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Summary of macroeconomic developments, October 2020

The economic recovery in the euro area has lost momentum in the autumn, as a result of the growing deterioration in the epidemiological situation. *After rising between May and July, the PMI slid to 50.4 points in September, while the survey assessments of future demand by firms in trade and other services also declined.The adverse impact on economic activity from the tightening containment measures, which is already being reflected in services, will be even larger in the coming months due to accelerated spreading of the virus. Amid a further downturn on the labour market, the declining confidence of consumers and firms will depress domestic demand, which is likely to make the losses in the euro area economy more pronounced and longer-lived than anticipated in the current forecasts, while deflationary pressures will also increase.*

The crisis in the euro area would be significantly deeper without the countercyclical response from economic policy, the like of which is unprecedented in peacetime. *The fiscal response from euro area countries has been profound: the European Commission has estimated the increase in their general government expenditure at close to EUR 540 billion. At the same time the Eurosystem had injected close to EUR 2,000 billion of additional liquidity into the economy by 25 September of this year via its longer-term refinancing operations and extensive asset purchases, while the European Commission's new multiannual financial framework and the Next Generation EU instrument worth more than EUR 1,800 billion are in the process of being approved. A significant portion of the EU funding will go into investment to mitigate climate change. According to some estimates, the economic restrictions during the coronavirus crisis may have reduced this year's global greenhouse gas emissions by 4% to 7%; the UN estimates that an annual reduction of 7.6% would be needed between 2020 and 2030 to limit the temperature rise to 1.5°C this century.*

The domestic economy continued its rapid recovery in the third quarter, which began immediately after the weakening of the first wave of infections in May, but the outlook has deteriorated sharply again in recent weeks. *The indicators of economic activity for July and August and the survey indicators for September suggest continuing growth in the majority of sectors, and this is confirmed by the econometric estimates of GDP trends. Amid the strong economic policy measures, the response from economic entities to this year's coronavirus crisis going into the autumn was different to the previous crisis: households did not refrain from purchases of durables over the longer term, and firms built up their inventories. At the same time the private sector's financial position remained favourable: there was only a small decline in household disposable income in real terms, while the operating surplus in the corporate sector actually increased slightly amid large government subsidies, and both sectors sharply increased their net saving. However the health picture took a sharp downturn, and with it the outlook for further recovery. The most vulnerable sectors will again be services where direct contact between the provider and customer is essential, while the rising uncertainty will only further delay firms in their investment decisions. This is reducing the probability of the realisation of the baseline scenario from Bank of Slovenia's June economic growth projections.*

The situation on the labour market remained solid as far as September, given the decline in GDP and the high uncertainty. *The monthly falls in employment almost came to a complete stop over the summer, while unemployment also underwent a sustained fall after peaking in May. Registered unemployment stood at 84,000 at the end of September, only 6,000 more than before the declaration of the epidemic, although it is highly likely to rise towards the end of the year. Because the emergency measures prevented most of the contraction in GDP from being transmitted to the labour market, the year-on-year decline of 15.8% in the number of hours worked is perhaps a more pertinent indicator of the situation in the second quarter of this year, rather than the fall in employment of just 1.9%. Firms' survey assessments of employment expectations were mostly positive in September, and were not yet reflecting the deterioration in the epidemiological situation. The impact of the new crisis has so far mainly been felt most acutely by younger generations and workers in precarious employment. Growth in the average monthly wage remains high relative to the level of economic activity, but for methodological reasons it is not reflecting the full developments in employees' purchasing power.*

The situation seems worse in foreign trade than on the domestic market as the recovery stalled over the summer. *Exports of numerous categories of goods stopped growing, while the structure of the year-on-year decline in merchandise imports is indicative of an output gap in manufacturing, in addition to price effects. The restrictions on travel and the changes in people's behaviour are even more of a hindrance to the recovery in services trade. The year-on-year falls in exports of travel services and transport services remained pronounced over the summer months. The loss of export revenues in the two segments had passed EUR 1,240 million by August of this year. Given the rising number of coronavirus cases in Europe in recent weeks, the outlook is deteriorating: Slovenia is already one of the euro area countries where the fall in services exports is a major factor in this year's decline in GDP. The 12-month current account surplus remains close to a record high of EUR 3 billion, even after revision. This might indicate weakness in domestic demand, but equally might also indicate the economy's high capacity to service its external debt and to maintain its external competitiveness. With regard to the latter, it should be noted that amid otherwise relatively favourable price developments, it could soon come under rising pressure from unit labour costs, which are already far removed from the euro area and EU averages.*

Deflation continued in September. *The largest factor in the year-on-year fall in prices of 0.7% was again a fall in prices of refined petroleum products, which have been maintained at low levels in recent months by a countercyclical excise duty policy. In the wake of slower growth in global prices of food commodities, food price inflation has also slowed since May, but nevertheless remains high, primarily on account of year-on-year rises in prices of fresh fruit. There are also domestic deflationary pressures in the form of weaker private consumption and diminishing utilisation of production capacity, which are reducing core inflation, which in the environment of weak demand is yet to feel any impact from rising unit labour costs. Core inflation stood at just 0.3% in September, service price inflation having fallen sharply this year. The euro area saw deflation of 0.3% in September, with core inflation at just 0.2%, as inflation was further reduced by countercyclical tax measures, most notably in Germany from the perspective of the impact on the aggregate figure. Price developments over the remainder of the year remain highly uncertain, given the spread of the pandemic and the resulting tightening of containment measures, and the chances of continuing deflation are substantial. Price measurement and inflation analysis will also be hindered, at least in part.*

The pandemic is having a huge impact on the public finances, and future fiscal developments are subject to numerous risks and uncertainties. *The general government deficit in the first half of this year amounted to 11.0% of GDP. General government revenues declined by slightly more than nominal GDP, while growth in general government expenditure was high, largely as a result of the measures under the anti-coronavirus laws. The general government debt amounted to 78.2% of GDP at the end of June, up 12.6 percentage points on the end of last year. The terms of borrowing remained favourable, thanks to the highly accommodative monetary policy, and also the solidity of Slovenia's macroeconomic position compared with many euro area countries, which is also a positive factor in its sovereign credit rating. The Ministry of Finance is forecasting a general government deficit of 8.6% of GDP for this year, with only a gradual reduction in the following years. The ratio of government debt to GDP is also expected to decline slowly: according to current estimates, the debt is forecast to reach 82.4% of GDP by the end of the year. Whether additional measures are needed to support the economy, and how long the fiscal consolidation will take, will depend on the epidemiological picture and the resulting economic situation.*

Main macroeconomic indicators

	2017	2018	2019	19Q4	20Q1	20Q2	2017	2018	2019	19Q4	20Q1	20Q2
			Slovenia						*euro area*			
Economic developments						*y-o-y growth rates in %*						
GDP	4.8	4.4	3.2	2.0	-2.4	-13.1	2.6	1.8	1.3	0.9	-3.0	-14.9
- industry	7.0	2.9	6.1	5.0	-0.9	-16.0	3.4	1.6	-1.0	-1.7	-4.8	-18.4
- construction	7.1	8.1	7.1	2.0	1.6	-9.8	2.6	2.8	3.1	1.2	-2.0	-14.7
- mainly public sector services	1.9	1.8	1.5	0.9	0.0	-4.1	1.1	1.0	1.1	1.0	-1.3	-8.5
- mainly private sector services	5.7	4.8	3.8	2.0	-1.4	-14.5	3.0	2.1	1.3	0.8	-3.0	-16.0
Domestic expenditure	3.9	5.0	3.4	1.0	-3.4	-12.8	2.3	1.8	1.9	1.3	-1.6	-14.2
- general government	0.4	3.0	1.7	-0.3	4.2	-0.9	1.1	1.1	1.8	1.8	0.8	-2.5
- households and NPISH	1.9	3.6	4.8	2.3	-6.4	-17.4	1.8	1.5	1.3	1.2	-3.6	-16.0
- gross capital formation	13.6	10.3	1.5	-1.3	-3.0	-12.1	5.0	3.2	3.4	1.1	1.3	-20.4
- gross fixed capital formation	10.2	9.6	5.8	-1.2	-5.4	-16.5	3.8	3.1	5.7	4.6	1.8	-20.9
- inventories and valuables, contr. to GDP growth in pp	0.8	0.3	-0.9	0.0	0.4	0.9	0.3	0.0	-0.5	-0.8	-0.1	0.1
Labour market												
Employment	3.0	3.2	2.5	1.8	1.2	-1.9	1.6	1.5	1.2	1.1	0.4	-3.1
- mainly private sector services	3.1	3.4	2.6	1.8	1.0	-2.7	1.8	1.6	1.2	1.0	0.2	-4.2
- mainly public sector services	2.5	2.2	1.8	1.9	2.1	1.8	1.1	1.2	1.5	1.5	1.2	0.3
Labour costs per employee	3.0	3.9	4.9	4.1	3.1	-1.8	1.7	2.2	1.9	1.5	0.6	-4.5
- mainly private sector services	3.0	4.1	4.5	3.5	2.7	-5.3	1.7	2.3	1.8	1.3	-0.1	-6.8
- mainly public sector services	3.1	3.3	6.6	6.6	6.1	6.6	1.9	2.0	2.2	2.1	2.5	1.1
Unit labour costs, nominal*	1.2	2.8	4.2	3.9	6.9	11.0	0.7	1.9	1.9	1.8	4.2	8.6
Unit labour costs, real**	-0.3	0.6	1.9	1.5	4.1	8.5	-0.4	0.5	0.1	-0.1	2.2	6.1
						in %						
LFS unemployment rate	6.6	5.1	4.5	4.0	4.6	5.2	9.1	8.2	7.6	7.4	7.5	7.3
Foreign trade						*y-o-y growth rates in %*						
Current account balance as % of GDP***	6.2	5.8	5.6	5.6	5.9	5.9	3.1	2.9	2.3	2.3	2.0	2.2
External trade balance as contr. to GDP growth in pp	1.2	-0.2	0.1	1.1	0.7	-1.5	0.4	0.2	-0.5	-0.4	-1.5	-1.1
Real export of goods and services	11.1	6.3	4.1	1.1	-0.9	-23.5	5.5	3.6	2.5	1.9	-2.9	-21.7
Real import of goods and services	10.7	7.2	4.4	-0.3	-1.9	-24.4	5.1	3.6	4.0	3.0	0.2	-20.8
Financing						*in % of GDP*						
Banking system's balance sheet	93.9	88.4	88.0	88.0	90.0	95.0	260.3	256.3	261.2	261.2	280.2	295.5
Loans to NFCs	21.8	20.6	19.9	19.9	20.2	20.7	36.9	36.4	36.1	36.1	36.6	39.4
Loans to households	21.5	21.7	22.0	22.0	22.0	22.4	49.3	49.0	49.2	49.2	49.6	51.4
Inflation						*in %*						
HICP	1.6	1.9	1.7	1.6	1.6	-1.2	1.5	1.8	1.2	1.0	1.1	0.2
HICP excl. energy, food, alcohol and tobacco	0.7	1.0	1.9	1.9	1.6	0.6	1.0	1.0	1.0	1.2	1.1	0.9
Public finance						*in % of GDP*						
Debt of the general government	74.1	70.3	65.6	65.6	69.0	78.2	87.6	85.7	84.0	84.0	86.2	...
One year net lending/net borrowing of the general government***	0.0	0.7	0.5	0.5	-0.8	-4.7	-1.0	-0.5	-0.6	-0.6	-1.0	...
*- interest payment****	2.5	2.0	1.7	1.7	1.7	1.7	1.9	1.8	1.6	1.6	1.6	...
*- primary balance****	2.5	2.7	2.2	2.2	0.9	-3.0	1.0	1.4	1.0	1.0	0.6	...

Notes: Data is not seasonally and working days adjusted.
** Nominal unit labour costs are the ratio of nominal compensation per employee to real labour productivity.*
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**** 4-quarter moving sum.*
Source: SORS, Eurostat, Bank of Slovenia, ECB, Ministry of Finance, Bank of Slovenia calculations.