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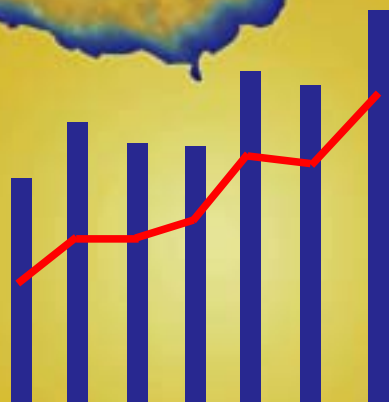


ECONOMIC OUTLOOK AND POLICY SERVICES

- SLOVENIA - CURRENT ECONOMIC TRENDS

2004-2005

Autumn Issue



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SLOVENIA - CURRENT ECONOMIC TRENDS 2004 - 2005

General Overview

In May 2004, Slovenia made a decisive step for its further economic and political development. **Entering the EU** represents a formal turning point on its path from transition to an advanced European economy. The changes, however, bring about not only new opportunities but also new challenges. Slovenian business sector has proved to be quite well prepared for these changes. Nevertheless, some branches still have to undergo significant structural adjustments in the direction of improved efficiency, technology and marketing strategies. On the other hand, taking over the Common Foreign Trade Policy of EU, which resulted in changing of Slovenia's foreign trade agreements, has already affected Slovenia's international trade, fostering exports as a driving force of the economy.

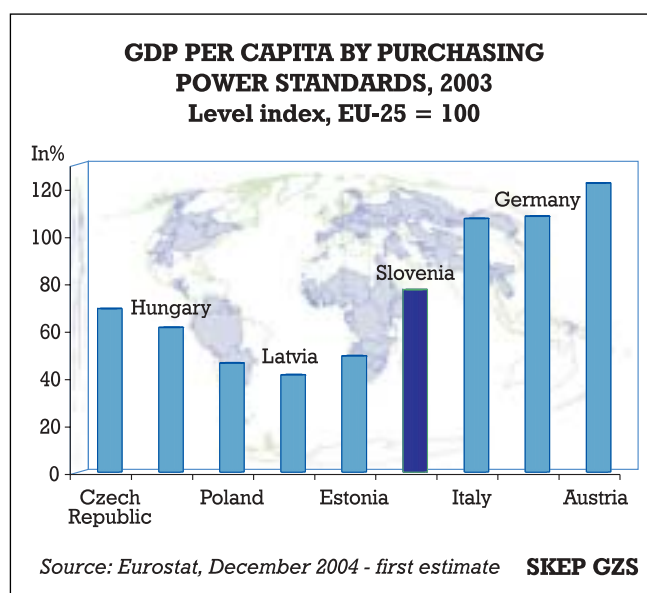
SLOVENIA - GROSS DOMESTIC PRODUCT, 2003	
GDP, in EUR million (current prices)	24,592
GDP, in USD million (current prices)	27,749
GDP per capita, in EUR (current prices)	12,319
GDP per capita, in USD (current prices)	13,900
GDP per capita compared to EU-25, in PPS	77%

Source: National Statistical Office, September 2004; Eurostat, October 2004

Generally, current economic trends in Slovenia have been positive. Similarly to most of the EU and world economies, this year is expected to be the most dynamic one in the recent years also for Slovenia. According to the first estimates of the National Statistical Office from mid-December 2004, GDP grew by 4.5 percent in the first three quarters of 2004. Over the whole 2004, we expect around 4 percent **GDP growth**, driven largely by strengthening **exports** and **imports**. Trade with other new EU member countries has further intensified this year. According to the latest estimates, Slovenia could record, in real terms, a 8.5 percent rise in exports of goods and services in 2004. Import growth will still exceed export growth, but with a tendency of

nearing in growth rates. The current account balance, relative to GDP, thus demonstrates only a minor deficit, close to equilibrium.

Among the components of **domestic demand**, investment growth is confirmed to rise by around 8 percent, according to our forecasts. The purchasing power of the domestic market, stemming from both, public and private consumption could increase by around 3 percent. Wages – an important source of households' incomes – have risen moderately this year, with close to 2 percent growth expected over the whole year.



In mid-2004, Slovenia entered the ERM2 regime. Sustainability of the exchange rate positively affected the price movement and the **inflation** pressures eased. Like in 2003, also in 2004 inflation continued to decelerate and is foreseen to run on average at 3.7 percent in 2004. Consequently, also interest rates recorded a downward trend. However, bank loans' interest rates for compa-

SLOVENIA - MAIN BUSINESS CYCLE INDICATORS

	2003 Estimates	2004 Forecasts	2005 Forecasts
GDP, real growth rate in % (*)	2.5	3.9	3.9
• Private consumption, real growth rate in %	2.8	3.0	3.0
• Public consumption, real growth rate in %	2.6	3.0	3.0
• Gross fixed investment, real growth rate in %	6.3	8.0	8.0
• Exports of goods and services, real growth rate in %	3.2	8.5	6.0
• Imports of goods and services, real growth rate in %	6.8	9.0	6.5
Employment, growth rate in %	-0.8	0.3	0.5
Unemployment rate (standardised by ILO definition), in %	6.7	6.5	6.4
Consumer prices - annual average, growth rate in %	5.6	3.7	2.9
Compensation per employee - average, real growth rate in %	1.8	2.2	2.3
Public sector deficit (% of GDP)	-1.4	-1.8	-1.8
Current account balance (% of GDP)	-0.4	-0.9	-1.0
Short-term interest rates, 3m - treasury bills, nominal (estimate)	10.8	8.5	8.0
Long-term interest rates, on banking loans, nominal (estimate)	12.6	8.9	8.5
Exchange rate, SIT per EUR, annual average (estimate)	236.4	239	240.5
Exchange rate, USD per EUR, assumption	1.13	1.23	1.25

Sources: Konjunkturna gibanja, No.4, November 2004, SKEP GZS, based on different domestic and international sources (SURS, BS, etc.)

Estimates and forecasts: SKEP - Economic Outlook and Policy Services, Chamber of Commerce and Industry of Slovenia, November 2004.

nies have been by some percentage points higher than in the EU on average.

The situation on **the labour market** has been improving slightly, however employers remain cautious in their employment decisions. In the small private sector, the negative trend from the past has slightly improved. Total employment growth is forecast at 0.3 percent and the standardised rate of unemployment by ILO definition could fall below 6.5 percent in 2004.

A combination of the necessary **macroeconomic policies** should further strive for a real convergence of Slovenian economy. The fiscal and income policies are expected to support the anticipated adoption of the Euro in 2007, with continuing restrictive approach to public expenditures and wages. Both should be of particular consideration in the two-year period of Slovenia's participation in the ERM2 regime.

Foreign Trade, Balance of Payment, FDI

After entering the EU in May 2004, Slovenia has maintained very positive **foreign trade** trends. The first estimates for the first three quarters of 2004 confirm that exports and imports rose beyond all expectations. Compared to the same period of 2003, exports of goods were up by 9 percent, and imports by more than 10 percent in real terms. 2004 was characterised by imports growth exceeding the exports growth, with trade deficit escalating almost by one third in comparison to the same period last year. As **services** recorded a widened surplus, the balance of payment deficit remained narrow, amounting to EUR 48.5 million in the first nine months this year.

SLOVENIAN EXPORTS AND IMPORTS, in EUR				
	2003	I-IX 2004	2003	I-IX 2004
	EUR million		Growth rates in %	
EXPORTS	11,285	9,214	2.9	10.2
EU-25	7,556	6,101	1.2	8.4
Other countries	3,729	3,113	13.0	13.9
IMPORTS	12,239	10,053	2.0	11.6
EU-25	9,256	7,879	2.5	15.6
Other countries	2,983	2,174	1.0	-0.8

Source: National Statistical Office, I-IX 2004 forecasted data.

In 2004, in merchandise trade exports of capital goods increased the most (by 17 percent in EUR terms). The robust exports hastened the manufacture of electrical and optical equipment, machinery and equipment, chemicals and cosmetics, which altogether make up some 40 percent of Slovenia's total exports of goods. Favourable export trends stepped up production in manufacturing, which on the other hand accelerated also import flows. On the imports side, consumer goods imports boosted the most (by over 15 percent in EUR terms), and imports of intermediate goods and capital goods increased by over 10 percent in the first nine months of 2004.

The **EU-25 countries** remain Slovenia's most important trading markets, with 66 percent share in the total value of exports and 78 percent share in the total value of imports. Economic recovery in the EU member states positively affected also Slovenia's exports. In EUR terms, exports and imports of goods to and from the EU-25 increased by 8.4 and 15.6 percent, respectively.

Exports to Austria, Belgium, Spain, Denmark, Sweden, Greece and Great Britain boosted the most, whilst the exports growth to Germany and France was below the average (4.3% and 4.4% respectively). Total trade deficit with the EU-25 countries widened by 45 percent in the first three quarters of 2004, most markedly with Austria and Italy. Trade with Germany and Great Britain generated a surplus. Trade with new EU member states continued to flourish, in particular the exports to Czech Republic, Hungary, Slovakia and Poland.



In the course of 2004, exports to **non-EU countries** have been on the rise, up by 13.9 percent in EUR terms. Exports to Russia and other CIS-countries accelerated the most. In the first nine months of 2004, the surplus with the latter group of countries doubled compared to last year, amounting to EUR 81 million. Exports to Russia, the most important trading partner in this group, soared by 24 percent and imports by 9 percent in the first nine months. Also thanks to high oil prices, this market recorded a rapid economic growth, resulting also in a strengthened export demand for Slovenian goods. Despite worsening of the trading conditions with the region of Former Yugoslavia after Slovenia entered the EU – previous bilateral agreements were more advantageous – exports to **South-Eastern European countries** were up by 11 percent compared to the first nine months of 2003. Exports to Croatia boosted by 15 percent and to Serbia and Montenegro by as much as 19 percent. Moreover, by taking over the Common Foreign Trade Policy of EU, Slovenia gained better access to some third markets, such as Latin America, South Mediterranean countries, South Africa. In the course of 2004, exports of goods to these areas increased by one quarter.

EXPORTS AND IMPORTS - GOODS				
Shares of total in %				
	2003		I-IX 2004	
	Exports	Imports	Exports	Imports
EU-25	66.9	75.6	66.2	78.4
Other countries	33.1	24.4	33.8	21.6

Source: National Statistical Office

After equilibrium in **balance of payment** in 2003, again Slovenia saw positive developments in the first three quarters of 2004. The trade deficit stood at EUR 472 million, whilst the services surplus totalled EUR 491 million. This resulted in an only negligible current account deficit, representing 0.3 percent of GDP. Both, exports and imports of services grew in EUR terms,

by 11 percent and 9 percent, respectively. In line with an accelerated goods trade, transport services boosted the most of all services - exports by 18 percent and imports by as much as 20 percent. Moreover, travel has also been increasing rapidly in 2004, both its exports and imports.

IMPORTS BY MAJOR PRODUCT GROUPS

Steel and steel products
Motor cars
Petroleum oils
Parts and accessories of motor vehicles
Pharmaceuticals
Motor vehicles for the transport of goods
Automatic data processing machines
Unwrought aluminium
Petroleum gases

In the area of **foreign direct investments**, domestic investment abroad exceeded the inward net investment in 2004. In the first nine months, there was a net investment outflow worth EUR 309 million, most of it in the form of ownership capital to the South Eastern European countries and also in some EU-25 Member States. In the same period, the net inflow of inward investment to Slovenia totalled EUR 188 million.

Prices, Interest Rates, Exchange Rates & Policy

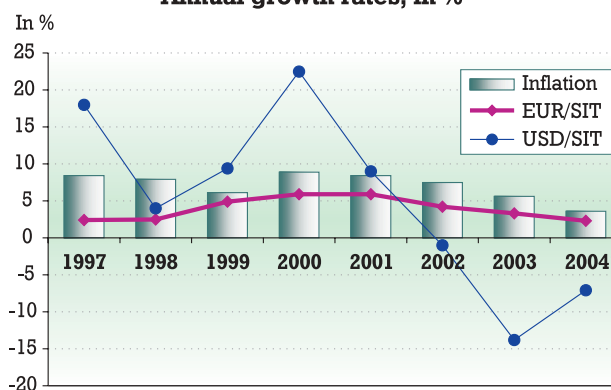
The trend of **lowering inflation** has continued throughout 2004. In the first eleven months, the average inflation run at 3.6 percent, and for the whole year it is estimated at 3.7 per cent. This points to around 2 percentage point drop in inflation over the previous year, which is a similar drop as recorded last year. In 2004, the most significant inflation risk came from the international environment, by skyrocketing of oil and raw material prices reflected in rising fuel prices. Nevertheless, domestic inflation impulses appeared mainly from the services sector - municipal services, housing, accommodation, education, insurance and financial services. On the other hand EU memberships brought about lower tariffs and also tougher competition on some goods markets, i.e. food, beverages, clothing, footwear, which eventually put downward pressure also on the prices of

these goods. Quite a restrictive policy regarding administered prices, as well as monetary and fiscal policies have been supporting the relaxing of prices. Besides, the inflation fears stemming from exchange rate risk faded significantly with Slovenia entering the ERM2 mechanism.

The **producer prices** trend seems to have changed in the course of 2004: after years of lagging behind, they recorded a 4.2 percent rise in the first eleven months, surpassing the rise in consumer prices. Growth has been recorded mostly in energy-related and intermediate goods industries.

A trend of further lowering of **interest rates** has been perceived all over 2004. In October, the average banks' nominal interest rate on short-term loans for companies was reported at 8.1 percent and three-month inter-banking rate at 4.1 percent. Bank loans' interest rates for best clients are by and large formed at the EURIBOR level and rose by 1-2 percentage points. In terms of harmonised long-term interest rates, Slovenia meets the convergence criterion. In September, this rate stood at 4.66% and was among the lowest of the new EU member countries.

EUR, USD AND INFLATION Annual growth rates, in %



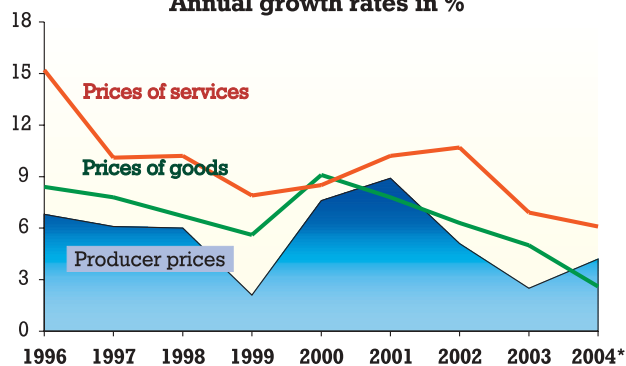
Source: National Statistical Office and Bank of Slovenia; * I-XI 2004

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Note: Growth rates for EUR from 2002 on, for DEM before 2002

Slovenia entered the **exchange rate** mechanism ERM2 at the end of June 2004 and set the central parity at SIT 239.64 per 1 EUR, with allowed fluctuations of $\pm 15\%$. According to the Bank of Slovenia data, the exchange rate deviations from the central parity have been negligible since entering the ERM2. Over the last months, the Tolar/Euro exchange rate practically calmed down. In November 2004, Euro stood at SIT 239.77 average rate, up by 1.4 percent compared to December 2003 in nominal terms. Domestic prices rose by 3.5 percent, real depreciation of Tolar against Euro caused less favourable export performance of Slovenian firms. Exporters were additionally losing because of weak USD throughout 2004. In November, measured in terms of Tolar, it was down by 4.3 percent compared to December last year.

INDUSTRIAL PRODUCER PRICES COMPARED TO PRICES OF GOODS AND SERVICES, 1996-2004 Annual growth rates in %



Source: National Statistical Office, * I-XI 2004

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Production and Services

In the first nine months of 2004, **industrial output** recorded quite a strong growth of 5.8 percent over the same period of 2003. Production in manufacturing picked up by 6 percent. Capital goods industries saw the highest rise of 10 percent,

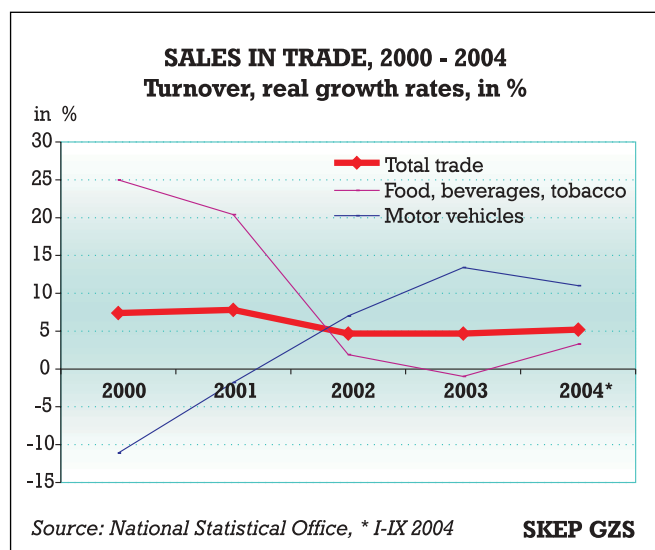
intermediate goods industries were up by 7.8 percent, whilst consumer goods industries have been less dynamic, with only 1 percent average growth. In the breakdown by sectors, the highest rise was recorded in manufacture of electrical and optical equipment (21 percent) and manufacture of chemicals (17 percent), where also stock volumes rose considerably. On the other hand, some other activities saw a significant drop in output, most markedly the manufacture of leather products and textiles, followed by food and beverages products, non-metal mineral products and wood products. With further lowering of employment in most of the industrial branches, the **productivity in industry** rose by 7.1 percent in the first nine months of 2004.

The **construction** saw a considerable expansion of residential buildings, whilst the civil engineering works grew somewhat less than in the previous year. The total value of construction put in place climbed by 3 percent in real terms in the first nine months of 2004. The main push came from accelerated residential investment, with investment activity of the business sector being lively as well. Growth in infrastructure (motorways, municipal investments, etc.) has been slower. Still, the value levels remain high. In the structure of total value of construction put in place, civil engineering accounts for 51 percent and buildings for 49 percent.

TRADE		
Real growth in %	2003	I-IX 2004 I-IX 2003
SALES IN TRADE - TOTAL	4.7	5.2
• Food, beverages, tobacco	-1.0	3.3
• Non-food	8.3	3.5
• Motor vehicles	13.4	11.0
• Fuels	4.1	4.1

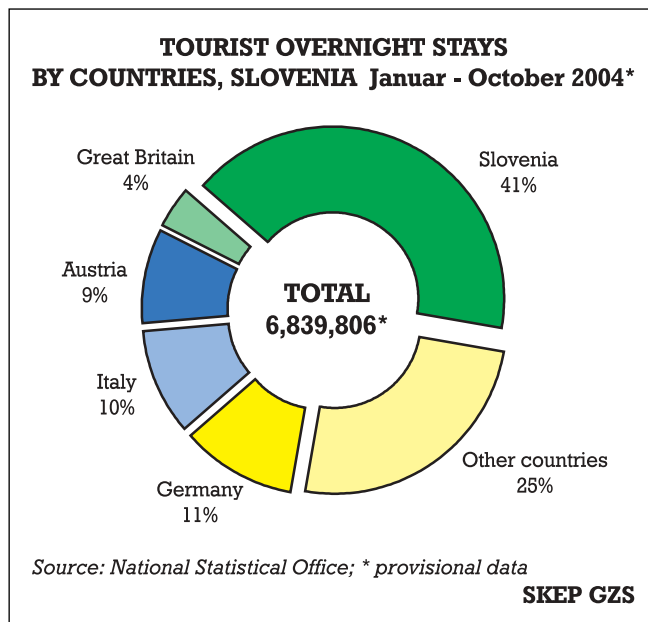
Source: National Statistical Office; Note: Trade by real turnover indices

Domestic trade trends continued to be favourable also during 2004. The turnover was up by 5.2 percent in real terms in the first nine months. Similar to 2003, the trade of motor vehicles expanded the most, with over 11 percent real upsurge. In the first three quarters, sales of food, beverages and tobacco were up by 3.3 percent, while turnover in non-food stores confirmed a 3.5 percent real increase. In line with expanding real estate market and residential construction, the sales of construction material, household equipment and sales of furniture recorded the



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highest growth. In 2004, also retail sales via mail order houses and sales of pharmaceutical, medical and cosmetic products were on the rise. A modest rise of 4.1 percent was recorded in the retail sale of fuels.



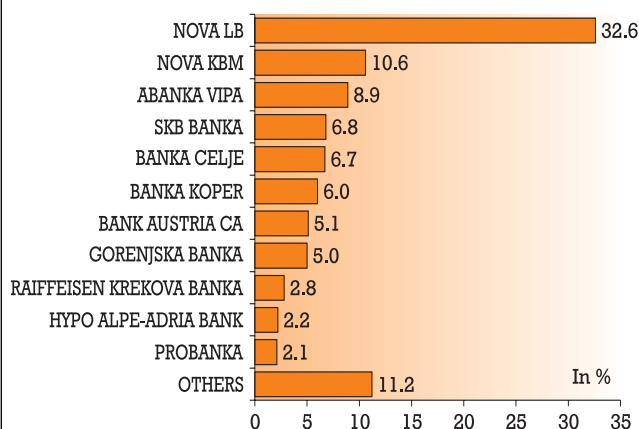
Tourism with 4 percent growth on average is estimated to see around 2.4 million of tourist arrivals in 2004. The most important has been a high rise in the **foreign tourist visits**, especially from the western countries. They importantly contributed to a high 9 percent growth of foreign tourist receipts, amounting to one billion EUR in the first ten months. Tourist flows reveal a significant increase in the number of tourists to Slovenia, especially from Great Britain and France. Visits from the United States, Australia, Canada, Japan and Israel have also risen remarkably. As for the neighbouring countries, Italians are the most likely to visit Slovenia, while tourist arrivals from Austria and Croatia were somewhat less numerous. Tourist flows from the eastern countries, such as Russia and Poland, have decreased. **Domestic tourism** was down 5 percent in 2004, after a slight improvement in 2003. Geographically, the capital Ljubljana and spa resorts saw the highest growth in tourism.

Banking, Stock Exchange

Developments in the **banking sector** indicate a relatively good yield performance of banks in the first nine months of 2004. At the end of third quarter, the total assets were some 8 percent higher than at the beginning of the year. The highest, 24 percent growth was recorded by small sized banks, medium sized banks progressed by 17 percent, whilst the largest banks somewhat narrowed their shares in total. In 2004, the banking sector saw a significant rise in foreign exchange loans, which comprise already 60 percent of total loans and some 88 percent of loans to companies.

Total turnover on the **Ljubljana Stock Exchange** (LjSE) in the first eleven months of 2004 recorded around 7 percent rise over the previous year. The number of issuers and traded securities on LjSE stabilised, although their structure has been changing: quotations of investment funds have been reduced, while common shares are on the rise. In 2004, the most traded securities

MARKET SHARES OF BANKS IN SLOVENIA By assets on 30. 9. 2004, in %



Source: Bank of Slovenia

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are those of a pharmaceutical company *Krka*, the leading trade company *Mercator*, oil trade company *Petrol* and the leading domestic appliances producer *Gorenje*. Slovenian stock market index SBI-20 again reached its historical high in November 2004 with 4.935 points. The average return of the SBI in the last twelve months was 23 percent. The level of foreign ownership of shares of Slovenian companies (according to the market capitalisation) in November 2004 was 4 percent.

ANNUAL RETURN OF SLOVENIAN STOCK MARKET INDEX SBI20

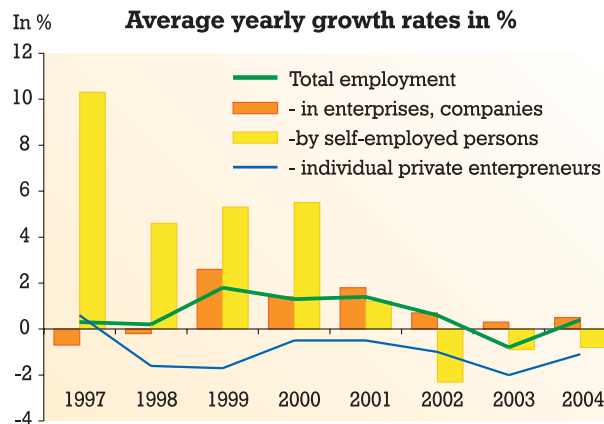
2000	0.1%
2001	19.0%
2002	55.2%
2003	17.7%
2004 (I-XI)	22.8%

Source: Ljubljana Stock Exchange

Labour Market, Wages, Labour Costs

A slight recovery on Slovenia's labour market observed already in the first half of 2004 has continued throughout the year. Levelling of the downward trend in small private business sector has been the most obvious. Employment in companies has

LABOUR MARKET TRENDS 1997 - 2004 Average yearly growth rates in %



Source: National Statistical Office, * I-IX 2004

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been gradually picking up. As a result, **total employment** rose by 0.4 percent in the first nine months of 2004.

Registered **unemployment rate** as well as standardised unemployment rate by ILO definition dropped to 10.7 and 6.0 percent, respectively. The supply of **job vacancies** has been improving according to the National Employment Service in 2004, with the seasonal exception of the summer. Nevertheless, the EU accession has already influenced Slovenian labour market to some extent. Fiercer competition from low labour cost countries and slow restructuring of Slovenian firms in some sectors (especially textile and food industry) have forced firms to cut back on their workforce substantially.

LABOUR FORCE

	Number 2003	Growth in % 2003	2004 I-IX
LABOUR FORCE	874,921	-1.3	-0.2
1. Total employment	777,247	-0.8	0.4
• in enterprises, companies	632,981	0.3	0.5
• by self-employed persons	66,164	-0.9	-0.8
• self-employment	78,101	-8.8	0.3
- individual private entrepreneurs	43,308	-2.0	-1.1
2. Registered unemployment	97,674	-4.8	-4.7

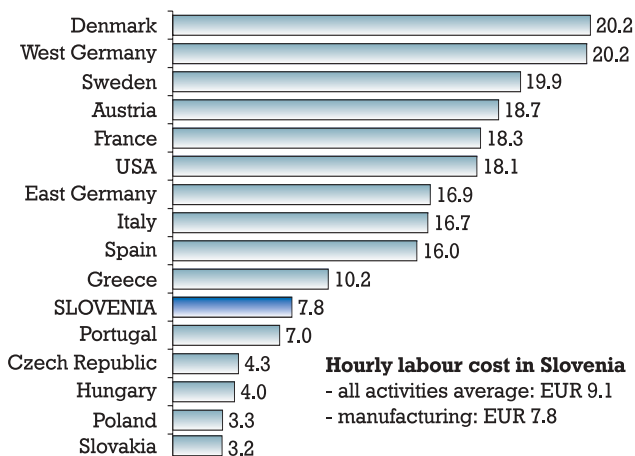
Source: National Statistical Office

In 2005, further improvement is expected, although a modest one since employers intend to stay cautious in their decisions regarding new hiring. According to our forecast, a modest rise in total employment (0.5 percent) and around 6.4 percent ILO unemployment rate on average is expected.

Wage trends have been temperate throughout the year, with a 1.8 percent real growth of wages on average and 3.6 percent in manufacturing. In the first nine months of 2004, the average monthly **gross wage** stood at SIT 261,951 - EUR 1,098, and in manufacturing it was SIT 220,968 (EUR 926). Average monthly take-home wage in Slovenia was SIT 164,720 (EUR 690). The statutory gross **minimum wage** in force as from August 2004 is SIT 117,500 - EUR 490.

Taking into account the new private sector wage agreement and the expected further moderate wage growth in public sector, the

HOURLY LABOUR COST IN MANUFACTURING, 2003 In EUR, European Union and USA



Hourly labour cost in Slovenia
- all activities average: EUR 9.1
- manufacturing: EUR 7.8

Source: IW-Koeln, August 2004; for Slovenia SKEP GZS

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average real gross wage growth in Slovenia could be around 2 percent in 2004 and 2005, on average. However, solutions set in sectoral collective agreements should ensure the real wage growth lagging behind productivity by at least one percentage point. Otherwise the macroeconomic goals set out in the Social Agreement could be threatened.

The average **hourly labour cost** for employer, including additional labour costs, by our estimate, totalled SIT 2,198 (EUR 9.2) in the first half of 2004, while in manufacturing it was SIT 1,885 (EUR 7.9), indicating a slight upward tendency compared to 2003. The estimate is based on 40-hour working week, with ½ hour daily meal break included.

Expectations

In the coming period, Slovenia could generate a relatively dynamic economic growth, aiming to achieve or even surpass the average level of development of the EU-25. In 2005, real GDP growth is forecast to preserve the dynamics from 2004, with continuing positive developments in international trade. The strongest domestic impulses are expected to come from investment activity, with an estimated 8 percent annual growth rate. Private consumption could proceed at around 3 percent annual growth, with wages retaining stable real growth of around 2 percent. Inflation – a crucial player in achieving the convergence criterion and adopting the euro – is forecast to come under 3 percent on annual level. In 2005, some key fiscal reforms regarding corporate taxation and personal income taxes will be implemented.

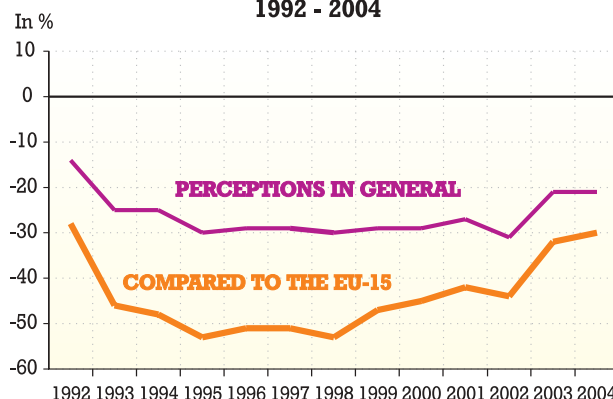
The **business expectations** of companies, measured by SKEP surveys, have in general recorded a slightly positive trend during 2004, thus reflecting the overall prospects and developments in the global business cycle. In the September 2004, the expectations further improved. 40 percent of business leaders expressed high confidence, whilst only 8 percent of them expected worsening of global business opportunities in the coming six months. 79 percent of companies in industry and 65 percent in services counted on a rise in real turnover in 2005. The first results of the survey conducted in December 2004 show some weakening of the general business expectations for

the next six months. However, there is a belief that the second half of 2005 could bring about some more positive business impulses. Expectations of Slovenian companies are closely linked to the predictions about oil and other commodity price developments, as well as about the latest general European economic trends. Still, the majority of Slovenian business leaders remain **prevalingly confident** at the turn of the year.

Short-term export expectations continue to be high, exceeding the domestic sales expectations. Companies do believe that the rise in prices will further slow down, even though this is not so certain in trade and other services. Strengthening investment is more expressed in services' companies, especially trade companies. As far as the **introduction of Euro** is concerned, especially in the export-oriented industries, hardly anyone says it could be postponed. The majority of companies even call for an earlier introduction of Euro than officially scheduled for 1 January 2007.

In line with the Lisbon Strategy, whose aim is to make the European Union (EU-25) the most competitive and dynamic economy in the world, the perceptions of Slovenian companies regarding **competitiveness** have improved both in 2003 and 2004. Further improving of administration, taxation and industrial policy are the main fields where Slovenia should strengthen its competitiveness, as urged by companies in recent surveys.

COMPETITIVENESS: PERCEPTIONS OF SLOVENIAN COMPANIES, 1992 - 2004

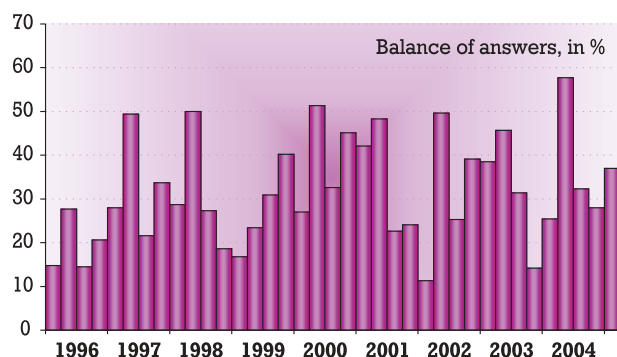


Source: SKEP CCIS Surveys on
Perceptions on Competitiveness

SKEP GZS

Ljubljana, December 2004

BUSINESS EXPECTATIONS: Short-term export expectations, quarterly, 1996 - 2004



Source: SKEP CCIS Surveys on
Business Expectation for the next quarter.

SKEP GZS

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