

Boštjan Vasle: Speech – Slovenian Bankers' Day

Speech by Mr Boštjan Vasle, Governor of Bank of the Slovenia, at the Slovenian Bankers' Day, organised by the Bank Association of Slovenia, Ljubljana, 24 November 2021.

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Ladies and Gentlemen,

My greetings to you all!

I am delighted to be able to speak to you again at your annual gathering, although I would much rather be able to do this in real life. Alas, the worsening health situation makes this impossible.

The great uncertainty surrounding the future evolution of the health situation is not affecting just our gatherings, but also the entire economic picture in Slovenia, in Europe and across the globe, and thus economic policy decisions too, including monetary policy, about which I will say more later.

The Slovenian and euro area economies have recovered well in recent quarters: Slovenia has already surpassed its pre-pandemic GDP, while the euro area overall is very close to reaching it. The unemployment rate has fallen, and firms are again facing labour shortages.

A key contribution to this positive picture has been made by economic policy: fiscal support to alleviate the impact of the pandemic amounted to more than 5% of GDP in Slovenia last year, and will be slightly lower this year at around 4% of GDP. Similar large-scale packages have been seen throughout the euro area.

In the area of monetary policy too we have put in place the largest measures to date. There are two key measures: (i) the pandemic emergency purchase programme, in the amount of EUR 1,850 billion, and (ii) extremely low-cost long-term loans to banks in the amount of EUR 2,200 billion. The two measures together amounted to an incredible 36% of euro area GDP.

But uncertainty remains high, with regard to the health picture and the economic picture alike. Despite the availability of vaccines, the health situation is worsening again, and the pandemic is once again curtailing economic activity. Further uncertainty relates to the normalisation of our policies, which we will have to embark on in the months ahead.

Meanwhile other effects of the pandemic and the measures are becoming evident: after several years of low inflation, the rate passed 4% in the euro area and 3.5% in Slovenia in October. It will rise slightly further before the end of the year. For the moment the rise is largely being ascribed to temporary factors related to developments and measures during the early part of the crisis.

- For example, one significant factor is the tax changes in Germany: they had a significant impact on euro area inflation of around 0.6 percentage points, but the effect will drop out of the calculation in the early part of next year.
- In all likelihood it will be a similar case with oil prices: after sharp rises over the last year, in recent weeks they have shown signs of easing.
- Other factors, most notably the logjams in logistics and global supply chains are currently thought to be mostly temporary in nature, although they will continue to drive inflation for at least several more quarters. They might also have a longer-term impact on inflation, particularly if they lead to the shortening of production chains or the migration of production to closer locations that are less favourable in price terms.

The rise in inflation is therefore not unexpected, but it has been more pronounced and more sustained than was anticipated at the beginning of the reversal. The key to future developments is what happens in two areas:

- the first is the expectations of firms and financial markets.
- The second, a related area, is the labour market, and the passthrough of higher prices into wage demands.

These two factors could lead to inflation remaining above 2%, its core target level, for a sustained period.

My message is the following: if the developments and projections indicate that higher inflation could become more persistent, we have sufficient instruments at our disposal to adequately address the inflationary pressures.

The first monetary policy decisions will be taken soon, in mid-December, when we decide whether to end the pandemic emergency purchase programme, and whether to potentially make changes to the APP, i.e. our ordinary asset purchases, and also decide on the fate of the targeted longer-term refinancing operations (TLTRO III). Here it is vital that the measures are designed to grant sufficient flexibility if the situation does not unfold in line with the core scenario. We must therefore ensure sufficient manoeuvring room in the event of a further deterioration in the pandemic, and thus in the economic situation, and also in the event of inflationary pressures lasting longer than anticipated and inflation being more sustained than expected.

To close, allow me to touch on the banking system. The Slovenian banking system as a whole and the individual banks have survived the crisis to date without major upheaval. The key performance indicators have remained stable, and the changes in your activities have not differed significantly from those in other euro area countries.

The anticipated normalisation of economic policy will also entail a change in your business environment, both in terms of financing and in terms of the take-up of risks, which during the crisis were to a great extent mitigated by economic policy measures. A major segment of your business activities will come to the fore again, namely lending to firms for their current operations and investment cycles, particularly in light of the broader commitments made by our country: (i) the transition to increased sustainability, and (ii) improvements in the area of digitalisation.

And it is in this area that I see considerable opportunities for the Slovenian banking system, as bank lending to firms remains significantly below the euro area average, which is one of the key reasons why the banking system remains among the smallest in the euro area in terms of total size. This is in turn one of the factors in the modest operating profits recorded by the banks.

At the ECB we have found banks to be profitable this year. The financial stability review released last week highlights that banks in the euro area differ greatly in their sources of profit. The first group, with relatively high profitability in the first half of this year, consists of banks whose increase in profits comes mainly from their primary business. The second group consists of banks with below-average profitability in the first half of the year: these banks recorded worse operating profits than last year, which they compensated for by releasing impairments and provisions and through other items.

I should end by saying that these are the key challenges facing the Slovenian banking system. After the pandemic eases, the risks to economic growth abate and economic policy normalises, you will once again need to give them greater attention, and be ready for the various scenarios that lie ahead of us.

Thank you for your time.