# Information on economic, financial and monetary developments

February 2024

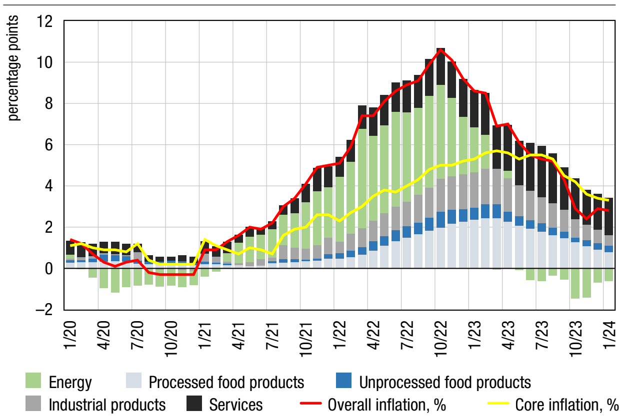
# Summary

**Real activity in the euro area held steady in the last quarter of 2023 from the previous quarter, after a mild contraction during the summer months (–0.1%).** This is the fifth consecutive quarter of stagnation or quarterly change in economic activity only within a narrow range of ±0.1%. Noticeable differences continue to persist among member states, ranging from a marked fall in real GDP in Germany to a pronounced growth in Spain. Currently available estimates suggest that the subdued dynamics might continue into the beginning of 2024 (Figure 1) as a result of a modest growth in personal consumption and of investments stifled by higher costs of borrowing and uncertainties regarding the outlook for the economies of Europe and the world. This is supported by high-frequency indicators, with the preliminary composite PMI for the private sector and the economic sentiment index (ESI) still moving below the long-term average, despite a small recovery.

**After accelerating towards the end of last year owing to an unfavourable base effect, overall inflation in the euro area, according to the first Eurostat estimate, slowed down only slightly to 2.8% in January, from 2.9% in December.** Amid falling prices of energy and food commodities, food inflation continued to fall, (from 6.1% in December to 5.7% in January), although it remained relatively high. The intensity of inflation slowdown in the euro area faded somewhat with the removal of the fiscal measures of support to households aimed at alleviating the effects of the previous energy price increase, which contributed to a smaller annual fall in the prices of energy to 6.3% in January, from 6.7% in December. Core inflation (excluding the prices of energy and food) in the euro area continued to slow down, having fallen from 3.4% in December to 3.3% in January as a result of adrop in the inflation of prices of industrial products to 2.0% from 2.5% in December, while the inflation of the prices of services held steady at the same level as in December (4%), remaining elevated largely due to the pressures arising from a robust growth in labour costs.

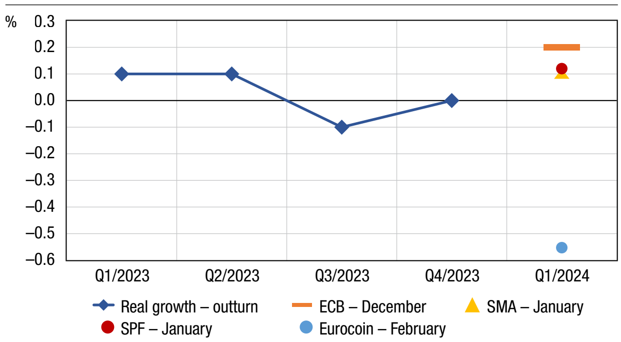
**Croatia witnessed further relatively favourable economic developments during that period.** High-frequency indicators for the fourth quarter of 2023 point to a pronounced strengthening of economic activity towards the end of last year, following a small growth seen in the third quarter. According to the CNB's nowcasting model, in the fourth quarter of 2023, the real GDP might rise by 1.0% from the previous three months and reach 3.8% on an annual level (Figure 3). Despite a considerable fall in industrial production in December, mainly due to a sharp fall in the production of energy and capital goods, its average level in the October to December period remained higher than the average in the preceding three months. Also, the real retail trade turnover continued to grow relatively strongly, supported by positive developments in the labour market and subsiding inflation, which had a positive impact on developments in the real disposable income of households and consumer optimism. The trend of stable and widespread growth in total employment continued towards the end of last year, accompanied by an accelerated growth in real wages. The construction sector witnessed very favourable developments, with the average volume index of construction works in October and November exceeding the

Figure 2 Inflation indicators in the euro area



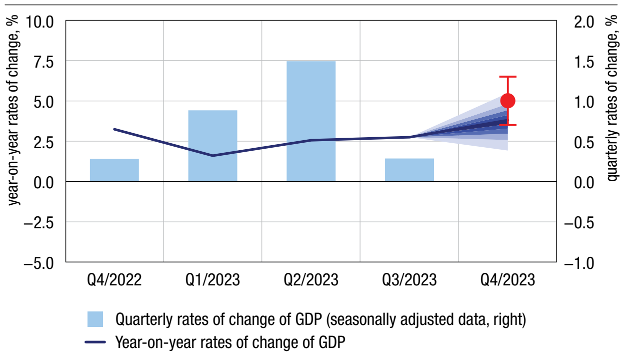

Note: Core inflation is measured by the harmonised index of consumer prices that excludes energy, food, alcoholic beverages and tobacco prices. The last available data refer to the first estimate for January 2024.
Source: Eurostat.

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



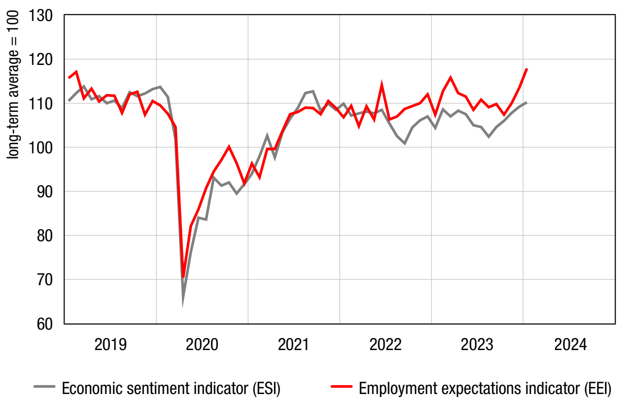

Notes: Abbreviation ECB – December refers to ECB December projections of real growth in the euro area (Broad Macroeconomic Projection Exercise, BMPE). Abbreviations SMA (Survey of Monetary Analysts) and SPF (Survey of Professional Forecasters) refer to the results of the ECB survey of market participants in January. 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 3 Quarterly gross domestic product



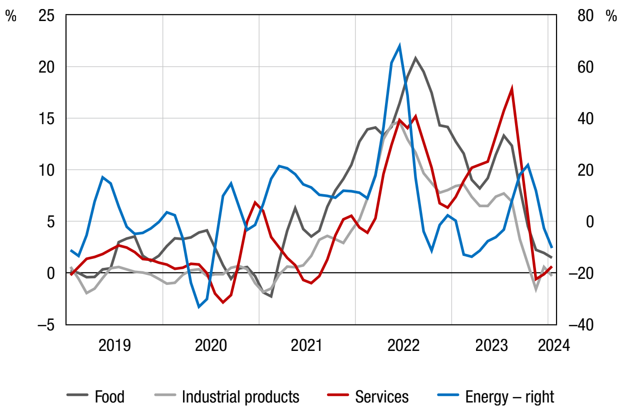

Notes: The estimate for the fourth quarter of 2023 refers to the Monthly Indicator of Real Economic Activity of the CNB (for more details on the calculation of the MRGA indicator, see Kunovac, D., and B. Špalat: "Nowcasting GDP Using Available Monthly Indicators", CNB Working Paper, W-39). The models are estimated on the basis of data published until 2 February 2024. 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.

Figure 4 Economic sentiment and employment expectations indicators



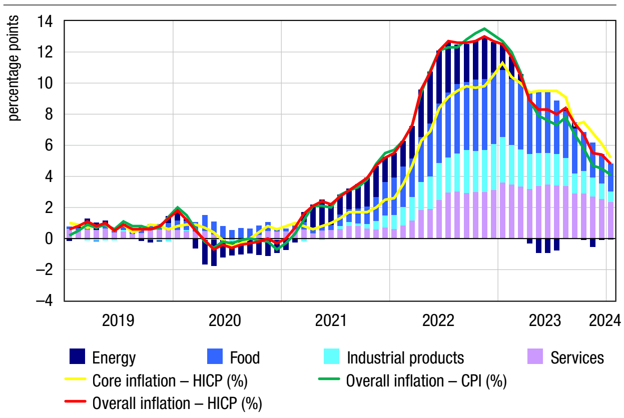

Notes: The economic sentiment index (ESI), and employment expectation index (EEI) are calculated based on data from business and consumer confidence surveys. For more information, see methodological guidelines of the European Commission.
Source: EC.

Figure 6 Momentums of main inflation components



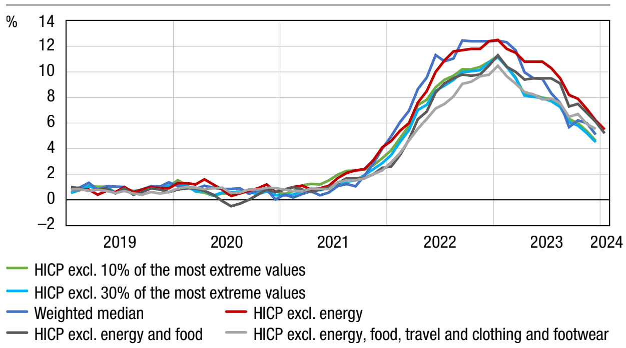

Note: The quarter-on-quarter rate of change on an annual level is calculated from the quarterly moving average of seasonally adjusted harmonised consumer price indices.
Sources: Eurostat and CNB calculations.

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 January 2024.
Sources: CBS, Eurostat and CNB calculations.

Figure 7 Core inflation indicators



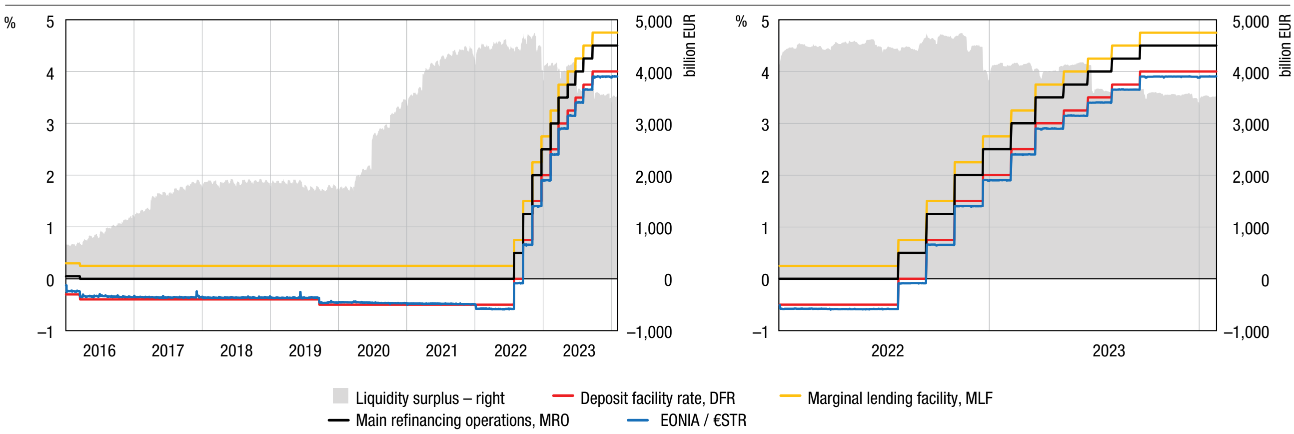

Notes: Trimmed mean is the measure of the central tendency calculated by eliminating 5% (15%) of components with maximum and minimum annual rates of change in a given month. The total data set refers to 87 HICP components. The weighted median is a form of median without the most extreme values, which excludes all values but the weighted median of the distribution of price change. Data are available as at December 2023, except for HICP excluding energy and HICP excluding energy and food, which are available as at January 2024.
Sources: Eurostat and CNB calculations.

level achieved in the same period of 2022 by over 10%.

**Business and consumer confidence surveys for January suggest that the favourable economic activity in Croatia will continue into the beginning of this year.** The economic sentiment index kept on improving, mirroring the pickup in consumer and business optimism, with most activities expecting to see a further increase in the number of employed persons (Figure 4). In January, consumer optimism thus continued to outpace its long-term average, reaching the highest level since August 2021. Business expectations in construction and particularly in service activities in January improved from December last year, with both indices reaching pre-pandemic levels. By contrast, the expectations in industry stagnated and worsened in trade, nevertheless both still moving above long-term averages.

**The annual rate of inflation in Croatia continued to trend downwards at the beginning of the year, with current inflation, already very low, steadily falling further. According to the first Eurostat estimate, inflation measured by the harmonised index of consumer prices (HICP) fell considerably to 4.8% in January from 5.4% in December** (Figure 5) and the slowdown in core inflation (excluding energy and food prices) in January was even more pronounced, having fallen to 5.2% from 6.1% in December. There are different indicators of core inflation suggesting that inflationary pressures are subsiding (Figure 7). Inflation slowdown has been broadly based in the past months, covering all the main components of inflation (except energy) and reflecting a considerable easing of current inflationary pressures since autumn last year, amid the lessening of the effects of past shocks (increased prices of energy and other raw materials, disturbances in supply chains and increased demand once the economy opened up again). Against the backdrop of current inflationary pressures, the annual rate of inflation has been slowing down steadily, influenced by favourable base effects and the gradual exclusion of the unusually high monthly rates of inflation at end-2022 and in early 2023. Service inflation saw a significant drop in January, falling to 7.3% from 8.1% in December 2023, amid a bigger than usual rise in the prices of some services in the wake of the introduction of the euro. The fall in the inflation of the prices of industrial products to 2.6% in January from 3.7% in December contributed to the slowdown in overall inflation in January 2024. The inflation of the prices of food also slowed down slightly, falling to 6.2% in January from

Figure 8 Key ECB interest rates




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

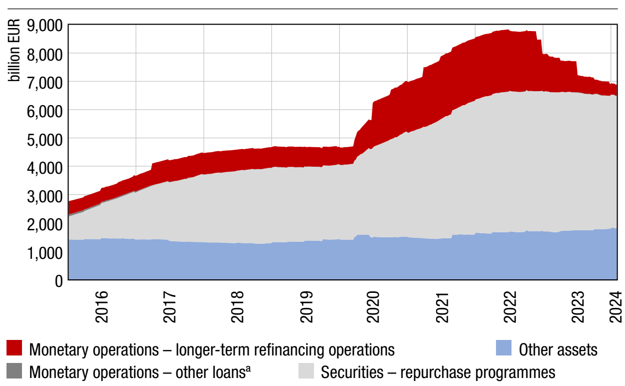
6.5% in December. By contrast, the inflation of the prices of energy rose slightly in January to –0.3% from –0.5% in December. The momentums of overall and core inflation (quarterly rates of change on an annual level) decreased in January owing to a much smaller momentum of all the main components of inflation (except services) (Figure 6). All indicators of the momentum of inflation have fallen in the recent months below their long-term averages. Thus, in the past three months, the momentum of core inflation has been well below 1% and its long-term average, which stood at 1.7% in the pre-pandemic period (2000-2019).

**At a meeting held on 25 January, 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 the ECB's monetary policy) remained at 4.0%. The Governing Council noted that the incoming information broadly confirmed its previous assessment of the medium-term inflation outlook. Aside from an energy-related upward base effect on overall inflation, the declining trend in core inflation has continued, and the past interest rate increases keep being transmitted forcefully into financing conditions. 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. As concerns the pandemic emergency purchase programme (PEPP), the Governing Council intends to reinvest, in full, the principal payments from maturing securities purchased under the PEPP during the first half of 2024 but over the second half of the year, the Governing Council intends to reduce the PEPP portfolio by EUR 7.5bn per month on average and to discontinue reinvestments under the PEPP at 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.

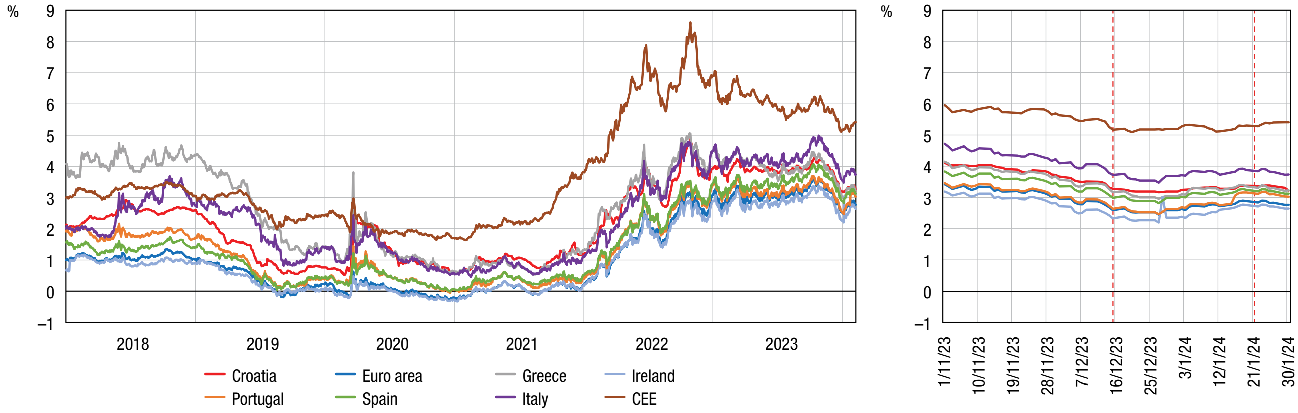
**Financial markets saw no major changes in January.** In line with the decision of the ECB's Governing Council to keep the key interest rates unchanged, the overnight interest rate on the European money market, €STR, remained at 3.9%, unchanged from end-December (Figure 11). The three-month EURIBOR was also stable and stood at 3.9% at the end of January, the same level as that recorded at end-December. The Croatian money market also witnessed no major changes. The overnight interest rate on banks' demand deposit trading moved within a relatively narrow range of 3.7%, the same as at end-January. Amid ample bank liquidity, the volume of trading on the overnight money market remained relatively modest. Domestic banks' free reserves returned close to the level seen at the beginning of 2023, following a drop in the first half of that year. Thus the average daily surplus liquidity of the domestic banking system stood at EUR 15.9bn. The yields on long-term government bonds, after falling for several months, rose in January and then fell slightly towards the end of the month following the meeting

Figure 9 Eurosystem balance sheet



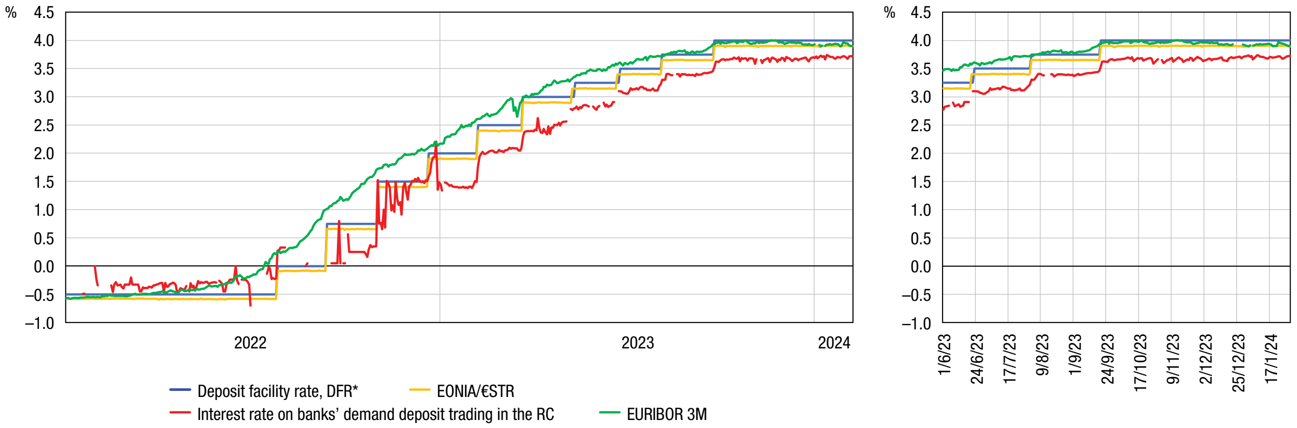

Notes: The Eurosystem monetary balance sheet asset items are shown in grey and red and non-monetary in blue.
[a] Other loans include main refinancing operations, fine-tuning reverse operations, structural reverse operations, marginal lending facility and credits related to margin calls.
Source: ECB.

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



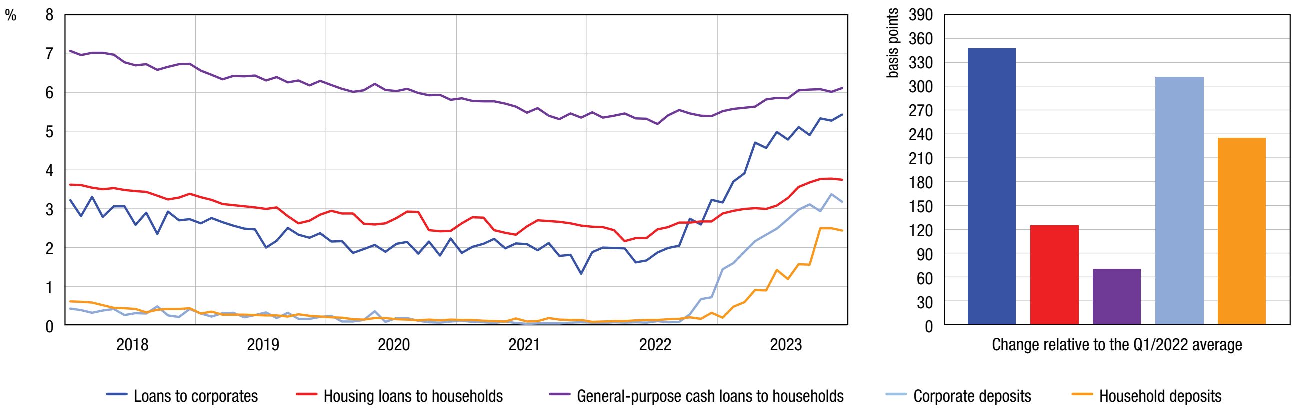

Notes: CEE – countries of Central and Eastern Europe (the Czech Republic, Hungary, Poland and Romania); yields for the euro area and CEE have been weighted by the share of GDP of the countries included. Data from the euro area do not include those from Estonia, Latvia, Luxembourg and Malta. The red dotted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



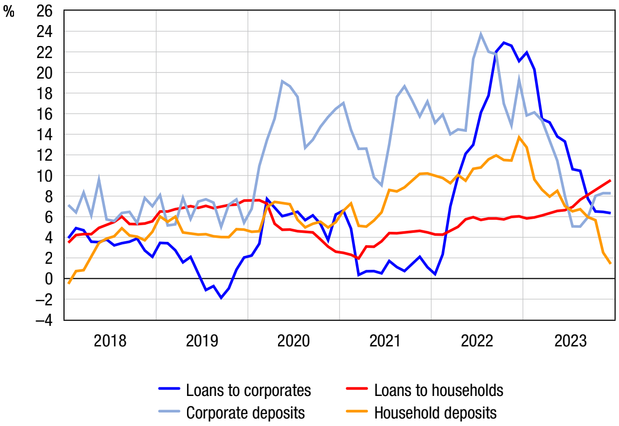

Notes: Data up to December 2022 refer to loans and deposits in kuna and currencies indexed to kuna and in euro and currencies indexed to euro, and from January 2023 to loans and deposits in euro and currencies indexed to euro. Data refer to pure new loans and deposits. Deposits with a maturity of up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

of the ECB's Governing Council (Figure 10). Yields at end-January remained at almost the same level as at end-December, with the euro area GDP-weighted average of long term government bond yields standing at 2.7% and the yield on long-term Croatian bonds at 3.3%.

**The interest rates on domestic banks' loans mainly rose in December, while those on time deposits fell, both changes being of low intensity.** The average interest rate on pure new loans to non-financial corporations reached 5.4% in December, up 16 basis points from November. As regards the costs of household financing, general-purpose cash loans agreed upon in December had an average interest rate of 6.1%, 11 basis points up from the month before, while the average interest rate on pure new housing loans fell only slightly and stood at 3.7%. Viewed in relation to the period preceding the ECB's monetary tightening, at the end of 2023, borrowing from banks was more expensive by 348 basis points for corporates, 125 basis points for housing loans and 70 basis points for general-purpose cash loans (Figure 12). With respect to sources of bank financing, the beginning of the last quarter saw an unusually large number of new household time deposits in banks offering the highest deposit rates, which resulted in their rising significance for the formation of the average interest rate. However, this changed soon, as in November bank clients tended to be more inclined than in October to accept lower interest rates from their banks instead of turning to banks offering better time deposit terms. This slowed down interest rate growth and in December also led to a smaller fall in interest rates. The average interest rate on pure new household time deposits thus fell by 5 basis points to 2.4% in December, while that on corporate time deposits fell by 19 basis points to 3.2%. Compared to the period prior to monetary policy normalisation, the interest rates on pure new time deposits of households rose in December by 235 basis points and those of corporates by 312 basis points.

**Corporate lending remains subdued, while household loans continue to grow.** The growth in total loans in December (excluding the general government) of EUR 158m can mostly be attributed to the growth in loans to households (EUR 95m) but also, to a lesser degree, to the growth in loans to corporates (EUR 50m). The growth was recorded in both housing and general-purpose cash loans. On an annual level, the growth in household loans accelerated further from 9.1% in November to 9.5% in December (transaction-based), which is fully due to acceleration in the annual growth in general-purpose cash loans from 10.4% to 11.1%, while the growth in housing loans slowed down slightly from 10.0% to 9.9%. Subdued corporate lending led to a small annual slowdown in the growth of loans to that sector, from 6.5% to 6.3%. As a result of a slump in government deposits, driven by a sharp increase in government expenditures and a seasonal fall in fiscal revenues, total domestic deposits (general government excluded) rose by a steep EUR 1.9bn in December last year, fuelled equally by household and corporate deposits (EUR 0.7bn each) as well as by deposits of other financial institutions EUR 0.4bn). The growth in total deposits was also partly the result of value added payments (VAT) into the government budget being paid later because the last day of December fell on a Sunday so some of the VAT payments were moved to the beginning of January. Time deposits rose by EUR 1.2bn, driven by an increase in interest rates on time deposits, and overnight deposits by EUR 0.7bn. The annual growth in deposits of non-financial corporations held steady at the November level of 8.3%, in contrast with the growth in household deposits which slowed down to 1.4% in December from 2.5% in November due to the base period effect, i.e. a considerably faster growth in household deposits in December 2022, ahead of the introduction of the euro (Figure 13).

**Figure 13 Corporate and household loans and deposits**
year-on-year rates of change, transaction-based




Source: CNB.