REPUBLIC OF SLOVENIA
FISCAL COUNCIL

Public finance and macroeconomic developments

July 2022

Drawn up by the Fiscal Council's Analysis Service

Ref. No.: 30-2/2022/2

Data available up to and including 5 July 2022 were used.

The present document contains an analysis of fiscal trends in the general government sector in accordance with the European System of Accounts methodology (ESA, 2010), also used for the monitoring of EU fiscal rules, which are published quarterly as national accounts statistics by SORS. It also follows trends in the state budget, local government budgets, the pension insurance fund (ZPIZ) budget and the health insurance fund (ZZZS) budget in accordance with the IMF methodology for monitoring government finance statistics (GFS) based on the cash flow principle, which are published on a monthly basis by the Ministry of Finance.

The comments on the state budget implementation (Section 2) refer to the daily data available at:
https://proracun.gov.si/#.

Summary

Public finance position continues to improve gradually on the back of strong revenue growth, coupled with a rapid recovery in economic activity and the withdrawal of support to mitigate the effects of the epidemic, while the rest of public spending is growing markedly. For the time being, heightened macroeconomic risks are mainly reflected in the worsening economic outlook and an increase in pessimism. At present, economic activity remains broadly favourable, although labour market imbalances are deepening and the current account surplus is shrinking rapidly. At the same time, inflation is rising and becoming more broad-based. A key short-term economic policy challenge is to mitigate the consequences of inflation, where the measures taken so far are broad and, to a certain extent, inadequate from a long-term perspective, as they reduce dedicated resources for the green transition. The challenges of achieving long-term sustainability, in particular the health and pension funds, have been highlighted again more clearly thanks to recent measures. Despite the reduction, the government debt-to-GDP ratio remains higher than before the epidemic, with some manoeuvring room to cope with the already existing tightening of financing conditions, notably in the form of a very favourable balance in the treasury account. The autumn budgetary documents should provide for a slightly restrictive fiscal policy in the coming years, which would open room for action were significant current risks to be realized, and indicate the course of action to address the relatively high medium- and long-term risks to the sustainability of Slovenia's public finances.

* * *

The general government deficit was significantly lower in the first quarter of this year (-3.1% of GDP) than in the same period last year (-7.9% of GDP). Under the no-policy-change scenario of the 2022 Stability Programme it is projected to reach -4.1% of GDP this year. Provisional data on the outturn of the state budget for the first half of the year indicate a continuation of a gradual improvement. The state budget deficit amounted to EUR -128 million over this period, and, without the direct effect of COVID measures, there was a surplus of EUR 264 million, which is more than in the first half of the pre-crisis year 2019. The year-on-year improvement is driven by the lower negative impact of COVID measures of EUR 1.3 billion and by EUR 1.1 billion of higher revenue in the context of the recovery in domestic demand. Growth in other public spending, excluding the influence of COVID measures, has increased significantly (EUR 0.6 billion or 10.2% year-on-year). This was only to a lesser extent due to higher investment activity, which, according to our estimate, will again fall behind the otherwise very optimistic plans at the year-round level. The growth in consumption is largely due to higher transfers to individuals and households, as well as subsidies, mainly due to measures to mitigate the effects of the inflation.

Unlike the state budget this year, the situation in the other three general government budgets is less favourable than last year. Although municipal budgets are in surplus, this is lower than in the first five months of last year, despite a renewed increase in the lump sum and additional earmarked funds, mainly due to a rise in investment spending by around half. With a slowdown in the growth of social contribution revenue, the financing of social insurance funds is more challenging than last year due to higher expenditure conditioned by the measures. The Pension and Disability Insurance Institute of Slovenia (ZPIZ) expenditure growth is almost twice as high as in the same period last year due to another extraordinary and a relatively high February regular pension adjustment, so that a 13% year -on-year increase in the transfer from the State budget was needed to balance the pension budget

The Health Insurance Institute of Slovenia has a larger deficit than in the five months of last year, with the strengthening of expenditure growth, which is mainly due to higher expenditures on sickness benefits after the entry into force of the Health Care and Health Insurance Act (ZZVZZ-R) in March, and higher transfers to public institutions for labour costs, which, according to the Fiscal Council estimate, are largely due to the agreement on the increase of salaries for nurses.

General government gross debt stood at 75.1% of GDP at the end of the first quarter, still 9.5 pps higher than at the end of 2019 before the onset of the epidemic. The projected policy change of the ECB in the context of high inflation is already reflected in the tightening of financing conditions. Since April this year, the required yield on 10-year government bonds has exceeded the implicit interest rate on total government debt for the first time since the euro area debt crisis and the domestic banking crisis. While credit ratings remain stable, some manoeuvring room for fiscal policy is lent by the extended time to maturity of debt at 10 years and, in particular, the balance in the single treasury account, which at the end of June this year reached record levels, with EUR 9.1 billion or 16% of GDP forecast for this year.

The actual and future potential impact of the measures taken up to the beginning of July to mitigate the effects of elevated inflation is estimated at around EUR 650 million. While an important part of the estimated impact will have no effect on the general government balance, its side effects result from the reduction of dedicated resources for the green transition. According to the overall estimate, the impact on the general government balance sheets will amount to around EUR 400 million; however, this does not include any successful claims by traders of petroleum products or loss of VAT revenue for the period when the final prices of liquid fuels were frozen.

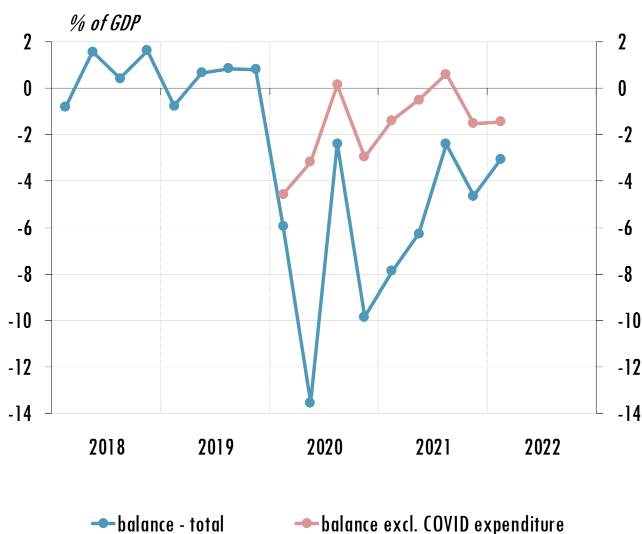
The Fiscal Council welcomes the government's decision in the adopted guidelines on the preparation of the budgetary documents to prepare a comprehensive medium-term fiscal framework in the autumn and to adjust fiscal policy orientations, if necessary, to the updated macroeconomic forecast by IMAD. The current situation and forecasts remain favourable despite increased risks, which is also reflected in improved government revenue projections for 2022-2024. In the current situation, fiscal policy could make it more difficult to address rising inflation through indiscriminate demand management measures. Therefore, as in the epidemic period, the Fiscal Council calls on economic policy makers to adequately target any further measures to mitigate the effects of the inflation, which should be aimed at the most affected population groups and parts of the economy.

The reduction of the debt-to-GDP ratio will be more difficult in the future due to the increase in financing costs and the expected slowdown in economic growth. In order to achieve the required consolidation, which is necessary to create manoeuvring room for fiscal policy in the face of future shocks and to address long-term challenges, certain discretionary measures are likely to be needed. The European Fiscal Board recommends a slightly restrictive fiscal policy stance for the euro area in 2023, which, according to the Fiscal Council, would also be appropriate for Slovenia. In addition, future budgetary documents should allow room for temporary measures if the current risks are further exacerbated or realised.

1. Fiscal trends – general government (ESA 2010 methodology)

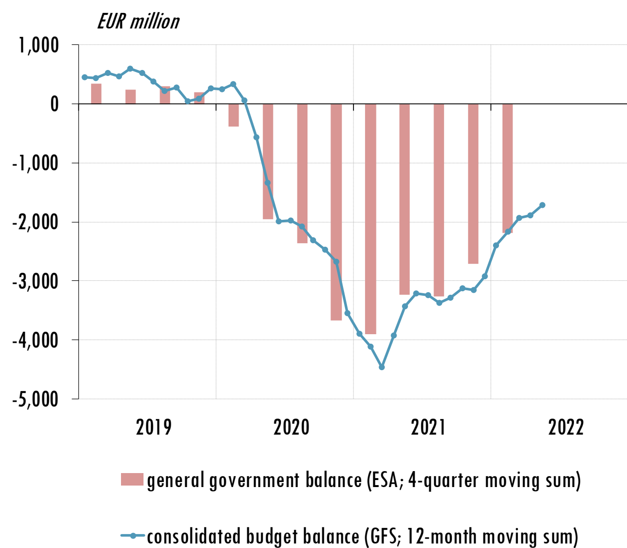
The **general government deficit** in the first quarter of 2022 amounted to EUR -405 million or -3.1% of GDP, which is significantly lower than in the same period last year (-EUR 919 million or -7.9% of GDP). The balance net of the direct impact of COVID expenditure amounted to -1.4% of GDP, the same as in the first quarter of last year. This means that the significant year-on-year increase in revenue has been offset by an increase in other public spending, only to a lesser extent in investment spending. Available consolidated balance sheet data under the cash flow methodology suggest a continuation of similar developments and a further narrowing of the deficit up to and including May. The no-policy-change scenario in the 2022 Stability Programme projects the general government deficit to be -4.1% of GDP this year and -3.3% of GDP excluding the direct impact of COVID expenditure.

Figure 1.1: General government balance



Source: SORS, FC calculations.

Figure 1.2: Public finance balances

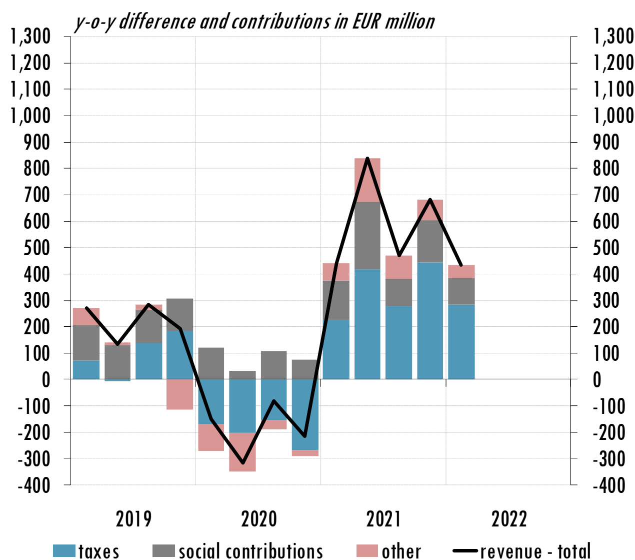


Source: SORS, MoF, FC calculations.

The continuation of relatively high **revenue** growth (8.3%) mainly stemmed from increased revenue from taxes on production and imports, mainly VAT, combined with the strengthening of domestic demand. Revenue growth from income taxes has largely eased due to the base effect, especially for revenue from taxes on income of individuals and households. On the back of favourable labour market developments, revenue from social contributions continued to grow, while other major categories of revenue were also larger.

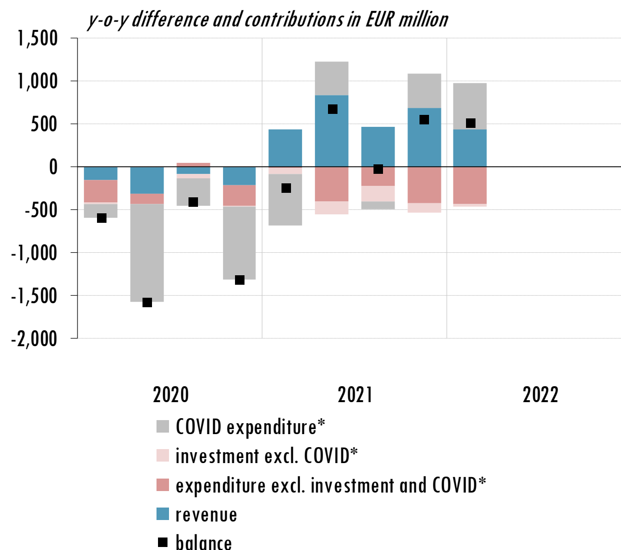
Total **expenditure** was lower year-on-year (-1.3%) in the first quarter due to a much smaller scale of measures to mitigate the effects of the epidemic. Such measures amounted to EUR 756 million in the first quarter of last year and EUR 215 million in the first quarter of this year. Without taking into account the direct impact of COVID measures, the relatively high annual growth rate of remaining public spending (8.6%) continued. This was only to a small extent the result of increased investment activity, which was 6.3% year-on-year, contributing only 0.5 pps to total growth. Excluding the impact of COVID measures, social benefits expenditure exceeded the level of a year ago by far the most, mainly due to higher pensions. More importantly, personnel expenditure increased by 8.4% year-on-year. By contrast, interest expenditure continued to be lower year-on-year, but the decline slowed significantly compared to previous quarters.

Figure 1.3: General government revenue (ESA)



Sources: SORS, FC calculations.

Figure 1.4: Factors of change to the general



Source: SORS, FC calculations. Note: *Positive sign denotes a decrease, negative sign denotes an increase.

Table 1.1: The main aggregates of the general government sector

	Q1				Q2-Q4							
			change				change				change	
	2021	2022	EUR million	%	2021	2022*	EUR million	%	2021	2022**	EUR million	%
REVENUE	**5,215**	**5,650**	**434**	**8.3**	**17,627**	**18,592**	**965**	**5.5**	**22,843**	**24,242**	**1,399**	**6.1**
TAXES	2,434	2,719	285	11.7	8,555	8,930	376	4.4	10,989	11,650	661	6.0
Taxes on production and imports	1,419	1,671	253	17.8	5,430	5,641	210	3.9	6,849	7,312	463	6.8
Curr. taxes on income, wealth, etc.	1,012	1,044	31	3.1	3,113	3,279	166	5.3	4,125	4,323	197	4.8
Capital taxes	3	4	1	44.8	12	11	-1	-7.2	15	15	1	3.5
SOCIAL CONTRIBUTIONS	2,149	2,250	101	4.7	6,583	6,846	264	4.0	8,731	9,096	365	4.2
PROPERTY INCOME	43	45	3	5.9	280	293	13	4.7	322	338	16	4.8
OTHER	590	635	46	7.7	2,210	2,522	312	14.1	2,800	3,158	358	12.8
EXPENDITURE	**6,134**	**6,055**	**-79**	**-1.3**	**19,414**	**20,470**	**1,056**	**5.4**	**25,548**	**26,525**	**977**	**3.8**
COMPENSATION OF EMPLOYEES	1,651	1,560	-91	-5.5	4,910	4,885	-25	-0.5	6,561	6,445	-116	-1.8
INTERMEDIATE CONSUMPTION	693	757	64	9.2	2,488	2,514	26	1.0	3,182	3,271	90	2.8
SOCIAL TRANSFERS	2,361	2,627	266	11.3	7,373	7,811	438	5.9	9,734	10,438	705	7.2
INTEREST	173	159	-14	-8.1	487	508	20	4.2	661	667	6	0.9
SUBSIDIES	451	105	-346	-76.7	713	480	-233	-32.7	1,165	586	-579	-49.7
GROSS FIXED CAPITAL FORMATION	520	553	33	6.4	1,934	3,051	1,117	57.8	2,454	3,604	1,150	46.9
CAPITAL TRANSFERS	22	27	5	23.5	183	220	36	19.9	205	247	42	20.2
OTHER	262	266	4	1.6	1,325	1,001	-324	-24.4	1,587	1,267	-320	-20.1
Balance	**-919**	**-405**	**513**		**-1,786**	**-1,878**	**-92**		**-2,705**	**-2,283**	**422**	
Primary balance	**-745**	**-246**	**499**		**-1,299**	**-1,370**	**-71**		**-2,044**	**-1,616**	**428**	
Balance, GDP %	**-7.9**	**-3.1**		**4.8**	**-4.4**	**-4.4**		**0.1**	**-5.2**	**-4.1**		**1.1**
Primary balance, GDP %	**-6.4**	**-1.9**		**4.5**	**-3.2**	**-3.2**		**0.0**	**-3.9**	**-2.9**		**1.1**
Nominal GDP, EUR million	**11,667**	**13,229**		**13.4**	**40,353**	**42,938**	**2,585**	**6.4**	**52,020**	**56,167**	**4,146**	**8.0**

Sources: SORS, MoF. Notes: *Implicitly calculated to match MoF forecast. **MoF forecast: Stability Programme 2022 (April 2022).

Table 1.2: Estimate of the financial impact of inflation mitigation measures

Act Determining the Measures to Mitigate the Consequences of Energy Commodity Price Rise (ZUOPVCE)[1]	188
Act Determining Measures to Mitigate the Consequences of Energy Commodity Price Rise in Business and Agriculture (ZUOPDCE)[2]	87
Decree determining the amount of excise duty on electricity[3]	3
Decree amending the Decree determining the amount of excise duty on energy commodities[3]	40
Decree amending the Decree on the environmental tax on pollution from carbon dioxide emissions[4]	35
Decree amending the Decree on the method of determining and calculating the contribution for ensuring support for the production of electricity from high-efficiency cogeneration and renewable energy sources[5]	180
Decree amending the Decree on energy savings[5]	40
Measures to aid agriculture[1]	22
Buying-in wheat[6]	44
TOTAL	**640**

Sources: National Assembly of the Republic of Slovenia, MoF, Official Gazette of the Republic of Slovenia, Government of the Republic of Slovenia, FC estimates. Notes: [1] Estimate of the Government at the time of adoption; [2] Outturn up to and including 1 July 2022 according to the MoF data; [3] Estimate by the Fiscal Council based on the Ministry of Finance sales data for February-April 2022; [4] Estimate by the Fiscal Council based on anticipated 3-month validity; [5] Estimate by the Fiscal Council based on anticipated maximum one-year validity; [6] Estimate on the basis of the average annual crop in the period 2015-2021 at a price of EUR 300/t.

The rise in inflation in recent months has led to the adoption of a number of **measures to mitigate the impact of the inflation**. According to the Fiscal Council, the immediate actual and future potential effect of measures adopted up to and including 1 July 2022 amounts to around EUR 650 million. While an important part of the estimated impact will have no impact on the general government balance, it has side effects due to the reduction in dedicated resources for the green transition. In particular, the Emergency Measures to Mitigate the Impact of High Energy Prices Act (ZUOPVCE)[1] provide for a certain exceptions to the requirement for payment of gridline charges and the renewable energy source (RES) contribution in the period between February and April this year, and the Decree adopted in mid-June, which obviates the payment of the RES contribution for up to one more year.[2] This will reduce the revenue of electricity distribution companies and BORZEN, which are not part of the general government. As a result, the Fiscal Council estimates that the impact on the general government balance will amount to around EUR 400 million, out of the total volume of measures currently known, amounting to around EUR 650 million. However, this estimate does not include any successful claims by oil dealers and VAT revenue for the period when final prices of liquid fuels were frozen. The Fiscal Council calls on economic policy makers to ensure that any further measures to mitigate the impact of the inflation are adequately targeted and temporary. Simulations of alternative measures show that the biggest impact on consumption (relatively higher for non-liquidity-limited households) and on lowering inflation stems from the reduction of taxes on liquid fuels, and, from a social and long-term perspective, targeted income support for the most vulnerable population groups in terms of achieving climate objectives.[3]

[1] Act Determining the Measures to Mitigate the Consequences of Energy Commodity Price Rise.

[2] Decree amending the Decree on the method of determining and calculating the contribution for ensuring support for the production of electricity from high-efficiency cogeneration and renewable energy sources.

[3] See "Targeted income support is the most social and climate-friendly measure for mitigating the impact of high energy prices", at https://voxeu.org/article/targeted-income-support-mitigate-impact-high-energy-prices.

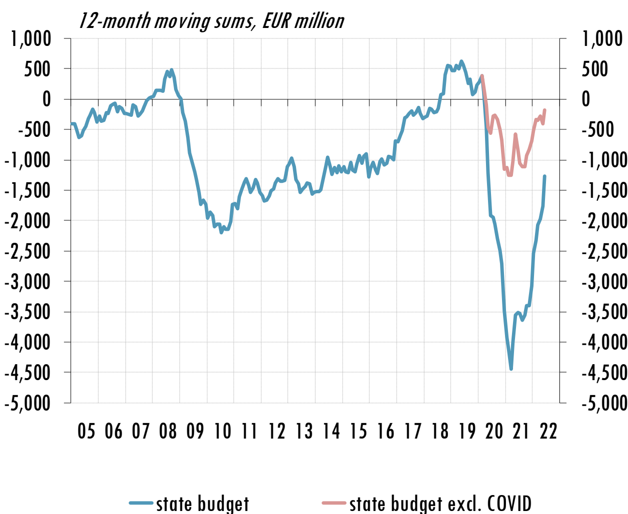
2. Central government budget (the GFS cash flow methodology)

According to provisional data, the government budget deficit amounted to EUR -128 million in the first half of the year. Without the direct impact of COVID measures, the state budget would have a surplus of EUR 264 million, which is higher than in the first half of the pre-crisis year 2019. The improvement stems from revenue growth as a result of the recovery in domestic demand, while public spending growth has also strengthened significantly.

Revenues increased by 18.0% year-on-year in the first half of 2022 and 20.6% without taking into account the direct impact of COVID measures. The strong growth was mainly due to the rapid recovery of domestic demand, but also partly to the low base of last year and the balance of advances received on the first tranche of the Recovery and Resilience Plan (RRP) in January this year. Higher revenue from VAT and corporate income tax contributed most to growth. The revenues from the corporate income tax were 50% higher than before, which is attributed to the extremely high settlements as a result of strong private sector performance last year. After the expiry of payments of allowances, which were quite high at the beginning of last year, the growth in income tax revenue moderated significantly. The revenue from excise duties was also higher year-on-year, despite the reduction of excise duties levied to the lowest permitted level, due to an increase in the quantities sold, in particular of liquid fuels. In the coming months, owing to the base effect and heightened risks to economic growth, the Fiscal Council expects a moderation in the growth rates of major tax revenue. On a full-year basis, however, these will be higher than expected at the time of the adoption of the national budget, in the absence of a significant deterioration in the economic situation. By taking into account the outturn in the first half of the year, revenue in the second half of the year could be a fifth lower year-on-year while still achieving the budget projections. Revenue from EU funds increased by 30% year-on-year in the first half of the year, but, unlike tax revenue, the Fiscal Council does not expect it to reach the projections in the budgetary documents over the whole year. In this case, in the second half of the year, they should be almost EUR 200 million higher than in the total of last year.

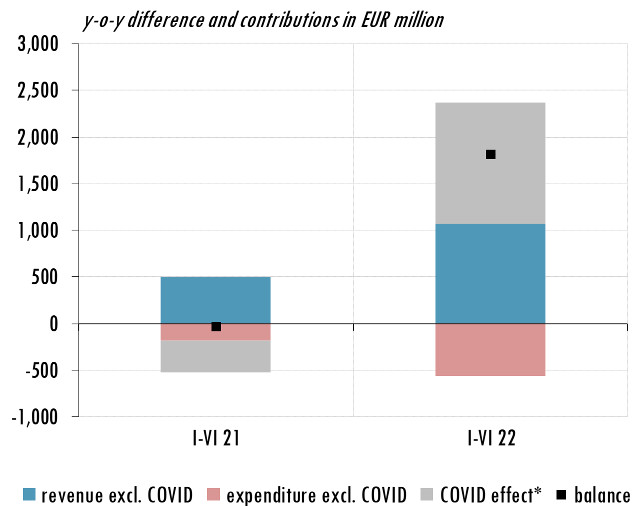
Expenditure was down 11.6% year-on-year, almost entirely due to significantly lower expenditure on COVID measures. These amounted to EUR 472 million, compared to EUR 1,877 million in the first half of last year. Without this effect, expenditure would have been 10.2% higher on a year-on-year basis.

Figure 2.1: State budget balance



Source: MoF, FC calculations.

Figure 2.2: Factors of change to the state budget balance



Source: SURS, FC calculations. Note: *Positive sign denotes a decrease, negative sign denotes an increase.

Table 2.1: State budget

	January-June				July-December							
	2021	2022	change 2022/2021		2021	2022*	change 2022/2021		2021	2022**	change 2022/2021	
			EUR million	%			EUR million	%			EUR million	%
Revenue	**5,390**	**6,358**	**968**	**18.0**	**5,783**	**5,110**	**-673**	**-11.6**	**11,174**	**11,469**	**295**	**2.6**
VAT	1,869	2,280	410	22.0	2,362	1,919	-442	-18.7	4,231	4,199	-32	-0.8
Excise duties	646	665	19	3.0	825	799	-26	-3.2	1,470	1,463	-7	-0.5
Personal income tax	852	910	58	6.8	662	597	-64	-9.7	1,514	1,507	-7	-0.4
Corporate income tax	627	942	315	50.2	488	112	-376	-77.1	1,115	1,054	-61	-5.4
EU funds	411	534	124	30.1	536	1,139	603	112.4	947	1,673	726	76.7
Non-tax	447	361	-87	-19.4	371	142	-229	-61.7	818	502	-316	-38.6
Other revenue	538	667	129	24.0	541	402	-138	-25.6	1,079	1,070	-9	-0.8
Expenditure	**7,336**	**6,487**	**-849**	**-11.6**	**6,918**	**7,454**	**535**	**7.7**	**14,254**	**13,940**	**-314**	**-2.2**
Total labour costs	2,305	1,825	-480	-20.8	1,903	1,978	74	3.9	4,209	3,803	-405	-9.6
Transfers to individ. and househ.	1,456	969	-487	-33.4	1,076	708	-368	-34.2	2,532	1,678	-855	-33.8
Expend. on goods and services	610	690	80	13.1	913	654	-259	-28.3	1,523	1,344	-179	-11.7
Investment	324	419	95	29.4	915	1,872	958	104.7	1,238	2,291	1,053	85.0
Curr. transfers to soc. sec. funds	866	843	-22	-2.6	484	617	133	27.6	1,350	1,461	111	8.2
Subsidies	578	359	-219	-37.8	237	200	-37	-15.8	815	559	-256	-31.4
Interest	430	350	-80	-18.5	297	333	36	12.2	727	683	-43	-6.0
Payments to the EU budget	317	355	38	12.1	312	225	-87	-27.9	629	580	-49	-7.7
Other expenditure	451	676	225	50.0	780	865	84	10.8	1,231	1,541	310	25.2
Balance	**-1,945**	**-128**	**1,817**		**-1,135**	**-2,343**	**-1,209**		**-3,080**	**-2,472**	**608**	

*Source: MoF, FC calculations. Note: *Implicitly calculated to match MoF forecast. ** Amendments to the budget for 2022 (Oct. 21).*

Table 2.2: Impact of COVID measures on state budget outturn

	January-June 2021 EUR million		January-June 2022 EUR million		excl. COVID y-o-y change	
	COVID	excl. COVID	COVID	excl. COVID	EUR million	%
Revenue	**185**	**5,205**	**79**	**6,279**	**1,074**	**20.6**
VAT	-15	1,884	41	2,239	355	18.8
Excise duties	32	614	2	663	49	8.0
Personal income tax	-7	859	7	903	44	5.1
Corporate income tax	149	478	4	939	460	96.3
EU funds[1]	53	357	16	518	161	45.0
Non-tax	0	447	0	361	-87	-19.4
Other revenue	-27	565	11	656	91	16.2
Expenditure	**1,877**	**5,458**	**472**	**6,015**	**557**	**10.2**
Total labour costs	552	1,753	29	1,797	44	2.5
Transfers to individuals and households	707	749	72	897	149	19.9
Expenditure on goods and services	133	478	140	551	73	15.3
Investment	5	318	9	410	92	28.9
Current transfers to social security funds	1	865	68	775	-90	-10.4
Subsidies	357	221	22	337	116	52.7
Interest	0	430	0	350	-80	-18.5
Payments to the EU budget	0	317	0	355	38	12.1
Other expenditure	122	329	133	543	214	65.1
Balance	**-1,692**	**-253**	**-393**	**264**	**517**	

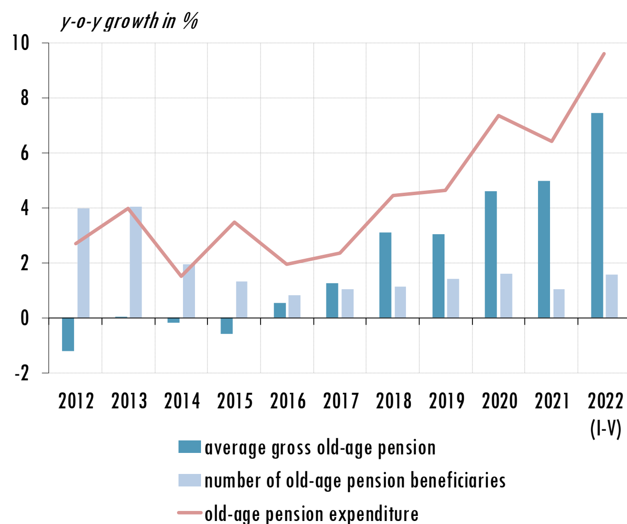
Sources: MoF, FURS, FC estimates and calculations. Note: [1] The effect on balance of revenue from EU funds used for financing of COVID measures is neutralized, so that they are interpreted as higher total revenue from EU funds.

A large part of the total growth without the impact of COVID measures is due to the transfer of received Recovery and Resilience Plan funds of EUR 118 million to the budgetary fund in January. The main contributors to growth were higher transfers to individuals and households, and subsidies, the latter mainly in conjunction with measures to cushion the effects of the inflation. Investment spending was higher at around 30% year-on-year, and in order to reach the projections from the budget, its volume in the second half of the year should be around EUR 630 million higher than in the whole of last year. Labour cost growth (excluding the impact of COVID allowances) stood at 2.5% in the first half of the year, while interest expenditure decreased by 18.5% year-on-year.

3. Public finance budgets (the GFS cash-flow methodology)

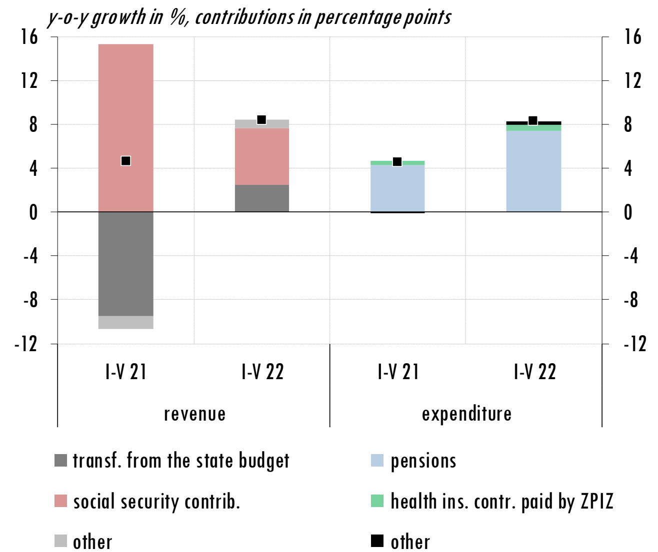
In the first five months of this year, the annual growth of the **Pension and Disability Insurance Institute of Slovenia (ZPIZ)** expenditure (8.3%) was almost twice as high as in the same period last year (4.6%). Against the backdrop of modest growth in the number of total users, this was mainly due to higher pensions following the exceptional January and relatively high February regular adjustment (4.4%). Old-age pensions, which account for around 80% of total pension expenditure, were up 4.9% year-on-year in the first five months of this year, with an increase of 0.8% in the number of users. Due to higher pensions, the increase in expenditure on the payment of the contribution to health insurance of pensioners was also higher than in the same period last year. The financing structure for the Pension and Disability Insurance Institute of Slovenia is the opposite of last year, as the growth of revenue from social contributions slowed following the high growth of last year, so that the strengthening of pension expenditure required a higher transfer from the state budget. The transfer from the state budget amounted to EUR 538 million in the first five months of this year, which is 13.1% more year-on-year.

Figure 3.1: Pensions



Source: Pension and Disability Insurance Fund of Slovenia (ZPIZ), MoF, FC calculations.

Figure 3.2: ZPIZ revenue and expenditure



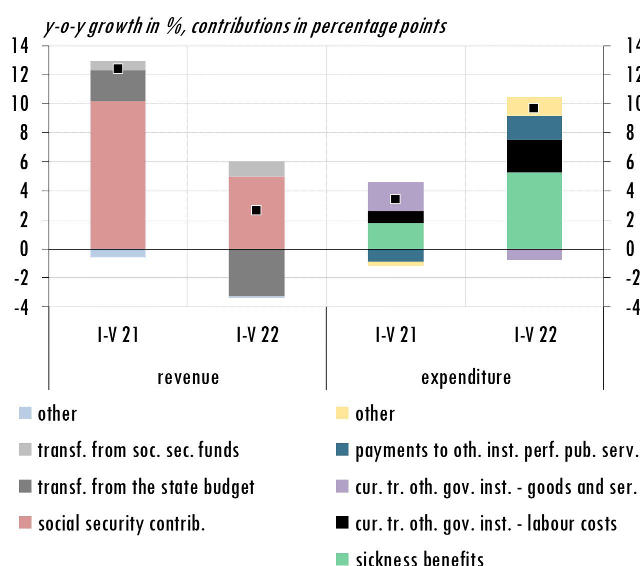
Source: MoF, FC calculations.

Deficit of the **Health Insurance Institute of Slovenia (ZZZS)** amounted to EUR -121 million in the first five months of this year, which is significantly higher than in the same period last year (EUR -17 million). This is due to significantly lower revenue growth (2.7%; I-V of 2021: 12.4%) as well as higher expenditure growth (9.7%; I-V of 2021: 3.4%). The lower revenue growth is in similar terms a result of

lower growth in revenue from social contributions and of lower transfers from the state budget, which were higher last year due to increased costs to contain the epidemic. With regard to the same period last year, higher expenditure on sickness benefits was the largest contributor to expenditure growth. This growth increased significantly from March this year, when the Health Care and Health Insurance Act (ZZVZZ-R) entered into force, which reduced from 30 to 20 days the period after which the Health Insurance Institute of Slovenia takes over the payment of sickness benefit from the employer. The growth of transfers to public institutions for labour costs was also much higher than last year, which is partly linked to the agreement reached last November on raising salaries for nurses.

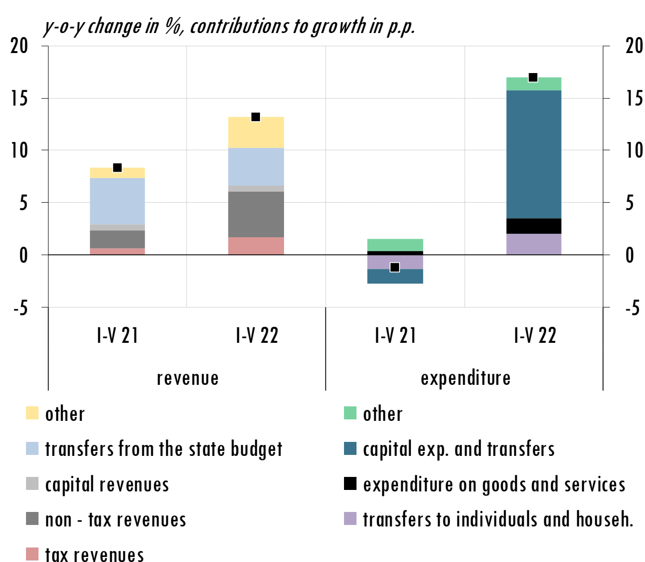
In the first five months of this year, the **municipal budgets'** surplus (EUR 74 million) was lower compared to the same period last year (EUR 91 million). Revenue growth strengthened (13.2%; I-V of 2021: 8.3%), which was mainly due to growth in revenue from wealth and donations received. Unlike the same period last year, revenue from the most important source, personal income tax, was higher in the first five months of this year, also due to the renewed increase of the lump sum. Transfers from the state budget were also higher year-on-year, in the form of funds for investment and the funds related to the Municipal Costs Relief Act. However, revenue growth related to developments in the real estate market moderated, mainly on account of year-on-year lower revenue from the compensation for the use of building land. Expenditure increased significantly in the first five months of this year (17.0%; I-V of 2021: -1.2%), mainly due to a year-on-year increase of around half in investment expenditure. Much higher than in the same period last year, there was also an increase in expenditure on year-on-year consumption, both at the level of municipalities and in public institutions whose founders are municipalities. However, the expiry of the restrictive measures resulted in increased transfers to individuals, in particular for the reimbursement for school transport and the payment of the difference between the cost of kindergarten programmes and the payments by parents. Among the major categories of expenditure were lower overall labour costs year-on-year, which increased significantly in the same period of last year, mainly due to the payment of allowances.

Figure 3.3: ZZZS revenue and expenditure



Source: MoF, FC calculations.

Figure 3.4: Revenue and expenditure of local government



Source: MoF, FC calculations.

4. General government debt

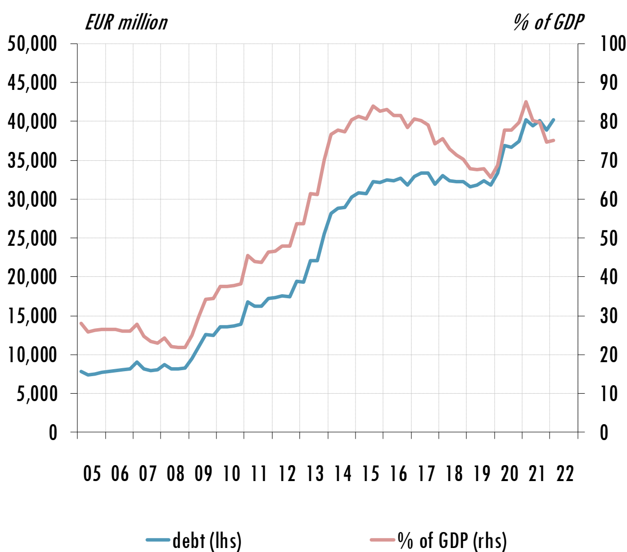
At the end of the first quarter of 2022, gross general government debt stood at EUR 40.2 billion, which is EUR 1.4 billion more than at the end of 2021 and EUR 8.5 billion more than before the crisis at the end of 2019. The debt comprised 75.1% of GDP, increasing by 9.5 pps of GDP from the end of 2019. While approximately two thirds of the increase in the debt-to-GDP ratio during the crisis period can be explained with high primary deficits, largely due to measures to contain the epidemic and due to the economic downturn, the debt ratio has been declining in the last few quarters mainly on the back of strong economic growth, with rising inflation also contributing more markedly to the decline.

Most of the borrowing took place at the beginning of this year with issuances of long-term securities, while the volume of borrowing of the state budget totalled just over EUR 2.9 billion until May. The Republic of Slovenia issued two bonds in January 2022, which was faced by high demand among investors. One 4-year bond maturing in 2026 was issued for EUR 1.25 billion at a coupon rate of 0.0%, and a 40-year bond for EUR 500 million was issued at a coupon rate of 1.175%. In the first five months, the issuances of six existing bonds totalling EUR 1.1 billion were further increased. Among these, the RS77 and RS85 bond issues maturing in 2032 and 2050 had the largest additional increases, of EUR 450 million and EUR 400 million respectively.

In 2022, the Republic of Slovenia repaid EUR 1.2 billion in debt until May, most of which related to repayments of principals of long-term securities. According to the data, which also include the current treasury bills issued, some EUR 0.6 billion of the principal liabilities of the state budget are due for repayment this year.

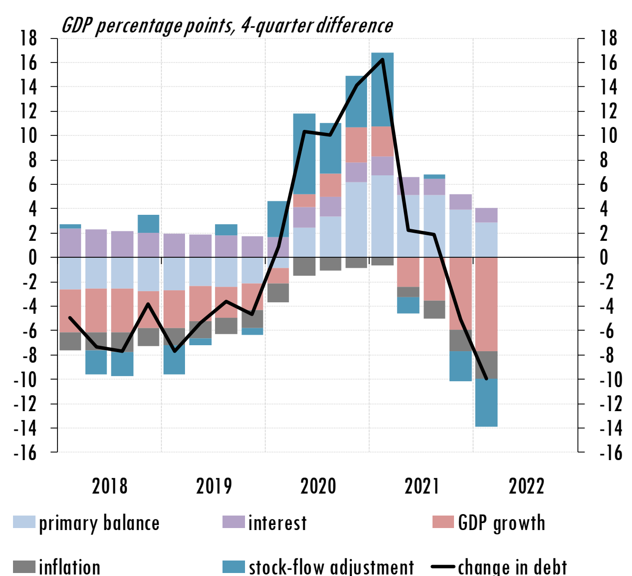
Funds in the single treasury account decreased over the course of last year, but they exceeded the highest levels reached in March last year by the end of June this year. At the end of June, at EUR 9.1 billion (around 16% of GDP forecast for this year), they were almost EUR 3.4 billion higher than at the end of last year. This amount of treasury account assets, which provide liquidity to the state budget, is about EUR 4 billion higher than the long-term average.

Figure 4.1: General government debt (ESA)



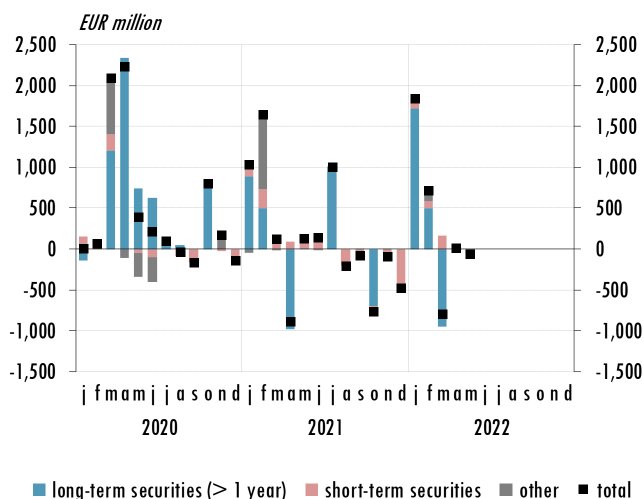
Source: SORS, FC calculations.

Figure 4.2: Change in general government debt



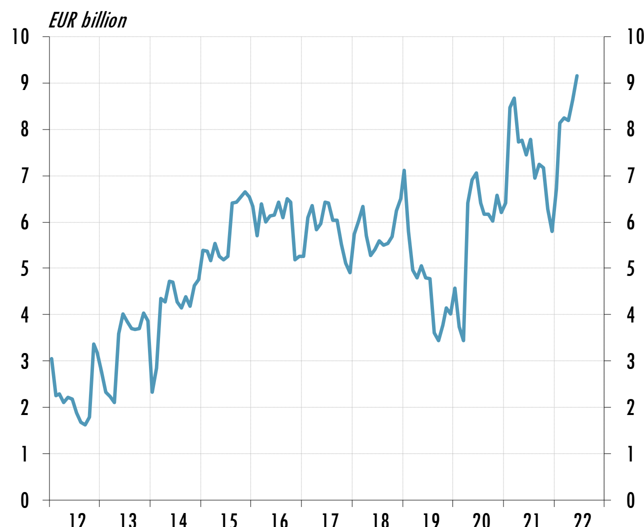
Source: SORS, FC calculations.

Figure 4.3: State budget net lending (borrowing)*



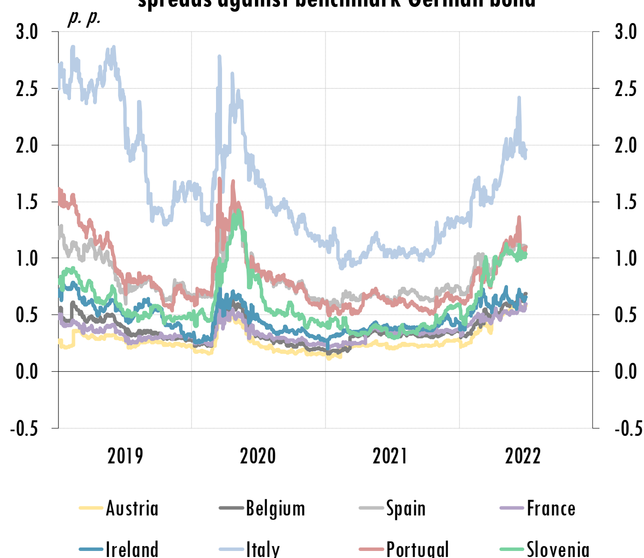
*Source: MoF, FC calculations. Note: *Difference between borrowing and repayment of debt by components in the financing account of the state budget.*

Figure 4.4: Treasury single account position



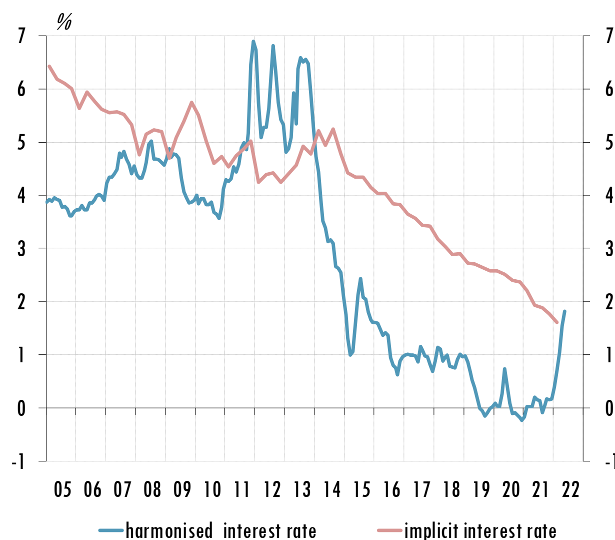
Source: MoF.

Figure 4.5: Reference 10-year government bond spreads against benchmark German bond



Source: Bloomberg, FC calculations.

Figure 4.6: Harmonised long-term interest rate and implicit public debt interest rate



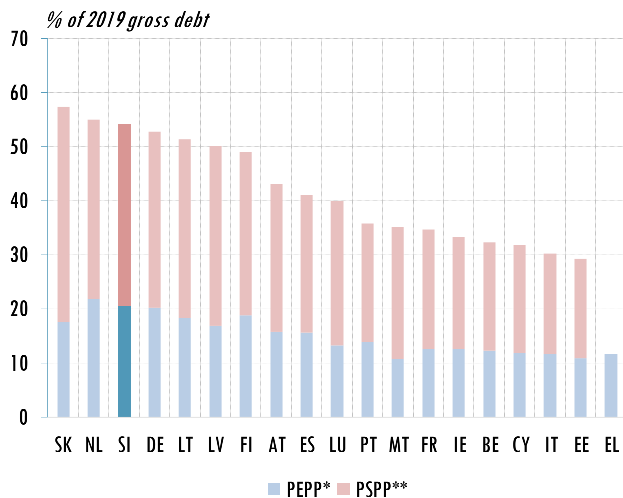
Source: ECB, SORS, FC calculations.

The yield requirements on long-term bonds of euro area countries, including Slovenia, have risen for almost a year, mainly reflecting expectations in connection with the announced change in the ECB's policy towards tightening financing conditions. From the lowest values reached in the middle of last summer, the required yields increased by 190-280 bps by the end of June this year (Slovenia: 260 bps). For the first time since the euro area debt crisis and the domestic banking crisis between 2011 and 2013, the yield requirement has exceeded the implicit interest rate on total government debt from April this year. Both yield requirements and yield spreads on German bonds have risen above historical averages for most euro area countries over the past three months, despite the agreed aid packages at the EU level and a still extremely accommodating monetary policy. One of its important instruments is the extraordinary asset purchase programme for the period of the epidemic, in which the share of purchased Slovenian government bonds by the Eurosystem in government debt remains among the largest in the euro area. The interest rate of all previous treasury issuances in 2022 was

negative, at around -0.4% for all maturities, although the latest issuances of the 6-month and 18-month treasury bills approached 0% after almost 7 and 6 years respectively. Sovereign debt ratings have not changed in the last year, and all three leading agencies — Moody's, Standard&Poors, and Fitch — confirmed stable rating prospects for the Republic of Slovenia. The future distribution of liabilities continues to improve, even after the average weighted time to maturity of debt in 2021 has already reached 10 years. According to the latest data available, from end-2020 to end-2021, government guarantees decreased by approximately EUR 360 million to EUR 4.7 billion, representing 9.1% of GDP.

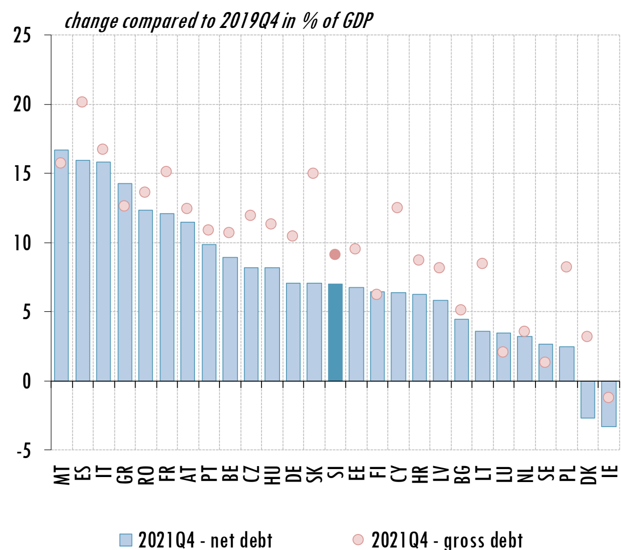
The Slovenian general government's gross debt-to-GDP ratio is below the EU average, although the difference (-13.5 pps of GDP) is 50% below the long-term average difference. Compared to the period before the onset of the pandemic crisis, the increase in the ratio in the fourth quarter of 2021[4] was 1.6 pps of GDP less than the increase in the EU average, making Slovenia the 12th out of the 27 EU countries. Not counting the general government financial receivables, resulting mainly from pre-financing, Slovenia is 14th among EU Member States in terms of the general government net debt increase in the same period.

Figure 4.7: PEPP and PSPP



*Source: Eurostat, ECB, FC calculations. Notes:*PEPP: Pandemic Emergency Purchasing Programme, cumulative net purchases March 2020–May 2022, ** PSPP: Public Sector Purchase Programme, cumulative net purchases March 2015–May 2022.*

Figure 4.8: General government net and gross debt



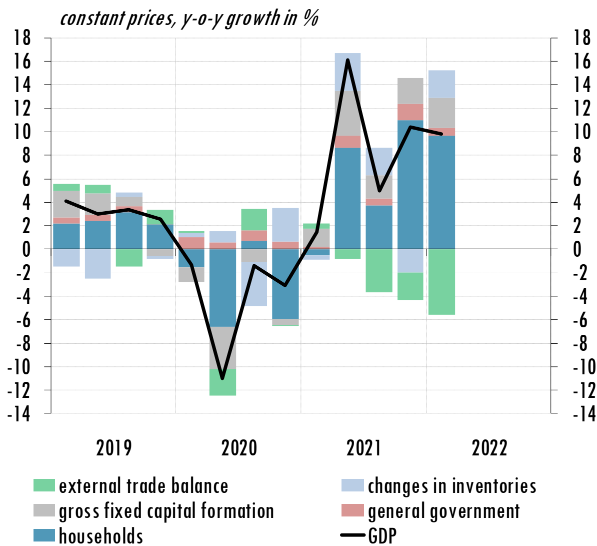
Source: Eurostat, ECB, FC calculations.

5. Macroeconomic trends and risks

GDP growth was solid in the first quarter of this year, despite a moderation in economic dynamics, following strong acceleration at the end of last year, exceeding the long-term average both in annual and quarterly terms. While GDP growth in Slovenia was the sixth highest among EU countries at 8.1% on average last year, quarter-on-quarter growth in the first quarter of this year was the ninth highest at 0.8%. The long-term average quarterly growth was outpaced by all components of domestic demand at the start of the year, with the exception of government consumption, which, like exports, showed a decline in the first quarter. In the case of exports, the consequences of markedly increased uncertainty in the international environment have hitherto been the most pronounced. Economic activity in 2021 averaged above pre-crisis levels and, while risks are significant, forecasts suggest that the levels of pre-crisis trend could be reached next year.

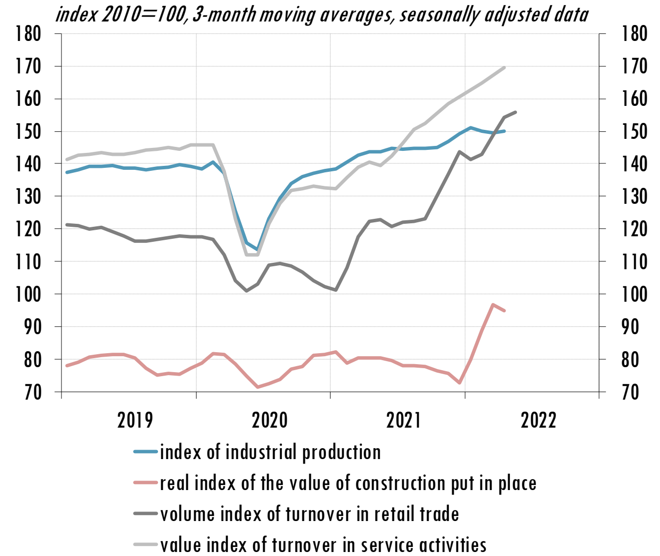
[4] Data for the first quarter of 2022 will be published by Eurostat on 21 July 2022.

Figure 5.1: Gross domestic product



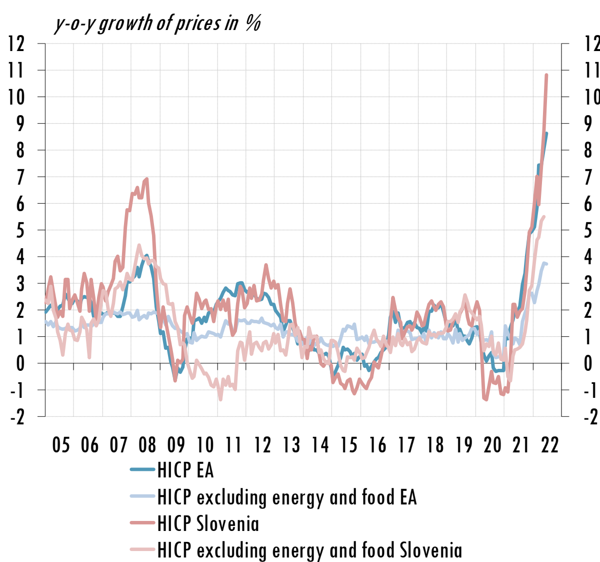
Source: SORS, FC calculations.

Figure 5.2: Activity indicators



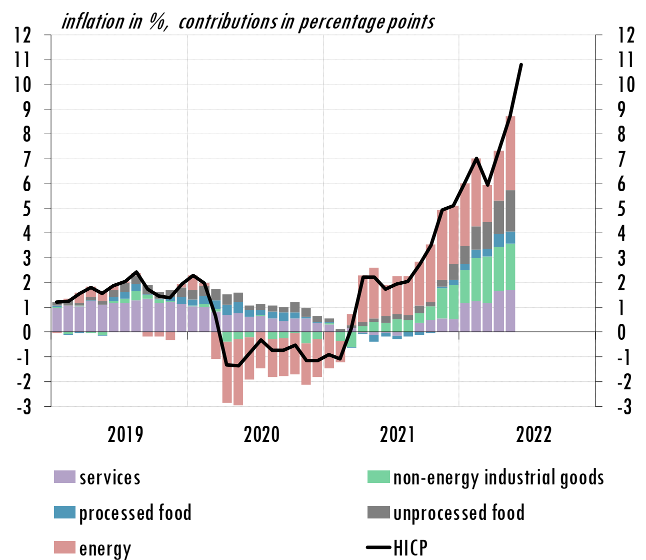
Source: SORS, FC calculations.

Figure 5.3: HICP inflation



Sources: Eurostat, FC calculations.

Figure 5.4: HICP inflation and contributions to growth



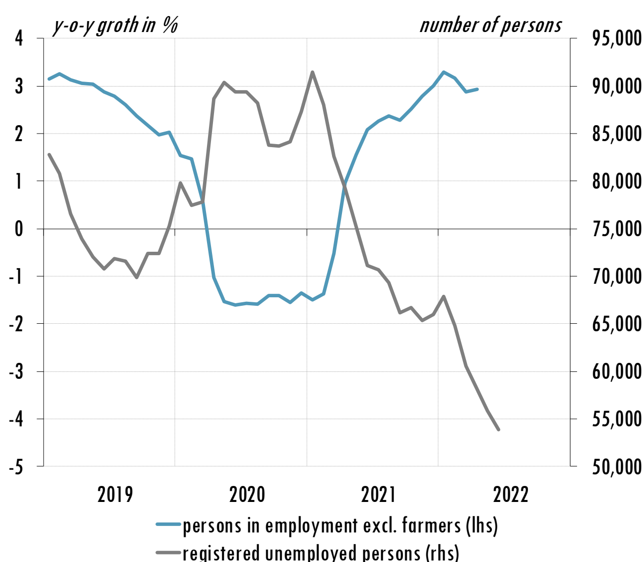
Source: FC calculations.

The strong economic growth at the time of the transition from last year to this year was mainly driven by the acceleration of domestic final consumption, and in particular household consumption. The household consumption was supported by large-scale cumulated savings from a period of crisis, which was driven by strong growth in household incomes during a period when consumption was constrained, as restrictive epidemiological measures have been released. Thus, the household saving rate (the share of savings on disposable income) has already fallen to levels from the end of 2019, and also below the level of the long-term average. At the moment, such a volume of savings does not allow households to significantly absorb the effects of rapid price increases on average, while consumer pessimism has been growing since the middle of last year, which roughly coincides with the beginning of the period of higher inflation. At the beginning of this year, investment remained high, driven by expectations of high demand from the second half of last year, and allowed by favourable financing conditions and a high level of gross operating surplus. The removal of epidemiological restrictions has significantly

reduced heterogenous recovery of individual activities. In addition to the rapid growth of construction, indicators of most services and retail trade overperformed the solid growth in manufacturing production. Strong domestic demand in 2021 and early this year also resulted in a significant negative contribution of net foreign trade to economic growth. In the first quarter of this year, the one-year contribution was the most negative since the introduction of VAT in mid-1999 and, together with unfavourable terms of trade, is causing the current account surplus to shrink rapidly. After five years of steady high levels, it started to shrink in the middle of last year, with a year-on-year decline of almost EUR 2.5 billion in March this year. This is more than double the contraction that preceded the global financial and economic crisis in 2008.

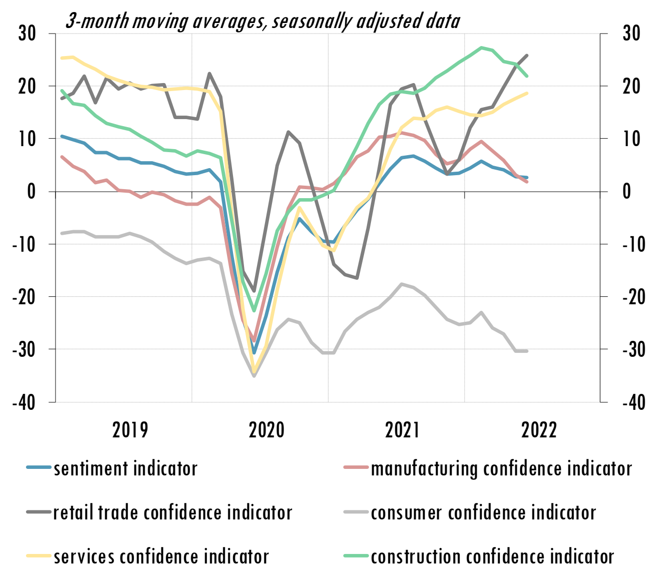
Strong aggregate demand is also reflected in the labour market. Quarterly employment growth was around three times above the long-term average in the first quarter of this year. The number of unemployed and the unemployment rate are more favourable than the values achieved before the crisis and are also close to or below the levels seen before the global crisis more than a decade ago. A number of indicators point to a deepening of mismatches between labour supply and demand. At the start of the year, foreign nationals accounted for more than half of the growth in additional employment. In most activities, the share of companies reporting shortages of (qualified) workers is still increasing, which is also reflected in the rapid increase in the number of job vacancies and the highest job vacancy rate ever recorded. A trend towards an increase in the share of long-term unemployed among unemployed persons as the total number of unemployed decreases may also indicate a shift in the economy's post-crisis structure. Persisting inconsistencies, particularly in activities with more pronounced labour shortages (construction, tourism), could create pressures on wage growth or business operation costs. Following a relatively rapid increase in optimism over the future employment developments last year, expectations moderated across all industries, against the background of increased uncertainties.

Figure 5.5: Labour market



Source: SORS, Employment Service of Slovenia, FC calculations.

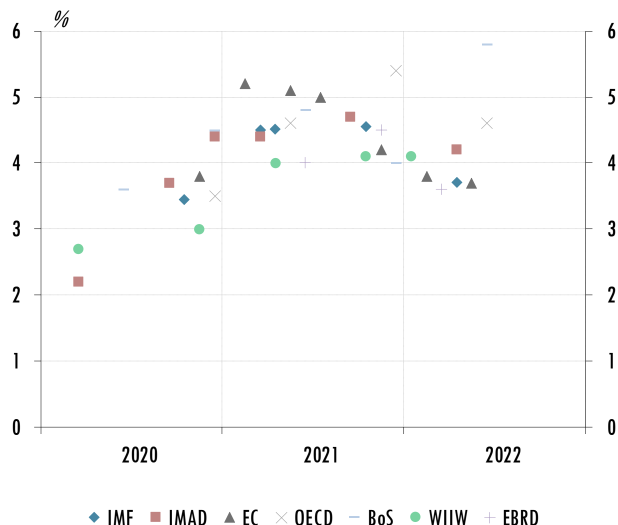
Figure 5.6: Business tendency and consumer surveys



Source: SORS, FC calculations.

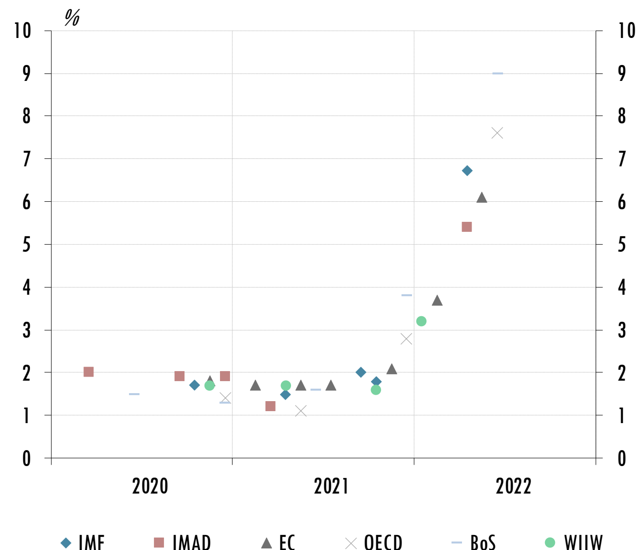
As for most other EU countries, recent macroeconomic forecasts for Slovenia are less favourable than indicated last year. The decline in projected GDP growth in 2022 is mainly due to uncertainty in the international environment. The forecasts prepared this year thus point to growth in Slovenia's GDP of

Figure 5.7: Real GDP growth in 2022 forecasts for Slovenia



Source: IMF, IMAD, European Commission (EC), OECD, Bank of Slovenia (BoS), WIIW, EBRD.

Slika 5.8: Inflation in 2022 forecasts for Slovenia

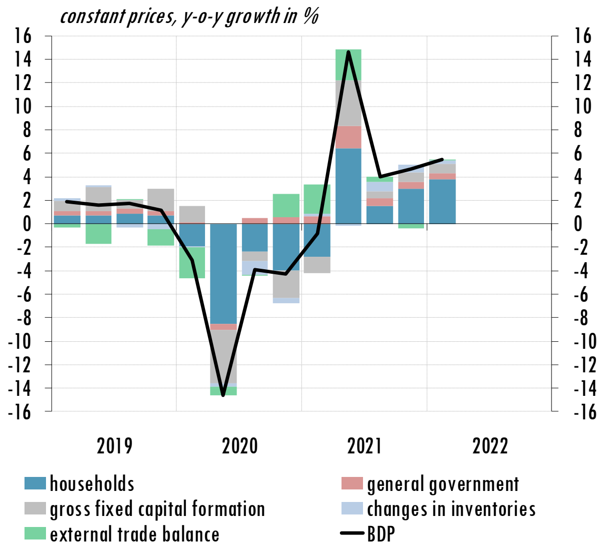


Source: IMF, IMAD, European Commission (EC), OECD, Bank of Slovenia (BoS), WIIW.

around 4% this year and of around 3% next year. Both are on average only about 0.5 pps less than last year's forecasts and at the same time higher than the long-term average. Uncertainties about the future impact of geopolitical tensions, in addition to the contraction in economic growth forecasts, are reflected in additional scenarios prepared by some institutions. Some pessimistic scenarios thus point to the possibility of a recession in Slovenia and in the euro area (the June forecast of the BoS and the ECB), while in similar scenarios, the recession should not occur at the EU level this or next year (the EC forecast of May), despite the inclusion of the projected economic consequences of the Ukrainian crisis and the prolonged persistence of commodity and food prices at high levels. Contrary to the relatively small change in current GDP forecasts, a more significant reversal occurred in the inflation projections, as the latest projections for Slovenia point to price growth in 2022 at around 6%, while in most of 2021 the projections indicated inflation below 2% in 2022. In the recent period, inflation forecasts have also increased to a slightly smaller extent, by around 1 pp to 3%, for 2023. The structure, magnitude and duration of inflation, together with the economic policy response, will also have a significant impact on future economic developments. At the same time, inflation projections remain subject to high uncertainty about the further development of geopolitical tensions and their direct and indirect consequences.

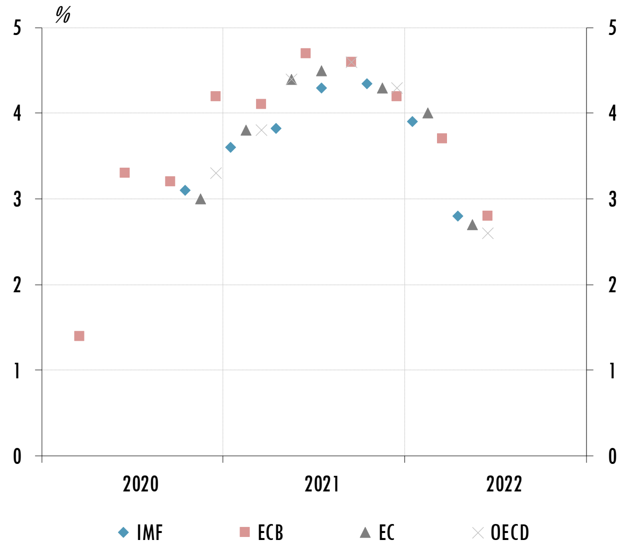
Economic growth was favourable in major trading partners last year, but it moderated at the end of last year and at the beginning of this year. Current GDP dynamics slowed from over 2% in the previous two quarters to just 0.3% in the fourth quarter of 2021 and in the first quarter of 2022; the moderation in activity was accompanied by a slowdown in confidence and demand expectations in manufacturing and trade in the context of Russia's aggression in Ukraine as a result of increased uncertainty, while consumers became much more pessimistic. GDP in the euro area achieved the pre-crisis level, which is also exceeded by most business tendency indicators, with the exception of the consumer confidence indicator. In particular, supply side constraints and strong increases in energy commodities and food prices are currently the main drivers of the rise in inflation, which is becoming more broad-based and exceeded 8% in the euro area in May and June this year.

Figure 5.9: Gross domestic product - euro area



Source: Eurostat, ECB, FC calculations.

Figure 5.10: Real GDP growth in 2022 forecasts for euro area



Source: IMF, European Commission(EC), OECD, ECB.

Recovery in the main trading partners is expected to continue in 2022 however with only modest quarterly growth, with annual growth halving from last year to just above 2.5% in the euro area. Growth is expected to be stimulated in particular by domestic demand, supported by favourable labour market conditions, as well as by increasing public investment, also building on the instruments introduced in the recent crisis at the EU level. Inflation forecasts continue to point to a temporary inflation shock, despite the broadening of the range of products whose price growth is increasing significantly. Inflation in the euro area is expected to fall to just below 3% in 2023, following an average increase of over 6% this year. In particular, the assumed moderation in energy commodities prices is expected to contribute to this, while core inflation is expected to remain relatively high at above 3%, also due to the partial pass-through of high wage growth into services prices.