Information on economic, financial and monetary developments

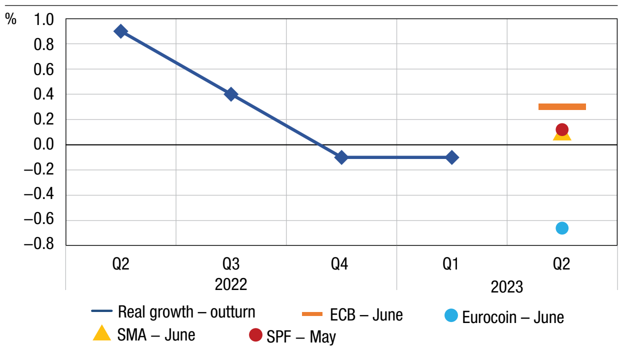
July 2023

Summary

The euro area economy recorded a slight contraction in the last two quarters (–0.1%) and technically sank into recession. Economic activity might remain weak in the second quarter, with large discrepancies between different projections, varying from positive to negative, which also reflects different signals from individual segments of the economy (Figure 1)[1] . The unfavourable trends in the manufacturing sector were largely offset by a strong upswing in the services sector in the past few quarters. However, some high-frequency data, especially the purchasing manager index, show signs of a slowdown in activity in the services sector as well towards the end of the second quarter. Given that manufacturing has been in contractionary territory for some time, the total purchasing manager index reached the demarcation line between expansion and contraction of the economy in June. The first estimates suggest that inflation fell to 5.5% in June, from 6.1% in May, again largely on the back of declining energy prices. Core inflation (excluding food and energy) edged up from 5.3% in May to 5.4% in June, which indicates the persistence of inflationary pressures, even if one-off statistical factors influencing the trend in core inflation are taken into account. In addition, there are still marked differences among inflation rates across euro area member states.

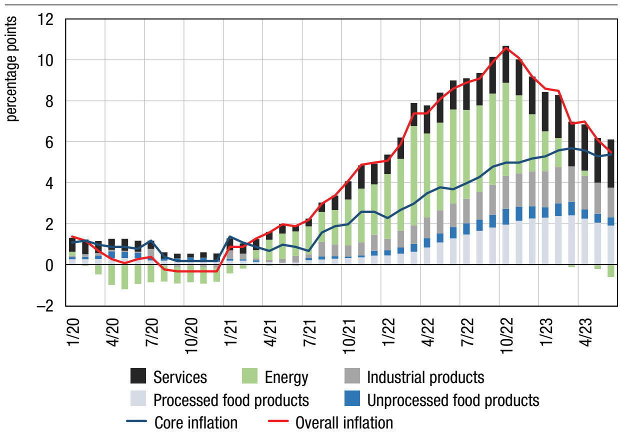
Economic activity in Croatia continued its steady upward trend in the second quarter, at the pace seen at the beginning of the year. According to high-frequency indicators, real GDP is estimated to have grown by 1.3% from the quarter before, even though the annual growth rate might edge down to 2.6% due to the base effect (Figure 3). Industrial production continued to grow quarter-on-quarter in April and May, albeit at a slower pace from the quarter before, which is associated with a decline in the production of capital goods, following their strong upswing in the past eight quarters, and an accelerated decrease in the production of durable goods. In contrast, favourable developments in the production of energy and non-durable consumer goods continued, with a slight increase in the production of intermediate goods, following their decline in the previous quarter. After stagnating in the previous two quarters, retail trade improved perceptibly, mirroring favourable labour market trends and the recovery in real income underpinned by the continued growth in employment and the rise in real wages, which also boosted consumer optimism. The services sector also recorded positive developments, reflected in the turnover volume of service activities, the amount of fiscalised receipts and nights stayed by foreign tourists. According to eVisitor data, the number of tourist overnight stays in the second quarter was 9% higher than in the same period last year and was relatively broadly based. According to data for counties with high tourist turnover, the Dubrovnik-Neretva County recorded the sharpest growth in the number of overnight stays (by almost 20%), while the number of overnight stays in the Šibenik-Knin County grew only slightly from the previous year, by 0.5% (Figure 4). However, the number of tourist nights in June was slightly lower than the year

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



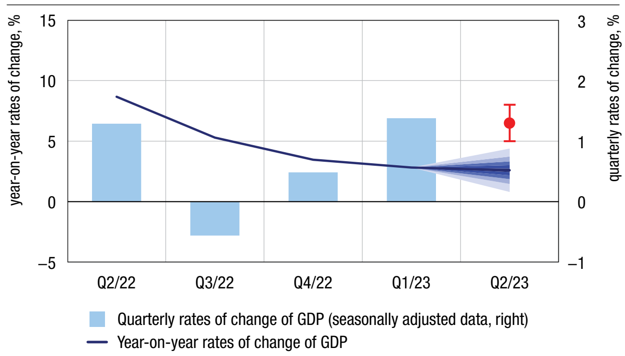
Notes: Abbreviation ECB – June refers to ECB June projections of real growth in the euro area (Broad Macroeconomic Projection Exercise, BMPE). Abbreviations SMA (Survey of Monetary Analysts) and SPF (Survey of Professional Forecasters) refer to the results of the ECB survey of market participants in June and May respectively. 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 (June 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.

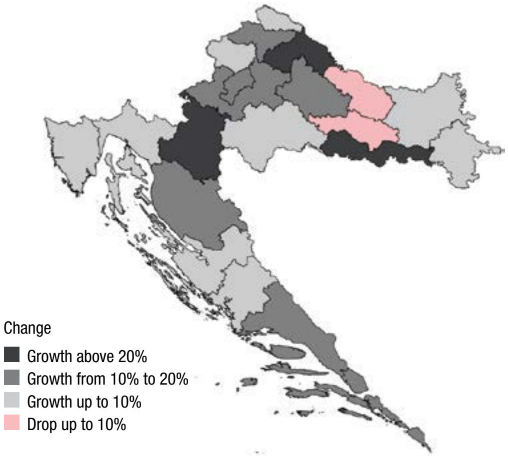
Figure 3 Quarterly gross domestic product



Note: The estimate for the second 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 30 June 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.

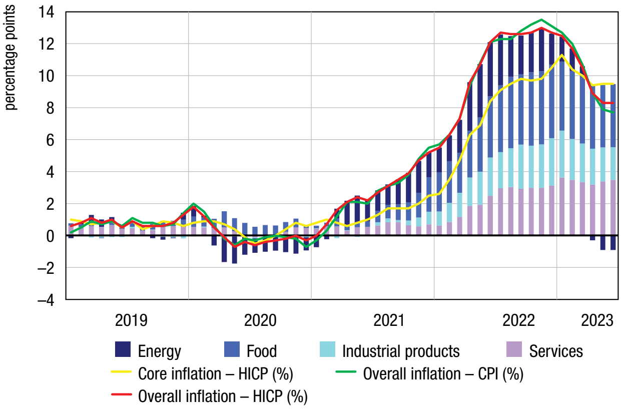
1 In addition to figures shown in the Information on economic, financial and monetary developments, there is an additional group of figures and relevant data from which they were derived. These figures and time series are shown in an Excel datafile Annex: Figures and tables

Figure 4 Change in the number of overnight stays in the second quarter of 2023 from the same period in 2022



Source: eVisitor.

Figure 5 Inflation indicators in Croatia

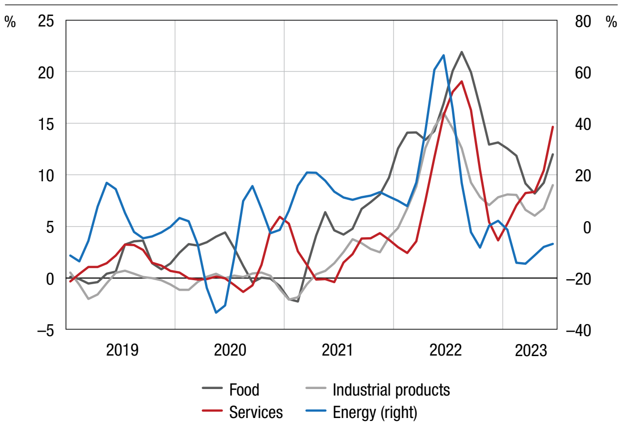


Notes: Core inflation is measured by the harmonised index of consumer prices, which excludes energy, food, alcoholic beverages and tobacco prices. The last available data refer to the first estimate for June 2023.
Sources: Eurostat and CNB calculations.

before, which is also associated with the holidays schedule in the main outbound markets. Business confidence in the services sector edged down, although it remained above its long-term average. A slip in confidence was observed in both industry and trade in June, while optimism in construction increased further from the already relatively high levels. As a result, it seems that the fall in construction activity in April might be only temporary (partly due to inclement weather hampering construction activity). Employment continued to grow in the second quarter, which also partly led to a drop in the unemployment rate, while the growth in nominal wages continued to accelerate, albeit at a somewhat more subdued pace than in early 2023. Real wages also rose considerably, underpinned by the gradual slowdown in inflation.

The annual inflation rate measured by the harmonised index of consumer prices held steady at 8.3% in June, after slowing down for six consecutive months. The annual rate of change in energy prices remained unchanged at –7.0%, while the annual growth rate of food prices (including alcohol and tobacco) edged up to 13.5%, with almost unchanged contributions of these two components. Core inflation also remained at a high

Figure 6 Momentums of main inflation components



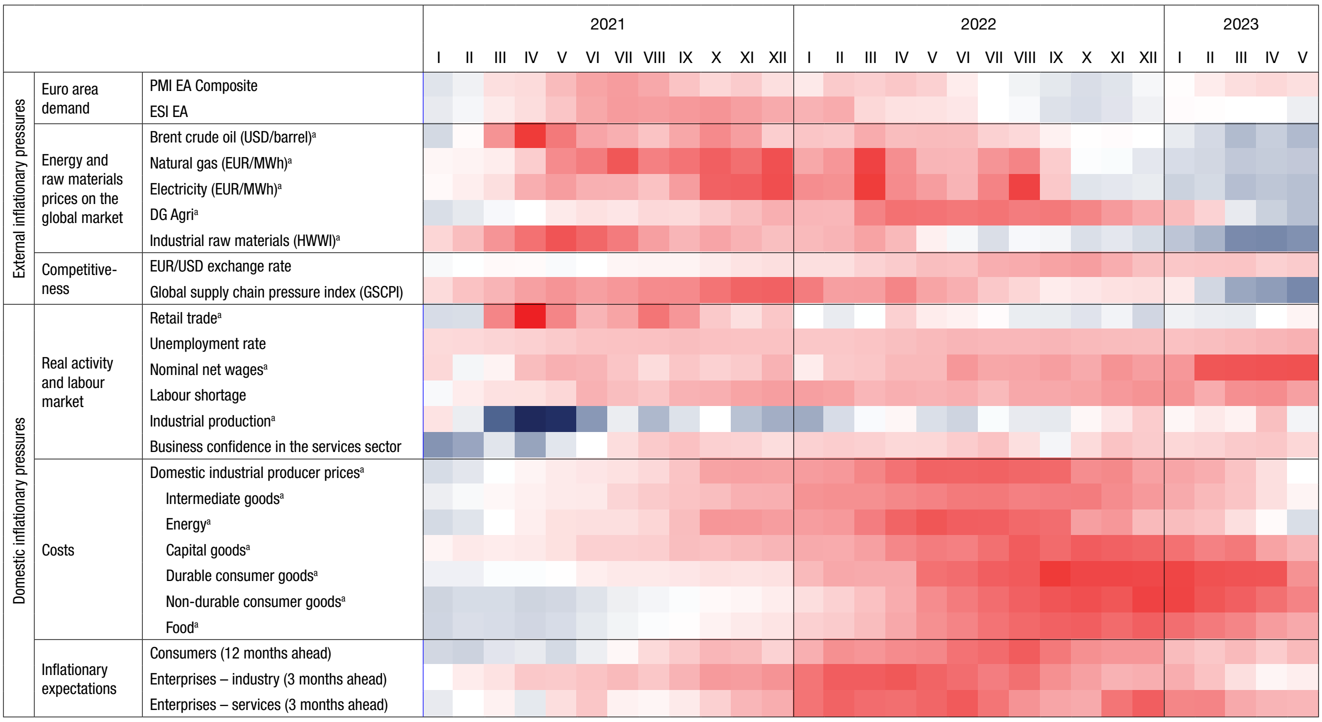
Note: The quarter-on-quarter rate of change is calculated from the quarterly moving average of seasonally adjusted harmonised consumer price indices.
Sources: Eurostat and CNB calculations.

9.5% (Figure 5). Short-term inflation indicators increased, with a rise in the momentum of inflation in the prices of food, services and industrial products, which is associated with the persistently high producer prices of food products and other consumer goods (Figure 6). Such movements suggest that the annual growth rate of prices might remain elevated. In contrast, inflationary pressures related to other raw materials and energy continued to recede and were considerably weaker than last year. The prices of Brent crude oil on the global market stabilised at a level below USD 80.00 per barrel in the past two months, while the prices of natural gas in the European market held at a level of around EUR 30.00/MWh (much below the average in 2022). Prices of other raw materials continued to trend down, with a comprehensive normalisation of global supply chains (Figure 7), which explains a considerable deceleration in the momentums of inflation components, relative to the peak levels reached in mid-2022, despite their recent increase.

ECB's key interest rates were raised by a further 25 basis points at the meeting of the Governing Council on 15 June. The interest rate on monetary deposits of credit institutions with the central bank (currently the most important ECB key interest rate) has been set at 3.50% starting from 21 June (Figure 8). In addition, investments under the asset purchase programme (APP) will be discontinued as of July 2023. As concerns the pandemic emergency purchase programme (PEPP), the principal payments from maturing securities purchased under the programme are to be reinvested until at least the end of 2024.

The increase in ECB's key interest rates quickly spilled over to money market interest rates, while yields in the government bond market remained stable. The pass-through of the June increase in key ECB interest rates of 25 basis points to the unsecured money market segment was immediate and complete, with the €STR rising to 3.4% and holding steady at that level until end-June. The three-month EURIBOR continued to climb, reflecting expectations of further key interest rate hikes, albeit at a slower pace than in the past few months (Figure 11), reaching 3.6% at the end of June, its highest level since late 2008. The increase in key interest rates spilled over quickly to the Croatian money market. Thus the overnight interest rate on banks' demand deposits trading rose by 23 basis points in June, standing at 3.1% at the end of that month. As in the previous few months, long-term government bond yields recorded no significant changes in June and remained almost unchanged

Figure 7 Indicators of external and domestic price pressures



[a] Annual rate of change.

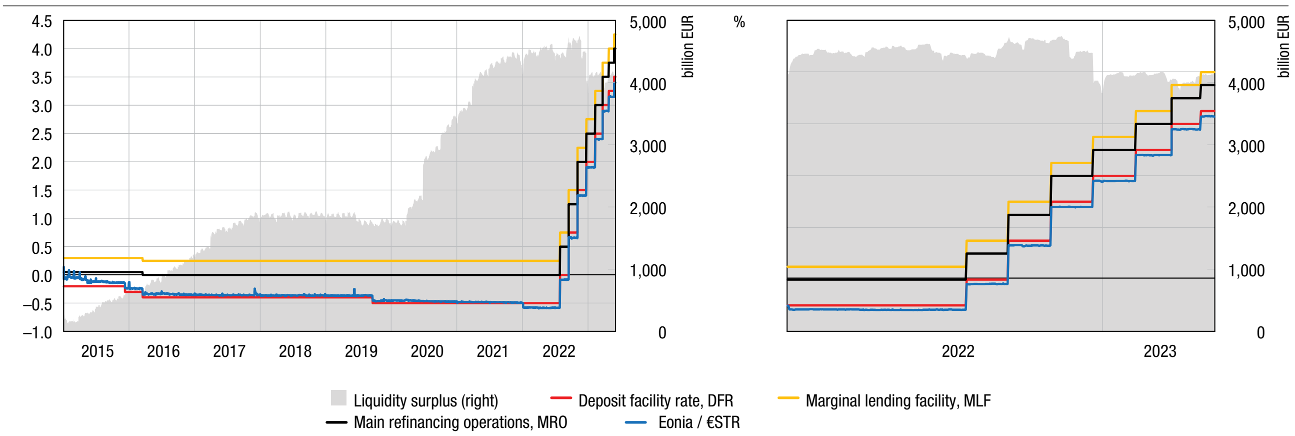
Notes: Labour shortage shows the ratio between the vacancy rate and the registered unemployment rate. The PMI EA Composite and ESI EA series have been corrected after standardisation so as to show the neutral value in white. Grey indicates that no data are available in the current month.

Sources: ECB, SDW, Eurostat, Bloomberg, NY Fed, HWWI, CBS and Ipsos.

in late June from the levels recorded at end-May (Figure 10). The euro area GDP-weighted average of long-term government bond yields stood at 3.1% at the end of June, with the yield on long-term Croatian bonds standing at 3.8%.

The tightening of monetary policy in the euro area continued to influence the interest rates of domestic banks. The average interest rate on pure new loans to non-financial corporations decreased by 15 basis points in May, to 4.5% (Figure 12), driven by several factors. On the one hand, the share of syndicated loans (granted at relatively high interest rates) in total financing decreased, while on the other hand the share of loans granted at relatively low interest rates (working capital loans) increased. If the impact of the change in the structure of newly granted loans is excluded, May saw a rise in the costs of corporate financing. However, lending activity remained robust, while further slowdown in the growth of corporate loans on an annual basis, from 15.2% in April to 13.9% in May, was due to base effects associated with exceptionally high amounts of corporate loans granted in mid-2022 (Figure 13). As regards the borrowing costs of households, the interest rate on pure new housing loans remained almost unchanged in May, at the level of 3.0%. The new round of the government housing loans subsidy programme triggered an increase in the amount of housing loans granted and a slight decrease in the average interest rate on household loans, given that subsidised housing loans are usually granted at lower interest rates than the market average. The growth of general-purpose cash loans accelerated, from 5.0% to 5.7% on an annual basis. The interest rate on pure new

Figure 8 ECB key interest rates and reference market interest rates in the euro area

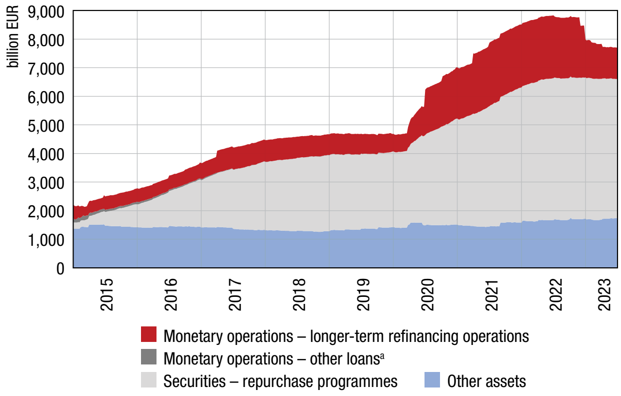


Notes: DFR (deposit facility rate); MLF (marginal lending facility); MRO (main refinancing operations). The EONIA was replaced by €STR in early 2022.

Source: ECB.

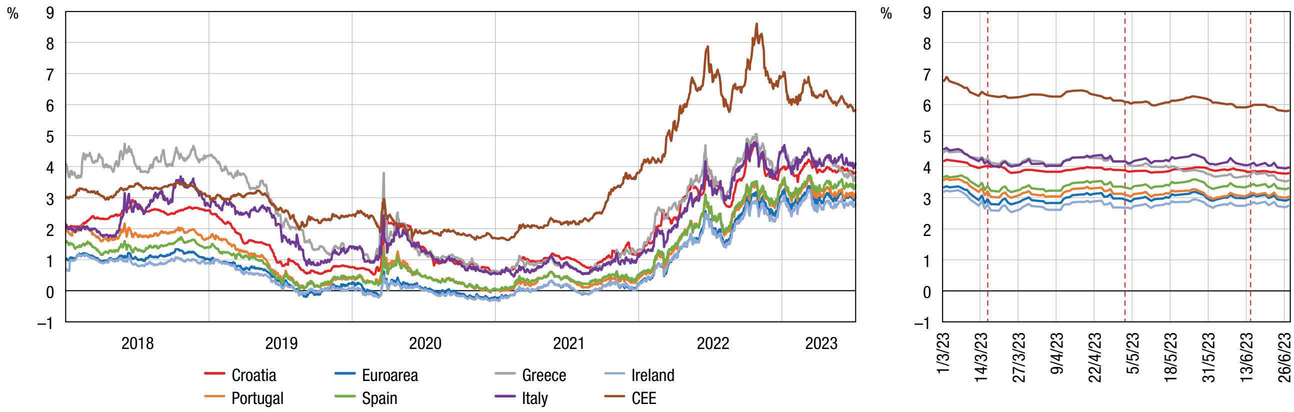
general-purpose cash loans stood at 5.81% in May, up by 18 basis points from April. The tightening of monetary policy also affected the interest rates on bank deposits. The interest rate on pure new time deposits of non-financial corporations reached 2.32%, up by 227 basis points from June 2022. Over the same period, the interest rate on pure new household time deposits edged up by 76 basis points, to 0.9% in May.

Figure 9 Eurosystem balance sheet



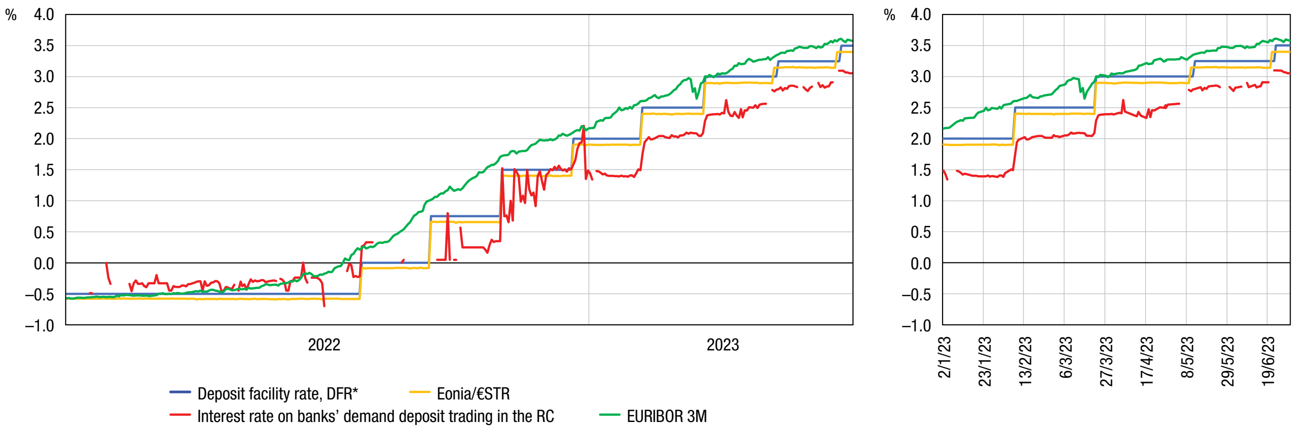
Note: The Eurosystem monetary balance sheet asset items are shown in grey and red and non-monetary in blue. [a] Other loans include main refinancing operations, fine-tuning reverse operations, structural reverse operations, marginal lending facility and credits related to margin calls.
Source: ECB.

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



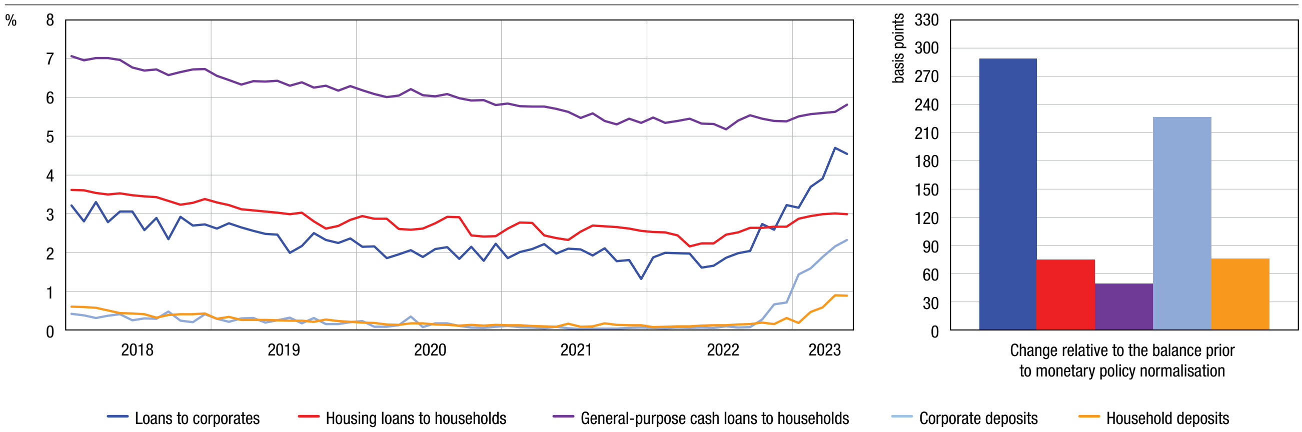
Notes: CEE – countries of Central and Eastern Europe (the Czech Republic, Hungary, Poland and Romania); yields for the euro area and CEE have been weighted by the share of GDP of the countries included. Data from the euro area do not include those from Estonia, Latvia, Luxembourg and Malta. The red dotted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

Figure 11 ECB key interest rate and overnight market interest rates in the euro area and Croatia



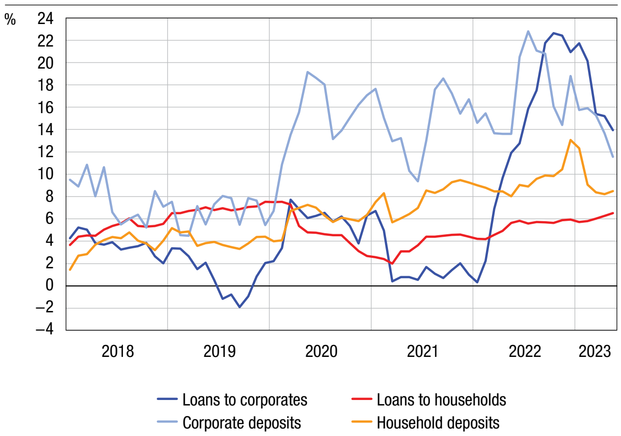
Notes: DFR (deposit facility rate). The EONIA was replaced by €STR in early 2022. The overnight interest rate on the money market in Croatia in 2022 is based on euro transactions.
Sources: ECB and CNB.

Figure 12 Interest rates on pure new loans and time deposits of corporates and households



Note: 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.
Source: CNB.

Figure 13 Corporate and household loans and deposits



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