REPUBLIC OF SLOVENIA
**FISCAL COUNCIL**

# Public finance and macroeconomic developments

January 2018

Prepared by Fiscal Council Analysis Service

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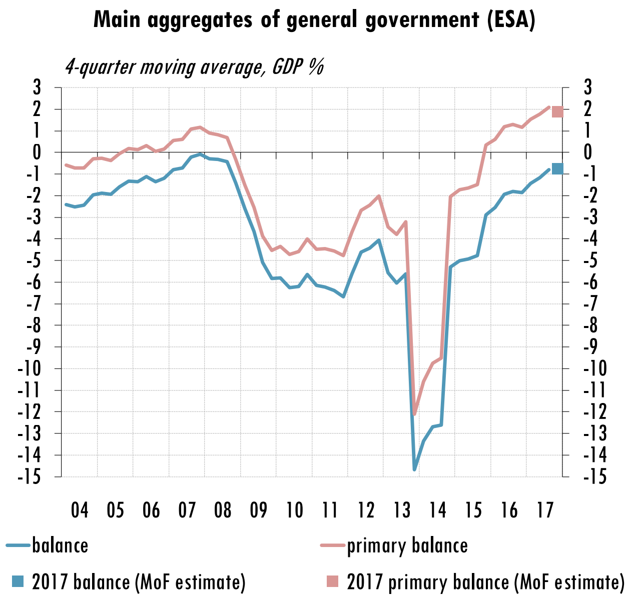
# Summary

The general government deficit further decreased last year due to a stronger revenue growth which greatly exceeded the increase in general government expenditure. In the first three quarters of 2017 the general government deficit was 0.4% of GDP or 1.4 percentage points of GDP, i.e. EUR 400 million, less than in the same period of the previous year. The annual deficit will be similar or below the assessment made by the Government in the Draft budgetary plan for 2018 (-0.8% of GDP). According to the Fiscal Council's (FC) estimate, the reduction in the structural balance deficit was much less significant in comparison with the general government deficit. At the same time pressure on public finance is increasing, which could reduce the planned structural effort in 2018. In the Fiscal Council's opinion, the structural effort was at the minimum required limit already in the latest budgetary documents. The materialisation of the aforementioned pressures would entail a reduction in the countercyclical orientation of the fiscal policy and slow down the decrease in general government indebtedness.

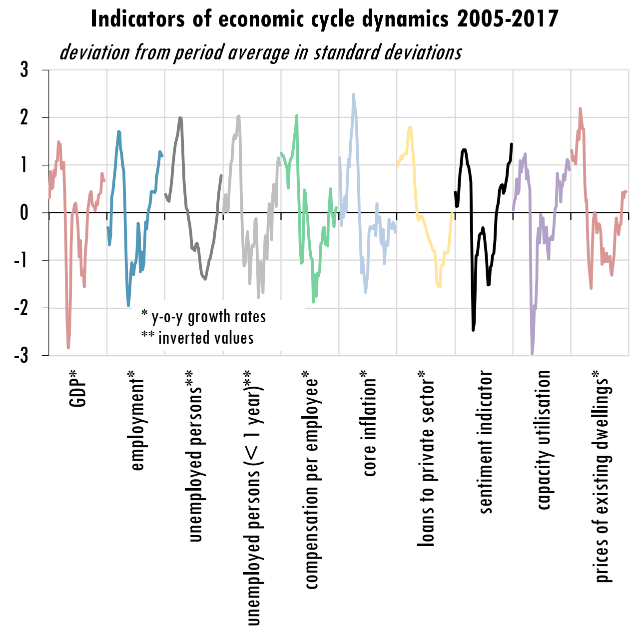
The increase in general government revenue (6.1%) in the first three quarters of 2017 was mainly due to high and broadly based economic growth and will probably not differ much from the latest official assessments of the Government on the annual level (6.0%). The increase in general government revenue was largely derived from the higher revenue from taxes and social contributions, and its increased dynamics as compared to 2016 was mainly due to a lower deceleration of drawing on EU funds than in the previous year. The total general government expenditure increased by 2.8% in the first three quarters of 2017. This was mainly due to compensations to employees and social transfers. The increase in general government expenditure in 2017 is expected to be slightly below the target set by the Government (3.4%), which is mainly attributed to a lower-than-planned increase in expenditure on investment and intermediate consumption.

At the end of the third quarter, the general government debt was EUR 650 million higher than in the same period of the previous year. In addition to economic growth, the improvement of the primary balance also had a positive effect on the 3 percentage points reduction in the share of debt in GDP to 78.5%, while further reduction thereof continued to be inhibited primarily by high interest payments. A significant reduction in the implicit interest rate for the general government debt and the extension of its maturity was not only due to the favourable financing conditions but also to the Government's active debt-management policy. This is a positive development given the high level of general government debt: over the next ten years, the Government will have to make principal and interest payments averaging about 6% of the current GDP per year.

The majority of economic data published after the adoption of budget documents in the autumn of 2017 showed a continued pattern of favourable economic trends, and the estimates of various institutions indicated that the negative output gap had closed in 2017. In addition to the output gap, the Fiscal Council monitors a broader range of indicators to determine the cyclical position of the economy. On the basis of these indicators, it may be assessed that Slovenia's economy was still in a normal economic cycle at the end of 2017. Indicators of economic activity, (un)employment and economic sentiment have already exceeded the average growth rates/long-term levels. However, the movement of labour costs, indicators of prices and loans to the private sector still lag behind the long-term average, while the surplus in the current account of the balance of payments remains high. Taking into account the available forecasts, it may be assessed that the positive risks associated with economic trends derived particularly from the domestic environment are prevailing. These risks are associated with a potential additional upswing in investment activity and structural restrictions in the labour market with increased pressures on costs and prices.




*Source: SORS, MoF Draft Budgetary Plan (Oct.17), FC caclulations.*



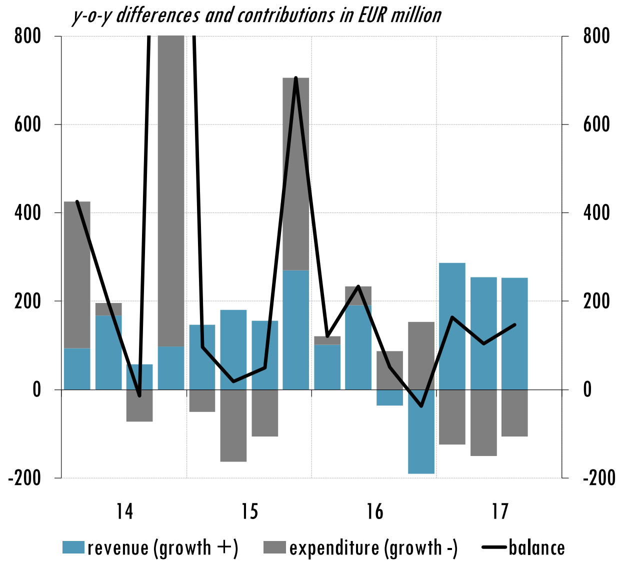

*Sources: SORS, ECB, Eurostat, Employment Service of Slovenia, FC calculations.*

## Fiscal trends – The general government sector

The general government deficit further decreased last year due to a stronger revenue growth, which strongly exceeded the increase in general government expenditure. In 2017, the general government deficit amounted to 0.4% of GDP, which was 1.4 percentage points of GDP or EUR 400 million less than in the same period of 2016. Assuming similar trends in the last quarter of the previous year, the annual deficit will be similar or below the latest official assessment made by the Government in the Draft budgetary plan for 2018 (–0.8% of GDP). The reduction in deficit was mainly due to the favourable economic trends. According to the Fiscal Council's estimate, the reduction in the structural balance deficit, which does not take into account cyclical trends and one-off measures, was much less significant. In addition to the reduction in the general government deficit, there was also an increase in the surplus of the primary general government balance, which does not include interest payments, from 1.2% of GDP in the first three quarters of 2016 to 2.5% of GDP in the same period last year.

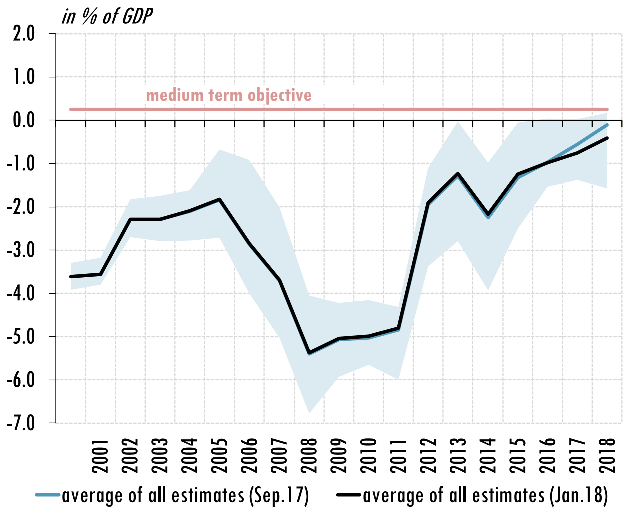
The revenue increase (6.1%) was mainly due to the higher revenue derived from taxes and social contributions, associated with the favourable economic and labour market conditions. The stronger growth dynamic was also the result of a lesser decline in capital revenue, particularly revenue from the EU budget. After a decline in 2016, total general government expenditure increased by 2.8% in the first three quarters of 2017. The year-on-year growth in all major expenditure categories increased throughout the year. The increase in compensation of employees (4.2%) continued, the relaxation of austerity measures resulted in an increased growth of social transfers and the increase in intermediate consumption expenditure was also higher than in the previous year. After a considerable decline in 2016, investment expenditure slightly declined further in the first three quarters of last year, which was due to a still low level of drawing on EU funds. Interest payments remained at a similarly high level as in previous years.

**General government balance (ESA)**



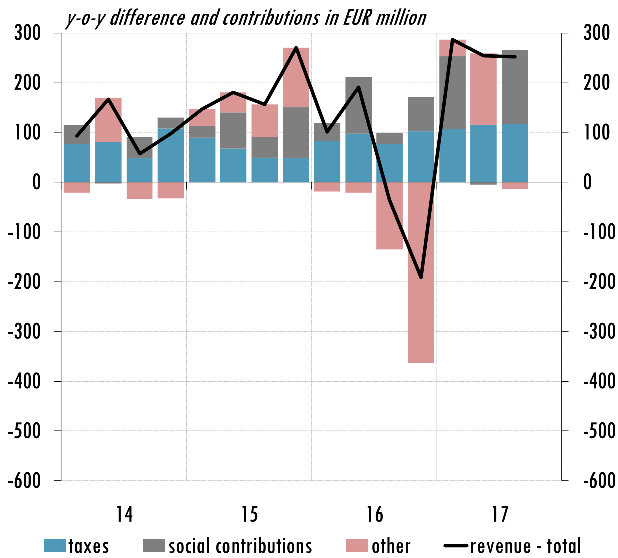

*Source: SORS, FC calculations.*

**Structural balance estimates**



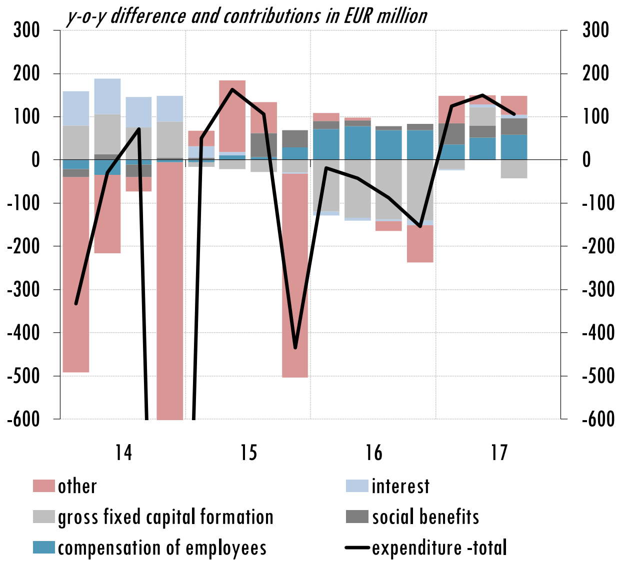

*Source: FC calculations. Note: shaded area represents structural balance estimate range based on Ministry of Finance general government balance estimates and IMAD, European Commission, IMF, OECD and FC output gap estimates.*

**General government revenue (ESA)**




*Sources: SORS, FC calculations.*

**General government expenditure (ESA)**

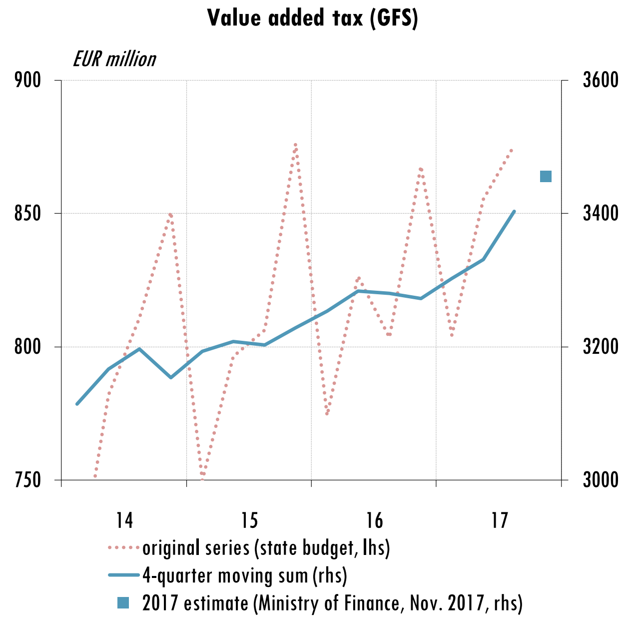



*Source: SORS, FC calculations.*

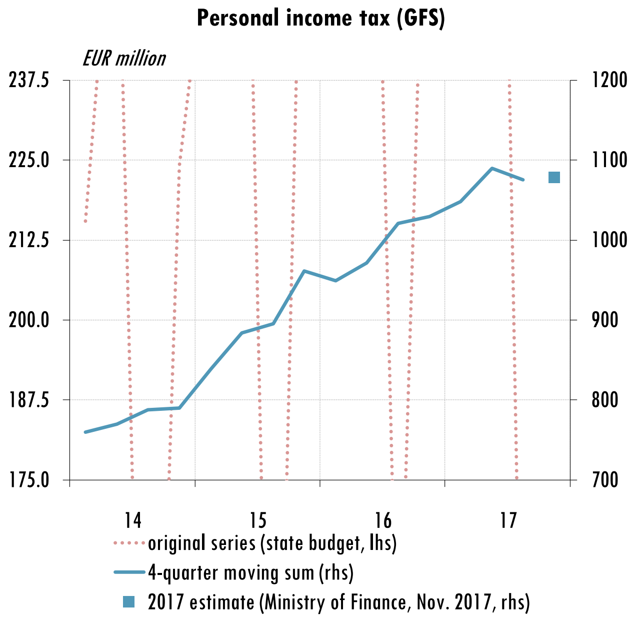
## General government revenue

The increase in general government revenue (6.1%) in the first three quarters of 2017 was mainly due to strong and broadly based economic growth and will, at the annual level, probably not differ much from the latest official assessments presented by the Government in the Draft Budgetary Plan for 2018 (6.0%). The revenue increase would thus be similar to the projected nominal GDP growth. The increase in general government revenue continues to be largely derived from the higher revenue from taxes and social contributions, and its increased dynamics as compared to 2016 was mainly due to a lesser decline in capital revenue as a result of maintenance of the volume of drawing on EU funds at the same low level as in the previous year.

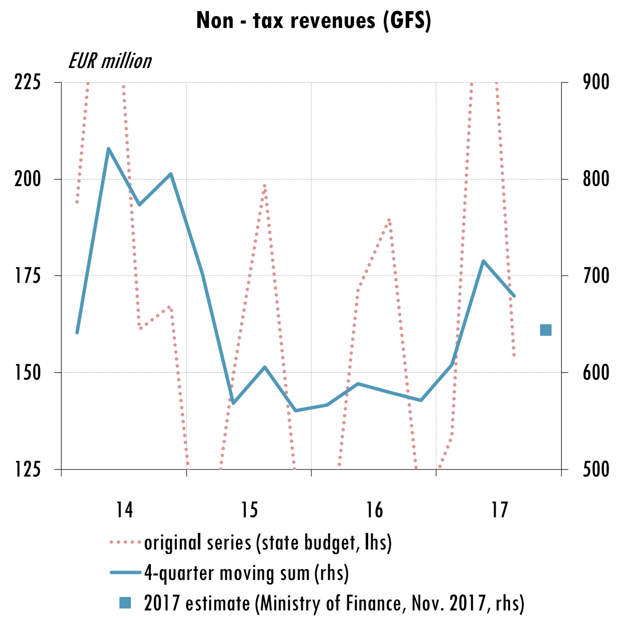
As regards tax revenues, there was a stronger year-on-year increase in revenues from taxes on production and imports (4.2%), particularly from VAT, which is considered to be the result of faster nominal increase in private consumption. The increase in current taxes on income and wealth (7.0%) remained at the same level as in the previous year, with the increase in total compensation of employees remaining similar to previous year, while the gross operating surplus recorded a much higher increase. In our estimate, the total increase in tax revenues in 2017 will be in line with the Government's assessments, with taxes on production slightly higher than planned, and revenues from taxes on income and wealth slightly lower than planned. The continued considerable improvement in labour market conditions last year resulted in increased revenue from social contributions (6.6%), which, in our estimate, will prove to have been higher than that projected by the Government throughout 2017. Other current revenues also showed an increase, including property income resulting from major dividend payments by state-owned companies in the first three quarters of 2017. Capital revenue, which declined considerably (−79.1%) in 2016 on the transition to the next European financial perspective, further declined in the first three quarters of 2017. The dynamics of capital revenue thus show two missed years in drawing on EU funds and has a significant impact on the dynamics of the Government's investment activity.



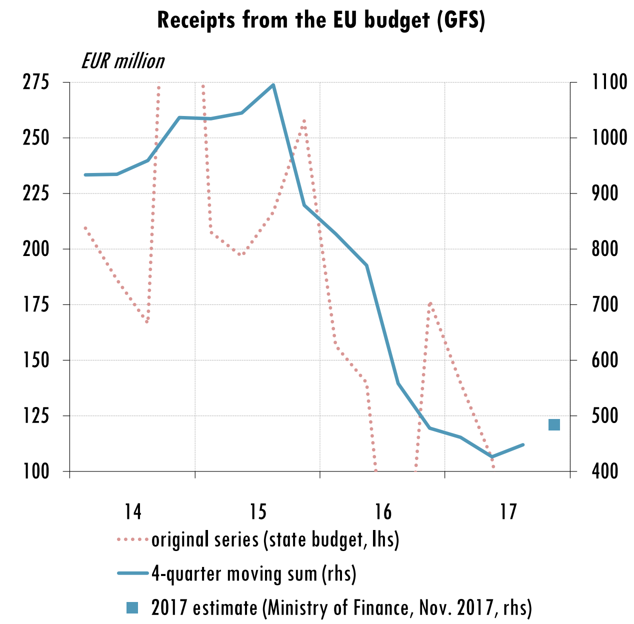

*Source: MoF, Predlog sprememb proračuna 2018 (Nov. 2017), FC calculation.*




*Source: MoF, Predlog sprememb proračuna 2018 (Nov. 2017), FC calculation.*




*Source: MoF, Predlog sprememb proračuna 2018 (Nov. 2017), FC calculation.*



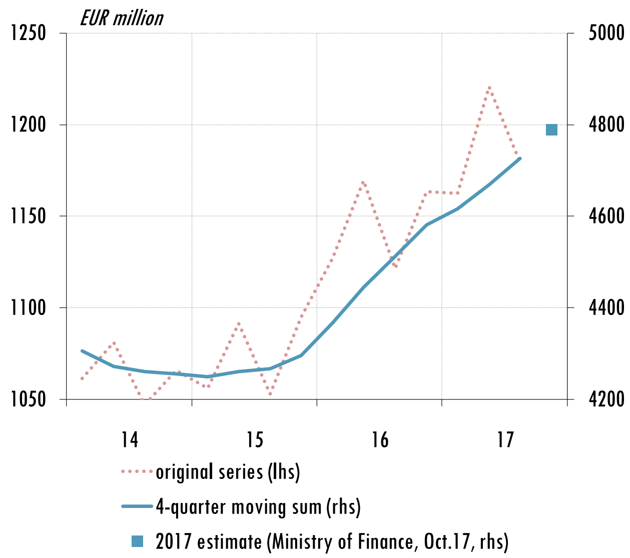

*Source: MoF, Predlog sprememb proračuna 2018 (Nov. 2017), FC calculation.*

## General government expenditure

After a decline due to a sharp drop in investment activity on the transition to the next European financial perspective in 2016, general government expenditure increased by 2.8% in the first three quarters of 2017. The increase in the whole year is expected to be slightly below the target set by the Government for 2018 (3.4 %), which is mainly attributed to a lower-than-planned increase in investment expenditure in conjunction with a reduced drawing on EU funds and a lower increase in expenditure on intermediate consumption, where the increase was planned considerably above the long-term average. The increase in expenditure would thus equal only less than one half of the anticipated GDP growth.

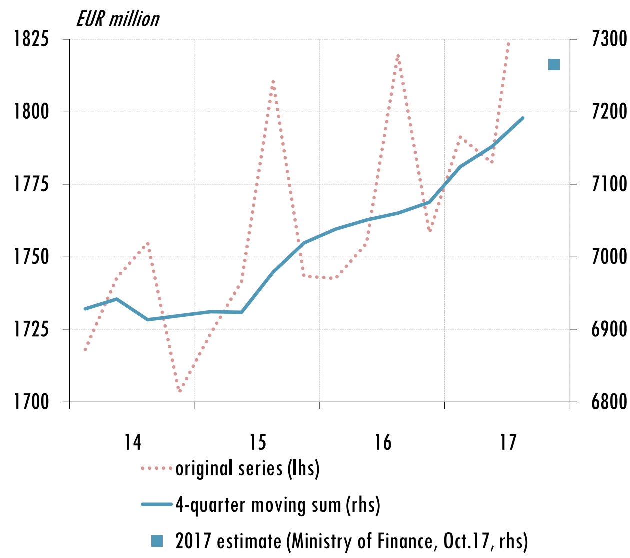
The increase in expenditure in the first three quarters of 2017 was again largely due to compensation of employees, but its growth slowed down in comparison with 2016 and was within Government projections. The number of employees in the general government increased by 1.8% (register data), growth being highest in healthcare and social assistance services (3.4%). The higher increase in social transfers (2.7%) as a result of further relaxation of austerity measures, was also in line with projections. Expenditure on intermediate consumption also increased, but it was considerably lower than the planned 9% annual increase. In the case of such an increase that has been exceeded only twice since 2000, expenditure on intermediate consumption would exceed the FC's current estimate by almost EUR 150 million in 2017. The estimated expenditure on subsidies was also overestimated by approximately EUR 50 million. In the first three quarters of 2017 it remained at the same level as in the same period of the previous year; an annual increase of almost one-fifth had been expected. The key reason for the lower increase of expenditure than planned was investment, which was planned to increase by a good 3% after a nearly 30% decrease in 2016, but it actually decreased by approximately the same percentage in the first three quarters of 2017. In the first three quarters of 2017, interest payments remained at approximately the same high level as in the previous year while they should decrease by almost 10% in the whole year according to the Government's October projections.

**Compensation of employees (ESA)**



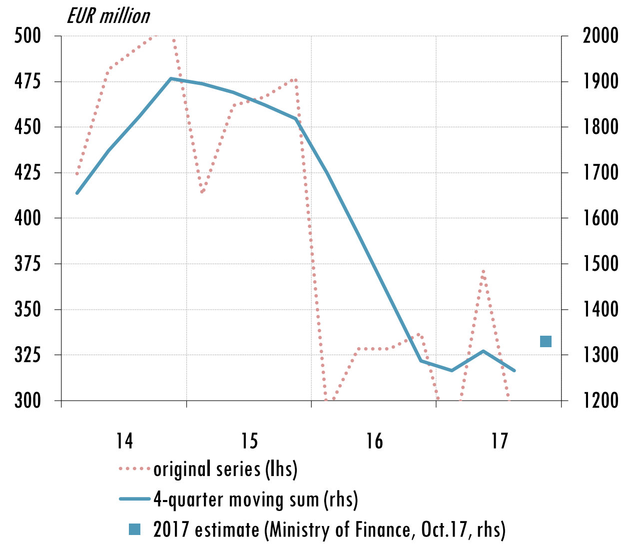

*Source: SORS, MoF Draft Budgetary Plan(Oct.17), FC caclulations.*

**Social benefits (ESA)**



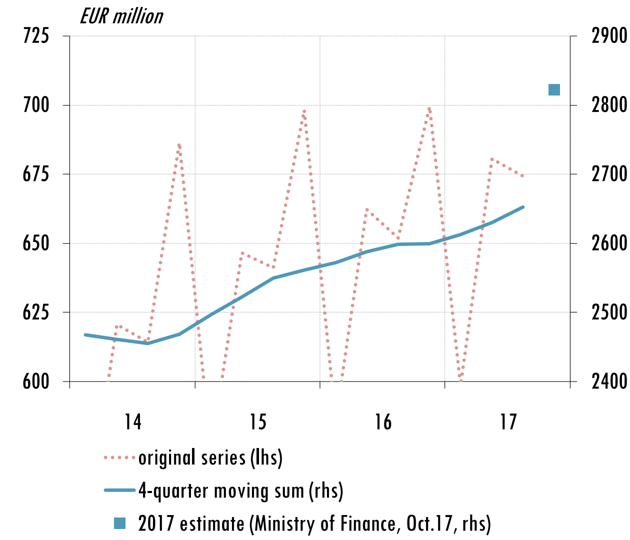

*Source: SORS, MoF Draft Budgetary Plan (Oct.17), FC caclulations.*

**Gross fixed capital formation (ESA)**




*Source: SORS, MoF Draft Budgetary Plan (Oct.17), FC caclulations.*

**Intermediate consumption (ESA)**

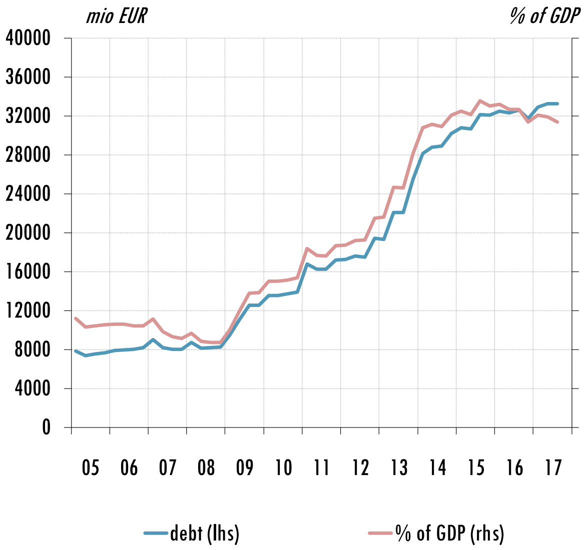



*Source: SORS, MoF Draft Budgetary Plan (Oct.17), FC caclulations.*

# General government debt

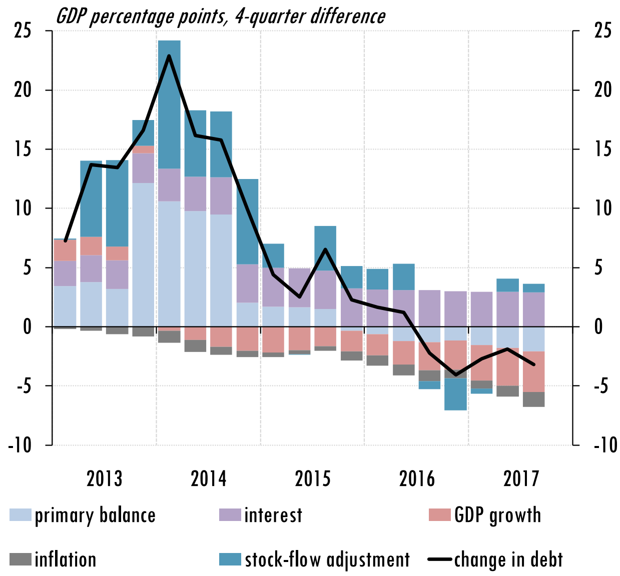
At the end of the third quarter, the general government debt was EUR 650 million higher than in the same period of the previous year. In addition to economic growth, which directly impacts the denominator in the presentation of the relative ratio, the cyclical improvement of the primary balance has recently also had a positive effect on the 3 percentage points reduction in the GDP share to 78.5%. A considerable reduction in the share of debt in GDP is still inhibited by a high level of interest payments, which is partially also due to the Government's additional borrowing, taking advantage of the favourable financing conditions on the market. The required yield on Slovenian government bonds is at its all-time low and has been around 1% since the beginning of 2016. The Government has been replacing relatively expensive bonds issued in US dollars in the period 2012-2014 with cheaper bonds. At the same time, there was a relatively large amount of pre-financing to meet future liabilities, which is also reflected in the amount of the Government's financial resources on the treasury single account. This balance has decreased over the past two years, but still totalled EUR 4.9 billion, or 11.5% of GDP, at the end of 2017. In addition to favourable financing conditions, the Government's active debt-management policy has in recent years contributed to a significant reduction in the implicit rate of interest for the general government debt, to less than 4%, and to a more appropriate time distribution of liabilities, particularly in terms of extending the due date for payment of the principal. This is a positive development given the high level of general government debt: over the next ten years, the Government will have to make principal and interest repayments averaging EUR 2.5 billion or about 6% of the current GDP per year.

**Consolidated gross debt of general government (ESA)**



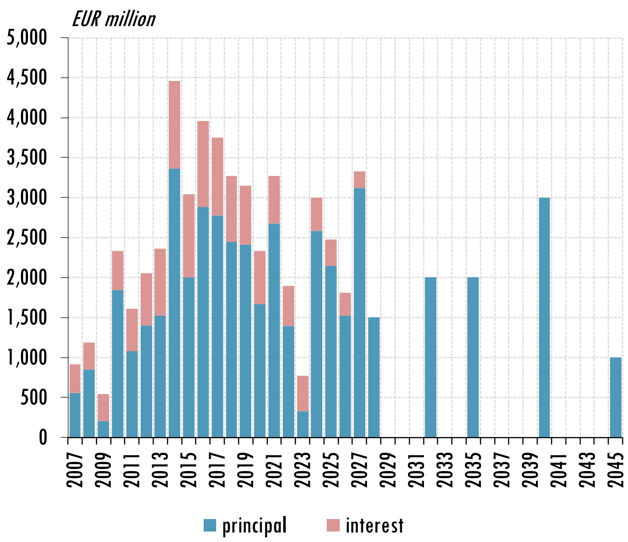

*Source: SORS, FC calculations.*

**Change in general government debt**



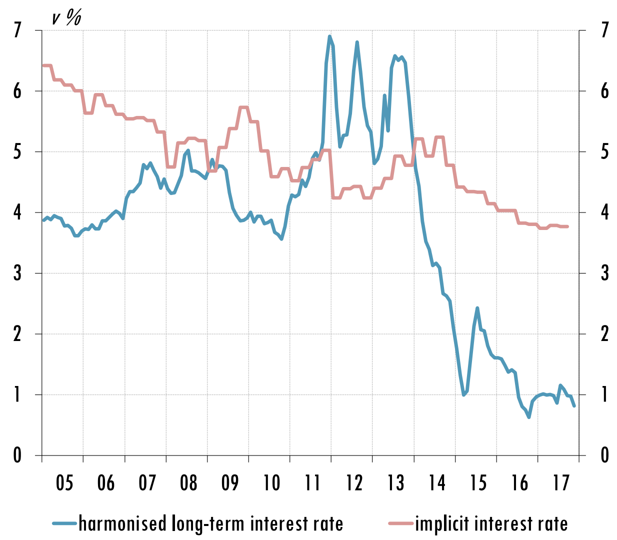

*Source: SORS, FC calculations.*

**State budget debt repayments***




**Note: no information on interest payments after 2027.*
*Source: Ministry of Finance.*

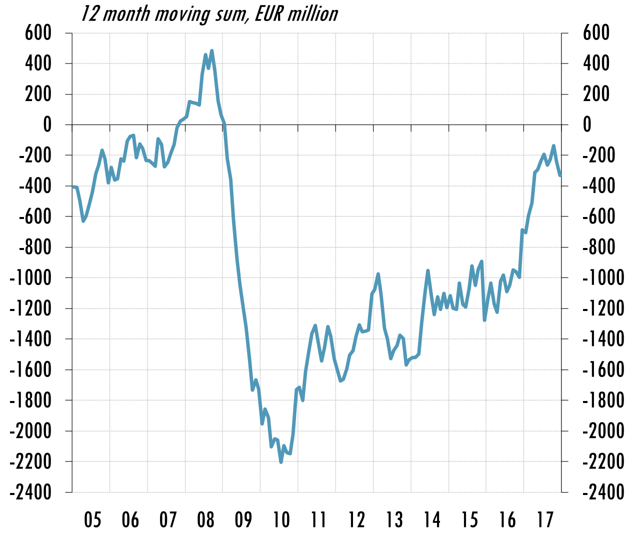
**Harmonised long-term interest rate (10 year) and implicit public debt interest rate**




*Sources: ECB, SORS, FC calculations.*

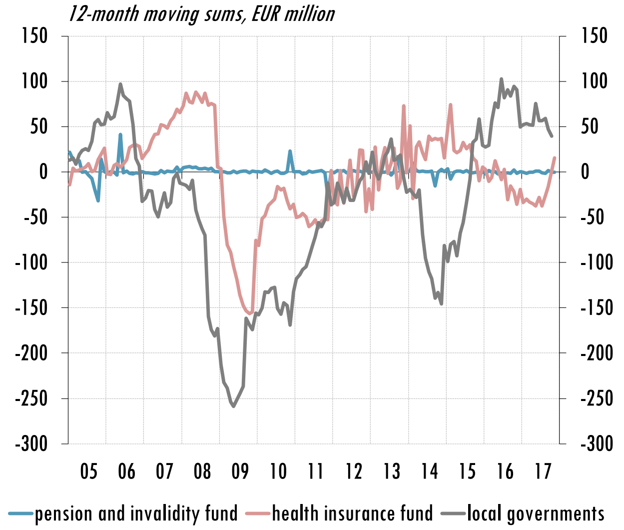
# Public finance budgets

**State budget balance**



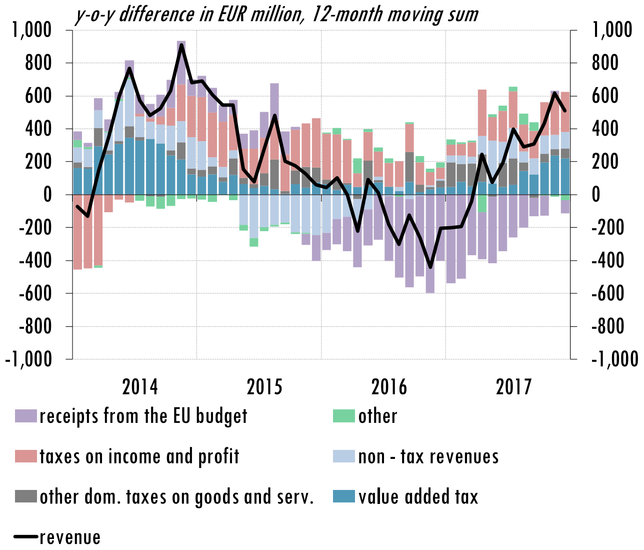

*Source: Ministry of Finance, FC calculation.*

**Local governments, pension and invalidity fund and health insurance fund budgets**



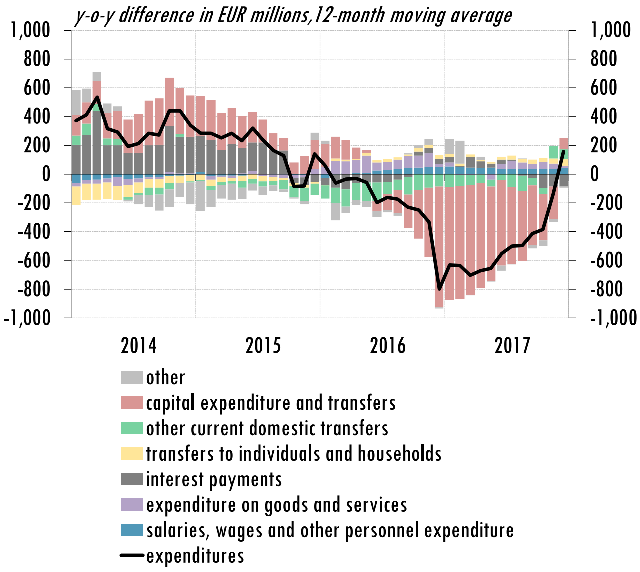

*Source: Ministry of Finance, FC calculations.*

**State budget - revenues**



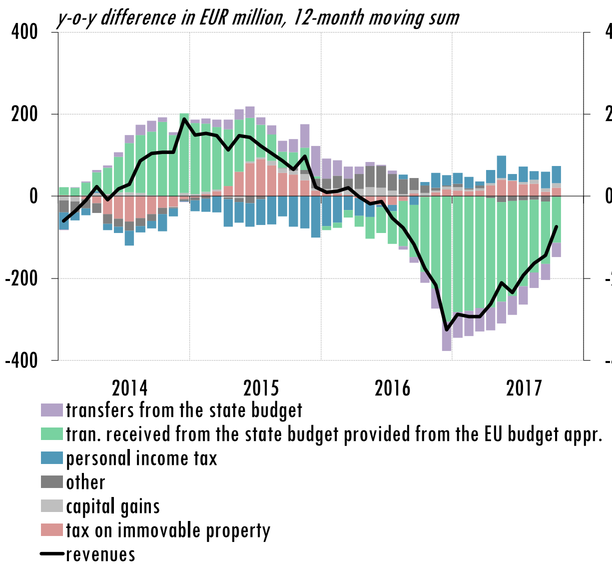

*Source: Ministry of Finance, FC calculations.*

**State budget - expenditures**



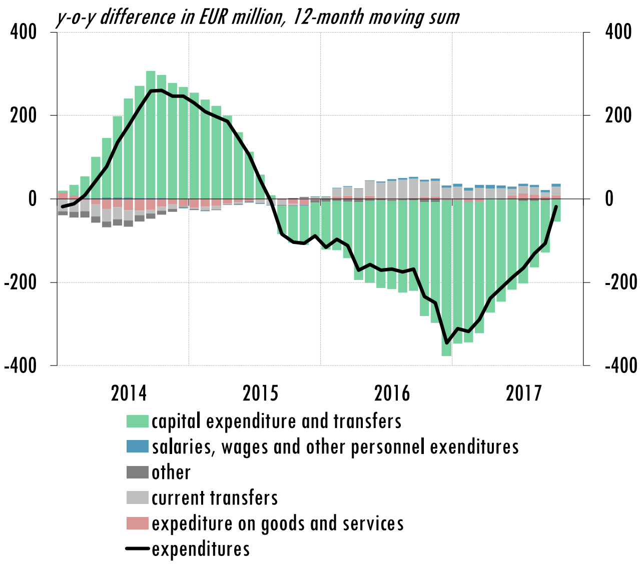

*Source: Ministry of Finance, FC calcuations.*

**Local government budgets - revenues**




*Source: Ministry of Finance, FC calculations.*

**Local government budgets - expenditures**



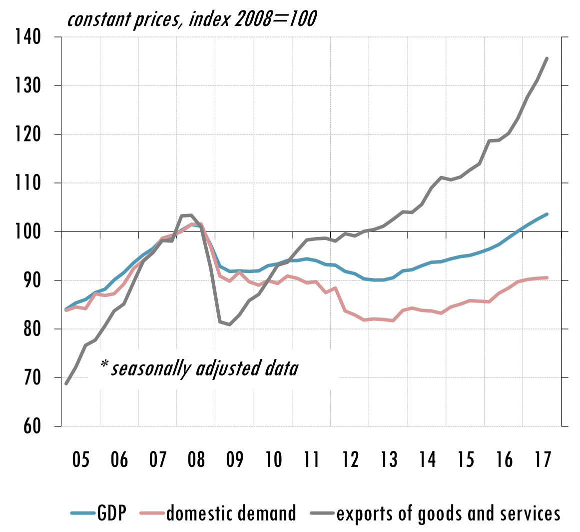

*Source: Minstry of Finance, FC calculations.*

## Macroeconomic trends

In our view, the Slovenian economy was in a normal economic cycle at the end of 2017. After four years of favourable economic trends, estimates by various institutions show that the negative output gap has closed in 2017. The current output gap estimates by some institutions (the EC and the OECD) already point to the overheating of the economy, but, due to the uncertainty and variability of such estimates, we have also been monitoring other indicators to determine the cyclical position of the economy. Indicators of economic activity, (un)employment and economic sentiment have already exceeded the average growth rates/levels since 2005. On the other hand, the movement of labour costs, indicators of prices and loans to the private sector in particular still lag behind the long-term average, while the surplus in the current account of the balance of payments remains high.

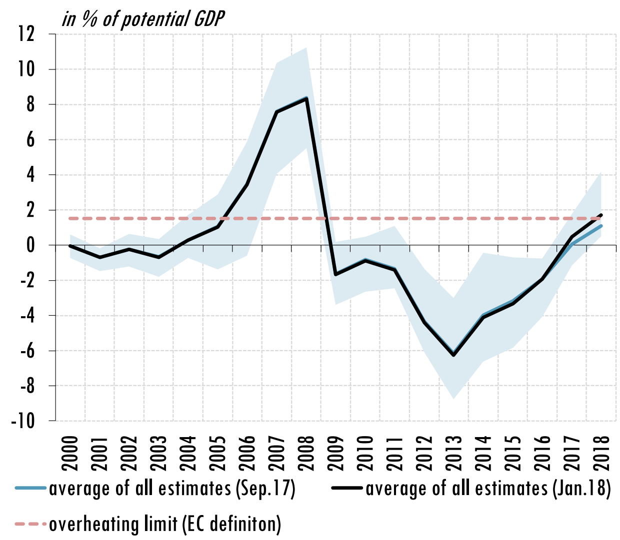
The majority of economic data published after the adoption of budget documents in the autumn of 2017 showed a continued pattern of favourable economic trends. The strong economic growth continued in the third quarter of 2017. Gross domestic product was higher year on year in the first three quarters by 4.7%, which was double the average increase in the EU. Taking into account an increase in all GDP components, economic growth was broad-based. The strong growth in exports was due to the favourable economic conditions in our trading partners and improved competitiveness of exporters. The revival of investment activity continued, particularly as demand growth, the need to replace equipment and the favourable financial position of enterprises stimulated the growth of investment in machinery and equipment. There was also a revival of private-sector investments in construction projects. Household consumption was positively affected by continued considerable improvement in labour market conditions, with the number of employed last year having been exceeded only in 2008. There was also a gradual increase, albeit a moderate one, in wages. The core inflation rate (excluding energy and food) has remained slightly below 1% since 2016.

**GDP, domestic demand and exports**



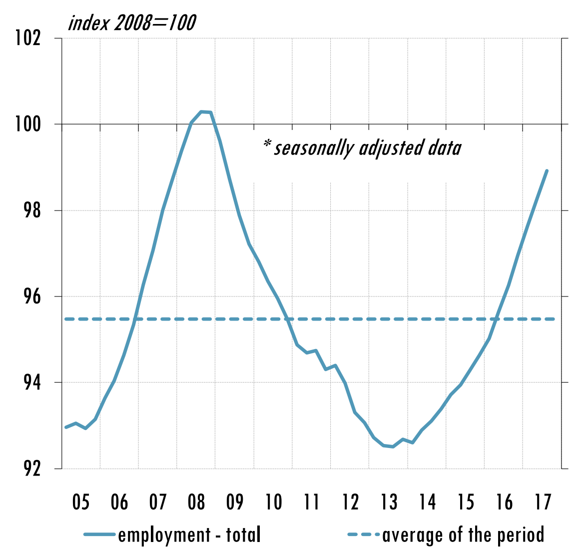

Source: SORS, FC calculations.

**Output gap estimates (Sep.17 vs Jan.18)**



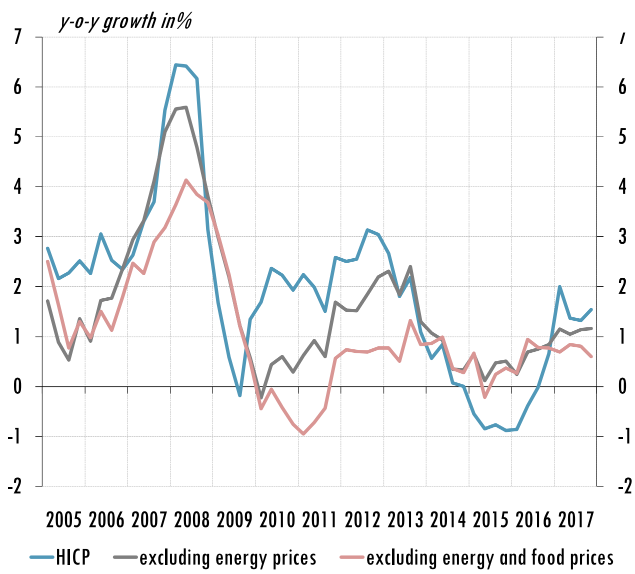

Source: FC calculations. Note: shaded area represents output gap estimate range based on IMAD, European Comission (EC), IMF, OECD and FC estimates.

**Employment (domestic concept)**




Source: SORS, FC calculation.

**HICP and measures of core inflation**

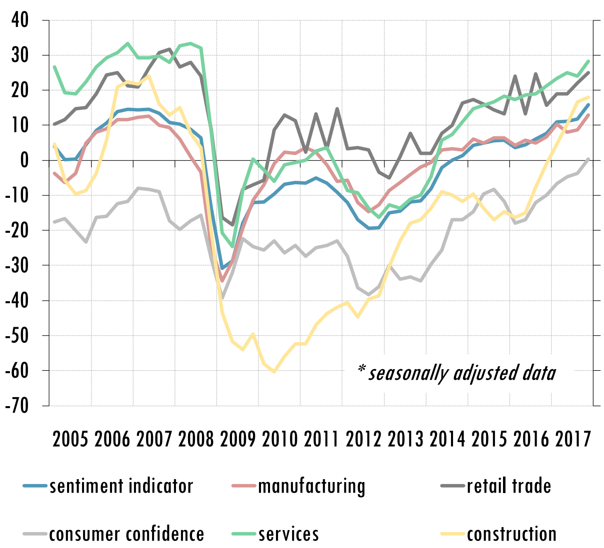



Source: SORS, FC calculations.

# Macroeconomic trends

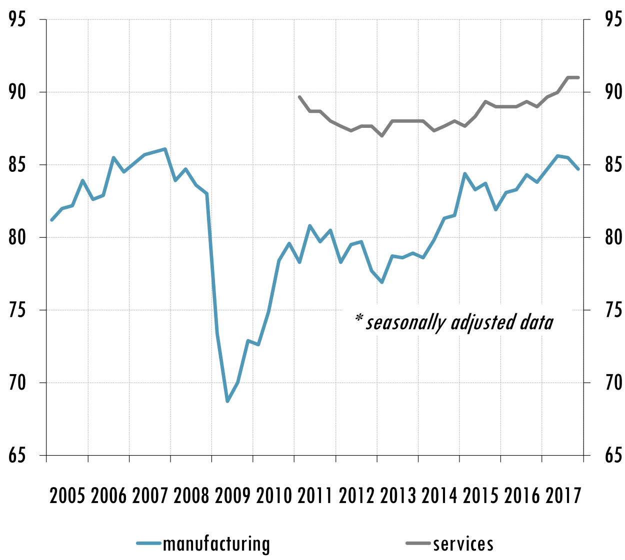
The increase in domestic demand is still not reflected in cost and price pressures and, given the prevailing methods of financing the private sector, which, particularly in the corporate sector, is not based on any major borrowing, did not yet cause any economic imbalances. The existing forecasts and risk assessments point to a rise in the possibility of an overheating of the economy in the future years. Although the increase in economic activity is expected to slow in the next few years, most forecasts show continued favourable economic trends. Despite the relatively high level of uncertainty at the international level, which could slow growth in Slovenia's major trading partners, positive risks were accumulating in the domestic environment. Economic activity could particularly be accelerated by giving an additional impetus to investment activity, while cost and price pressures in the economy could also be increased due to structural restrictions in the labour market.

**Business tendency and consumer surveys***



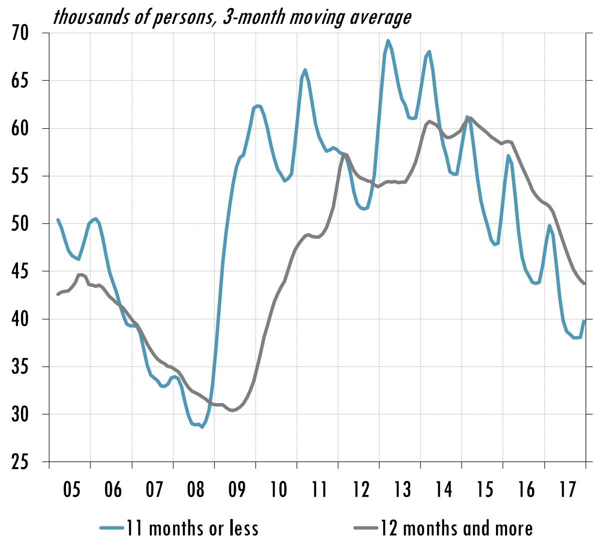

*Source: SORS, FC calculations.*

**Business tendency - capacity utilisation***



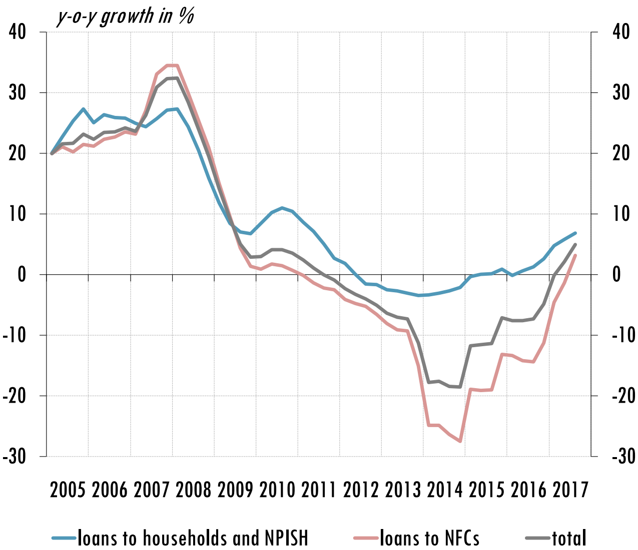

*Source: SORS, FC calculations.*

**Number of registered unemployed persons according to unemployment duration**




*Source: Employment Service of Slovenia, FC calculations.*

**Loans to hosueholds and NFCs**




*Source: ECB, FC calculations.*

| | Q3 | | | | Q1-Q3 | | | | Q4 implicitly | | | | MoF (DBP, state budget) | | | |
|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|
| | | | change | | | | change | | | | change | | | | change | |
| | 2016 | 2017 | EUR million | v % | 2016 | 2017 | EUR million | v % | 2016 | 2017* | EUR million | v % | 2016 | 2017** | EUR million | v % |
| **REVENUE** | **4390** | **4643** | **253** | **5.8** | **12940** | **13735** | **794** | **6.1** | **4470** | **4721** | **251** | **5.6** | **17410** | **18456** | **1046** | **6.0** |
| TAXES | 2262 | 2379 | 117 | 5.2 | 6572 | 6911 | 339 | 5.2 | 2329 | 2475 | 146 | 6.3 | 8901 | 9386 | 485 | 5.4 |
| Taxes on production and imports | 1539 | 1603 | 64 | 4.2 | 4330 | 4513 | 183 | 4.2 | 1564 | 1602 | 38 | 2.4 | 5894 | 6115 | 221 | 3.7 |
| *-of which: Value added tax (GFS)* | *804* | *876* | *72* | *9.0* | *2404* | *2535* | *131* | *5.5* | *868* | *921* | *53* | *6.1* | *3272* | *3456* | *184* | *5.6* |
| Current taxes on income, wealth, etc. | 721 | 772 | 51 | 7.0 | 2232 | 2388 | 156 | 7.0 | 763 | 874 | 112 | 14.6 | 2995 | 3263 | 268 | 8.9 |
| *-of which: Personal income tax (GFS)* | *136* | *123* | *-14* | *-10.1* | *731* | *778* | *46* | *6.4* | *298* | *301* | *3* | *0.9* | *1029* | *1078* | *49* | *4.8* |
| *-of which: Corporation tax (GFS)* | *141* | *183* | *41* | *29.2* | *467* | *591* | *123* | *26.4* | *132* | *180* | *48* | *36.6* | *599* | *771* | *172* | *28.6* |
| Capital taxes | 2 | 4 | 2 | 87.5 | 10 | 10 | -1 | -5.2 | 2 | -1 | -3 | -154.3 | 12 | 9 | -4 | -30.6 |
| SOCIAL CONTRIBUTIONS | 1429 | 1578 | 149 | 10.4 | 4386 | 4676 | 290 | 6.6 | 1581 | 1631 | 50 | 3.2 | 5967 | 6307 | 340 | 5.7 |
| PROPERTY INCOME | 168 | 125 | -43 | -25.8 | 408 | 461 | 53 | 13.1 | 55 | 13 | -42 | -75.6 | 463 | 475 | 12 | 2.5 |
| OTHER | 531 | 561 | 30 | 5.7 | 1574 | 1687 | 113 | 7.1 | 504 | 601 | 96 | 19.1 | 2079 | 2288 | 209 | 10.0 |
| **EXPENDITURE** | **4556** | **4662** | **106** | **2.3** | **13489** | **13869** | **380** | **2.8** | **4675** | **4907** | **232** | **5.0** | **18165** | **18777** | **612** | **3.4** |
| COMPENSATION OF EMPLOYEES | 1121 | 1179 | 58 | 5.2 | 3418 | 3563 | 145 | 4.2 | 1163 | 1227 | 63 | 5.4 | 4581 | 4789 | 208 | 4.5 |
| INTERMEDIATE CONSUMPTION | 652 | 674 | 22 | 3.4 | 1900 | 1953 | 53 | 2.8 | 699 | 869 | 169 | 24.2 | 2600 | 2822 | 223 | 8.6 |
| SOCIAL BENEFITS | 1820 | 1859 | 39 | 2.2 | 5317 | 5433 | 116 | 2.2 | 1758 | 1832 | 74 | 4.2 | 7075 | 7265 | 190 | 2.7 |
| INTEREST | 308 | 315 | 8 | 2.5 | 914 | 925 | 11 | 1.2 | 305 | 191 | -114 | -37.4 | 1219 | 1116 | -103 | -8.4 |
| SUBSIDIES | 73 | 75 | 2 | 2.2 | 230 | 229 | -1 | -0.4 | 85 | 143 | 58 | 68.3 | 315 | 372 | 57 | 18.2 |
| GROSS FIXED CAPITAL FORMATION | 328 | 286 | -43 | -13.0 | 950 | 929 | -21 | -2.2 | 337 | 401 | 64 | 19.0 | 1287 | 1330 | 43 | 3.3 |
| OTHER CAPITAL TRANSFERS | 24 | 29 | 5 | 22.8 | 69 | 122 | 53 | 76.4 | 67 | 105 | 38 | 57.0 | 136 | 227 | 91 | 66.9 |
| OTHER | 229 | 244 | 14 | 6.3 | 691 | 716 | 25 | 3.6 | 260 | 140 | -121 | -46.4 | 951 | 855 | -96 | -10.1 |
| **Balance** | **-166** | **-19** | **147** | | **-549** | **-134** | **415** | | **-205** | **-186** | **19** | | **-754** | **-321** | **434** | |
| **Primary balance** | **142** | **297** | **154** | | **365** | **791** | **426** | | **100** | **5** | **-95** | | **465** | **795** | **331** | |
| **Balance, GDP %** | **-1.6** | **-0.2** | | **1.4** | **-1.8** | **-0.4** | | **1.4** | **-2.0** | **-1.7** | | **0.2** | **-1.9** | **-0.8** | | **1.1** |
| **Primary balance, GDP %** | **1.4** | **2.7** | | **1.3** | **1.2** | **2.5** | | **1.3** | **1.0** | **0.0** | | **-0.9** | **1.1** | **1.9** | | **0.7** |
| **Nominal GDP, EUR million** | **10390** | **11107** | **717** | **6.9** | **30022** | **32035** | **2013** | **6.7** | **10396** | **10727** | **331** | **3.2** | **40418** | **42761** | **2343** | **5.8** |

Source: SORS, Ministry of Finance (MoF). Notes: *Implicitly calculated to match MoF projection. **MoF forecast from Draft budgetary plan 2018 (October 2017) and Predlog sprememb državnega proračuna 2018 (October 2017; GFS), which include MoF estimates for 2017.