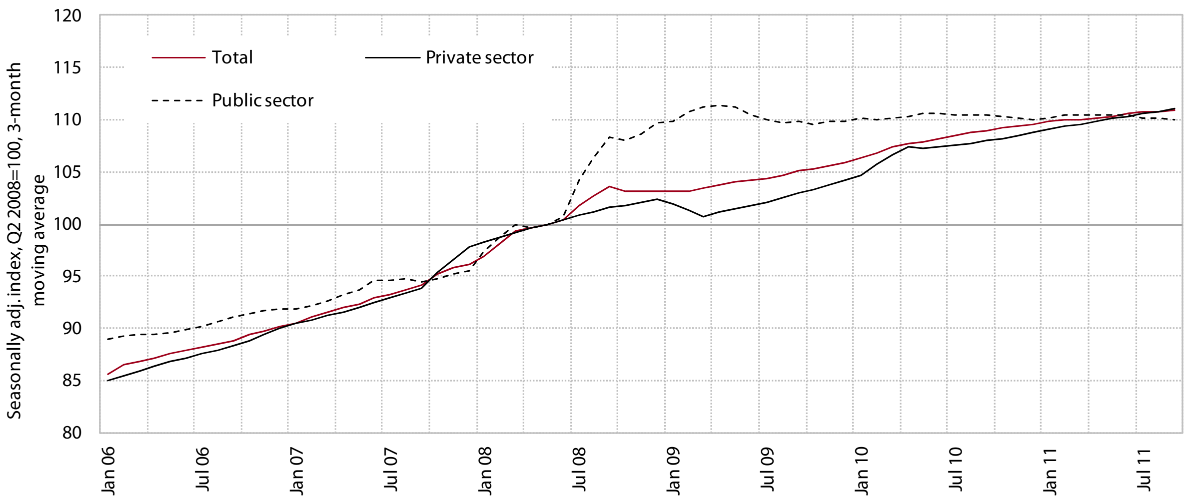
Source: SORS; 2011–2013 forecasts by IMAD.

Note: *The average number of the unemployed in 2011 is a SORS figure.

Wages

In 2011, wage growth was lower than in 2010. We estimate a 2.7% nominal increase in the private sector in 2011 as a whole, which, amid a lower realisation by October than anticipated in the autumn, can already be attributed to a slower-than-expected recovery of the economy. Wage growth will thus also be much lower than in 2010, when it was under a relatively strong influence of the rise in the minimum wage. In the public sector, the last monthly payments for 2011 also showed a lower realisation than expected, meaning that the average 2011 wage remained at the same level as a year before (0%).

Figure 7: Gross wage per employee relative to Q2 2008



Source: SORS; seasonal adjustment by IMAD.

Economic conditions are also not likely to be conducive to visible wage growth in 2012–2013. The expected only gradual strengthening of economic activity, the efforts to preserve the competitive position of enterprises on the domestic and foreign markets, the anticipated further growth of unemployment and relatively low inflation foreseen in 2012 and 2013 create an environment that will not be conducive to noticeable wage growth in the private sector so that wage growth will be lower than forecast in the autumn. In 2012, nominal growth is expected to be even somewhat lower than last year, 2.4%, with more than one percentage point coming from the final adjustment to the new level of the minimum wage. Nominal wage growth in 2013 will be, in a more favourable economic environment, somewhat higher (2.9%). In view of the general economic and public finance situation, we assume that the limits to more visible public sector wage growth will stay in place in this period as well. The Act on Additional Intervention Steps for 2012 precludes wage adjustments until the end of June. We assumed that the restrictive wage policy in the public sector would also stay in place after that period, meaning that the average nominal wage in the public sector would stagnate in 2012 and 2013.

Table 5: Forecasts for average growth in the gross wage per employee

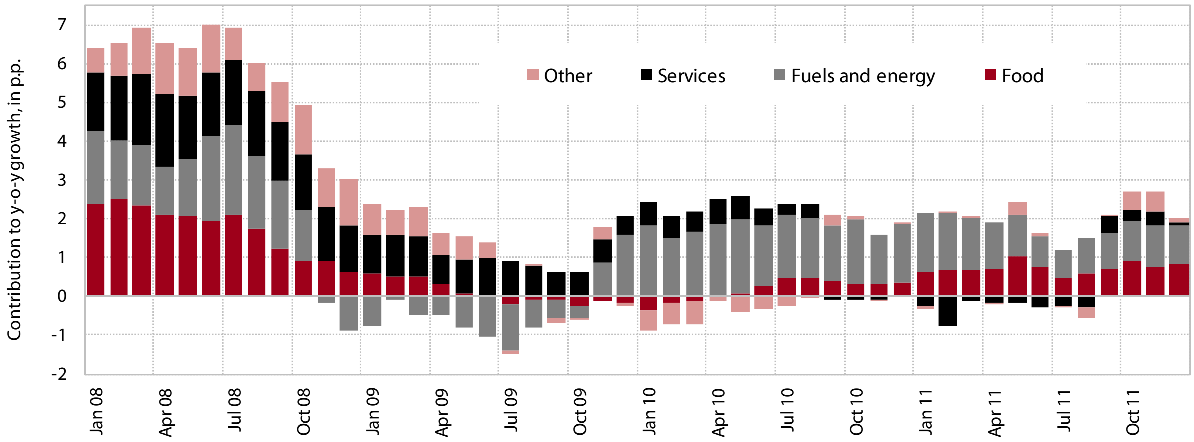
Growth rates, in %	2010	2011		2012		2013	
		Autumn forecast (Sept. 11)	**Winter forecast (Jan. 12)**	Autumn forecast (Sept. 11)	**Winter forecast (Jan. 12)**	Autumn forecast (Sept. 11)	**Winter forecast (Jan. 12)**
Nominal growth							
Gross wage per employee	3.9	2.5	**2.0**	2.4	**1.7**	2.6	**2.1**
- Private sector	5.1	3.2	**2.7**	3.1	**2.4**	3.4	**2.9**
- Public sector	-0.1	0.5	**0.0**	0.6	**-0.1**	0.5	**0.0**
Labour productivity	2.9	3.0	**2.8**	3.9	**3.0**	4.1	**4.1**
Real growth							
Gross wage per employee	2.1	0.9	**0.2**	0.6	**-0.1**	0.6	**0.3**
- Private sector	3.2	1.6	**0.9**	1.3	**0.6**	1.4	**1.1**
- Public sector	-1.8	-1.1	**-1.8**	-1.2	**-1.9**	-1.5	**-1.8**
Labour productivity	4.0	3.0	**2.2**	2.0	**1.6**	2.5	**2.7**

Source: SORS; 2011–2013 forecasts by IMAD. Note: Labour productivity is measured as GDP per employee.

Inflation

Consumer prices in Slovenia were up 2.0% y-o-y in December 2011. The growth of the general price level was impacted by subdued economic activity and higher oil and food prices seen at the beginning of 2011. Higher energy and food prices contributed 1.0 p.p. and 0.8 p.p. to 2% inflation, respectively, while the growth of prices of services and that of other goods contributed only 0.1 p.p. each. In 2011, inflation thus stood at a similar level as in the preceding three years. The price dynamics in the past four years were mainly affected by the economic crisis and consequent lower demand for consumer goods, which was reflected in relatively low core inflation. Higher energy prices and net tax rises related to public finance difficulties also played a significant role in that period. The net effect of changes in taxation in 2011 was otherwise modest, around 0.1 p.p. Prices of seasonal goods in 2011 were more volatile than in previous years. In the last quarter, particularly strong price swings were recorded for clothing and footwear.

Figure 8: Breakdown of y-o-y inflation in Slovenia



Source: SORS; calculations by IMAD.

Inflation is expected to remain low in 2012 and 2013. We estimate that the economic situation in Slovenia will not put upward pressures on prices in the coming years. Assuming that commodity prices will be stable, and in the absence of other price shocks from the international environment, y-o-y inflation will total 1.8% in these two years. Concerning tax policy, the forecast assumes a continuation of the policy of counter-cyclical adjustment of excise duties, which prevents major fluctuations in prices of liquid fuels. It also takes account of the already adopted rises in excise duties on tobacco and tobacco products, while all other possible tax policy measures aimed at cutting the general government deficit entail a risk for higher price growth.

Table 6: Inflation forecasts

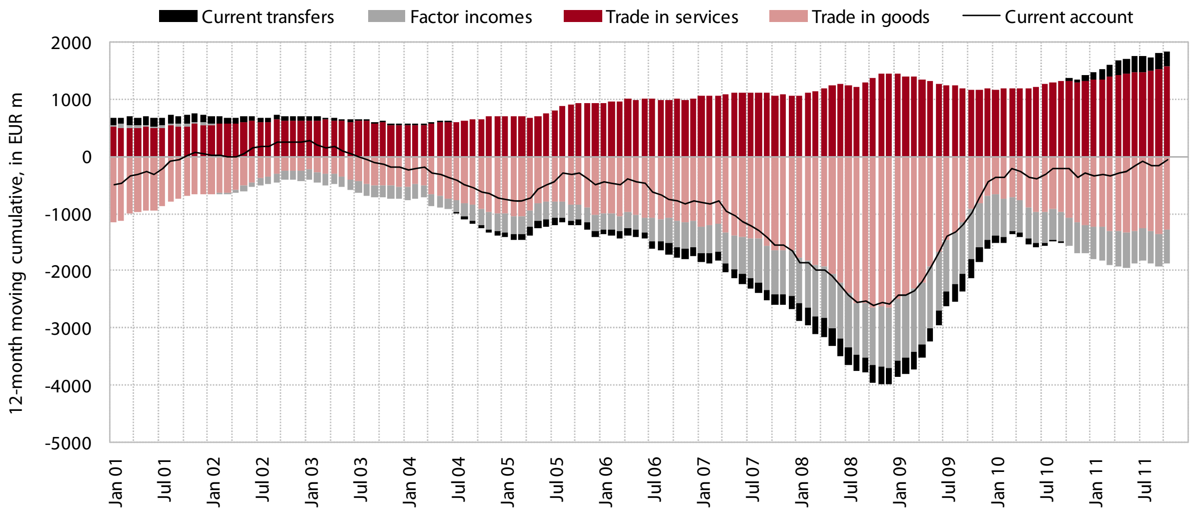
In %	2010	2011		2012		2013	
		Autumn forecast (Sept. 11)	**SORS**	Autumn forecast (Sept. 11)	**Winter forecast (Jan. 12)**	Autumn forecast (Sept. 11)	**Winter forecast (Jan. 12)**
Inflation – annual average	1.8	1.6	**1.8**	1.8	**1.8**	2.0	**1.8**
Inflation – Dec/Dec	1.9	1.7	**2.0**	1.9	**1.8**	1.9	**1.8**

Source: SORS; 2012–2013 forecasts by IMAD.

Current account of the balance of payments

The current account of the balance of payments is expected to remain balanced. The deficit of the current account amounted to EUR 20.2 m in the first ten months of 2011, which is less than in the same period of the preceding year (EUR -247.8 m). Considering these movements, it is projected to reach EUR 192 m or 0.5% of GDP in 2011. The merchandise trade deficit is higher than in 2010 due to faster growth in import prices than export prices. Payments of interest on government and private sector debts are also growing. On the other hand, the overall surplus in services trade is set to be wider due to higher inflows from tourism in Slovenia and a higher surplus in trade in transport services. Amid a similarly high rate of absorption of EU funds and a somewhat wider deficit in the private sector's transfers, the surplus in current transfers will be slightly lower than in 2010. The deficit is also set to remain at 0.5% of GDP in 2012, while in 2013 we expect a surplus of 0.9% of GDP. Namely, assuming that the modest economic growth in these two years will still result from the strengthening of exports rather than higher domestic consumption and that the terms of trade will remain roughly unchanged, the deficit in merchandise trade is expected to decline. The overall surplus in services trade will continue to increase gradually with further growth in the surplus in transport and travel services. Provided that the absorption of EU funds remains roughly at the same level as in 2010 and 2011, Slovenia's budgetary position regarding EU funds will remain relatively favourable in 2012 and 2013. On the other hand, general government net payments of interest on external debt will keep growing, as will, most probably, net outflows of dividends and reinvested profits, which will widen the deficit in factor incomes.

Figure 9: Current account of the balance of payments



Source: Bank of Slovenia; calculations by IMAD.

Table 7: Current account of the balance of payments

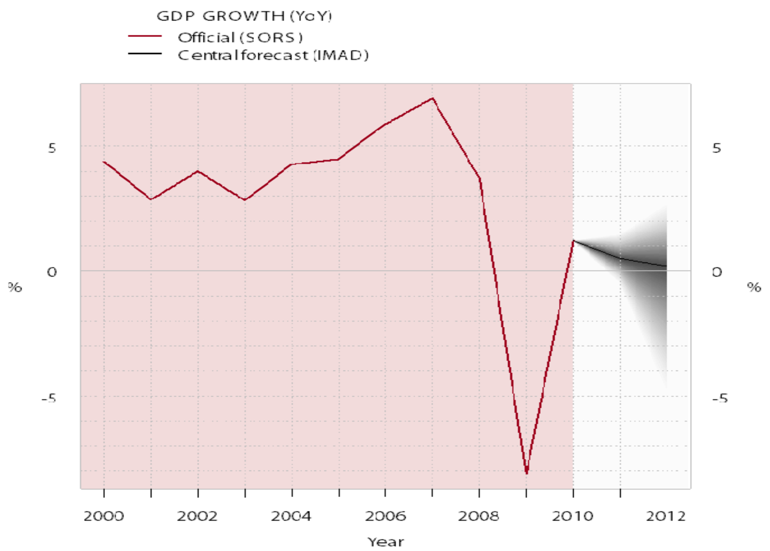
	2010	2011		2012		2013	
		Autumn forecast (Sept. 11)	**Winter forecast (Jan. 12)**	Autumn forecast (Sept. 11)	**Winter forecast (Jan. 12)**	Autumn forecast (Sept. 11)	**Winter forecast (Jan. 12)**
Current account, in EUR m	-297	-351	**-192**	-181	**-176**	378	**321**
Current account, in % of GDP	-0.8	-1.0	**-0.5**	-0.5	**-0.5**	1.0	**0.9**

Source: BS; SORS, 2011–2013 forecasts by IMAD.

Risks to the materialisation of the forecast for economic growth

Downside risks to the economic activity in Slovenia's main trading partners continue to exist. The key downside risks for GDP growth in the next two years are linked to the deepening and spreading of the sovereign debt crisis in the euro area and fiscal problems in the US. The concerns about the fiscal sustainability of the euro area have intensified in recent months, despite the agreements at the highest political level. Credit ratings keep deteriorating and the costs of new borrowing in the most exposed countries continue to rise. The absence of adequate action and a spillover of the sovereign debt crisis onto thus far more healthy economies therefore pose a serious risk. The severe fiscal consolidation to be carried out by euro area countries in the next two years will, because it will be pursued simultaneously in many countries, also depress economic growth in the euro area. This represents another risk to the euro area economy as in the case of extraordinary events individual countries would have much less leeway to take appropriate action. The OECD cautions that a lack of a credible medium-term strategy to ensure the sustainability of public finances in the US also poses a significant downside risk to further growth. It estimates that the materialisation of all risks could have serious implications for global economic growth and does not rule out a prolonged recession in the euro area and the US. The OECD thus estimates that if this scenario materialises, GDP growth in the euro area in 2012 will be 2 p.p. short of the OECD central forecast, with the decline deepening further in 2013.[2]

Figure 10: Central forecast of GDP growth and distribution of the expected risks



Source: SORS; calculations by IMAD.

Under such a scenario of economic trends, Slovenia's GDP would also shrink in 2012. Simulations assuming a 2% fall of economic activity in the euro area, which would also affect economic activity in countries that are Slovenia's major export markets (the US, Russia, countries of the former Yugoslavia), show that the anticipated further recovery of Slovenia's economy would come to a halt in 2012, given that in the last two years it has mainly derived from strengthening external trade. Slovenia's GDP would thus drop 3.8% in real terms in 2012. Exports and fixed capital formation would shrink the most (-8.1% and -11.5%), due to lower export demand, as well as under a strong impact of an additional tightening of lending conditions. Private consumption would also drop (-1.5%) against the background of increased uncertainty and mounting tensions on the labour market, and a further aggravation of economic conditions would necessitate a larger adjustment of government consumption (-3%).

Table 8: Simulation of the effect of the fall of economic activity in the euro area on economic activity in Slovenia in 2012

Real growth, in %	2011	2012	2012
	Winter forecast		Simulation
Gross domestic product	0.5	0.2	-3.8
Exports of goods and services	7.3	2.9	-8.1
Imports of goods and services	5.5	1.0	-9.5
Private consumption	0.0	-0.5	-1.5
Government consumption	0.3	-0.7	-3.0
Gross fixed capital formation	-10.5	0.0	-11.5
Contribution of change in inventories to GDP growth, in p.p.	*1.3*	*-0.8*	*-0.8*

Source: calculations by IMAD.

[2] OECD Economic Outlook, No. 90, November 2011. For a more detailed description of the scenario see Box 1.5.