

Economic growth

Welcome to the Recession

The figures on GDP growth in the first quarter of this year had been awaited with some trepidation. Heavily dependent on investment spending and exports, Slovenia's economy was bound to suffer a sharp slowdown, register a second consecutive quarter of negative economic growth and thus slip into the recession. Few were, however, prepared for the news that the economy contracted by 8.5 percent in the first three months of this year compared to the same period of 2008.



Slovenia's exports, Gorenje's house appliances and Revoz's cars are among the most important ones, are taking a beating



The good times

That exports are the engine of the country's economic growth has become a platitude in political as well as expert circles. True, exports account for more than two thirds of Slovenia's output. In the past three years, however, the contribution of trade to economic

growth was marginal or even negative; the economy imported more goods and services than it exported, with trade balance shaving off a few percentage points off economic growth, rather than adding to it (see chart).

These trade deficits were a symptom of the profligacy fuelled by

cheap credit that was made available to the economy once the euro was introduced in 2007, and banks started to fight for market shares with ever more attractive interest rates and ever laxer loan-underwriting standards. Banks in Slovenia grew increasingly dependent on international financial markets. Demand for credit far exceeded the volume of deposits, so banks issued bonds and took out syndicated loans abroad to satisfy the appetites of households and companies that poured the money into real estate, stocks and equipment.

As long as exports grew smartly on the back of surging world demand, it made sense to invest in the expansion of production facilities. Slovenia's biggest exporters, such as Revoz, a subsidiary of French car maker Renault, and Gorenje, a household appliances producer, saw their profits rise smartly, while households could rest assured that the surging real estate and stock markets would take good care of their investments. Or so it seemed.

The crunch

A glance at Slovenia's current account deficit, which jumped from 1.7 percent of GDP in 2005 to 5.9 in 2008, suffices to demonstrate that the country's growth has been somewhat unbalanced. In this respect, Slovenia is similar to the three Baltic countries, which were accumulating double-digit current account deficits in the boom times and are now the only ones in the EU registering steeper falls in output than Slovenia. Not much of a consolation.

Simply put, the current account deficit indicates not only that the economy is importing more than it is exporting, but also that it is paying more in interest to foreign lenders than it gets in returns on its own investments abroad. The main conduit for this outflow of funds has been Slovenia's banks, which have relied heavily on international financial markets to finance the credit growth at home; coupon payments on bonds have to be made and loans have to be paid back. The fact that the banks' lending often found its way into red-hot real-estate and stock markets had been overlooked, until it became too late.

With the US financial meltdown in full swing and interbank markets frozen, foreign creditors have been increasingly unwilling to refinance loans given to Slovenian banks, so the latter have had to cut lending and dedicate funds to servicing their debts. The real-estate market was the first to feel the pinch; with less money to go around, the demand for apartments fell, while companies started cutting costs, scraping plans to relocate to new premises. Construction firms and developers

have thus been left sitting on a sizable stock of residential and commercial real estate of falling value, a problem when debt incurred in the process of building has to be repaid.

Sobering up

It is no wonder then that fixed capital investment plunged by a third in the first quarter of 2009, compared to the same quarter of the previous year. However, it was not only investment in residential and non-residential real estate that took the hit, but also investment in transport equipment and machines. Fearing unemployment, households are putting off purchases of cars, while companies have to deal with excess capacity, built up in times of rising export orders.

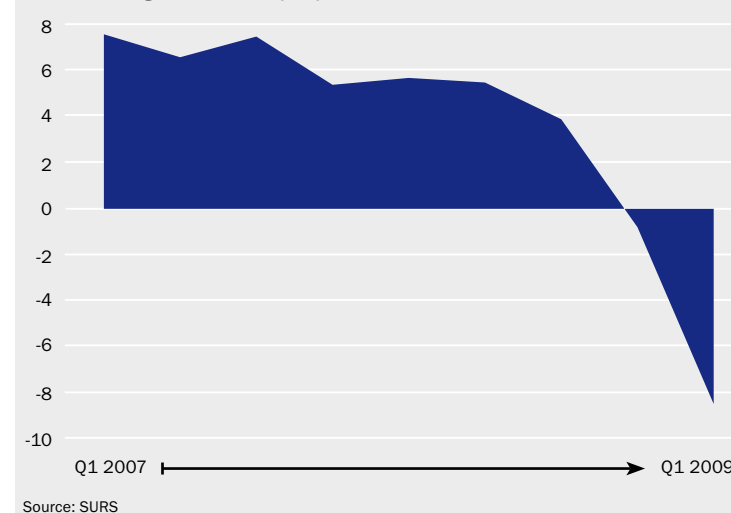
Now that Slovenia's main trading partners, such as Germany and Italy, are deep in recession, exports are also flailing. Many Slovenian firms are tightly integrated into the supply chains of German car manufacturers and capital equipment producers; with Asian growth slowing down as the US consumers retrench, German firms export much less to China than they used to. In an interwoven global economy, a meltdown on the US real estate market can have almost immediate consequences for a medium-sized enterprise supplying car seat covers to German car giants.

It seems that with households squeezed between the credit crunch and rising unemployment, and firms faced with falling orders, only the government is willing to spend more. However, there is a limit to government spending; bonds are increasingly hard to sell

and the budget deficit is rising fast. The economy is in for a hard landing in any case. Just how hard is it going to be depends largely on events outside of Slovenian policymakers' control. Which is, again, hardly a consolation. ■

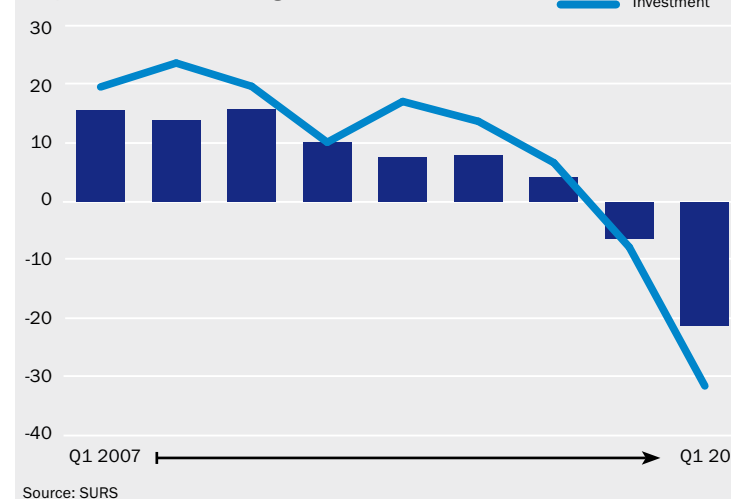
Slovenia's current account deficit jumped from 1.7 percent of GDP in 2005 to 5.9 in 2008.

Falling off a cliff
economic growth, in %, y-o-y



Source: SURS

Ouch!
export and investment growth, in %



Source: SURS

Interview: Erhard Busek

"I Miss Closer Cooperation"

Erhard Busek, PhD., former chief of the Austrian Christian Conservative People's Party and vice-chancellor of Austria between 1991 and 1995, is also a well known figure in Slovenia. He is a recognized Balkan expert, thanks to his work as former special co-ordinator of the Stability Pact for South Eastern Europe. We caught up with him on the occasion of the IEDC-sponsored conference "Leading in Crisis: Challenges and Opportunities for Europe."

By Simon Demšar



► You are one of the most prominent experts on the western Balkans region. How do you evaluate the political situation in the region? Do you see the spirit of nationalism re-emerging?

Having observed the western Balkans for a very long time, I have to say that the political situation is comparatively very stable in the region. In Europe, in general there is a kind of nationalism, but it has to be said that it is more national ego than nationalism. There are some bilateral problems or some unsolved questions, such as the Hungarian minority in Romania or something similar, which is creating a wrong impression.

► The economic crisis will hit the region hard. What measures could the Western Balkans coun-

tries take to fight it?

In comparison to other parts of the world, the economic crises in the region have been handled quite well. To be quite direct: the region is trained in handling crises; if it is falling, it is not so far to reach the bottom as in some western countries. Measures were taken by individual countries, but what I miss is really closer regional cooperation, because the requests for investment and infrastructure are a common issue, which might be useful in fighting the situation.

► Do you think the economic turmoil will postpone the entry of these countries in the EU?

No. What really delays entry are the bilateral problems and the hesitation to fulfil the conditions of the *acquis communautaire*.

► Bosnia-Herzegovina can hardly be called a normally functioning state. In your view, what are its biggest challenges?

The answer is in the question: the biggest challenge is for Bosnia-Herzegovina to be a state.

► Do you think the disagreements over the sea border between Croatia and Slovenia are just political posturing or are there real economic interests involved?

The disagreements between Croatia and Slovenia have some real interest in the background but mainly they are more psychological. To be blunt: I have the impression that the whole question is psycho-pathological.

► In your view, which country of the region has the greatest potential in terms of economic growth?

Croatia has already done a lot, but I am sure that Serbia also has huge possibilities of improving. Bosnia-Herzegovina and partly Albania are quite away back. Montenegro is coming up and Macedonia is blocked by political difficulties.

► Away from the Balkans, how much do you think can conferences such as this one in Bled contribute to practical solutions?

Leadership is extremely important in the present time. To create concern about missing leadership and to show the way to go - this is a great contribution of the Bled conference. The situation in the region is not only one where politicians are responsible; it also concerns the business community, scientists and the civil society. ■