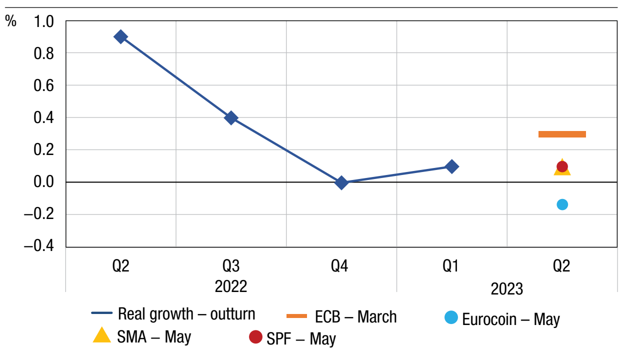
Information on economic, financial and monetary developments

May 2023

Summary

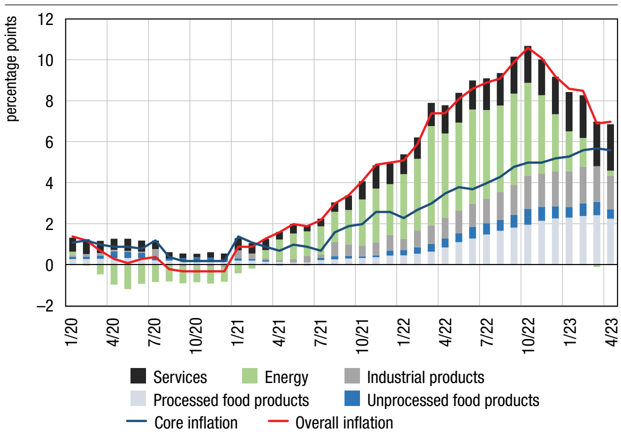
Following a stagnation in the last quarter of last year, according to preliminary Eurostat data, the real activity in the euro area rose by a slight 0.1% on a quarterly level in the first three months of 2023. Poor economic growth in the euro area is expected to continue in the second quarter. Compared to the end of 2022 and the expectations for the beginning of the year, the first quarter witnessed more favourable developments in most of the high-frequency indicators of economic activity and business and consumer expectations. Similar trends continued into April, and according to the data available, the GDP nowcasting model for the euro area in the second quarter also suggests low but positive growth rates (Figure 1)[1]. Diverging developments were observed in different economic activities and among member states. Thus, for instance, the purchasing manager index in services activities continued to rise, suggesting a marked expansion, in contrast with developments in manufacturing, which again witnessed a deterioration and a further fall in the contraction zone. According to preliminary data, the German economy stagnated at the beginning of the year, while the remaining three major economies, Italy, France, and Spain witnessed a growth in real economic activity. After slowing down for five consecutive months, the annual inflation rate in the euro area accelerated slightly in April to 7.0% from 6.9% in March, mostly due to the increased contribution of the energy component. Core inflation, excluding food and energy prices, slowed down slightly, having fallen from 5.7% in March to 5.6% in April (Figure 2).

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 May. 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 (May estimate).
Sources: Eurostat, ECB and Banca d'Italia.

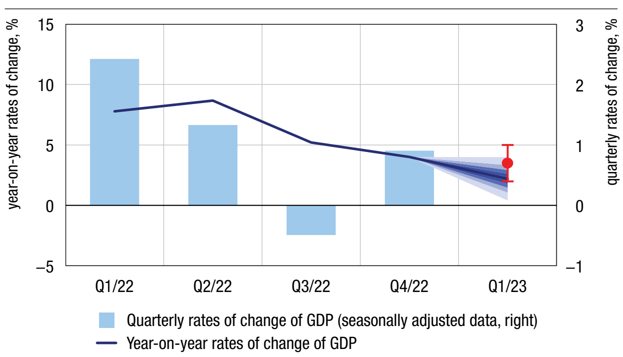
Figure 2 Annual rates of inflation in the euro area



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

High-frequency data for the first quarter suggest a further growth in domestic economic activity, with Croatia's real GDP in the first quarter of the year, according to the CNB's nowcasting model of economic activity, possibly rising by 0.7% from the end of 2022, and by 2.2% on an annual level (Figure 3). The growth in industrial production accelerated on a monthly level in March (Figure 4), reflecting the growth in the production of intermediate goods and non-durable consumer goods. On the first quarter level, industrial production rose by 1.4% from the end of 2022, after having fallen in the previous three quarters. Construction activity rose in February after falling in January this year, which resulted in stagnation compared to the previous quarter's average. The volume of construction works on buildings increased, while that of civil engineering works, mostly associated with public investment, decreased slightly from the end of the year before. The real retail trade turnover fell in March from the stagnation of the previous month. Such developments in the first quarter resulted in a fall of 0.4% from the end of the previous year, thus continuing the negative trend present from the beginning of the second half of 2022. It seems that subdued consumption in retail trade, despite wage growth, is largely due to relatively low consumer confidence, which continues to hold steady at long-term average levels. Employment growth continued into the first quarter, while the growth in nominal wages accelerated strongly and was

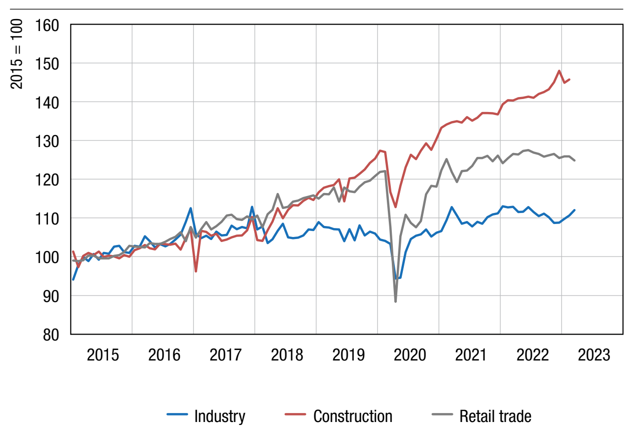
Figure 3 Quarterly gross domestic product



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 28 April 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.

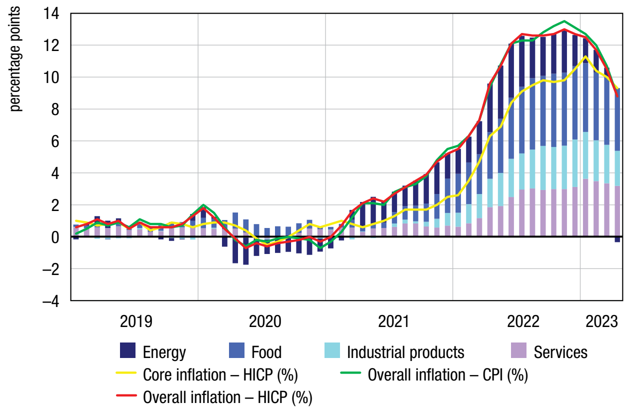
1 In addition to figures shown in the Information on economic, financial and monetary developments, there is an additional group of figures and relevant data from which they were derived. These figures and time series are shown in an Excel datafile Annex: Figures and tables

Figure 4 High-frequency indicators of economic activity
seasonally adjusted real values



Source: CBS.

Figure 5 Inflation indicators in Croatia

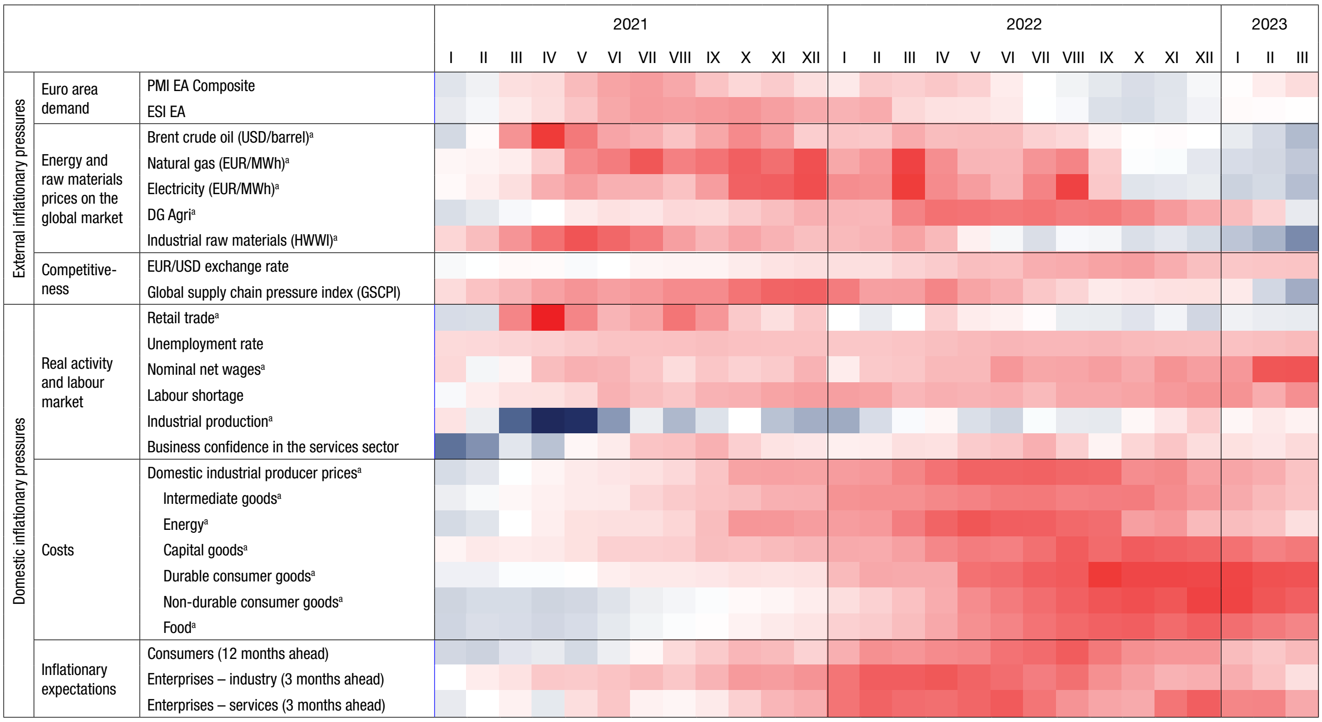


Notes: Core inflation is measured by the harmonised index of consumer prices that excludes energy, food, alcoholic beverages and tobacco prices. The last available data refer to the first estimate for April 2023.
Sources: Eurostat and CNB calculations.

broadly based. Real wages also rose, after falling for the previous five consecutive quarters.

The annual inflation in Croatia continued to slow down for the fifth consecutive month and, according to the first Eurostat estimate, in April it stood at 8.8% (measured by the harmonised index of consumer prices), down from 10.5% in March. The slowdown in overall inflation was due to all the main components, but mostly to energy prices (Figure 5), once the effect of gas and electricity price increases in April 2022 had waned. Albeit to a lesser extent, the slowdown was also driven by food prices, however, their contribution continues to be the biggest of all major components of inflation. At the same time, the slowdown in the growth in industrial products and services prices brought core inflation down from 10.0% in March to 9.3% in April. The easing of inflationary pressures (Figure 6) is largely the result of weaker imported pressures due to a fall in the prices of energy and other raw materials on the global market. The prices of natural gas and electricity on the international market fell by 50% from the month prior to the outbreak of the war in Ukraine, and the prices of industrial raw materials have fallen to record lows in the past two years. In addition to lower prices of raw materials, the pressures in the global supply chains also continued to ease. For now, lower input costs in the production process are spilling relatively slowly to producer prices of consumer goods; however, the developments in corporate inflationary expectations in industry, which have been trending downwards since February, suggest a further slowdown in their growth. In contrast, the strong labour market

Figure 6 Indicators of external and domestic price pressures



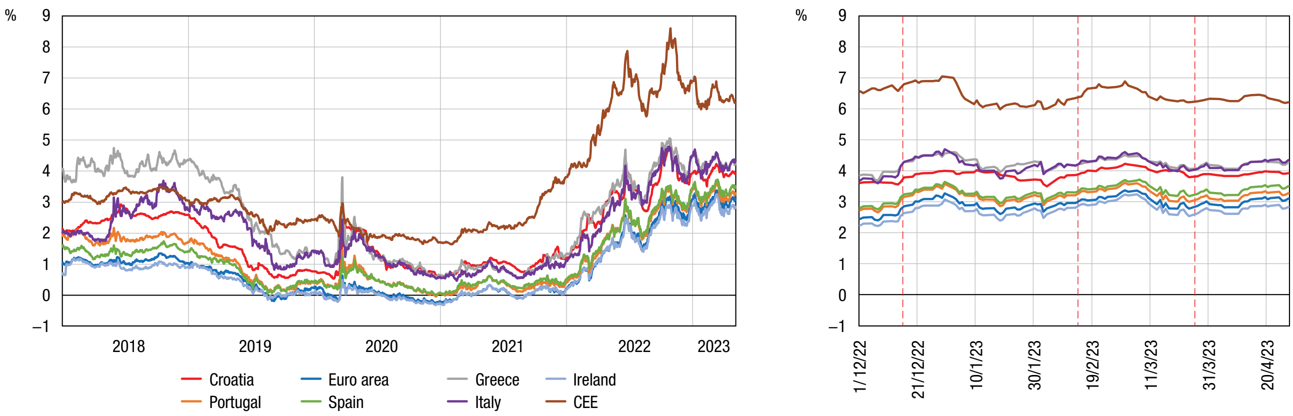
[a] Annual rate of change.
Notes: Labour shortage shows the ratio between the vacancy rate and the registered unemployment rate. The PMI EA Composite and ESI EA series have been corrected after standardisation so as to show the neutral value in white. Grey indicates that no data are available in the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

marked by a steady employment growth and a fall in unemployment and a much faster wage growth (partly attributable to the adjustment for the loss of purchasing power accumulated since the second half of 2021) contribute to keeping core inflation at elevated levels.

Following increased volatility in March associated with the uncertainties concerning the state of U.S., and, to a much lesser extent, European banks, the global financial markets showed signs of stabilisation in April. After falling to 2.7% in mid-March, in the expectation of a slowdown in the intensity of the interest rate hike, by the end of the month the quarterly EURIBOR returned to the level of 3.0% and at the end of April stood at 3.3% (Figure 8). The pass-through of the increase in key ECB interest rates of 50 basis points to the unsecured segment of the money market was immediate and complete, with the €STR rising to 2.9% and holding steady at that level until end-April. The increase in ECB key interest rates also spilled to the Croatian money market, but the overnight rates in Croatia remained at a somewhat lower level. Thus the overnight interest rate on banks' demand deposits trading rose by 40 basis points in March, reaching 2.4% at the end of that month and held steady at that level until end-April. As regards the costs of short-term government financing, the interest rate on one-year T-bills of the Ministry of Finance at the last auction in April was 3.3%, up from 2.9% in March. As for the costs of long-term government financing, after a brief fall in the yields on long-term government bonds in March, the yields on euro area government bonds continued to rise slightly in April, with the yield on long-term Croatian bonds standing at 3.9%, up by 3 basis points from the end of March (Figure 7). Nevertheless, at end-April, the yields on long-term Croatian bonds were still slightly lower than at the end of February.

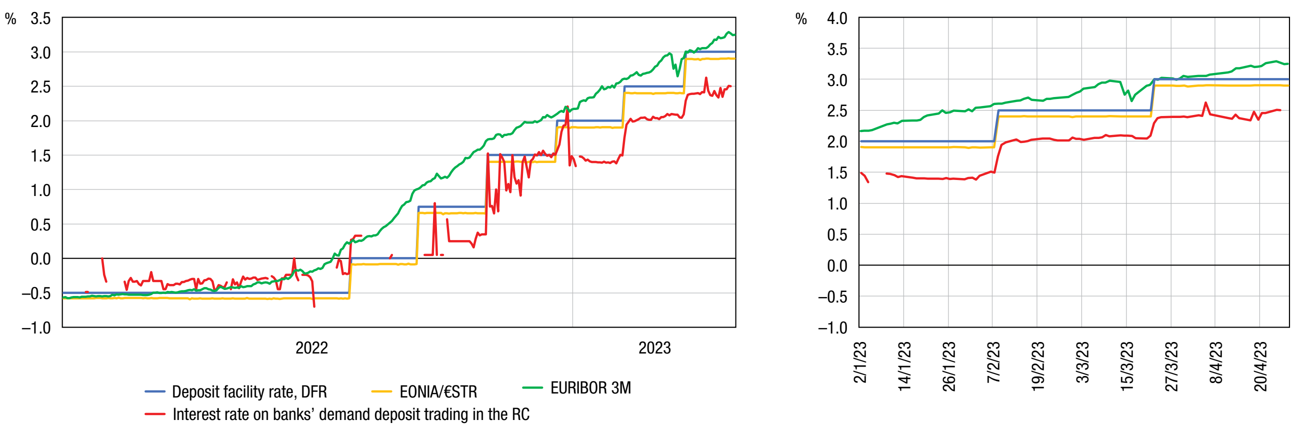
The earlier tightening of ECB monetary policy continues to impact the costs of financing of non-financial corporations more heavily than those of households. The average interest rate on pure new loans to non-financial corporations reached 3.9% in March, up by 22 basis points from February, or up by 196 basis points from the period preceding monetary policy normalisation (Figure 9). As regards lending, the growth in loans to non-financial corporations slowed down from 20.1% in February to 15.4% in March, as a result of the effect of the base period, or a much faster growth in loans to corporates in March

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



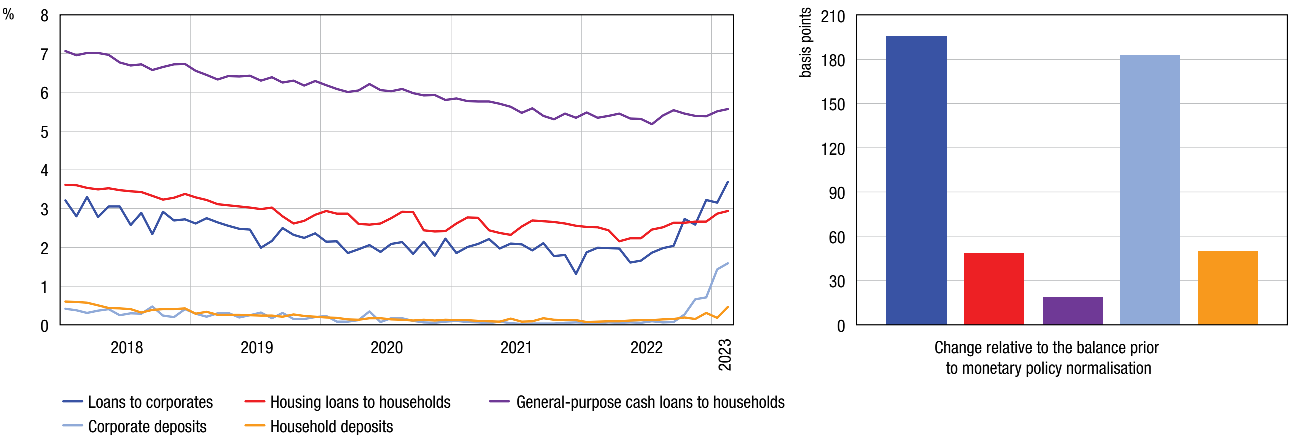
Notes: CEE – countries of Central and Eastern Europe (the Czech Republic, Hungary, Poland and Romania); yields for the euro area and CEE have been weighted by the share of GDP of the countries included. Data from the euro area do not include those from Estonia, Latvia, Luxembourg and Malta. The red dotted 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

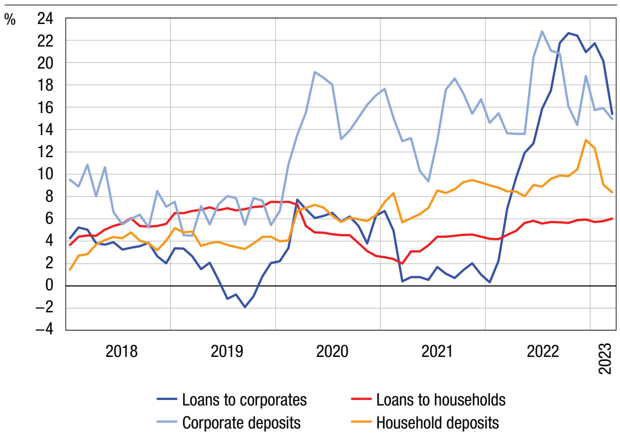


Note: Data up to December 2022 refer to loans and deposits in kuna, in kuna with a currency clause in euro and in euro, and from January 2023 to loans and deposits in euro.
Source: CNB.

last year (Figure 10). Household lending continued to grow steadily, with the interest rates on loans to that sector remaining almost unchanged. As a result, the average interest rate on pure new general-purpose cash loans held steady at its February level (5.6%) and that on housing loans rose only slightly (3.0%). 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 in mid-March. Interest rates should not increase significantly given that subsidised housing loans are granted at interest rates that are lower than market averages. As regards the interest rates on pure new time deposits, their level in the corporate sector has been rising almost continuously since October last year. For several months now, this has led to a transfer in corporate sector deposits from overnight to time deposits. Total household deposits fell by EUR 0.4bn in March. This was partly due to government bond purchases, which rose by further EUR 0.3bn in early March, from the EUR 1bn in government bonds initially subscribed in February. The average interest rate on pure new household time deposits reached 0.6% in March, up by 12 basis points from February.

At its last monetary policy meeting held on 4 May, the Governing Council of the European Central Bank increased its key interest rates by 25 basis points. In accordance with the new decision, the interest rate on monetary deposits of credit institutions with the central bank (currently the most important ECB interest rate, which in the present conditions of high primary liquidity determines the interest rates on the money market) has been set at 3.25% starting from 10 May. Also, the expectation is that the ECB balance sheet normalisation, i.e. the reduction in the portfolio of Eurosystem securities purchased within the asset purchase programme might accelerate in the second half of the year. Until the end of the second quarter of 2023 the principal of only a part of the securities in the portfolio will be reinvested (average monthly reduction of EUR 15bn), after which, as of July 2023, the Governing Council expects to discontinue the reinvestments under the APP. In contrast, the maturing principal payments from securities purchased under the pandemic emergency purchase programme will be reinvested until at least the end of 2024.

Figure 10 Corporate and household loans and deposits



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