autumn forecast of economic trends 2023

Summary

Economic growth is slowing this year, especially in the export-oriented part of the economy, growth in private consumption is also lower, while construction investment continues to rise. IMAD forecasts real GDP growth of 1.6% this year, which is slightly lower than expected in the Spring Forecast (1.8%), with the level and structure of GDP having changed significantly since the last forecast. In nominal terms, the forecast is heavily influenced by the revised base following the release of the first annual GDP estimate for 2022 by SURS, which lowered the initial estimate of nominal GDP based on quarterly data by almost EUR 2 billion. Real growth rates are affected in particular by the slowdown in the economies of Slovenia's main trading partners, which is stronger than expected in the spring, especially in Germany, weighing on export growth. The forecast is also affected by changes in the real growth of some aggregates in the release of the first annual estimate for last year, in particular private consumption, and value added in manufacturing and construction. In general, it appears that, in contrast to previous estimates, the post-COVID-19 recovery was more concentrated in 2021 and economic growth last year was below the EU average. There have also been some changes in the indicators of the household saving rate, which is now much higher, and productivity, especially in manufacturing, which has declined. This also substantially changes the base for the preparation of the forecast, as it suggests that the impact of the drop in purchasing power was greater and that households were more cautious in their spending than originally assumed, and that cost pressures had a greater impact on activity in the predominantly export-oriented part of the economy. Growth in exports of goods and services will therefore lag slightly behind that of foreign demand this year. In construction investment, however, we expect the high level of activity to continue, even if it will gradually weaken. According to the data on business trends in construction, indicator for new orders is declining, and the data on building permits also point to a weakening of activity. However, recovery from the August floods will have a stimulating effect on construction activity. We estimate that the direct negative impact of the floods on manufacturing and transportation activity and on exports will be temporary and, although significant at the local level, will not have a major effect at the macroeconomic level. Investment in equipment and machinery will be lower this year than last, given the weakening of activity in the international environment and higher interest rates. Private consumption growth will be lower than last year; we expect moderate growth in the second half of the year (after an estimated decline in the second quarter), driven by high employment, continued moderate real wage growth and government measures to mitigate rising energy costs and eliminate the consequences of natural disasters and to a smaller extent also by the replacement of durable and non-durable goods damaged in the August floods. Turnover in trade will be lower this year than last. Although slowing down, growth in the consumption of services, especially related to tourism, will continue. Government consumption will be higher than last year, in the second half of the year due to higher expenditure on goods and services in connection with the elimination of the consequences of floods.

In the next two years, GDP growth is expected to return to slightly higher levels (2.8% in 2024 and 2.5% in 2025). With a gradual strengthening of external demand growth in the next two years, we expect a renewed growth in

exports, a strengthening of growth in value added in manufacturing and continued growth in trade in services. For 2024, we forecast further growth in investment (5.5%), boosted by the recovery and reconstruction after this year's floods and a renewed growth in business investment in machinery and equipment. Investment growth is higher than expected in the spring forecast, due to additional investment related to flood recovery and reconstruction. However, the construction sector is subject to a number of uncertainties given the relatively high capacity utilisation. In particular, the additional demand associated with the elimination of the consequences of the floods could drive up prices in the construction sector and crowd out other investments. Investment growth is expected to slow in 2025 (to 4.3%). Private consumption will be 2.3% and 1.8% higher in 2024 and 2025, respectively, amid strengthened real income growth. This will be driven by continued employment and wage growth and slowdown in price growth, which will boost the consumption of non-essential goods and services. We expect that the propensity to save will be similar in 2024 and 2025 as in 2023 and 2022, when (according to revised data) it was higher than before the epidemic. Higher growth in government consumption over the next two years (1.9% in 2024 and 2.2% in 2025) will be driven also by continued growth in health expenditure and the gradual implementation of the long-term care system.

Continued moderation of growth in employment and decline in unemployment is expected until the end of this year, while severe labour shortages will not allow for stronger employment growth over the next two years. The tight situation will be eased slightly by certain measures to facilitate the recruitment of foreign labour. The demographic trends, i.e. a marked decline of the population aged 20–64 since 2012, will become an even greater obstacle to the growth of value added.

Average nominal gross wage growth will be high this year (8.6%), but subdued in real terms (1.0%) given the still-high inflation; real growth will gradually accelerate over the next two years as inflation eases and labour shortages persist. Nominal wage growth will exceed 8% this year in both the private and public sectors. The acceleration of growth in the private sector compared to last year will be influenced by continued pressures in the labour market in the face of labour shortages, increased efforts to maintain the purchasing power in the context of elevated inflation, and the January increase in the minimum wage. In the public sector, wage growth will be mainly influenced by the implementation of last year's agreement with public sector unions. Nominal wage growth will weaken somewhat over the next two years amid lower price pressures, but will remain relatively high due to labour market pressures, which will persist given the unfavourable demographic trends. The forecast for gross wage growth is subject to significant risks related to labour market pressures and the announced reform of the public sector wage system. However, the dynamics of its implementation and the assessment of its impact on wage growth are difficult to assess at this stage.

We expect inflation to continue to ease over the rest of the year, although at a slower pace than in recent months; it could only gradually decline towards 2% by the end of 2025. We expect services price growth to start moderating towards the end of this year, but still to remain relatively high and to make a significant contribution to inflation throughout the forecast horizon. The contribution of food prices will also remain relatively high this year, but growth of food prices is declining after reaching high levels at the beginning of the year. In the absence of shocks, the contribution of energy prices is expected to be moderate over the entire forecast horizon (although year-on-year fluctuations are to be expected due to the base effect related to past government measures[1]), and the gradual slowdown in non-energy industrial goods price growth is also expected to continue. As price growth gradually weakens, inflation at the end of this year is expected to be 5.4% and average 7.6% in 2023 a whole, mainly due to the high levels at the beginning of the year. For 2024–2025, we expect inflation to weaken further in the absence of external shocks; supported by monetary policy measures, it is expected to fall to slightly above 3% by the end of 2024 and close to 2% by the end of 2025.

The Autumn Forecast is subject to some uncertainties, notably related to the international economic environment, where activity is weakening, the broader economic impact of the recent floods in Slovenia, the pace of inflation moderation and the impact of deteriorating cost competitiveness on the export-oriented part of the economy. Economic growth in Slovenia and its trading partners is weakening this year, especially in the export-oriented part of the economy. This is related to the slowdown in global growth, which could be even weaker than currently expected. In addition to weaker demand, the export-oriented part of the economy is also facing a deterioration in cost competitiveness, which could have a greater impact on export activity than expected in the forecast. Uncertainties and risks to economic growth in the euro area are also related to the possible persistence of inflation, which could further constrain household purchasing power and lead to a stronger tightening of monetary policy, with negative consequences on lending and investment activity. In this context, upside risks to inflation arise from a number of factors, including higher energy prices, potentially higher growth of services prices and faster-than-expected increases in food prices, which could be highly volatile given the increasing frequency of extreme weather events. The uniqueness of the event, incomplete damage assessment, incomplete reconstruction plans and non-final government measures make it difficult to accurately predict the broader economic impact of the recent natural disaster. At the same time, there is a growing risk that additional demand for construction work will drive up construction prices given the relatively high capacity utilisation, while higher demand for labour could lead to a faster increase in wages given the already acute labour shortage, thus creating headwinds for the decline in inflation. There are also some upside risks to the economic growth. These arise in particular from successful efforts to attract labour and efficient absorption of EU funds, as well as from reform measures.

---

[1] Especially in the period between September 2023 and May 2024, as the reduced VAT rate on certain energy products used for heating purposes was in force in the same period of the previous year. As of 1 September this year, the Decree on the method of determining and calculating the contribution for ensuring support for the production of electricity from high-efficiency cogeneration and renewable energy sources (2022) expired. According to it, the monthly contribution for the promotion of the production of electricity from high-efficiency cogeneration and renewable energy sources was reduced by 50%.