Information on economic, financial and monetary developments

November 2023

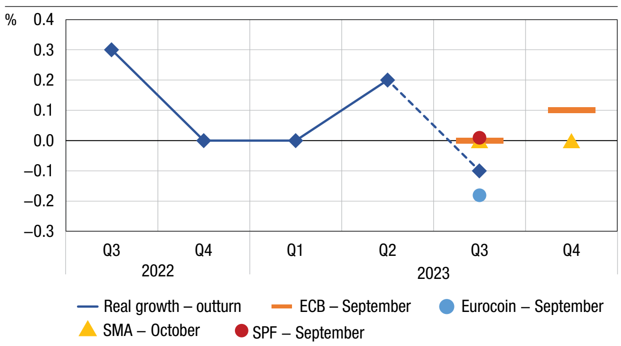
Summary

According to the first Eurostat estimates, euro area economic activity contracted slightly from July to September 2023 from the previous quarter, with survey data signalling that economic activity might remain weak towards the end of the year. Following its upward revision by 0.2% in the second quarter, according to still incomplete data, euro area real GDP edged down in the third quarter (by 0.1%), reflecting not only a weakness in the manufacturing sector, but also a deceleration in the services sector. Data for the major euro area economies reveal heterogeneous movements. Thus, real GDP moderated slightly in Germany and stagnated in Italy, whereas in France and Spain it continued its upward trend, albeit at a slower pace than in the quarter before. The largest drop was observed in Ireland, which has faced very volatile economic developments due to a strong impact of the activities of multinational enterprises on overall activity. Economic activity in the euro area remained subdued at the beginning of the fourth quarter. The preliminary composite Purchasing Managers' Index (PMI) for the private sector fell in October to the lowest level recorded in the past three years, and has for five months now been below the 50 threshold which indicates contraction, with declines in both services and manufacturing activities. The European Commission's economic sentiment index (ESI) edged down further in October, suggesting similar trends.

Inflation in the euro area declined sharply in October to 2.9%, from 4.3% in September (Figure 2). This is mainly due to a further annual drop in energy prices (11.1%) relative to September (4.6%) as a result of the base effect, that is, of a considerable increase in energy prices in October last year and, to a lesser extent, a monthly decrease in October this year. Food inflation in the euro area also declined in October, although it remained relatively high (7.5%). Amid faltering economic activity, tight financing conditions and abating imported inflationary pressures, core inflation in the euro area continued to decline (to 4.2%, from 4.5% in September).

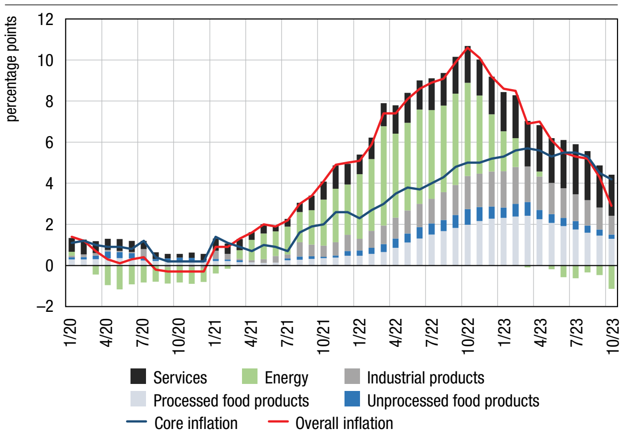
The CNB's estimate of Croatian real GDP trends in the third quarter is slightly more favourable than previously anticipated, meaning that the current activity might decrease only slightly, by 0.2%.[1] Real GDP might grow by 2.0% from July to September this year from the same period in the previous year (Figure 3). Industrial production recorded a relatively sharp monthly growth in September, with a strong pick-up in the production of capital goods and non-durable consumer goods. However, due to the unfavourable trends seen in the previous two months, industrial production decreased from the second quarter on average. Following stagnation in July and August, retail trade turnover was marked by very favourable trends in September and continued to trend up quarter-on-quarter. The increase in real retail trade turnover has spurred the continued growth of employment and real wages, although labour market indicators have started showing the first signs of a slowdown in economic activity. For the most part, the current increase in

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



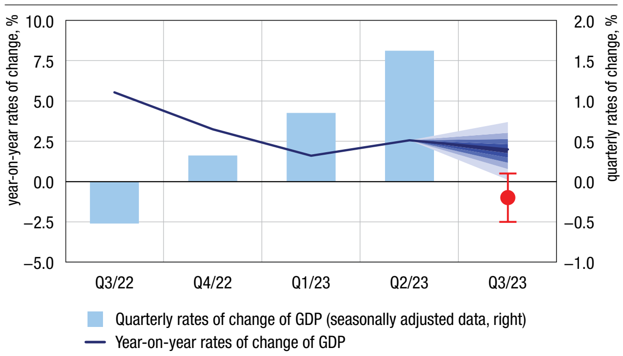
Notes: Abbreviation ECB – September refers to ECB September projections of real growth in the euro area (Macroeconomic Projection Exercise, MPE). Abbreviations SMA (Survey of Monetary Analysts) and SPF (Survey of Professional Forecasters) refer to the results of the ECB survey of market participants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

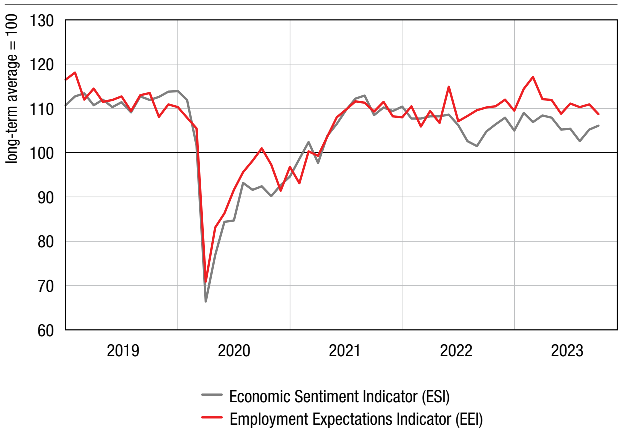
1 The estimate is based on the revised statistical data published in October, which suggest a contraction of real GDP growth by 0.6 percentage points in the first half of 2023.

wages is attributable to wage growth in the public sector following the agreement between the Government of the Republic of Croatia and government employees' unions in effect as of 1 June this year. On an annual basis, wage growth in the public sector caught up with wage increases seen in the rest of the economy, which were particularly pronounced at the beginning of the year. Construction activity also picked up in July and August from the average recorded in the period from April to June, with growth seen in the volume of construction works and a decrease recorded in the volume of civil engineering works.

Survey data point to favourable developments at the very beginning of the last quarter of 2023. The economic sentiment index improved from the quarter before, due to the strengthening of consumer and business optimism. A particularly strong rise in optimism was recorded in industry, having previously trended down since the end of last year. Expectations in construction deteriorated slightly. However, business optimism in all activities has exceeded its long-term average. Employment expectations also recorded a slight decline (Figure 4), with the lack of qualified workers still being one of the main limiting factors in all activities.

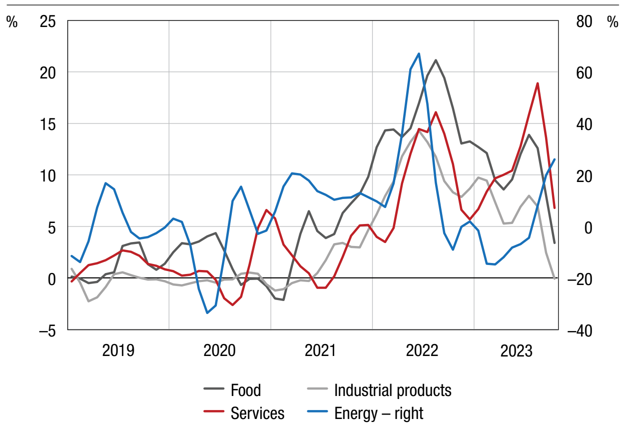
According to the first Eurostat estimate, inflation in Croatia measured by the harmonised index of consumer prices decelerated in October to 6.7%, from 7.4% in September (Figure 5), due to a slowdown in food and energy inflation. Food inflation (including alcohol and tobacco) dropped to 8.5%, from 10.0% in September, which is almost half the peak level of 16% recorded in the last quarter of 2022. The continued downward trend in food inflation is due to many factors, such as the spillover of lower prices of energy, fertilisers and food commodities in the world market to the import and domestic producer prices of food, the normalisation of global supply chains, the favourable base effects due to a spike in food prices in 2022, as well the measures introduced by the Croatian government to limit the prices of some essential products. In addition, the decline in energy inflation in October to –0.5% from the 2.8% recorded in September is the result of a drop in these prices from the month before, as well as the favourable base effect (due to the monthly increase in these prices in October last year). The average price of Brent crude oil in the world market reached USD 91.4 in October, a decrease of 2.8% from September. The rise in crude oil prices following the start of conflict in the Middle East was

Figure 4 Economic sentiment and employment expectations indicators



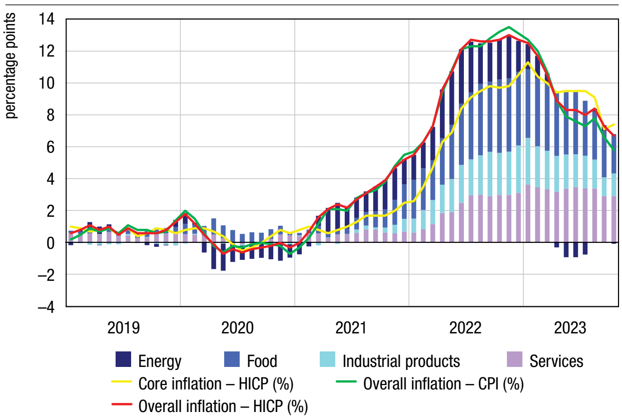
Source: EC.

Figure 6 Momentums of main inflation components



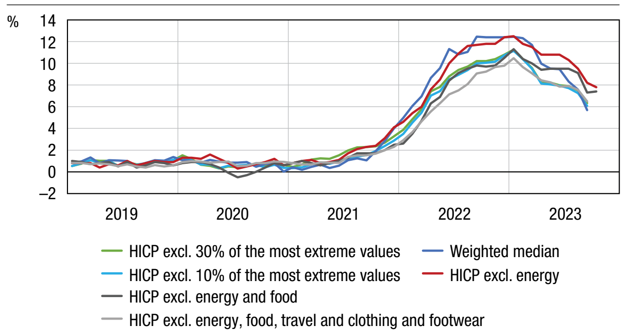
Note: The quarter-on-quarter rate of change on an annual level is calculated from the quarterly moving average of seasonally adjusted harmonised consumer price indices.
Sources: Eurostat and CNB calculations.

Figure 5 Inflation indicators in Croatia



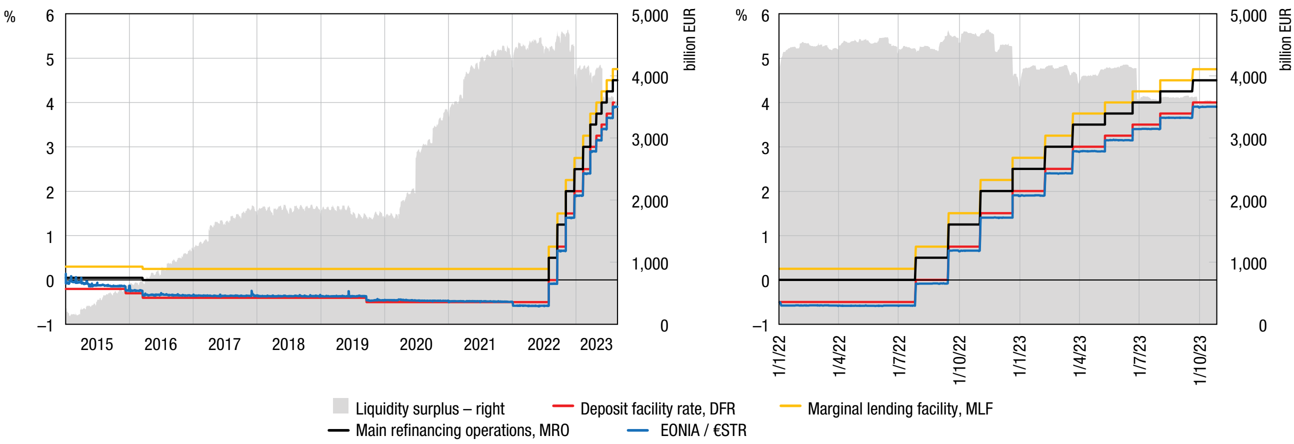
Notes: Core inflation is measured by the harmonised index of consumer prices that excludes energy, food, alcoholic beverages and tobacco prices. The last available data refer to the first estimate for October 2023.
Sources: Eurostat and CNB calculations.

Figure 7 Core inflation indicators



Notes: Trimmed mean is the measure of the central tendency calculated by eliminating 5% (15%) of components with maximum and minimum annual rates of change in a given month. The total data set refers to 87 HICP components. The weighted median is a form of median without the most extreme values, which excludes all values but the weighted median of the distribution of price change. Data are available as at September 2023, except for HICP excluding energy and HICP excluding energy and food, which are available as at October 2023.
Sources: Eurostat and CNB calculations.

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

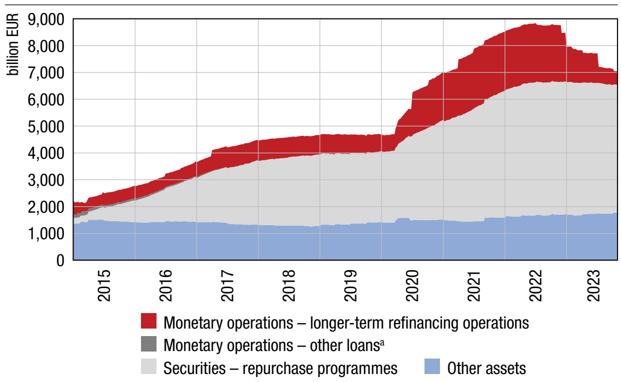


Notes: DFR (deposit facility rate); MLF (marginal lending facility); MRO (main refinancing operations). The EONIA was replaced by €STR in early 2022.
Source: ECB.

short-lived and the prices stabilised quickly. However, a potential spike in these prices due to geopolitical tensions still poses a serious risk to inflation in the future. Core inflation, excluding food and energy prices, edged up from 7.3% in September to 7.4% in October, owing to the acceleration of industrial goods inflation (up from 4.8% to 5.4%) following a considerable decrease in September, while services inflation remained unchanged (9.2%). Different core inflation indicators have been decreasing (Figure 7), even though they remain elevated, largely due to domestic factors, that is, inflationary pressures stemming from wage growth. Momentums of headline and core inflation (quarter-on-quarter rates of change on an annual level) have been losing steam for two consecutive months, owing to a weaker momentum of inflation in the prices of food, services and industrial goods, while momentum in energy inflation has been growing steadily from the beginning of the second quarter (Figure 6).

At a meeting held on 26 October, the ECB's Governing Council decided to keep the three key interest rates unchanged (Figure 8). The interest rate on monetary deposits of credit institutions with the central bank (currently a relevant indicator of

Figure 9 Eurosystem balance sheet



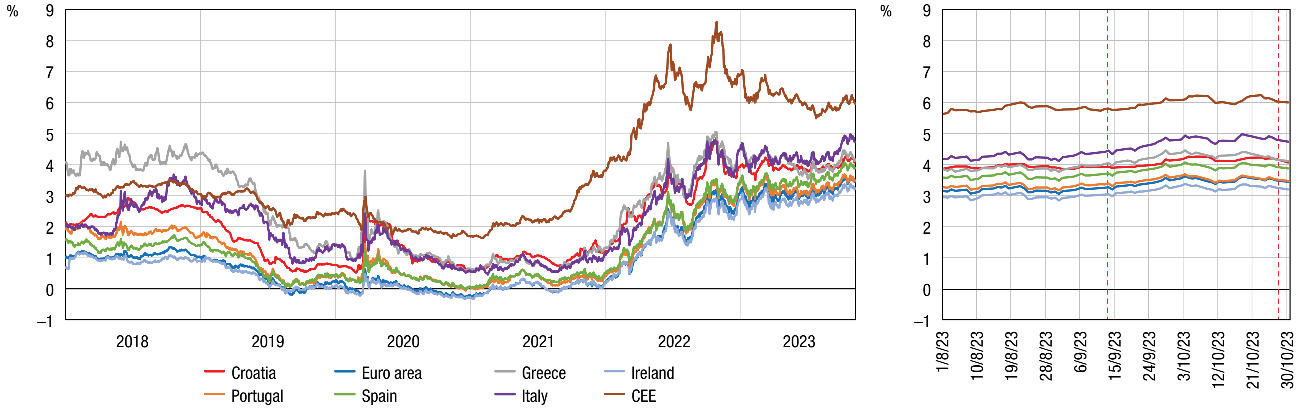
Notes: The Eurosystem monetary balance sheet asset items are shown in grey and red and non-monetary in blue.
[a] Other loans include main refinancing operations, fine-tuning reverse operations, structural reverse operations, marginal lending facility and credits related to margin calls.
Source: ECB.

the ECB's monetary policy) remained at 4.0%. The Governing Council emphasized that inflation was still expected to stay too high for too long, and that domestic price pressures remained strong, even though, according to the latest available data for September, inflation dropped markedly, and measures of underlying inflation continued to ease. In addition, the Governing Council of the ECB considered that the key interest rates were at levels that, maintained for a sufficiently long duration, would make a substantial contribution to the timely return of inflation to its target level. The Governing Council's future decisions will ensure that the key ECB interest rates are set at sufficiently restrictive levels for as long as necessary and will continue to follow a data-dependent approach.

The size of the Eurosystem's balance sheet has continued to decrease gradually (Figure 9). Banks are still repaying amounts borrowed under the targeted longer-term refinancing operations, whereas the portfolio of securities purchased within the asset purchase programme (APP) is declining steadily at a measured and predictable pace, given that from July 2023 the Eurosystem no longer reinvests the principal payments from maturing securities. By contrast, the principal payments from maturing securities purchased under the pandemic emergency purchase programme (PEPP) will be reinvested until at least the end of 2024. Also, flexibility will be applied in reinvesting redemptions coming due in the PEPP portfolio, with a view to countering risks to the monetary policy transmission mechanism related to the pandemic.

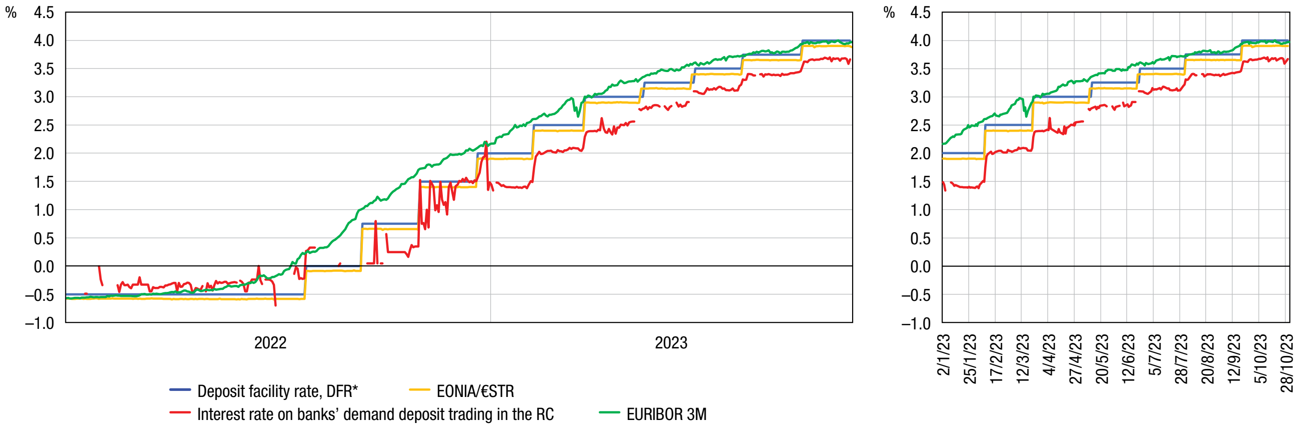
Financial markets saw no major changes in October. In line with the decision of the ECB's Governing Council to keep the key interest rates unchanged, the overnight interest rate on the European money market, €STR, remained at 3.9%, unchanged from end-September (Figure 11). The three-month EURIBOR was also rather stable in October, reflecting market expectations of key ECB interest rates remaining unchanged, and ended the month at 4.0%, the level recorded at end-September. The Croatian money market also witnessed no major changes. The overnight interest rate on banks' demand deposits trading held steady at 3.7% at the end of October. After having increased in September, long-term sovereign bond yields stabilised in October (Figure 10), declining only modestly at end-October following the ECB Governing Council meeting. Yields remained almost unchanged at the end of October from the levels recorded at end-September. The euro area GDP-weighted average of long

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



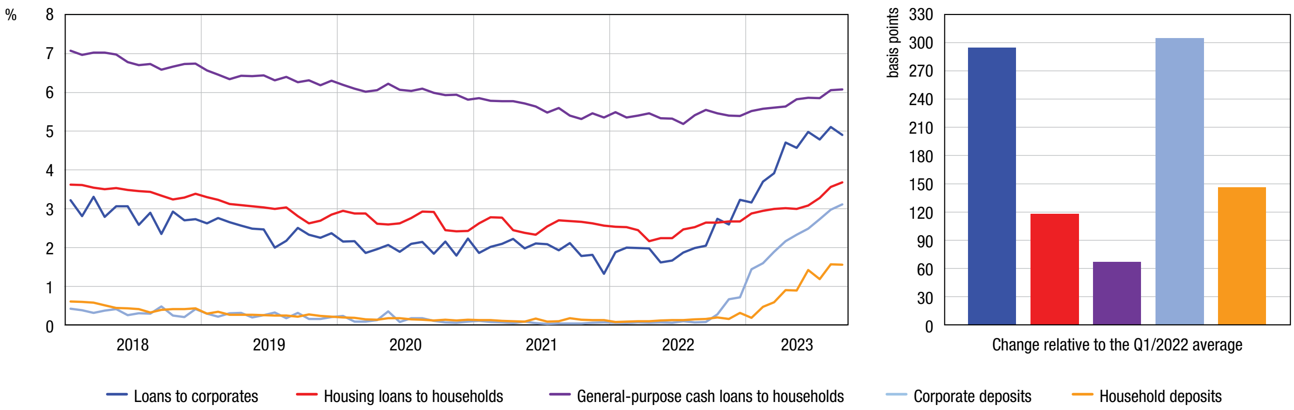
Notes: CEE – countries of Central and Eastern Europe (the Czech Republic, Hungary, Poland and Romania); yields for the euro area and CEE have been weighted by the share of GDP of the countries included. Data from the euro area do not include those from Estonia, Latvia, Luxembourg and Malta. The red dotted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

Figure 11 Key ECB 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



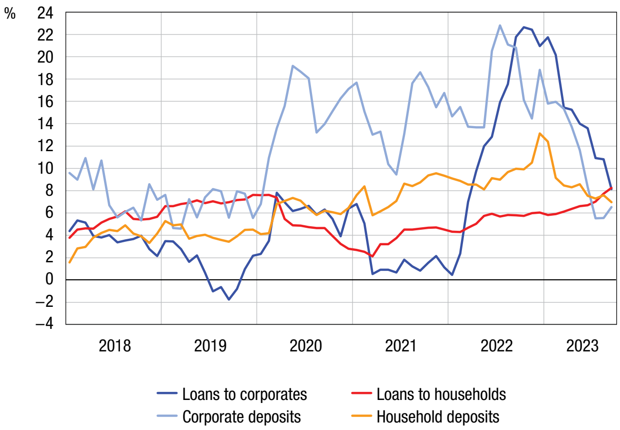
Notes: Data up to December 2022 refer to loans and deposits in kuna and currencies indexed to kuna and in euro and currencies indexed to euro, and from January 2023 to loans and deposits in euro and currencies indexed to euro. Data refer to pure new loans and deposits. Deposits with a maturity of up to 1 month have been excluded.
Source: CNB.

term government bond yields stood at 3.5% at end-October, while the yield on long-term Croatian bonds reached 4.1%.

The modest growth of domestic banks' interest rates continued in September. Households borrowed at somewhat higher interest rates in September relative to August. The interest rate on pure new housing loans rose by 12 basis points to 3.7% in September, while the interest rate on pure new general-purpose cash loans remained almost unchanged from August and stood at 6.1%. Viewed in relation to the period preceding the ECB's monetary tightening cycle, the interest rate on pure new housing loans rose by 118 basis points, while that on pure new general-purpose cash loans grew by 67 basis points. As regards the financing costs of non-financial corporations, the average interest rate on pure new loans to this sector was 4.9% in September, down by 20 basis points from the month before and up by 295 basis points from the period preceding the lifting of key ECB interest rates (Figure 12). The decline in the interest rate on pure new loans to corporates in September was largely driven by the decrease in the share of syndicated loans and, to a lesser extent, of working capital loans and investment loans (granted at relatively high interest rates) in total financing. If the impact of the change in the structure of newly granted loans is excluded, September saw a rise in the costs of corporate financing. The rise in key ECB interest rates also affected the interest rates on deposits, especially in the corporate sector – the interest rate on pure new time deposits of corporates stood at 3.1% in September, up by 14 basis points from August and up by 305 basis points from the period preceding the lifting of key ECB interest rates. The interest rate on pure new household deposits remained almost unchanged in September from the month before and stood at 1.5%, up by 146 basis points from the first quarter last year.

Household lending continued to rise sharply, while the growth in corporate loans remained subdued. Total loan growth in September (EUR 0.3bn) was mostly driven by household loans (EUR 0.2bn), which accelerated their growth on an annual level from 7.6% in August to 8.1% in September (transaction-based). Housing and general-purpose cash loans increased at a similar rate month-on-month (EUR 0.1bn). On an annual level, the growth in general-purpose cash loans accelerated from 7.4% to 8.7%, while the annual growth rate of housing loans remained unchanged from August (10.1%). Despite the slight improvement from recent months, corporate lending remained subdued. The growth in corporate loans slowed down perceptibly on an annual level (from 10.7% in August to 8.0% in September), as compared with a very robust increase in corporate loans in September 2022. As regards domestic deposits, following their sharp increase during the peak tourist season (EUR 1.3bn), household and corporate deposits grew at a considerably slower pace in September (EUR 0.2bn). On an annual level, the growth in deposits of non-financial corporations accelerated from 5.5% to 6.4% (transaction-based), while the growth of household deposits slowed down from 7.5% to 6.9%, which is attributable to the base effect, that is, an unusually strong rise in household deposits in September last year (Figure 13).

Figure 13 Corporate and household loans and deposits



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