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Summary of macroeconomic developments, January 2022

Despite the scale of the pandemic, activity indicators in the euro area were at high levels at the end of last year, but the risks remain significant. *Firms saw their business conditions become more challenging, which was reflected for example in the composite PMI and the economic sentiment indicator, although they are both still above their pre-crisis levels. After two quarters when quarterly growth stood at more than 2%, economic activity in the euro area is likely to have slowed in the final quarter of last year, which can be primarily attributable to difficulties in private-sector services as the containment measures were gradually tightened. The situation varied greatly from sector to sector: the aggregate confidence indicators in manufacturing and in construction reached their highest levels to date in December, despite shortages of raw materials and semi-finished products, and a rise in production costs. Production is also hampered by labour shortages amid falling unemployment, and in the short term by absences from work caused by the record case numbers under the omicron wave. In a situation of surplus demand and strong price pressures in the international environment, inflation in the euro area reached 5.0% in December, the highest figure to date. The Eurosystem's December projections expect GDP growth in the euro area to reach 4.2% this year, and 2.9% in 2023, while inflation should slow to 1.8% over the same period. These projections are again accompanied by major risks and uncertainties.*

The mood on the financial markets in the final quarter of last year mainly reflected the faster scaling-back of accommodativeness by central banks, which is also being signalled by the ECB, although its monetary policy stance remains among the more supportive in the eyes of market participants, compared with other central banks in advanced economies. *Market interest rates in the euro area rose further, and suggest that the financial markets see a possibility of emerging from the negative interest rate environment significantly more quickly than was anticipated before the pandemic. The rise in borrowing costs for the government sector and the private sector was moderate in the euro area in the final quarter of last year, and the level reached in the early part of this year was still comparable to before the pandemic. The financing conditions for euro area businesses remain sufficiently supportive, and with them the conditions for economic growth. This is also being reflected in bank lending to the non-banking sector, which was up 3.3% in year-on-year terms in November. The high growth and volatility in energy futures prices in the final quarter of last year are indicative of the significant uncertainty surrounding future developments in prices. Market participants are nevertheless still expecting annual euro area inflation to fall to just below 2.0% over the medium term, i.e. from 2023, in line with the latest Eurosystem projections.*

According to current figures, the adverse impact on the domestic economy from the deterioration in the epidemiological situation is relatively small for now, but the risks are significant. *The economic growth in Slovenia has been slowing since it regained its pre-crisis level of GDP, and amid heavy government investment is being driven markedly by domestic demand, which is significantly stronger than the euro area average. Growth in exports also remains high. Despite rising indicators of labour shortages and disruptions to supply chains, the monthly activity indicators mostly remained encouraging over the autumn, as only a small*

number of sectors were genuinely affected. The economic sentiment improved in December, and firms' assessments of the strength of demand were again high. Activity continued to rise going into the new year: the total value of card payments and ATM withdrawals, and freight vehicles' mileage on domestic motorways remain well above their pre-crisis levels. Our assessment is that the macroeconomic risks remain significant: case numbers have reached record levels, making absence from work a burning issue, while many firms have been hit hard by high energy costs. The surge in inflation might also depress private consumption, with the average gross wage already showing zero year-on-year growth in real terms in October.

With employment at a record high, labour shortages are increasingly evident in the domestic economy. *The number of persons in employment again reached a record high in November, and rising employment is evident in almost all sectors. With domestic unemployment falling fast, firms are increasingly seeking to hire foreign nationals, who last autumn accounted for approximately half of the year-on-year rise in the number of persons in employment excluding self-employed farmers. The increased hiring of foreign workers is mitigating the adverse effects of the structural imbalances on the domestic labour market, and is consequently reducing wage pressures. Year-on-year growth in the average gross wage slowed, following the reductions in crisis bonuses in the public sector. It stood at 3.6% in October, although wage growth in the private sector remained above 5%, more than 2 percentage points higher than in 2019. With employment rising, and growth in nominal average wages persisting at high levels, year-on-year growth in the total wage bill also remained high in the third quarter of last year, at 8.2% according to national accounts figures.*

High import prices and strong domestic demand are being increasingly reflected in the current account. *The merchandise trade surplus over the 12 months to November declined to the level seen in early 2013, when austerity measures had the economy in a phase of fiscal and balance-of-payments consolidation. A major factor in the decline, the largest seen to date, was the high growth in import prices, which left nominal merchandise imports over the first eleven months of last year up fully 27.2% in year-on-year terms. Exports also remained robust after picking up again in November: over the first eleven months of last year they were up 18.2% in year-on-year terms. Only exports of road vehicles remained down on their pre-crisis level, as supply difficulties with components hit the car industry inside and outside Slovenia. Services trade is strengthening sharply at the same time, although due to containment measures the recovery in trade in travel services remains gradual at best, and still subject to considerable uncertainty, at least in the short term. The highlight in factor income is increased outflows for dividends from FDI. The 12-month current account surplus amounted to EUR 1.8 billion in November, down fully EUR 1.5 billion in year-on-year terms. Last year's growth in domestic demand was not only reflected in the current account position, but also in the net financial position of the private sector, as its saving-investment gap began to shift slowly towards investment.*

Inflation stood at 5.1% in December, its highest rate of the last 13 years, with an increasing share of goods in the HICP basket seeing rising prices. *The share of products and services recording inflation of more than 2.0% stood at 61.4% in December, while almost 85% of the consumer basket is now seeing rising prices. Inflation is still being driven mainly by the high energy prices accompanying strong global economic growth and geopolitical tensions. High growth in prices of agricultural products and food commodities drove up food price inflation, the year-on-year rate reaching 3.6% in December. Amid strong domestic demand, prices of non-energy industrial goods are also rising alongside services prices as input costs rise. This is strengthening core inflation, which had reached 2.9% by the end of the year, 0.3 percentage points more than the euro*

area average. Via the weights for calculating the HICP, the official inflation rate is still being held down by the effect of pandemic-induced changes in consumption patterns. Had the weights remained unchanged, headline inflation would have reached 5.9%, and core inflation 3.3%. Despite the signs of more broadly based inflation, our expectation for the second half of the year is for a certain slowdown due to easing excess demand, strong base effect, and resolving issues in supply chains and in the energy markets.

The general government deficit and debt are declining as a ratio to GDP, although the debt is significantly higher than in 2019 in nominal terms. *The general government deficit over the first nine months of last year amounted to 5.2% of GDP, down 1.8 percentage points in year-on-year terms. Growth in general government revenues was high at almost 11%, thanks to strong economic growth driven largely by booming final consumption, and high increase in employment and wages. Growth in general government expenditure was around 4 percentage points lower. Growth in government investment was high at 26%, and the year-on-year rate hit approximately 40% in the third quarter. The volume of the anti-coronavirus measures in the second half of the year was smaller than in the first half, following the expiry of the largest measures in June. According to the Ministry of Finance's estimates, the general government debt reached 77.5% of GDP at the end of last year. This was down 7.5 GDP percentage points on its peak in the first quarter of last year, thanks to economic growth, although the nominal debt remains significantly higher than before the pandemic. Amid pronounced monetary policy support, borrowing during the pandemic was undertaken under very favourable terms, which is reducing the interest payment burden despite the nominally higher debt.*

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Analysis of the impact on the financing conditions in euro area countries from the central bank asset purchase programmes has also been drawn up. *It confirms their effectiveness, and highlights the transmission channels. The monthly envelope of the APP already stood at EUR 20 billion before the pandemic, and in April 2020 the Governing Council of the ECB added the pandemic emergency purchase programme (PEPP), with a total envelope of EUR 1,850 billion. Both aim to ensure that the right monetary policy stance is maintained, while the PEPP also targets homogenous monetary policy transmission throughout the euro area. Our assessments are that the two programmes have successfully supported an accommodative monetary policy. The announcement and implementation of asset purchases reduced risk premiums and interest rate expectations, consequently reducing real required yields on euro area bonds. At the same time they also encouraged a rise in inflation expectations, although the effect of depressing real yields was larger, which meant that nominal required yields were also reduced. All these effects contribute to push the medium-term inflation outlook towards its new symmetrical target of 2%. Conversely, if monetary policy has to respond to high inflation in line with the forward guidance, the reduction in net purchases and later the ending of the reinvestment of maturing principal will help to raise required yields, and will thus contribute significantly to reducing inflation.*

Selection of macroeconomic indicators on a monthly basis, Slovenia

	2019	2020	12 m. 'till Oct.21	3 m. 'till Oct.20	3 m. 'till Oct.21	2021 Aug.	2021 Sep.	2021 Oct.	2021 Nov.	2021 Dec.
Economic Activity										
					balance of answers in percentage points					
Sentiment indicator	6,0	-11,8	-0,1	-5,2	4,5	6,5	4,7	2,3	3,1	5,0
- confidence indicator in manufacturing	0,3	-8,6	6,9	1,0	7,3	11,0	8,0	3,0	6,0	10,0
					year-on-year growth rates in %					
Industry: - total	2,8	-6,4	8,9	-2,1	7,1	7,4	8,1	5,9	10,1	...
- manufacturing	3,2	-6,2	10,3	-2,1	8,5	9,3	10,2	6,4	11,5	...
Construction: - total	3,4	-0,7	-2,0	2,8	-5,8	-7,5	0,8	-10,6	-17,3	...
- buildings	0,1	-7,8	-16,5	-3,2	-26,6	-18,6	-26,9	-33,0	-38,4	...
Trade and service activities - total	2,5	-9,7	6,5	-6,0	13,1	11,6	11,8	15,7	...	...
Wholesale and retail trade and repair of motor vehicles and	2,7	-14,5	0,1	-3,1	-3,2	-3,7	-1,8	-3,9	...	...
Retail trade, except of motor vehicles and motorcycles	3,5	-5,9	8,0	-2,7	15,9	9,6	15,0	23,1	...	...
Other private sector services	2,3	-11,6	6,7	-8,0	15,5	15,3	13,0	18,2	...	...
Labour market					*year-on-year growth rates in %*					
Average gross wage	4,3	6,0	7,0	4,9	4,2	4,8	4,1	3,6	...	...
- private sector	3,9	4,5	5,4	4,4	6,0	6,0	6,2	5,7	...	...
- public sector	5,4	7,9	9,8	5,3	1,6	3,4	1,0	0,5	...	...
Real net wage[1]	2,0	7,1	5,0	6,3	0,8	2,1	0,7	-0,4	...	...
Registered unemployment rate (in %)	7,7	8,7	8,0	8,8	6,9	7,1	6,8	6,8	6,7	...
Registered unemployed persons	-5,5	14,6	-6,5	19,6	-20,9	-21,4	-21,1	-20,3	-22,3	-24,4
Persons in employment	2,5	-0,6	0,6	-1,2	2,3	2,3	2,2	2,4	2,7	...
- private sector	3,0	-0,9	0,5	-1,7	2,7	2,6	2,5	2,9	3,2	...
- public sector	1,0	0,1	1,0	0,3	1,2	1,3	1,1	1,2	1,3	...
Price Developments					*year-on-year growth rates in %*					
HICP	1,7	-0,3	1,0	-0,7	2,8	2,1	2,7	3,5	4,9	5,1
- services	3,1	1,8	0,5	1,4	1,0	0,2	1,2	1,4	1,6	1,6
- industrial goods excluding energy	0,3	-0,5	0,4	-0,6	1,6	1,8	1,3	1,7	3,9	4,4
- food	1,6	2,8	0,5	2,7	0,5	0,0	0,9	0,5	1,4	3,6
- energy	0,8	-10,8	5,1	-12,4	16,7	13,8	15,5	20,7	25,1	20,8
Core inflation indicator[2]	1,9	0,8	0,4	0,5	1,2	0,7	1,2	1,6	2,7	2,9
Balance of Payments - Current Account					*in % GDP*					
Current account balance	6,0	7,4	4,1	9,1	2,3	2,5	1,1	3,3	-0,9	...
1. Goods	2,7	5,0	1,7	5,1	-1,2	-1,4	-2,5	0,3	-3,1	...
2. Services	6,0	4,3	4,3	5,0	5,6	5,4	6,0	5,4	5,2	...
3. Primary income	-1,7	-0,9	-1,0	-0,3	-1,3	-1,0	-1,5	-1,5	-1,5	...
4. Secondary income	-1,1	-1,0	-0,9	-0,7	-0,8	-0,5	-1,0	-1,0	-1,3	...
					nominal year-on-year growth rates in %					
Export of goods and services	4,5	-10,1	14,2	-8,8	21,7	28,2	22,5	16,1	24,0	...
Import of goods and services	4,0	-11,7	20,1	-11,2	33,4	34,4	38,1	28,3	34,2	...

Public Finances Consolidated general government (GG) balance[3]	2019	2020	12 m. 'till Nov.21		2020 Jan.-Nov.		2021 Jan.-Nov.	
	EUR milions		% GDP	y-o-y, %	EUR mio	y-o-y, %	EUR mio	y-o-y, %
Revenue	19.232	18.529	41,3	11,9	16.888	-3,0	19.290	14,2
Tax revenue	17.179	16.460	36,4	11,3	15.044	-3,9	17.025	13,2
From EU budget	731	730	1,7	8,1	623	15,6	774	24,1
Other	1.323	1.338	3,2	21,6	1.221	0,1	1.492	22,2
Expenditure	18.969	22.071	47,5	12,6	19.483	14,1	21.492	10,3
Current expenditure	8.228	9.128	20,1	15,6	8.061	7,9	9.123	13,2
- wages and other personnel expenditure	4.470	4.965	11,3	17,4	4.525	10,5	5.314	17,4
- purchases of goods, services	2.728	3.021	6,4	13,6	2.565	5,8	2.805	9,3
- interest	791	778	1,4	-5,9	765	-1,7	719	-6,0
Current transfers	8.704	10.868	22,4	7,6	9.828	23,6	10.346	5,3
- transfers to individuals and households	7.324	8.251	18,0	12,2	7.551	12,4	8.451	11,9
Capital expenditure, transfers	1.527	1.549	3,7	28,7	1.114	-4,3	1.466	31,6
GG surplus/deficit	263	-3.542	-6,2		-2.595		-2.202	

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.