Information on economic, financial and monetary developments

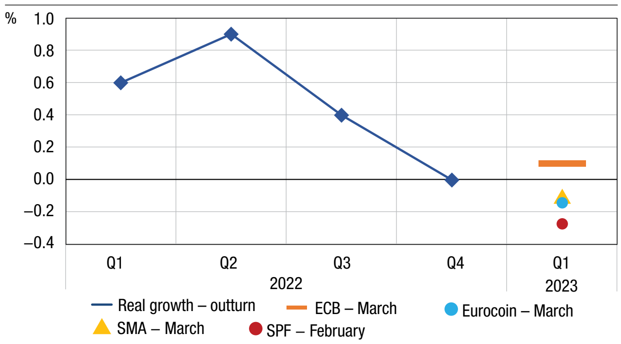
April 2023

Summary

A prolonged stagnation of real activity and a decline in the euro area annual inflation rate might mark the first quarter of 2023. At the same time, an improvement in most high-frequency economic indicators and business and consumer expectations resulted in overall positive estimates for real GDP in the first quarter compared with the previous expectations, which had suggested a potential contraction (Figure 1).[1] According to seasonally adjusted data, industrial production in the euro area grew by 0.7% in January from December 2022, but only in the segment of the production of intermediate goods, mainly due to the return of supply chains to normal and the decrease in energy costs. The recovery was uneven, with industrial production in Germany recovering considerably from December and other major countries, Italy, Spain and notably France, reporting a monthly fall. The retail trade turnover also grew slightly in January (0.3% from December), which is less than expected and points to a persistent weakness in personal consumption in the environment of high inflation and lower real income. Notwithstanding the increase in the cost of living and unfavourable financing conditions, consumer confidence grew in February and March, with the PMI data suggesting further improvement in aggregate demand, notably in services, and industry continued to record a decline in new orders. The slowdown in the annual consumer price inflation in the euro area intensified, from 8.5% in February to 6.9% in March, reflecting the fall in energy prices. However, the core inflation continued to edge up (from 5.6% in February to 5.7% in March) due to the spillover of earlier price increases in energy and raw materials and labour market pressures. Standing out among individual components in terms of intensity of growth are the prices of services (Figure 2) and prominent among member states is Germany, where the growth in the prices of services also contributed considerably to the rise in core inflation

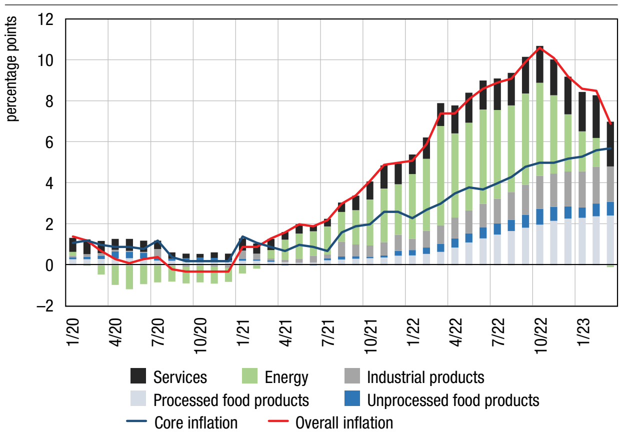
The available high-frequency data, included in the CNB's nowcasting model of economic activity (MRGA), indicate that Croatia's real GDP could grow by 0.7% in the first quarter of 2023 from the end of 2022, while its annual growth could amount to 2.2% (Figure 3). Industrial production continued its relatively strong monthly growth in February due to the pronounced growth in energy production, while manufacturing output decreased. After the decline in the second half of 2022, retail trade turnover held steady in January and February compared with the last quarter in 2022. Construction activity, following strong growth towards the end of the previous year, fell noticeably in January from December. Construction works on buildings and civil engineering, mostly associated to investment activity of the public sector, decreased. Labour market developments remained relatively favourable and, even though the number of employed persons grew and the growth in wages accelerated, consumer confidence fell in March below its long-term average. Business confidence stayed above its historical average, continuing to trend upwards in March in all activities, except

Figure 1 Quarterly growth rates of real GDP in the euro area



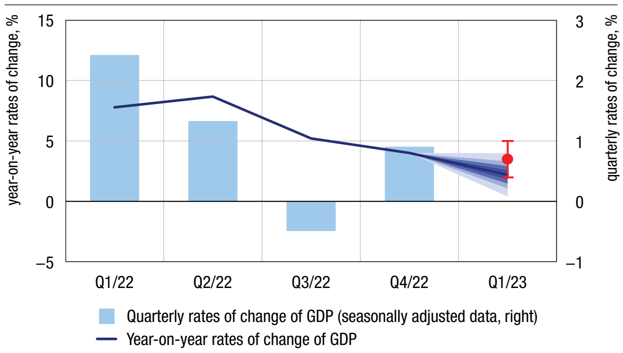
Notes: Abbreviation ECB – March refers to ECB March projections of real growth in the euro area (Macroeconomic Projection Exercise, MPE). Abbreviations SMA (Survey of Monetary Analysts) and SPF (Survey of Professional Forecasters) refer to the results of the ECB survey of market participants in February and March. The Eurocoin indicator developed by Banca d'Italia refers to the model for nowcasting the quarterly rate of change in the real GDP of the euro area derived from the available high-frequency data (March estimate).
Sources: Eurostat, ECB and Banca d'Italia.

Figure 2 Annual rates of inflation in the euro area



Note: Core inflation is measured by the harmonised index of consumer prices that excludes energy, food, alcoholic beverages and tobacco prices.
Source: Eurostat.

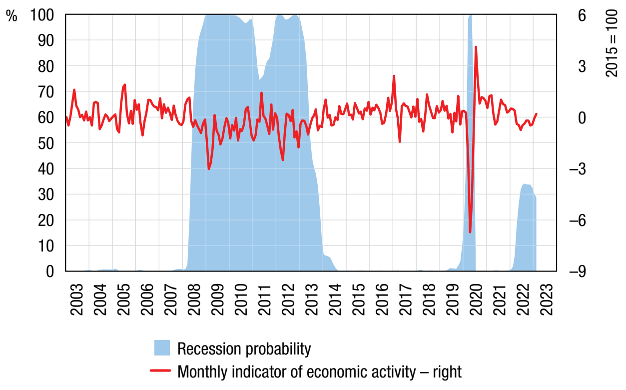
Figure 3 Quarterly gross domestic product



Notes: The estimate for the first quarter of 2023 refers to the Monthly indicator of real economic activity of the CNB (for more details on the calculation of the MRGA indicator, see Kunovac, D., and B. Špalat: "Nowcasting GDP Using Available Monthly Indicators", CNB Working Paper, W-39). The models are estimated on the basis of data published until 31 March 2023. The red dot denotes an estimate of the quarterly change in real GDP, with historical errors of estimates within ±1 standard deviation.
Sources: CBS (seasonally adjusted by the CNB) and CNB calculations.

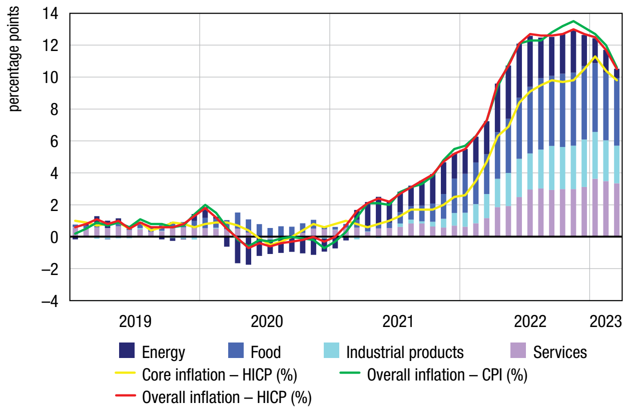
1 In addition to figures shown in the Information on economic, financial and monetary developments, there is an additional group of figures and relevant data from which they were derived. These figures and time series are shown in an Excel datafile Annex: Figures and tables

Figure 4 Recession indicator
seasonally adjusted real values



Note: The monthly indicator of economic activity is a synthetic index of economic activity constructed on the basis of available high-frequency indicators using a principle component analysis method (for more details see HNBlog "Ulazi li Hrvatska u recesiju?" by Kunovac and Šimatović).
Source: CNB.

Figure 5 Inflation indicators in Croatia

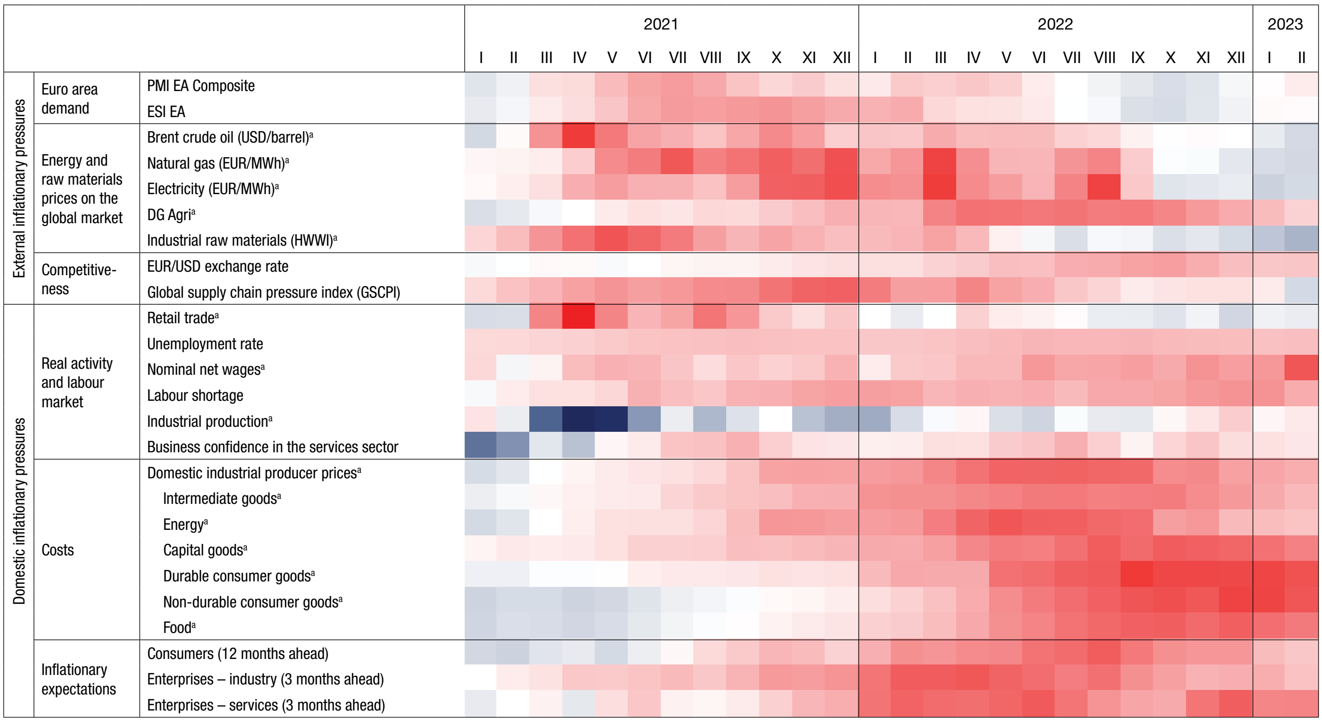


Notes: Core inflation is measured by the harmonised index of consumer prices that excludes energy, food, alcoholic beverages and tobacco prices. The last available data refer to the first estimate for February 2023.
Sources: Eurostat and CNB calculations.

for Industry. In line with developments described above, the recession probability estimate for the domestic economy decreased in the first quarter of 2023 compared with the previous quarter and currently stands at about 30%(Figure 4).

Inflation in Croatia declined for the fourth month in a row and, after reaching 11.7% in February, the annual inflation rate (measured by the harmonised index of consumer prices) amounted to 10.5% in March 2023, according to Eurostat's flash estimate. Energy prices contributed the most to the slowdown in total inflation (Figure 5) due to a noticeable decrease in refined petroleum product prices in March and the strong impact of the base period (i.e. the leap in energy prices after the outbreak of the war against Ukraine at the end of February 2022). Moreover, core inflation slowed down modestly, from 10.4% in February to 9.8% in March, and the growth in food product prices held steady at the previous month's level. The easing of inflationary pressures (Figure 6) was in particular driven by import factors related to price developments in energy and other raw materials in the global market as well as to further alleviation of pressures in global supply chains. Inflation pressures also eased at the euro area level, accompanied by the continued slowdown in the annual growth of producer prices on the domestic market. The base effect of the steep increase in prices in 2022 also contributed to the decline in the annual inflation rate. By contrast, a relatively fast growth in nominal wages and labour force shortages, coupled with the effects of previous increases in the prices of energy and other raw materials as well as intermediate goods, helped to keep core inflation elevated.

Figure 6 Indicators of external and domestic price pressures



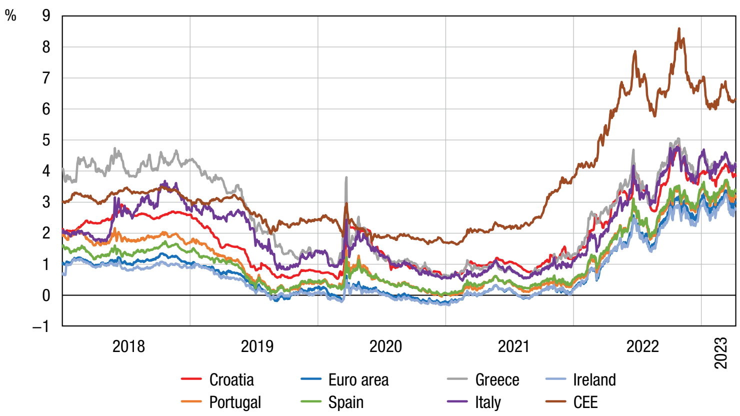
[a] Annual rate of change.
Notes: Labour shortage shows the ratio between the vacancy rate and the registered unemployment rate. The PMI EA Composite and ESI EA series have been corrected after standardisation so as to show the neutral value in white. Grey indicates that no data are available in the current month.
Sources: ECB, SDW, Eurostat, Bloomberg, NY Fed, HWWI, CBS and Ipsos.

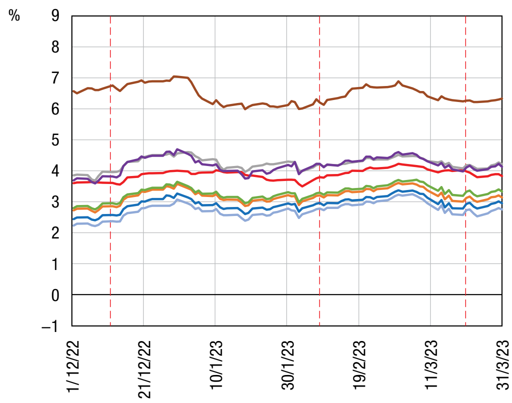
In addition, inflationary expectations of consumers increased in March from February but remained much lower than at the end of the previous year. Therefore, the return of inflation rate to low levels is expected to be only gradual and accompanied by pronounced risks.

Due to concerns about financial market tensions possibly leading to tighter financing conditions, participants in these markets moderated their expectations of further monetary policy tightening so that currently only a slight further increase in key interest rates is expected. Also, amid rising uncertainty, the volatility of the expected path of interest rates increased. Tensions in euro area financial markets grew in March due to the failure of two US banks, Silicon Valley Bank and Signature Bank, and the failure of the Swiss bank Credit Suisse. This has reinforced the still pronounced uncertainty about the outlook for inflation and economic growth and heightened volatility in short-term and long-term interest rates in the financial markets. The six-month EURIBOR fell sharply in mid-March but returned to the level recorded at the end of February (3.3%) by the end of the month. Following the entry into force of the last ECB decision to raise the key interest rates by 50 basis points, the €STR grew to 2.9% on 22 March, remaining at that level until the end of the month (Figure 8). The increase in key ECB interest rates spilled over partly to the Croatian money market. Thus the overnight interest rate on banks' demand deposit trading stood at 2.4% at the end of March, up from 2.1% at the end of February. As regards the government's long-term financing costs, the mounting financial market tensions in March led to a fall in long-term government bond yields. Yields on long-term government bonds in Croatia declined to the same extent as euro area GDP-weighted government bond yields (Figure 7). The yield on long-term bonds in Croatia stood at 3.8% at the end of March, down by 31 basis points from the end of February.

The pass-through of the increase in key ECB interest rates to domestic financing conditions continued in February, mostly marked by the rise in interest rates in Croatia. The average interest rate on pure new loans to non-financial corporations was 3.7% in February, up by 53 percentage points from January (Figure 9). Despite the increase in interest rates, loans to non-financial corporations continued to grow; however, their annual growth rate fell to 20.1% in February due to the base effect, i.e. stronger corporate lending in February 2022

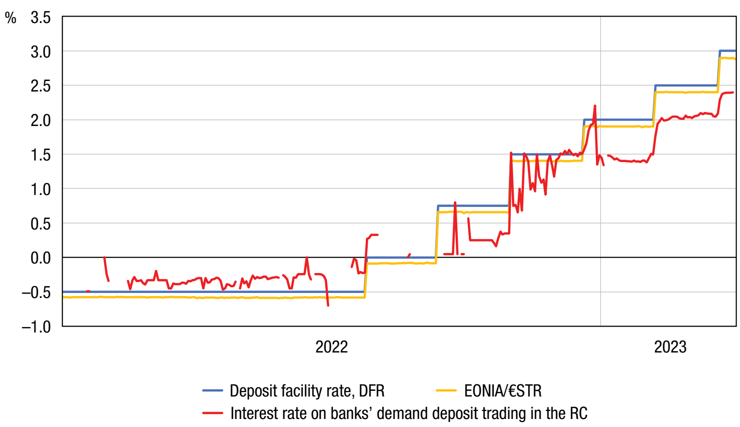
Figure 7 Yields on long-term government bonds with the remaining maturity of approximately 10 years

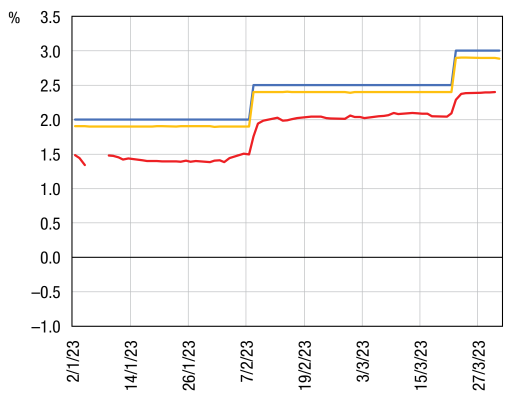




Notes: CEE – countries of Central and Eastern Europe (the Czech Republic, Hungary, Poland and Romania); yields for the euro area and CEE have been weighted by the share of GDP of the countries included. Data from the euro area do not include those from Estonia, Latvia, Luxembourg and Malta. The red dotted lines denote ECB Governing Council meetings in December, February and March.
Sources: Bloomberg, Eurostat and CNB calculations.

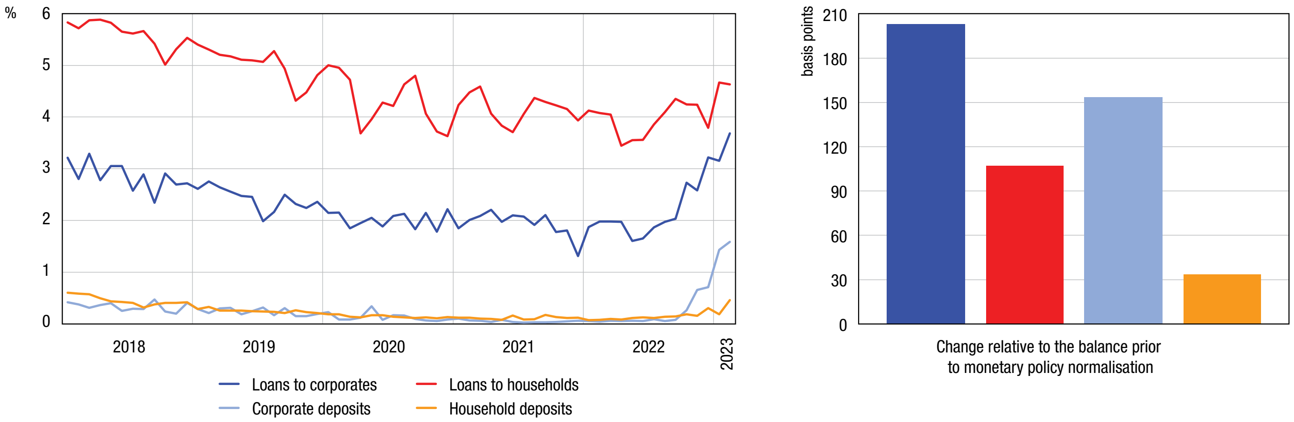
Figure 8 ECB key interest rate and overnight market interest rates in the euro area and Croatia





Notes: The EONIA was replaced by €STR in early 2022. The overnight interest rate on the money market in Croatia in 2022 is based on euro transactions.
Sources: ECB and CNB.

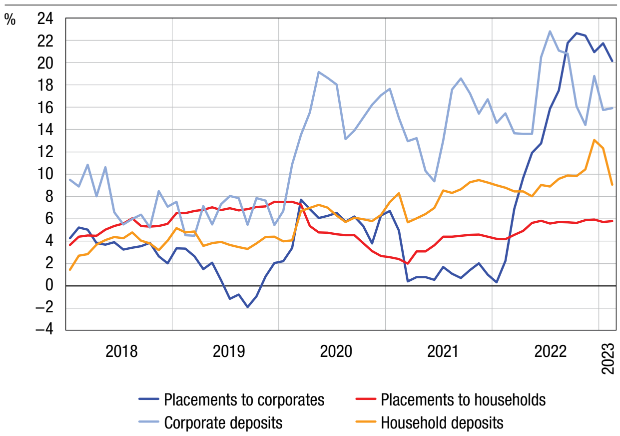
Figure 9 Interest rates on pure new loans and time deposits of corporates and households



Notes: Data up to December 2022 refer to loans and deposits in kuna, in kuna with a currency clause in euro and in euro, and from January 2023 to loans and deposits in euro. The balance before monetary policy normalisation refers to June 2022.
Source: CNB.

(Figure 10). Lending to households grew modestly while interest rates remained almost unchanged. As a result, the average interest rate on pure new housing loans remained at its January level (2.9%) and that on general-purpose cash loans edged up (5.6%). A stronger growth in housing loans is expected in the following months due to the effects of the implementation of the new round of the government housing loans subsidy programme as of mid-March. Interest rates should not increase significantly given that subsidised housing loans are granted at interest rates that are lower than market averages. Trends in time deposits show that the interest rate on funds deposited by corporates was 15 basis points higher than in January (1.6%), contributing to further reallocation of funds from overnight deposits to time deposits. In the household sector, the purchase of government bonds, which by the end of February reached the amount of about EUR 1bn, resulted in a strong fall of deposits. Moreover, the average interest rate on pure new time deposits reached 0.5% in February, up by 30 basis points from January.

Figure 10 Corporate and household placements and deposits



Note: Annual rates of change, transaction-based.
Source: CNB.