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SUMMARY OF MACROECONOMIC DEVELOPMENTS

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Summary of macroeconomic developments, July 2020

The world is facing a deep economic, health and social crisis due to the Covid-19 pandemic. According to the latest OECD figures, this year's decline in global GDP is estimated to be significantly larger than during the financial crisis of 2008 and 2009, and the estimates for the euro area are particularly negative. Although the euro area countries have varied in terms of the length and severity of their containment measures, they will all be in recession this year. They mostly began to loosen the containment measures in May, but as expected the recession in the euro area deepened in the second quarter of this year, as suggested by a number of high-frequency indicators. The outlook for the recovery improved slightly in June, as the composite PMI rose sharply. According to a European Commission survey, there was also an improvement in firms' expectations of demand in the third quarter. There are thus signs of a recovery in the second half of the year, but given the considerable uncertainty surrounding the further spread of the virus, it could be weak and very gradual. Due to the sharp downturn in the economy, the huge uncertainty and the increased deflationary pressures, the Eurosystem expanded the envelope of its pandemic emergency purchase programme (PEPP) by an additional EUR 600 billion and extended the horizon to at least June 2021, while additional measures were also taken by the Fed amid the struggles of the US economy. Inflation in euro area countries remained heterogeneous during the crisis.

According to the short-term indicators, the decline in domestic economic activity was largest in April, as expected, and slightly more encouraging signs of recovery in the third quarter had begun to appear in June. The composite economic indicator in April was down approximately 25% in year-on-year terms. Despite methodological differences, this accords reasonably well with the estimated decline in value-added in the initial scenarios of Bank of Slovenija's most recent economic projections, and is significantly larger than at the lowest point of the crisis in 2009, primarily as a result of the pronounced shock in the service sector. The fall in foreign trade was also larger in April than at that time. Despite the lifting of restrictions and the introduction of anti-crisis measures, the situation remained aggravated over the remainder of the second quarter. Firms and households were again less pessimistic in June, but their confidence remained below the average levels seen during the crisis in 2009. A number of alternative high-frequency indicators also remained down in year-on-year terms. The outlook for the third quarter is more favourable for now: according to a SORS survey, firms are expecting a significant increase in demand, while household consumption is likely to be less constrained.

The shock in economic activity has also brought a sharp downturn on the labour market. Having recorded positive growth in March, the workforce in employment excluding self-employed farmers was already down 1% in year-on-year terms by April. Given the nature of the containment measures, the largest shock was seen, as expected, in services where direct contact between the consumer and the provider is essential. The workforce in employment in accommodation and food service activities was down more than 10% in April. An even larger downturn was prevented by the emergency measures, and the number of registered unemployed in June actually declined slightly from May. It nevertheless stood at more than 89,000 and was up 26.3% in year-on-year terms. Here it should be noted that the emergency measures are impeding insight into the actual situation on

the labour market, as they are having a strong impact on employment and wage statistics. Growth in the average wage thus stood at more than 10% in April, but due to the situation this figure is not particularly representative. The outlook for the remainder of the year is not too optimistic: according to surveys of firms, the downturn on the labour market is expected to continue.

Like a number of other euro area countries, Slovenia found itself in deflation in the second quarter of this year. It stood at 0.8% in June, less than in April and May, albeit primarily as a result of the expiry of the government ordinance cutting electricity prices. The year-on-year falls in energy prices remained a major factor in the deflation, and energy prices are being held low by excise duty policy. For the third consecutive month, energy prices remained the main factor of the inflation gap between Slovenia and the euro area, which was positive in June, at 0.3%. Prices of industrial goods also fell during the epidemic, and service price inflation slowed further, reducing core inflation to below 1%. This was driven by the sell-off of inventories, and weakened inflationary pressures from the foreign and domestic environments. Here it should be noted that the data on services prices was less reliable in April, owing to difficulties in measurement. During the epidemic, only food prices rose significantly. Amid the decline in consumption, inflation will remain weak over the remainder of the year, leaving aside the huge uncertainty surrounding the possible renewed spread of the epidemic. Firms' expectations with regard to future growth in selling prices have also declined sharply. Further evidence of the increased uncertainty in price developments comes from the wider divergence in consumers' inflation expectations.

The contraction in the economy and the pronounced anti-crisis measures have brought a significant deterioration in the fiscal situation. The deterioration in the public finances is especially evident in the cash flow figures, according to which the consolidated general government deficit over the first five months of the year amounted to EUR 1.4 billion. General government balance was already less favourable in the first quarter of this year, but an even larger deterioration came in April and May as the crisis developed. Consolidated general government revenues during the first five months of the year were down EUR 720 million or 9.2% in year-on-year terms, driven largely by reduced inflows of taxes and social security contributions. At the same time the measures to alleviate the economic and social impact of the crisis increased expenditure by EUR 874 million or 11.4%. According to the ESA 2010 methodology, the general government deficit could amount to around 8% of GDP this year, while the general government debt could reach a similar level to 2015, when it stood at 82% of GDP, its highest figure to date. The ratio of debt to GDP will nevertheless remain significantly below the euro area average this year, which the European Commission estimates will exceed 100%.

* * *

The signposted recovery of the Slovenian economy is taking place in a highly uncertain situation. The current estimate of the strength of foreign demand is extremely low, as all foreign trade partners are in recession. It is highly uncertain at the same time, as economies all over the world are facing coronavirus shocks of differing sizes, which are asynchronous, and the pandemic itself is not yet under control. This is exacerbating the dis-

ruption to supply chains, and is delaying the potential investment by the export sector further into the future. The domestic situation is also uncertain. The current situation on the labour market could be rather deceptive when it comes to the depth of the crisis, as the job preservation measures are currently having a beneficial impact, but according to various surveys firms remain pessimistic with regard to future employment. The assessment of labour market indicators has also been made more difficult by the methodological approach of including the anti-crisis measures in the official statistics. It is a similar case with the assessments of firms' financial health, which despite the crisis are not yet showing any increase in financial difficulties compared with February, at least in SORS surveys. The situation is being alleviated by the anti-crisis measures and the high financial reserves of firms, underlining record profits in 2019. Uncertainty prevails also regarding the government's administrative capacity to launch a new investment cycle. There will be plenty of potential domestic and foreign financial resources, but it is uncertain whether they can be used quickly and productively, at least judging by past experience of the utilisation of EU funds.¹

¹ Detailed analysis of the economic situation is given in the Economic and Financial Developments, July 2020, which can be found at <https://bankaslovenije.blob.core.windows.net/publication-files/economic-and-financial-developments-july-2020.pdf>.

Main macroeconomic indicators – Slovenia

| | 12 m. 'till Apr.18 | 12 m. 'till Apr.19 | 12 m. 'till Apr.20 | 3 m. 'till Apr.19 | 3 m. 'till Apr.20 | 2020 Feb. | 2020 Mar. | 2020 Apr. | 2020 May |
|---|--|-----------------------|-----------------------|----------------------|----------------------|--------------|--------------|--------------|-------------------|
| Economic Activity | | | | | | | | | * data for Jun.20 |
| | <i>balance of answers in percentage points</i> | | | | | | | | |
| Sentiment indicator | 13.4 | 10.3 | 0.5 | 8.1 | -12.8 | 4.8 | -3.8 | -39.3 | -32.6 (-24.0*) |
| - confidence indicator in manufacturing | 10.3 | 5.4 | -4.6 | 1.7 | -15.3 | 1.0 | -8.0 | -39.0 | -26.0 (-21.0*) |
| | <i>year-on-year growth rates in %</i> | | | | | | | | |
| Industry: - total | 9.0 | 3.8 | -1.2 | 4.3 | -9.4 | 3.7 | -8.7 | -22.9 | ... |
| - manufacturing | 9.7 | 4.2 | -0.6 | 4.9 | -9.0 | 5.9 | -8.4 | -23.8 | ... |
| Construction: - total | 16.4 | 20.2 | -1.0 | 23.6 | -1.2 | 6.5 | -2.1 | -6.5 | ... |
| - buildings | 22.7 | 15.1 | -2.2 | 22.3 | -6.6 | -9.1 | 3.7 | -14.8 | ... |
| Trade and service activities - total | 6.9 | 7.1 | -2.5 | 5.7 | -14.7 | 0.6 | -14.8 | -28.4 | ... |
| Wholesale and retail trade and repair of motor vehicles and | 14.0 | 9.4 | -8.0 | 6.0 | -33.9 | -4.1 | -39.5 | -54.4 | ... |
| Retail trade, except of motor vehicles and motorcycles | 3.3 | 5.7 | -1.6 | 8.3 | -11.1 | 0.0 | -12.1 | -19.8 | ... |
| Other private sector services | 6.9 | 6.7 | -2.9 | 4.3 | -15.8 | 2.1 | -16.4 | -31.3 | ... |
| | <i>year-on-year growth rates in %</i> | | | | | | | | |
| Labour market | | | | | | | | | |
| Average gross wage | 3.4 | 3.6 | 4.6 | 4.5 | 5.7 | 5.0 | 0.3 | 11.9 | ... |
| - private sector | 3.9 | 3.9 | 4.0 | 4.3 | 4.3 | 6.1 | -1.4 | 8.4 | ... |
| - public sector | 3.4 | 3.6 | 5.8 | 5.3 | 7.7 | 3.2 | 3.5 | 16.3 | ... |
| Real net wage ¹ | 2.1 | 1.1 | 3.1 | 2.2 | 6.5 | 3.5 | 0.9 | 15.1 | ... |
| Registered unemployment rate (in %) | 8.9 | 8.0 | 7.7 | 8.0 | 8.3 | 7.9 | 8.0 | 9.1 | ... |
| Registered unemployed persons | -14.7 | -8.3 | -2.4 | -5.8 | 5.5 | -4.1 | 1.7 | 19.9 | 25.6 |
| Persons in employment | 3.6 | 3.1 | 1.7 | 3.0 | 0.4 | 1.5 | 0.7 | -0.9 | ... |
| - private sector | 4.7 | 3.9 | 2.1 | 3.8 | 0.6 | 2.0 | 0.9 | -1.1 | ... |
| - public sector | 0.7 | 0.9 | 0.7 | 1.1 | 0.1 | 0.3 | 0.2 | -0.1 | ... |
| | <i>year-on-year growth rates in %</i> | | | | | | | | |
| Price Developments | | | | | | | | | |
| HICP | 1.5 | 1.9 | 1.5 | 1.5 | 0.4 | 2.0 | 0.7 | -1.3 | -1.4 |
| - services | 1.9 | 2.7 | 2.9 | 3.0 | 2.3 | 2.7 | 2.2 | 1.8 | 2.1 |
| - industrial goods excluding energy | -0.8 | -0.5 | 0.2 | 0.0 | -0.1 | 0.5 | 0.4 | -1.3 | -1.0 |
| - food | 2.5 | 1.6 | 2.5 | 0.6 | 3.7 | 3.4 | 3.6 | 4.0 | 3.9 |
| - energy | 3.4 | 5.5 | -1.6 | 2.6 | -8.9 | 1.1 | -8.4 | -19.1 | -20.8 |
| Core inflation indicator ² | 0.7 | 1.3 | 1.8 | 1.7 | 1.2 | 1.8 | 1.4 | 0.5 | 0.7 |
| | <i>in % GDP</i> | | | | | | | | |
| Balance of Payments - Current Account | | | | | | | | | |
| Current account balance | 6.4 | 5.9 | 7.0 | 5.7 | 7.5 | 9.7 | 6.8 | 6.1 | ... |
| 1. Goods | 3.7 | 2.7 | 3.3 | 3.0 | 5.2 | 6.4 | 4.2 | 5.0 | ... |
| 2. Services | 5.3 | 6.1 | 6.0 | 5.9 | 4.5 | 6.0 | 4.3 | 3.3 | ... |
| 3. Primary income | -1.8 | -1.8 | -1.4 | -1.7 | -1.4 | -1.4 | -1.5 | -1.3 | ... |
| 4. Secondary income | -0.8 | -1.0 | -0.9 | -1.5 | -0.8 | -1.3 | -0.2 | -0.9 | ... |
| | <i>nominal year-on-year growth rates in %</i> | | | | | | | | |
| Export of goods and services | 12.9 | 8.3 | -2.1 | 8.7 | -15.5 | 3.9 | -11.9 | -36.6 | ... |
| Import of goods and services | 12.7 | 8.8 | -3.3 | 9.6 | -18.0 | -0.2 | -12.1 | -39.6 | ... |
| | | | | | | | | | |
| Public Finances | 2018 | 2019 | 12 m. 'till | | 2019 | | 2020 | | |
| | | | May.20 | | Jan.-May. | | Jan.-May. | | |
| Consolidated general government (GG) balance ³ | <i>EUR millions</i> | | % GDP | y-o-y, % | EUR mio | y-o-y, % | EUR mio | y-o-y, % | |
| Revenue | 18,594 | 19,232 | 38.9 | -3.2 | 7,844 | 7.4 | 7,125 | -9.2 | |
| Tax revenue | 16,225 | 17,179 | 34.5 | -1.8 | 7,049 | 7.3 | 6,272 | -11.0 | |
| From EU budget | 796 | 731 | 1.5 | -19.3 | 348 | 21.2 | 309 | -11.2 | |
| Other | 1,572 | 1,323 | 3.0 | -9.7 | 447 | 0.1 | 544 | 21.6 | |
| Expenditure | 18,068 | 18,969 | 41.7 | 7.0 | 7,636 | 6.6 | 8,510 | 11.4 | |
| Current expenditure | 7,966 | 8,228 | 17.9 | 5.0 | 3,423 | 3.9 | 3,691 | 7.8 | |
| - wages and other personnel expenditure | 4,168 | 4,470 | 9.8 | 8.0 | 1,788 | 8.8 | 1,974 | 10.4 | |
| - purchases of goods, services | 2,634 | 2,728 | 6.0 | 5.6 | 1,044 | 5.7 | 1,156 | 10.7 | |
| - interest | 868 | 791 | 1.6 | -3.8 | 523 | -13.2 | 490 | -6.3 | |
| Current transfers | 8,237 | 8,704 | 19.5 | 10.0 | 3,582 | 5.5 | 4,142 | 15.6 | |
| - transfers to individuals and households | 6,926 | 7,324 | 16.1 | 7.8 | 2,998 | 6.1 | 3,323 | 10.9 | |
| Capital expenditure, transfers | 1,432 | 1,527 | 3.3 | 4.0 | 368 | 30.7 | 421 | 14.3 | |
| GG surplus/deficit | 526 | 263 | -2.8 | | 208 | | -1,386 | | |

Notes: 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.

Sources: SORS, Bank of Slovenia, Ministry of finance, Bank of Slovenia calculations.