

**BANKA
SLOVENIJE**

EVROSYSTEM



SUMMARY OF MACROECONOMIC DEVELOPMENTS

OCTOBER 2021

Title: Summary of macroeconomic developments
No.: October 2021

Published by: BANKA SLOVENIJE
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The figures and text herein may only be used or published if the source is cited.
Analysis is based on data available up to 15 October 2021. The content of the report was discussed at the Banka Slovenije Governing Council meeting on 19 October 2021.

This publication is also available in Slovene.

Summary of macroeconomic developments, October 2021

Following the strong economic performance in the second quarter, which was largely driven by private consumption as the containment measures were relaxed, GDP growth remained high in the euro area in the third quarter. However, the euro area is facing certain problems in supply chains, while inflation has also been driven upwards by rising energy prices. The economic recovery thus lost momentum during the third quarter, although the economic sentiment remained high, despite the supply-side disruptions. With the strong economy the situation on the labour market is improving and firms are increasingly reporting labour shortages. Nonetheless, wage growth remains moderate for now and the cost competitiveness of the euro area is favourable. This was at least partly reflected in the rising current account surplus, which is indicative of the room for additional strengthening of domestic consumption. Inflation is temporarily elevated, driven mostly by rising energy prices, and partly by constraints on the supply side. The effects of administrative measures are also evident. Inflation in the euro area stood at 3.4% in September, while long-term market inflation expectations were also slightly higher. Our assessment remains that the current spike in inflation is temporary, given the number of temporary factors at work, although the risks of continuing inflation are rising.

Greater volatility has been evident on the global financial markets since the spring of this year, but the financing conditions remain highly favourable. Given the increased uncertainty surrounding the impact of the renewed spread of the epidemic, borrowing costs on the debt security markets fell during the summer, followed by a rise in September that took them back to the level seen before July. The rise was driven primarily by the temporary rise in inflation and the expectations that certain major central banks would respond by gradually dialling back the accommodative stance of monetary policy. The financing conditions in the euro area nevertheless remained highly favourable in October for the public and the private sector alike. Within the Eurosystem, we decided to maintain our strongly accommodative monetary policy, while remaining alert to current inflationary pressures.

After a rapid rebound in the first half of the year, growth also slowed slightly in the domestic economy. The earlier lifting of containment measures saw the recovery in Slovenia begin more quickly this year than in the euro area overall. GDP in the second quarter was up 16.3% in year-on-year terms, which ranks Slovenia in the top half of euro area countries in terms of economic growth. Later in the year growth slowed slightly, as capacity utilisation is high, and the pre-crisis level of activity has been reached, while a shortage of intermediate goods and skilled workers is increasingly evident, and growth in freight transport has also slowed. Year-on-year growth in card payments, ATM withdrawals and invoices registered with tax authorities remained stable in early October, an indication that private consumption remains consistent. Given the favourable economic developments, our assessment is that this year's economic growth will be higher than forecast in June.

Labour market conditions remain favourable. The workforce in employment reached almost 902,000 in July, its highest figure to date, while registered unemployment declined further in August and September, providing basis for the government's reduced intervention in the labour market. Firms are increasingly hiring

foreign workers, which is easing wage pressures. Evidence that these are not yet elevated comes from the wage dynamics in the private sector, which remain moderate despite this year's rise in the minimum wage. Year-on-year growth in the average gross wage, which stood at 7.1% in July, is still largely being driven by wage increases in the public sector. The temporary lay-off scheme in the private sector preserved employment and consumer purchasing power during the epidemic, while crisis bonuses sharply raised wages in the public sector. The deterioration in cost competitiveness will be at least partly offset by the lifting of the emergency labour market measures and further economic growth.

The growth in domestic demand has reduced the current account surplus this year, and the trend of increase in net saving by the private sector has come to an end. The 12-month current account surplus fell below EUR 3 billion in August, the lowest figure since January 2020. The decline this year has been fuelled by strong nominal growth in merchandise imports. Despite the waning effect of a low base, the year-on-year rate hit 33.0% in August, with growth in import prices becoming an increasingly important factor. The slightly lower growth in exports (25.5%) was largely attributable to volatility in car production caused by parts shortages. The situation facing exporters is expected to become more difficult over the remainder of the year, and manufacturing firms are already reducing their short-term export expectations in light of the disruptions to supply chains. There should be fewer complications in services trade, where exports of business services, construction services, and insurance and pension services have strengthened this year. Exports of travel services will continue to recover as restrictions on border crossings in Europe are lifted, but they remain well down on their pre-crisis level, which is also the main reason for a reduced services trade surplus. The developments in the current account reflect the saving-investment gap of non-financial corporations and households, as this year's growth in private consumption and investment has brought an end to the trend of increase in their net financial assets, although the private sector's surplus saving remains high.

Inflation stood at 2.7% in September, the main factors remaining temporary in nature. Energy price inflation has risen due to positive base effects and the rise in oil prices. At the same time non-energy industrial goods are rising in price, as firms currently have issues with high commodity prices and disruption to supplies of intermediate goods. Rising costs are also being passed through into final prices on the domestic market in the booming economy. After the relaxation of containment measures in the spring, prices of certain services also began to rise, as providers took advantage of the strong demand to cover rising costs and to compensate for last year's losses. Core inflation stood at 1.2% in September. Measured inflation is being reduced by the change in weights for HICP compilation caused by last year's changes in consumption patterns. Under last year's weights, headline inflation would have stood at 3.5% in September, and core inflation at 1.8%. Our assessment is that the current high inflation is temporary in nature, and will therefore be of limited duration, but there are risks of inflation being higher than current expectations.

The fiscal position improved in year-on-year terms in the first half of the year amid the high economic growth. General government revenues grew even more strongly in the second quarter than in the first quarter, thanks to a base effect and a further rise in economic activity, while growth in general government expenditure slowed considerably, which therefore reduced the deficit. The amount of the measures remained large in the first half of the year, but the largest in financial terms expired in June. Various anti-coronavirus measures have

nevertheless remained in place in the second half of this year. Having reached 80.0% of GDP by the end of June, the general government debt is forecast to decline to 78.5% of GDP by the end of the year according to the Ministry of Finance, primarily as a result of economic growth and the utilisation of pre-financing. Fiscal policy faces a challenging period, although the option of deviating from fiscal rules remains in place this and next year. In the wake of their reactivation, governments will also have to provide funding for meeting climate and digital targets, and for implementing other structural reforms. Support for this will also be provided by EU funding for national recovery and resilience plans, within the framework of which Slovenia already received pre-financing in September. In fiscal policy the key remains that the structural position is not deteriorating, and the measures in connection with the epidemic remain temporary.

Given its progressive taxation and high social transfers, income inequality in Slovenia is among the lowest in Europe, and in nominal terms was the same in 2019 as in 2007. But in real terms, taking account of the differing inflation rates across income groups, it has increased slightly. It is also expected to have increased in 2020. Although the official measure of inflation describes the growth in consumer prices being faced by the average consumer, the generalised nature of the measure means that it cannot describe the inflation faced by each individual. Everyone's personal inflation depends on their consumption patterns, which usually correlate with their own income position. Our estimates are that the basket of consumer goods for low-income households has risen more in price than the basket of wealthier households over the last 15 years. The higher inflation is largely attributable to price trends in food and housing. Detailed analysis is provided in a special section at the end of the publication.

Selection of macroeconomic indicators on a monthly basis, Slovenia

	12 m. 'till Jul.19	12 m. 'till Jul.20	12 m. 'till Jul.21	3 m. 'till Jul.20	3 m. 'till Jul.21	2021 May.	2021 Jun.	2021 Jul.	2021 Aug.
Economic Activity									<i>*data for Sep.21</i>
	<i>balance of answers in percentage points</i>								
Sentiment indicator	8.3	-7.0	-2.5	-23.8	6.4	5.8	7.8	5.6	6.4 (4.7*)
- confidence indicator in manufacturing	3.5	-9.3	5.3	-19.0	11.0	12.0	11.0	10.0	10.0 (7.0*)
	<i>year-on-year growth rates in %</i>								
Industry: - total	3.0	-5.1	6.8	-11.0	16.9	22.1	20.4	8.8	8.3
- manufacturing	3.3	-4.6	7.6	-11.0	18.5	24.2	21.9	10.2	9.8
Construction: - total	14.3	-5.0	0.5	-10.5	-1.8	-3.9	7.8	-8.2	-6.8
- buildings	8.7	-9.7	-9.9	-13.1	-22.9	-14.2	-14.7	-36.3	-20.2
Trade and service activities - total	5.9	-6.0	1.5	-10.7	12.8	17.1	14.2	7.8	...
Wholesale and retail trade and repair of motor vehicles and	4.5	-9.0	0.2	-4.0	-2.9	10.3	-4.3	-13.5	...
Retail trade, except of motor vehicles and motorcycles	6.4	-3.1	3.1	-1.0	11.1	12.8	13.2	7.4	...
Other private sector services	5.4	-7.5	0.5	-15.3	16.5	19.9	18.3	11.8	...
	<i>year-on-year growth rates in %</i>								
Labour market									
Average gross wage	3.8	5.2	7.2	6.4	7.0	6.1	7.7	7.1	...
- private sector	4.0	4.2	5.0	4.8	5.3	2.4	7.5	6.1	...
- public sector	4.0	6.6	10.8	8.2	10.4	13.4	8.3	9.3	...
Real net wage ¹	1.5	4.8	6.4	8.6	3.5	1.1	5.1	4.2	...
Registered unemployment rate (in %)	7.9	8.2	8.4	9.2	7.4	7.7	7.3	7.3	...
Registered unemployed persons	-6.9	5.0	3.2	25.4	-19.4	-16.9	-20.5	-21.0	-21.4 (-21.1*)
Persons in employment	3.0	0.7	-0.3	-1.3	1.9	1.5	2.0	2.2	...
- private sector	3.7	0.8	-0.6	-1.7	2.0	1.5	2.2	2.5	...
- public sector	1.1	0.3	0.8	-0.3	1.4	1.5	1.5	1.3	...
	<i>year-on-year growth rates in %</i>								
Price Developments									
HICP	1.8	0.8	0.2	-0.8	2.0	2.2	1.7	2.0	2.1 (2.7*)
- services	2.8	2.6	0.6	1.8	-0.1	-0.2	0.0	-0.2	0.2 (1.2*)
- industrial goods excluding energy	-0.2	0.0	-0.2	-0.5	1.5	1.3	1.2	1.9	1.8 (1.3*)
- food	1.4	2.8	1.1	2.7	0.0	-0.8	0.5	0.1	0.0 (0.9*)
- energy	4.1	-5.9	-2.2	-15.2	14.6	19.7	11.2	13.4	13.8 (15.5*)
Core inflation indicator ²	1.5	1.5	0.3	0.8	0.5	0.5	0.5	0.6	0.7 (1.2*)
	<i>in % GDP</i>								
Balance of Payments - Current Account									
Current account balance	5.9	6.4	6.2	5.4	3.0	2.5	3.0	3.6	2.9
1. Goods	2.8	3.8	3.4	6.5	1.1	-0.2	1.9	1.6	-0.7
2. Services	6.0	5.1	4.1	3.8	3.8	3.1	4.3	3.9	5.2
3. Primary income	-1.7	-1.6	-0.8	-3.8	-1.7	-1.1	-1.9	-2.1	-1.1
4. Secondary income	-1.1	-1.0	-0.5	-1.1	-0.1	0.7	-1.3	0.2	-0.5
	<i>nominal year-on-year growth rates in %</i>								
Export of goods and services	6.6	-7.1	6.0	-16.5	21.1	35.2	22.3	9.2	27.2
Import of goods and services	7.1	-8.2	8.2	-17.6	31.4	42.3	32.7	21.3	32.7
Public Finances									
	2019	2020	12 m. 'till Aug.21	2020 Jan.-Aug.	2021 Jan.-Aug.				
Consolidated general government (GG) balance ³	<i>EUR milions</i>		<i>% GDP</i>	<i>y-o-y, %</i>	<i>EUR mio</i>	<i>y-o-y, %</i>	<i>EUR mio</i>	<i>y-o-y, %</i>	
Revenue	19,232	18,529	40.7	8.1	12,006	-3.8	13,751	14.5	
Tax revenue	17,179	16,460	36.0	8.0	10,681	-4.8	12,185	14.1	
From EU budget	731	730	1.6	7.8	403	-0.9	456	13.2	
Other	1,323	1,338	3.1	9.3	923	8.5	1,110	20.3	
Expenditure	18,969	22,071	47.4	13.5	14,252	15.1	15,822	11.0	
Current expenditure	8,228	9,128	20.1	16.4	5,870	7.2	6,779	15.5	
- wages and other personnel expenditure	4,470	4,965	11.3	16.7	3,361	12.4	4,044	20.3	
- purchases of goods, services	2,728	3,021	6.5	16.7	1,787	3.7	2,024	13.3	
- interest	791	778	1.5	-5.2	610	-3.2	564	-7.6	
Current transfers	8,704	10,868	22.7	10.3	7,345	26.4	7,771	5.8	
- transfers to individuals and households	7,324	8,251	18.2	14.4	5,518	12.0	6,321	14.6	
Capital expenditure, transfers	1,527	1,549	3.5	14.1	699	-1.5	881	25.9	
GG surplus/deficit	263	-3,542	-6.8		-2,246		-2,071		

Note: Economic activity data are working day adjusted (with exception of sentiment and confidence indicators data, which are seasonally adjusted). Other data in the table are original. Monthly activity indicators for industry, construction and services are shown in real terms.

¹ HICP deflator. ² Inflation excluding energy, food, alcohol, tobacco. ³ Consolidated central government budget, local government budgets and social security funds (pension and disability insurance fund and health insurance fund) in cash accounting principle.

Source: SORS, Banka Slovenije, Ministry of finance, Banka Slovenije calculations.