Information on economic, financial and monetary developments

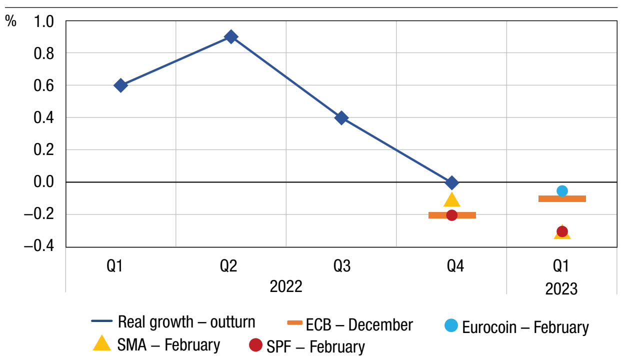
March 2023

Summary

Although preliminary data suggested little growth, the last revised data showed that economic activity in the euro area held steady in the last quarter of 2022. Such an outturn surpasses expectations and model estimates that suggested a small fall in economic activity (Figure 1)[1]. The major economies of Germany and Italy fell slightly while those of France and Spain recorded a very modest growth of real GDP. A more pronounced weakening of economic activity was avoided owing to a relatively limited fall in personal consumption and to favourable developments in construction. The resilience of the economy of the euro area was supported by a sharp fall in energy prices, partly attributed to a warm winter and reduced energy consumption. High-frequency economic and confidence indicators continued to improve in January and February 2023, particularly in the services sector, with the purchasing manager index again in expansion territory. However, most of the available market forecasts still suggest a possible small decline in real activity in the euro area in the first quarter of the year. Poor economic activity in the euro area was accompanied in January and February by a further trend of slowdown in the annual rate of inflation, which started in November last year, mostly reflecting a fall in energy prices. Even though the total annual consumer price inflation fell to 8.5% in February, the annual rate of core inflation continued to rise slightly, reaching 5.6%, with service prices accelerating the most (Figure 2).

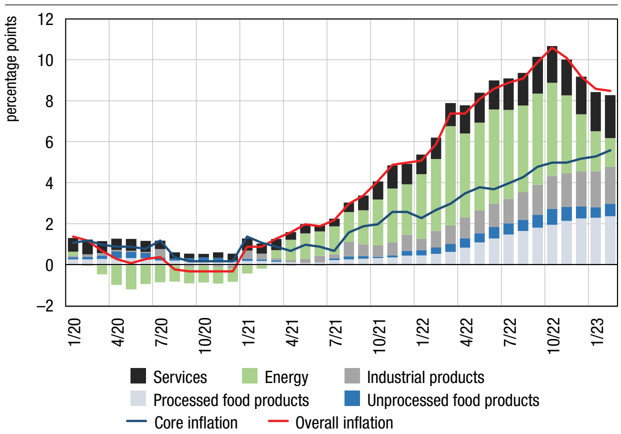
After substantial growth towards the end of last year, the monthly indicators of economic activity suggest that Croatia's real GDP continued to rise in early 2023. As shown by preliminary CBS data, real GDP rose by 0.9% on a quarterly level at the end of 2022, having risen 4.0% from the same period of 2021. Such developments are the result of a further relatively strong growth in the export of services and investments, while increased government consumption on the production side led to favourable developments in construction and services. In contrast, personal consumption and goods exports fell considerably. The CNB's nowcasting model of economic activity suggests that the real GDP continued to rise in the first quarter of 2023 and that it could reach 2.3% on an annual level, up 0.8% from the last quarter of 2022. (Figure 3). This diminished the risk of the domestic economy being in recession (Figure 4). Industrial production in January rose considerably on a monthly level, having risen from the average level in the last quarter of 2022. Its growth was largely concentrated in the production of capital goods and energy while the production of intermediate goods and durable and non-durable consumer goods declined. After falling towards the end of 2022, in January the real retail trade turnover recovered slightly from December, which can be attributed to a further recovery in consumer optimism and favourable developments in the labour market. The number of employed persons in January and February continued to rise at a pace similar to that seen in 2022, with the growth being relatively broadly based. After falling for six consecutive quarters,

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



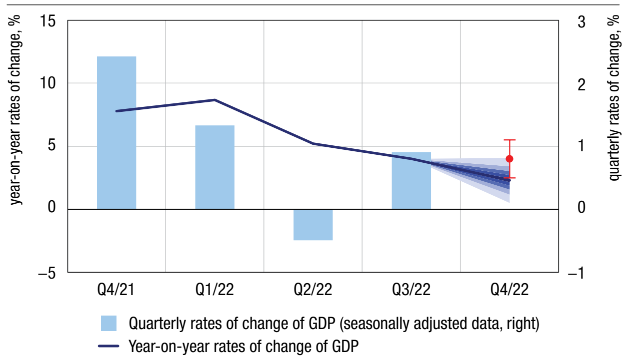
Notes: Abbreviation ECB – December refers to ECB December projections of real growth in the euro area. Abbreviations SMA (Survey of Monetary Analysts) and SPF (Survey of Professional Forecasters) refer to the results of the February ECB survey of market participants. The Eurocoin indicator developed 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 (February 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

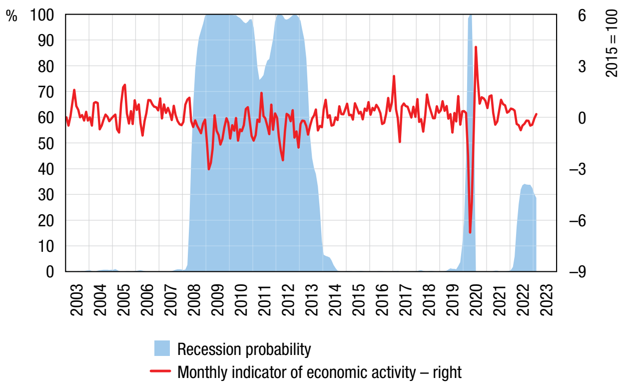


Notes: The estimate for the first quarter of 2023 refers to the Monthly indicator of real economic activity of the CNB (for more details on the calculation of the MRGA indicator, see CNB survey Kunovac, D., and B. Špalat: "Nowcasting GDP Using Available Monthly Indicators". The models are estimated on the basis of data published until 8 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.

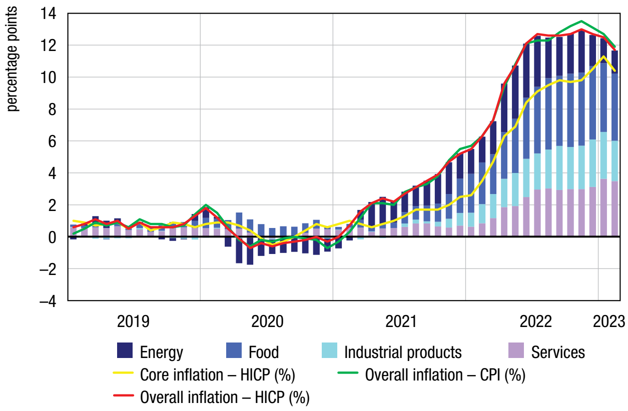
Figure 4 Recession indicator

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

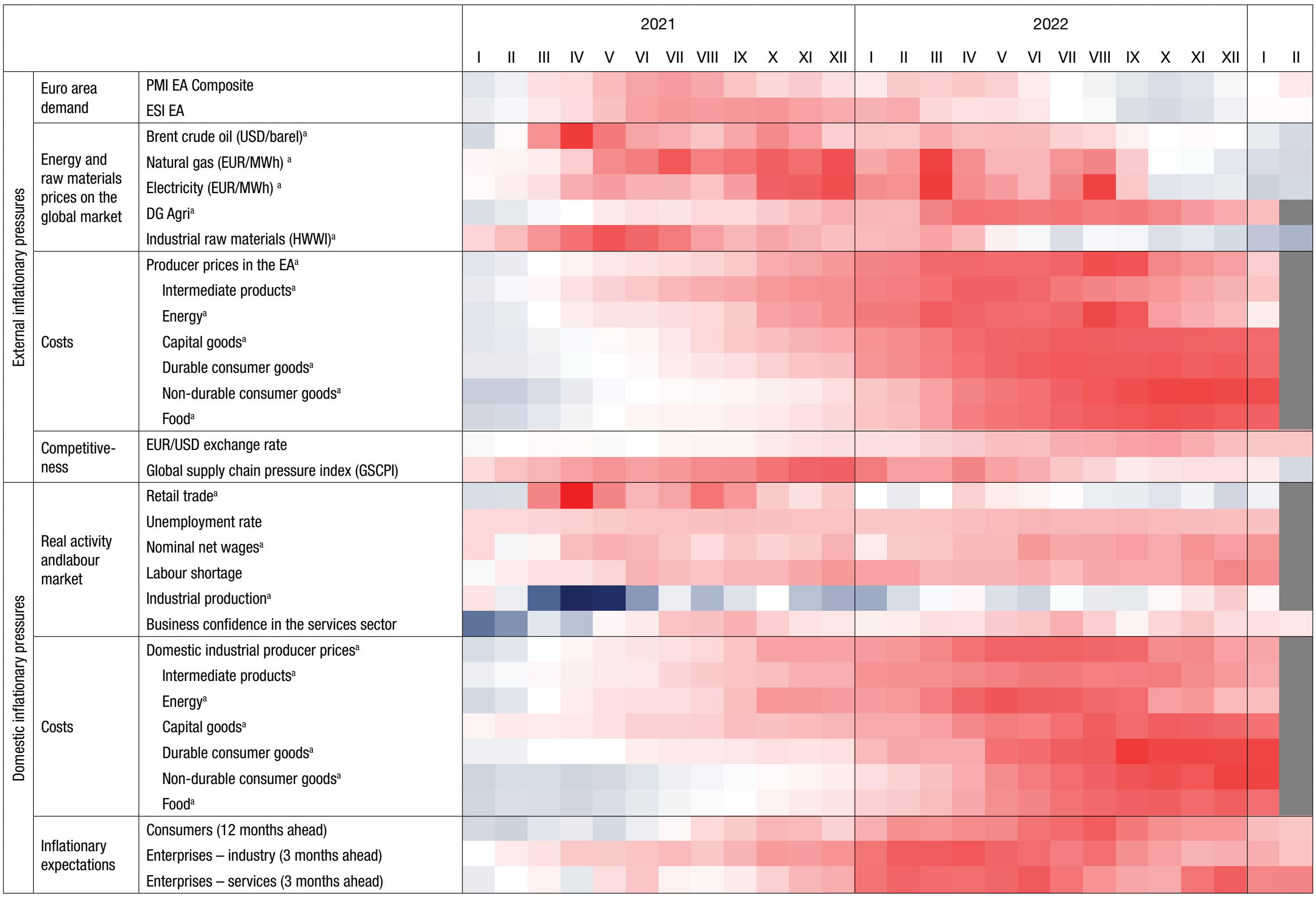


Notes: Core inflation is measured by the harmonised index of consumer prices that excludes energy, food, alcoholic beverages and tobacco prices. The last available data refer to the first estimate for February 2023.
Sources: Eurostat and CNB calculations.

real wages also rose slightly. Business optimism continues to be above the long-term average, with optimism in industry rising sharply in February.

The annual inflation rate measured by the harmonised consumer price index slowed down, for the third consecutive month, to 11.7% in February (according to the first Eurostat estimate), down from 12.5% in January. The indicators of short-term dynamics of overall inflation also point to diminished inflationary pressures. This fall notwithstanding, inflation remains high and inflation risks pronounced. As regards the components of overall inflation, core inflation fell from 11.3% in January to 10.4% in February, and the annual growth rates of energy and food prices also fell (Figure 5). The further slowdown in overall inflation is helped by the downward trend in the annual growth of crude oil prices and other raw materials in the global market present since the middle of last year, the elimination of

Figure 6 Indicators of external and domestic price pressures



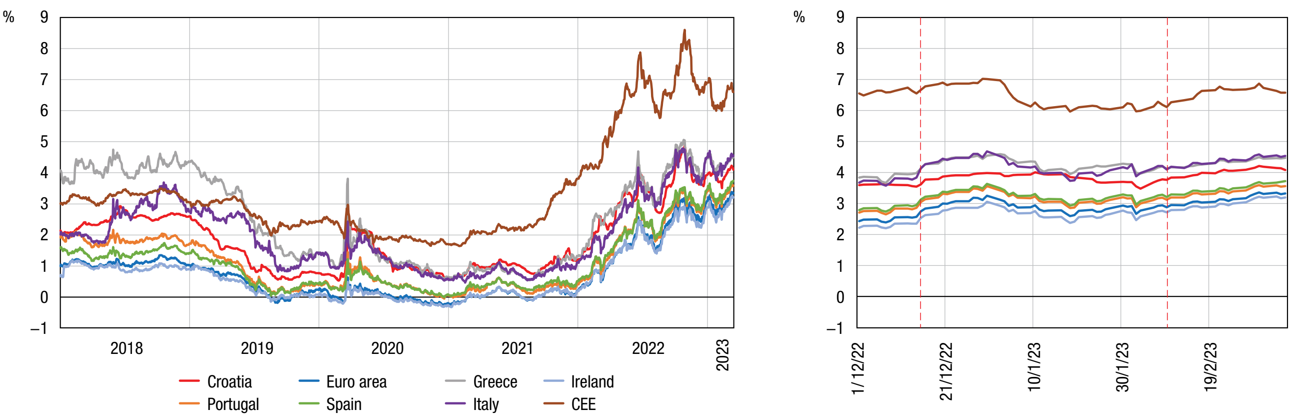
ª Annual rate of change.
Notes: Labour shortage shows the ratio between the vacancy rate and the registered unemployment rate. The PMI EA Composite and ESI EA series have been corrected after standardisation so as to show the neutral value in white. Grey indicates that no data are available in the current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

the remaining bottlenecks in supply chains (Figure 6), the fall in inflation in the euro area and the statistical impact of the pronounced price increase in the same period of the previous year. Survey results show a further fall in short-term inflationary expectations of consumers and corporates in the first two months of 2023. In contrast, consumer prices are still influenced by the postponed effects of the previous increase in the costs of energy and other raw materials and intermediate goods. In January, the producer prices of consumer goods on the domestic market continued to rise sharply on an annual level (14.4%, down only 0.2 percentage points from December 2022). The sharp growth in nominal wages and the labour shortage helped to keep inflation elevated.

Despite the elevated level of uncertainty in the financial markets, the Governing Council of the European Central Bank decided at its meeting on monetary policy on 16 March to increase key interest rates by 50 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 3.0% starting from March. Further decisions on the interest rates will be based exclusively on the incoming economic and financial data, the dynamics of underlying inflation, and the strength of monetary policy transmission. The Governing Council decided to continue with ECB balance sheet normalisation, i.e. to reduce the portfolio of Eurosystem securities purchased within the asset purchase programme, APP. Starting from early March 2023, this portfolio of securities will be reduced at a moderate and foreseeable pace (average monthly reduction of EUR 15bn) until the end of the second quarter of 2023, which means that the principals of the securities falling due will not be fully reinvested. In contrast, to reduce the risk to the monetary policy transmission mechanism associated with a potential fragmentation of financial markets during monetary policy normalisation, it has been decided that the flexible reinvesting of the principal of due securities in the portfolio of the pandemic emergency purchase programme, PEPP) will continue.

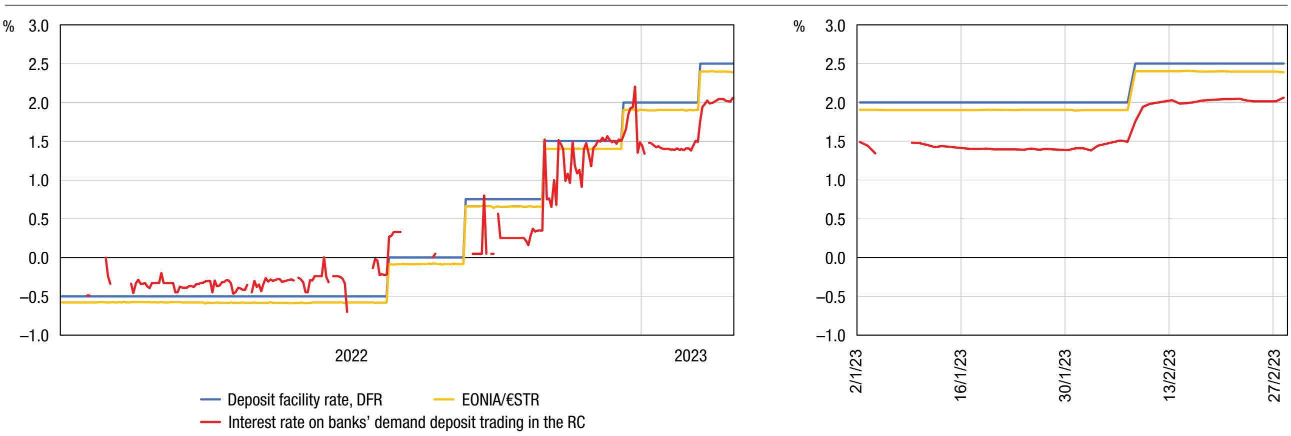
The increase in ECB key interest rates is also mirrored in the domestic financial market. After the last decision of the Governing Council came into force in early February, the

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



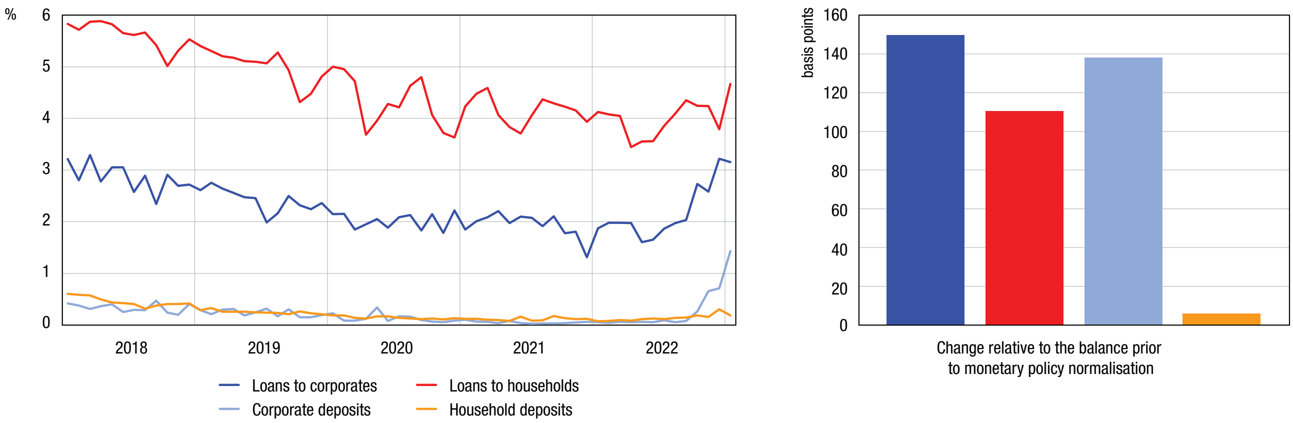
Notes: CEE – countries of Central and Eastern Europe (the Czech Republic, Hungary, Poland and Romania); yields for the euro area and CEE have been weighted by the share of GDP of the countries included. The euro area does not include data for Estonia, Latvia, Luxembourg and Malta. The red dotted lines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

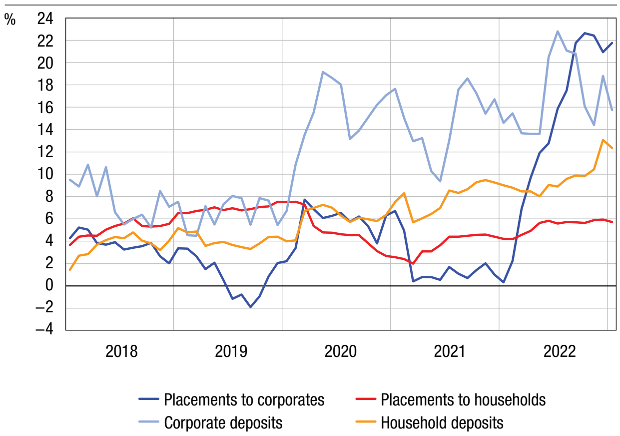


Notes: Data up to December 2022 refer to loans and deposits in kuna, kuna with a currency clause and in euro, and from January 2023 to loans and deposits in euro. The balance before monetary policy normalisation refers to June 2022.
Source: CNB.

overnight interest rate on the European money market, €STR, reached 2.4% and held steady at that level until the end of the month (Figure 8). The six-month EURIBOR also continued to grow, reaching 3.3% at the end of February. Despite the sustained modest activity in the domestic money market, the increase in key interest rates started to spill over to overnight interest rates on the Croatian money market. Thus the overnight interest rate on banks' demand deposit trading stood at 2.1% at the end of February, up from 1.4% at the end of January. As regards short-term government financing costs, the interest rate on one-year T-bills of the Ministry of Finance at the last auction in the second half of February stood at 2.7%, up from 2.5% in January. As regards the long-term costs of government financing, the expectations of further ECB monetary policy tightening led to an increase in yields on long-term government bonds in the wake of the last ECB Governing Council meetings held on 2 February both in the euro area and in Croatia (Figure 7). The increase in yields in Croatia was only slightly higher than the average in euro area countries, with the yields on Croatia's long-term government bonds standing at 4.0% at the end of February, having risen 53 basis points from end-January.

Amid ECB monetary policy tightening, the interest rates on bank loans in Croatia also rose, with those for loans to non-financial corporations continuing to grow faster than those for loans to households. Since the beginning of the cycle of increases in ECB key interest rates in July last year, the average interest rate on pure new loans to non-financial corporations rose by 150 basis points and came to 3.2% in January (Figure 9). Early this year, the demand for loans again generated by companies in the energy sector resulted in a further annual growth in corporate loans of over 20% (Figure 10). The cost of household borrowing also rose by 110 basis points from the period prior to monetary policy normalisation and reached 4.7% in January. This can partly be explained by the effect of housing loan subsidies in spring last year, when the share of lower interest, state-subsidised loans rose considerably. The relatively small amount of housing loans negotiated in January this year also contributed to the increase in the average interest rate. 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, while those in the household sector have not changed much.

Figure 10 Corporate and household placements and deposits



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