

Amid the moderation of economic activity and increased risks in view of instability in financial markets, in particular, international institutions have revised downwards their forecasts for economic growth in 2012. After the considerable easing of economic growth in the euro area in the second quarter this year, international institutions expect a continued moderation in the rest of the year and in 2012, along with deteriorated business expectations and the announced fiscal consolidation measures. There is however a huge risk that GDP growth may even be lower than forecast, given the persisting instability in financial markets and the possibility of a further spreading of the sovereign debt crisis across the euro area.

Short-term indicators of economic activity show that the recovery of Slovenia's economy decelerated at the end of the second quarter and the beginning of the third. Growth in nominal merchandise exports, the only indicator to exceed the 2008 average, eased in Slovenia in the summer months amid the moderation of activity in main trading partners. Similar goes for the real volume of industrial production in manufacturing, where the moderation in the summer months was even more pronounced due to a significant contraction of activity in medium-low-technology industries. Data on business trends indicate deteriorating expectations also for the autumn months. Construction activity otherwise picked up in July, but remains very low due to a substantial decline in previous months, lagging the most of all activities behind the average level in 2008. In the services sector, turnover continues to hover around the level reached at the beginning of the year.

The improvement in cost competitiveness of the economy slowed in the second quarter. Real unit labour costs are declining this year, in contrast to 2010 when Slovenia was the only euro area country where real unit labour costs still grew. Following an above-average gain in cost competitiveness in the first three months, Slovenia slipped into the group of countries with below-average improvements in the second quarter due to the slowdown of economic activity and hence lower productivity growth. In the second quarter, the improvement was otherwise again mainly attributable to labour productivity growth in industrial activities.

Having stabilised at the beginning of this year, the labour market situation deteriorated somewhat in the summer months; the average gross wage stagnated. In July, employment dropped for the second consecutive month, according to seasonally adjusted data, while registered unemployment rose in July and August. Overall 106,996 persons were unemployed at the end of August, an increase of 8.0% over the previous August. The average gross wage stagnated in June and July, seasonally adjusted; it strengthened slightly in the private sector, while it dropped somewhat in the public sector.

Consumer prices rose by 0.6% in September. Y-o-y inflation also increased substantially as a result of the base effect related to last year's movements of services prices. The increase in y-o-y inflation by 1.1 p.p. to 2.1% mainly reflected the end of the effect of the subsidy for primary school meals introduced in September 2010, because of which consumers had paid 68.8% less for school meals. According to Eurostat's flash estimate, y-o-y inflation in the euro area also increased in September (to 3.0%).

The already modest lending activity of Slovenia's banks slowed further in August. The aggravated situation in the banking system was one of the main reasons why the rating agencies Moody's and Fitch Ratings downgraded Slovenia's credit rating at the end of September. Enterprises and NFIs increased net repayments of loans. As households also made net repayments of domestic bank loans in August, the total net repayments in August were the highest in the last two years. In the first eight months of the year, the volume of domestic non-banking sector loans with domestic banks dropped by EUR 113.0 m, in contrast to the same period of 2010 when net flows totalled EUR 993.2 m. The quality of banks' assets continues to deteriorate and banks added as much as EUR 459.3 m in impairments and provisions in the first seven months, almost a quarter more than in the same period last year. In addition to the deteriorated situation in the banking system, the expected slowdown of the economic recovery, political uncertainty and procrastination on structural reforms are the main reasons for the downgrade cited by both agencies. They also assigned a negative outlook to Slovenia, which indicates a possibility of further downgrades.

The government approved a revised state budget for 2011, which matched expenditures to the estimated (lower) revenues, but left the deficit level unchanged (4.7% of GDP). The revised state budget anticipates that revenues and expenditures will be EUR 365 m lower than planned in the state budget for 2011 adopted in December 2011. With revenues and expenditures down by the same amount, the deficit level remains unchanged. The state budget deficit in 2011 is thus estimated at EUR 1.7 bn. The structure of spending cuts shows that savings are mainly made on investments that are being pushed forward to the following years. No major cuts will be made by systemic

savings, a measure which would be crucial for a more sustainable consolidation of public finances, and is already being enforced by several other European countries.

The inequality and poverty indicators show that material deprivation declined somewhat in 2010 while household income inequality increased slightly. The at-risk-of-poverty rate, which, according to the methodology for the calculation, mainly reflects income inequality within the population in 2009 (i.e. income distribution among households), increased after a long period of decline as a result of a drop in income of a significant proportion of households during the economic crisis and a concurrent, relatively large, increase in wages in certain activities with high average wages (such as health, public administration and electric power supply). The increase in income inequality did not translate into a deterioration of living conditions, as the material deprivation rate dropped somewhat, though it is still higher than in the period before 2008.