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Continuous upgrades in economic growth estimates is accompanied by the first signals of the 4th wave

On Slovenia's Economy

- The **European Commission (EC)** published its **summer forecast** on Wednesday, 7 July, raising the estimate for GDP growth in the euro area for 2021 from 4.3% to 4.8% (for 2022 from 4.4% to 4.5%) as well as for inflation (from 1.7% to 1.9% in 2021 and from 1.3% to 1.4% in 2022). For Slovenia, the upgrade was among the largest. Instead of the previously projected 4.9% growth in 2021, it is expected to stand at 5.7%, and for 2022 it will decrease slightly (from 5.1 to 5%). The consensus of independent institutions is currently at 4.7% GDP growth in 2021 and 4.4% in 2022, which in fact means that ECFIN's optimistic view is among the highest. The upgrades in growth estimates were guided by data on the minimum decline in GDP in the 1st quarter 2021, improving health picture and, accordingly, the withdrawal of containment measures in the Member States. Among the major risks in their view are the risks of the response of households and companies to changes in containment measures and the effect of the withdrawal of support measures. According to them, the difficulties in the supply of raw materials and semi-finished products are of a temporary nature and will only affect a limited number of industrial sectors. One of the key assumptions in the forecast is also the **assumption of containment measures**. These are, on average, the least restrictive after September 2020 and are expected to be released in the second half of the year, but some are expected to remain in force until the end of 2021 and early 2022. The scenario of a 4th wave of infections is not included in the forecast.
- Business expectations (and production) in large **consumers (users) of steel products** also improved in June, reaching a peak after December 2010. New orders rose to an 8-month high. The highest growth in new orders was recorded by steel consumers from Asia, while growth was slightly lower in the USA and Europe. For the fifth month in a row, employment is strengthening. For the first time in eight months, the supply of raw materials at steelmakers increased, which should curb the pressure of rising prices for iron ore, a key raw material in the steel industry. Quite similar dynamics was observed among the largest **consumers of copper**. The level of orders increased the most in Europe in June. On the one hand, there is a shortage of copper and semi-finished copper products, and on the other hand, companies are also increasing safety stocks of these materials under the impression of forecasts of higher price growth, which further affects high prices (thus reducing the likelihood of future price increases). Large **consumers of aluminium** face similar concerns as consumers of steel and copper. European and American companies are facing greater delivery delays than Asian ones, with the stock of orders growing the most since March 2011.



- In June 2021, **consumer prices** were on average 1.4% higher than in June 2020. The average 12-month growth was still meagre, at +0.1%. During the period, prices of goods did not change at all, while prices of services increased by 0.4%. Compared to the previous month (June 21 compared to May 21) prices increased the most in the category of recreation and culture (+3.9%; high growth of prices of holiday packages), where, for example, at the level of the last 12 months they were still negative (-1.8%), which can also be related to the impact of the withdrawal of containment measures. In the category restaurants and hotels, prices increased by 1.1% compared to May 21. In the category of food and non-alcoholic beverages, where media attention is highest (16% of the Slovenian consumer basket), prices in June were only 0.1% higher than in May. Compared to December 2020 (as the reference base period), food prices were higher by 2.1%, of which mainly meat (+ 2.6%), fish and seafood (+1%), oils and fats (+ 1.7%), most of all fruit (+ 5.7%) and vegetables (+ 7.4%). In our opinion, this was mainly due to the poorer season in Europe, partly also to higher transport costs from other, distant markets, exporters to Europe. In the category of milk, cheese and eggs, prices were even lower (-0.9%), mainly due to a high drop in egg prices (-3.8%).

On Global Economy

- The **price of a barrel of Brent crude** fell to around \$ 74 after the local peak (\$ 77) reached on July 6, which is still higher than the majority of analysts' expectations. After the last OPEC meeting, where no agreement has been reached, we estimate that members will increase production (there is a lot of free production capacity among members), which should again contribute to falling prices in the medium term. **Oil stocks in OECD countries** are close to the average for the period 2015-2019. Margins in refineries are still low, which means that physical demand for oil is not as high as shown by the price of contracts for future supply. In June, metal prices fell slightly as China released a large stock of aluminium, copper and zinc from state reserves (source: ING Think). Premium on imports of copper cathodes from China at a multi-year low, which should mean sufficient copper stocks. Already next year, the opening of new copper mines is expected to increase physical surplus of this raw material on the market. In the segment of agricultural raw materials, the story is similar. Prices have fallen since the multi-year highs, also due to improved weather conditions in the USA, which is expected to improve the prospects for good corn and soybean yields. The drought in Brazil, on the other hand, has lowered expectations about the success of the harvest in Brazil. Another negative effect for commodities (mostly on all) have become slightly different expectations about the tightening of monetary policy by FED. Expectations of lower bond purchases and a rise in the central interest rate as early as 2022 (as the market now expects, but expectations do not always materialize) have also **strengthened the dollar**, which again reached 1.18 by 1 euro.

On European Economy

- **Retail sales at the euro area** level increased by 4.6% in May (seasonally adjusted), which is expected to grow after a sharp decline in April (-3.9%). In the categories of non-food products, sales increased by 8.8%, in the sale of fuel by 8.1%, while sales of food, beverages and tobacco even decreased (-0.2%). In France, the Netherlands and Estonia, monthly growths were above 8%, with declines in Latvia (-3.9%), Finland (-3.3%) and Luxembourg (-0.7%). In Slovenia, retail sales were still relatively low (+3.6%) after a high drop in May (-



9.7%). Sales data in May 2020 were very poor and do not offer the best picture to compare. A comparison with the average month in 2015 shows that sales in May were a quarter higher in Slovenia and 14% higher in the euro area. In terms of growth, Romania, Lithuania, Poland, Estonia and Ireland were in first place. The high falls only affected Luxembourg, but this is due to the different treatment of product sales via certain online platforms (purchases from Germany are now counted in national accounts in Germany, no longer in Luxembourg, for example).

- **The current account surplus in the EU in the first quarter of 2021** amounted to € 117 billion (3.4% of GDP), which was slightly less than in the 4th quarter of 2020 (€ 127 billion), but more than in the 1st quarter of 2020 (€ 70 billion). The surplus was largest with the United Kingdom (€ 53 billion), the USA (€ 29 billion), Switzerland (€ 22 billion) and smaller with some other countries (around € 5 billion with Brazil, Hong Kong and Canada). Deficits were largest with China (€ 27 billion), Russia (€ 4.3 billion) and Japan (€ 3.4 billion).
- Based on a **strategic review of its policies**, the ECB has taken the somewhat expected decision to change its inflation target. According to its new strategy, they will allow inflation to temporarily exceed two percent, while so far, the goal has been to be close to two percent, but below this limit. In an environment of temporarily rising inflation, the ECB will not tighten monetary policy (raise interest rates or reduce bond purchases). In the short run, this means that the ECB is unlikely to cut bond purchases even in the months when year-on-year inflation remains high. Even more important is the decision to **take into account the cost of home ownership when calculating inflation in the future**. By including these costs (housing investment costs do not fall here), the calculation of inflation will be more similar to the US. This means that a change in the prices of real estate or financial assets will not be part of this inflation basket. If it would have been included, for example, falling real estate prices and financial assets could mean lower interest rates for longer than usual. However, the inclusion of these costs in inflation (HICP index) will also be a multi-annual project, which means that we cannot expect a proper calculation of inflation in the short term. So far, only rental costs have been included in inflation. **Support for the EU's climate goals** is also very important. Between the lines, it could be seen that this could mean everything from a preference for buying corporate bonds that invest in climate targets to potential additional disclosures that commercial banks will soon have to report on (share of portfolio matching climate targets, share of loan portfolio which does not support the objectives). The ECB will thus have the power to reduce the cost of projects for environmentally sustainable projects and at the same time increase the cost of financing for projects where CO₂ emissions are high. More at: https://www.ecb.europa.eu/home/search/review/html/ecb.strategyreview_monpol_strategy_statement.en.html

Chart of the Week

Changes in CPI, Slovenia	June 21/ June 20	June 21/ May 21	Last 12 months/previous 12 months
Total	1.4	0.6	0.1
Food and non-alcoholic beverages	-0.9	0.1	1
Alcoholic beverages and tobacco	3.9	0.2	2.7
Clothing and footwear	1.7	-0.4	-2.9
Housing, water, electricity, gas and other fuels	2.5	0.1	2.5



Furnishing, household equipment and routine household maintenance	1.3	-0.1	0.4
Health	3.2	0.0	2.1
Transport	5.5	0.6	-2.8
Communications	1.4	0.4	0.6
Recreation and culture	-2.8	3.9	-1.8
Education	0.9	0.1	1.1
Restaurants and hotels	2.5	1.1	0.9
Miscellaneous goods and services	-0.3	0.2	1.0
of that: Goods	2.3	0.2	0.0
of that: Services	-0.2	1.4	0.4

Comment: Prices are only slowly creeping up. June prices were strong in category of services where restrictiveness measures have been lifted.

Must Read of the Week

- The Commodities Boom and Consumer Prices, Goldman Sachs, US Economic Analysts, 5th of July 2021, for clients only

Comment/Abstract: Analysts at Goldman Sachs estimate that unlike in the 1970s, in recent decades even extreme fluctuations in commodity prices have had only small effects on longer-term inflation expectations, and they expect this to remain the case through the current commodity boom. GS estimates that commodity input prices account for a little over 3% of final core consumer prices in US. It's probably not far away from estimates for an average European consumer.

- Financial accounts of Slovenia (quarterly bulletin) for 1Q 2021, available only in SI at: https://bankaslovenije.blob.core.windows.net/publication-files/cetrletna_informacija_julij_2021.pdf

Comment: Data on quarterly value of main financial assets in the economy, at level of NFC, government, households, and financial intermediaries.

- Cautious optimism as Eastern European economies adapt to COVID-19; more at: <https://wiiw.ac.at/cautious-optimism-as-eastern-european-economies-adapt-to-covid-19-n-515.html>. Details available only to members.

Comment: Wiiw raised its GDP forecast for 20 out of 23 countries of Central, Eastern and South-Eastern Europe. On average, the region is projected to grow by 4.2% in 2021. A new wave of COVID-19 and premature fiscal tightening are the major risks to recovery. Growth in CESEE will be driven primarily by private consumption, which could boom as the pandemic moderates. This will be fuelled by the accumulated savings from 2020 and supportive bank lending. Business investment should also contribute, with companies resuming projects they put on hold in 2020. Wiiw growth upgrade does not come as a surprise as its spring forecast was already far too conservative.

Forecast of the Week

- Exports of services, Slovenia, June 21/May 20 (Statistical Office of RS): +4.0

Comment: After a 2.3% drop in May 21 (vs. April 21) we expect a rebound in May, which is expected to be led by exports of transport and tourism services.



Things to Keep in Mind for the Upcoming Week

- Value of construction works, May 21, Slovenia, (July 15), Statistical Office of RS
- Employment, Slovenia, May 21 Slovenia, (July 16), Statistical Office of RS
- Current Account Balance, May 21, Slovenia, (July 14), Statistical Office of RS

Quote of the Week

“One thing I've noticed about history - you can search on newspapers going back hundreds of years, search for 'economic forecast,' you don't find it. It would be very rare to find it.” *(Robert J. Shiller)*

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