Information on economic, financial and monetary developments

March 2024

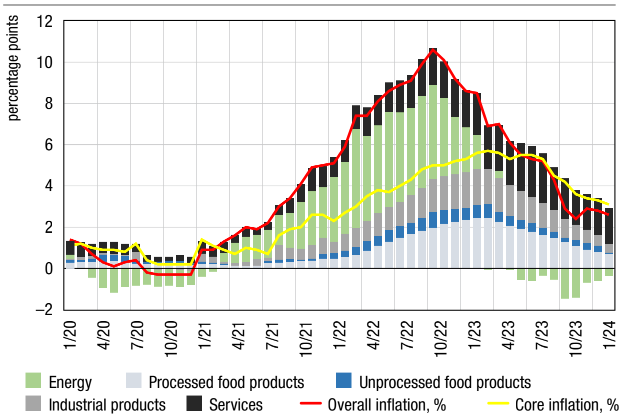
Summary

Real activity in the euro area held steady in the last quarter of 2023, as in the preceding part of the year. The stagnation still mostly reflects faltering industrial production and subdued developments in retail trade and construction, as well as a reversal of the positive trend in service activities in late 2023. Nevertheless, lower imports partly mitigated the impact of sluggish domestic demand on economic growth. Noticeable differences persist among member states, from a marked fall in economic activity in Germany to a sharp growth in Spain. Currently available data and estimates suggest that economic activity remained subdued in early 2024 (Figure 1) in the context of a modest increase in personal consumption and higher costs of borrowing that stifle investment as well as uncertainty regarding the outlook for the European and global economies. This is corroborated by muted high-frequency indicators, which are still moving below long-term averages, pointing to a contraction. Nevertheless, the PMI partially recovered from its low levels in the first two months of 2024, owing to stabilisation in the manufacturing industry. The economic sentiment index (ESI) continued to go down in the same period, largely owing to the gloomy mood in the services sector.

Overall inflation measured by the consumer price index in the euro area, according to the first Eurostat estimate, decelerated in February to 2.6% (from 2.8% in January), reflecting the slowdown in all the main components of inflation except energy (Figure 2). Inflationary pressures receded amid the fading impact of past supply shocks (growth in the prices of energy, food and other commodities) and a decline in demand due to tightened monetary policy. The slowdown in overall inflation in the euro area in February was mostly a result of the drop in food price inflation (to 4.0%, from 5.6% in January). In addition, industrial product inflation also slackened to 1.6% (from 2.0% in January). Furthermore, amid persistently elevated domestic inflationary pressures stemming from rising labour costs, inflation of service prices eased slightly in February (to 3.9%, from 4.0% in January). Euro area core inflation (excluding the prices of energy and food) continued to slow down for the seventh consecutive month, having fallen from 3.3% in January to 3.1% in February. By contrast, the inflation of energy prices rose in February (to –3.7%, from –6.1% in January), but remained in negative territory.

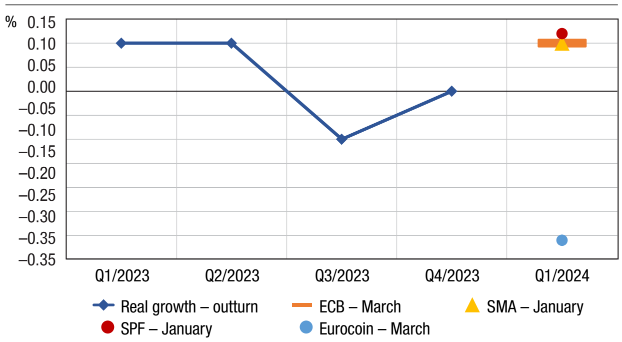
After slowing down in the third quarter, economic growth in Croatia picked up strongly in late 2023, so that real GDP rose by 2.8% on the entire year level. According to the first CBS estimates, real GDP grew by a high 1.3% on a quarterly level, whereas its annual growth rate surged to 4.3% in the fourth quarter of 2023 (Figure 3). Such movements were mainly the result of the ongoing sharp increase in domestic demand, in particular personal consumption, on the back of the robust labour market, high consumer confidence and falling inflation. Goods exports also saw a modest uptick after four consecutive quarters of decline. Looking at the production side, quarterly growth was broad-based in late 2023, except in agriculture, which saw a decrease. Croatia's real GDP recorded a relatively sharp expansion in 2023 as a whole, supported by mostly favourable developments in service activities, particularly tourism-related services.

Figure 2 Inflation indicators in the euro area



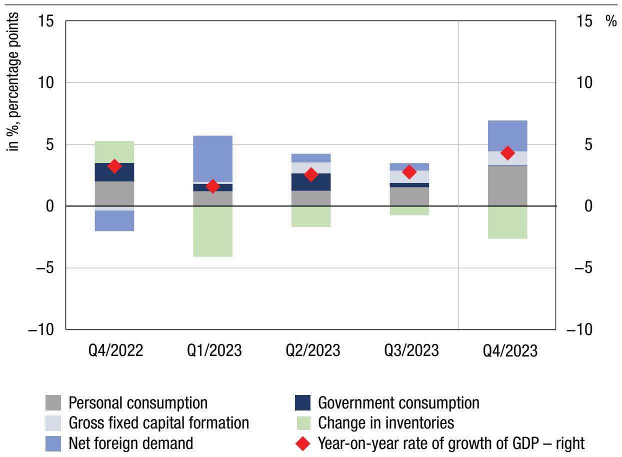
Notes: Core inflation is measured by the harmonised index of consumer prices, which excludes energy, food, alcoholic beverages and tobacco prices. The last available data refer to the first estimate for February 2024.
Sources: Eurostat and CNB calculations.

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



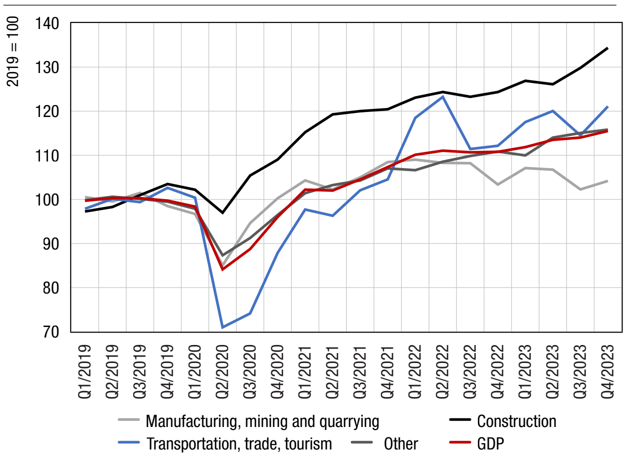
Notes: Abbreviation ECB – March refers to ECB March projections of real growth in the euro area (Broad Macroeconomic Projection Exercise, BMPE). Abbreviations SMA (Survey of Monetary Analysts) and SPF (Survey of Professional Forecasters) refer to the results of the ECB survey of market participants in 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 (March estimate).
Sources: Eurostat, ECB and Banca d'Italia.

Figure 3 Contributions to the annual growth of GDP in Croatia



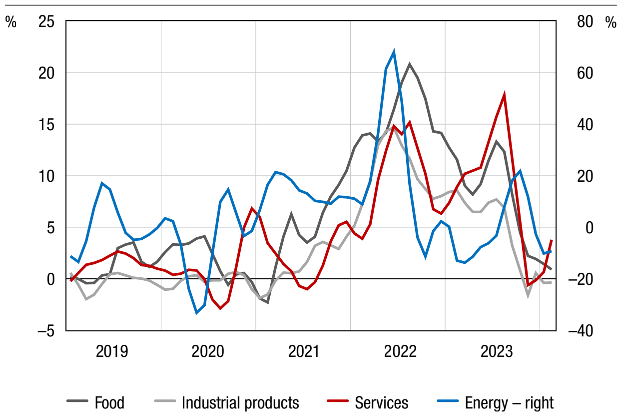
Source: CBS.

Figure 4 Gross value added by activity in Croatia



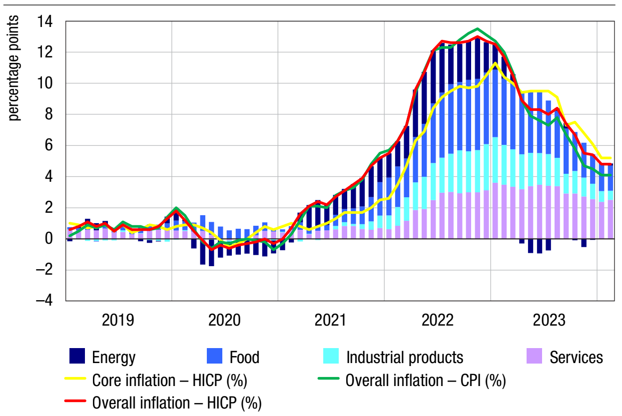
Note: "Tourism" denotes accommodation and food service activities.
Source: CBS.

Figure 6 Momentums of the main inflation components



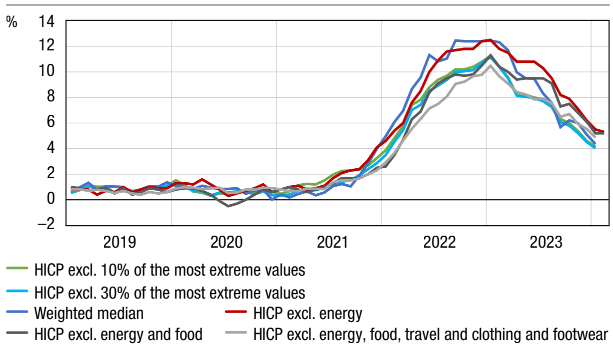
Note: The quarter-on-quarter rate of change on an annual level is calculated from the quarterly moving average of seasonally adjusted harmonised consumer price indices.
Sources: Eurostat and CNB calculations.

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

Figure 7 Core inflation indicators



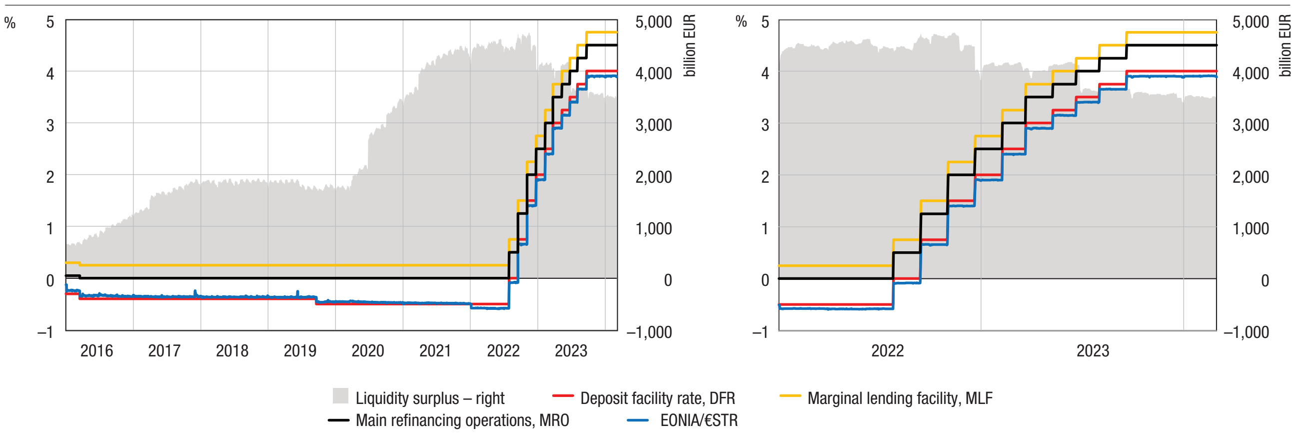
Notes: Trimmed mean is the measure of the central tendency calculated by eliminating 5% (15%) of components with maximum and minimum annual rates of change in a given month. The total data set refers to 87 HICP components. The weighted median is a form of median without the most extreme values, which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

In addition, investment and construction activities also grew rapidly on an annual basis, boosted strongly by the inflow of EU funds. On the other hand, manufacturing industry was weak due to a slump in foreign demand and goods exports (Figure 4). In such circumstances, the labour market continued to exhibit positive performance, which, paired with a stimulative fiscal policy, spurred a surge in personal consumption.

Business and consumer confidence surveys for January and February suggest that favourable economic trends in Croatia continued into early 2024. Despite a slight dip in February, the consumer confidence index in the first two months of 2024 remained much above the average for the last quarter of 2023 and at the highest level seen since mid-2021. The growth was broad-based across all the main components with most improvement seen in expectations about the overall financial situation and the consumption of durable goods in the next 12 months. Looking at business confidence, business expectations in service activities soared, while expectations in other activities deteriorated (particularly in industry). Nevertheless, optimism in all activities remained much above its long-term average.

According to Eurostat's first estimate, overall annual inflation measured by the harmonised index of consumer prices (HICP) remained at 4.8% in February, unchanged from January. The larger contribution of energy and services to inflation in February offset the smaller contribution of food and industrial products (Figure 5). The higher energy and services price inflation mirrors somewhat stronger current inflationary pressures in that segment. Energy inflation went up from –0.1% in January to 1.2% in February, mostly driven by the rise in the prices of refined petroleum products, with service price inflation going up from 7.4% to 7.8% in the same period. By contrast, against the backdrop of low current inflation, food inflation (including alcohol and tobacco) and industrial product inflation continued to lose pace in February. Food inflation dropped from 6.2% in January to 5.6%, mainly due to a negative base effect, that is, the exclusion of the high monthly growth rate of food prices in last February from the calculation of the annual inflation rate. At the same time, the inflation of the prices of industrial products fell to 2.2% (from 2.6% in January). However, as the decrease in the contribution of industrial products prices was equal to the increase in the contribution of services prices, the annual core

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.

inflation rate remained at 5.2% in February.

Current inflation remains remarkably low. Even though indicators of current inflation edged up in February (Figure 6), they remained below their long-term averages. Overall inflation momentum, which shows where annual inflation would be if prices had continued to move as in the preceding six months, stood at 0.9% in February, failing to surpass its long-term average for four consecutive months[1] (the average was 2.2% in the period from 2000 to 2019). The momentums of most components of inflation were very low, with a rise seen only in the momentum indicator for service inflation, which exceeded its long-term average in February.

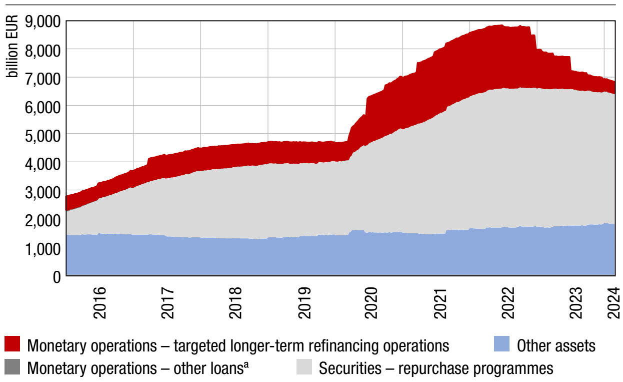
The significant easing of inflationary pressures arising from the earlier stages of the price chain should decelerate the annual rate of consumer price inflation in the coming months. That is, the most recent data available show that the downward trend in the inflation of producer prices of food products, present from the beginning of 2023, continued into January 2024, when inflation dropped to 1.3%, down by 14.3 percentage points from January 2023. The annual growth in producer prices of intermediate and durable consumer goods also decelerated sharply.

At a meeting held on 7 March, 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 inflation had declined further since its January meeting. 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 for 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. 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.

Long-term interest rates went up in February, reflecting a shift in the expectations of financial market participants in favour of delayed and slower cuts in key interest rates. The overnight interest rate on the European money market, €STR, remained at 3.9% in February, unchanged from the most recent increase in ECB key interest rates in September 2023

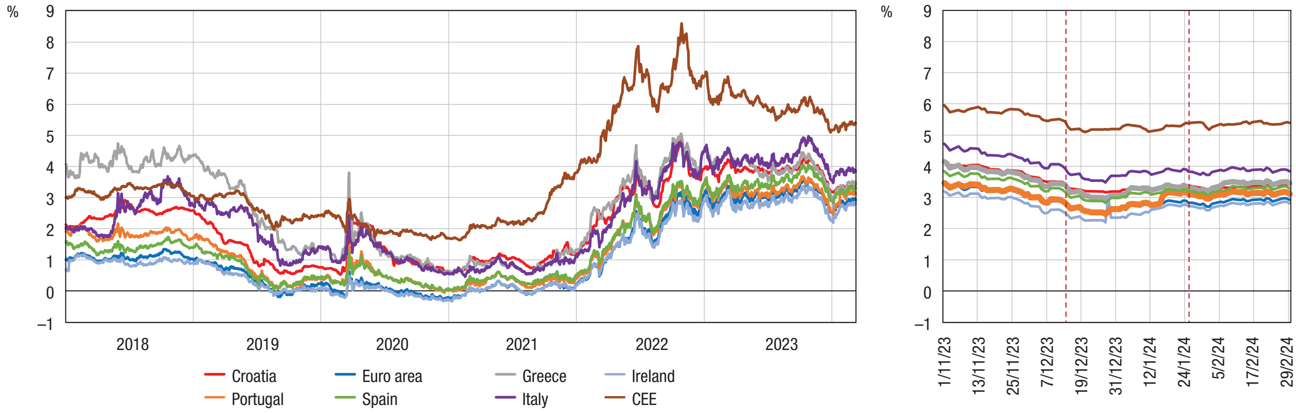
Figure 9 Eurosystem balance sheet



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

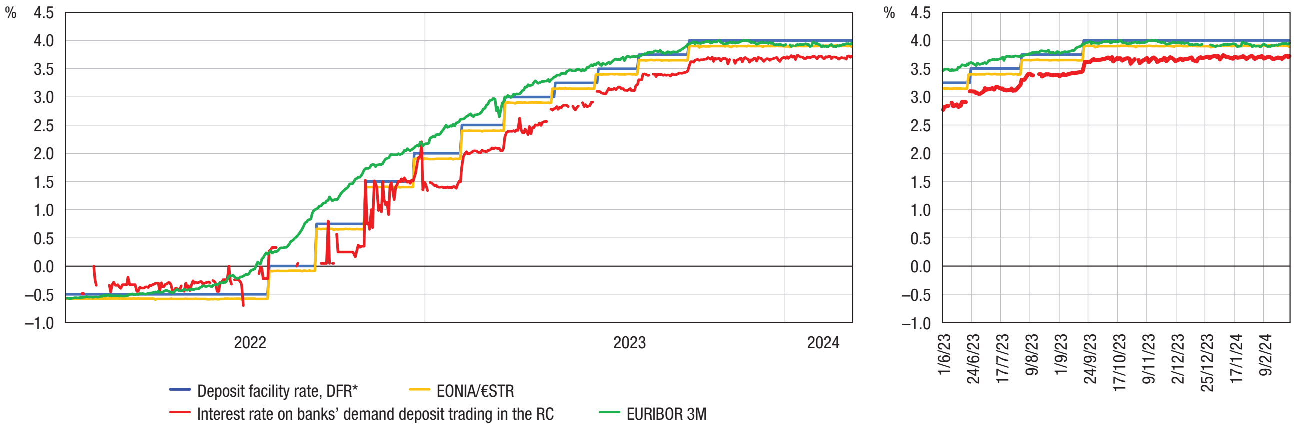
1 Momentum is a short-term inflation indicator which shows annualised three months-on-three months rates of price change, seasonally adjusted.

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



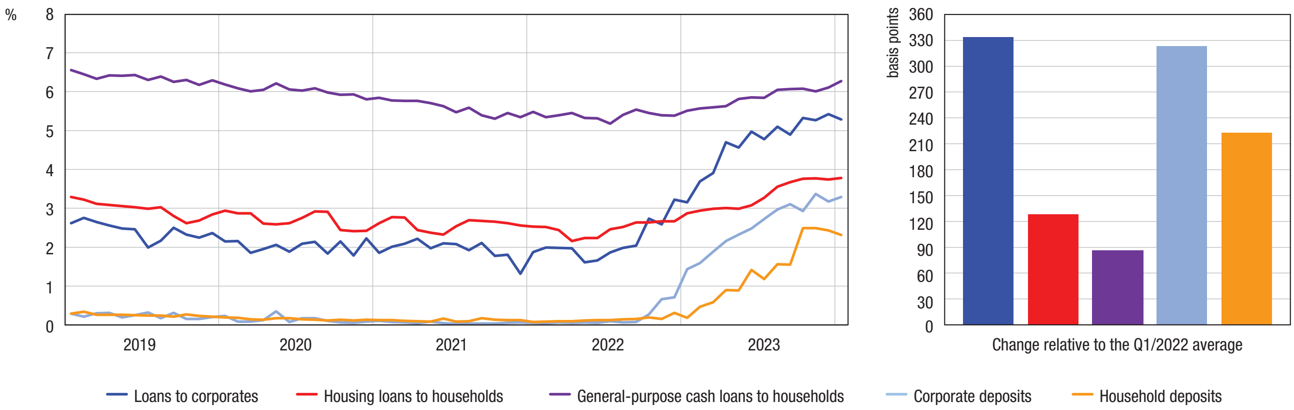
Notes: CEE – countries of Central and Eastern Europe (the Czech Republic, Hungary, Poland and Romania); yields for the euro area and CEE have been weighted by the share of GDP of the countries included. Data from the euro area do not include those from Estonia, Latvia, Luxembourg and Malta. The red dotted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



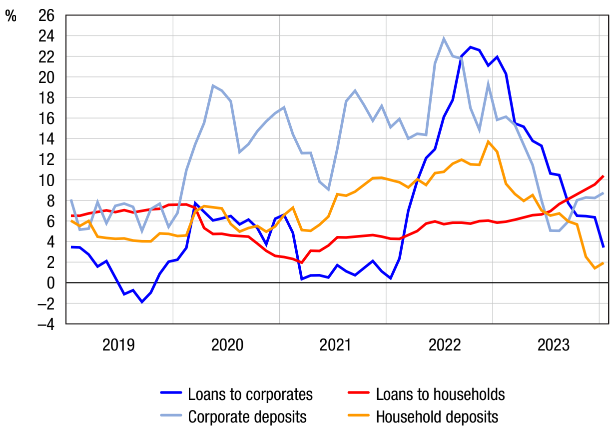
Notes: Data up to December 2022 refer to loans and deposits in kuna and currencies indexed to the kuna and in euro and currencies indexed to the euro, and from January 2023 to loans and deposits in euro and currencies indexed to the euro. Data refer to pure new loans and deposits. Deposits with a maturity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

(Figure 11). The Croatian money market also witnessed no major changes. The overnight interest rate on banks' demand deposit trading moved within a relatively narrow range around 3.7%, the same as at end-February. EURIBOR grew in the same period, particularly for longer-term lending, reflecting a shift in market expectations in favour of delayed and slower cuts in key interest rates. The Ministry of Finance raised EUR 1.05bn by issuing T-bills in February, almost three-quarters of which were with a maturity of 364 days. Yield at issue of 91-day T-bills stood at 3.75% for citizens and at 3.70% for institutional investors, while yield at issue of 364-day T-bills stood at 3.65% and 3.50% for citizens and institutional investors, respectively. These yields were slightly lower than for 364-day T-bills issued in November 2023, when the yield for citizens and institutional investors reached 3.75% and 3.65%, respectively. Yields on long-term euro area government bonds increased in February. This reflected a number of factors: central bank announcements about the beginning and pace of monetary policy easing (both in the US and the euro area), favourable economic developments in the US, marked by faster-than-expected economic growth, as well as a slower decrease in inflation in both the US and the euro area at the beginning of 2024 compared with previous expectations of market participants (Figure 10). The euro area GDP-weighted average of long-term government bond yields rose by 21 basis points in February, reaching 2.9%, with the yield on long-term Croatian bonds going up 17 basis points, to 3.4% at the end of February. As the yield on German government bonds grew more than that on Croatian bonds, the spread between the yields on Croatian and German government bonds dropped to below 100 basis points after a long time. In early March 2024, the government issued a eurobond worth EUR 1.5bn maturing in 2023. The bond bears a yield of 3.4%, i.e. much lower than the yield on last year's 10-year bond issued in the domestic market (3.8%). Parallel to the increase in yields on government bonds, major global stock indices continued on their upward trend in February, with many of them reaching record highs. The Croatian stock exchange index, CROBEX, also grew sharply, surpassing the level seen in October 2008.

Interest rates of domestic banks on corporate loans edged down, while the rates on household loans grew slightly in January 2024. The average interest rate on pure new corporate loans stood at 5.3% in January, down by 14 basis points from the month before. The decrease was largely due to the lower interest rate on loans to micro enterprises, while, broken down by loan purpose, the largest negative contribution came from investment and factoring loans. As regards the costs of household financing, the average interest rate on pure new housing loans rose marginally, to 3.8%, while the interest rate on general-purpose cash loans was 16 basis points higher than in December (6.3%). Viewed in relation to the period preceding the ECB's monetary tightening, borrowing from banks was more expensive by 334 basis points for corporates, 128 basis points for housing loans and 86 basis points for general-purpose cash loans (Figure 12). The contracting of new loans at higher interest rates and adjustment of repayment of variable interest rate loans to growing benchmark parameters gave an upward push to interest rates on existing corporate loans, i.e. on their stocks. The average interest rate on the stock of corporate loans was 190 basis points higher in January than in the first quarter of 2022. By contrast, no increase has yet been seen in the interest rate on the stock of housing and general-purpose cash loans.

The interest rate on corporate time deposits went up, while that on household time deposits went down from December to January. The average interest rate on pure new corporate deposits rose by 12 basis points in January, to 3.3%. As regards households, the slower reallocation of deposits across banks, which was seen in November and December, continued into January, with the average interest rate on pure new household time deposits, which dropped slightly in December, falling by another 12 basis points in January, to 2.3% This was mostly due to the decrease in the interest rate on 6 to 12 month deposits as well as the structure of new time deposits, where the share of 6 to 12 month deposits decreased mainly in favour of deposits with shorter maturities, from 3 to 6 months. More specifically, in anticipation of lower key interest rates, banks raised their interest rates on deposits with shorter maturities, thereby increasing their attractiveness. Compared to the period prior to monetary policy normalisation, the interest rates on pure new time deposits of corporates rose in December by 323 basis points and those on household deposits by 223 basis points. The growth in interest rates on new business was also reflected in the increase in interest rates on existing deposits. The interest rates on the stock of corporate and household time deposits reached 2.8% and 1.4% respectively.

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



Source: CNB.

Household lending continued to rise in January, while corporate loans decreased. Loans to domestic sectors (excluding the general government) declined in January by EUR 0.2bn or 0.4% (transaction-based), largely due to the drop in corporate loans (of EUR 0.3bn or 2.1%). The fall was almost entirely due to the repayment of a syndicated loan granted to companies in the energy sector. On the other hand, household loans rose by EUR 0.1bn (0.6%), with over one half of the growth being accounted for by general-purpose cash loans and the rest being accounted for by housing loans. The increase in loans to non-financial corporations almost halved year-on-year, from 6.4% in last December to 3.4% in January this year. On an annual level, the growth in household loans picked up further in the same period (from 9.5% to 10.4%), driven by the acceleration in general-purpose cash loans from 11.1% to 12.2%, a rate last seen in mid-2019, and the faster increase in housing loans, from 9.9% to 10.5%. Given that the momentum of housing loans indicates a slight pick-up in current activity, the acceleration in the annual growth in housing loans is primarily a result of the base effect. More specifically, January 2023 was marked by the absence of any significant increase in housing loans as some households tried to obtain loans before that month, ahead of the expected increase in interest rates, while some decided to wait for another round of the housing loans subsidy programme.

Domestic deposits declined in January. Domestic deposits (excluding those of the general government) dropped by EUR 0.9bn or 1.5% in January from the previous month (transaction-based), reflecting a decrease in corporate deposits (of EUR 1.0bn), with overnight deposits falling by EUR 1.1bn and time deposits growing by EUR 0.1bn. Corporates usually lower the balances in their transaction accounts in January, after increasing them in December of the year before, with some of the decrease being attributable to external payments of individual corporations. In the same period, the fall in household overnight deposits (of EUR 0.2bn), was more than offset by the growth in time deposits (of EUR 0.3bn) on the back of higher interest rates banks offer on the latter deposits. If analysed on an annual basis, the rise in total corporate deposits picked up from 8.2% in December to 8.7% in January (transaction-based), while the growth in household deposits accelerated from 1.4% to 1.9% (Figure 13).